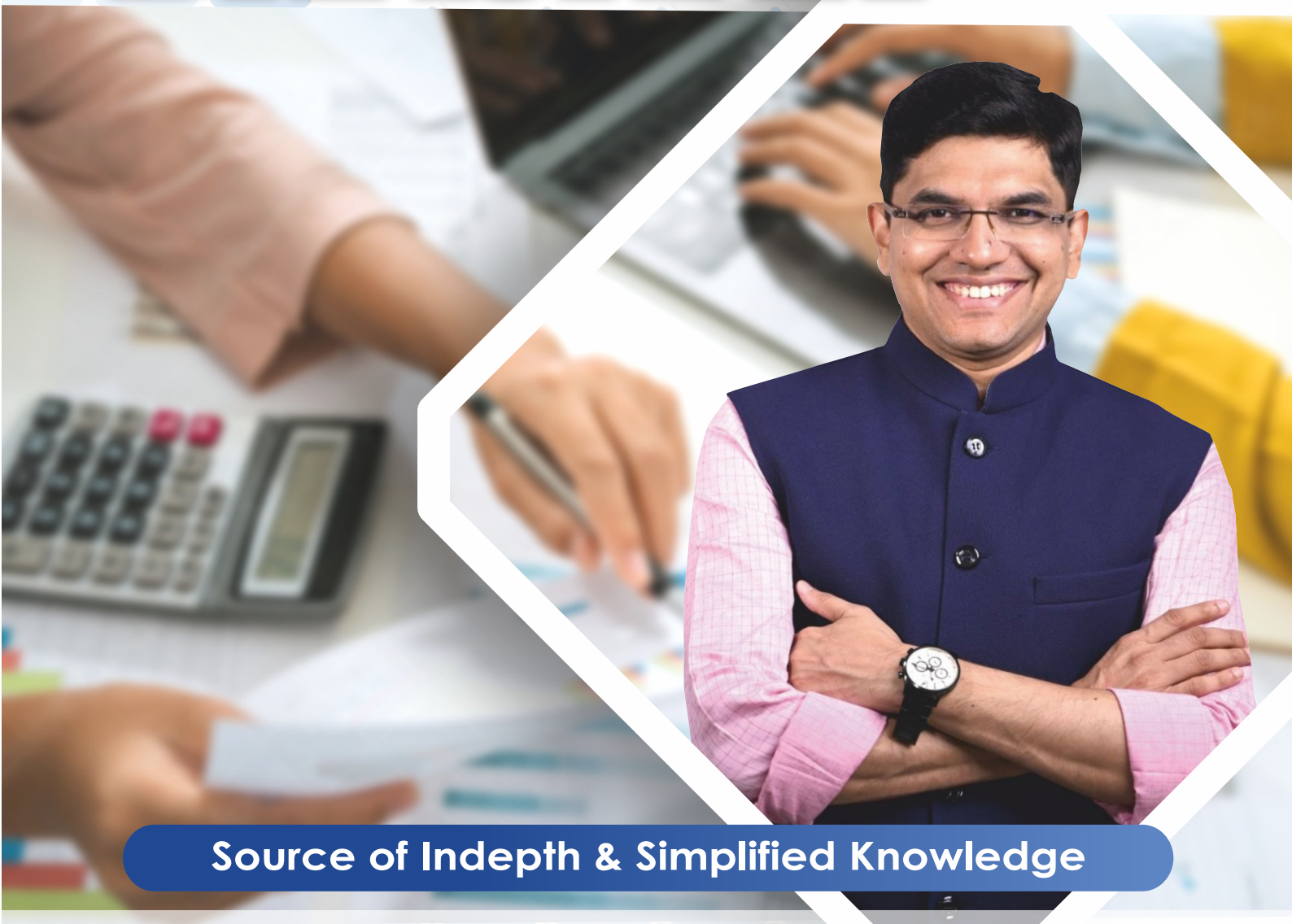
V'Smart Academy

VOLUME 1

CA FINAL AUDIT BHASKAR



Source of Indepth & Simplified Knowledge

- Applicable for Nov23
- Charts and summary to facilitate revision.
- All Questions from "PARAM" Question Bank & MCQ Book are linked with concepts of Bhaskar.

RAVI TAORI

SNEHAL TAORI

Auditguru.in

WhatsApp Ravi Sir
Only for Study related doubts
9096 0000 33

PREFACE

Hello Everyone

We understand that audit is voluminous subject and sometimes it can be tiring to study so we spend lot of time in designing our books and lectures. They are like babies to us. And we are hopeful that they should make your study efforts comfortable, efficient and effective.

Important features:

- ***All amendments Till May 23 from new study material issued by ICAI & statutory updates are incorporated.***
- ***Notes are in tabular form along with corresponding headings and standard indenting so that there is ease to read and remember.***
- ***Cross referencing is given for questions and MCQs with respective books, so that students can practice questions as they cover topics. This is a game changer feature.***
- ***Questions and MCQs which do not have direct connection to any topic in Chapter, SA are given at the end of chapter as unique questions and MCQs.***
- ***Colorful charts, summaries, mnemonics, stories and logical flow of points are given to improve retention.***
- ***Significance of text color:***

Green color is for Examples, Blue is for summary, Pink is for shortcuts

Following are some important points which students should follow.

Study Methodology

1. *Watch videos and understand the concept. It is advised to watch 3-4 hours of lecture every day.*
2. *Equal time or at least half of the time should be given for self study same day. Time requirement will depend upon comfort level in Audit subject. Lectures will be of no use if they are not backed with self study.*
3. *Understanding concept and answering questions are two different things. Understanding is first step, retention is second and then knowing what to write in which question is the final step.*
4. *Use revision audios given on telegram channel (see pinned message) to increase grip over subject.*
5. *It is important for students to do writing practice of 50 to 100 questions from different chapters and standards.*
6. *Keep revising headings of the chapters covered earlier every time you start your study, just headings.*
7. *Ask each and every doubt in discussion point tab given on website www.auditguru.in.*
8. *Revise* ***FADU & PARAM*** *Question Bank multiple times. Use* ***Youtube FADU revision videos.***

Doubt Solving

It is very important to clear each and every doubt of yours. In this world of technology, you can post all your doubts anytime from anywhere. Simply login to Auditguru.in, go to discussion point tab and post all your doubts chapter wise. You can also search and read doubts of other students. I answer doubts continuously on website. You will get an email as your doubt is solved. You can take photos of any content where you have doubt, upload on Google drive and share link in questions or comments, it will make doubt

You can Connect with Ravi sir @ 9096000033, 7020699683 on Whatsapp

I would like to mention my Sincere thanks to **VSMART management. Vishal Bhattad Sir** has always inspired me to become a better professor. **Ujwal Bhattad Sir** has been my Mentor on every aspect of teaching..

I am blessed with best people in my team. They have worked passionately with all enthusiasm.
CA Vaishnavi, CS Rajni, CA Priyanka, Devesh, ACCA Akash, CA Neha, CA Anjanesh, Vaibhav B, Vaibhav R, Kunal, Rahul, Gitanjali.

Lastly but most importantly, we all are thankful to **Snehal Madam** for her contribution in making this book. She is our Fire Fighter, Trouble shooter & my Life Line.

Suggestions
Any suggestions, mistakes, errors or discrepancy noted may be kindly brought to the notice shall be dealt with suitably.

Happy Studying!!!

CA RAVI TAORI

For Administrative or technical queries, please contact @ 09322011915
E-mail @ support @ auditguru.in

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t.me/auditguru

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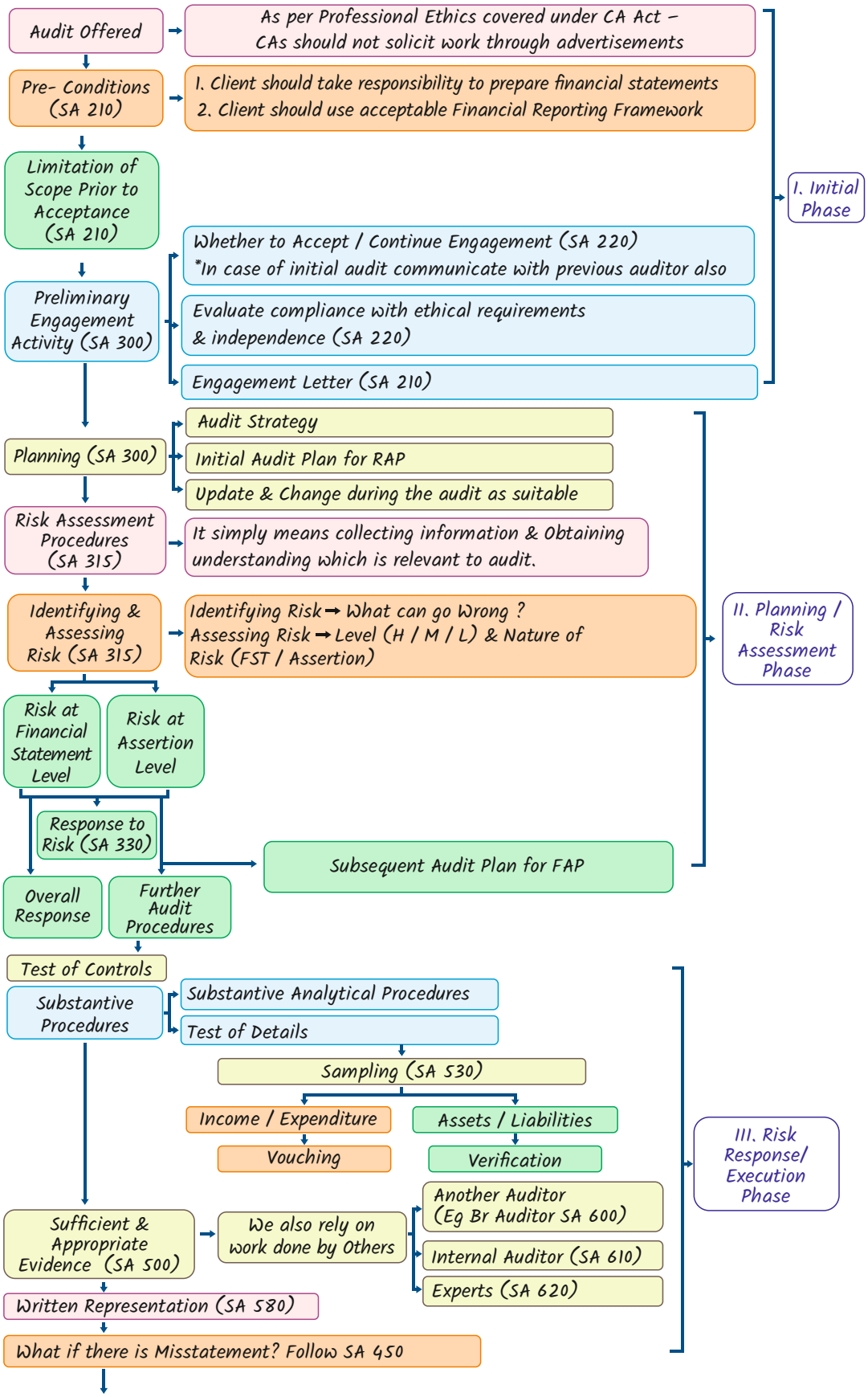
8.01 - 8.09

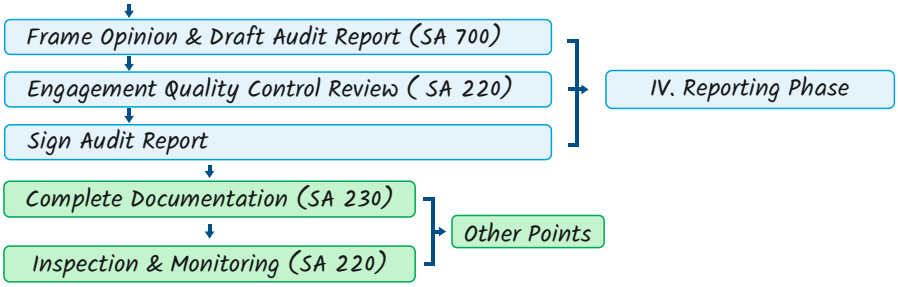
01 AUDITING STANDARDS, STATEMENTS AND GUIDANCE NOTES - AN OVERVIEW

PART – I CORE AUDIT PROCESS AND INTRODUCTION TO SA

(CNO—CAP.020) CORE AUDIT PROCESS

Chart

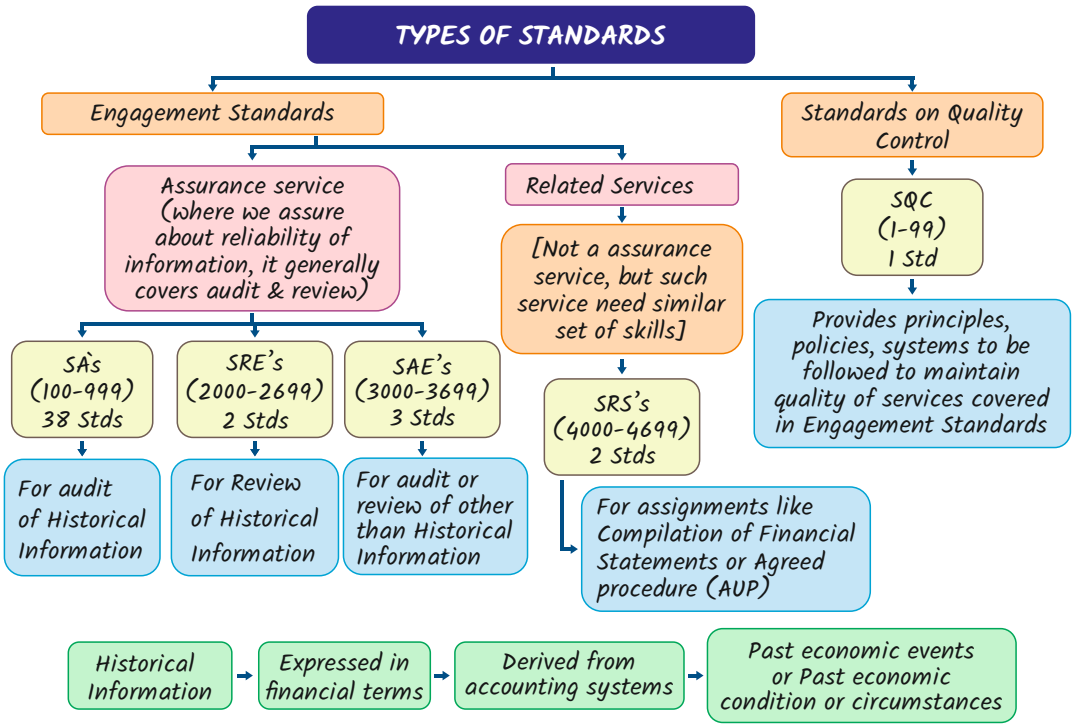



Frame Opinion & Draft Audit Report (SA 700)
Engagement Quality Control Review (SA 220)
Sign Audit Report
IV. Reporting Phase
Complete Documentation (SA 230)
Inspection & Monitoring (SA 220)
Other Points

INTRODUCTION TO STANDARDS ON AUDITING

(CNO—INTRO.020) TYPES OF STANDARDS

Chart



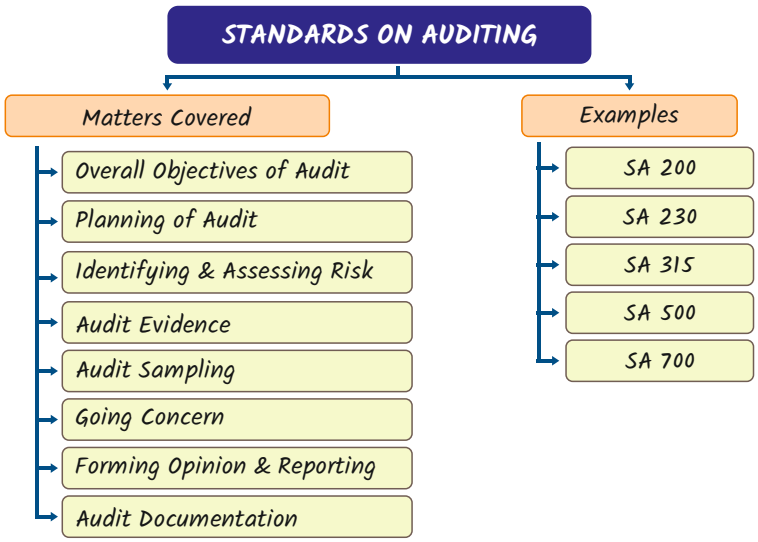
The following Standards issued by the Auditing and Assurance Standards Board under the authority of the Council are collectively known as the Engagement Standards:

- ***Standards on Auditing (SAs)**, to be applied in the **audit of historical financial information.***
- ***Standards on Review Engagements (SREs)**, to be applied in the **review of historical financial information.***
- ***Standards on Assurance Engagements (SAEs)**, to be applied in **assurance engagements, other than audits and reviews of historical financial information.***
- ***Standards on Related Services (SRSs)**, to be applied to engagements involving application of **agreed upon procedures to information, compilation engagements, and other related services engagements**, as may be specified by the ICAI.*

Standards on Quality Control (SQCs), issued by the AASB under the authority of the Council, are to be applied for all services covered by the Engagement Standards as described in paragraph above.

(CNO—INTRO.030) Standards on Auditing

Chart

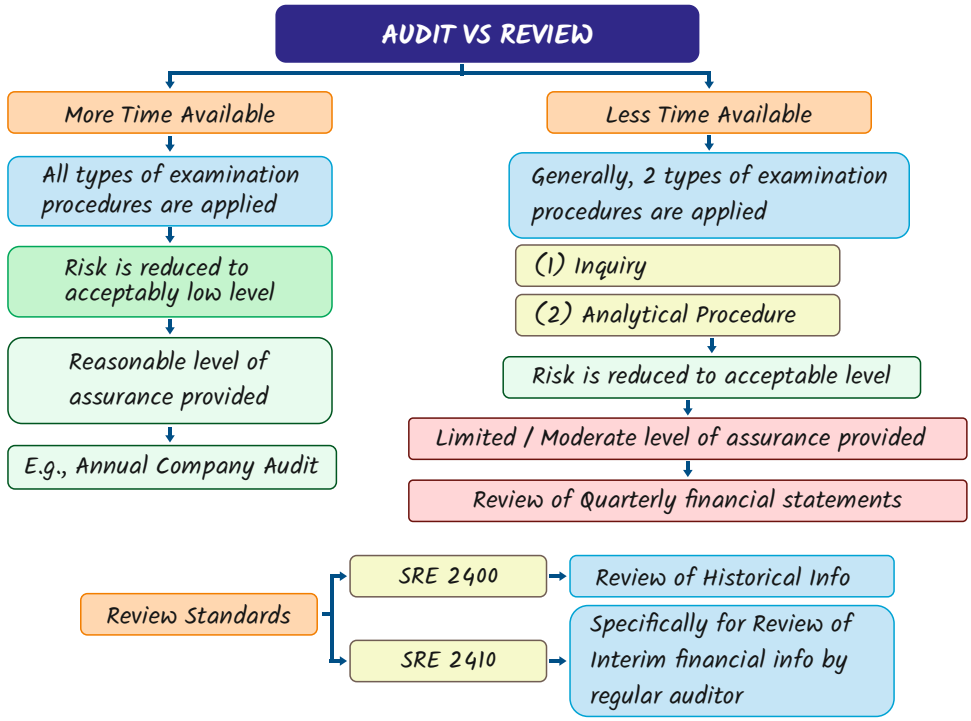


Matters covered by SAs

Standards on Auditing have been issued on wide spectrum of issues in the field of auditing including (but not limited to) overall objectives of independent auditor, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit evidence, audit sampling, going concern and forming an opinion and reporting on financial statements, audit documentation. You would be studying about these standards and many others in subsequent chapters.

(CNO—INTRO.040) STANDARD ON REVIEW ENGAGEMENT & AUDIT VS REVIEW

Chart



Audit vs Review

It is to be understood that Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information". Remember that Standards on auditing apply in "audit" of historical financial information which is a reasonable assurance engagement whereas Standards on Review Engagements apply in "review" of historical financial information which is a limited assurance engagement only.

Here, we have to broadly understand that "audit" and "review" are two different terms. Audit is a reasonable assurance engagement and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, "review" is a limited assurance engagement and its objective is reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement.

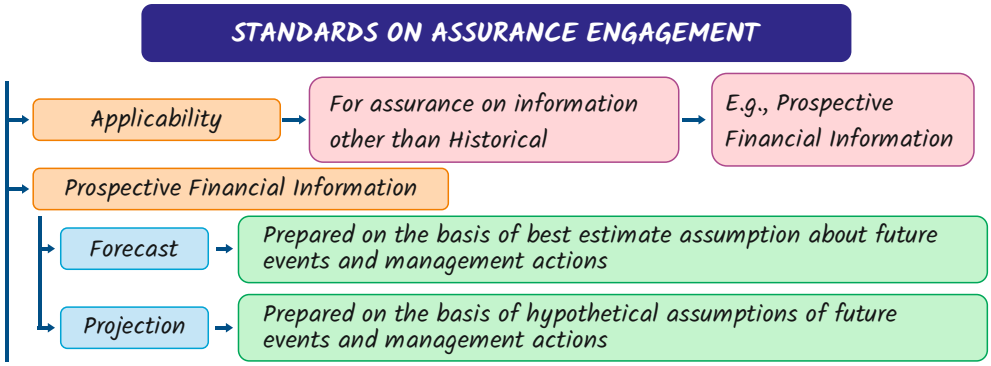
Examples of SREs

Examples of Standards on Review engagements are

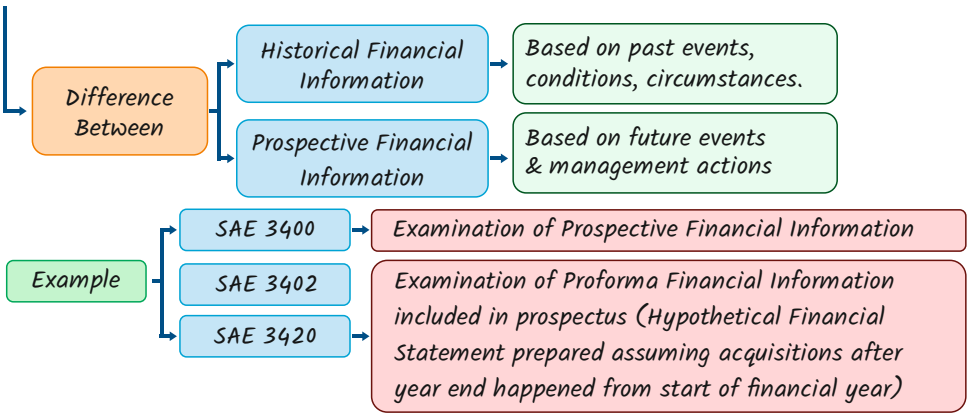
- SRE 2400 Engagements to Review Historical Financial Statements
- SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity.

(CNO—INTRO.050) Standards On Assurance Engagement

Chart



Chart



SAE

- ***Applicability of SAE***

  SAEs are applicable when we provide assurance on matters which are other than historical information. For example, an assurance engagement relating to examination of prospective financial information.

- ***Prospective Financial Information***

  Prospective financial information means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It can be in the form of forecast or projection or combination of both.

- ***Prospective Financial Information vs Historical Financial Information***

  Here, it is important to note the difference between "Historical financial information" and "Prospective financial information." The former relates to information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods. The latter relates to financial information based on assumptions about occurrence of future events and possible actions by an entity. Therefore, historical financial information is rooted in past events which have already occurred whereas prospective financial information is related to future events.

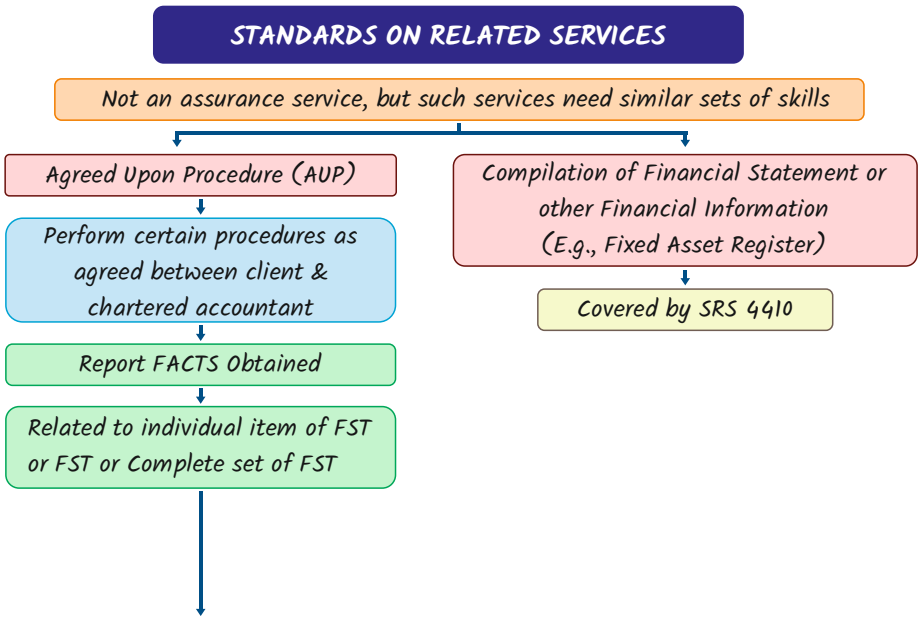
Examples of SAEs

Examples of Standards on Assurance Engagements are: -

- SAE 3400 The Examination of Prospective Financial Information
- SAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

(CNO—INTRO.060) Standards on Related Services (QNO-0.200)

Chart



E.g., Accounts Receivable List
(1) Match with Debtor ledger
(2) Call for confirmation & match them
(3) Reconcile Difference
Covered by SRS 4400

SRS

These standards apply in engagements to perform agreed-upon procedures regarding financial information. For example, an engagement to perform agreed-upon procedures may require the auditor to perform certain procedures concerning individual items of financial data, say, accounts payable, accounts receivable, purchases from related parties and sales and profits of a segment of an entity, or a financial statement, say, a balance sheet or even a complete set of financial statements.

Examples of SRSs

Examples of Standards on related services are: -

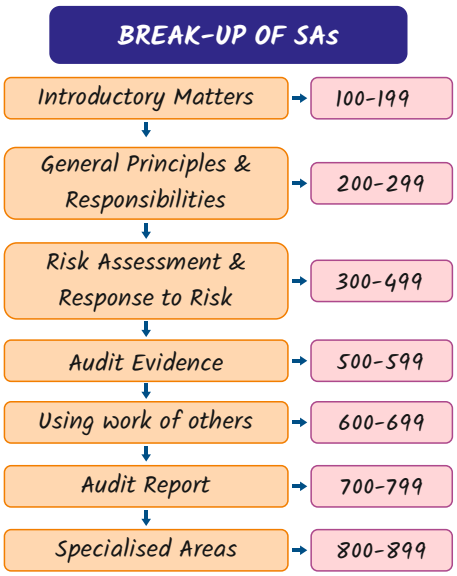
- SRS 4400 Engagements to perform agreed-upon procedures regarding financial information
- SRS 4410 Compilation engagements

(CNO—INTRO.065) Comparing Standards

Nature of Service	Audit	Review	Agreed-upon	Compilation
Comparative Level of assurance provided by the auditor	High, but not absolute assurance (Reasonable)	Moderate assurance	No assurance	No assurance
Report Provided	Positive assurance on assertion(s)	Negative assurance on assertion(s)	Factual findings of procedures	Assistance & compliance of standards

(CNO—INTRO.070) Breakup of SAs

Chart



(CNO—INTRO.075) WHAT IS THE PROCEDURE FOR ISSUING STANDARDS?

- AASB identifies project/ area where standard is required
- Constitutes study Group/ Task Force
  Conveyor is appointed who appoints 5-7 members
- Study group submits preliminary draft to chairman.
- Preliminary Draft is approved by chairman
- Draft is hosted on AASB website for minimum 21 Days
- Draft considered in meeting & Exposure draft is finalized
- Proposed exposure Draft sent to council members, minimum 10 days are provided for comments and changes.

- Exposure draft is issued to members & other public bodies and hosted on ICAI website for minimum 60 days.
- Comments received up-to 10days prior to AASB meeting are hosted, AASB meeting is held and draft is finalized.
- Proposed standard is placed before council & approved & issued.

(CNO—INTRO.078) DRAFTING OF SA

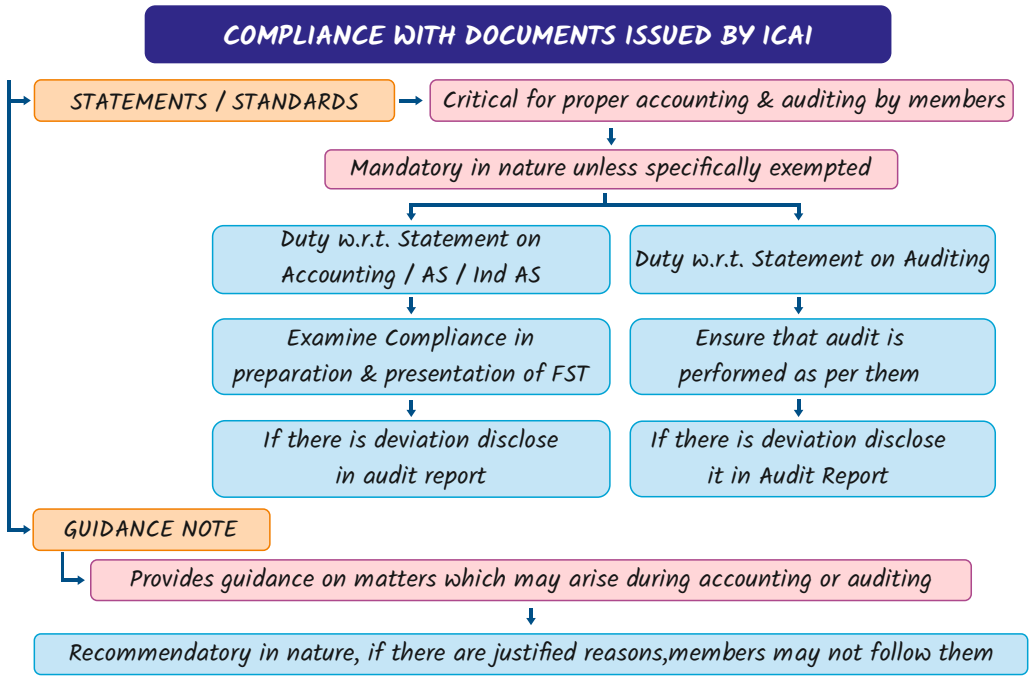
DRAFTING OF SA	
Section I	**Section II**
INTRODUCTION	Application and Other Explanatory Material
DEFINITION	APPENDICES
OBJECTIVES	
REQUIREMENTS	

- **Introduction:** It includes the **purpose, scope, and subject matter as well as the responsibilities of the auditor and others** in that context. (SA 250)
- **Objective:** It includes the **objective of the auditor in the audit area** addressed by that particular SA.
- **Definitions:** For higher understanding of the SAs, pertinent terms are delineated in each SA.
- **Requirements:** Every objective is shored up by clearly stated requirements. Requirements are always expressed by the phrase "the auditor shall."

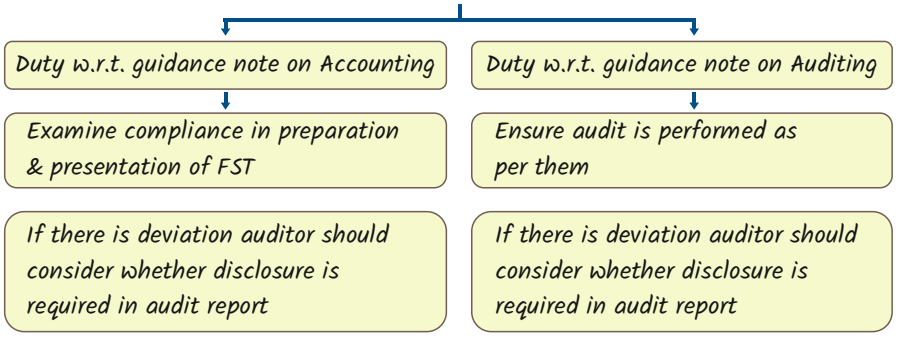
Application and Other Explanatory Material: The application and other explanatory material explains more exactly what is meant by a requirement or is intended to cover or includes examples of procedures that can be appropriate under certain circumstances.

(CNO—INTRO.080) Compliance of Documents Issued By ICAI

Chart



Continue on Next Page



1a. Statements / Standards Mandatory

The Institute has from time to time, issued 'Guidance Notes' and 'Statements' on a number of matters. The 'Statements' have been issued with a view to securing compliance by members on matters which, in the opinion of the Council, are critical for the proper discharge of their functions. 'Statements' therefore are mandatory.

1b. Duty of Auditor for Statements / Standards

Accordingly, while discharging their attest function, it will be the duty of the members of the Institute:

- to examine whether 'Statements' relating to accounting matters are complied with in the presentation of financial statements covered by their audit. In the event of any deviation from the 'Statements', it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations; and
- to ensure that the 'Statements' relating to auditing matters are followed in the audit of financial information covered by their audit reports. If, for any reason, a member has not been able to perform an audit in accordance with such 'Statements', his report should draw attention to the material departures, therefrom.

2a. Guidance Notes Recommendatory

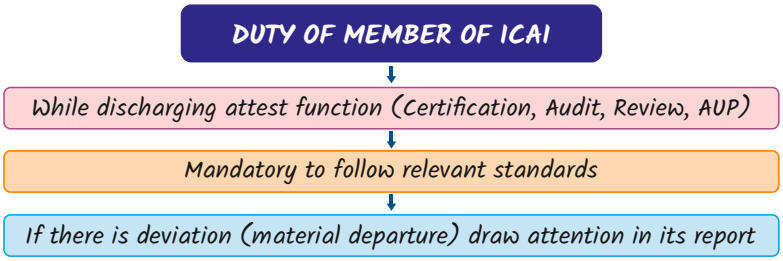
'Guidance Notes' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may rely in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are recommendatory in nature.

2b. Duty of Auditor for Guidance Note

- A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so.
- Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary.

(CNO—INTRO.090) Duty of Members of ICAI

Chart



Duty to Follow SAs

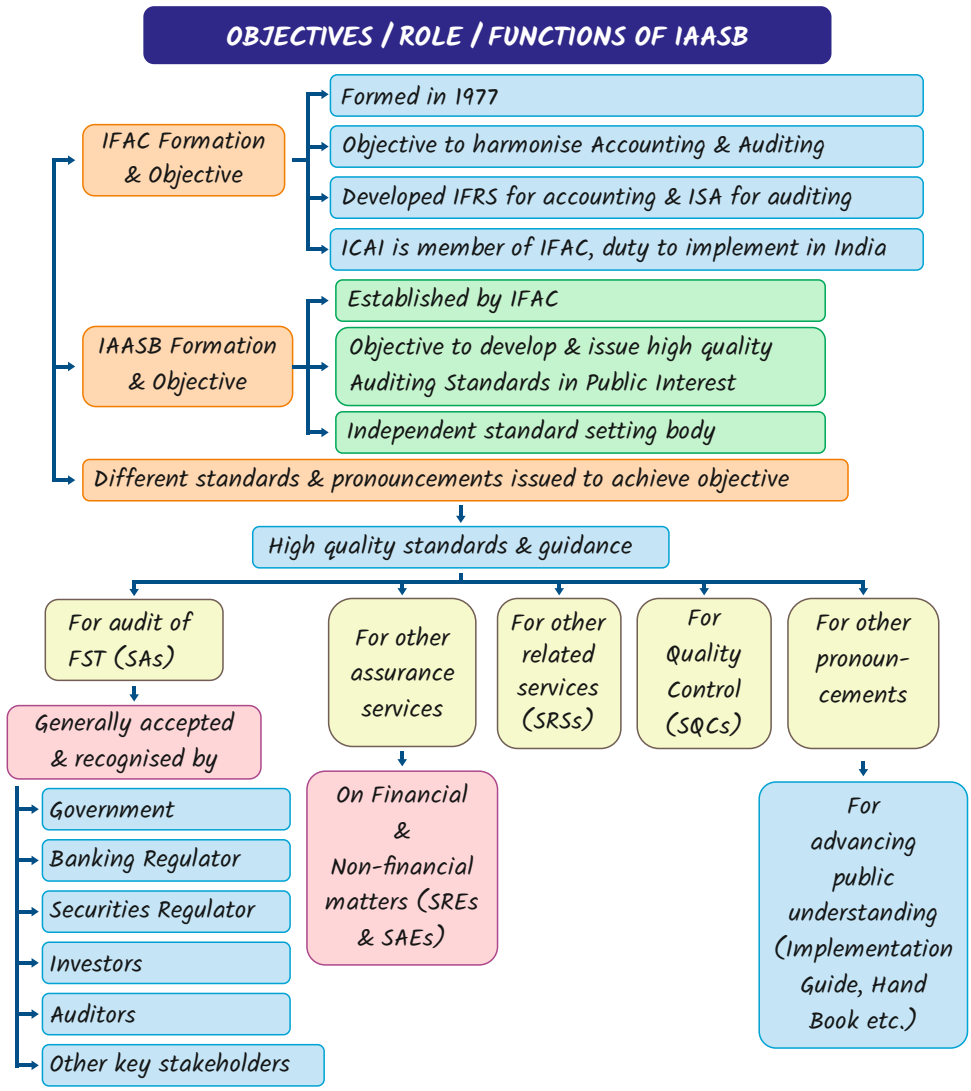
These Standards will apply whenever an independent audit is carried out; that is, in the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion thereon.

While discharging their attest function, it will be the duty of members of the Institute to ensure that the Standards are followed in the audit of financial information covered by their audit reports. If for any reason a member has not been able to perform an audit in accordance with the Standards, his

report should draw attention to the material departures therefrom, auditors will be expected to follow Standards in the audits commencing on or after the date specified in the statement. Remember all Standards are mandatory from the date mentioned therein and it is obligatory upon members of Institute to adhere to these whenever an audit is carried out.

(CNO—INTRO.120) OBJECTIVES OF IAASB

Chart



Formation of IFAC

In 1977, the International Federation of Accountants (IFAC) was formed with objective to harmonize accounting and auditing on an international scale. They are doing this by developing international financial reporting standards for accounting and international standards on auditing for audit. ICAI is member of IFAC, so they have to implement this harmonization in India.

Formation & Objective of IAASB

The IFAC has established the IAASB to develop and issue, in the public interest and under its own authority, high quality auditing standards for use around the world. The IAASB functions as an independent standard-setting body under the auspices of IFAC.

Different Standards & Pronoun-cements Issued to Achieve this Objective

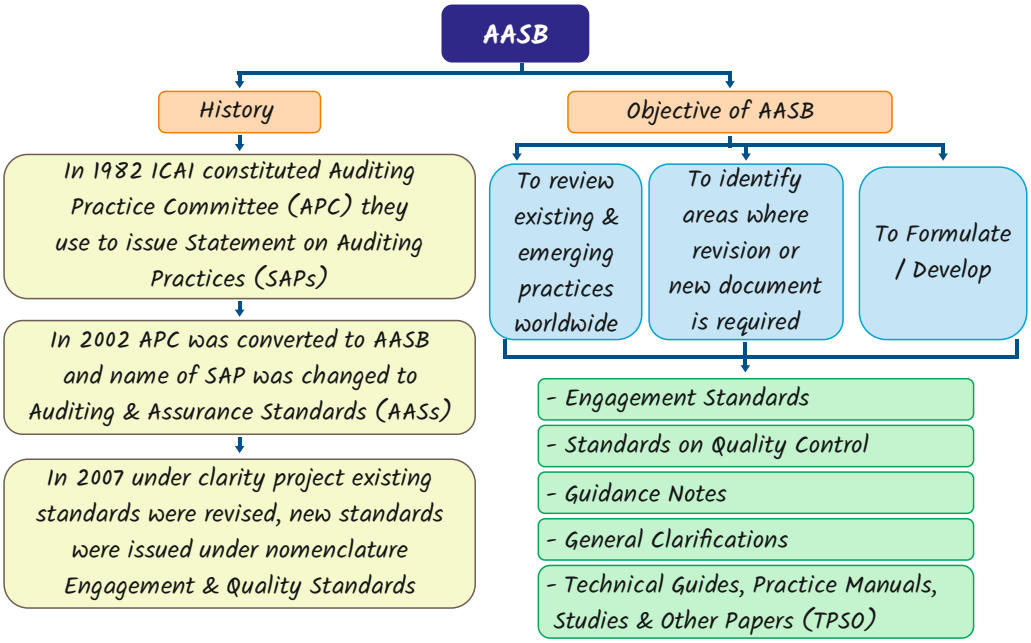
The IAASB achieves this objective by:

- Establishing high quality auditing standards and guidance for financial statement audits that are generally accepted and recognized by investors, auditors, governments, banking regulators, securities regulators, and other key stakeholders across the world; (i.e., SAs)
- Establishing high quality standards and guidance for other types of assurance services on both financial and non-financial matters; (i.e., SREs & SAEs)
- Establishing high quality standards and guidance for other related services; (i.e., SRSs)
- Establishing high quality standards for quality control covering the scope of services addressed by the IAASB; (i.e., SQCs)

- Publishing other pronouncements on auditing and assurance matters, thereby advancing public understanding of the roles and responsibility of professional auditors and assurance service providers. (i.e., Standard wise Implementation Guide, Handbook on Standards—Combined all standards & related material)

(CNO—INTRO.140) OBJECTIVES & FUNCTION OF AASB

Chart



History of AASB

ICAI constituted Auditing Practices Committee (APC) in 1982, they use to issue Statements on Standard Auditing Practices (SAPs). In July 2002, this committee was converted into Auditing and Assurance Standard Board (AASB) and nomenclature (Names) of SAPs was changed to Auditing and Assurance Standards (AASs). In 2007, AASB issued several revised / new standards as per IAASB clarity project. Objective of clarity project was to improve clarity of International Standards on Auditing (ISAs) which are used by ICAI to issue SAs in India. These new standards were called engagement and quality standards as discussed earlier.

Objective of AASB

- Objectives and Functions of the Auditing and Assurance Standards Board:
  - To review existing & emerging practices and identify areas where new or revision of existing & then to formulate / develop following
    - Engagement Standards,
    - Standards on Quality Control,
    - Guidance Notes,
    - General Clarifications,
    - Technical Guides, Practice Manuals, Studies & Other papers (TPSO)

Different Terms

Standards –Mandatory in nature unless exempted.
Statements – Statements and standards are same. Earlier we use to call them statements but now as per international trend, we call them standards. So we can say that statement is old name of standards.
General Clarification – Issued to explain content given in Standards / Statements.
Guidance Notes -- Recommendatory in nature we may not follow them if there are justified reasons. E.g., Guidance note on Bank Audit.
Technical Guides, Practice Manual, Studies and Other papers (TPSO) – ICAI used to issue them to provide checklists and specimen working papers helpful for practicing chartered accountants. Now a days ICAI issues them in the name of Implementation Guide or Practitioners Guide.

(CNO—INTRO.150) LINKAGE BETWEEN SAS AND DISCIPLINARY PROCEEDINGS

Discussion

- The SAs (as well as other statements on auditing) represent the generally accepted procedure(s) of audit. As such, a member who does not perform his audit in accordance with these statements and fails to disclose the material departures there from, becomes liable to the disciplinary proceedings of the Institute as follow:
  - Clause 5 of Part I of the Second Schedule to the Chartered Accountants Act, 1949, according to which a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity.
  - Clause 6 of Part I of the Second Schedule to the Chartered Accountants Act, 1949, according to which a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he fails to report a material misstatement known to him to appear in financial statement, where he is concerned with that financial statement in a professional capacity.
  - Clause 7 of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.
  - Clause 9 of Part I of the Second Schedule to the Chartered Accountants Act, 1949 which specifies that a chartered accountant in practice shall be guilty of professional misconduct if he "fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances".

(CNO—INTRO.160) LIST OF SAs

Hello everyone, first of all let me clarify, I believe in 100% conceptual studies, where we know reasons & applications through examples. If you do that, studying is fun & you remember things. But my crazy thought process came up with something more to remember SA numbers in funny way. You may call it madness, you may laugh. But go through it once imagine things given, I bet you will never do mistake with SA numbers. It is based on principles of memory techniques. This is helpful when you get confused in exams. Read slowly one by one associate it with SA number, as soon as you see number crazy logic should come up.

"Remember correct SA number cannot give you full marks they can only improve marking by 1 mark & it matters"			
200	Double "0" agent (James Bond) ek teer se 2 shikar (objective) fulfil karta hay	Objectives of Audit	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
210	2 logo ne milker 1 LETTER (ENGAGEMENT LETTER) sign Kiya	Engagement Letter	Agreeing the Terms of Audit Engagements
220	Jab 2 aur 2 kandhe se kandha milker kaam karate hay toh QUALITY improve hoti hai	Quality Control	Quality Control for an Audit of Financial Statements
230	2nd Page ke bad 3rd Page aata hai koi bhi DOCUMENTS main	Audit Documentation	Audit Documentation
240	Jo log 2 ka 4 kartein hai wooh FRAUD haotein hai	Frauds	The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

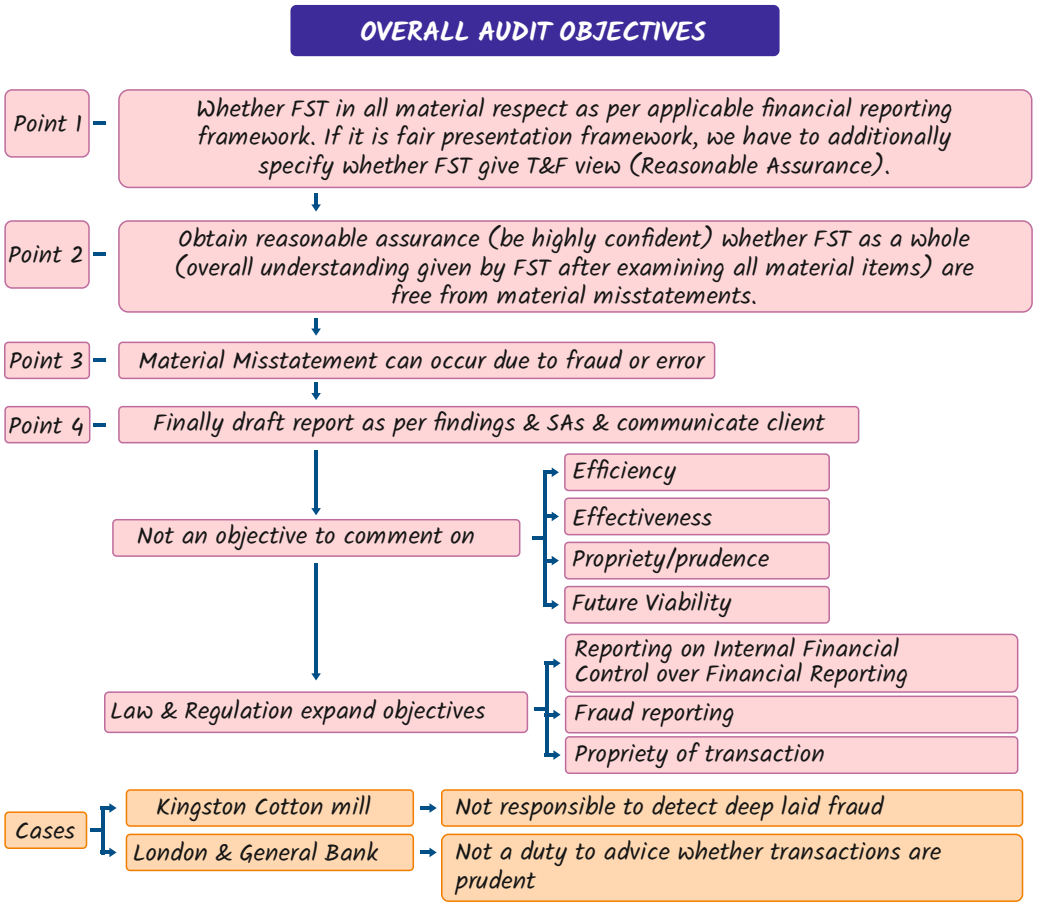
250	Ambani Sahab 2 se S reliance ka LEGAL COMPLIANCE dekhtein hai	Law	Consideration of Laws and Regulations in an Audit of Financial Statements
260	6 is 3 times BIGGER than 2: - Big means TCWG	Communication to	Communication with Those Charged with Governance
265	6 ke baad S kaise aa skate hai, there is PROBLEM WITH SYSTEM	Communication of Internal Control Deficiency	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
299	2 "9" SAATH(JOINTLY) main kaam kar Rahe hai	Joint Auditors	Joint Audit of Financial Statements
300	Double "0" agent ke pass her project kr Liye 3 PLAN hotein hai	Planning	Planning an Audit of Financial Statements.
315	15 / 3 =5, agar ek jagah pe paanch raastein miltein Ho toh that is extremely RISKY	Risk Assessmentlanning	Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment
320	20/3 = 6.677 0.677 is IMMATERIAL	Materiality	Materiality in Planning and Performing an Audit
330	30 / 3 = 10, Auditor should at least have 10 responsive procedures for various risks	Response to Risk	The Auditor's Responses to Assessed Risks
402	Char se do ho jao aur Apana kaam outsource kardo	Service Organisation	Audit Considerations Relating to an Entity Using a Service Organisation
450	4-5 Badi galtiyaan toh her audit main milli jati hai	Material Misstatement	Evaluation of Misstatements Identified During the Audit
500	Double "0" agent ke pass her chiz ko prove karne ke liye 5 EVIDENCE hotein hai	Audit Evidence	Audit Evidence
501	1 number pe jo areas hotein hai unko specific consideration lagta hai	Inventory / Litigation / Segment	Audit Evidence-Specific Considerations for Selected Items
505	Ek S andar hai dusra bhar hai, andar wala S BAHAR(EXTERNAL) WALE	External Communication	External Confirmations
510	5 se 10 saal mein rotation lagata hai aur new firm ke liye initial audit	Initial Audit Engagements	Initial Audit Engagements – Opening Balances
520	20/5 =4, Humne isse ko charo taraf se "ANALYSE" karna chahiye	Analytical Procedures	Analytical Procedures
530	30/5 = 6, we cannot check everything at the max 6 items in details so let's do sampling	Sampling	Audit Sampling

540	40/5 = 8, agar 8 ko kaatoge toh do ek E aur ek 3 banega and E for ESTIMATES (Highly Insane,	Estimates	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
550	Yeh 5 aur 5 dono RELATIVES din bhar aaps mein baat aur transactions kartein hai	Related Parties	Related Parties
560	5-6 months are crucial after balance Sheet date for SUBSEQUENT EVENTS	Subsequent Events	Subsequent Events
570	5+7=12 aur agla number hai 13 matlab khatra, NEXT YEAR IS DARK	Going Concern	Going Concern
580	5+8=13 jab khatra bana hua ho, saboot ki kaami mehsoos ho toh support ke liye management se WRITING MEIN CONFIRMATION LENA CHAHIYE	Written Representation	Written Representations
600	Double "0" always has 6 OTHER PEOPLE which help him	Other Auditors	Using Work of Others
610	Companies generally have 1 internal auditor	Internal Auditor	Using the Work of Internal Auditors
620	You should always have 2 EXPERTS for critical issues	Experts	Using the Work of an Auditor's Expert
700	Final work of Double" 0" agent is to give 7 PARAGRAPH REPORT	Audit Report	Forming an Opinion and Reporting on Financial Statements
701	No 1 Secret to Success is Focusing on Key Matters	Key Matter	Communicating Key Audit Matters in the Independent Auditor's Report
705	7-5 = 2, 2 TYPES OF OPINION are possible "Unmodified & Modified"	Types of Opinion	Modifications to the Opinion in the Independent Auditor's Report
706	7-6=1, 1 hi jaise 2 para graph EMP / OMP	EMP / OMP	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent
710	10-7=3, compare with at least 3 other reports	Comparatives	Comparative Information—Corresponding Figures and Comparative Financial Statements
720	20-7=13, 13 different documents are presented in annual report	Other Information	The Auditor's Responsibilities Relating to Other Information

Part 2 – SA 200 Series
[SA 200] OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND THE CONDUCT OF AN AUDIT IN ACCORDANCE WITH STANDARDS ON AUDITING

(CNO--SA200.020) WHAT IS OVERALL OBJECTIVE OF AUDIT? (MCQ-200.2) (QNO-0.300)

Chart



Overall Objective

As per SA-200 "Overall Objectives of the Independent Auditor", in conducting audit of financial statements, the overall objectives of the auditor are:

- To obtain **reasonable assurance** about whether the financial statements as a whole are **free from material misstatement,** whether **due to fraud or error,** thereby enabling the auditor to express an opinion on whether the financial statements are prepared, **in all material respects, in accordance with an applicable financial reporting framework;** and
- To **report on the financial statements,** and communicate as required by the SAs, in accordance with the auditor's findings.

The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form that opinion.

In some cases, however, the applicable laws and regulations may require auditors to provide opinions on **other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements.** While the SAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

Not an Objective

So, it follows from above that it is **no part of the auditor's duty to probe into the propriety of business** conduct. This contention has been held perfectly valid as it has been asserted that the conventional financial audit is concerned with examination of the transactions to ascertain the true and fair nature of the financial statements. The auditor is merely concerned with evaluating the evidence in support of transactions but need not examine the regularity and prudence of various decisions taken by the management.

However, of late, this has undergone a change as some of the requirements of law introduced in the past require the company auditor to go beyond the functions of reporting and express an opinion about the propriety or prudence of certain transactions in certain specific areas. Sections 143 of the Companies Act, 2013 contain various such matters. It may also be clarified that the usage of words "true and fair" is restricted to certain countries such as U.K. while in other countries like United States the expression "full and fair" is prevalent. However, both expressions aim to convey same meaning.

On a consideration of what has been discussed, it may be summed up that auditing has the principal objective of seeing whether or not the financial statements portray a true and fair state of affair and of reporting accordingly. ***An incidental and secondary, but by no means an insignificant audit objective, flowing from the former, is detection of errors and frauds and making recommendations to prevent their occurrence.***

If there remains a ***deep-laid fraud in the accounts****, which in the normal course of examination of accounts may not come to light, it* ***will not be construed as failure of audit****, provided* ***the auditor was not negligent in the carrying out his normal work****. This principle was established as early as in 1896 in the leading casein* ***Re-Kingston Cotton Mills Co****. (Re is Latin term, it means "in the matter of")*

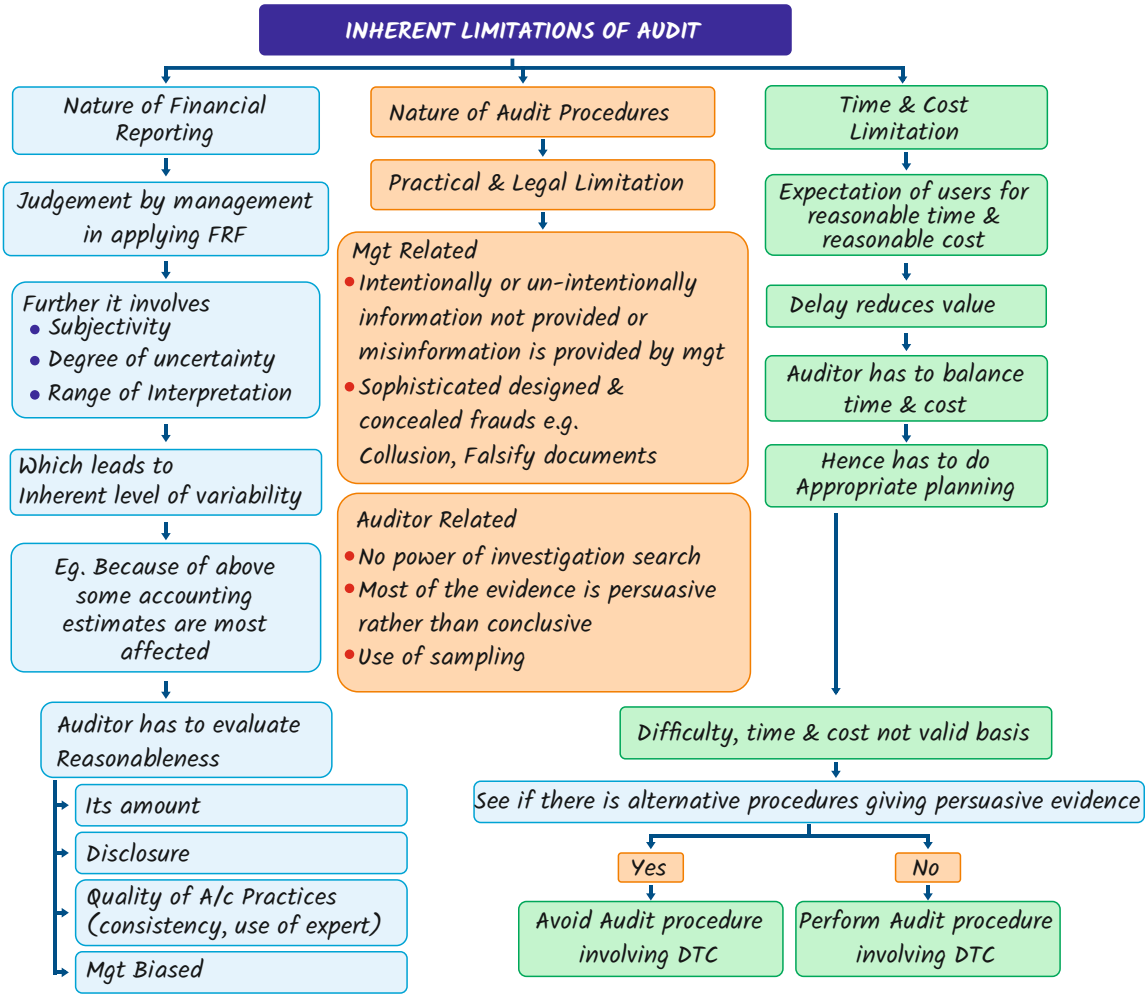
The nature of audit objectives was also highlighted in the leading case ***Re the London and General Bank Ltd. [1895]****. It was held that an auditor must ascertain that the books of account show the true financial position of the company. For the first time, the duties of the company auditor were spelled out in specific terms. Lord Justice Lindley observed,* ***"It is no part of an auditor's duty to give advice either to directors or shareholders as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans without security****. It is nothing to him whether the business of company is being conducted prudently or imprudently, profitably or unprofitably; it is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit and his duty is confined to that.*

Reasonable Assurance

Reasonable ***assurances a high level of assurance*** *(Not 100%, absolute assurance) It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However,* ***reasonable assurance is not an absolute level of assurance, because there are inherent limitations*** *of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.*

(CNO--SA200.040) WHAT ARE INHERENT LIMITATIONS OF AUDIT? (MCQ - 200.6)

Chart



Audit Risk Cannot Be Reduced to Zero

The auditor **is not expected to, and cannot, reduce audit risk to zero** and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because **there are inherent limitations of an audit,** which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being **persuasive rather than conclusive**. The inherent limitations of an audit arise from:

- The **nature of financial reporting;**
- The **nature of audit procedures;**
- The need for the audit to be conducted within a **reasonable period of time and at a reasonable cost.**

The Nature of Financial Reporting

- **Judgement Based: -**

  The preparation of financial statements involves **judgment by management** in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity.

  (E.g., Useful life of Fixed Assets & Residual Value / Valuation of Investments in Artistic Items Like Painting / Costing of Inventory – FIFO, Weighted Average, Standard Costing, Retail Costing)

- **Subjectivity / Range of Interpretations leads to Inherent Variability**

  In addition, many financial statement items involve **subjective decisions or assessments** or a **degree of uncertainty,** and there may be a **range of acceptable interpretations** or judgments that may be made. Consequently, some financial statement items are subject to an **inherent level of variability** which cannot be eliminated by the application of **additional auditing procedures.**

  (E.g., Uncertainty -- Useful life of Fixed Assets & Residual Value
  Subjectivity -- Valuation of Investments in Artistic Items Like Painting
  Range of Interpretations -- Costing of Inventory – FIFO, Weighted Average, Standard Costing, Retail Costing)

- ***Estimates are most affected because of above: – Auditor should check Reasonableness of Estimates & Qualitative Aspects of Accounting Practices (Including Management Bias)***
  For example, this is often the case with respect to certain accounting estimates. Nevertheless, the SAs require the auditor to give specific consideration to whether accounting estimates are reasonable in the context of the applicable financial reporting framework and related disclosures, and to the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

The Nature of Audit Procedures

*There are **practical and legal limitations** on the auditor's ability to obtain audit evidence. For example:*

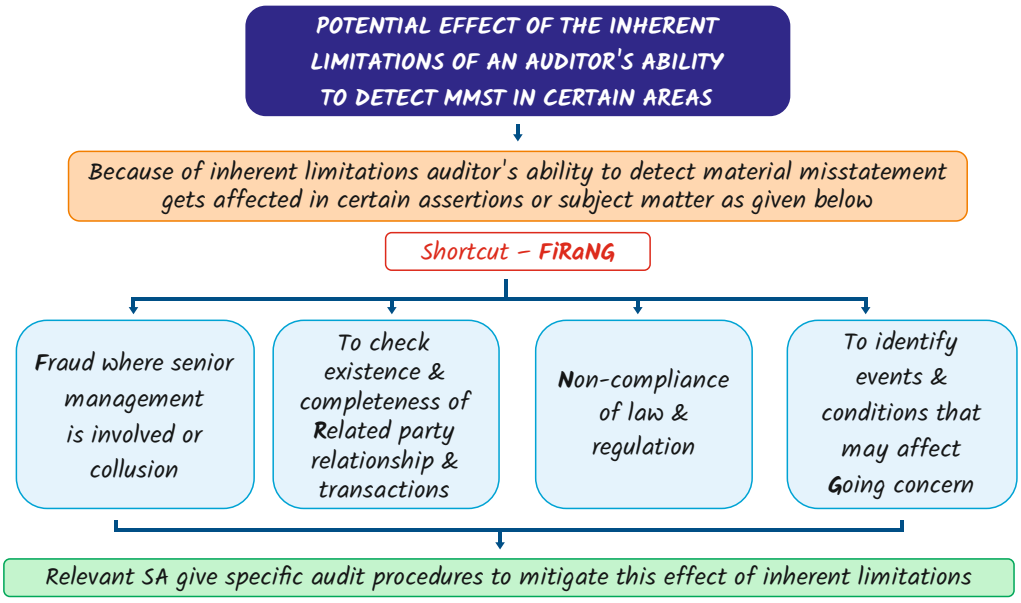
- ***Intentional or Unintentional Misinformation from Management:***
  *There is the possibility that **management or others may not provide, intentionally or unintentionally, the information** that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.*
  (E.g.- Management has entered in agreement to share revenue with Suppliers, Provision remained unrecorded)
- ***Sophisticatedly Designed Frauds: –***
  ***Fraud may involve sophisticated and carefully organised schemes** designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.*
  (E.g. Supplier, Store Manager, Quality Engineer, Accountant, MD all are involved)
- ***No powers of Investigation: –***
  *An audit is **not an official investigation into alleged wrongdoing.** Accordingly, the auditor is not given specific legal powers, such as the **power of search,** which may be necessary for such an investigation.*
- ***Sampling & Persuasive Evidence (Extra Points)***

Timeliness of Financial Reporting and the Balance between Benefit and Cost

- ***Difficulty, Time, or Cost Not Valid basis to Omit Audit Procedures in Some Cases***
  The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit.
- ***Delay reduces value of information: –***
  ***Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between their liability of information and its cost.** This is recognised in certain financial reporting frameworks (see, for example, the "Framework for the Preparation and Presentation of Financial Statements" issued by the Institute of Chartered Accountants of India (ICAI)).*
- ***Expectations of Users: –***
  Therefore, there is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognising that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.

(CNO--SA200.050) POTENTIAL EFFECTS OF THE INHERENT LIMITATION OF AN AUDITOR'S ABILITY TO DETECT MMST IN CERTAIN AREAS (QNO-0.500)

Chart



Discussion

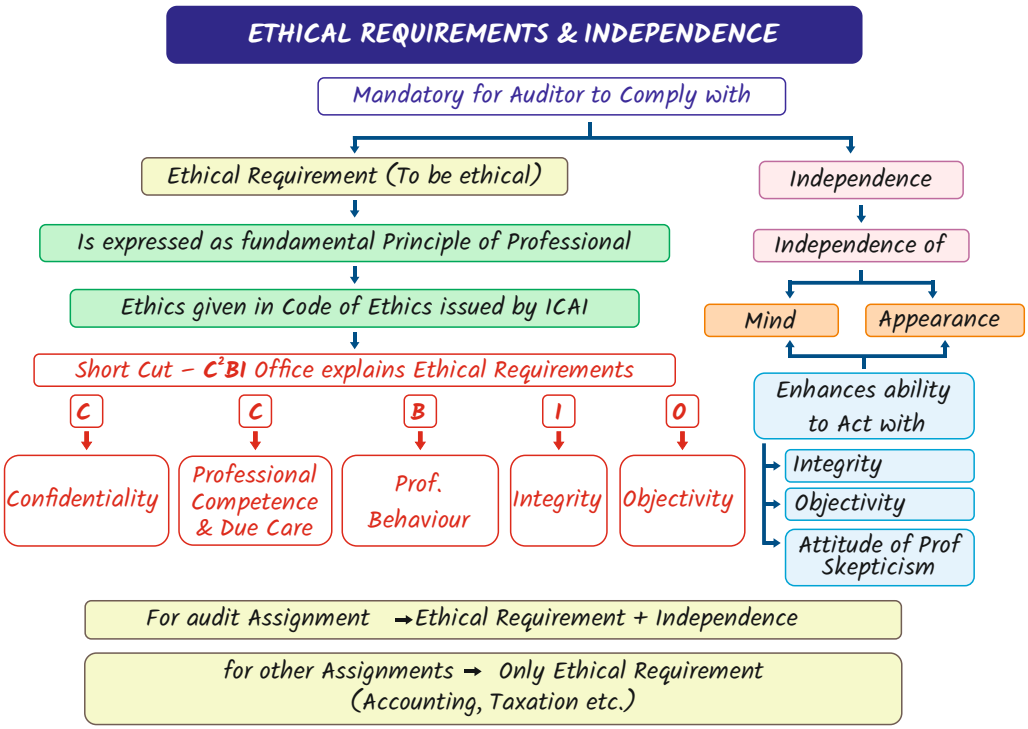
In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include: **(FiRaNG)**

- Fraud, particularly fraud involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue a going concern.

Relevant SAs identify specific audit procedures to assist in mitigating the effect of the inherent limitations.

(CNO--SA200.060) WHAT ARE ETHICAL REQUIREMENTS?

Chart



Mandatory

The auditor shall comply with relevant **ethical requirements**, including those pertaining to **independence**, relating to financial statement audit engagements.

Derived from Code of Ethics

Relevant ethical requirements ordinarily comprise the Code of Ethics issued by the Institute of Chartered Accountants of India.

The Code establishes the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements and provides a conceptual framework for applying those principles; ***(C²BI-Office explains ethical requirements)***

- *Confidentiality; and*
- *Professional Competence and due care;*
- *Professional Behaviour.*
- *Integrity;*
- *Objectivity;*

Independence (MCQ – SA 200.1, SA 200.3)

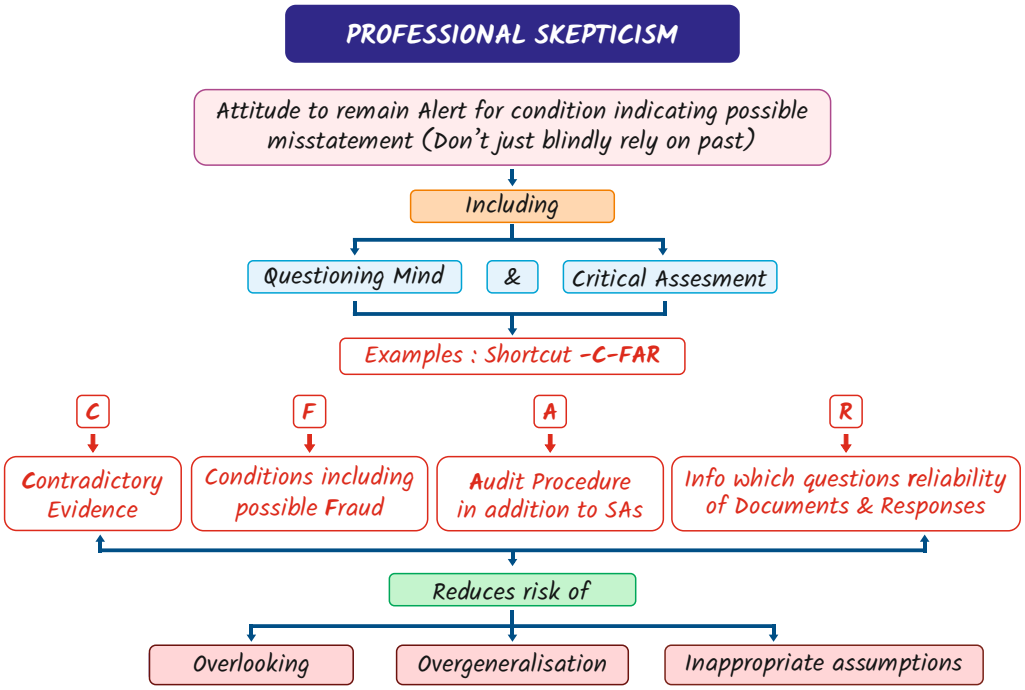
In the case of an ***audit engagement, it is in the public interest and, therefore, required by the Code of Ethics,*** *that the auditor be* ***independent of the entity*** *subject to the audit.*

The Code describes ***independence as comprising both independence of mind and independence in appearance.*** *The auditor's independence from the entity safeguards the auditor's ability to form an audit Overall Objectives of the Independent Auditor opinion without being affected by influences that might compromise that opinion.*

Independence enhances the auditor's ability to act with integrity, to be objective and to maintain an attitude of professional scepticism.

(CNO--SA200.080) WHAT IS PROFESSIONAL SKEPTICISM? (MCQ – 200.4)

Chart



Definition: -

Professional Skepticism: *– An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.*
(Some examples which are against professional scepticism,

- *Only because last time there were no problems, blindly relying on management, internal controls system.*
- *Accepting oral justifications, Xerox copies in important matters.*
- *Ignoring small, unusual things such as withdrawal of Rs 5 from bank or small errors such as negative inventory balance of small item etc)*

How to remain Skeptical?

(C-FAR)

- **Contradiction**
  Audit evidence that contradicts other audit evidence obtained.
  (E.g., Reconciliation given shows stock of 5,000 but insurance documents show stock of 3,500)

- **Fraud**
  Conditions that may indicate possible fraud.
  (E.g., 20% increase in consumption of petrol while production increased 5%)

- **Audit Procedure**
  Circumstances that suggest the need for audit procedures in addition to those required by the SAs.
  (E.g., SA 402 says rely on report if it is from Chartered Accountant, but we may not rely because of bad past experience in other assignment)

- **Reliability**
  Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
  (E.g., Figures are over written / 5-year-old document is appearing as if just printed)

What if PS is not followed?

Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of:

- Overlooking unusual circumstances.
  (E.g., % change in fuel consumption leads to discovery of fraud)

- Over generalising when drawing conclusions from audit observations.
  (E.g., Salary of one department was checked and it was declared salary of other 3 department would be same)

- Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.
  (E.g., Assuming that employees with more than 10 years with company are honest hence no need to check sales executed by them)

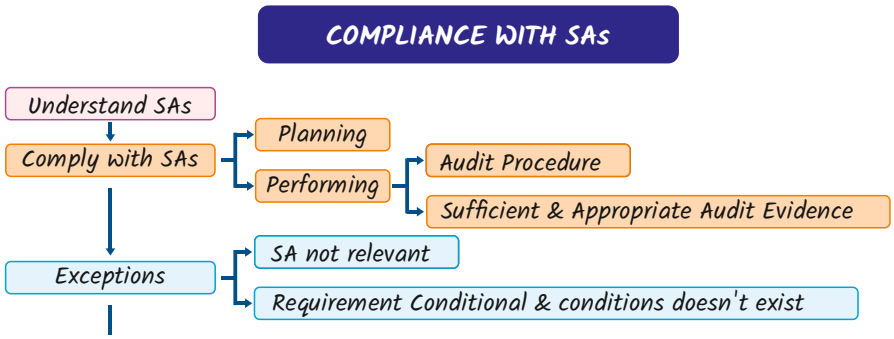
Don't misinterpret Professional Skepticism

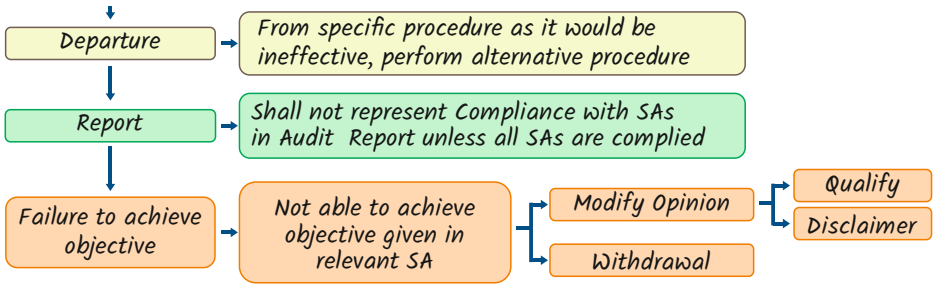
The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud, the SAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism.

(CNO--SA200.100) IS COMPLIANCE WITH SAs MUST?

Chart





Understand	The auditor shall have an **understanding of the entire text of a SA,** including its application and other explanatory material, to understand its objectives and to apply its requirements properly.
Comply	To achieve the overall objectives of the auditor, the auditor shall use the **objectives stated in relevant SAs in planning and performing the audit,** having regard to the inter-relationships among the SAs, to: ➢ Determine whether any **audit procedures in addition to those required by the SAs** are necessary in pursuance of the objectives stated in the SAs; and ➢ Evaluate whether **sufficient appropriate audit evidence has been obtained.**
Report	The auditor **shall not represent compliance with SAs in the auditor's report unless the auditor has complied with the requirements** of this SA and all other SAs relevant to the audit. (Understanding ⟶ Compliance ⟶ Achieve Objectives given in SAs ⟶ Additional audit procedures ⟶ Sufficient & Appropriate Evidence ⟶ Represent in Audit Report) ➢ **Exceptions** The auditor shall comply with each requirement of a SA unless, in the circumstances of the audit: ▪ The entire SA is **not relevant;** or (No Summary Financial Statements SA 810 not relevant) ▪ The requirement is not relevant because it is **conditional, and the condition does not exist.** (No need to apply SA 705 if there is no situation of modifying audit report)
Departure	In exceptional circumstances, the auditor may judge it necessary to **depart from a relevant requirement in a SA.** In such circumstances, the auditor shall **perform alternative audit procedures** to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement. (E.g. SA 501 asks to meet lawyers of company but if these lawyers are not trustworthy as per prior experience auditor may skip it and meet other reputed lawyers)
Failure to Achieve an Objective	**If an objective in a relevant SA cannot be achieved,** the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and there by requires the auditor, in accordance with the SAs, **to modify the auditor's opinion or withdraw from the engagement.** Failure to achieve an objective represents a **significant matter** requiring documentation in accordance with SA 230. (E.g. SA 240 asks to withdraw in exceptional circumstances but it's not possible in government company)

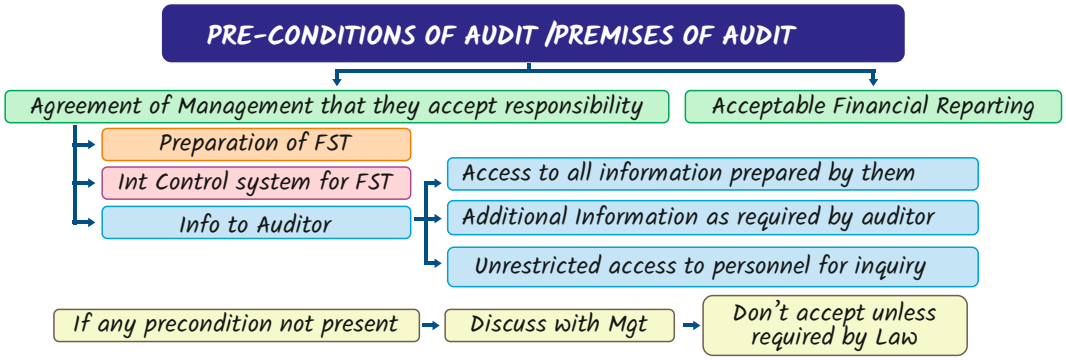
UNIQUE MCQS	
MCQ No.	200.5

[SA 210] AGREEING THE TERMS OF AUDIT ENGAGEMENTS

(CNO--SA210.020) WHAT ARE PRECONDITIONS OF AUDIT (QNO-3.050)(MCQ-210.8)

(Before asking any information & thinking about acceptance & continuance as per SQC 1 & SA 200, these conditions should be satisfied)

Chart



Preconditions of an audit

- **Acceptable FRF:-** The use by management of an **acceptable financial reporting framework**(Exp:-Reliable / Relevant etc)in the preparation of the financial statements and
- **Agreement:-the agreement** of management and, where appropriate, those charged with governance to the **premise on which an audit is conducted.**

(Exp:- Management should agree and take responsibility of financial reporting)

Auditor's Responsib-ility to Check 2 Conditions

In order to establish whether the preconditions for an audit are present, **the auditor shall:**

- **Acceptable FRF:-** Determine whether the financial reporting framework to be applied in the preparation of the **financial statements is acceptable;** and
- **Agreement:-Obtain the agreement** of management that it acknowledges and understands its responsibility:
  - **Preparation of Financial Statements**
    For the **preparation of the financial statements** in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
  - **Internal Control System**
    For such **internal control** as management determines is necessary **to enable the preparation of financial statements that are free from material misstatement,** whether due to fraud or error; and
  - **Information to Auditor**
    To **provide the auditor** with:
    - **Access to all information** of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
    - **Additional information that the auditor may request** from management for the purpose of the audit; and
    - **Unrestricted access to persons** within the entity from whom the auditor determines it necessary to obtain audit evidence.

Don't Accept Assignment

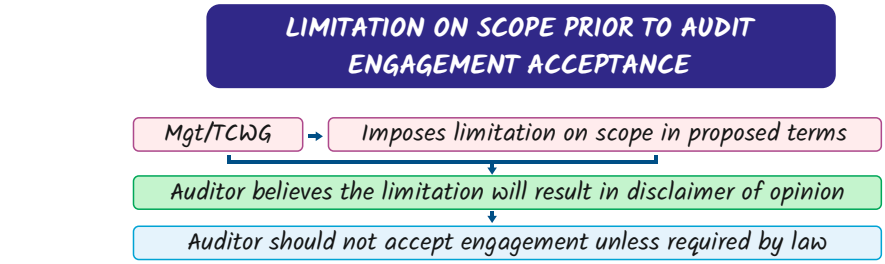
If the ***preconditions for an audit are not present, the auditor shall discuss the matter with management.***

Unless required by law or regulation to do so, ***the auditor shall not accept the proposed audit engagement:***

- *If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is* ***unacceptable;*** *or*
- *If the* ***agreement as discussed above has not been obtained.***

(CN--SA210.040) LIMITATION ON SCOPE PRIOR TO AUDIT ENGAGEMENT ACCEPTANCE (QNO-3.050) (MCQ-210.1)

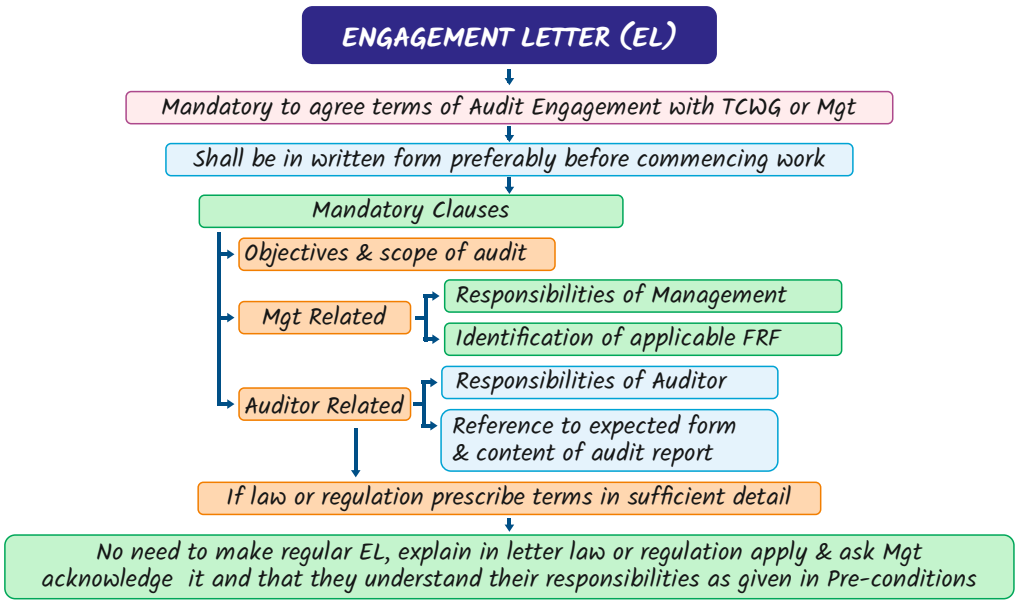
Chart



If management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor ***believes the limitation will result in the auditor "disclaiming an opinion" on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.***

(CN--SA210.060) IS ENGAGEMENT LETTER COMPULSORY? WHAT ARE ITS CONTENTS? (Mandatory Clauses) (QNO 2.010) (MCQ-210.5, Incs.57.5)

Chart



Compulsory Engagement Letter

The auditor ***shall agree the terms of the audit engagement*** *with management or those charged with governance, as appropriate.*

Mandatory Clauses

(QNO-2.010) (MCQ-210.2)

The agreed terms of the audit engagement ***shall be recorded in an audit engagement letter or other suitable form of written agreement*** *and shall include:*

- *The* ***objective and scope of the audit;***1
  - *(E.g. Express Opinion on Financial Statements – Standalone, Consolidated, Subsidiaries, Associates, Branches)*
- *The* ***responsibilities of the auditor;***4
  - *(E.g.Conduct Audit as per SAs)*

- The **responsibilities of management;**2
  - (E.g. Preparing Financial Statements etc)

- **Identification of the applicable financial reporting framework** for the preparation of the financial statements; and3
  - (E.g. AS or Ind AS per Sec 133)

- **Reference to the expected form and content of any reports** to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content. 5
  - (E.g. as per SA 700 series)

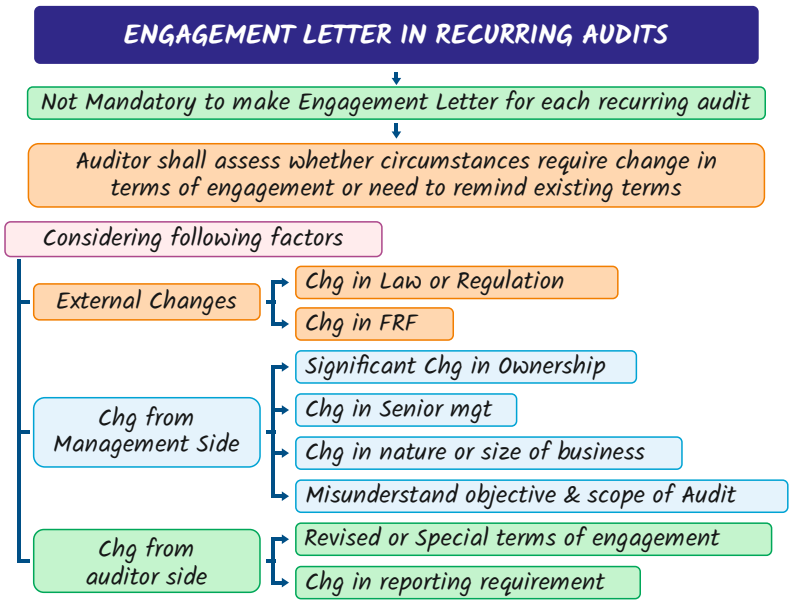
Law prescribes terms

If **law or regulation prescribes in sufficient detail the terms of the audit engagement** referred to in above paragraph, the **auditor need not record them in a written agreement, except for the fact that such law or regulation applies,** and that management acknowledges and understands its responsibilities as set out in pre-conditions.

- (E.g., IRDA may issue regulation covering all above matters between auditor & client then no need of engagement letter, just send simple letter to client that terms are as per regulations, please sign and send back the letter)

(CN--SA210.080) IS ENGAGEMENT LETTER REQUIRED AT RECURRING AUDITS? (QNO 3.000)

Chart



On recurring audits, the auditor **shall assess** whether **circumstances require the terms of the audit engagement to be revised** and whether **there is a need to remind the entity of the existing terms of the audit engagement.**

The auditor **may decide not to send a new audit engagement letter or other written agreement each period.** However, the **following factors** may make it appropriate to **revise the terms of the audit engagement or to remind** the entity of existing terms:

External Changes

- A change in legal or regulatory requirements.
  - (E.g., New company act / GST)
- A change in the financial reporting framework adopted in the preparation of the financial statements.
  - (E.g., Ind AS)

Change from Management Side

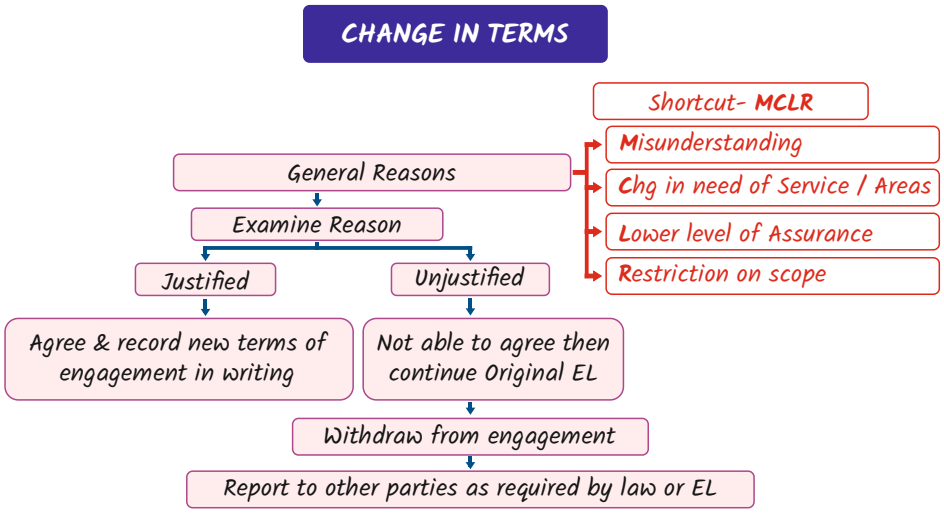
- A significant change in ownership.
  - (E.g., Takeover from other business group, pantaloons taken from Biyani to Aditya Birla Group)
- A recent change of senior management.
  (E.g., MD / CEO / CFO are replaced)
- A significant change in nature or size of the entity's business.
  - (E.g., Started manufacturing along with trading and now turnover has increased 3 times as compared to last year)
- Any indication that the entity misunderstands the objective and scope of the audit.
  - (E.g., They ask for Fraud Report / Compliance Report / Tax Report / Fixed Asset assessment report etc)

Change from Auditors Side

- A change in other reporting requirements.
  - (E.g. Reporting on Internal Financial Control)
- Any revised or special terms of the audit engagement.
  - (E.g. Separate Branch Auditors / Use of CAAT / Use of Expert etc which are justified)

(CNO--SA210.100) WHAT IF THERE IS CHANGE IN TERMS? (MCQ-210.4)

Chart



General Reasons for Change (Popular Reasons)

A request from the client for the auditor to change the engagement may result from-

- a change in circumstances affecting the need for the service,
  - (E.g., Change in Law -- IFCR)
- a restriction on the scope of the engagement, whether imposed by management or caused by circumstances.
  - (E.g., Visit to foreign branches restricted to cut costs or because of war)
- An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.
- a misunderstanding as to the nature of an audit or related service originally requested.

Examine reasons

The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement, especially any legal or contractual implications.
The auditor **shall not agree to a change in the terms of the audit engagement where there is no reasonable justification** for doing so.

(E.g., 3 months after appointment company plans to appoint separate branch auditor for some branches, this is change in terms of engagement which said all branches will be audited by principle auditor, auditor will have to determine whether it is justified or not).

- **Justified**

  If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

  (E.g., Continuing above example, if these are new branches with low turnover located far away from offices from principal auditor, then such steps appear justified as it will save time & cost of both principle auditor & company, in such case sign revised engagement letter)

- **Unjustified**

  If the auditor is **unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:**

  - Withdraw from the audit engagement where possible under applicable law or regulation; and
  - Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

    (E.g. But if these branches are big branches of company contributing to 40% of revenue and complicated matters then it is not justified then we will have to withdraw from assignments and inform TCWG, CAG if required by law)

(CNO--SA210.120) LOWER LEVEL OF ASSURANCE

Chart

LOWER LEVEL OF ASSURANCE

(Change from audit to review or review to AUP)

If lower level of assurance is justified, issue report as per revised terms, & in order to avoid confusion, no need to refer to original assignment or procedures.

↓

Only if assignment is agreed upon procedure(AUP) then explain all relevant procedures in report even if performed earlier.

Request for Lower Level of Assurance

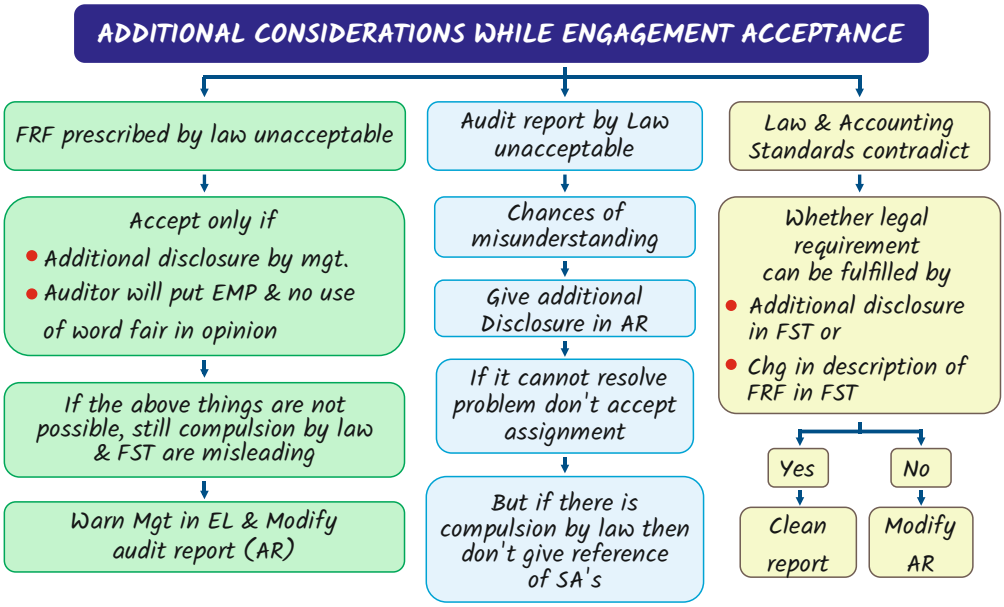
An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to-

- the original engagement; or
- any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.
  - (E.g., If it is justified because of lack of time and need of report to be submitted to investor quickly, we can accept such review assignment, then it will become purely review assignment and no reference to audit will be made.)

(CNO--SA210.140) ADDITIONAL CONSIDERATIONS WHILE ENGAGEMENT ACCEPTANCE

Chart



Financial Reporting Standards Supplemented by Law or Regulation

If financial reporting standards established by an authorised or recognised standards setting organization are supplemented by law or regulation, the auditor shall determine whether there are any conflicts between the financial reporting standards and the additional requirements. If such conflicts exist, the auditor shall discuss with management the nature of the additional requirements and shall agree whether:

(a) The additional requirements can be met through additional disclosures in the financial statements; or

(b) The description of the applicable financial reporting framework in the financial statements can be amended accordingly.If neither of the above actions is possible, the auditor shall determine whether it will be necessary to modify the auditor's opinion in accordance with SA 705

Financial Reporting Framework Prescribed by Law or Regulation— Other Matters Affecting Acceptance

- If the auditor has determined that the financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation, the auditor shall accept the audit engagement only if the following conditions are present:

  (a) Management agrees to provide additional disclosures in the financial statements required to avoid the financial statements being misleading; and

  (b) It is recognised in the terms of the audit engagement that:

  (i) The auditor's report on the financial statements will incorporate an Emphasis of Matter paragraph, drawing users' attention to the additional disclosures, in accordance with SA 706 and

  (ii) Unless the auditor is required by law or regulation to express the auditor's opinion on the financial statements by using the phrases "present fairly, in all material respects", or "give a true and fair view" in accordance with the applicable financial reporting framework, the auditor's opinion on the financial statements will not include such phrases.

- If the conditions outlined in above paragraph are not present and the auditor is required by law or regulation to undertake the audit engagement, the auditor shall:

  (a) Evaluate the effect of the misleading nature of the financial statements on the auditor's report; and

  (b) Include appropriate reference to this matter in the terms of the audit engagement.

Auditor's Report Prescribed by Law or Regulation

In some cases, the law or regulation applicable to the entity prescribes the layout or wording of the auditor's report in a form or in terms that are significantly different from the requirements of SAs. In these circumstances, the auditor shall evaluate:

(a) Whether users might misunderstand the assurance obtained from the audit of the financial statements and, if so,

(b) Whether additional explanation in the auditor's report can mitigate possible misunderstanding.

If the auditor concludes that additional explanation in the auditor's report cannot mitigate

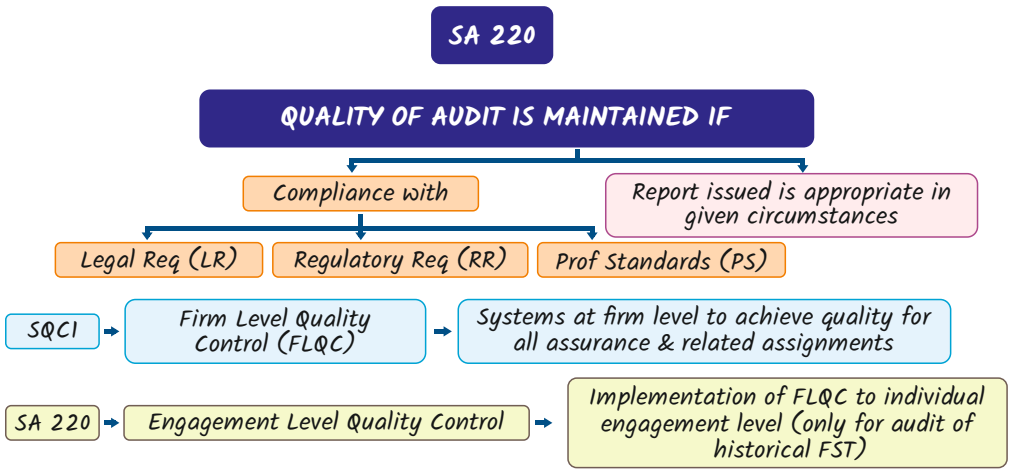
	possible misunderstanding, the auditor shall not accept the audit engagement, unless required by law or regulation to do so. An audit conducted in accordance with such law or regulation does not comply with SAs. Accordingly, the auditor shall not include any reference within the auditor's report to the audit having been conducted in accordance with SAs

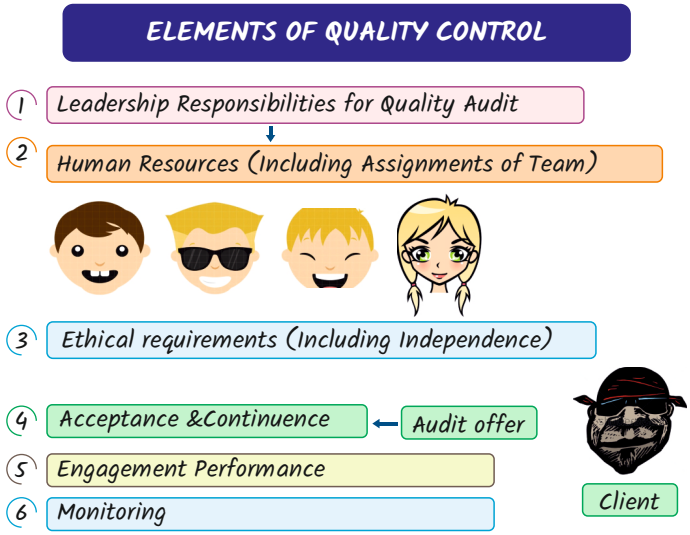
UNIQUE MCQS	
MCQ No.	210.6 / 210.7

[SA 220] QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS

(CNO--SA220.040) WHAT DO YOU MEAN BY QUALITY OF AUDIT? WHAT IS FIRM LEVEL QUALITY & ENGAGEMENT LEVEL QUALITY?

Chart





***Note : Part 1 & Part 2 omitted as not much relevant.

We will say that quality is maintained at particular audit engagement if: -

- If there is compliance with **professional standards and regulatory and legal requirements.**
  (E.g., AS / SA / Co Act / Sch III / Sch II etc.)

- The reports issued are appropriate in the circumstances.
  (E.g., Clean / Qualified / Adverse / Disclaimer etc.)

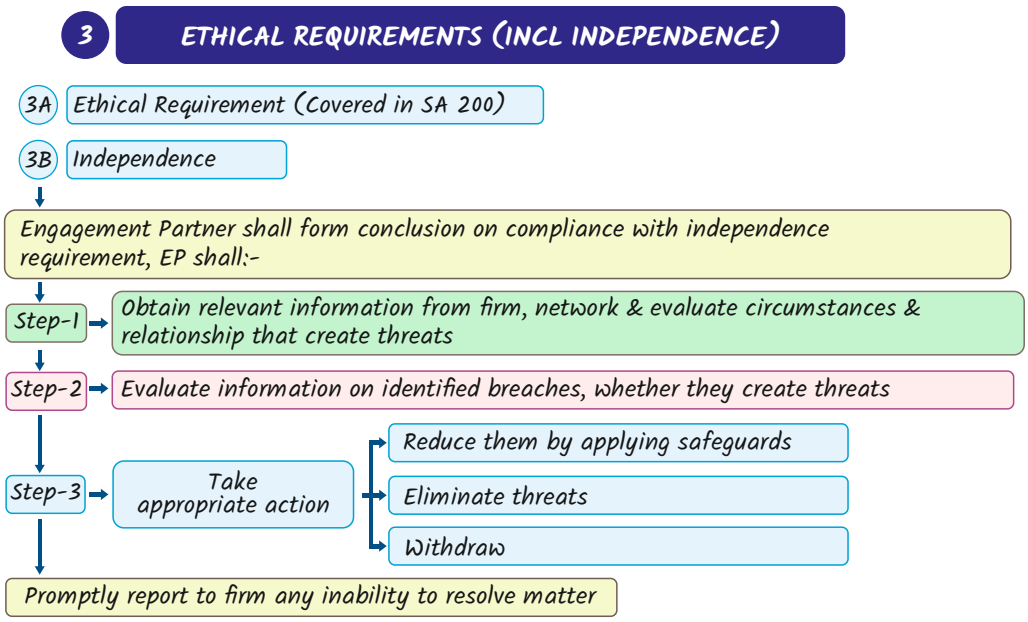
SQC 1 says that audit firm is supposed to maintain systems at **firm level** to achieve quality in audit with above things as ultimate objective. Such principles will be **applicable to all assurance & related assignments** of the firm as per SQC1.

On the other hand, **SA 220** deals with implementation of firm level quality control system to **individual engagement level.** Is applicable only to **audit of historical information**. It casts responsibility on engagement partner to implement quality control procedures.

WHAT IS LEADERSHIP RESPONSIBILITY FOR QUALITY OF AUDIT? (Leader should be sufficiently involved) (Not Expected in Detail) ASSIGNMENT OF TEAM (Not Expected in Detail)

(CNO—SA220.060) ETHICAL REQUIREMENTS(INCL INDEPENDENCE) (QNO-5.020)

Chart



The engagement partner **shall form a conclusion on compliance with independence requirements** that apply to the audit engagement. In doing so, the engagement partner shall:

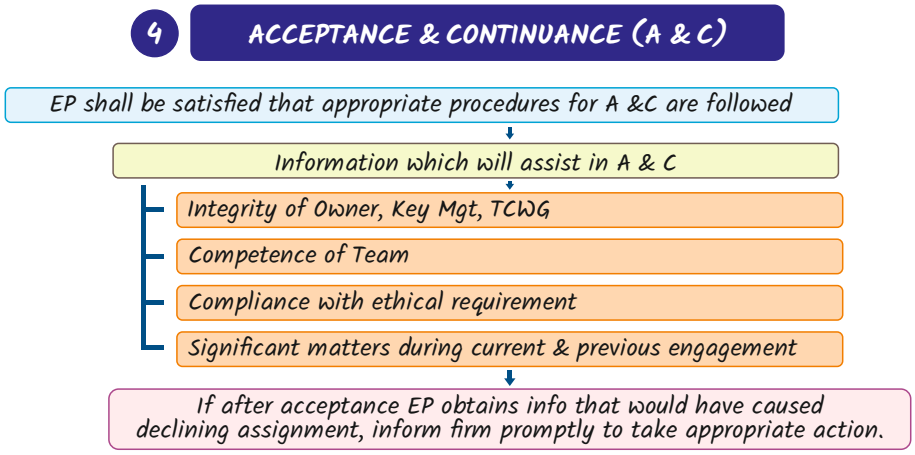
- **Obtain relevant information from the firm and, where applicable, network firms**, to identify and evaluate circumstances and relationships that create threats to independence;
  - (E.g., Shareholdings / relatives / business relationships of relatives / audit fees Vs non-audit fees etc.)

- **Evaluate information** on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
  - (E.g., Big or Small shareholding / distant, dependent relative / nature of business how old is business / audit fees etc. from whole group)

- **Take appropriate action** to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.
  - (Ask to sell shares, shift to other assignment / leave non-audit assignments or withdraw etc.)

(CNO--SA220.080) WHAT ARE ACCEPTANCE & CONTINUANCE PROCEDURES? (MCQ-220.1) (QNO-5.080)

Chart



*The engagement partner shall be satisfied that **appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements** have been followed and shall determine that conclusions reached in this regard are appropriate.*

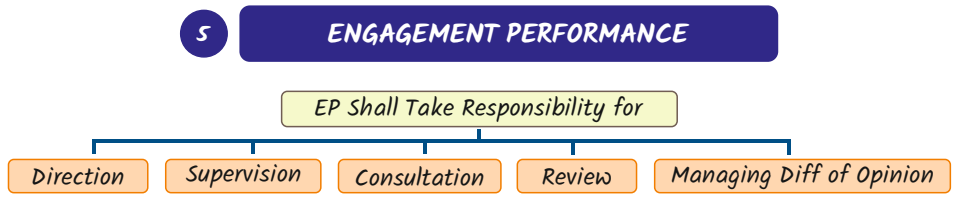
*If the engagement partner obtains information **that would have caused the firm to decline the audit engagement had that information been available earlier, the engagement partner shall communicate that information promptly to the firm,** so that the firm and the engagement partner can take the necessary action.*

Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- *The **integrity of the principal owners, key management and those charged with governance** of the entity;*
  - *(E.g., Kingfisher / Essar / Toshiba / Satyam etc.)*
- *Whether the engagement team is **competent to perform the audit engagement** and has the necessary capabilities, including time and resources;*
  - *(E.g., Knowledge training for Insurance / Defence / Space etc.)*
- *Whether the firm and the engagement team can **comply with relevant ethical requirements;** and*
  - *(E.g., Judgement will it be possible, afterwards it is throughout the audit)*
- ***Significant matters** that have arisen during the **current or previous audit engagement,** and their implications for continuing the relationship.*
  - *(E.g., Satyam & Toshiba)*

(CNO--SA220.100) REQUIREMENT FOR ENGAGEMENT PERFORMANCE? (QNO 4.000, 5.000 / Incs.39.5)

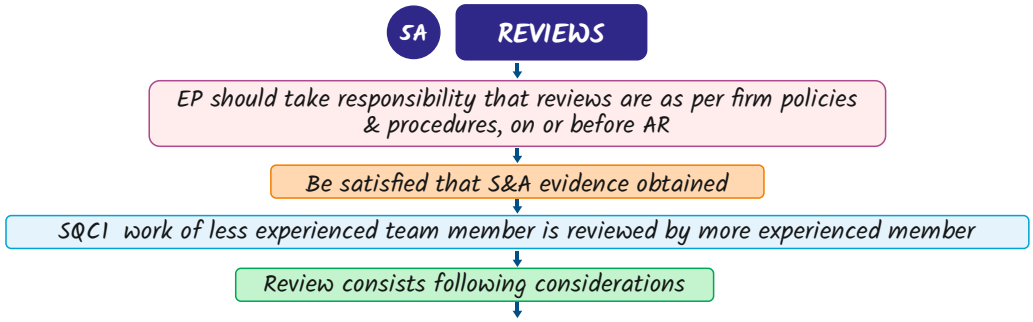
Chart

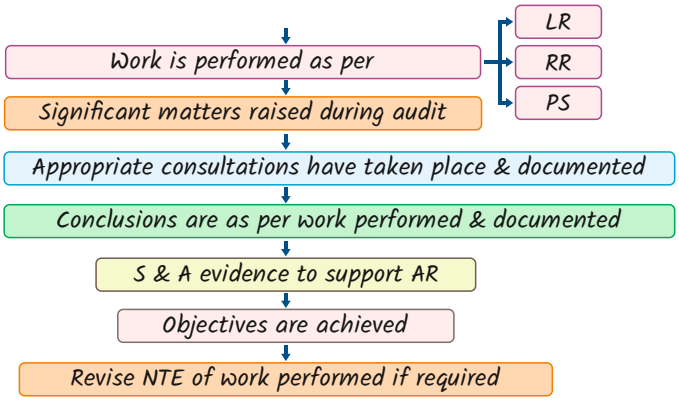


The engagement partner shall take responsibility for:(QNO-4.000)

- *Direction*
- *Supervision*
- *Consultation*
- *Reviews*
- *Managing Difference of Opinion*

Of assignment, to ensure engagement is as per regulatory and legal requirement and professional standards and auditor's report is appropriate in given circumstances.





Reviews

(QNO- 5.000)

- ***Engagement Partner Responsible:-*** *The engagement partner shall take responsibility for reviews being performed in accordance with* ***the firm's review policies and procedures. On or before the date of the auditor's report,*** *the engagement partner shall,* ***through a review of the audit documentation and discussion with the engagement team,*** *be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.*

- ***Review Responsibilities***

  Under SQC 1, the firm's review responsibility policies and procedures are determined on the basis that ***work of less experienced team members is reviewed by more experienced team members.***

  A review consists of consideration whether, for example:

  - *The work has been performed in accordance with* ***professional standards and regulatory and legal requirements.***

    (E.g., Sec 143 / IRDA Regulations / SAs)

  - ***Significant matters*** *have been raised for further consideration.*

    (E.g., Accounting for demerger)

  - ***Appropriate consultations have taken place and the resulting conclusions*** *have been documented and implemented;(Consult Mr A in firm who has audited many such cases)*

    The work performed supports the ***conclusions reached and is appropriately documented.***

    (E.g., Check whether documents and explanation provide basis for accounting done)
  - *The* ***evidence obtained is sufficient and appropriate*** *to support the auditor's report; and*

    (E.g., Check that all areas are appropriately covered)

  - *The objectives of the* ***engagement procedures have been achieved.*** *(We are able to form opinion with reasonable assurance)*
  - *There is a need to* ***revise the nature, timing and extent*** *of work performed;*

    (E.g., High Court order should be obtained, also written representation of CFO on accounting)

SB **MANAGING DIFFERENCE OF OPINION (DOP)**

Difference can be between engagement team, consultants, engagement partner, EQCR reviewer

Follow the firm's policies & procedures for dealing with & resolving DOP

Managing Difference of Opinion

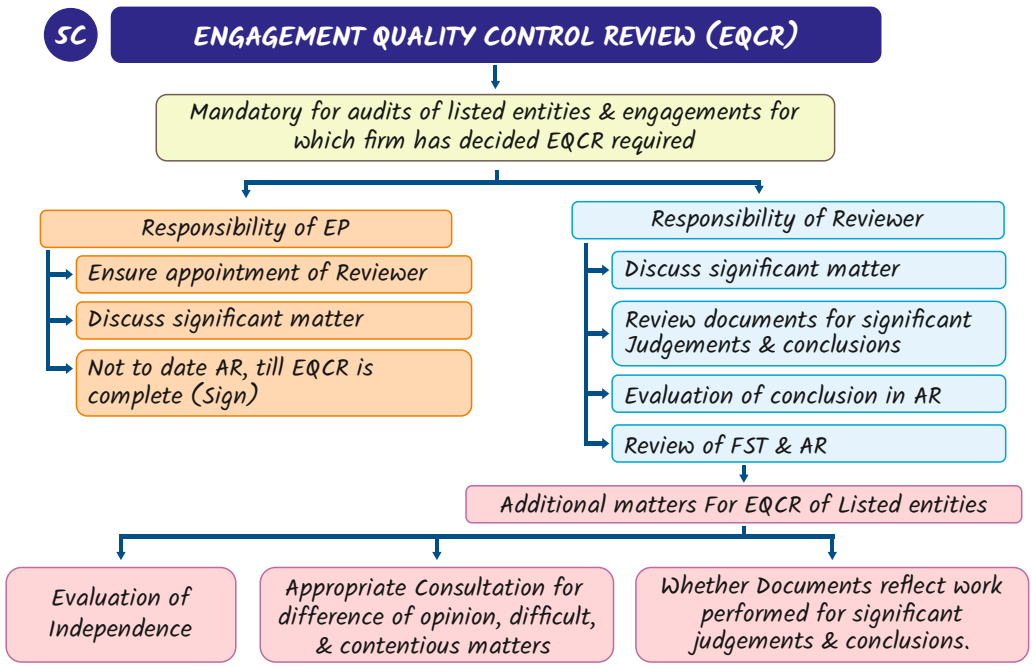
(QNO-4.000)

If differences of opinion arise ***within the engagement team, with those consulted*** *or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the* ***firm's policies and procedures for dealing with and resolving differences of opinion.***

(E.g., There is difference of opinion on whether to use services of expert for determining useful life of plant & machinery between team member & engineering advisor of firm as per firm's policy matter was informed to all partners and their opinions were taken in monthly meeting and as per view of majority decision was taken and difference of opinion was resolved.

(CNO--SA220.120) WHAT IS ENGAGEMENT QUALITY CONTROL REVIEW (EQCR)? (QNO-S.020)(MCQ-220.2)

Chart



Responsibility of Engagement Partner (QNO-S.010)

For audits of financial statements of listed entities, *and those other audit engagements, if any, for which the* ***firm has determined that an engagement quality control review is required.***

(E.g., suppose they have decided all clients having turnover more than 100 cores EQCR is compulsory),

The engagement partner *shall:*

- *Determine that an engagement quality control reviewer has been* ***appointed;***
- *Discuss* ***significant matters*** *arising during the audit engagement,* ***including those identified during the engagement quality control review, with the engagement quality control reviewer;*** *and*
- ***Not date the auditor's report until the completion of the engagement quality control review.***

Responsibility of Reviewer

The engagement quality control reviewer shall perform an ***objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report.*** *This evaluation shall involve:*

- *Discussion of* ***significant matters with the engagement partner;***
  (E.g. Significant Risk / Significant Difficulty / Material Misstatements)
- *Review of selected* ***audit documentation relating to the significant judgments*** *the engagement team made and the conclusions it reached; and*
  (E.g. Risk assessment, Materiality etc.)
- *Evaluation of the* ***conclusions reached*** *in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate.*
  (E.g. whether qualified opinion was appropriate or adverse was required etc.)
- ***Review of the financial statements and the proposed auditor's report;***
  (E.g. For compliance of Sch III)

(Reviewer documents his work and at the end he states, "Not aware about unresolved issues")

Extra Requirements in Case of Listed Companies

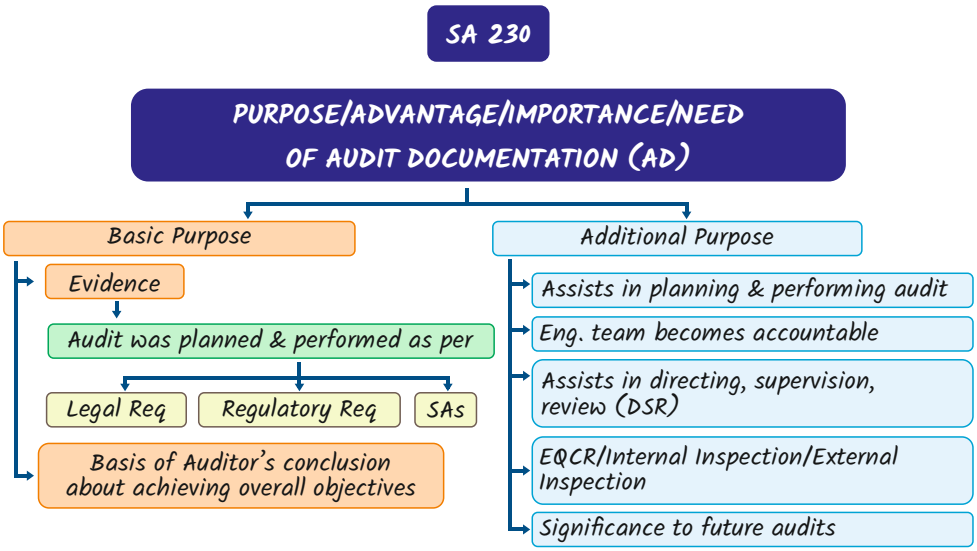
For audits of financial statements of listed entities, *the engagement quality control reviewer, on performing an engagement quality control review,* ***shall also consider the following:***

- *The engagement team's evaluation of the firm's* ***independence in relation to the audit engagement;***
- *Whether* ***appropriate consultation*** *has taken place on matters* ***involving differences of opinion or other difficult or contentious matters,*** *and the conclusions arising from those consultations; and*
- *Whether* ***audit documentation selected for review reflects the work performed*** *in relation to the significant judgments made and supports the conclusions reached.(Whether documents are reliable)*

[SA 230] AUDIT DOCUMENTATION

(CNO--SA230.020) WHY WE NEED AUDIT DOCUMENTATION AND WHAT ARE ITS PURPOSES?

Chart



Basic Purpose

Audit documentation that meets the requirements of this SA and the specific documentation requirements of other relevant SAs provides:

- Evidence that the audit was planned and performed **in accordance with SAs and applicable legal and regulatory requirements.**
- **Evidence of the auditor's basis** for a conclusion about the achievement of the overall objectives of the auditor; and

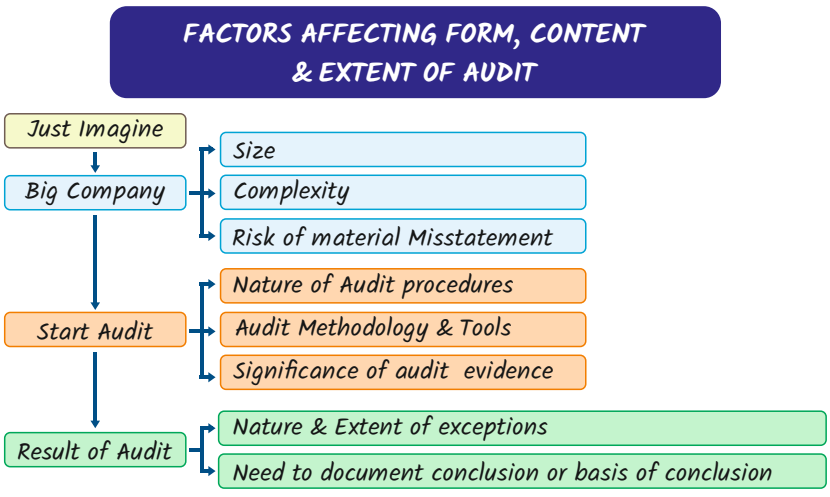
Additional Purpose

Audit documentation serves a number of additional purposes, including the following:

- Assisting the engagement team to **plan and perform the audit.**
- Enabling the engagement team to be **accountable for its work.**
- Assisting members of the engagement team responsible for s**upervision to direct and supervise the audit work, and to discharge their review** responsibilities in accordance with SA 220.
- Enabling the conduct of **quality control reviews and inspections** in accordance with SQC 1.
- Enabling the conduct of **external inspections** in accordance with applicable legal, regulatory or other requirements. (Like Peer Review & Review by Quality Review Board)
- Retaining a record of matters of **continuing significance to future audits.**

(CNO--SA230.040) WHAT ARE FACTORS AFFECTING FORM, CONTENT & EXTENT OF AUDIT DOCUMENTATION? (QNO-6.000)

Chart

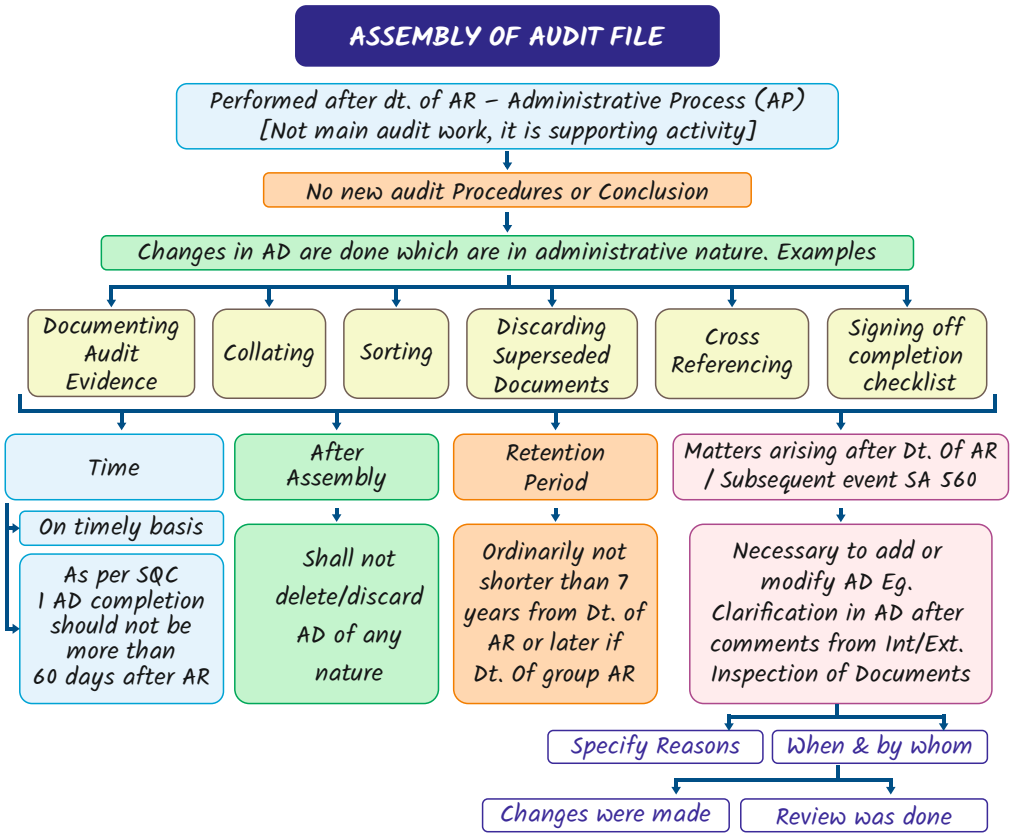


The form, content and extent of audit documentation depend on factors such as:

Text	Examples
*The **size and complexity** of the entity.*	*(↑ Size ↑ Extent, ↑ Complexity ↑ Extent)*
*The identified **risks of material misstatement.***	*(↑ Risk ↑ Extent)*
*The nature of the **audit procedures** to be performed.*	*(Test of controls → Flow Charts Content / Analytical Procedures → Graphs & Ratios)*
*The **audit methodology and tools** used.*	*(Manual Inspection of Records → Physical Form / CAAT → Electronic Form)*
*The **significance of the audit evidence** obtained.*	*(High Court Order of Amalgamation → Photocopy Document Form / Regular Purchase Order → Inspection + recorded PO number)*
*The **nature and extent of exceptions** identified.*	*(fraud + material → Extent → / error + material → Extent →)*
*The **need to document a conclusion** or the basis for a conclusion not **readily determinable from the documentation of the work performed or audit evidence obtained.***	*(Complex working → Detailed Calculation will be covered in content / Simple → Only references will be given in content)*

(CNO--SA230.060) WHAT IS ASSEMBLY OF AUDIT FILE? (MCQ – Incs.34.2 / Incs.34.4)

Chart

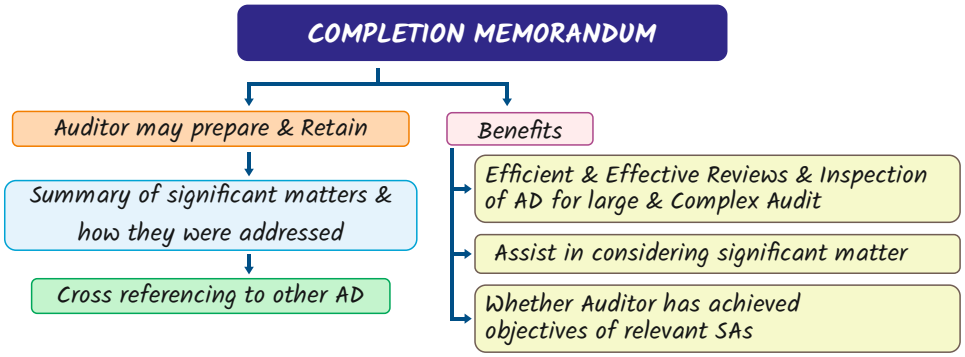


***Note- Superseded documents means notes that reflect preliminary or incomplete thinking, previous year document with typographical or other errors, duplicate documents or draft working papers or financial statements which are no longer required because we have a final version of those documents.

What is done in assembly?	The completion of the assembly of the final audit file after the date of the auditor's report **is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.** Changes may, however, be made to the audit documentation during the final assembly process if they are administrative in nature. Examples of such changes include: ➢ Deleting or discarding **superseded documentation.** ➢ **Sorting, collating and cross-referencing** working papers. ➢ **Signing off on completion checklists** relating to the file assembly process. ➢ **Documenting audit evidence** that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.
When to assemble?	The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a **timely basis after the date of the auditor's report.**
Completion?	**SQC 1 requires** firms to establish policies and procedures for the timely completion of the assembly of audit files. An appropriate time limit within which to complete the assembly of the final audit file is **ordinarily not more than 60 days** after the date of the auditor's report.
What after assembly?	After the assembly of the final audit file has been completed, the auditor **shall not delete or discard audit documentation of any nature before the end of its retention period.**
Retention Period (MCQ-230.1)	SQC 1 requires firms to establish policies and procedures for the **retention of engagement documentation.** The retention period for audit engagements ordinarily is **no shorter than seven years** from the date of the auditor's report, or, **if later, the date of the group auditor's report.**
What if matters after AR?	In circumstances, other than those "Matters arising after date of audit report" where the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, the auditor shall, regardless of the nature of the modifications or additions, document: ➢ The **specific reasons for making them;** and ➢ **When and by whom** they were made and reviewed. An example of a circumstance in which the auditor may find it necessary to modify existing audit documentation or add new audit documentation after file assembly has been completed is the need to **clarify existing audit documentation arising from comments received during monitoring inspections performed by internal or external parties.**

(CNO--SA230.080) WHAT IS COMPLETION MEMORANDUM?

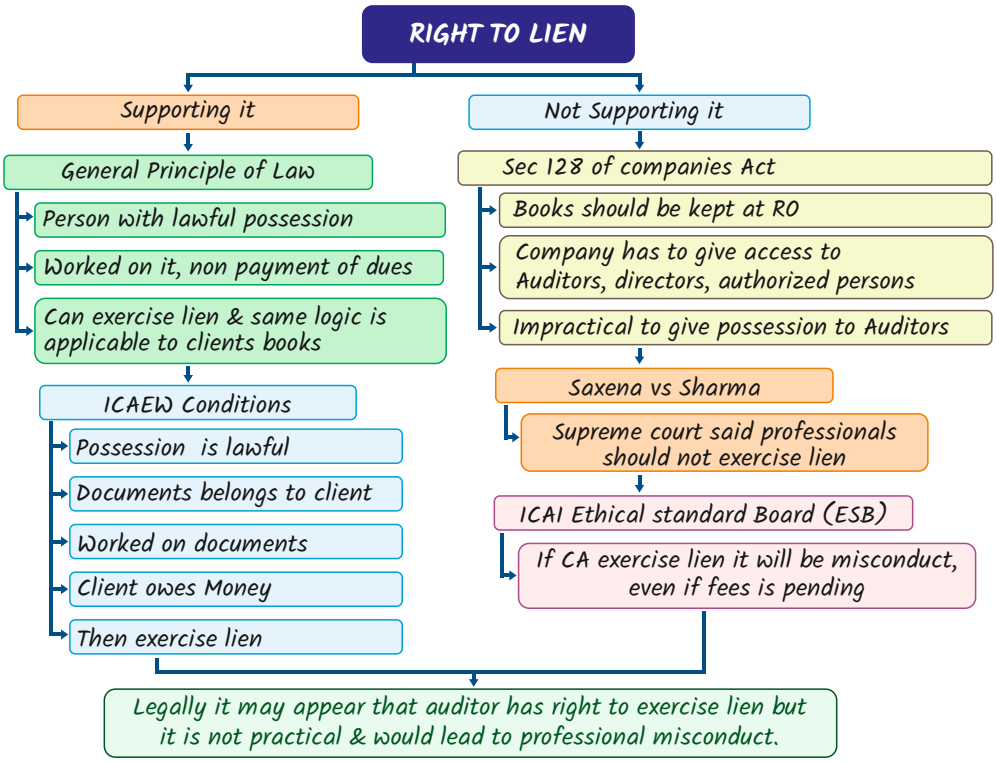
Chart



The auditor **"may"** consider it helpful to prepare and retain as part of the audit documentation a summary **(sometimes known as a completion memorandum)** that describes the **significant matters** identified during the audit and how they were addressed, or that includes **cross- references** to other relevant supporting audit documentation that provides such information. Such a summary may facilitate effective and **efficient reviews and inspections of the audit documentation, particularly for large and complex audits.** Further, the preparation of such a summary may **assist the auditor's consideration of the significant matters.** It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is **any individual relevant SA objective that the auditor cannot achieve** that would prevent the auditor from achieving the overall objectives of the auditor.

(CNO--SA230.100) RIGHT TO LIEN (QNO-8.000)

Chart



General Principles of Law

In terms of the ***general principles of law,*** any person having the ***lawful possession*** of somebody else's property, on which he has worked, may retain the property ***for non-payment of his dues*** on account of the work done on the property. ***On this premise,*** auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents.

ICAEW Conditions

Auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fee for work done on the following conditions:

- Documents retained must ***belong to the client*** who ***owes the money;***
- Documents must have come into ***possession of the auditor on the authority of the client;*** The auditor can retain the documents only if he has ***done work on the documents assigned to him;***
- Such documents can be retained which are ***connected with the work on which fees have not been paid.***

Sec 128 of Company Act

Under section 128 of the Act, books of account of a company ***must be kept at the registered office.*** These provisions ordinarily make it ***impracticable for the auditor to have possession*** of the books and documents. The company provides reasonable ***facility to auditor for inspection of the books of account by directors and others authorised to inspect*** under the Act.

In Saxena Vs Sharma Case

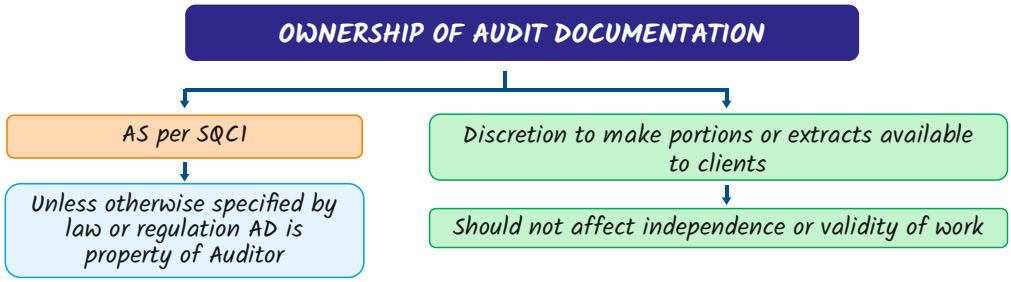
Supreme Court Said that professionals should not exercise lien on client documents as it would lead to a problem in running client business. ICAI ESB also said if CA exercises lien it will be misconduct.

Conclusion

Taking an overall view of the matter, ***it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints.*** His working papers being his own property, the question of lien, on them does not arise.

(CNO--SA230.120) OWNERSHIP OF AUDIT DOCUMENTS (MCQ-230.2/ Incs.36.4)

Chart



*** Branch Auditor is Owner of its audit documents, he may make it available to HO auditor as per audit requirements but ownership remains with him.

Discussion

- Standard on Quality Control (SQC) 1 provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor.
- He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

UNIQUE MCQS

MCQ No.	230.3

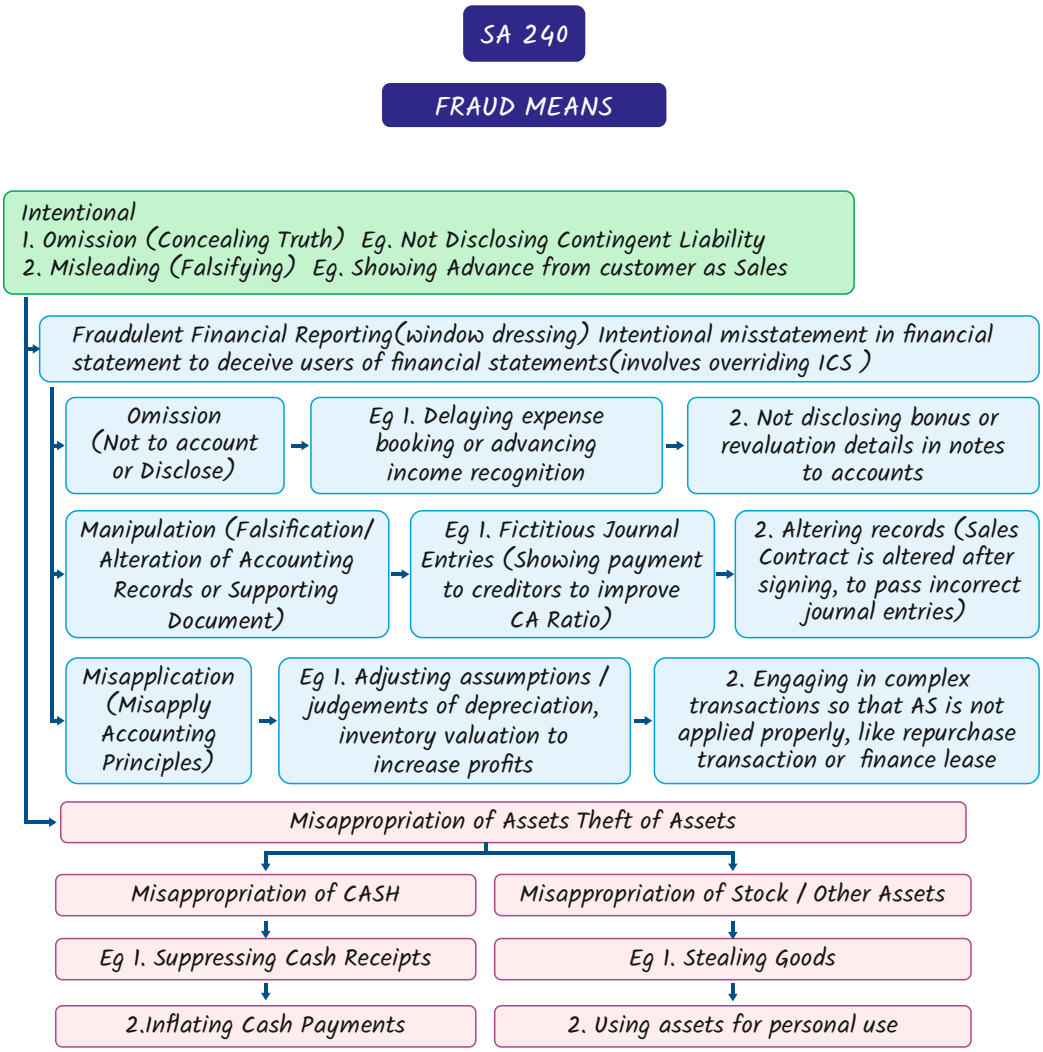
UNIQUE QNOS

QNO No.	7.000, 8.500

[SA 240]THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS

(CNO--SA240.020) WHAT ARE FRAUDS & ITS TYPES? (QNO 10.000)

Chart



Definition and Types of Fraud

An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, to deceive, to mislead (Advance received from customer shown as sales) or at least to conceal the truth (Contingent Liability not disclosed) to obtain an unjust or illegal advantage.

It follows that other things being equal, they are more serious than unintentional errors because of the implication of dishonesty which accompanies them. Its auditor's secondary / incidental objective to find out with reasonable assurance whether material frauds & errors exists. He may suspect or identify fraud and report it but it is not his responsibility to prove it in court of law.

Two types of intentional misstatements are relevant to the auditor–misstatements resulting from:

1. **Fraudulent Financial Reporting** (Window-dressing / Shenanigan)
2. **Misappropriation of assets.**

1.Fraudulent Financial Reporting (QNO-10.000)

- **What is FFR?**
  Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in "financial statements" to deceive financial statement users.

- **Who does it? How it Starts? Why they do it?**
  It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.

Such earnings management may start out with small actions or inappropriate adjustment of assumptions and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent financial reporting. Such a situation could occur when, due to pressures to meet market expectations or a desire to maximize compensation based on performance, management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements. In some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.

- ***Techniques by which management override controls to commit fraudulent financial reporting.***

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:-

- ***Omission***
  - *Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.*
    - *(E.g., delaying recording of claims paid to suppliers for late payment etc)*
  - *Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.*
    - *(E.g., Did not disclose that increase in share capital is through bonus issue and not due to fundraising, did not disclose that increase in fixed assets is due to upward revaluation)*
- ***Manipulation***
  - *Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.*
    - *(E.g., Passing accounting entry for payments to creditors to improve current assets ratio, Recording fake sale entries etc)*
  - *Altering records and terms related to significant and unusual transactions*
    - *(E.g., Records related to MBA fees paid for children of directors was shown as employee development expenses / Properties were taken on rent by MD for personal purpose, but agreement was altered to show it as business purpose)*
- ***Misapplication***
  - *Inappropriately adjusting assumptions and changing judgments used to estimate account balances.*
    - *(E.g., Suddenly increasing useful life to reduce depreciation & increase profits, Increasing % completion of WIP to increase profits)*
  - *Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.*
    - *(E.g., loan taken & repaid was structured into sale & repurchase, loan taken was shown as lease (which is finance lease)*

2. Misappropriation of Assets

- ***What? Who? Why? How?***

*Misappropriation of assets involves the **theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts.** However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways including:*

- **Embezzling receipts**
  - (E.g., Misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
- **Causing an entity to pay for goods and services not received**
  - (For example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).
- **Stealing physical assets or intellectual property**
  - (For example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).
- **Using an entity's assets for personal use**
  - (For example, using the entity's assets as collateral for a personal loan or a loan to a related party).

Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

(CNO--SA240.040) WHAT ARE FRAUD RISK FACTORS?

Chart

Events or Conditions that increase chances that fraud can happen in the form of Pressure / Incentive or Attitude / Rationalisation or Opportunity

Fraudulent Financial Reporting

Pressure / Incentive / Greed

Pressure is created because of financial stability or profitability is threatened by following factors:
(In sequence of importance)

LAW- New statutory or regulatory requirement
Market – High degree of market saturation or competition
Business – Increase in business failure
Customer – Significant decline in customer demand
Accounting – New accounting requirements
Operating losses – Threatening bankruptcy foreclosure or hostile takeover
Cashflow – Recurring negative cashflow or inability to generate cashflow though there is earning or growth in earning

Attitude / Rationalisation

Following attitude related matters may suggest inappropriate ethical values or standards communicated or enforced

(Shortcut- HIT Require Nerdy Friends)

H – History of violation of security or other laws
I – Excessive Interest by management in increasing or maintaining earning strength or inventory price
T - For tax motivated reasons using inappropriate means to minimize earnings
R – Relationship between management & auditor is strained & exhibited by following
(Shortcut- DR- DU)
D – Frequent disputes /
R – Restriction on auditor /
D – Domineering management /
U - Unreasonable demands on auditor
N – Not distinguishing between personal & business transaction
F – Failing to rectify significant deficiency

Continue on next Page...

Opportunity

Opportunity may be created for FFR because of following:

(Shortcut - opportunity hai TU DRS le)

T – Tax haven jurisdiction are having subsidiary / branch / significant bank a/c without any business justification
U – Unusual or highly complex significant transaction having difficult "substance over form " question
D – Ability to dominate or strong financial presence in certain industry which allows to dictate terms or condition to supply or customers
R – Significant related party transaction not in ordinary course of business or where related party not audited
S – Significant estimates affecting assets, liability, revenue & expenses

Misappropriation of Assets

Pressure / Incentive

Following circumstances create pressure for misappropriation

- Personal financial obligations
- Adverse relationship between entity & employees who have access to assets

Adverse relationship may occur because of following – known or anticipated layoffs / recent or anticipated changes to employee compensation / promotion / compensation not as per expectation & expenses already incurred as committed.

Opportunity

Following may create opportunity for misappropriation

Characteristic of assets or circumstances increasing susceptibility (chances) of misappropriation

- o Fixed assets which are small / marketable / no identification mark
- o Easily convertible bonds / computer chips / diamonds
- o Inventory items small in size & high in value or high in demand
- o Large cash in hand

Inadequate internal control because of following

- o Inadequate physical safeguards
- o Inadequate segregation of duties
- o Inadequate system of authorization
- o Inadequate records of transaction or assets
- o Inadequate access control over important records
- o Lack of timely reconciliation of assets
- o Inadequate oversight of senior management over expenditure
- o Inadequate management understanding of IT systems
- o Lack of mandatory vacation for employees

Attitude / Rationalisation

Careless attitude evident from following increasing chances of misappropriation

- o Not taking steps to reduce risks of misappropriation
- o Overriding existing control over misappropriation
- o No rectification of significant deficiency in internal control
- o No monitoring of controls over misappropriation
- o Tolerance of petty theft

Fraud risk factors *– Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud or rationalization.*

- ***Incentive or pressure*** *to commit fraudulent financial reporting may exist when management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target or financial outcome – particularly since the consequences to management for failing to meet financial goals can be significant. Similarly, individuals may have an incentive to misappropriate assets, for example, because the individuals are having habit of living beyond their means.*
- *A* ***perceived opportunity*** *to commit fraud may exist when an individual believes internal control can be overridden, for example, because the individual is in a position of trust or has knowledge of specific deficiencies in internal control.*
- *Individuals* ***may be able to rationalize committing a fraudulent act.*** *Some individuals possess an attitude, character or set of ethical values that allow them knowingly and intentionally to commit a dishonest act. However, even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them.*

(CNO--SA 240.060)	Fraudulent Financial Reporting (FFR)	Misappropriation of Assets (MAA)
Pressure / Incentive	➢ ***Pressure*** ▪ *Financial stability or profitability is threatened by economic, industry, or entity operating conditions.* *(E.g., Failure in economy or industry / Saturation / Rapid changes /Competition / Bankruptcy / Hostile takeover / Negative cash flows)* ▪ *Excessive pressure exists for management to meet the requirements of expectations of third parties.* *(E.g., SEBI to comply with listing agreement / investors / new debt or equity / creditors / Analyst)* ▪ *Pressure from TCWG to achieve targets* ➢ ***Incentive*** ▪ *Information available indicates that the personal financial situation of management or those charged with governance"is dependent on entity's FST* *(Significant financial interest / big portion is variable compensation / personal guarantees)*	➢ ***Pressure*** ▪ *Personal financial obligation*
Opportunities	➢ *Ability to dominate in industry (in appropriate or non- arm's length transactions)* *(E.g., Prices are hiked when sales need boost and later on discounts are given)*	➢ ***Susceptibility of Assets*** ▪ *FA or Inventory small in size/ movable/ marketable/ lacking observable identification of ownership* ▪ *Easily convertible investments such as bearer bonds / diamonds / computer chips* ▪ *Large amount of cash in hand*

	➢ Significant operations located across international borders (E.g., 30% sales are from Australian & European branches, it's difficult to get information & visit this branch) ➢ Use of business intermediaries with no justification (E.g., Sales to Russia are done through subsidiary in Dubai which is not audited as audit is not compulsory in Dubai) ➢ Bank accounts & subsidiaries in tax haven. (E.g., 5 bank accounts in Mauritius) ➢ Complex or unstable organization structure. E.g., Unnecessary frequent changes are made in managers and employees, before people become comfortable in working transfers take place) ➢ The monitoring of management is not effective (Very short time is allocated for supervision) ➢ Many assets & liabilities depend on subjective judgment (E.g., In information technology/ industry data / software / website are valued which involves subjectivity) ➢ Internal control components are deficient" ➢ Significant related party transactions not in ordinary course audited by other or not audited. (E.g., When sales need boost goods many transactions with related party are observed and they are returned after few months)	➢ **Inadequate ICS** ▪ Inadequate oversight of senior management. ▪ Lack of understanding in management over IT. ▪ Lack of controls over automated transactions. ▪ Inadequate job application screening. ▪ No Segregation of duty. ▪ Inadequate system of authorization. ▪ Inadequate record keeping of assets. ▪ Lack of timely & appropriate reconciliation & documentation ▪ Inadequate physical safeguards. ▪ Lack of mandatory leave for employees.
Attitude / Rationalization	➢ "**Attitude: -** ▪ Communication of Inappropriate values or ethical standards, that are not effective. (E.g., Promoting performance over ethics) ▪ Known history of violations of securities laws or other laws.	➢ "**Attitude": -** **(From Management Side)** ▪ Disregard to ICS over MAA (E.g., No interest in increasing security and conducting physical verification of stock) ▪ Overriding existing controls (E.g., Takes goods from godown without proper procedures)

(E.g., Faced SEBI penalties many time in past for insider trading)

- Non-financial management's excessive participation in or preoccupation in estimation process.

(E.g., Sales Head is taking more interest in financial statement finalization & overstate sales as compared to CFO)

- Excessive interest in increasing or maintain earning trend / stock price.

(E.g., Keeping overambitious targets for share prices)

- The relationship between management and the current or predecessor auditor is strained Time Constraint, Restrictions, Domineering, Frequent Disputes.

(E.g., this attitude towards auditors indicates something is wrong with financial statements)

➢ **Rationalization**

- Low morale among senior management.

(E.g., Constant humiliations by BOD, hence they resort to FFR)

- Dispute between shareholders in a closely held entity.

(E.g., One group manipulates to prove other group wrong)

- Committing to achieve aggressive or unrealistic forecasts

(E.g., Does press conference every quarter end makes tall claims to boosts share prices)

- Inappropriate means to minimize Reported earnings for tax-motivated reasons
- No action on existing deficiency

(E.g., There is no supervision by any manager on wellbeing of Godown)

- Intolerance to petty theft

Disregard to monitor / reduce risk of MAA

(E.g., Excess payment were not identified & responsible people were not reprimanded)

(From Employee Side)

- Changes in behaviour or lifestyle

E.g. Rolex watch of 50k and his salary is 10k)

➢ **Rationalization: -**

(From Employee Side)

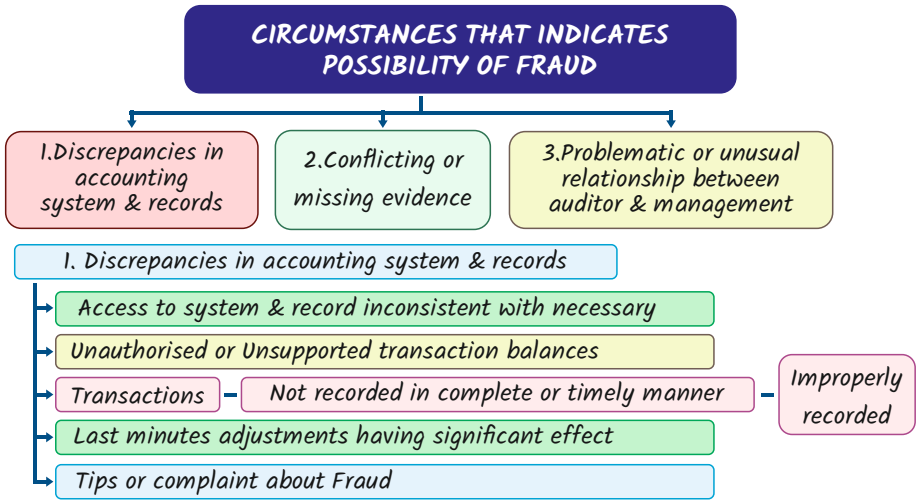
- Behaviour indicating displeasure / dissatisfaction

(E.g., Other department gets more bonus than us)

- Adverse relationship between entity & employees (Anticipated / known layoffs or change in compensation or promotion etc.)"

(CNO--SA240.080) EXAMPLES OF CIRCUMSTANCES THAT INDICATE THE POSSIBILITY OF FRAUD

Chart



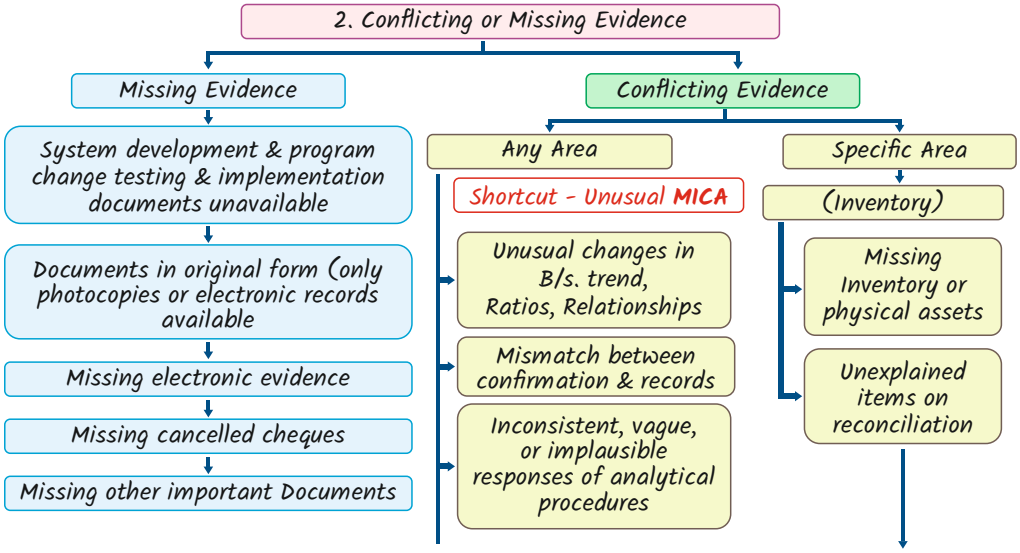
Examples of circumstances that indicate the possibility of fraud: The following are examples of circumstances that may indicate the possibility that the financial statements may contain a material misstatement resulting from fraud.

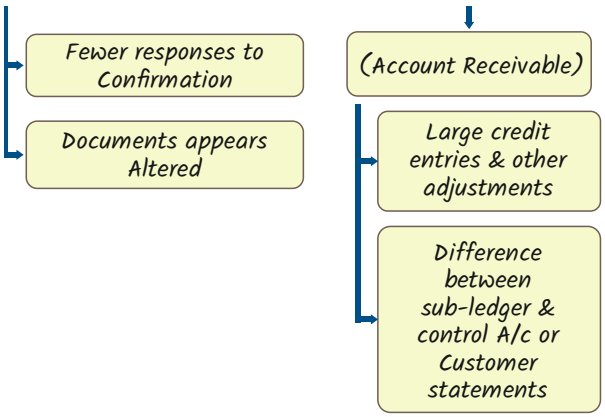
Discrepancies in the accounting records, including:

(System Access / Transactions Recording / Unsupported or Unauthorised / Last Minute Adjustments / Complaints)

- Evidence of employees' **access to systems and records inconsistent with that necessary** to perform their authorized duties.
  - (E.g., entries during odd time, post 9 PM or pre 9 AM)
- Transactions that are **not recorded in a complete or timely manner or are improperly recorded** as to amount, accounting period, classification, or entity policy.
  - (E.g., Some customer details such as PAN number, Addressee not recorded, interest on working capital loan capitalised)
- **Unsupported or unauthorized balances or transactions.**
  - (E.g., Office expenses debited as production expenses, transactions from username which was not authorised)
- **Last-minute adjustments** that significantly affect financial results.
  - (E.g., Adjustment to percentage completion of WIP)
- **Tips or complaints to the auditor** about alleged fraud.
  - (E.g., Chits in suggestion box alleging fraud)

Conflicting or missing evidence, including:

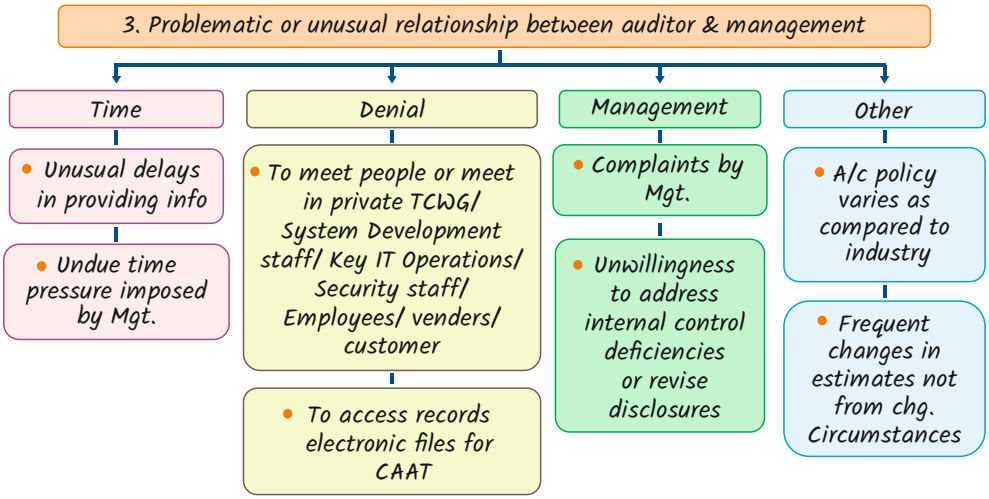




- ***Missing Evidence***
  - *Inability to produce evidence of key* ***systems development and program change testing and implementation*** *activities for current-year system changes and deployments.*
    - *(E.g., Inadequate justification for change in sales software)*
  - ***Unavailability of other than photocopied or electronically transmitted documents when documents*** *in original form are expected to exist.*
    - *(E.g., Transport bill is available in Xerox)*
  - *Unavailable or* ***missing electronic evidence,*** *inconsistent with the entity's record retention practices or policies.*
    - *(E.g., Customer tax registration numbers missing)*
  - *Missing or non-existent cancelled cheques in circumstances where cancelled cheques are ordinarily returned to the entity with the bank statement.*
  - ***Missing documents.***
    - *(E.g., Transport agreement missing)*
- ***Conflicting Evidence***
  - ***Unusual balance sheet changes or changes in trends or important financial statement ratios*** *or relationships,*
    - *(E.g., receivables growing faster than revenues.)*
  - ***Inconsistent, vague, or implausible responses from management or employees*** *arising from inquiries or analytical procedures.*
    - *(E.g., Management unable to explain rapid growth in receivables)*
  - *Fewer responses to confirmations than anticipated or a greater number of responses than anticipated.*
  - ***Unusual discrepancies*** *between the* ***entity's records and confirmation replies.***
  - *Documents that appear to have been* ***altered.***
    - *(E.g., Some customer orders have different format)*
- ***Conflicting Evidence (Inventory)***
  - *Missing inventory or physical assets of significant magnitude.*
  - *Significant unexplained items on reconciliations.*
    - *(E.g., Reconciliation of actual to system stock has long outstanding sales return & GIT)*

- **Conflicting Evidence (Accounts Receivable)**
  - Large numbers of credit entries and other adjustments made to **accounts receivable records.**
    (E.g., Many discounts, rebates etc in dealer schemes)
  - Unexplained or inadequately explained differences between the accounts receivable subledger and the control account, or between the customer statements and the accounts receivable sub-ledger.

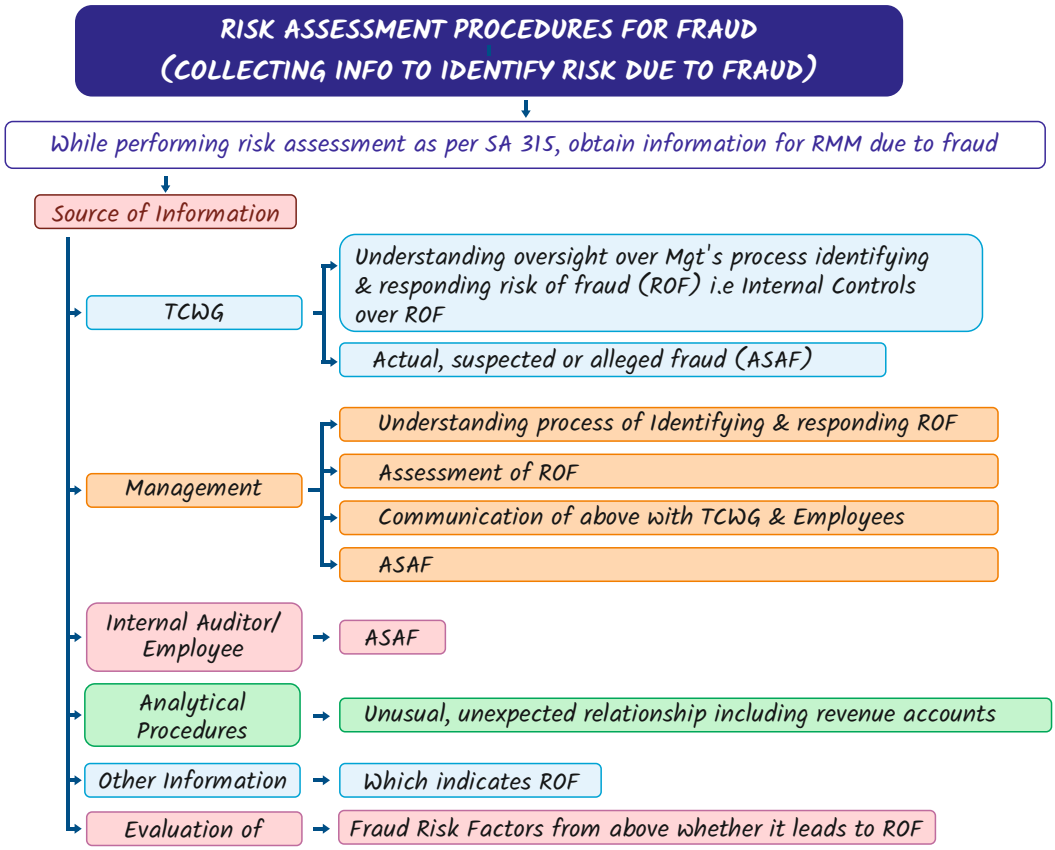
Problematic or unusual relationships between the auditor and management, including:



- **Time**
  - **Undue time pressures** imposed by management to resolve complex or contentious issues.
  - **Unusual delays** by the entity in providing requested information.
- **Denial**
  - **Denial of access to key IT operations staff and facilities,** including security, operations, and systems development personnel.
  - **Unwillingness by management** to permit the auditor to meet privately with **those charged with governance.**
  - **Denial of access** to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.
  - **Unwillingness to facilitate auditor access to key electronic files** for testing through the use of computer-assisted audit techniques.
- **Management**
  - **Complaints by management** about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.
  - **An unwillingness to add or revise disclosures in the financial statements** to make them more complete and understandable.
  - **An unwillingness to address identified deficiencies in internal control** on a timely basis.
- **Other**
  - Accounting policies that appear to be at **variance with industry norms.**
  - **Frequent changes in accounting estimates** that do not appear to result from changed circumstances.

(CNO--SA240.100) WHAT ARE RISK ASSESSMENT PROCEDURES FOR FRAUD? (QNO-12.000)

Chart



While performing risk assessment as per SA 315 obtain information for RMM due to fraud:- *When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, required by SA 315, the auditor* ***shall perform the procedures given in following paragraphs to obtain information for use in identifying the risks of material misstatement due to fraud.***

Inquiries of Management and Others within the Entity

Summary

Inquiry of Management – Process of Identifying & Responding ROF / Assessment of Fraud ROF / Communication with TCWG / Communication with employees.

Detailed Text

The auditor ***shall make inquiries of management*** *regarding:*

- *Management's* ***process for identifying and responding to the risks of fraud*** *in the entity, including* ***any specific risks of fraud that management has identified*** *or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a* ***risk of fraud is likely to exist;***
  - *(E.g., Management (MD/CFO/Executive Directors) determines chances of fraud in all departments in quarterly meeting with department heads and significant risks are discussed in detail along with how to compensate it through internal control system)*
- *Management's assessment of the* ***risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments;***
  - *(E.g., Sales targets are given excessive importance which puts loads of pressure on sales executive to achieve targets and get variable component which accounts for 80% of remuneration Hence daily sales monitoring report was prepared to supervise sales activity)*
- *Management's* ***communication, if any, to those charged with governance*** *regarding its processes for identifying and responding to the risks of fraud in the entity; and*
  - *(E.g., Management has sent a small presentation explaining situation to all board of directors)*

- *Management's* ***communication, if any, to employees*** *regarding its views on business practices and ethical behaviour.*
  - *(E.g., Management has issued advisory to all sales executive to stay away from manipulating sales in any way)*

Summary

Inquires with Management / Internal Auditors / Employees – actual, suspected or alleged fraud

Detailed Text

The auditor shall make inquiries of management, and others within the entity as appropriate, to determine whether ***they have knowledge of any actual, suspected or alleged fraud affecting the entity.***

- *(E.g., There can be fraud in Sales from Baddi Plant in Himachal Pradesh as there is unanticipated increase of 70% in past 6 months)*

For those entities that have an ***internal audit function,*** *the auditor shall make inquiries of internal audit to determine whether it has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.*

- *(E.g. Internal auditor explained that this increase is after 3 new appointments were made in sales team)*

Those Charged with Governance

Summary

Oversight of TCWG over Management & Internal Controls of Management over ROF

Detailed Text

Unless all of those charged with governance are involved in managing the entity, the auditor shall obtain an understanding of how those charged with governance ***exercise oversight of management's processes for identifying and responding to the risks of fraud*** *in the entity and the* ***internal control that management has established to mitigate these risks.***

- *(E.g., BOD reviews significant fraud risks and their internal control systems semi-annually)*

Summary

Inquires with TCWG --- actual, suspected or alleged fraud

Detailed Text

The auditor shall make inquiries of those charged with governance to determine whether they ***have knowledge of any actual, suspected or alleged fraud affecting the entity****. These inquiries are made in part to corroborate the responses to the inquiries of management.*

- *(E.g., They said they feel out of 3 products (A, B, C) at Baddi plant, there is suspicion in sale of product C)*

Unusual or Unexpected Relationsh-ips Identified

The auditor shall evaluate whether ***unusual or unexpected relationships that have been identified in performing analytical procedures****, including those related to revenue accounts, may indicate risks of material misstatement due to fraud.*

- *(E.g., Recent increase in sale at Baddi plant is from sales to only 5 customers and they are new registered few months back)*

Other Information

The auditor shall consider whether ***other information obtained*** *by the auditor indicates risks of material misstatement due to fraud.*

- *(E.g., Experience of previous assignments / similar assignments / review assignments)*
- *(E.g., In one of the similar companies in same industry where we provide consultancy services recently police complaint was filed for selling goods to fake clients and defaulting money receivable)*

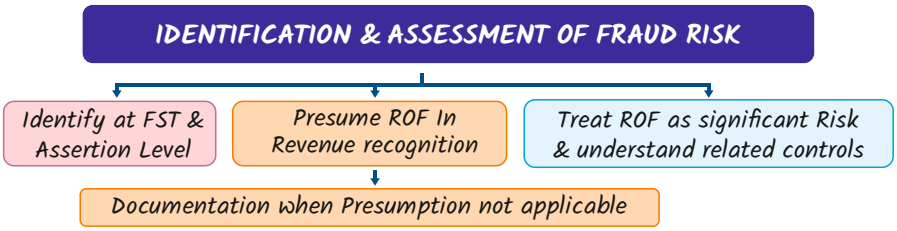
Evaluation of Fraud Risk Factors

The auditor shall evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicates that ***one or more fraud risk factors are present. While fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud.***

(CNO--SA240.120) IDENTIFICATION &ASSESSMENT OF FRAUD RISK? & FRAUD RISK IN REVENUE RECOGNITION?

Chart

QNO-11.500



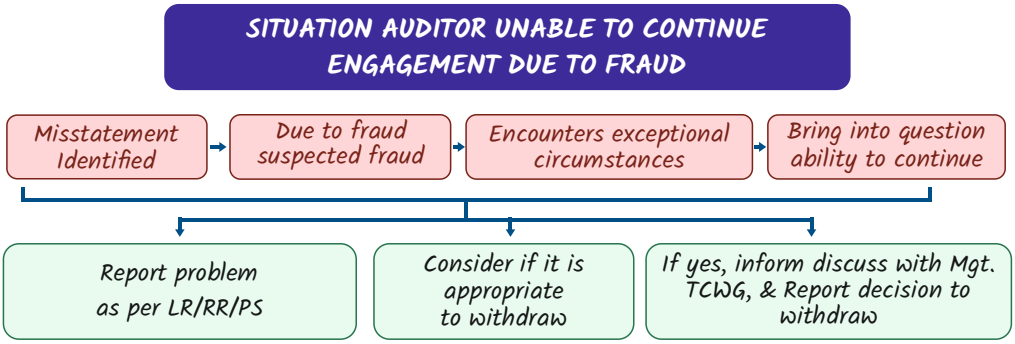
In accordance with SA 315, the auditor shall identify and assess the risks of material misstatement due to fraud ***at the financial statement level, and at the assertion level*** *for classes of transactions, account balances and disclosures.*

When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, ***based on a presumption that there are risks of fraud in revenue recognition,*** *evaluate which types of revenue, revenue transactions or assertions give rise to such risks.* ***Documentation required when the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud.***

The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks *and accordingly, to the extent not already done so, the auditor shall obtain an understanding of the entity's related controls, including control activities, relevant to such risks.*

(CNO--SA240.140) SITUATION WHEN AUDITOR IS UNABLE TO CONTINUE ENGAGEMENT DUE TO FRAUD?

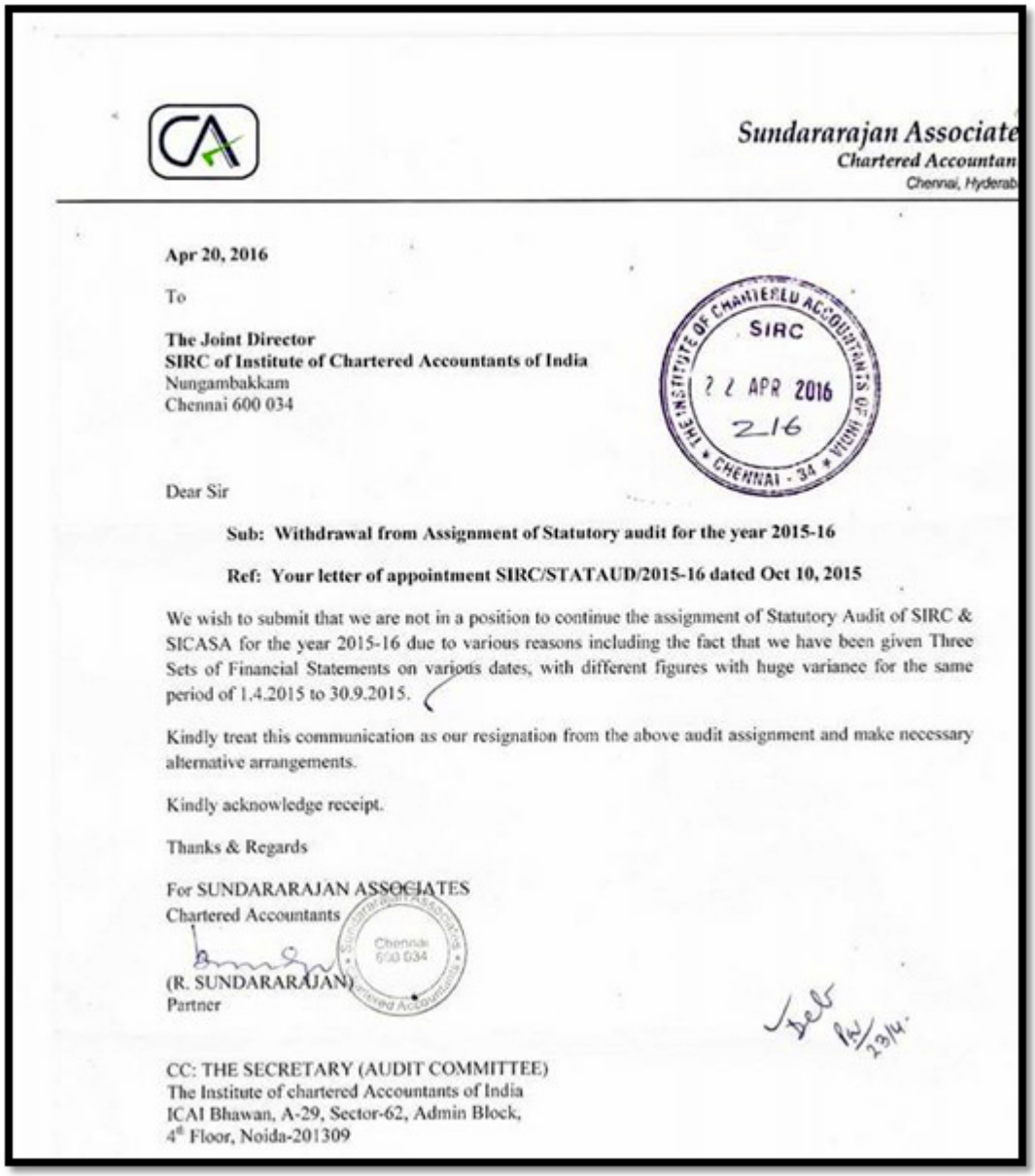
Chart



Exceptional Circumstances (MCQ-240.1 / Incs.38.1)

If, as a result of a ***misstatement resulting from fraud or suspected fraud,*** *the auditor encounters* ***exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:***

- *Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a* ***requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;*** *[E.g., Sec 143(12)]*
- *Consider whether* ***it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted;*** *and*
- *If the auditor withdraws:*
  - ***Discuss with the appropriate level of management and those charged with governance,*** *the auditor's withdrawal from the engagement and the reasons for the withdrawal; and* ***Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.***



Sundararajan Associate
Chartered Accountan
Chennai, Hyderab

Apr 20, 2016

To

The Joint Director
SIRC of Institute of Chartered Accountants of India
Nungambakkam
Chennai 600 034

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA SIRC 21 APR 2016 216 CHENNAI - 34

Dear Sir

Sub: Withdrawal from Assignment of Statutory audit for the year 2015-16

Ref: Your letter of appointment SIRC/STATAUD/2015-16 dated Oct 10, 2015

We wish to submit that we are not in a position to continue the assignment of Statutory Audit of SIRC & SICASA for the year 2015-16 due to various reasons including the fact that we have been given Three Sets of Financial Statements on various dates, with different figures with huge variance for the same period of 1.4.2015 to 30.9.2015.

Kindly treat this communication as our resignation from the above audit assignment and make necessary alternative arrangements.

Kindly acknowledge receipt.

Thanks & Regards

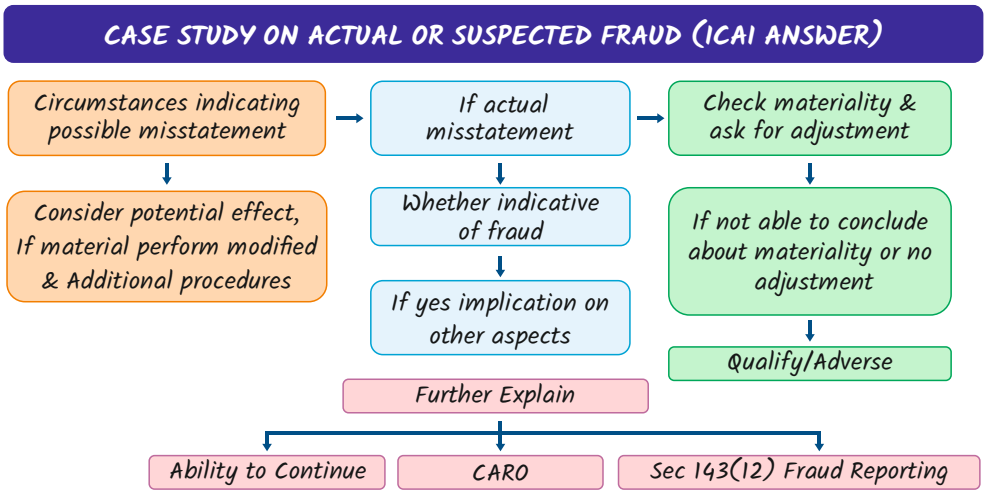
For SUNDARARAJAN ASSOCIATES
Chartered Accountants

(R. SUNDARARAJAN)
Partner

CC: THE SECRETARY (AUDIT COMMITTEE)
The Institute of chartered Accountants of India
ICAI Bhawan, A-29, Sector-62, Admin Block,
4th Floor, Noida-201309

(CNO--SA240.140) CASE STUDY ON ACTUAL OR SUSPECTED FRAUD

Chart



UNIQUE MCQS	
MCQ No.	240.2 / 240.3

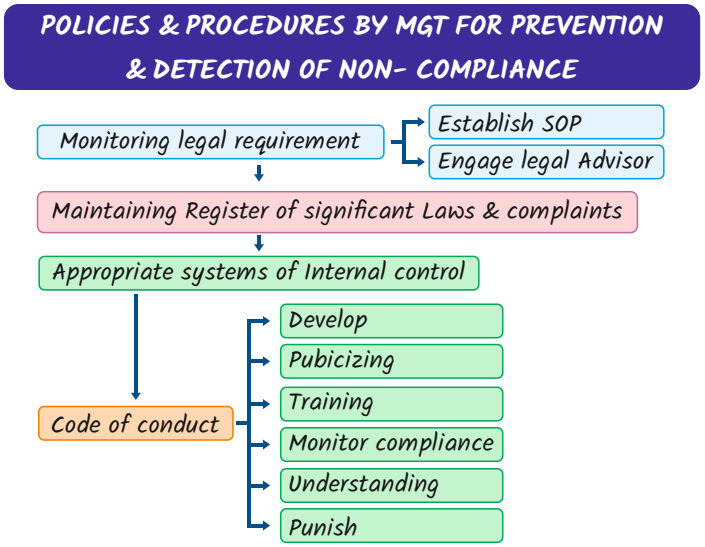
UNIQUE QUESTIONS		
QN013.0	Responsibility in Management Fraud	
QNO 14.0	Error in Valuation of Inventory ()	ONE COMMON ANSWER FOR ALL THESE QUESTIONS
QNO 15.0	Difference in Control Accounts	
QN016.0	IOU	
QN017.0	No Documentary or Other Evidence	
QN018.0	Special Audit Report Not Provided	
QN020.0	Teeming & Lading	

Students Notes

[SA 250] CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS

(CNO--SA250.010) POLICIES AND PROCEDURES BY MANAGEMENT FOR PREVENTION AND DETECTION OF NON-COMPLIANCE (QNO-23.500)

Discussion



As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", The following are examples of the types of policies and procedures entity may implement to assist in the prevention and detection of non-compliance with laws and regulations:

i. Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.

ii. Instituting and operating appropriate systems of internal control.

iii. Developing, publicizing and following a code of conduct.

iv. Ensuring employees are properly trained and understand the code of conduct

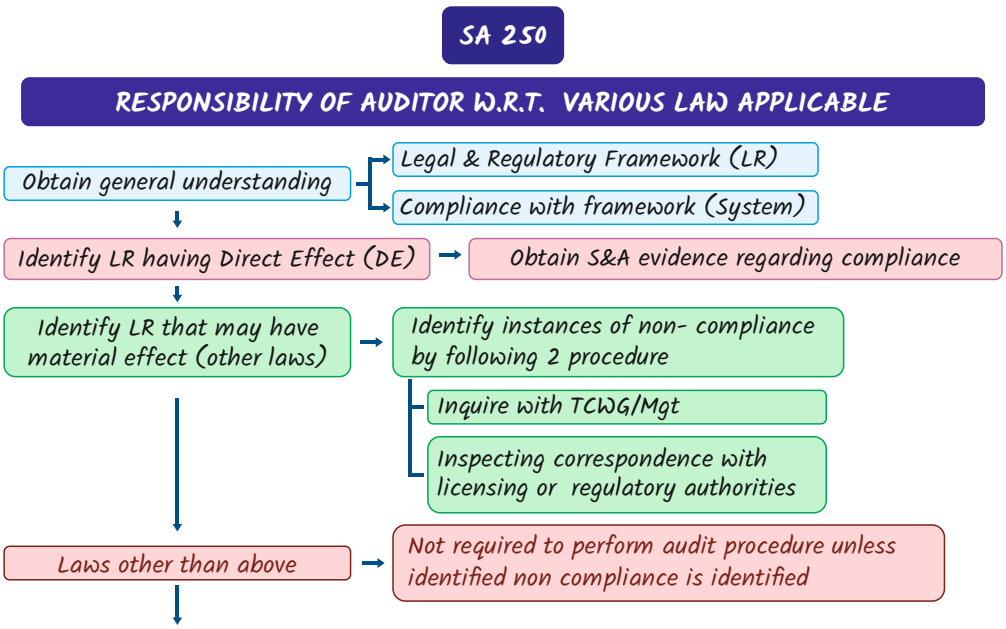
v. Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.

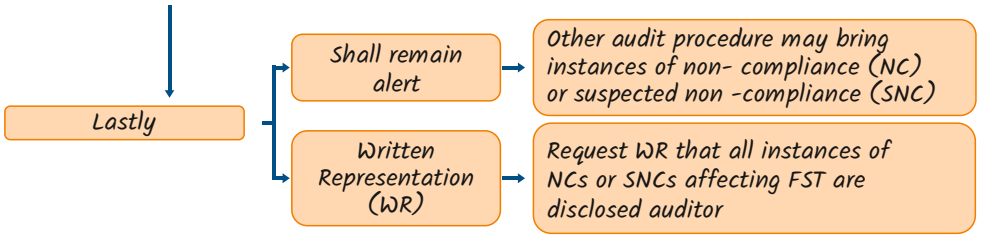
vi. Engaging legal advisors to assist in monitoring legal requirements.

vii. Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

(CNO--SA250.020) WHAT IS RESPONSIBILITY OF AUDITOR WITH RESPECT TO VARIOUS LAWS APPLICABLE TO AN ENTITY? / IS AUDITOR SUPPOSED TO CHECK COMPLIANCE OF EACH AND EVERY LAW (QNO-21.000)(MCQ-250.3)

Chart





General Understanding

As part of obtaining an understanding of the entity and its environment in accordance with SA 315, the auditor shall obtain a **general understanding of:**

- The **legal and regulatory framework applicable** to the entity and the industry or sector in which the entity operates; and(Banking Regulation Act / RBI Circulars etc)
- How the entity is **complying with that framework?**(Policies, Procedures, Registers, monitoring etc as studied above)

Direct Effect

The auditor shall obtain sufficient appropriate audit evidence regarding **compliance** with the provisions of those laws and regulations **generally recognised to have a direct effect** on the determination of material amounts and disclosures in the financial statements.

(E.g., Banking Act, IRDA Regulations, Sch II, Sch III / Sections of Company Act for loans, investments, expenses etc / Income Tax Act/ Payment of Gratuity / Payment of Bonus etc: - Sit with detailed checklist of laws and check through inquiry, observation & inspection whether compliance is done)

Other Laws (May have Material Effect)

The auditor shall perform the following audit procedures to help identify **instances of non-compliance** with **other laws and regulations that may have a material effect** on the financial statements:
(E.g., Factory Act, Industrial Dispute Act, Environment Act etc)

- **Inquiring of management and, where appropriate, those charged with governance,** as to whether the
- entity is in compliance with such laws and regulations; and
  Inspecting correspondence, if any, with the relevant licensing or regulatory authorities.
  (E.g., Letters etc exchanged with ministry, collector office, trade unions etc)

Laws other than discussed above

In the absence of identified or suspected non-compliance, the auditor is not required to perform audit procedures regarding the entity's compliance with laws and regulations, other than those set out in above paragraphs.

(E.g., Prevention of Terrorism Act / Defence Act etc)

Alert

During the audit, the auditor shall remain **alert** to the possibility that **other audit procedures** applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention.

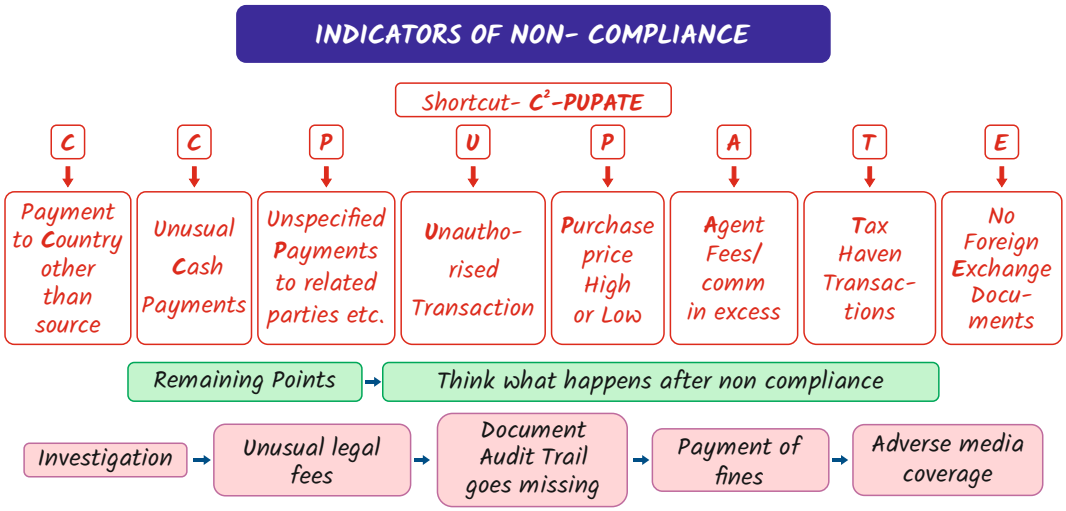
(E.g., Procedures which are generally performed for other audit aspect can also tell you more about non-compliance for example correspondence with previous auditor, reading board minutes, meeting with internal & external legal counsel under SA 501, Substantive checking of legal expenses etc)

Written Representation

The auditor shall request management and, where appropriate, those charged with governance to provide **written representations** that all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor.

(CNO--SA250.040) INDICATORS OF NON-COMPLIANCE? (QNO- 22.000) (MCQ – 250.2)

Chart



Could be non-compliance (C²-PUPATE) (QNO-22.000)

When the auditor becomes aware of the existence of, or information about, the following matters, it may be an indication of non-compliance with laws and regulations:

- Payments for goods or services made other than to the Country from which the goods or services originated.
  - (E.g., Non-Compliance of Customs Act)
- Unusual Payments in Cash purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.
  - (E.g., May be bribe)
- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
  - (E.g., Non-Compliance of Company Act)
- Unauthorised transactions or improperly recorded transactions. (Secret payments against law
  - (E.g., No approval as per company law etc)
- Purchasing at Prices significantly above or below market price.
  - (E.g., Non-Compliance of Income Tax Act)
- Sales commissions or Agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
  - (E.g., Non-compliance of IRDA Regulations etc)
- Unusual Transactions with companies registered in Tax havens.
  - (E.g., Non-Compliance of Income Tax Act)
- Payments without proper Exchange control documentation.
  - (E.g., Non-Compliance of FEMA)

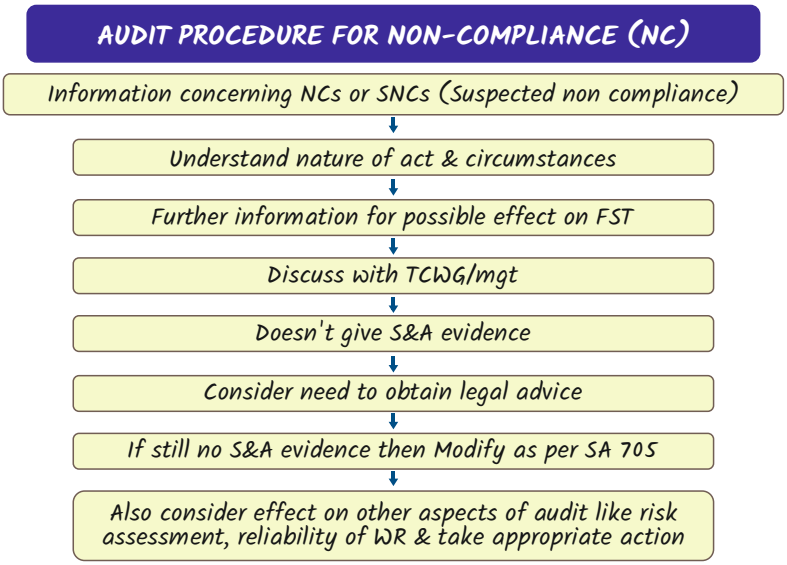
Post non-compliance matters

- Investigations by regulatory organisations and government departments or **payment of fines or penalties.**
- Unusual payments towards **legal and retainer ship fees.**
- Existence of an information system which **fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.**
- **Adverse media comment.**

(CNO--SA250.060) WHAT AUDIT PROCEDURES SHOULD BE PERFORMED IF THERE IS NON-COMPLIANCE?

(QNO-23.000, 23.050)(MCQ -Incs.08.4)

Chart



- ***Information concerning instances of non-compliances or suspected non-compliance Auditor should understand Nature of act & circum stances Possible effect on financial statement***
  If the auditor becomes aware of information concerning an instance of noncompliance or suspected non-compliance with laws and regulations, the auditor shall obtain: (Children working in factory premises, could be contravention of child labour act)
  - *An understanding of the **nature of the act and the circumstances** in which it has occurred (25 children were working in packing department under supervision of contractor without identity card & age proof); and*
  - *Further information to evaluate the **possible effect on the financial statements.** (Go through law, amendments, rule to determine penalty, impact on production license etc.)*

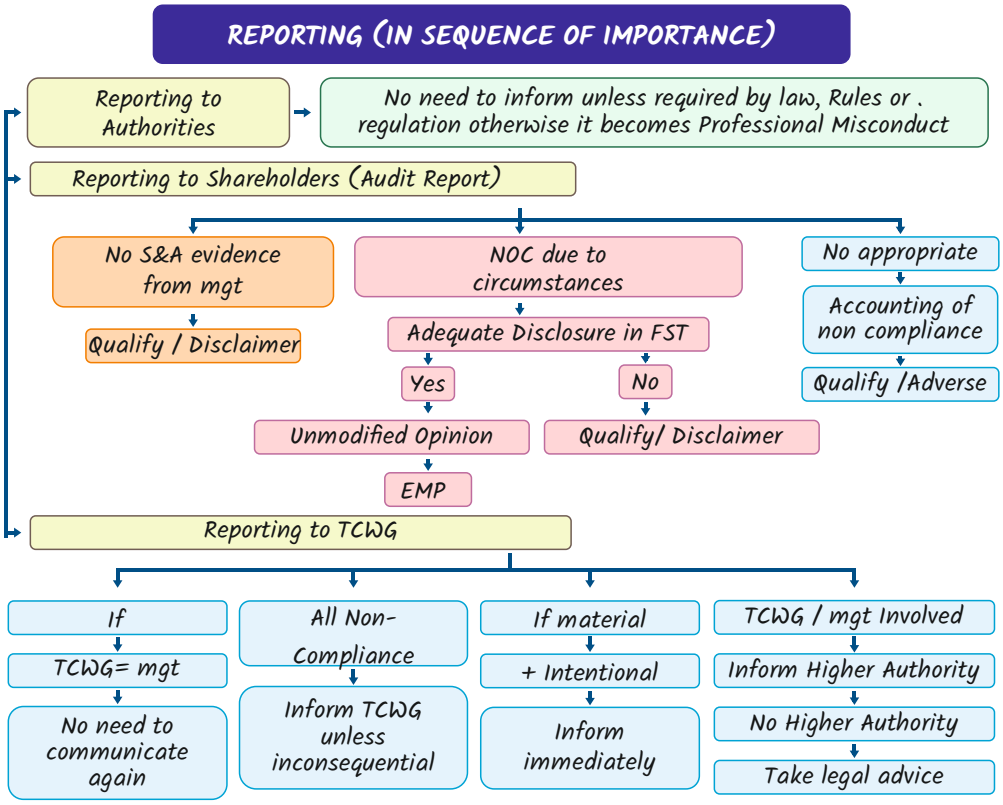
- ***Discuss with management → if not satisfied obtain legal advice***
  *If the auditor suspects there may be non-compliance, the auditor **shall discuss the matter with management and, where appropriate, those charged with governance.** If management or, as appropriate, those charged with governance **do not provide sufficient information that supports that the entity is in compliance with laws and regulations** and, in the auditor's judgment, the effect of the Suspected non-compliance may be material to the financial statements, **the auditor shall consider the need to obtain legal advice.** (Discuss with management if required obtain legal advice E.g. VODAFONE case).*

- ***If still not able obtain sufficient & appropriate evidence → Modify as per SA 705***
  *If sufficient information about suspected non-compliance **cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.** (Modify Opinion)*

- ***Impact on other areas***
  *The auditor shall evaluate the **implications of non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations, and take appropriate action.** (MD / CFO both were aware & they also gave in writing there are no child labour in firecracker factory, affects reliability of WR)*

(CNO--SA250.080) REPORTING OF NON-COMPLIANCE? (QNO-23.100, 23.500) (Incs.03.3)

Chart



Reporting Non-Compliance to Regulatory and Enforce-ment Authorities

If the auditor has identified or suspects non-compliance with laws and regulations, the auditor shall determine **whether the auditor has a responsibility to report the identified or suspected non-compliance to parties outside the entity.**

(No need to inform any authority unless required by law, in India there are few such laws E.g., Fraud Reporting by Auditor U/S 143(12) / FIR for fraud as per Maharashtra State Co-Operative Act)

Reporting Non-Comp-liance in the Auditor's Report on the Financial Statements

- **When to give Qualified / Adverse**

  If the auditor concludes that the non-compliance has a **material effect on the financial statements and has not been adequately reflected** in the financial statements, the auditor shall, in accordance with SA 705, **express a qualified or adverse opinion on the financial statements.**

  (E.g., Solvency level (assets-liabilities) not maintained by Insurance company which affects going concern, management has not taken any effect, give qualify or adverse opinion)

- **When to give Qualified / Disclaimer**

  If the auditor is **precluded by management or those charged with governance** from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statements has, or is likely to have, occurred, the auditor shall express a **qualified opinion or disclaim** an opinion on the financial statements on the basis of a limitation on the scope of the audit in accordance with SA 705.

  (E.g., Management not giving adequate information about asset & liability valuation and compliance with solvency margin, qualify or disclaimer)

- **What to do if limitation imposed by the circumstances?**

  If the auditor is **unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances** rather than by management or those charged with governance, the auditor shall **evaluate the effect on the auditor's opinion in accordance with SA 705.**

(Because of natural calamity it is not possible to determine solvency margin, if no appropriate disclosure in notes to accounts, may Qualify or Disclaimer, if there is proper disclosure then Clean + EMP)

Reporting Non-Compliance to Those Charged with Governance (QNO-23, 100)

- **Unless TCWG = Management, All Non-Compliances unless inconsequential**
  Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving identified or suspected on-compliance already communicated by the auditor, the auditor **shall communicate with those charged with governance matters involving noncompliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential**
  (E.g., Company failed to transfer unpaid dividend account to investor education & protection fund inform TCWG about it in monthly communication)

- If intentional and material – ASAP
  If, in the auditor's judgment, the non-compliance referred to in above is believed to be **intentional and material,** the auditor shall **communicate the matter to those charged with governance as soon as practicable.**
  (If such amount is big & intentionally done inform TCWG immediately through email or call)

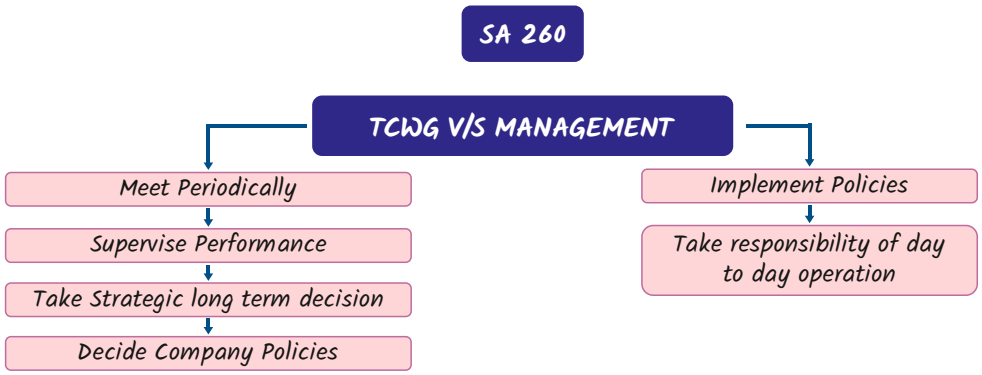
- **What if Management or TCWG is involved?**
  If the auditor suspects that **management or those charged with governance are involved** in non-compliance, the auditor shall communicate the matter **to the next higher level of authority at the entity, if it exists, such as an audit committee or supervisory board.** Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, **the auditor shall consider the need to obtain legal advice.**
  (If MD & audit committee members are involved then no need to inform them and take legal advice what can be done, may be speak at AGM)

UNIQUE MCQS	
MCQ No.	250.1

[SA 260] COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

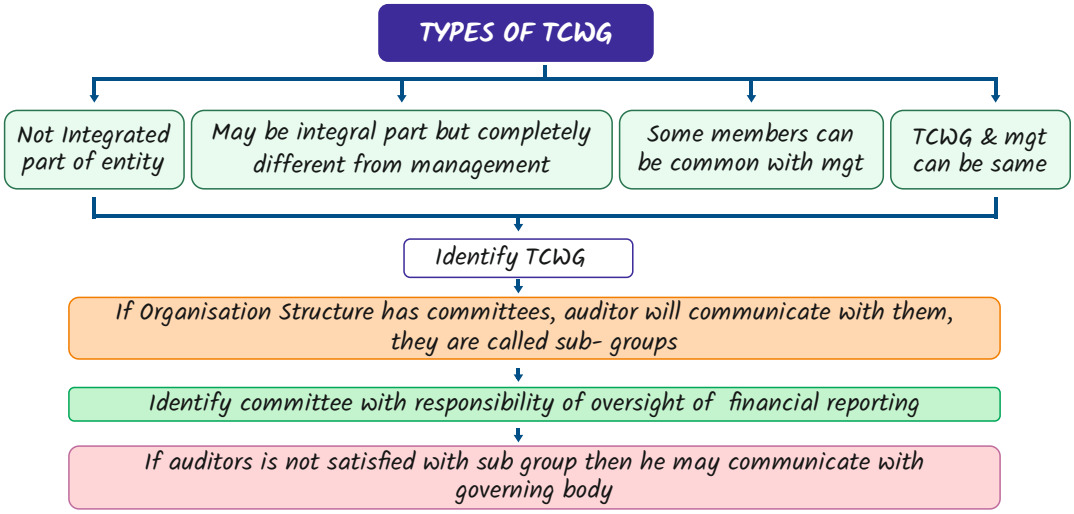
(CNO--SA260.020) HOW TO IDENTIFY TCWG?

Chart



- TCWG is group of people who meet periodically to supervise overview current management's performance, take strategic long-term decisions and decide company's policies. This includes overseeing the financial reporting process.
- Management is a group of people who are involved and take responsibility of day to day operations of the company.
- TCWG may be not be integral part of entity. (See table given below)
- TCWG may be integral part of entity.
- Members of TCWG may be completely different from management.
- In some cases, TCWG members may be different
- In some case all TCWG & management members may be same.

Chart

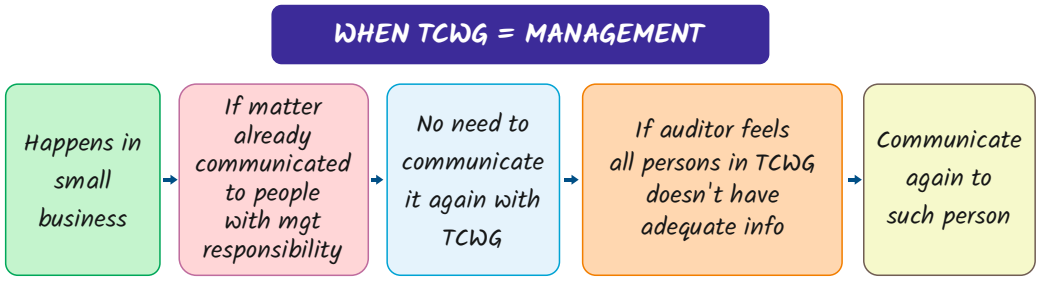


Entity	Management	TCWG	Remarks
Government Entity like ISRO	Directors appointed by central government.	Concerned Ministry	Here TCWG is not legal part of company.
Company	CEO & CFO (They are not directors)	Board of Directors	Here TCWG is integral part of entity but none of the members are common.
Co-Operative Society	Chairman + Secretary	Governing Body (Which includes Chairman & Secretary)	So some members in management are common
Partnership Firm	Partners	Partners	Here TCWG & Management are same

- The auditor **shall determine the appropriate person**(s) within the entity's governance structure with whom to communicate.
- If their governance structure includes committees, auditor may communicate to committees instead of Board of Directors. Such committees are called Sub-Groups.
  He must identify appropriate committee which is responsible for overseeing financial reporting, which is generally audit committee.
  (Generally, communication is done to Audit Committee, sometimes he may have to communicate to remuneration committee etc for matters relevant to them.)
- If auditor is not satisfied with response of sub group or he feels it is appropriate, he may communicate to governing body also.

(CNO--SA260.040) WHEN ALL OF THOSE CHARGED WITH GOVERNANCE ARE INVOLVED IN MANAGING THE ENTITY.

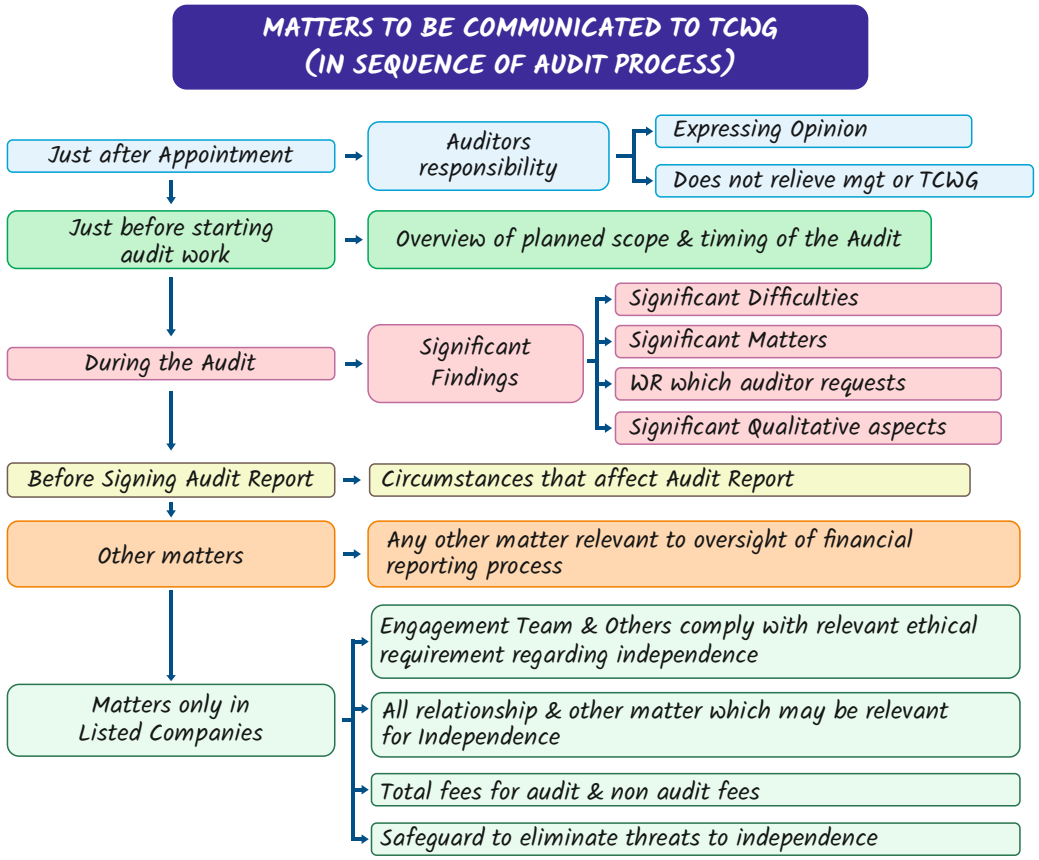
Chart



In some cases, all of those charged with governance are involved in managing the entity, for example, a small business where a single owner manages the entity and no one else has a governance role. In these cases, if matters required by this SA are communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the **matters need not be communicated** again with those same person(s) in their governance role. **The auditor shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity.**(Such as Significant Matters & WR).

(CNO--SA260.060) MATTERS TO BE COMMUNICATED TO TCWG? (QNO-24.000)

Chart



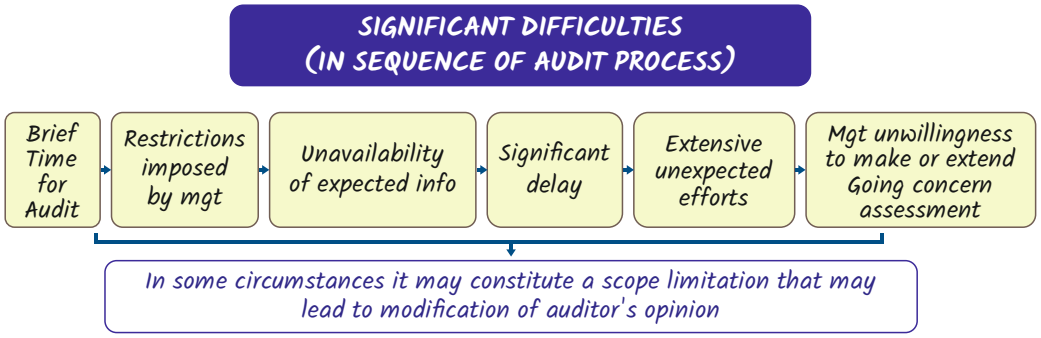
Just After Appointment	➢ ***The Auditor's Responsibilities in Relation to the Financial Statement Audit*** *The auditor **shall communicate** with those charged with governance the **responsibilities of the auditor** in relation to the financial statement audit, including that:* ▪ *The auditor is **responsible for forming and expressing an opinion** on the financial statements that have been prepared by management with the oversight of those charged with governance; and* ▪ *The audit of the financial statements **does not relieve management or those charged with governance** of their responsibilities.*
Just before starting Audit work	➢ ***Planned Scope and Timing of the Audit*** *The auditor shall communicate with those charged with governance an **overview of the planned scope and timing** of the audit, which includes communicating about the significant risks identified by the auditor.*
During the Audit	➢ ***Significant Findings from the Audit*** *The auditor shall communicate with those charged with governance. Unless all of those charged with governance are involved in managing the entity:-* ▪ ***Significant difficulties,** if any, encountered during the audit;* ▪ ***Significant matters** arising during the audit that were discussed, or subject to correspondence, with management; and* ▪ ***Written representations** the auditor is requesting;* ▪ *The auditor's views about **significant qualitative aspects** of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.* *(E.g. Whether Accounting Policies Are Conservative or Aggressive, Are they in line with industry practices etc)* ▪ *When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;* *(SLM & WDV are acceptable & popular in FRF but machine hour method of depreciation is more appropriate);*
Before signing audit report	*Circumstances that affect the form and content of the auditor's report, if any; and* *(Key Audit Matters under SA 701 / Modifications Under SA 705 / EMP or OMP under SA 706)*
Others	➢ *Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process.* *(E.g. Safety & Security of financial data)*
Only in Listed Companies	➢ *Auditor Independence* *In the case of **listed entities,** the auditor **shall communicate** with those charged with governance:* ▪ *A statement that the **engagement team and others in the firm** as appropriate, the firm and, when applicable, network firms have **complied with relevant ethical requirements regarding independence;** and* ▪ ***All relationships and other matters** between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This **shall include total fees charged** during the period covered by the financial statements for **audit and non-audit services** provided by the firm and network firms to the entity and components controlled by the entity. These **fees shall be allocated***

to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor; and

- The **related safeguards that have been applied** to eliminate identified threats to independence or reduce them to an acceptable level.

(CNO--SA260.080) SHORT NOTE ON SIGNIFICANT DIFFICULTIES TO BE COMMUNICATED TO TCWG (QNO-24.050)

Chart

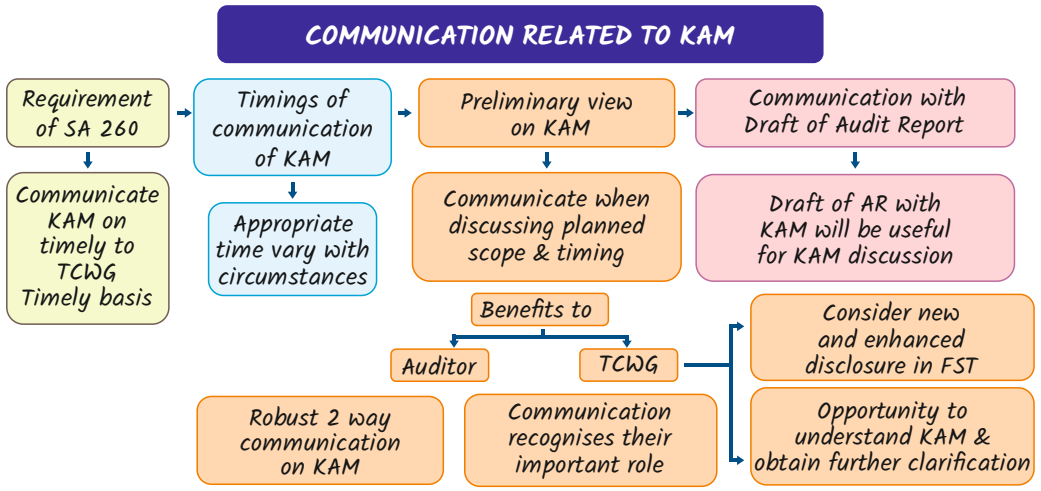


Significant difficulties, if any, encountered during the audit;

Text	Examples
An unnecessarily **brief time** within which to complete the audit.	(Only 1 week given to finish work at client's premises with availability of client staff)
Restrictions imposed on the auditor by management.	(Cannot visit factory & godown)
The **unavailability** of expected information.	(list of debtors & inventory is not available instead hardcopy of register is given)
Significant delays in management providing required information.	(information being provided after 3 weeks)
Extensive unexpected effort required to obtain sufficient appropriate audit evidence.	(to get voucher audit team member has to walk a 2 km, reach go down and search out of 10,000 files)
Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested	(Even that bank balance has reduced to zero, OD limit is exhausted not ready to prepare documents such as future cash to assess going concern)

(CNO--SA260.100) COMMUNICAITON RELATED TO KEY AUDIT MATTERS (QNO-24.100)

Chart



Requirement of SA 260

SA 260 (Revised) requires the auditor to communicate with those charged with governance on a timely basis.

Timings of Communication of KAM

The appropriate timing for communications about key audit matters will vary with the circumstances of the engagement.

Preliminary Views Commun-ication	However, the auditor may communicate **preliminary views** about key audit matters when discussing the **planned scope and timing** of the audit and may further discuss such matters when communicating **about audit findings.** ➢ **Robust Communication** Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time the financial statements are being finalized for issuance. ➢ **Opportunity to TCWG** Communication with those charged with governance enables them to be made aware of the key audit matters that the auditor intends to communicate in the auditor's report and provides them with an opportunity to obtain further clarification where necessary.
Draft of Auditor's Report	The auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate this discussion.
Conclusion	Communication with those charged with governance recognizes their important role in overseeing the financial reporting process and provides the opportunity for those charged with governance to understand the basis for the auditor's decisions in relation to key audit matters and how these matters will be described in the auditor's report. It also enables those charged with governance to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.

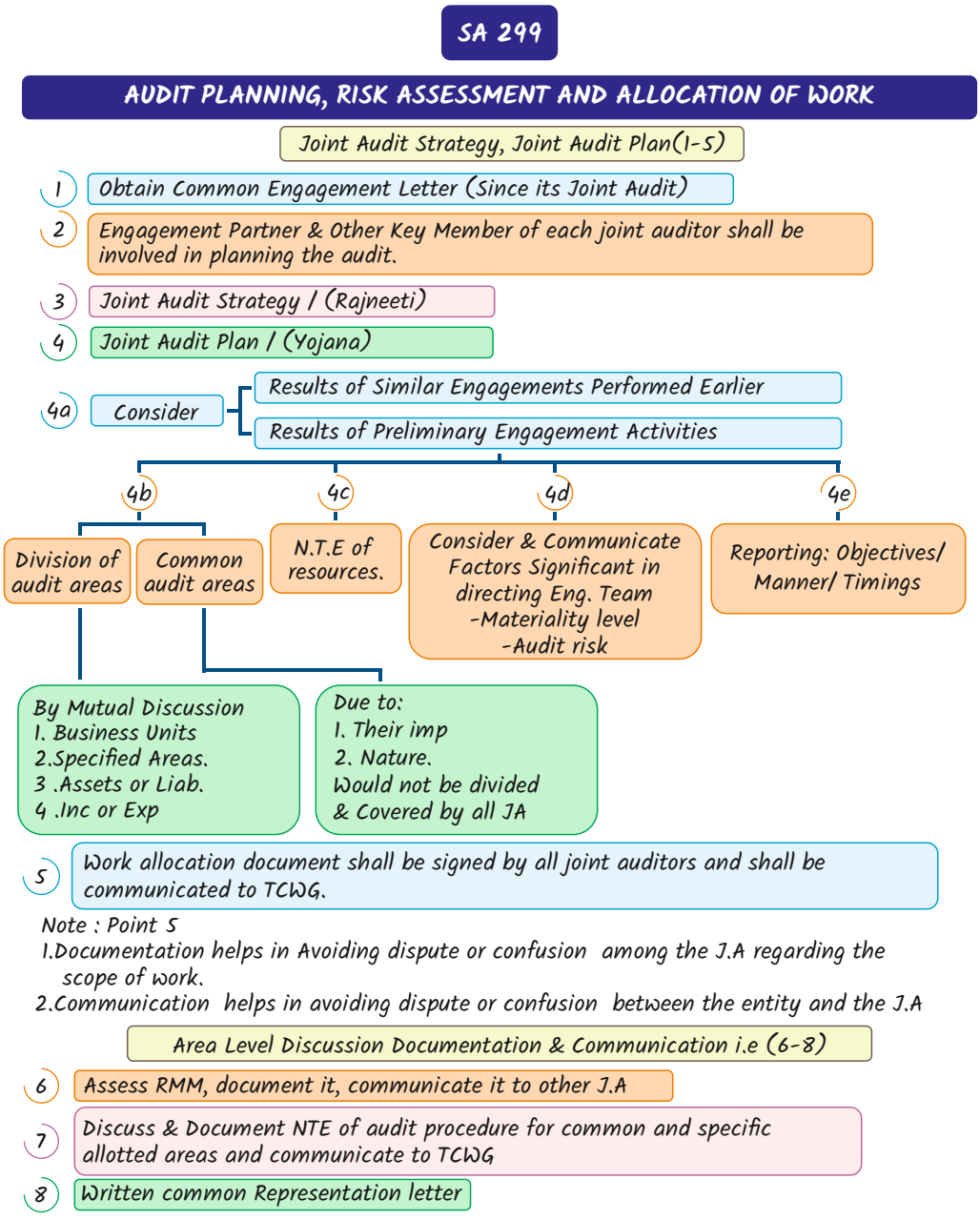
UNIQUE QUESTIONS	
QNO25.000	Communication to Shareholders Vs TCWG (Covered In SA 700)

UNIQUE MCQS	
MCQ No.	260.1

[SA 299] RESPONSIBILITY OF JOINT AUDITORS

(CNO--SA299.020) AUDIT PLANNING, RISK ASSESSMENT AND ALLOCATION OF WORK (QNO-27.100)

Chart



Details Text

1. The joint auditors **shall obtain common engagement letter.**
2. The **engagement partner and other key members** of the engagement team from **each of the joint auditors shall be involved in planning the audit.**
3. The joint auditors **shall jointly establish an overall audit strategy** that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.
4. Prior to the commencement of the audit, the joint auditors **shall discuss and develop a joint audit plan.** In developing the joint audit plan, the joint auditors shall:
   - Consider the **results of preliminary engagement activities** and, where applicable, whether knowledge gained on **other or similar engagements performed earlier by the respective engagement partner(s) for the entity is relevant.**
   - Identify **division of audit areas and common audit areas amongst the joint auditors** that define the scope of the work of each joint auditor;

- Ascertain the **nature, timing and extent of resources necessary** to perform the engagement.
- **Consider and communicate** among all joint auditors the **factors** that, in their professional judgment, are **significant in directing the engagement team's efforts;**
- Ascertain the **reporting objectives of the engagement** to plan the **timing of the audit and the nature of the communications** required;

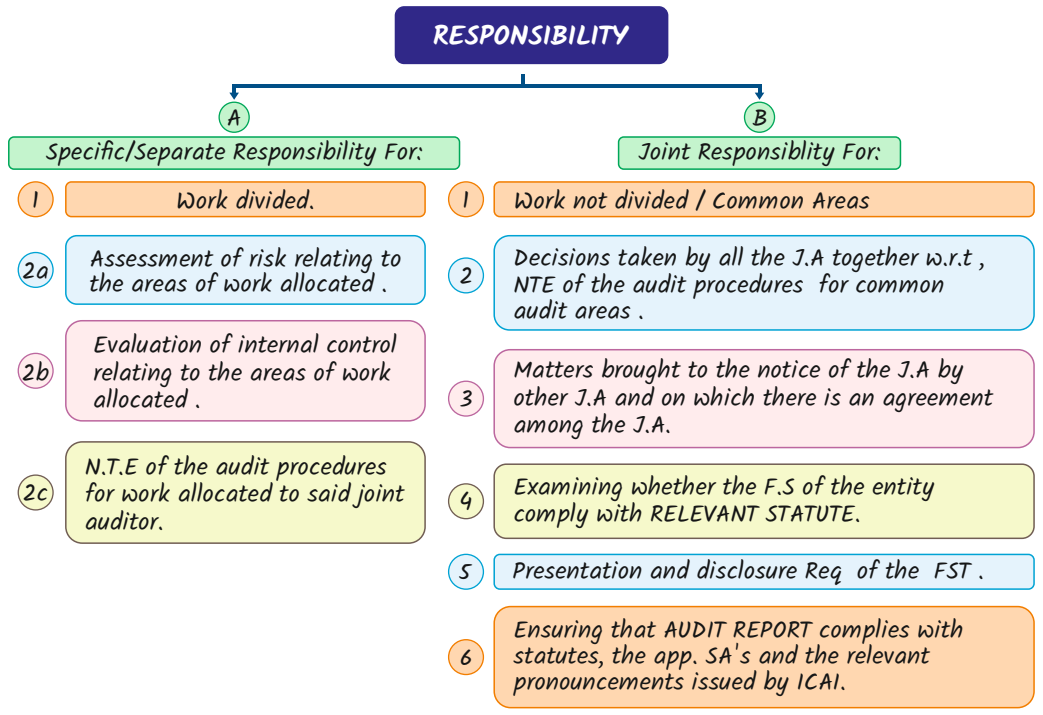
5. After identification and allocation of work among the joint auditors, **the work allocation document shall be signed by all the joint auditors and the same shall be communicated to those charged with governance of the entity.**(Ref: Note I Below)
6. At this stage, **risks of material misstatement need to be considered and assessed by each of the joint auditors** and shall be communicated to other joint auditors, and documented, **whether pertaining to the overall financial statements level or to the area of allocation among the other joint auditors.**
7. The joint auditors **shall discuss and document the nature, timing, and the extent of the audit procedures for common and specific allotted areas of audit to be performed** by each of the joint auditors and the same shall be communicated to those charged with governance.
8. The joint auditors **shall obtain common management representation letter.**

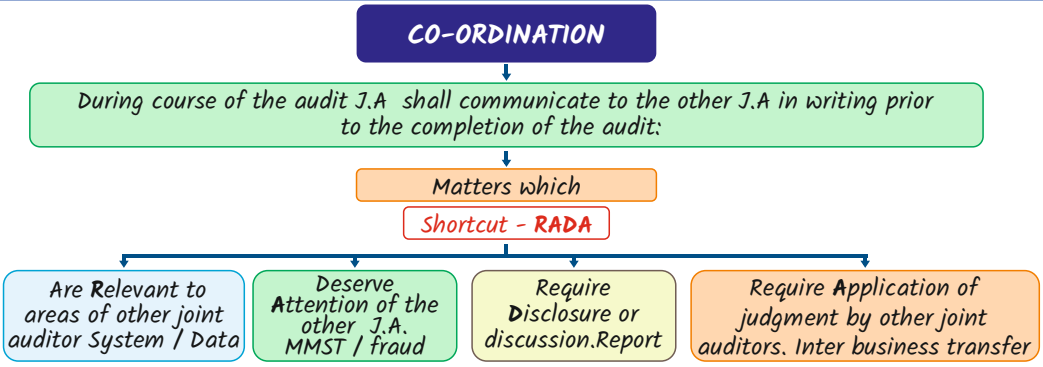
Note I: Ref Point 5 above: Include if Question is specifically asked on Documentation

The **documentation of allocation** of work **helps in avoiding any dispute or confusion** which may arise among the joint auditors regarding the scope of work to be carried out by them. **Further,** the **communication of allocation** of work to the entity **helps in avoiding any dispute or confusion** which may **arise between the entity and the joint auditors**

(CNO--SA299.040) RESPONSIBILITY AND CO-ORDINATION AMONG JOINT AUDITORS (QNO-28.100)

Chart





Part A . Specific Responsi-bilities

1. *In respect of audit* ***work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated*** *to such joint auditor including proper execution of the audit procedures.*

2a,2b,2c.

It shall be the ***responsibility of each joint auditor to determine the nature, timing and extent of audit procedures to be applied in relation to the areas of work allocated to said joint auditor.*** *It is the individual responsibility of each joint auditor to study and evaluate the prevailing system of internal control and assessment of risk relating to the areas of work allocated to said joint auditor.*

Part B. Joint Responsi-bilities

All the joint auditors ***shall be jointly and severally responsible for:***

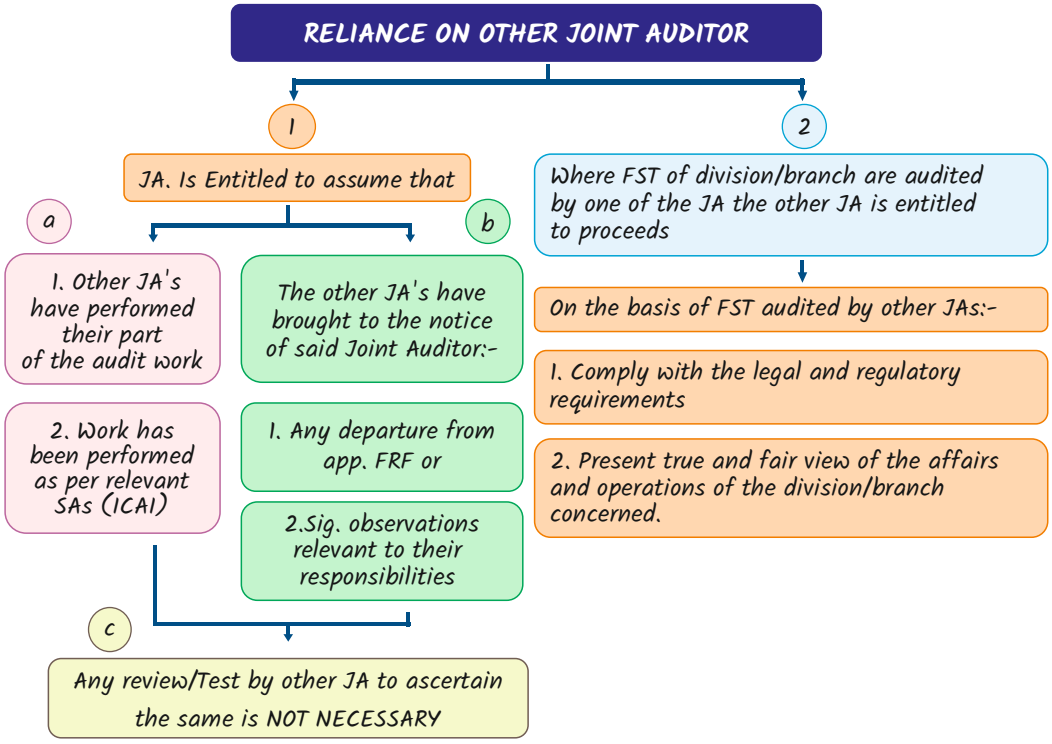
1. *The audit* ***work which is not divided*** *among the joint auditors and is carried out by all joint auditors;*
2. ***Decisions taken by all the joint auditors under audit planning*** *in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors.*
3. *Matters which are brought to the* ***notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;***
4. ***examining that the financial statements of the entity comply with the requirements*** *of the relevant statutes;*
5. ***Presentation and disclosure*** *of the financial statements as required by the applicable financial reporting framework;*
6. *Ensuring that the* ***audit report complies with the requirements*** *of the relevant statutes, the*

Co-ordination

Where, in the course of the audit, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by other joint auditors, the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

(CNO--SA299.060) RELIANCE ON OTHER JOINT AUDITORS (QNO-28.200)

Chart



Detailed Text

1. ***Each joint auditor is entitled to assume that:***
   - a. *The* ***other joint auditors have brought to said joint auditor's notice any departure from applicable financial reporting framework or significant observations that are relevant to their responsibilities noticed in the course of the audit.***
   - b. *The* ***other joint auditors have carried out their part of the audit work and the work has***

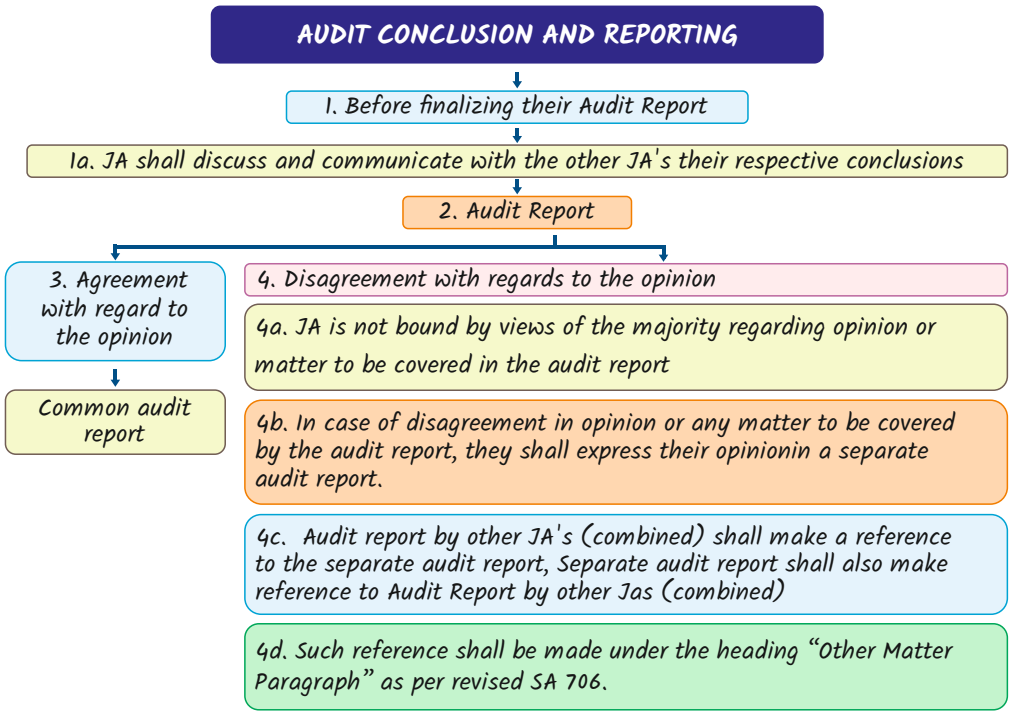
actually been performed in accordance with the Standards on Auditing *issued by the Institute of Chartered Accountants of India.*

c. ***It is not necessary for a joint auditor to review the work performed by other joint auditors or perform any tests in order to ascertain whether the work has actually been performed in such a manner.***

2. *Where financial statements of a* ***division/branch are audited by one of the joint auditors, the other joint auditors are entitled to proceed on the basis that such financial statements comply with all the legal and regulatory requirements and present a true and fair view of the state of affairs and of the results of operations of the division/branch concerned.***

(CNO—SA299.080) AUDIT CONCLUSION AND REPORTING (QNO-28.100 /28.200)(MCQ-Incs.33.1)

Chart



Detailed Text

The joint auditors are ***required to issue common audit report,*** *however,* ***where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report.***

A joint auditor is ***not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make reference to the separate audit report(s) issued by the other joint auditor(s). Further, separate audit report shall also make reference to the audit report issued by other joint auditors.***

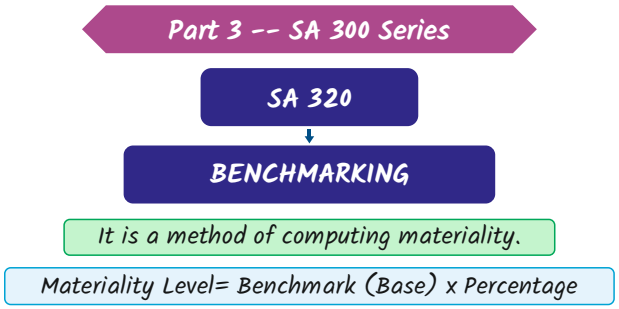
Such reference shall be made under the heading "Other Matter Paragraph" as per Revised SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report".

Before finalizing their audit report, ***the joint auditors shall discuss and communicate with each other their respective conclusions*** *that would form the content of the audit report.*

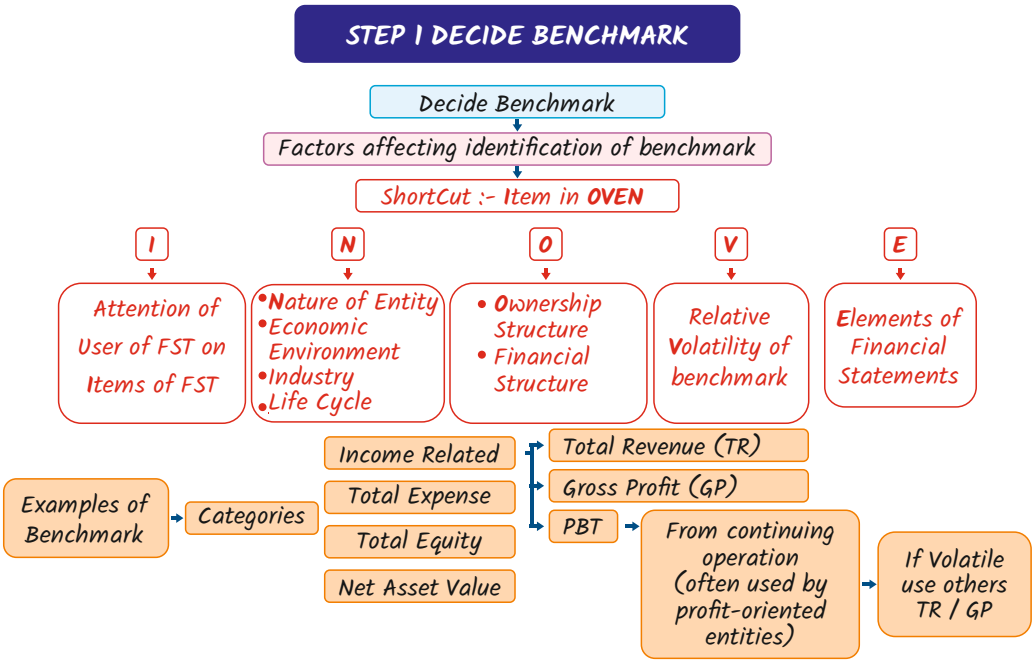
Part 3 – SA 300 Series
[SA 320] MATERIALITY IN PLANNING AND PERFORMING AN AUDIT

(CNO—SA320.020) BENCHMARKING (QNO-42.000)

Chart



Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.



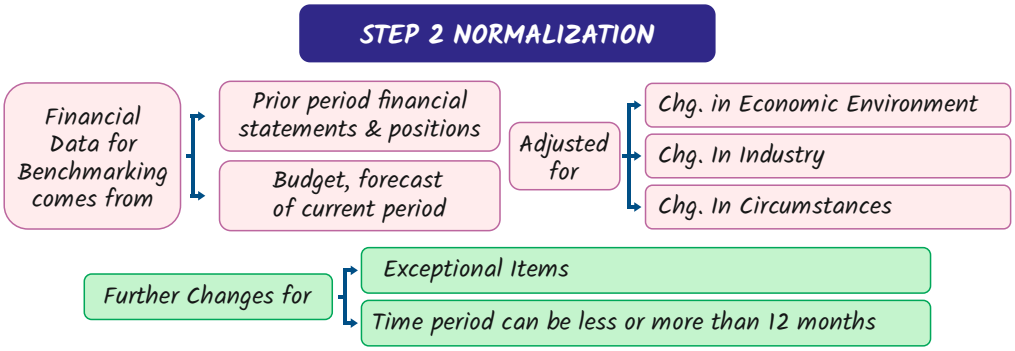
Step I Decide Benchmark (Base)

Factors that may affect the identification of an appropriate benchmark include the following:

- The **elements of the financial statements** (for example, assets, liabilities, equity, revenue, expenses);
  Whether there are items on which the **attention of the users of the particular entity's financial statements tends to be focused** (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- The nature of the entity, where the entity is at in its **life cycle,** and the **industry and economic environment** in which the entity operates;
- The entity's **ownership structure** and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
- The **relative volatility of the benchmark.**

Examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include **categories of reported income** such as profit before tax, total revenue, gross profit and total expenses, total equity or net asset value. Profit before tax from continuing operations is often used for profit-oriented entities. **When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues.**

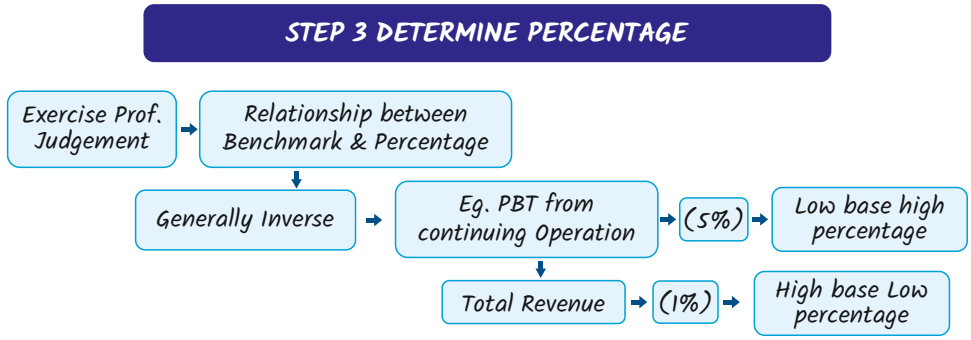
Step 2 Normaliz-ation (Adjusting Base)



In relation to the chosen benchmark, relevant financial data ordinarily **includes prior periods' financial results and financial positions,** the period to-date financial results and financial position, and **budgets or forecasts for the current period,** adjusted for **significant changes in the circumstances of the entity** (for example, a significant business acquisition) and relevant changes of conditions in the industry or economic environment in which the entity operates.

For example, when, as a starting point, the materiality for the financial statements as a whole is determined for a particular entity based on a percentage of profit before tax from continuing operations, circumstances that give rise to an exceptional decrease or increase in such profit may lead the auditor to conclude that the materiality for the financial statements as a whole is more appropriately determined using a normalized profit before tax from continuing operations figure based on past results.

Materiality relates to the financial statements on which the auditor is reporting. Where the financial statements are prepared for a financial reporting period of more or less than twelve months, such as may be the case for a **new entity** or a change in the financial reporting period, materiality relates to the financial statements prepared for that financial reporting period.



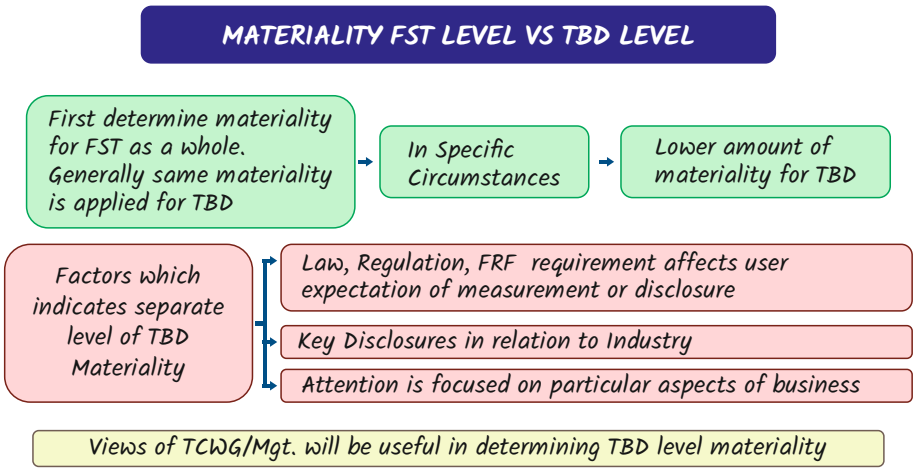
Step-3 Determine Percentage

Determine Percentage to be applied to a chosen benchmark involves the exercise of professional judgment. There is a relationship between the percentage and the chosen benchmark, **such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue.**

For example, the auditor may compute Materiality in Planning and Performing an Audit consider five percent of profit before tax from continuing operations to be appropriate for a profit-oriented entity in a manufacturing industry, while the auditor may consider one percent of total revenue or total expenses to be appropriate for a not-for-profit entity. Higher or lower percentages, however, may be deemed appropriate in different circumstances.

(CNO—SA320.040) FINANCIAL STATEMENT LEVEL V/S SPECIFIC AREA LEVEL MATERIALITY (QNO-43.000)

Chart



When establishing the overall audit strategy, the auditor shall determine **materiality for the financial statements as a whole.** If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could **reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.**

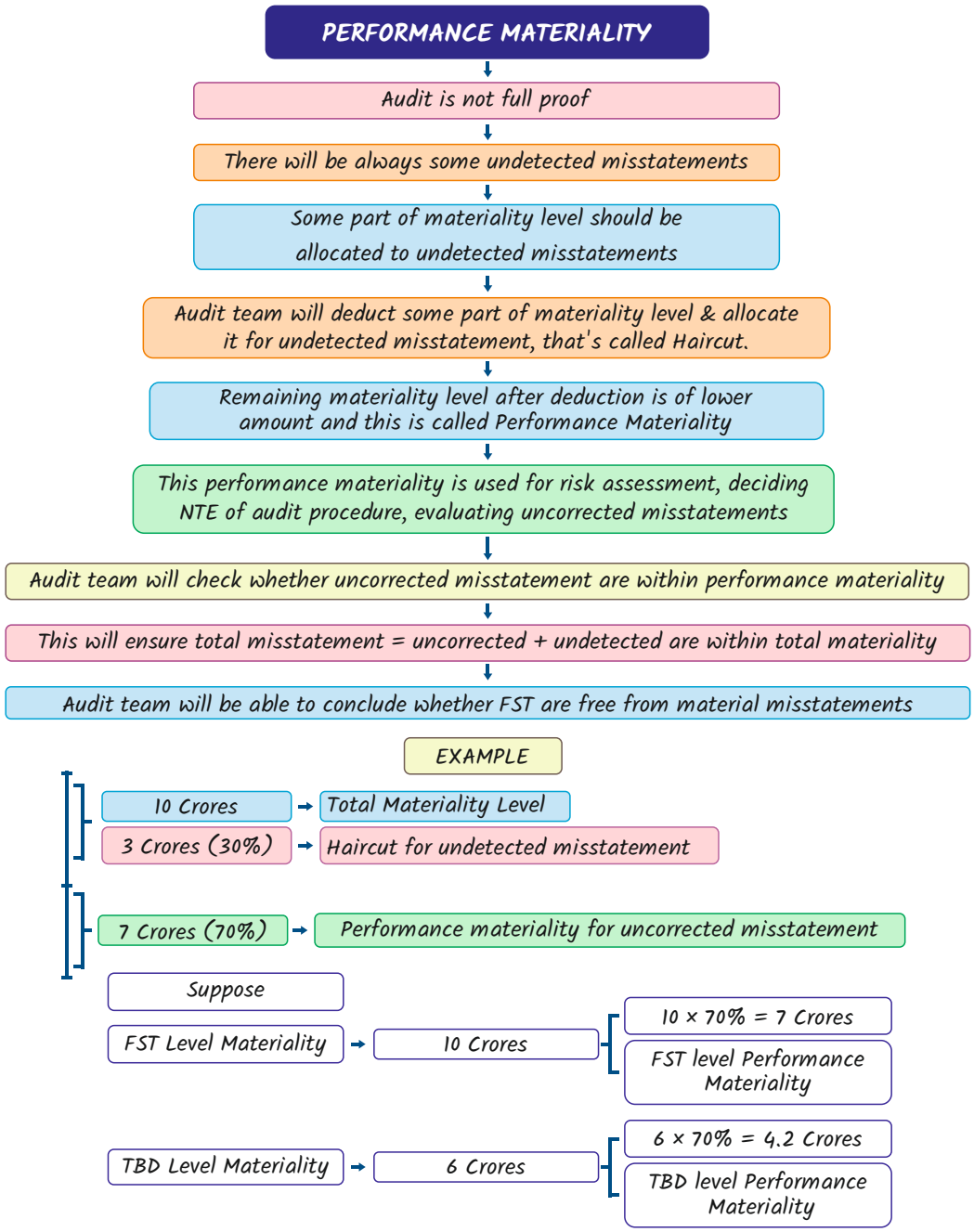
Factors that may indicate the existence of one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements include the following:

- Whether **law, regulations or the applicable financial reporting framework** affect users' expectations regarding the measurement or disclosure of certain items.
  - (for example, related party transactions, and the remuneration of management and those charged with governance).
- The **key disclosures in relation to the industry in which the entity operates.**
  - (for example, research and development costs for a pharmaceutical company).
- Whether **attention is focused on a particular aspect of the entity's business** that is separately disclosed in the financial statements.
  - (for example, a newly acquired business).

In considering whether, in the specific circumstances of the entity, such classes of transactions, account balances or disclosures exist, the auditor may find it **useful to obtain an understanding of the views and expectations of those charged with governance and management.**
or rationalization.

(CNO—SA320.060) PERFORMANCE MATERIALITY (MCQ – Incs.40.3 / Incs.45.3)

Chart



Performance materiality means the amount or amounts set by the auditor at ***less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.*** *If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.*

The auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures

Planning the audit solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and ***leaves no margin for possible undetected misstatements.***

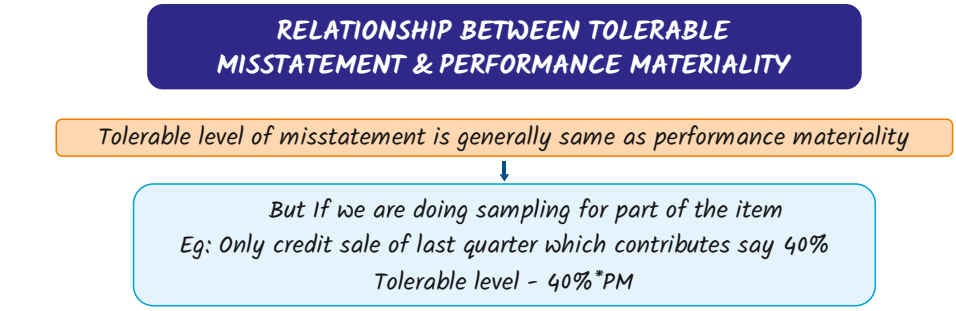
Performance materiality (which, as defined, is one or more amounts) is set to reduce to an appropriately

low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole. *Similarly, performance materiality relating to a materiality level determined for a particular class of transactions, account balance or disclosure is set to reduce to an appropriately low level the probability that the aggregate of uncorrected*

and undetected misstatements in that particular class of transactions, account balance or disclosure exceeds the materiality level for that particular class of transactions, account balance or disclosure.
The determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. It is affected by the auditor's understanding of the entity, updated during the performance of the risk assessment procedures; and the nature and extent of misstatements identified in previous audits and thereby the auditor's expectations in relation to misstatements in the current period.

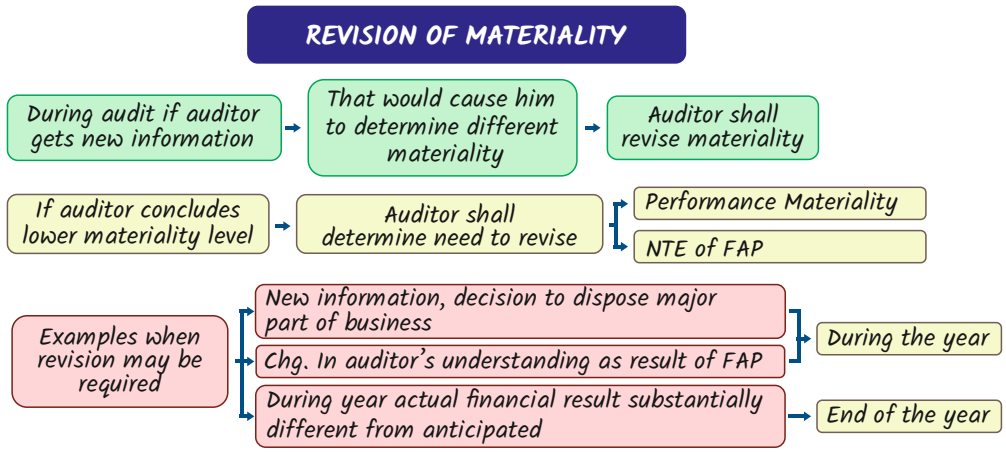
(CNO—SA320.070) RELATIONSHIP BETWEEN TOLERABLE MISSTATEMENT AND PERFORMANCE MATERIALITY

Chart



(CNO—SA320.080) REVISION OF MATERIALITY (QNO-43.000) (MCQ-320.1, 320.3)

Chart



The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) **in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.**

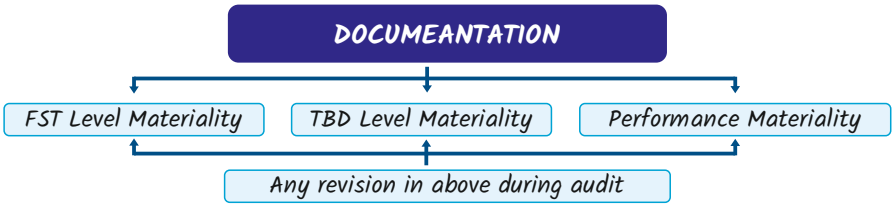
If the auditor concludes that a **lower materiality** for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether **it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.**

Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a change in circumstances that occurred during the audit.
(for example, a decision to dispose of a major part of the entity's business), new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.

For example, if during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality.

(CNO—SA320.100) DOCUMENTING THE MATERIALITY

Chart



The audit documentation shall include the following amounts and the factors considered in their determination:

- Materiality for the **financial statements as a whole.**
- If applicable, the materiality level or levels for **particular classes of transactions, account balances or disclosures;**
- **Performance materiality;** and
- Any **revision** of (a)-(c) as the audit progressed.

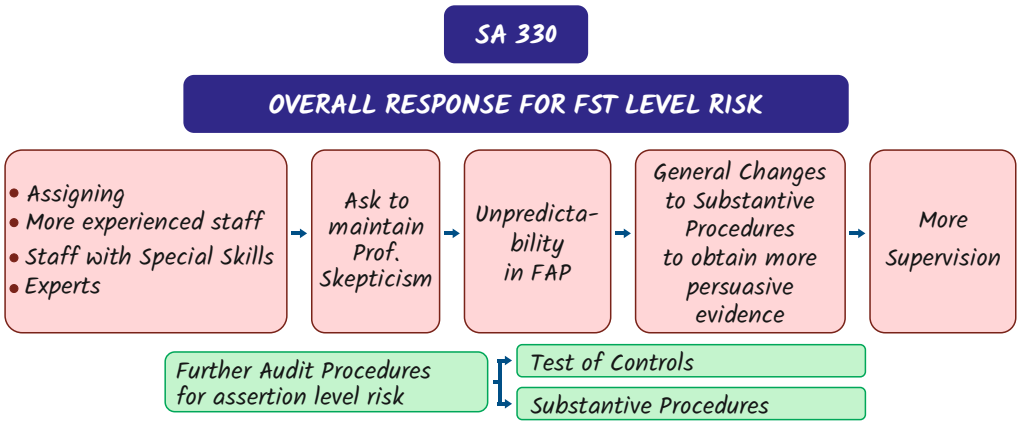
UNIQUE MCQs

MCQs 320.2, INcs.17.1

[SA 330] THE AUDITOR RESPONSE TO ASSESSED RISK

(CNO—SA330.020) OVERALL RESPONSES

Chart



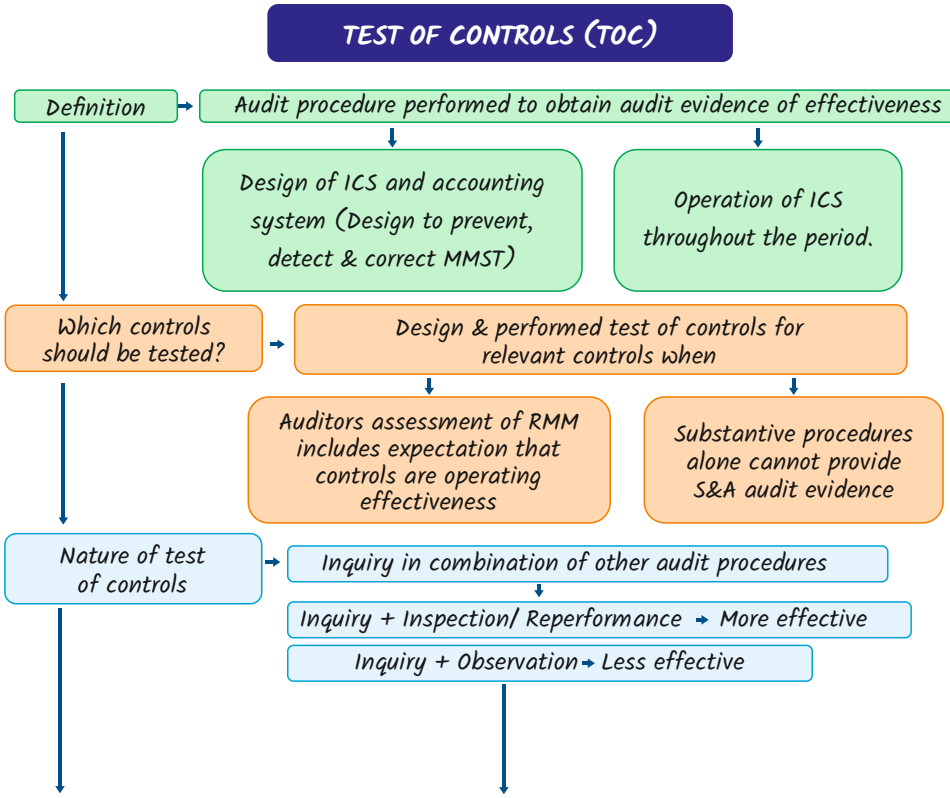
The auditor shall design and implement overall responses to address the assessed risks of material misstatement ***at the financial statement level.***

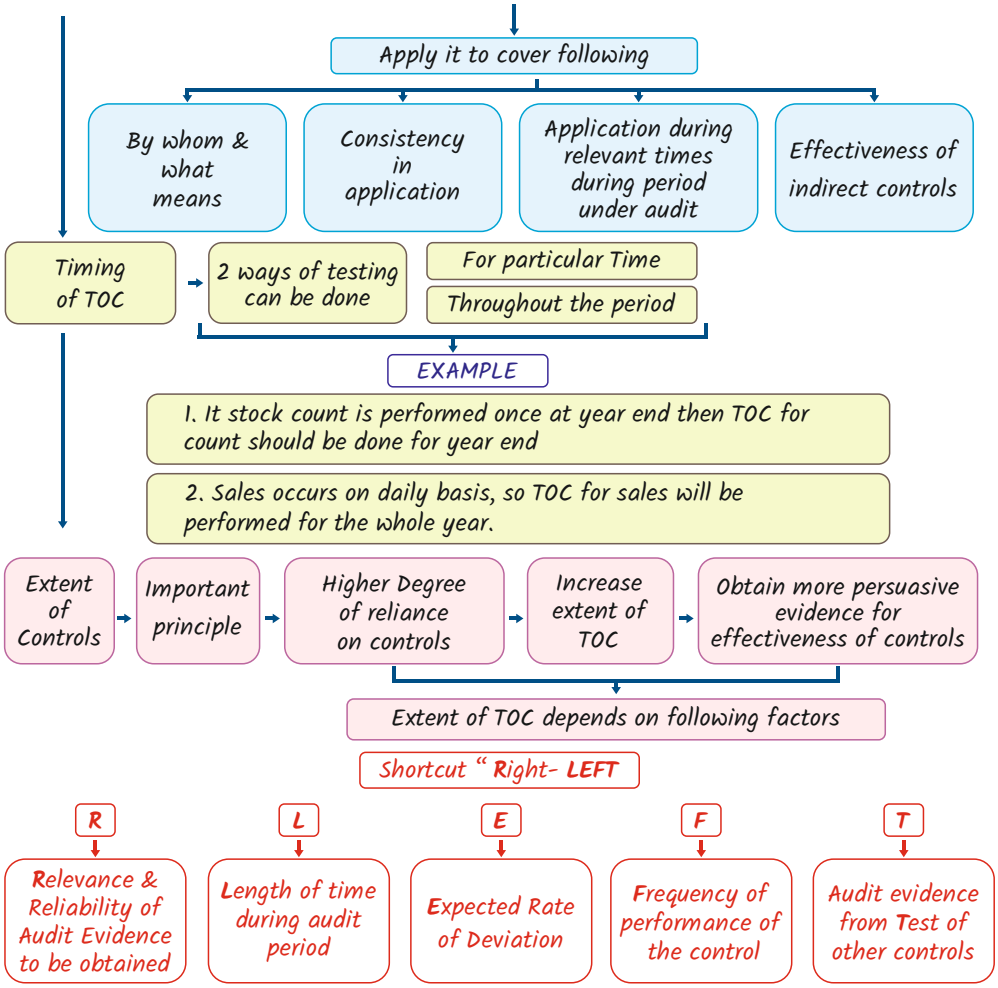
Overall responses to address the assessed risks of material misstatement at the financial statement level may include:

- *Emphasizing to the audit team the need to maintain* ***professional scepticism.***2
- *Assigning* ***more experienced staff*** *or those with special skills or* ***using experts.***1
- *Providing* ***more supervision.***5
  Incorporating additional elements of ***unpredictability in the selection of further audit procedures*** *to be performed.*3
- ***Making general changes*** *to the nature, timing or extent of audit procedures, for example: performing substantive procedures at the period end instead of at an interim date; or modifying the nature of audit procedures to obtain more persuasive audit evidence.* 4(Stock Count & External Conformation are more effective if done at the year-end)

(CNO—SA330.040) TESTS OF CONTROLS (QNO-47.000)(MCQ-330.9,Incs.25.2)

Chart





Definition

Test of Controls are performed to obtain audit evidence about effectiveness of

(a) ***design of the accounting and internal control systems,*** *i.e., whether they are suitably designed to prevent or detect and correct material misstatements; and*

(b) ***operation*** *of the internal controls throughout the period.*

Which Controls Should be Tested

The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:

- ***The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively***

  (E.g., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or (Rate of goods purchased is approved by purchase manager (who is new to organization), latter system checks it with rates in agreements and average of past 3 / 6 months. Software based control is expected to function effectively so let's check it)

- ***Substantive procedures alone cannot provide sufficient appropriate audit evidence*** *at the assertion level.*

A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. ***(In banks interest and other charges are automated, they are system generated entries in such situations test of controls are must they cannot be ignored, in fact we will check them in greater details)***

Nature of test of controls

In designing and performing tests of controls, the auditor shall:

- Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:
  - **(a)** How the controls were applied at relevant times during the period under audit. 3 (Are there any changes during the year, if yes have separate evaluation)
  - **(b)** The consistency with which they were applied. 2(Whether every transaction is evaluated carefully, automated controls are consistent but human based controls can be more or less depending on people or product involved, MD related purchases may be compromised in rates)
  - **(c)** By whom or by what means they were applied. 1(By Purchase Manager by Signing PO, By Software by matching customer code and rejecting unregistered names)
- Determine whether the controls to be tested depend upon other controls (indirect controls), and if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls. 4(Software based controls may depend on general IT / EDP controls of access controls, development controls etc. so we will have to check them also)

Further explanation of point (a) above **Inquiry** alone is not sufficient to test the operating effectiveness of controls.

Accordingly, other audit procedures are performed in combination with inquiry. In this regard, inquiry combined with **inspection** or **reperformance** may provide more assurance than inquiry and observation, since an observation is pertinent only at the point in time at which it is made.

The nature of the particular control influences the type of procedure required to obtain audit evidence about whether the control was operating effectively. For example, if operating effectiveness is evidenced by documentation, the auditor may decide to inspect it to obtain audit evidence about operating effectiveness.

Extent of test of controls

When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls. Matters the auditor may consider in determining the extent of tests of controls include the following:

FLERT

- The **F**requency of the performance of the control by the entity during the period. (Stock count is weekly Vs Fixed asset count is half yearly)
- The **L**ength of time during the audit period that the auditor is relying on the operating effectiveness of the control. (More time more checking)
- The **E**xpected rate of deviation from a control. (If expected rate is very close to tolerable rate of deviation then we have to check more of that control, to extra sure)
- The **R**elevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level. (Double payment is big risk so software feature to detect same number of PO is relevant, so check more)
- The extent to which audit evidence is obtained from **T**ests of other controls related to the assertion. (If other controls on that assertion are not effective do more checking here)

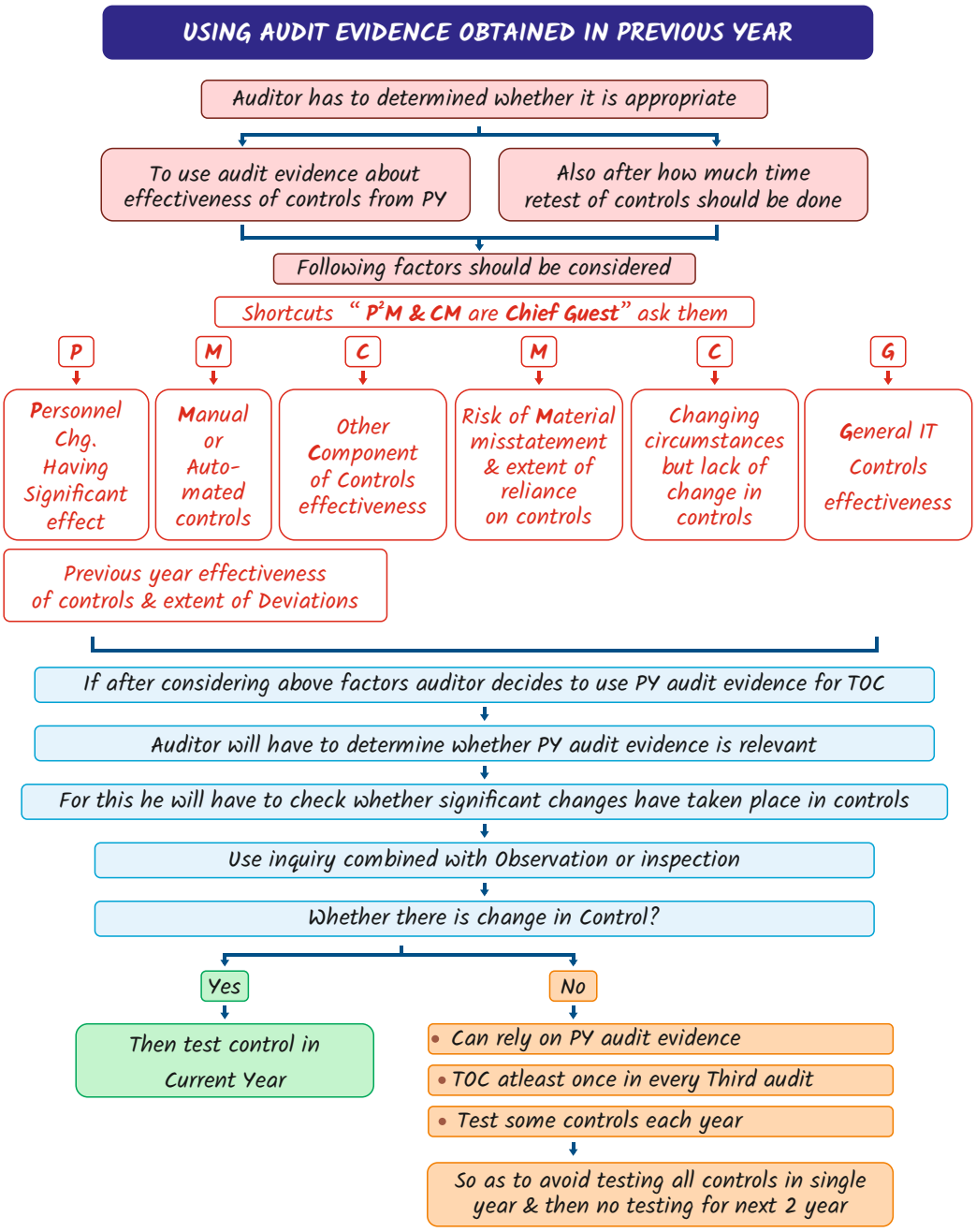
Timing of Tests of Controls

The auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls in order to provide an appropriate basis for the auditor's intended reliance. (Some controls are performed at year end so they should be checked at year end example, cut off control etc.)

Audit evidence pertaining only to a point in time may be sufficient for the auditor's purpose, for example, when testing controls over the entity's physical inventory counting at the period end. If, on the other hand, the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate. Such tests may include tests of the entity's monitoring of controls.

(CNO—SA330.060) USING AUDIT EVIDENCE OBTAINED IN PREVIOUS AUDITS (QNO 49.000)

Factors



In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:

CPM @ MCG

- *The effectiveness of the **control and its application by the entity,** including the nature and extent of deviations in the application of the control noted in Previous audits, and whether there have been Personnel changes that **significantly affect the application of the control;** (Purchase & Store Manager Retired at the beginning of the year, they were replaced my new comers)*
- *The risks arising from the characteristics of the control, including whether it is Manual or automated; (Quotation Selection & Issuing PO is subjective matter and depends on approving authority, behaviour can change over period of time)*
- *The effectiveness of **other elements of internal control**, including the Control environment, the entity's monitoring of controls, and the entity's risk assessment process; **(Poor attitude of management towards internal control system is encouragement to wrong doers)***
- *The risks of Material misstatement and the extent of reliance on the control. (Higher risk less reliance on previous year evidence)*

- Whether the lack of a change in a particular control poses a risk due to Changing circumstances; and **(GST)**
- The effectiveness of General IT-controls; **(Purchase entries are ID restricted, but people use each other's computer and they know username passwords)**

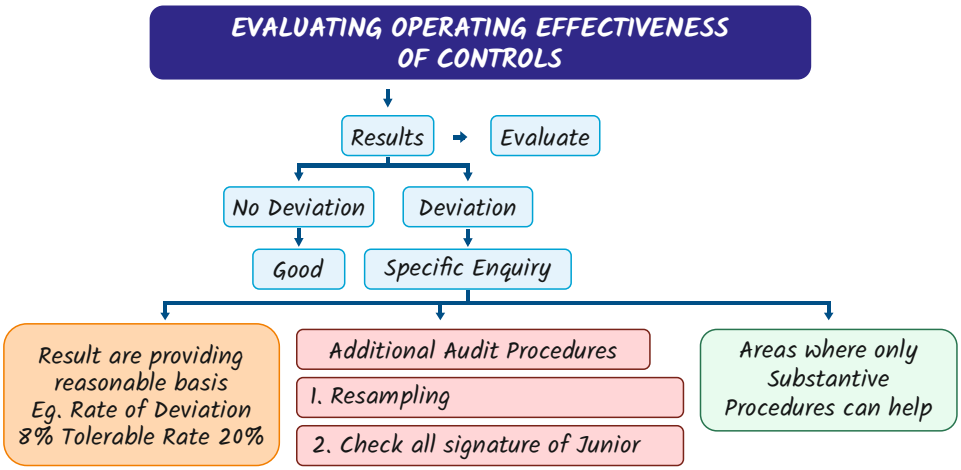
Auditor plans to rely on previous year evidence on TOC

If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor shall establish the continuing relevance of that evidence by obtaining audit evidence about whether **significant changes** in those controls have occurred subsequent to the previous audit. The auditor shall obtain this evidence by performing inquiry combined with observation or inspection, to confirm the understanding of those specific controls, and:

- ***Changes in ICS***
  If there have been changes that affect the continuing relevance of the audit evidence from the previous audit, the auditor shall test the controls in the current audit.
- ***Frequency of TOC***
  If there have not been such changes, the auditor shall test the controls at least once in every third audit, and shall test some controls each audit to avoid the possibility of testing all the controls on which the auditor intends to rely in a single audit period with no testing of controls in the subsequent two audit periods.

(CNO-SA330.080) EVALUATING THE OPERATING EFFECTIVENESS OF CONTROLS (MCQ-330.8)

Specific inquiries by auditor when deviations from controls are detected.



When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make **specific inquiries to understand these matters and their potential consequences,** and shall determine whether:

- The tests of controls that have been performed provide an **appropriate basis** for reliance on the controls; (Sample rate of deviation was 8% and tolerable rate is also 10%, so it is appropriate basis to rely on controls, if sample rate of deviation would have been higher than 10% then it would not be reliable control)
- Additional tests of controls are necessary; or (If junior officers' signature are obtained in 20% bills, check whether rate and quality was appropriate in such bills)
- The potential risks of misstatement need to be addressed using substantive procedures. (If controls are not reliable auditor will have to work on substantive procedures)

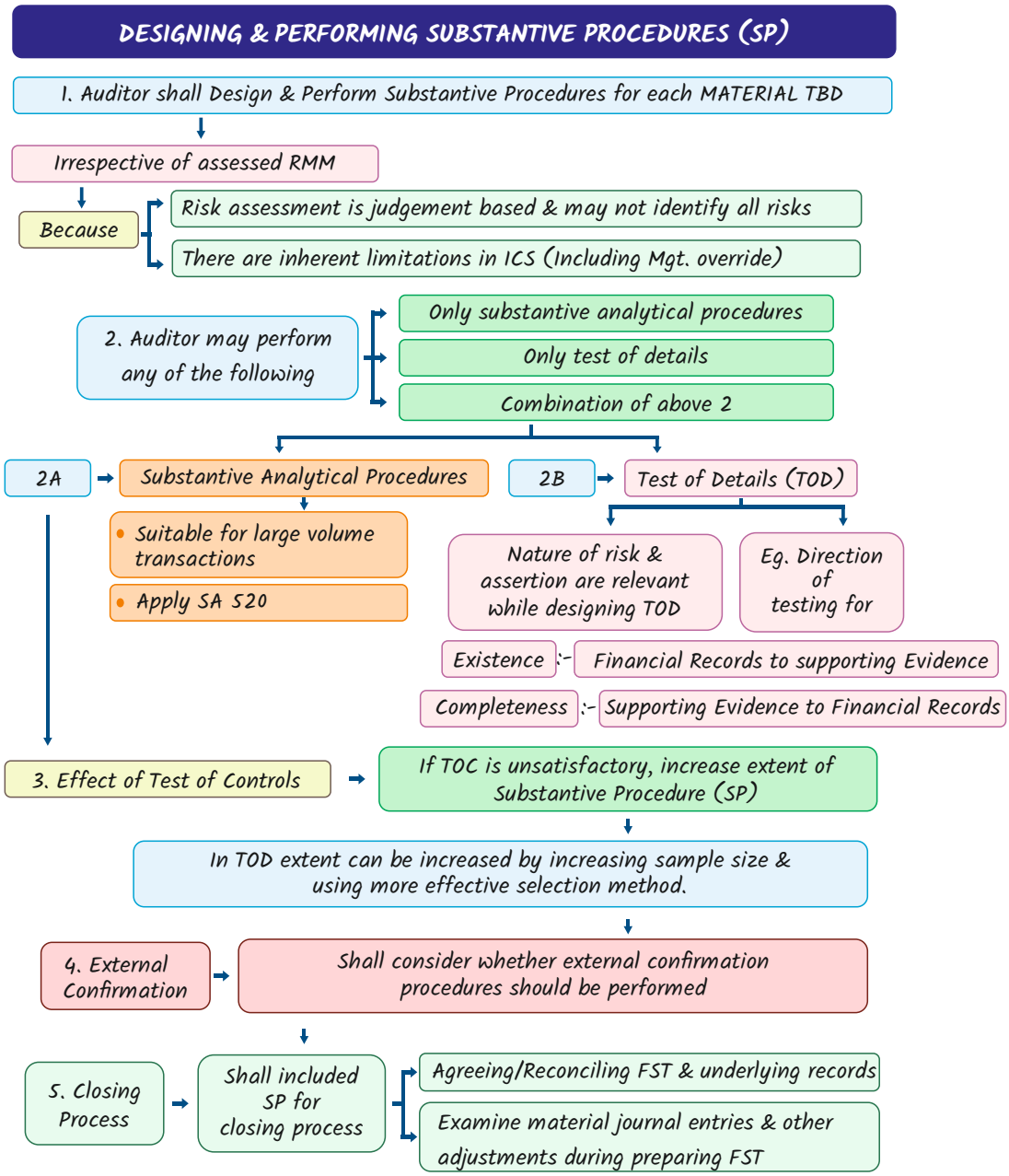
Misstatement Detected

When evaluating the operating effectiveness of relevant controls, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective.

A material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control. (Even tough purchase manager is honest and approves purchase bill carefully, team detected, over payment in 5 bills then rethink should we rely on controls)

(CNO—SA330.100) DESIGNING AND PERFORMING SUBSTANTIVE PROCEDURES
(QNO-50.000) (MCQ-330.1/ 330.2/ 330.3/330.4/330.5/330.6/330.7)

Chart



Substantive Procedures for Material Items

Designing and Performing Substantive Procedures Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for **each material class** of transactions, account balance, and disclosure.

This requirement reflects the facts that:

- The auditor's **assessment of risk is judgmental** and so may not identify all risks of material misstatement; and
- There are **inherent limitations to internal control**, including management override.

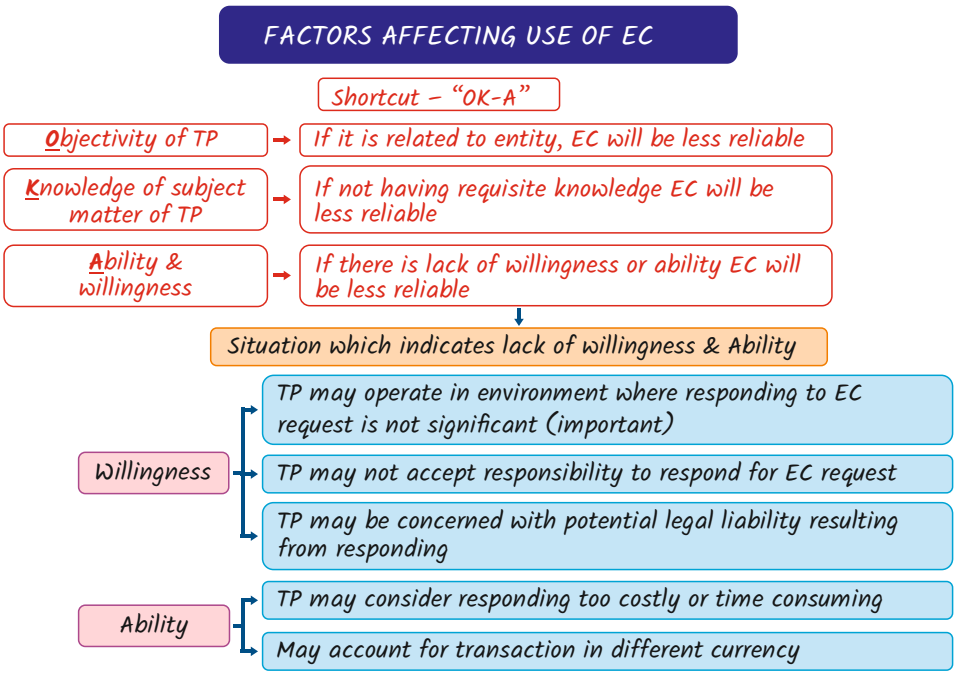
Effect of Test of Controls

Because the assessment of the risk of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing.

Types of Substantive Tests	Depending on the circumstances, the auditor may determine that: ➢ Performing **only substantive analytical procedures** will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment **of risk is supported by audit evidence from tests of controls. (Electricity bills payments)** ➢ **Only tests of details** are appropriate. **(Legal Expenses)** ➢ A **combination of substantive analytical procedures** and tests of details are most responsive to the assessed risks **(Salary)**
Substantive Analytical Procedures	Substantive analytical procedures are generally more applicable to **large volumes of transactions** that tend to be predictable over time. SA 520, "Analytical Procedures" establishes requirements and provides guidance on the application of analytical procedures during an audit.
Test of Details	The nature of the risk and assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included. **(List to actual stock Existence and actual stock to list Completeness)**
External Confirmation	The auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures.
Closing Process	The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process: ➢ **Agreeing or reconciling the financial statements** with the underlying accounting records; and ➢ Examining **material journal entries and other adjustments** made during the course of preparing the financial statements. The nature, and also the extent, of the auditor's examination of journal entries and other adjustments depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement.

(CNO-SA330.120) Factors to be considered while deciding whether to go for external confirmation (QNO-S0.500)

Chart



Discussion

4. Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

(i) The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.

(ii) The ability or willingness of the intended confirming party to respond – For example, the confirming party:

may operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.
may not accept responsibility for responding to a confirmation request;
may consider responding too costly or time consuming;
may have concerns about the potential legal liability resulting from responding; or
may account for transactions in different currencies;

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

(iii) The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

Appendix, just for reference no need to include in answers for exams

Assertion	**Relevant Internal Controls**	**Test of Controls**	**Substantive Procedures**
Occurrence (Risk is there is any fake purchase transaction)	**1.Purchases are approved by** Senior Manager **2.**Computer **Accepts entry of only authorized supplier** (Introduced from 1st January)	Test of Con1. Check whether all PRN are properly signed and stamped, match signatures from official records 2. Try to enter name of unauthorized vendortrols	Randomly select certain purchase transactions. Match them with GRN & Transporters Receipt. Take confirmation from supplier for significant transactions.
Accuracy (Risk that prices are overstated, to get kickbacks from suppliers)	**Computer** internally agrees price given in agreement / quotations with purchase order and purchase invoice.	Check whether prices in system are as per agreements. Try to enter different prices in Quotations /PO / PI	Compute price charged from purchase register; match it with Agreement / Quotations / PO / PI. Check whether it is reasonable as compared to market prices. Scan for unusual prices.
Classification (Risk that expenses of one department are charged to other, leading to inappropriate inventory valuation)	There is chart which clearly explains which material should be debited to which department / store account. **(Revised on monthly basis)** UniformHR Department OilProduction Department PaperOffice Expenses	See whether there Is such chart whether it is regularly updated, whether **employee** is trained.	Check whether purchases are classified as per its nature to proper department & cost centre.
Completeness (Risk that some transactions are left out, purchase are understated, and profits are overstated)	PRN / PO / GRN are prenumbered so that if any document is missing **system** will show error.	Check system error report. Inquire and inspect treatment of cancelled bills.	Match total number of transactions purchase register with stores ledger & total purchases in TB.

Cut-off *(Risk that purchase are adjusted by transferring current year to next and vice-versa)*	*No specific control only* ***supervisor*** *instructs to ensure everything is recorded.*	*No internal control checking, control risk is high for this assertion.*	*Check last 20 transactions of the year under audit and first 20 transactions of the next year.*

Unique Questions	
QNO 47.500	*Test of Control Interim Period -- Identifying & Disclosing Related Party*

Part 4 – SA 400 Series
[SA 402] AUDIT CONSIDERATIONS RELATING TO AN ENTITY USING A SERVICE ORGANISATION

Part 4 -- SA 400 Series

SA 402

CHART 1

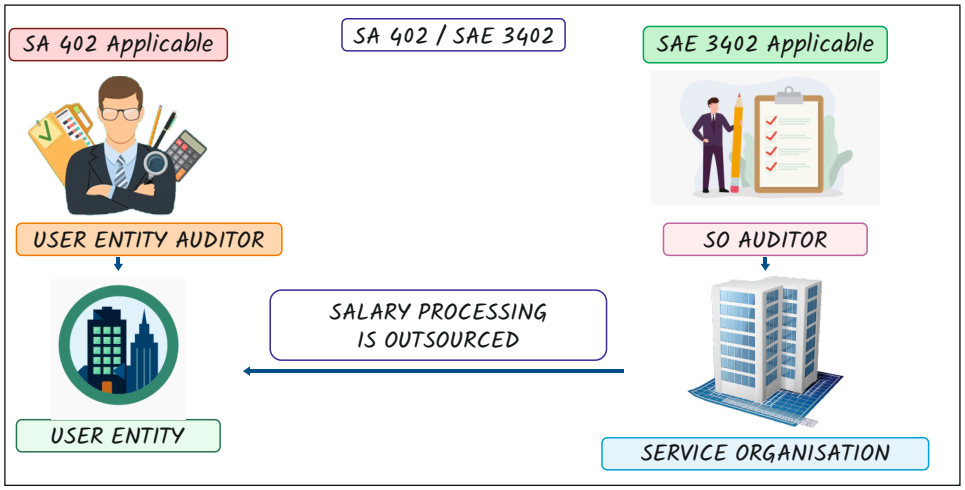
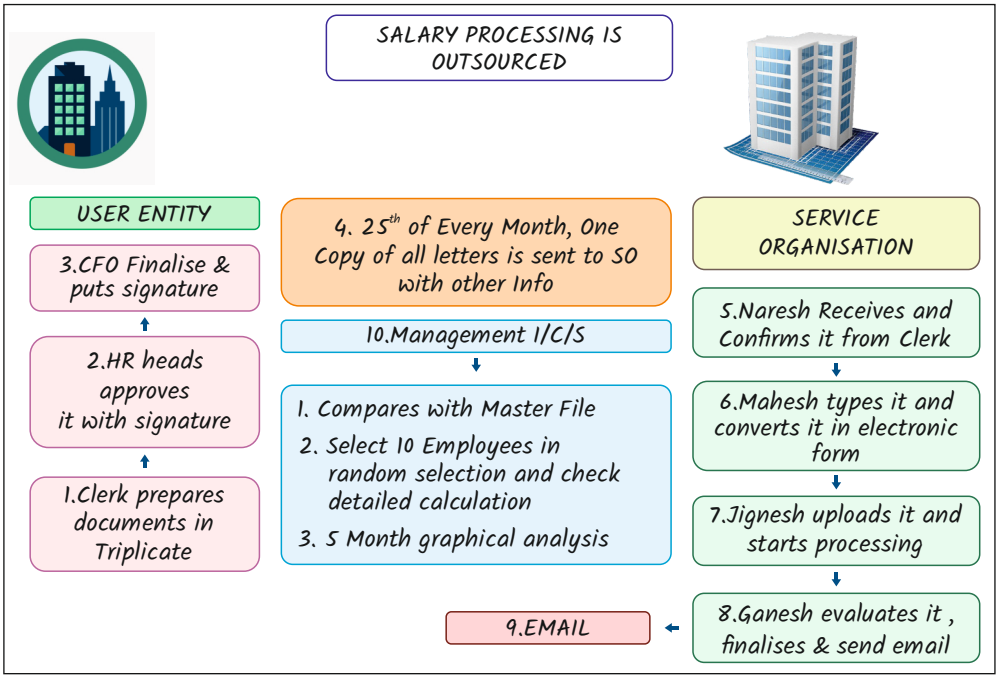


CHART 2



(CNO—SA402.020) OBTAINING AN UNDERSTANDING OF THE SERVICES PROVIDED BY A SERVICE ORGANISATION, INCLUDING INTERNAL CONTROL (REGULAR AUDIT PROCEDURES) (QNO-S2.000)

Obtaining Understanding: -

OBTAINING UNDERSTANDING OF SERVICES PROVIDED BY SERVICE ORGANISATION (SO) INCLUDING ICS

While understanding User Entity (UE) auditor shall obtain understanding how UE uses services of SO including following points

4 Info points are related to Services	4 Info points are related to SO
• Nature of services	• Nature of Relationship
• Significance of services	• Contractual Terms

- Effect of services on ICS
- Nature & Materiality of TBD affected by services
- Degree Interaction with SO
- Relevant Controls applied on Transactions processed by SO

Summary

Obtaining understanding of entity & its environment is covered under SA 315 / SA 402 further explains which information should be obtained if services of SO is used

Detailed Text

When obtaining an understanding of the user entity in accordance with SA 315, the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including.

Four Information points are Related to Services

Summary

Nature of Services / Significance of Services / Effect of Services on ICS / Nature & Materiality of TBD affected by Service

Detailed Text

- The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control;
- The nature and materiality of the transactions processed, or accounts or financial reporting processes affected by the service organisation;

Four Information Points are Related to SO

Summary

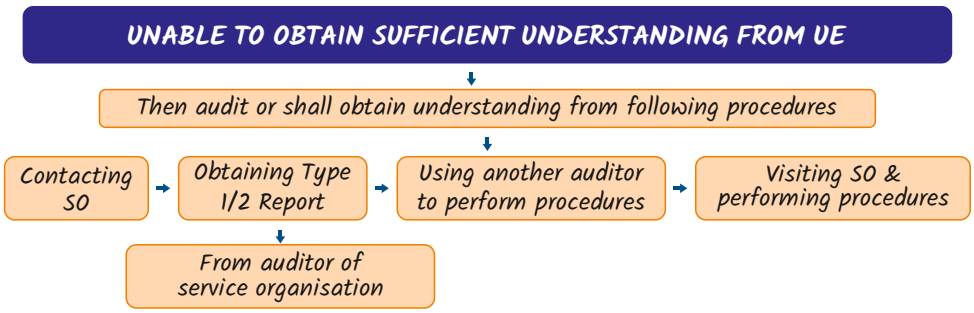
Nature of Relationships with SO / Contractual Terms / Degree of Interaction with SO / Relevant Controls applied on transactions processed by SO

Detailed Text

- The **nature of the relationship** between the user entity and the service Organisation, including the relevant **contractual terms** for the activities undertaken by the service organisation.
- The **degree of interaction** between the activities of the service organisation and those of the user entity; and
- When obtaining an understanding of internal control relevant to the audit in accordance with SA 315, the user **auditor shall evaluate the design and implementation of relevant controls at the user entity** that relate to the services provided by the service organisation, including those that are applied to the transactions processed by the service organisation.

(CNO—SA402.040) UNABLE TO OBTAIN SUFFICIENT UNDERSTANDING FROM USER ENTITY (ADDITIONAL PROCEDURES) (QNO-S2.000)

Chart

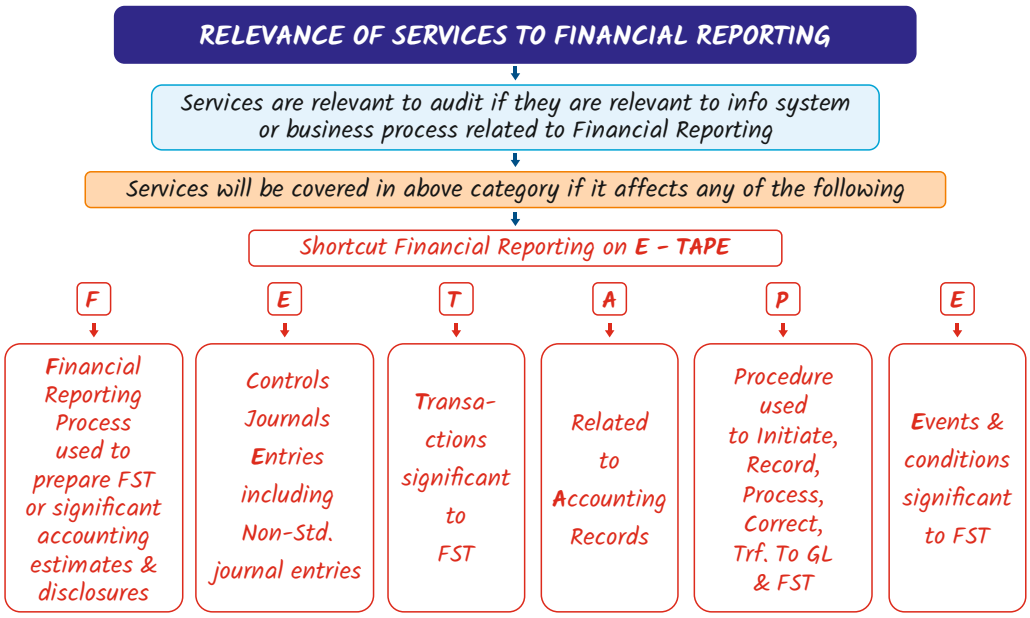


If the user auditor is unable to obtain a sufficient understanding from the User entity, the user auditor shall obtain that understanding from one or more of the following procedures: (Easy to Difficult Steps)

- **Contacting the service organisation,** through the user entity, to obtain specific information;
- Using **another auditor to perform procedures** that will provide the necessary information about the relevant controls at the service organisation.
- Obtaining a **Type I or Type 2 report,** if available;
- **Visiting the service organisation** and performing procedures that will provide the necessary information about the relevant controls at the service organisation;

(CNO—SA402.060) FACTORS TO BE CONSIDERED TO UNDERSTAND RELEVANCE OF SERVICES TO FINANICAL REPORTI (QNO-S2.100)

Chart



Summary

Relevant for audit if it is part of information system, including business processes relevant to financial reporting

Detailed Text

As per SA 402 "Audit Considerations relating to an Entity using a Service Organization", services provided by a service organisation are **relevant to the audit of a user entity's financial statements when those services, and the controls over them, are part of the user entity's information system, including related business processes, relevant to financial reporting.**

(E.g., Security, Cleaning services outsourcing may not be relevant for auditor)

Although most controls at the service organisation are likely to relate to financial reporting, there may be other controls that may also be relevant to the audit, such as controls over the safeguarding of assets. A service organisation's services are part of a user entity's information system, including related business processes, relevant to financial reporting if these services **affect any of the following:**

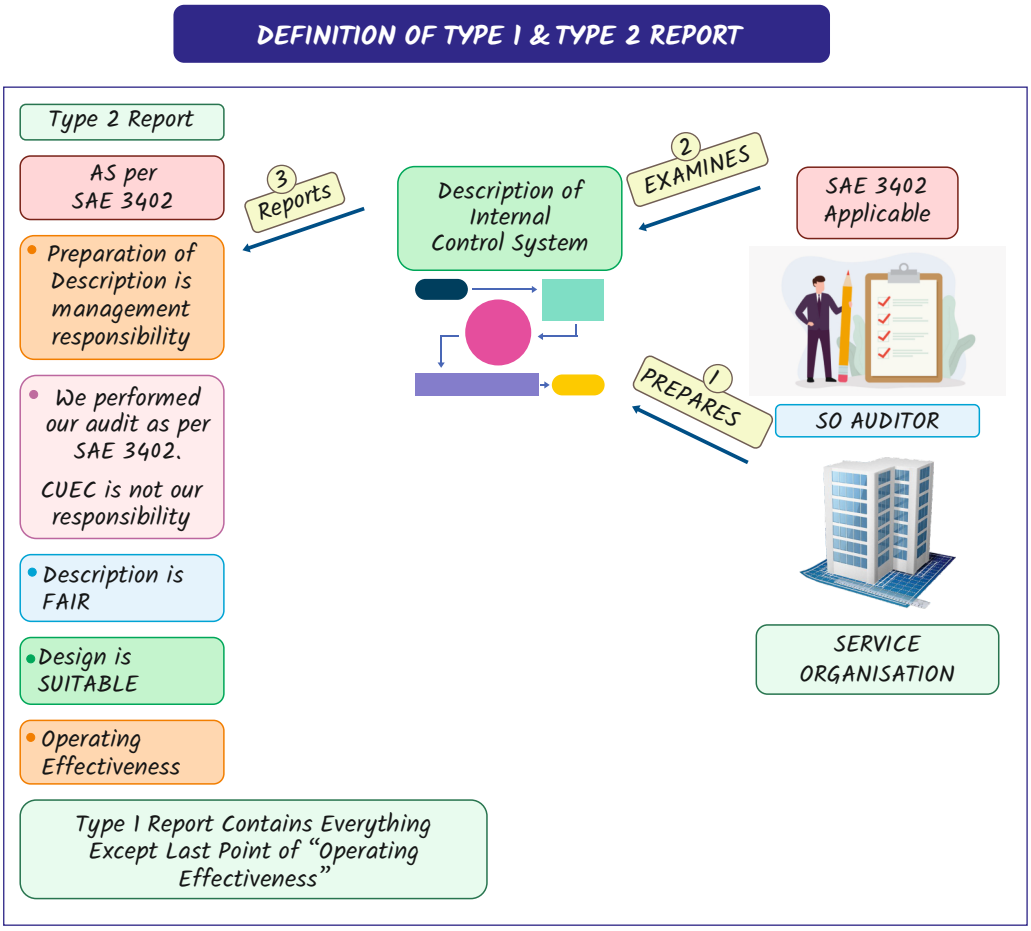
No **ESCAPE** from relevant services.

Text	Examples
The financial reporting process used to prepare the user entity's financial statements, **including significant accounting Estimates and disclosures;**	(E.g. Useful life of assets, inventory valuation etc)
The **classes of transactions** in the user entity's operations that are **Significant to the user entity's financial statements;**	(E.g. online sales occur from third party websites like amazon / flipkart etc)
How the user entity's information system **Captures events and conditions,** Other than transactions, **that are significant to the financial statements;**	(E.g. Events & Conditions of Impairment testing of plant , goodwill, financial instruments is outsourced to ca firm)
The related Accounting records, either in electronic or manual form, supporting information and specific accounts in the user entity's financial statements that are used to initiate, record, process and report the user entity's transactions; this includes the correction of incorrect information and how information is transferred to the general ledger;	(E.g. Creditor ledger accounting outsourced)

➢ ***The Procedures, within both information technology (IT) and manual systems,*** *by which the user entity's transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;*	*E.g. Raw material price collection, party evaluation, quality check is outsourced)*
➢ ***Controls surrounding journal Entries,*** *including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.*	*(E.g. Creditor ledger accounting outsourced)*

(CNO-SA402.080) DEFINITION OF TYPE 1 & TYPE 2 (MCQ-402.1, Incs.54.2)

Chart



Type 1

Report on the description and design of controls at a service organisation (referred to in this SA as a Type 1 report) – A report that comprises:

- *A **description, prepared by management of the service organisation,** of the service organisation's system, control objectives and related controls that have been designed and implemented as at a specified date; and*
- *A **report by the service auditor with the objective of conveying reasonable assurance** that includes the service auditor's opinion on the description of the service organisation's system, control objectives and related controls and the suitability of the **design** of the controls to achieve the specified control objectives.*

Type 2

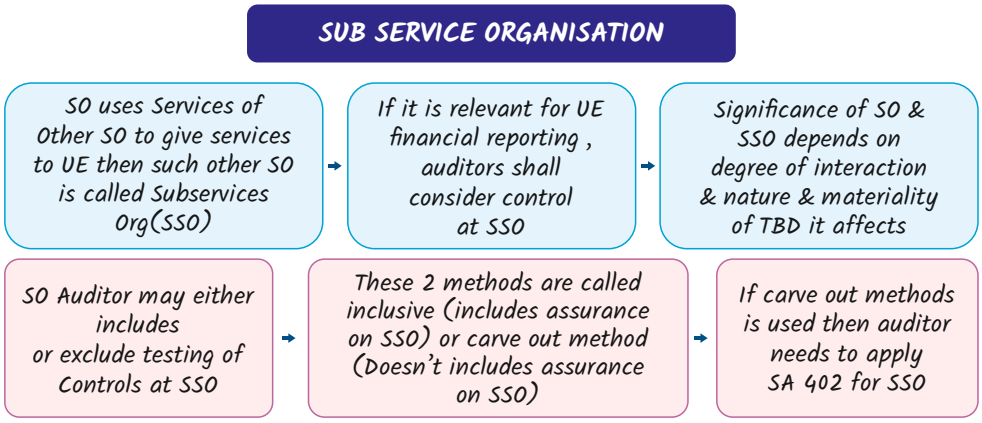
Report on the description, design, and operating effectiveness of controls at a service organisation (referred to in this SA as a Type 2 report) – A report that comprises:

- *A **description, prepared by management of the service organisation,** of the service organisation's system, control objectives and related controls, their design and implementation as at a specified date or throughout a **specified period and, in some cases, their operating effectiveness throughout a specified period;** and*
- *A report by the service auditor with the objective of conveying reasonable assurance that includes:*

- The service auditor's opinion on the description of the service organisation's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and
- A description of the service auditor's tests of the controls and the results thereof.

(CNO—SA402.100) TYPE 1 AND TYPE 2 REPORTS THAT EXCLUDE THE SERVICES OF A SUBSERVICE ORGANISATION (QNO 53.000)

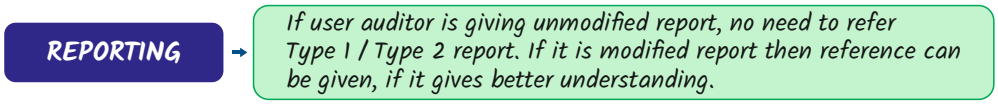
Chart



Use of Subservice Organisation	It may happen that UE is taking services from, SO which are in turn given by SSO. SSO can be related to SO or sperate entity all together.
Sufficient Understa-nding	Nature of Services / Significance of Services / Effect of Services on ICS / Nature & Materiality of Transactions in determining significance of SO & SSO controls. If Sufficient understanding is not obtained from User Entity then Type 1 / Type 2 can give auditor better understanding.
Controls at SSO	Auditor needs to consider controls at SSO. One of the important aspects is regarding Interactions, It will include interaction between UE / SO / SSO.
Two Methods of Reporting	SO Auditor may either include or exclude control objectives & controls of SSO. These 2 methods of reporting are called inclusive & carve out method respectively. It is mandatory for SO to include description of controls at SSO in its description of controls. If carve out method of reporting is used and controls at SSO are relevant, then auditor needs to apply requirements of SA 402 in respect of SSO.

(CNO—SA402.120) REPORTING (QNO—53.050)

Chart



Discussion

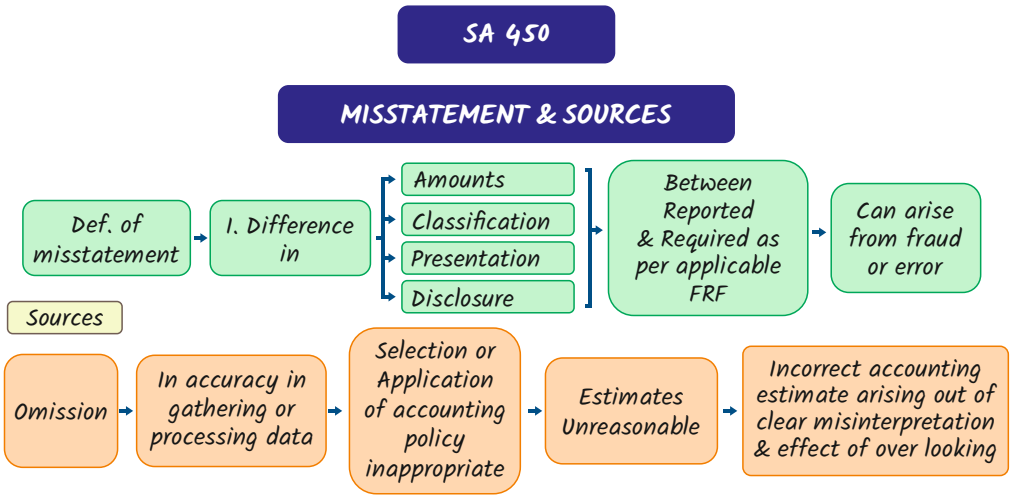
- The user auditor shall modify the opinion in the user auditor's report in accordance with SA 705 if the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organisation relevant to the audit of the user entity's financial statements.
- The user auditor shall not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion.
- If reference to the work of a service auditor is relevant to an understanding of a modification to the user auditor's opinion, the user auditor's report shall indicate that such reference does not diminish the user auditor's responsibility for that opinion.

UNIQUE MCQs	
MCQs	402.2

[SA 450] EVALUATION OF MISSTATEMENT IDENTIFIED DURING AUDIT OF FINANCIAL STATEMENT

(CNO-SA450.020) MISSTATEMENT & SOURCES (QNO-54.000)

Chart



Misstatement – A ***difference*** between the ***amounts, classification, presentation, or disclosure*** of a reported financial statement item and the amount, classification, presentation, or disclosure ***that is required for the item to be in accordance with the applicable financial reporting framework.***

Misstatements can arise from error or fraud.

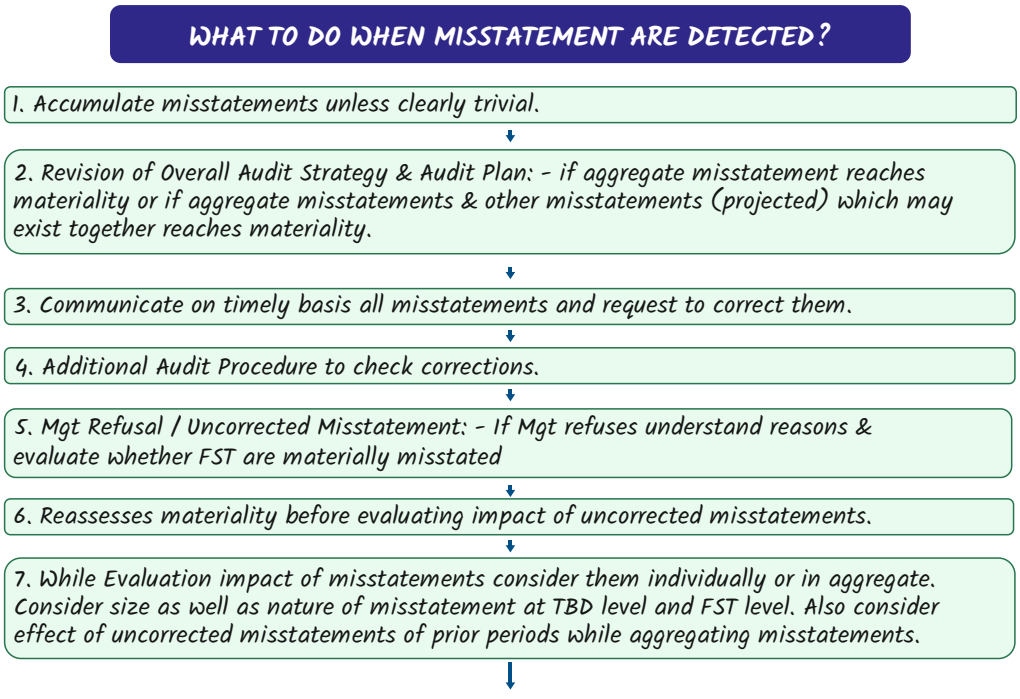
Misstatements may result from:

- An ***omission*** of an amount or disclosure;
- An ***inaccuracy in gathering or processing data*** from which the financial statements are prepared;
- An ***incorrect accounting estimate*** arising from overlooking, or clear misinterpretation of, facts; and
- ***Selection or Application of accounting policies that the auditor considers inappropriate.***
- Judgments of management concerning accounting ***estimate that the auditor considers unreasonable.***

Examples of misstatements arising from fraud are provided in SA 240.

(CNO-SA450.040) WHAT TO DO WHEN MISSTATEMENTS ARE DETECTED (EVALUATION)? (QNO-55.000)

Chart
(MCQ-450.1)



8. Communicate to TCWG all uncorrected misstatements. Identify material misstatements individually, also uncorrected misstatements of previous period. Explain effect on opinion. And request them to correct all misstatements.

9. WR From Mgt/ TCWG on whether they believe effects of misstatements in individual or aggregate is immaterial. WR should have attached list of such misstatements.

10. Consider effect on Audit Opinion as per SA 705

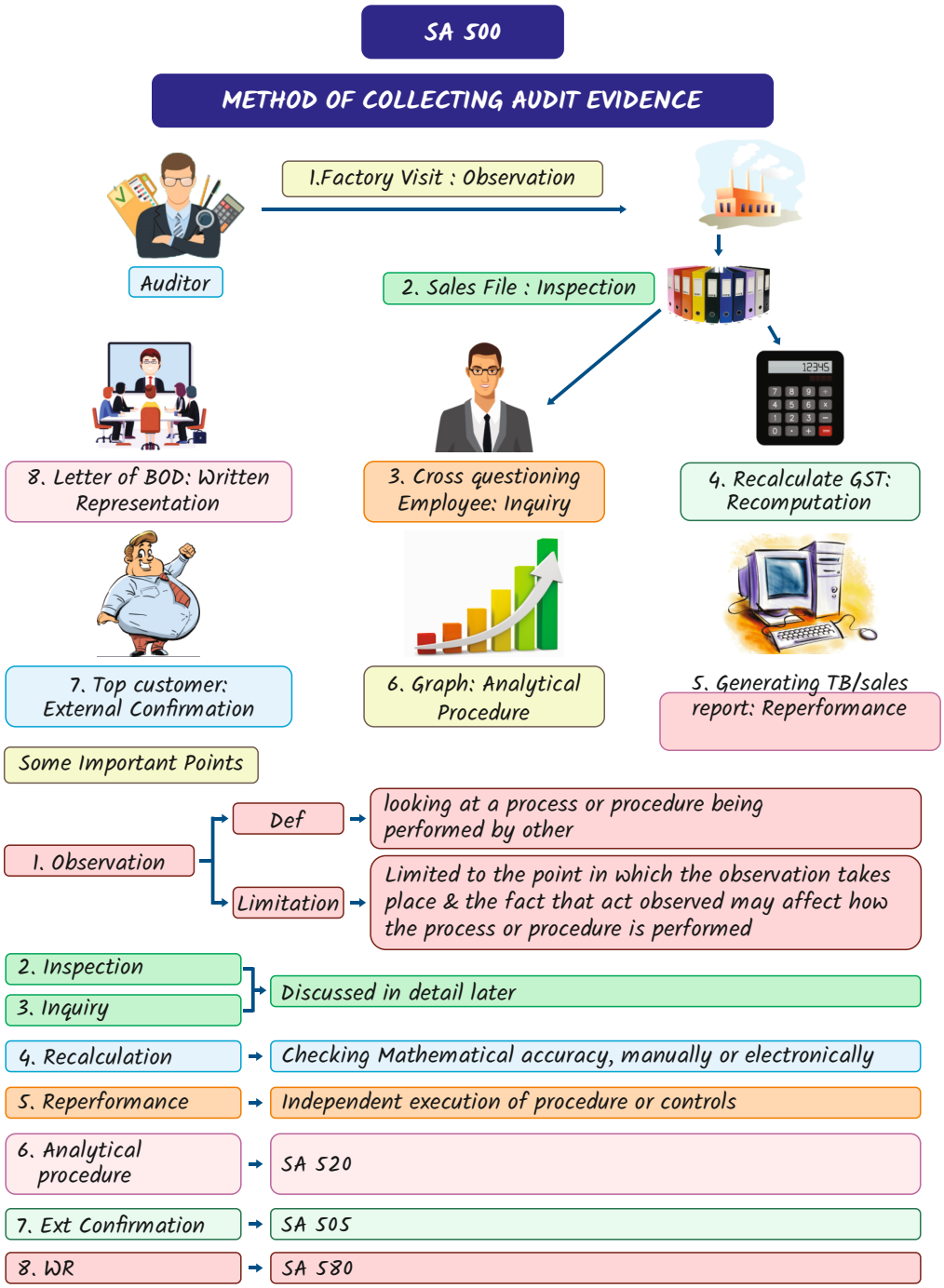
1. The auditor shall **accumulate misstatements** identified during the audit, other than those that are **clearly trivial.**
2. The auditor shall determine whether the **overall audit strategy and audit plan need to be revised if:**
   - The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; or
   - The **aggregate of misstatements accumulated during the audit approaches materiality** determined in accordance with SA 320.
3. The **auditor shall communicate on a timely basis all misstatements** accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation. **The auditor shall request management to correct those misstatements.**
4. If, at the auditor's request, **management has examined a class of transactions, account balance or disclosure and corrected misstatements** that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain.
5. If management **refuses to correct some** or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of **management's reasons for not making the corrections** and shall take that understanding into account when **evaluating whether the financial statements as a whole are free from material misstatement.**
6. Prior to evaluating the effect of uncorrected misstatements, **the auditor shall reassess materiality determined in accordance with SA 320** to confirm whether it remains appropriate in the context of the entity's actual financial results.
7. The auditor shall**determine whether uncorrected misstatements are material, individually or in aggregate.**

   In making this determination, the auditor shall consider:
   - The **size and nature of the misstatements,** both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and
   - The **effect of uncorrected misstatements related to prior periods** on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.
8. The auditor **shall communicate with those charged with governance uncorrected misstatements** and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation. The auditor's communication shall identify material uncorrected misstatements individually. **The auditor shall request that uncorrected misstatements be corrected. The auditor shall also communicate with those charged with governance the effect of uncorrected misstatements related to prior periods** on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.
9. The auditor shall request a **written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.**
10. Consider effect of uncorrected misstatements on Audit Opinion as per SA 705.

Part 5 – SA 500 Series [SA 500] AUDIT EVIDENCE

(CNO—SA500.020) METHODS OF OBTAINING AUDIT EVIDENCE

Chart



Observation

Observation consists **of looking at a process or procedure** being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities. Observation provides audit evidence about the performance of a process or procedure but is **limited to the point in time at which the observation takes place**, and by the fact that the act of being observed may affect how the process or procedure is performed.

Inspection

Inspection **involves examining records or documents,** whether internal or external, in paper form, electronic form, or other media, **or a physical examination of an asset.**

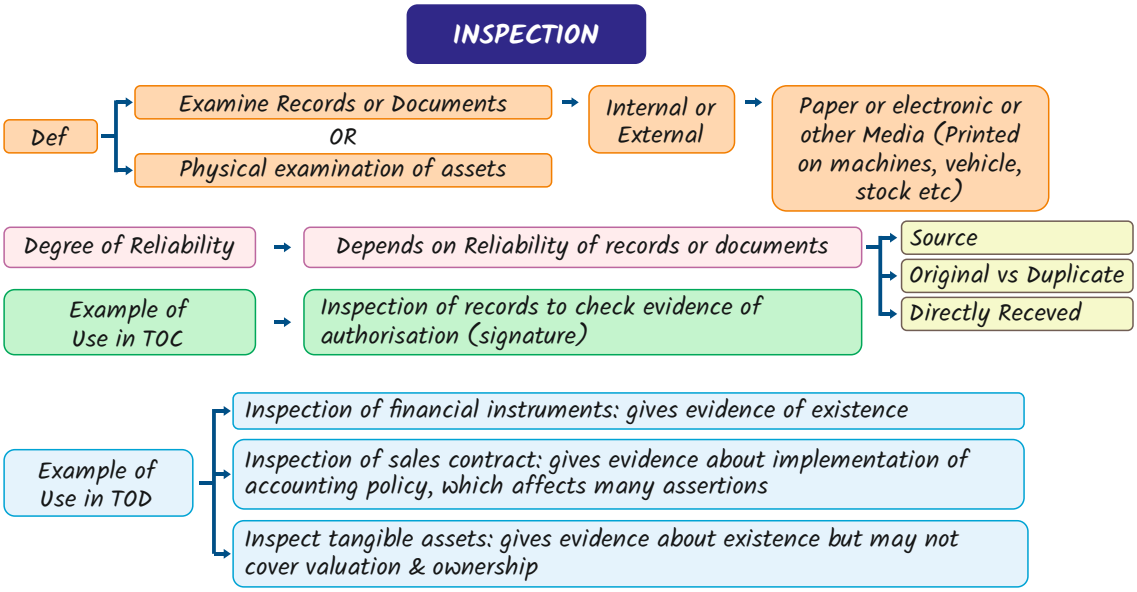
Inquiry

Inquiry consists of seek information of knowledgeable persons, financial and non- financial, within the entity or outside the entity. **Inquiry is used extensively throughout the audit in addition to other audit procedures.**

Recalculation	Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.
Re-performance	Re-performance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.
Analytical Procedures	Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.dent execution of procedures or controls that were originally performed as part of the entity's internal control.
External Confirmation	An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
Written representation	Written Statement by Management to confirm certain matters or to support other evidence.

(CNO—SA500.040) INSPECTION & INQUIRY IN DETAIL EVIDENCE (QNO 57.000)

Chart



Inspection

- **Definition**
  Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

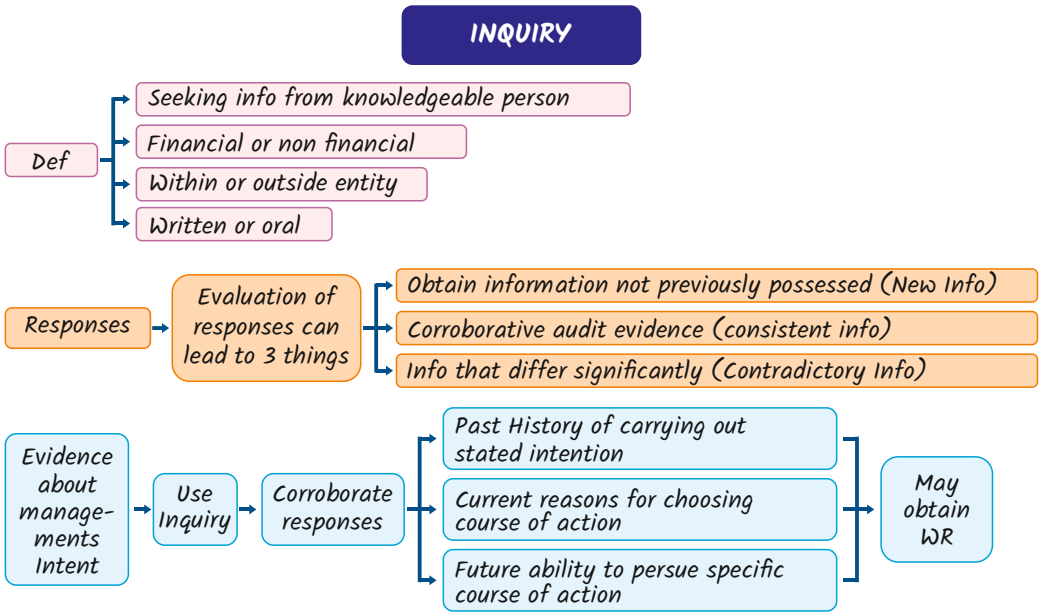
- **Degree of Reliability**
  Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their **nature** (Original Vs Duplicate) and source (Internal Vs External) and, in the case of internal records and documents, on the effectiveness of the controls over their production (Software/Register used).

- **Example of use in Test of Control**
  An example of inspection used as a test of controls is inspection of records for evidence of authorization.

- **Example of use in Substantive testing (Test of Detail)**
  (Existence)
  Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a share certificate or bond. Inspection of

such documents may not necessarily provide audit evidence about ownership or value. (Revenue Recognition Policy) In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition. (Not for Valuation & Rights & Obligation) Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

Chart



Inquiry (QNO-57.000)

- **Definition**

  Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity.

- **Written or Oral**

  Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries.

- **Responses**

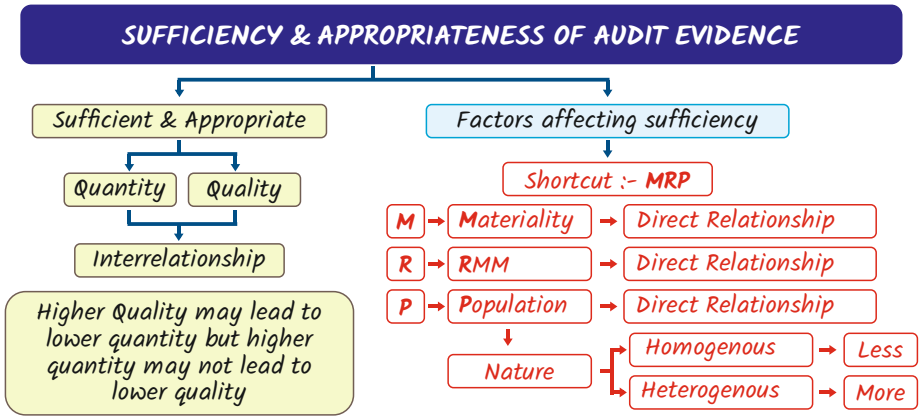
  Evaluating responses to inquiries is an integral part of the inquiry process. Responses to inquiries may provide the auditor with information **not previously possessed** or with **corroborative audit evidence.** Alternatively, responses might provide information that **differs significantly from other information** that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to **modify or perform additional audit procedures.**

- **Evidence about Management's Intent**

  Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry. In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

(CNO—SA500.060) SUFFICIENCY AND APPROPRIATENESS OF AUDIT EVIDENCE

Chart



Inter-relationship

Interrelationship Between Quantity & Quality

The sufficiency and appropriateness of audit evidence are interrelated.

The higher the quality, the less quantity may be required. Obtaining more audit evidence, however, may not compensate for its poor quality.

Sufficiency & Factors Affecting Sufficiency

More Evidence from Different Sources and in Bigger Size

Sufficiency is the measure of the quantity of audit evidence.

Auditor's judgment as to sufficiency may be affected by the factors such as:(MRP)

(i) Materiality

(ii) Risk of material misstatement

(iii) Size and characteristics of the Population.

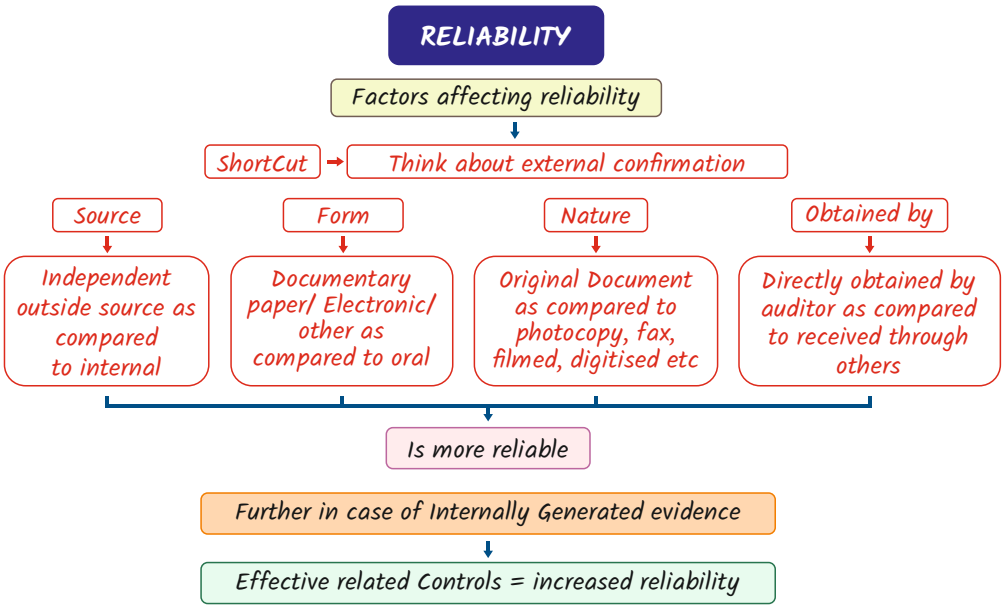
- **Materiality Direct Relationship**
  - **Meaning of Materiality**
    Materiality may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements.
  - **Relationship**
    Less evidence would be required in case assertions are less material to users of the financial statements. But on the other hand, if assertions are more material to the users of the financial statements, more evidence would be required.

- **Risk Direct Relationship**
  - **Meaning of RMM**
    Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components described as follows at the assertion level: -
    - **Inherent risk**—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.
    - **Control risk—The** risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control.
  - **Relationship**
    Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand, if assertions have a higher risk of material misstatement, more evidence would be required.

- **Size of Population Direct Relationship & Characteristic of Population Homogeneous – Less Heterogeneous – More**
  Size of a population refers to the number of items included in the population. Less evidence would be required in case of smaller, more homogeneous population but on the other hand in case of larger, more heterogeneous populations, more evidence would be required.

(CNO—SA500.080) RELIABLE & RELEVANT (MCQ-500.3)

Chart



When designing and performing audit procedures, the auditor shall consider the reliability & relevance of the information to be used as audit evidence

Reliability (MCQ-500.5)

The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its ***source and its nature, and the circumstances*** *under which it is obtained, including the* ***controls over its preparation and maintenance*** *where relevant.*

For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity. While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:

- *The reliability of audit evidence is increased when it is obtained from* ***independent*** *sources* ***outside*** *the entity.*
- *Audit evidence in* ***documentary form,*** *whether paper, electronic, or other medium, is more reliable than evidence obtained orally*
  - *(E.g. a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).*
- *Audit evidence provided by* ***original documents*** *is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.*
- *Audit evidence obtained* ***directly by the auditor***
  - *(E.g. observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).*
- *The reliability of audit evidence that is generated internally is increased when the* ***related controls,*** *including those over its preparation and maintenance, imposed by the entity are effective.*

Case on Reliability

The auditor of a limited company has given a clean report on the financial statement on the basis of xerox copies of the books of accounts, vouchers and other records which were taken away by the Income Tax Department in search under section 132 of the I.T. Act, 1961. Comment.

Answer

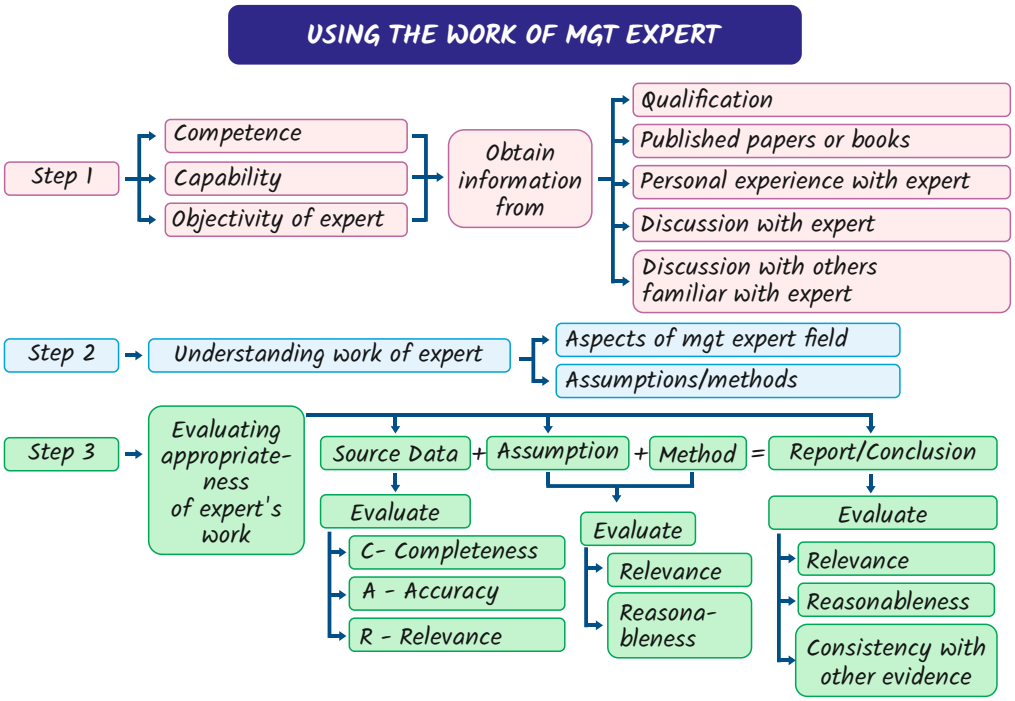
- ***First explain all above points and then write below discussion and conclusion.***
  Applying the above, the degree of reliance which can be placed by the auditor on the documentary audit evidence available in the present case will be considerably increased if the ***xerox copies of account books and vouchers are certified to be true copies by the Income Tax***

Department. If the tax authorities refuse to certify the same, the auditor should get the certificate to this effect from the management of the company.

The auditor should use procedure like confirmation of balances from third parties, inspection of tangible assets, etc. and obtain evidence which ***corroborates the documentary evidence available.*** *In any case, the auditor has to satisfy himself that he has obtained sufficient and appropriate audit evidence to support the figures contained in the financial statements and formulate his opinion accordingly.* ***Under such circumstances, the auditor should appropriately report (OMP) and bring this fact to the attention of shareholders. In case he was satisfied, a simple paragraph of information was enough but in case the auditor failed to establish the reliability of evidence available, he would be required to a disclaimer of opinion.***

(CNO—SA500.100) USING THE WORK OF A MANAGEMENT'S EXPERT (QNO-S8.000/S8.500) (MCQ-S00.6)

Chart



Steps before relying on Manage-ment's Expert.

The auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes, -

- *Evaluate the* ***competence, capabilities and objectivity*** *of that expert;*
- *Obtain an* ***understanding of the work*** *of that expert; and*
- *Evaluate the* ***appropriateness of that expert's work*** *as audit evidence for the relevant assertion.*

Competence, Capabilities and Objecti-vity – Sources of Evidence

The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as: -

- ***knowledge of that expert's qualifications;***
- ***published papers or books*** *written by that expert.*
- ***personal experience*** *with previous work of that expert;*
- ***discussions*** *with that expert;*
- ***discussions with others*** *who are familiar with that expert's work;*

Understan-ding field of Expert

Aspects of the management's expert's field relevant to the auditor's understanding may include what assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes.

Evaluating Work of Expert

The auditor may also consider the following while evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion:

- *If that expert's work involves* ***significant use of source data,*** *the relevance, completeness, and accuracy of that source data.*

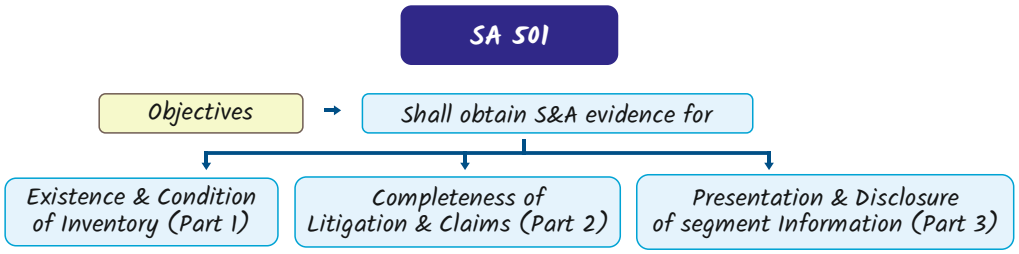
- *If that expert's work involves use of **significant assumptions and methods,** the relevance and reasonableness of those assumptions and methods; and*
- *The **relevance and reasonableness** of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;*

UNIQUE MCQs	
MCQs	500.7 / 500.8, Incs.49.3

[SA 501] AUDIT EVIDENCE: - SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS

(CNO--SA501.020) OBJECTIVE AS PER SA 501

Chart



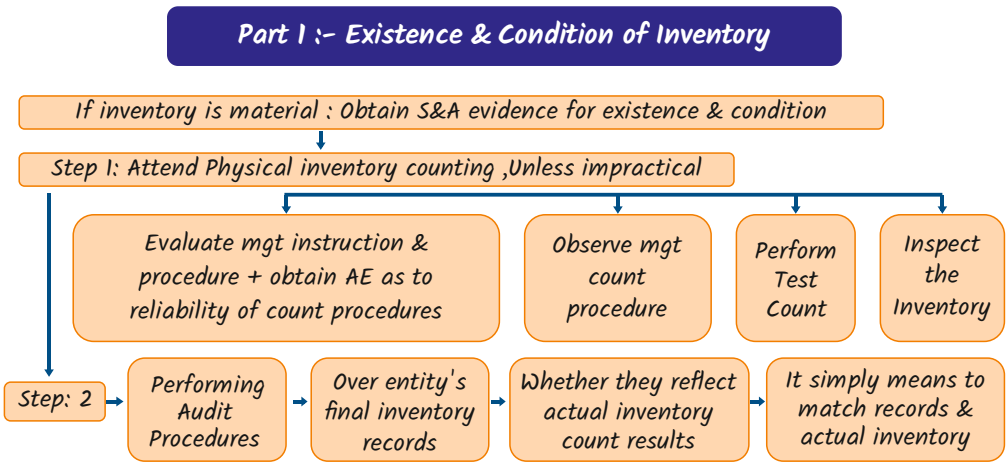
The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:

- Existence and condition of inventory;
- Completeness of litigation and claims involving the entity; and
- Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

PART 1: - INVENTORY

(CNO--SA501.040) EXISTENCE & CONDITION OF INVENTORY (QNO-60.000)

Chart



When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the **existence and condition of inventory** by:

- ***Attendance at physical inventory counting,*** unless impracticable
  - *Evaluate **management's instructions and procedures** for recording and controlling the results of the entity's physical inventory counting; Obtaining audit evidence as to the reliability of management's count procedures
  - Observe the **performance of management's count procedures;**
  - ***Inspect the inventory;*** and
  - Perform test counts; and
- ***Performing audit procedures*** over the entity's **final inventory records to determine whether they accurately reflect actual inventory count results.**

  These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out.

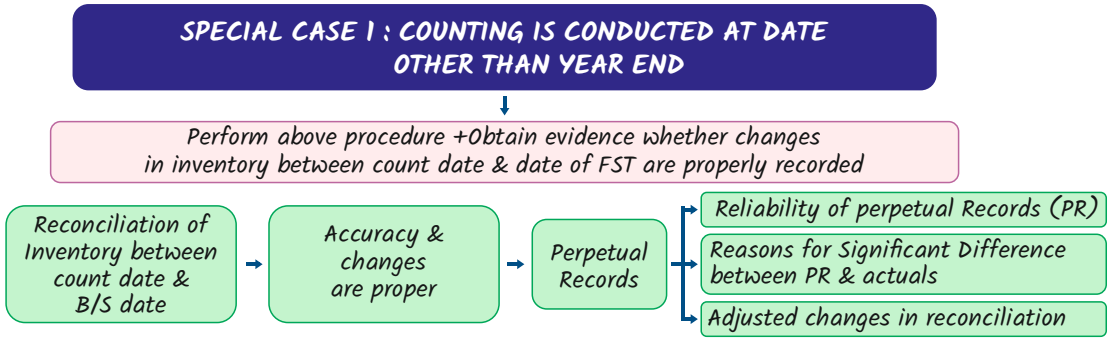
  Detailed Text

  *Evaluate Management's Instructions and Procedures
  - Control over the movement of inventory
  - Application of appropriate control activities
  - Accurate identification of the stage of completion of work in progress, of slow moving,

- *obsolete or damaged items and of inventory owned by a third party*
- *Procedures used to estimate physical quantities*

(CNO--SA501.060) COUNTING IS CONDUCTED AT A DATE OTHER THAN YEAR END (QNO- 59.000)

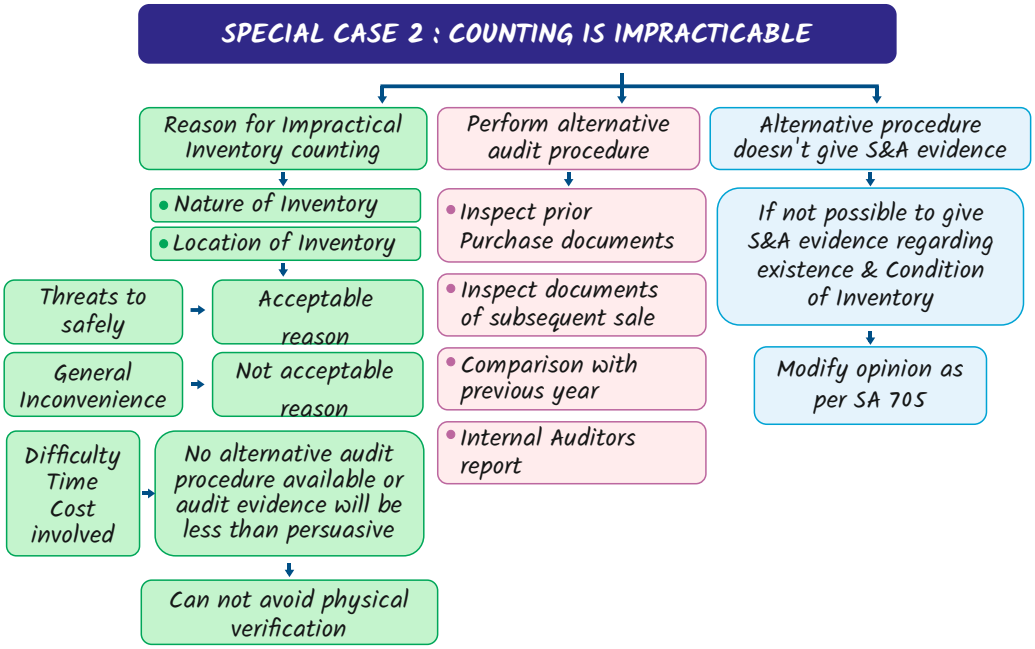
Chart



If physical inventory counting is conducted at a date other than the date of the financial statements, *the auditor shall, in addition to the procedures discussed before, perform audit procedures to obtain audit evidence about whether* ***changes in inventory between the count date and the date of the financial statements are properly recorded.***

(CNO--SA501.080) COUNTING IS IMPRACTICABLE (QNO-60.000)

Chart



Reasons for Impractical Inventory Counting

In some cases, attendance at physical inventory counting may be impracticable.

- ***Nature & Location of Inventory***
  This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable.
- ***Difficulty / Time / Cost***
  Further, as explained in SA 200, the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

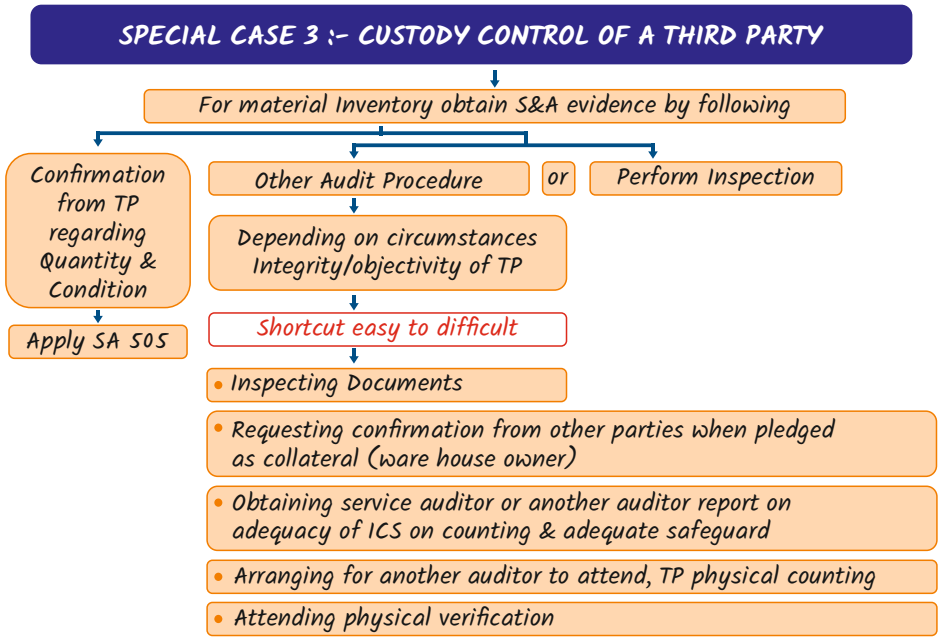
Examples of Alternative Procedures

In some cases where attendance is impracticable, alternative audit procedures, for example inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

Alternative Procedures Doesn't Give Sufficient & Appropriate Evidence	In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.
Conclusion & Basic Principle – If impractical Perform Alternative Procedures	If attendance at physical inventory counting is impracticable, the auditor shall perform **alternative audit procedures** to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. **If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.**

(CNO--SA501.100) CUSTODY AND CONTROL OF A THIRD PARTY (QNO-60.050) (MCQ-501.2)

Chart

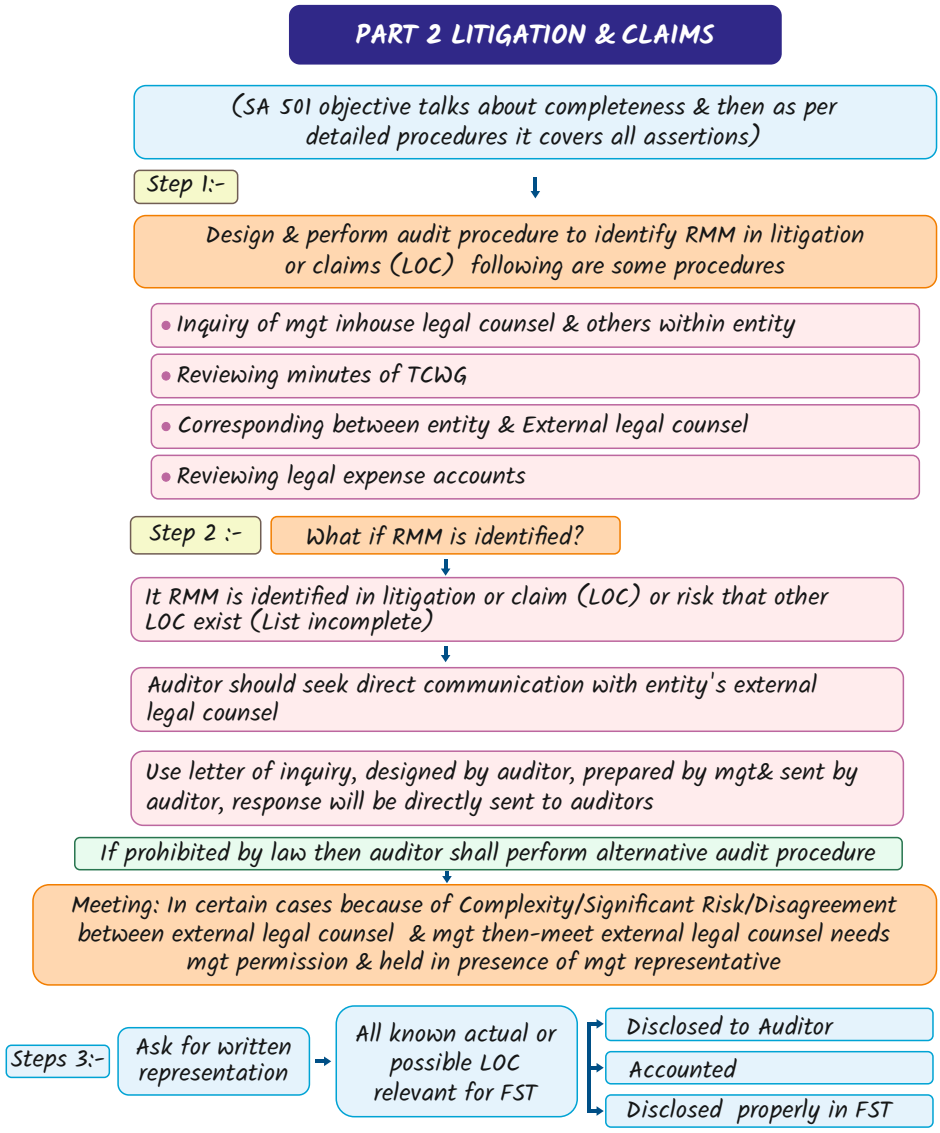


Basic Principle	**Basic Principle – If Custody & Control of Third Party then Request Confirmation or Other Audit Procedures** When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following: • Request **confirmation from the third party** as to the quantities and condition of inventory held on behalf of the entity. • Perform **inspection or other audit procedures** appropriate in the circumstances.
Confirmation	SA 505 establishes requirements and provides guidance for performing external confirmation procedures.
Other Audit Procedures	Depending on the circumstances, for example where information is obtained **that raises doubt about the integrity and objectivity of the third party**, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include: • **Inspecting documentation regarding inventory held by third parties,** for example, warehouse receipts. • Requesting confirmation from **other parties when inventory has been pledged as collateral.**(Warehouse Owner)

- Obtaining **another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control** for ensuring that inventory is properly counted and adequately safeguarded.
- **Attending or Arranging for another auditor to attend,** the third party's physical counting of inventory, if practicable.

(CNO-SA501.120) PART 2: - LITIGATIONS & CLAIMS / DESIGN & PERFORM PROCEDURES FOR COMPLETENESS LITIGATION AND CLAIMS WHICH MAY LEAD TO RMM (MCQ-501.3)

Chart



The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

Step 1

- **Inquiry of management** and, where applicable, others within the entity, including in-house legal counsel;
- **Reviewing minutes of meetings** of those charged with governance and
- **Correspondence between the entity and its external legal counsel;** and
- Reviewing **legal expense accounts.**

Step2

If risk of material misstatement, then direct communication with the entity's external legal counsel.

LETTER

- ***What if RMM exists? – Direct Communication with Lawyer***
  - If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek

direct communication with the entity's external legal counsel.

The auditor shall do so through a **letter of inquiry, prepared by management and sent by the auditor,** requesting the entity's external legal counsel to communicate directly with the auditor.

- **Prohibition**
  If law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures.

- **MEET**
  In Certain Cases – Complexity / Significant Risk / Disagreement between Client & Management then – Meet External Legal Counsel
  In certain circumstances, the auditor also may judge it necessary to meet with the entity's external legal counsel to discuss the likely outcome of the litigation or claims.

  This may be the case, for example, where:
  - The auditor determines that the matter is a significant risk.
  - The matter is complex.
  - There is disagreement between management and the entity's external legal counsel.

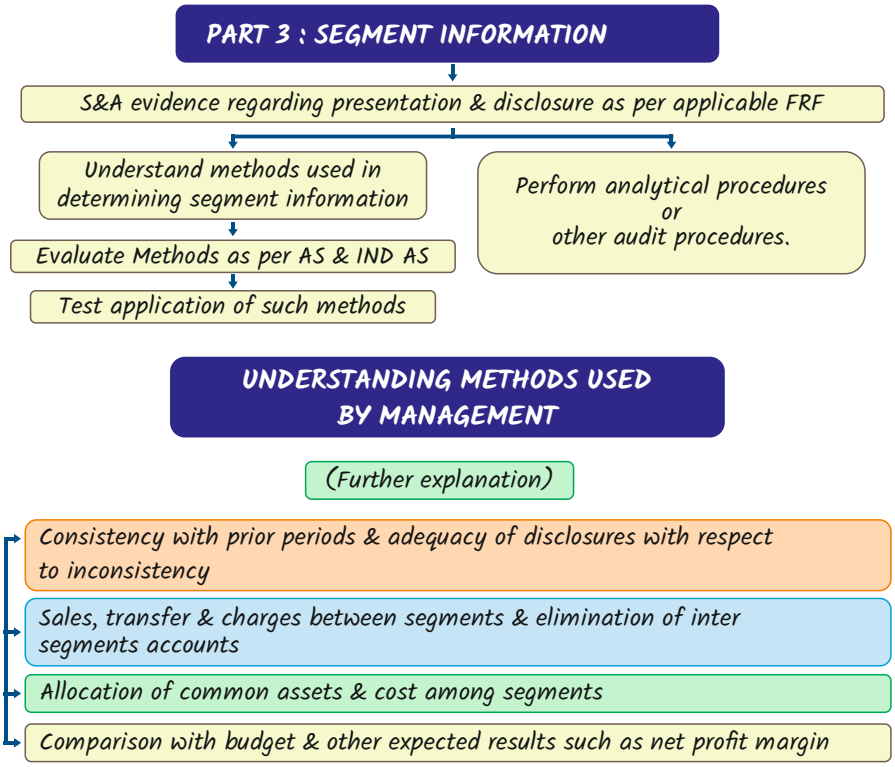
Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

Step 3

- **Written Representations**
  The auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

(CNO-SA501.160) PART-3 SEGMENT INFORMATION (QNO-60.060)

Chart

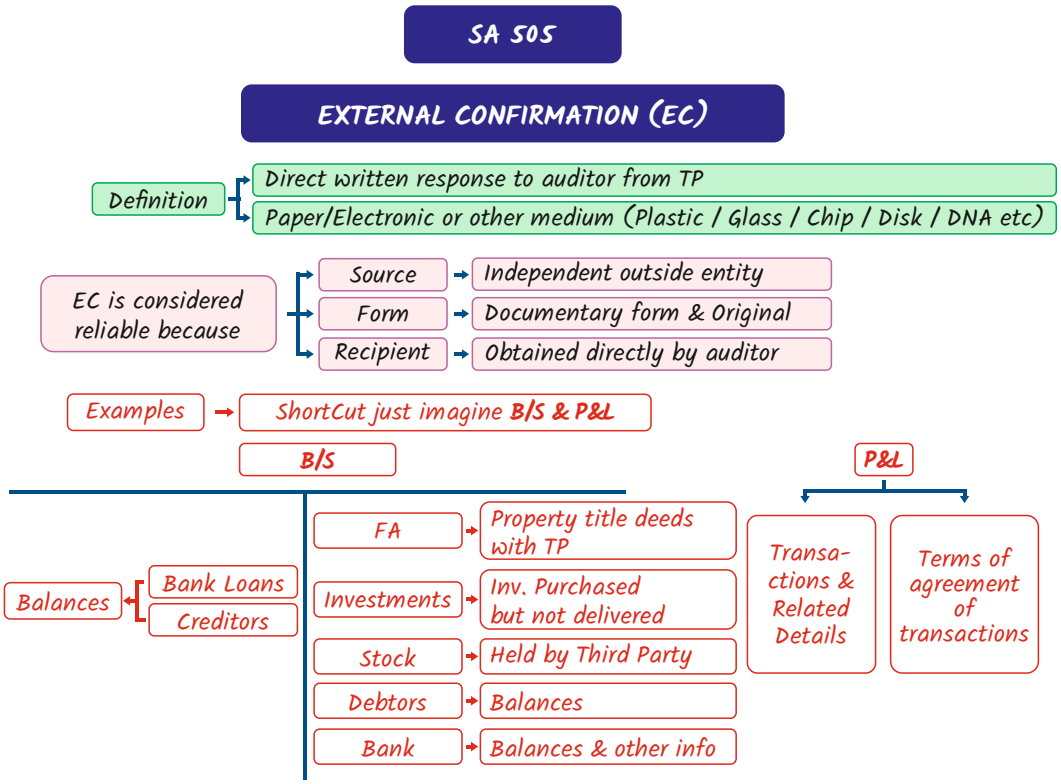


Audit Procedures	*The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:* ➢ *Obtaining an understanding of the methods used by management in determining segment information. Further,* ▪ *Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and* ▪ *Where appropriate, testing the application of such methods; and* ▪ *Performing analytical procedures or other audit procedures appropriate in the circumstances*
Further Explanation: Understanding of the Methods Used by Management	➢ *Depending on the circumstances, example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:* ▪ *Sales, transfers and charges between segments, and elimination of intersegment amounts.* ▪ *Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.* ▪ *The allocation of assets and costs among segments.* ▪ *Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies*
UNIQUE MCQS	
MCQ No.	*501.1 Incs.53.3*

[SA 505]EXTERNAL CONFIRMATIONS

(CNO—SA505.020) WHAT IS EXTERNAL CONFIRMATION? (QNO 61.000) (MCQ-505.6)

Chart



1. External confirmation

External confirmation *– Audit evidence obtained as a* ***direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.***

- *Audit evidence is more reliable when it is obtained* ***from independent sources outside the entity.***
- *Audit evidence* ***obtained directly by the auditor*** *is more reliable than audit evidence obtained indirectly or by inference.*
- *Audit evidence is more reliable when it exists in* ***documentary form, whether paper, electronic or other medium.***

Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity.

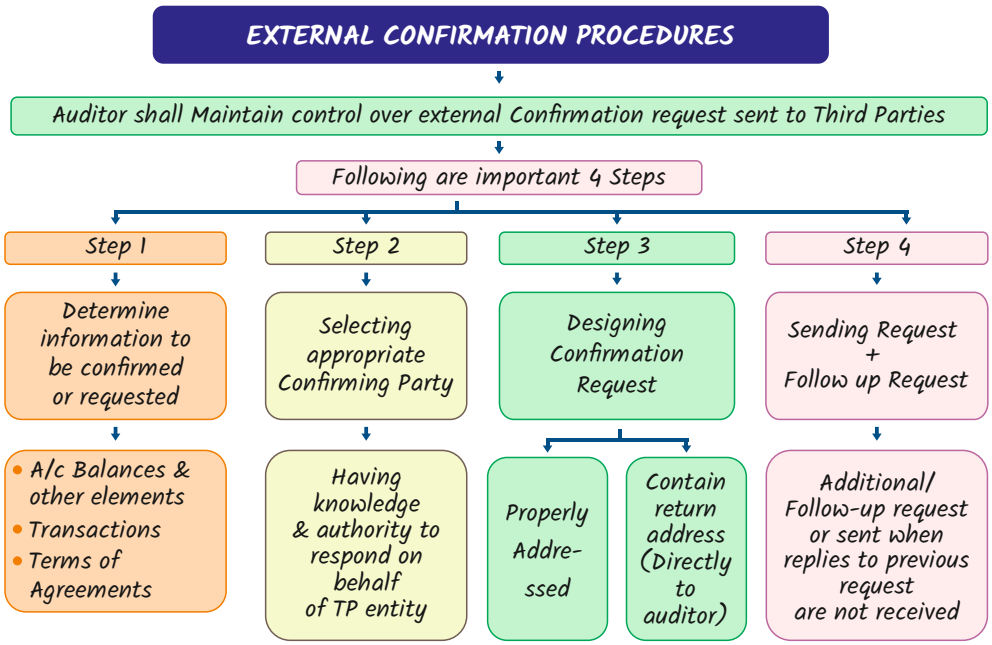
2.Examples (QNO-61.000)

Situations where External Confirmations may be used/parties to whom we are ask for conformation.

- *Debtor balances;*
- *Creditor balances;*
- *Terms of agreement or transactions with third parties;*
- *Bank Balance and other information from bankers;*
- *Stock held by third parties;*
- *Property title deeds held by third parties;*
- *Investments purchased but delivery not taken; &*
- *Bank loans.*

(CNO—SA505.040) EXTERNAL CONFIRMATION PROCEDURES (QNO 62.000)

Chart



Auditors Control over External Confirmations

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

1. Determining the **information to be confirmed or requested;**
2. Selecting the **appropriate confirming party;**
3. **Designing the confirmation requests,** including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
4. **Sending the requests, including follow-up requests** when applicable, to the confirming party.

1.Determining the Information to be Confirmed or Requested

External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements. They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a "side agreement".

2.Selecting the Appropriate Confirming Party

Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed.

(E.g. a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.)

3.Designing Confirmation Requests (QNO-62.000/62.100)

Directly affect the confirmation **response rate,** and the **reliability and the nature** of the audit evidence.

Factors to consider when Designing confirmation requests

FACTORS TO CONSIDER WHEN DESIGNING CONFIRMATION REQUESTS INCLUDE:

Letter Head of the Company
To
Customer
Address
Subject:- Confirmation Request
Our annual audit is being conducted by ABC & Associates; it's their regular audit procedure to call for confirmations. This time your account is selected for confirmation process. This doesn't change or has any impact on our legal understandings & balances. It has nothing to do with discounts and other issues.
Balance / Transaction / Cheque / Agreement etc as per our records is.....
Sign
Please write balance as per your records in cut out area given below

1. Layout & Presentation
Letter Head Vs Blank

2. Management Encouragement
More Encouragement—More Response

3. Assertions being examined
Existence – Debtor Balance (Ledger Folio Number)
Occurrence-Transactions (Dates)
Completeness – Total Transactions (Time Period)
Cut off – Last Bill & Last Cheque (Number)

4. Ability to Confirm information
Invoice wise balance vs total balance
Depending on Software & Its access

5. Management Authorization Sign
Higher Authority—More Response

6. Risk of Material Misstatement
Low Risk-Negative Confirmation Request
High Risk-Positive Confirmation Request

7. Method of Communication
Paper Form / Electronic Form / Any Other Form

8. Prior Experience
When it should be sent / How many should be selected

4. Sending Requests

Determining that requests are properly addressed, includes testing the **validity of some or all of the addresses on confirmation requests before they are sent out.**

Follow-Up on Confirmation Requests

The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time.

(E.g. the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request)

(CNO--SA505.060) NEGATIVE CONFIRMATIONS (QNO-62.100) (QNO-63.000)

Chart

NEGATIVE CONFIRMATION

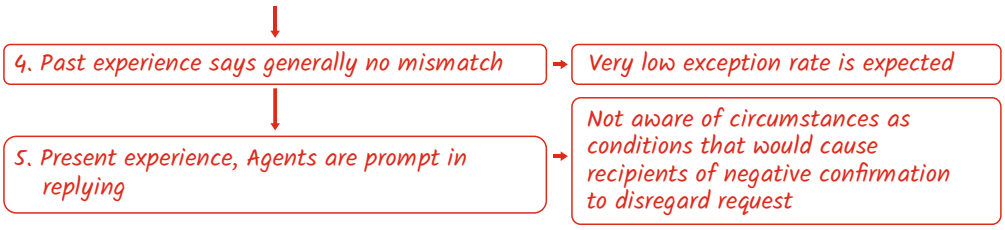
Def: Confirming Party/ TP will reply only if they disagree with information provided in request

Less persuasive evidence as compared to positive confirmations so positive confirmation is preferred

Negative confirmation as sole substantive audit procedure for RMM only if ALL following conditions satisfied

ShortCut: Imagine Herba Life Nutrition Co. (Notional)

1. First it takes 50000 deposit from each agent → Assess RMM is low
2. App based dealings & daily cash deposit → Controls relevant to assertions are operating effectively
3. Agents spread across world 10000 agents → Comprises large number of small, homogeneous transactions, balances, conditions



Definition

Negative confirmation request – A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

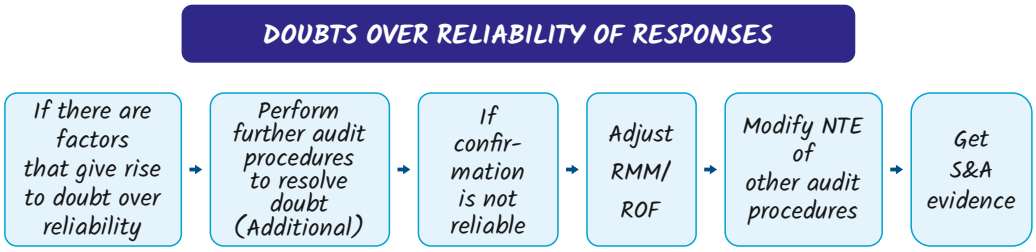
Situations

Negative confirmations **provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:**

- The auditor has **assessed the risk of material misstatement as low** and has obtained sufficient appropriate audit evidence regarding the **operating effectiveness of controls relevant to the assertion;**
- The population of items subject to negative confirmation procedures **comprises a large number of small, homogeneous, account balances, transactions or conditions;**
- **A very low exception rate is expected;** and
- **The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation** requests to disregard such requests.

(CNO—SA505.080) RELIABILITY OF RESPONSES

Chart



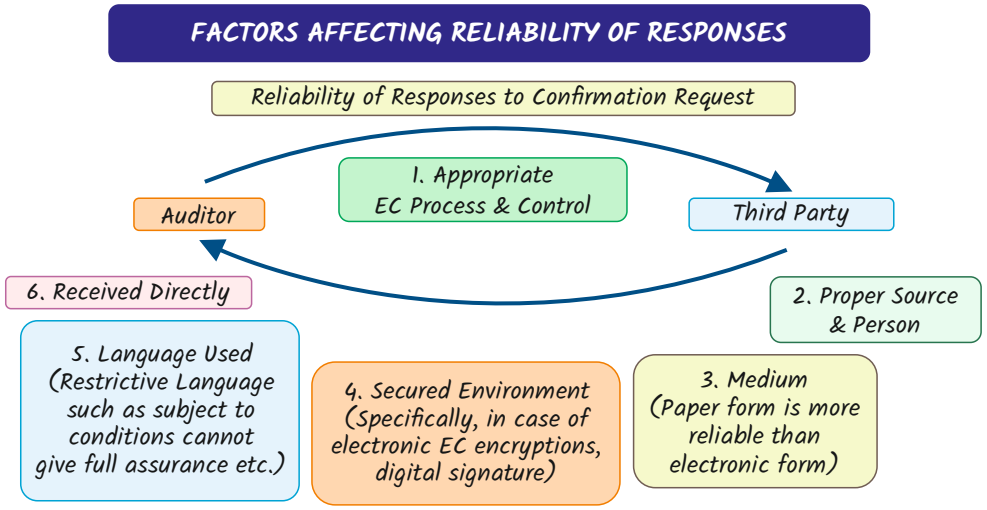
If the auditor identifies **factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts.**

If the auditor determines that a **response to a confirmation request is not reliable,** the auditor **shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud,** and on the related nature, timing and extent of other audit procedures.

(Factors that gives rise to doubt over reliability Perform further audit evidence for reliabilityIf confirmation is not reliable Adjust RMM /ROF Perform other audit procedures to get S&A evidence)

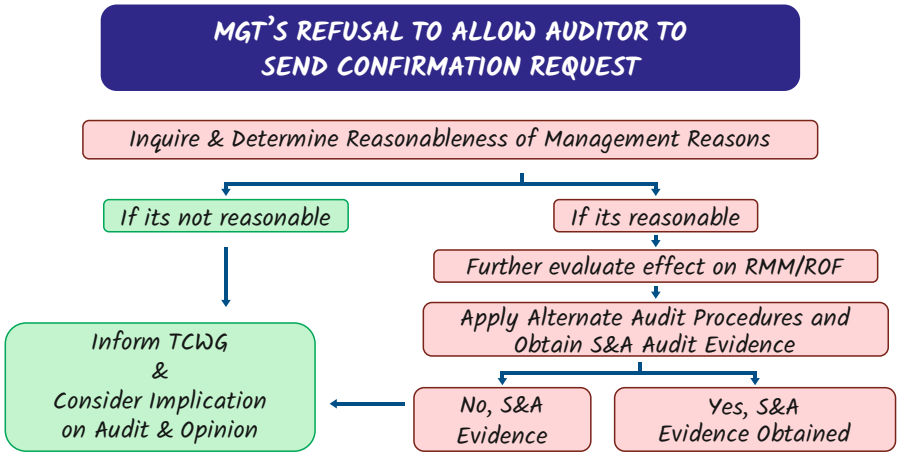
Following are factors affecting reliability

Chart



(CNO—SA505.100) MANAGEMENT'S REFUSAL TO ALLOW THE AUDITOR TO SEND A CONFIRMATION REQUEST

(QNO-65.000) (MCQ-505.7)

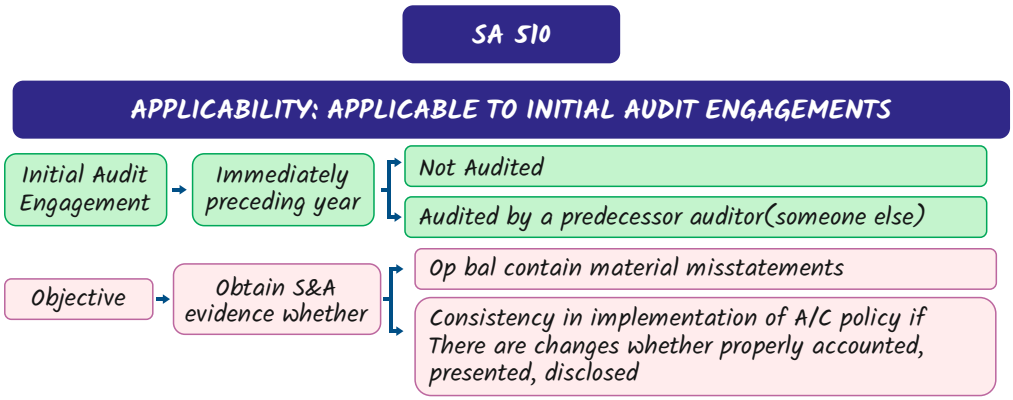
Chart	
Inquiry	***If management refuses to allow the auditor*** *to send a confirmation request, the auditor shall:* ***Inquire as to management's reasons*** *for the refusal, and seek audit evidence as to their validity and reasonableness;*
Evaluate	***Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and***
Alternative audit procedures	***Perform alternative audit procedures*** *designed to obtain relevant and reliable audit evidence.* ***If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260. The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705.***

UNIQUE MCQS	
MCQ No.	505.1
MCQ No.	505.2
MCQ No.	505.3
MCQ No.	505.4
MCQ No.	505.8, 505.9 / Incs.42.3

[SA 510] INITIAL AUDIT ENGAGEMENTS OPENING BALANCES

(CNO--SA510.020) APPLICABILITY & OBJECTIVES OF SA 510 (QNO-66.000/66.100)

Chart



- **Applicability**

  This Standard on Auditing (SA) deals with the auditor's responsibilities relating to opening balances when conducting an **initial audit engagement.**

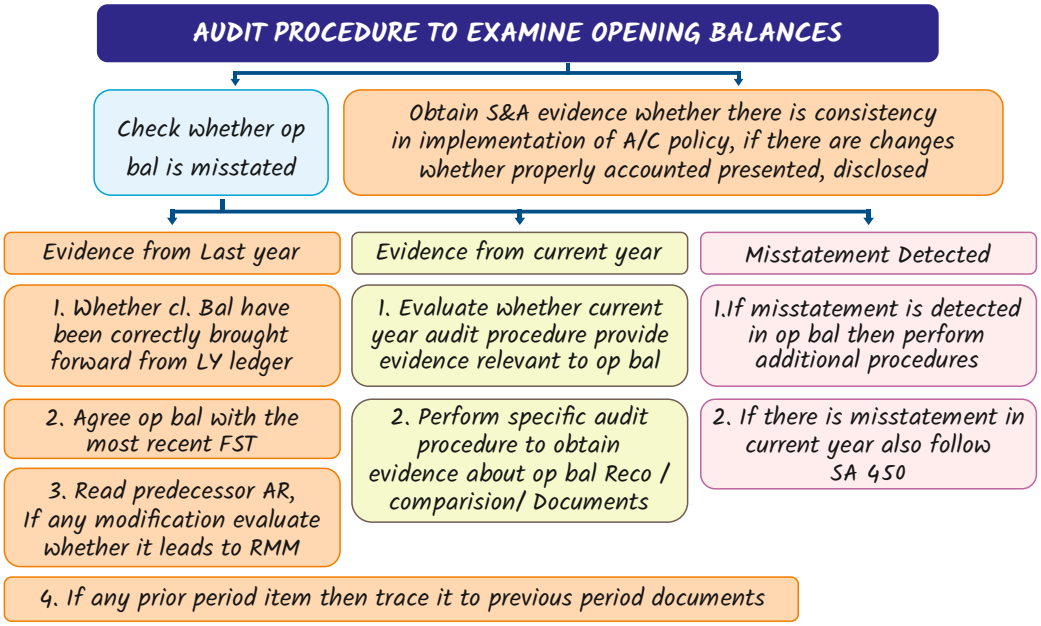
  Initial audit engagement – An engagement in which either:
  - The financial statements for the prior period were **not audited;** or
  - The financial statements for the prior period were **audited by a predecessor auditor.**

- **Objective**

  In conducting an initial audit engagement, **the objective of the auditor with respect to opening balances** is to obtain sufficient appropriate audit evidence about whether:
  - Opening balances contain **misstatements that materially affect** the current period's financial statements; and
  - Appropriate **accounting policies reflected in the opening balances** have been consistently applied in the current period's financial statements or **changes thereto are properly accounted for and adequately presented and disclosed** in accordance with the applicable financial reporting framework.

(CNO--SA510.040) AUDIT PROCEDURES TO EXAMINE OPENING BALANCES (QNO-66.000) (MCQ-510.2, Incs.55.3)

Chart



The auditor shall **read the most recent financial statements,** if any, and the **predecessor auditor's report thereon**, if any, for information relevant to opening balances, including disclosures.

The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

- *Determining whether the prior period's* ***closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;***
- *Determining whether the opening balances reflect the* ***application of appropriate accounting policies;*** *and*
- *Performing one or more of the following:*
  - *Where the prior year financial statements were audited, perusing the* ***copies of the audited financial statements*** *including the other relevant documents relating to the prior period financial statements;*
  - *Evaluating whether* ***audit procedures performed in the current period provide evidence relevant to the opening balances;*** *or*
  - *Performing* ***specific audit procedures*** *to obtain evidence regarding the opening balances.*

- ***Relevant Information in the Predecessor Auditor's Report***

  If the prior period's financial statements were audited by a predecessor auditor and there was a modification to the opinion, ***the auditor shall evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period's financial statements in accordance with SA 315.***

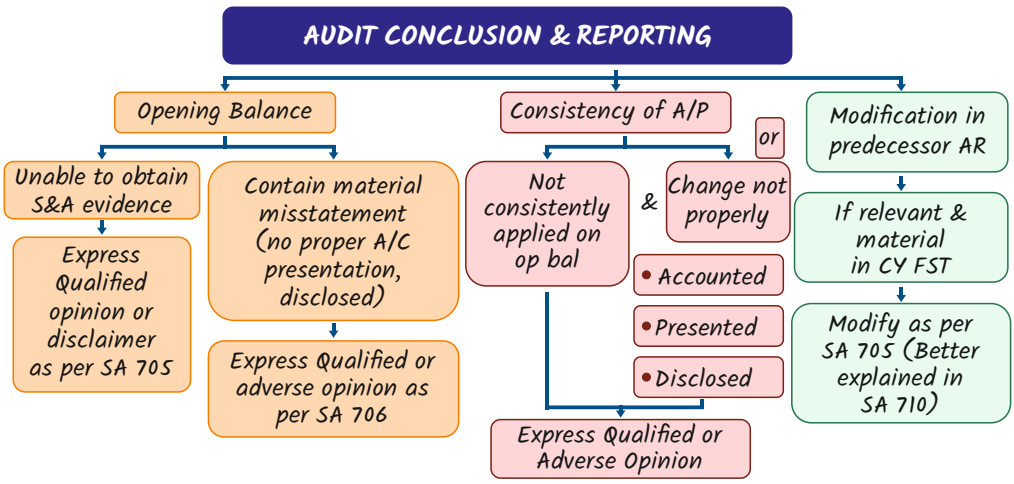
  If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance in accordance with SA 450.

- ***Consistency of Accounting Policies***

  The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been ***consistently applied in the current period's financial statements, and whether changes in the accounting policies have been properly accounted for and adequately presented and disclosed*** *in accordance with the applicable financial reporting framework.*

(CNO--SA510.060) AUDIT CONCLUSION & REPORTING

Chart



If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.

- ***Conclusion and Reporting on Material Misstatement of Opening Balance: –***
  If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705.

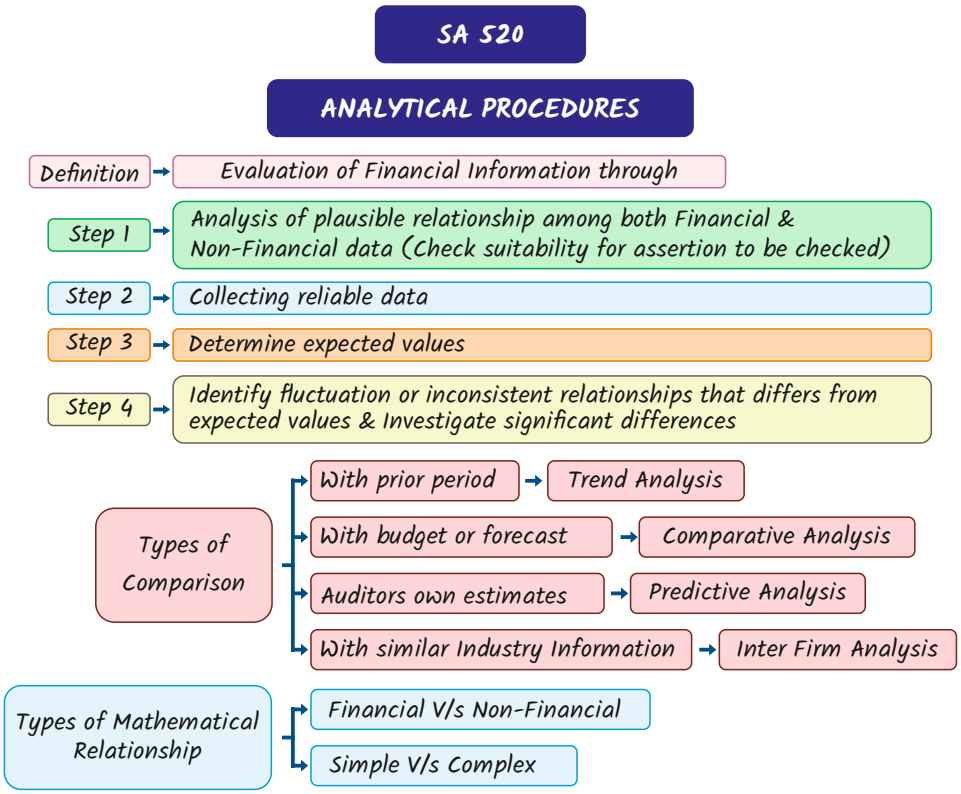
- ***Conclusion and Reporting on Consistency of Accounting Policies relating to Opening Balance: –***
  If the auditor concludes that:
  - *The current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework; or*
  - *A change in accounting policies is not properly accounted for or not adequately presented or disclosed in accordance with the applicable financial reporting framework, the auditor shall express a qualified opinion or an adverse opinion as appropriate in accordance with SA 705.*

- ***Modification in Predecessor Auditor's Report***
  If the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's opinion that remains relevant and material to the current period's financial statements, the auditor shall modify the auditor's opinion on the current period's financial statements in accordance with SA 705(Revised) and SA 710

[SA 520] ANALYTICAL PROCEDURES

(CNO—SA520.020) ANALYTICAL PROCEDURES (QNO-68.000)

Chart



Definition (MCQ-S20.3)

The term "analytical procedures" means evaluation of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such ***investigation*** *as is necessary of identified* ***fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values*** *by a significant amount.*

Thus, analytical procedures include the consideration of comparisons of the entity's financial information with as well as consideration of relationships.

Examples of Comparison of Financial Data

Text	Examples
Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:	
➢ *Comparable information for prior periods.*	*(Trend Analysis)*
➢ *Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.*	*(Comparative Analysis)*
➢ *Auditor's own estimate*	*(Predictive Analysis)*
➢ *Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.*	*(Intern Firm Analysis)*

4 types of Comparisons as explained above

Thus, we can say that Analytical Procedures may be segregated into these major types as comparison of client and industry data, comparison of client data with similar prior period data, comparison of client data with client-determined expected results, comparison of client data with auditor-determined expected results and comparison of client data with expected results, using non-financial data.

Simple Comparisons to Complex Analysis

Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. (Correlation & Regression) Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

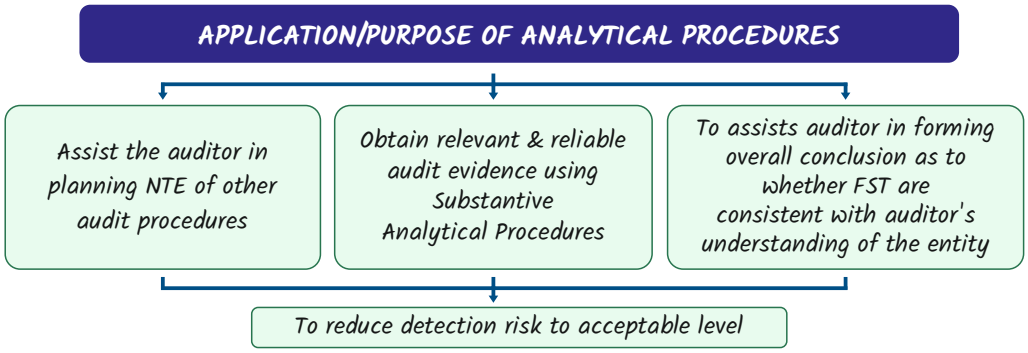
Examples of Comparison of Relationships

Analytical procedures also include consideration of relationships, for example:

- Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
- Between financial information and relevant non-financial information, such as payroll costs to number of employees.

(CNO—SAS20.040) APPLICATION / PURPOSE OF ANALYTICAL PROCEDURES (QNO-68.000)

Chart

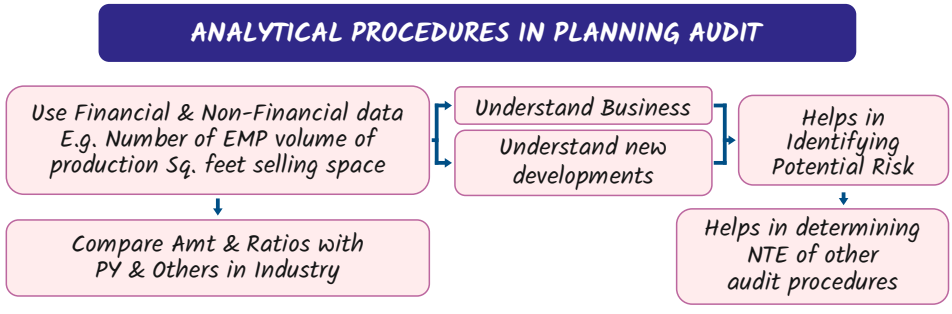


Analytical procedures are used for the **following purposes:**

- To assist the auditor in **planning** the nature, timing and extent of other auditing procedures.
- To obtain relevant and reliable audit evidence when **using substantive analytical procedures;** and
- To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

(CNO--SAS20.060) ANALYTICAL PROCEDURES IN PLANNING THE AUDIT

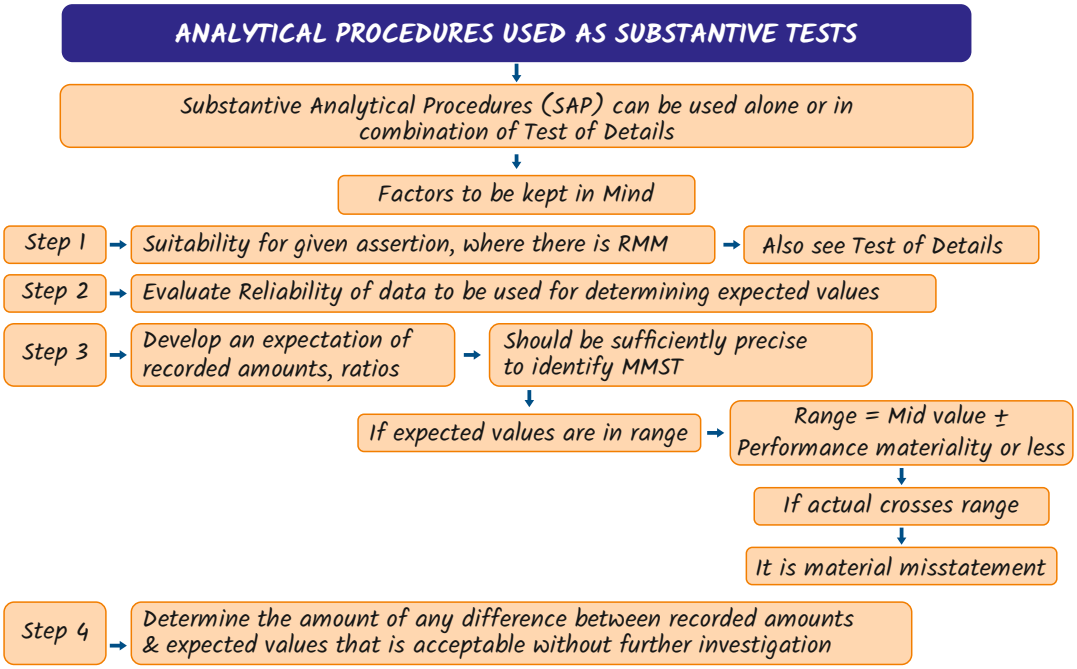
Chart



In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.

(CNO—SA520.080) ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS (QNO-71.000)

Chart

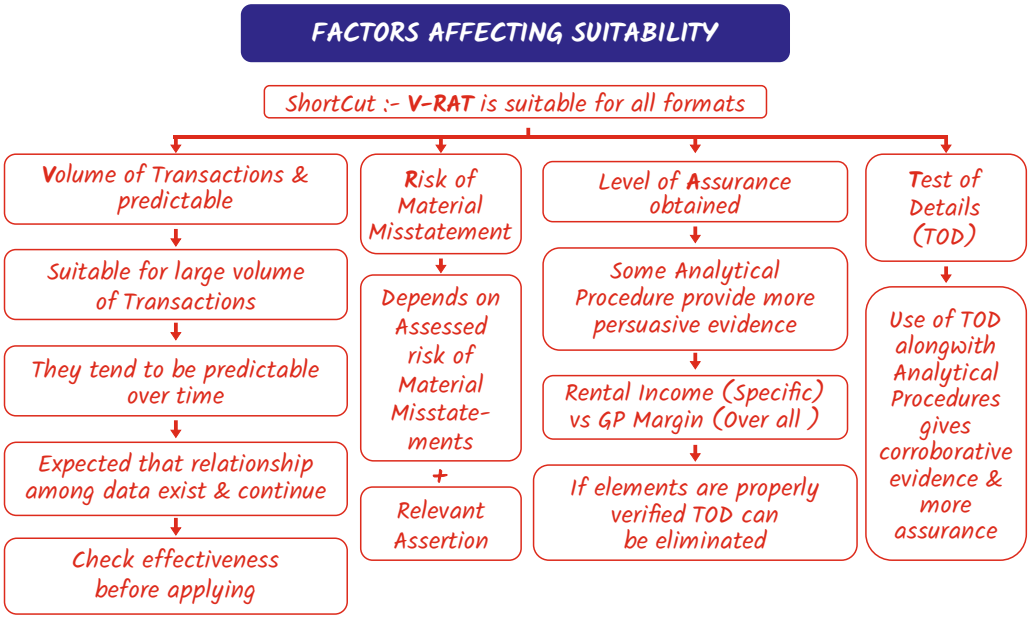


When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall:

- Determine the suitability of particular **substantive analytical procedures for given assertions,** taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
- Evaluate the **reliability of data** from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;
- **Develop an expectation** of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
- Determine **the amount of any difference** of recorded amounts from expected values that is acceptable without further investigation.

(CNO—SA520.100) FACTORS AFFECTING SUITABILITY (QNO 70.000)

Chart



DETAILED THEORY (QNO 70.000)

- **Volume of Transactions**

Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure.

(E.g. If an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognized trade ratios (such as profit margins for di erent types of retail entities) can often be used e ectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.)

- **Risk of Material Misstatement**

The determination of the suitability of particular substantive analytical procedure is influenced by the nature of the assertion and the auditor's assessment of the risk of material misstatement. For example, if controls over sales order processing are weak, the auditor may place more reliance on tests of details rather than on substantive analytical procedures for assertions related to receivables.

- **Different Levels of Assurance**

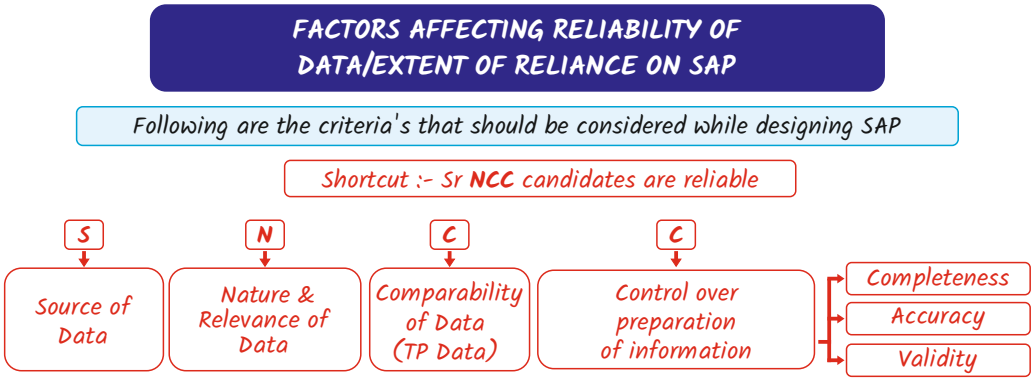
Different types of analytical procedures provide di erent levels of assurance. Analytical procedures involving, for example, the prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified. In contrast, calculation and comparison of gross margin percentages as a means of confirming a revenue figure may provide less persuasive evidence but may provide useful corroboration if used in combination with other audit procedures.

- **Test of Details**

Particular substantive analytical procedures may also be considered suitable when tests of details are performed on the same assertion. For example, when obtaining audit evidence regarding the valuation assertion for accounts receivable balances, the auditor may apply analytical procedures to an aging of customers' accounts in addition to performing tests of details on subsequent cash receipts to determine the collectability of the receivables.

(CNO--SA520.120) FACTORS AFFECTING RELIABILITY OF DATA / EXTENT OF RELIANCE ON ANALYTICAL PROCEDURES (QNO-68.000, 73.000)

Chart

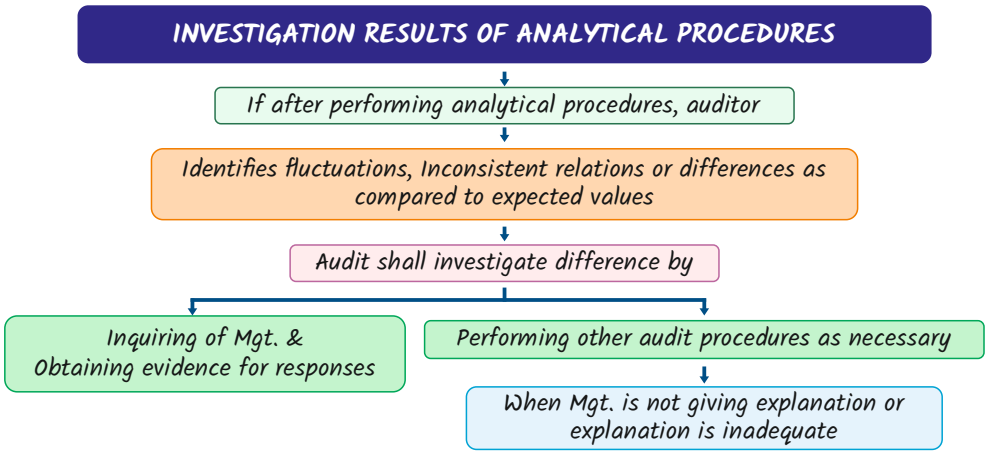


SA 520 on 'Analytical Procedures' provides that the reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant criteria when determining whether data is reliable for purposes of designing substantive analytical procedures-

➢ ***Source of the information** available.*	***E.g.** information may be more reliable when it is obtained from independent sources outside the entity;*
➢ ***Comparability of the information***	***E.g.** broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products;*
➢ ***Nature and relevance** of the information available.*	***E.g.** whether budgets have been established as results to be expected rather than as goals to be achieved; and*
➢ ***Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity.***	***E.g.** controls over the preparation, review and maintenance of budgets.*

(CNO-SAS20.140) INVESTIGATING RESULTS OF ANALYTICAL PROCEDURES (QNO-73.100)

Chart (MCQ-520.2, 520.6, Incs.53.4)



If analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

- *Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and*

  Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

- *Performing other audit procedures as necessary in the circumstances.*

  The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

(CNO—SA520.160) ANALYTICAL PROCEDURES THAT ASSIST WHEN FORMING AN OVERALL CONCLUSION (MCQ-520.5)

Chart	**ANALYTICAL PROCEDURES THAT ASSIST WHEN FORMING OVERALL CONCLUSION** ↓ Mandatory to design & perform analytical procedures near the end of audit for overall conclusion ↓ Above procedures are performed to corroborate conclusion formed during audit regarding TBD ↓ This assists auditors to draw condition & form opinion ↓ May identify previously unidentified RMM & further plan audit procedures ↓ Similar to those performed for risk assessment procedure at planning stage.
	The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.
Corroborate conclusions with evidence during audit	The conclusions drawn from the results of analytical procedures designed and performed in accordance with above paragraph intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements. This assists the auditor to draw reasonable conclusions on which to base the auditor's opinion.
May modify RMM & Further Audit Procedures	The results of such analytical procedures may identify a previously unrecognised risk of material misstatement. In such circumstances, SA 315 requires the auditor to revise the auditor's assessment of the risks of material misstatement and modify the further planned audit procedures accordingly.
Similar to procedures used during planning	The analytical procedures performed for overall conclusion may be similar to those that would be used as risk assessment procedures. (Planing stage)

UNIQUE MCQS	
MCQ No.	520.1
MCQ No.	520.4

[SA 530] AUDIT SAMPLING

(CNO—SA530.020) SAMPLING RISK & NON-SAMPLING RISK (QNO-74.000)

Chart

SAMPLING RISK

The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure

↓

Sampling risk can lead to two types of erroneous conclusions

Type I – Error	Type II – Error
(Over Reliance on Controls) In the case of a test of controls, that controls are more effective than they actually are	**(Under Reliance on Controls)** In the case of a test of controls, that controls are ineffective but in reality they are effective
(Incorrect Acceptance) or in the case of a test of details, that a material misstatement does not exist when in fact it does	**(Incorrect Rejection)** In the case of a test of details that material misstatement exists when infact it does not
(Reduces Effectiveness of Audit) The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion	**(Reduces Effeciency of Audit)** This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

SAMPLING RISK

The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure.

Chart

NON-SAMPLING RISK

Chances that auditors reachs inappropriate conclusions because of reasons given below

- Inappropriate procedures (Design)
- Failure to recognise misstatement or Deviation (Implementation)
- Misinterpretation of Audit Evidence (Evaluation)

NON-SAMPLING RISK

The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

Examples of non-sampling risk include use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognise a misstatement or deviation.

- **Inappropriate Audit Procedure:** – Only cost of fixed assets was checked by tracing bills & agreements with fixed asset register, no checking for depreciation, revaluation, AS compliance, physical verification.
- **Failure to recognize a misstatement or deviation:** – Customers were given discount at the time recovery of credit sales without any authorization. Article failed to point it out as irregularity as all details were on printed documents.

- ***Misinterpretation of Audit Evidence:*** *– Only 2 debtors out sample of 200 picked from 3000 debtors sent replies to positive confirmation request, stating that there was small mismatch. Auditor concluded that in all other debtors' balances match hence no material misstatement exists in sample and population. It was case of inadequate evidence; he should have performed alternative audit procedures.*

(CNO--SAS30.040) SAMPLING PROCESS

Chart

SAMPLING PROCESS

1. Sample Designing	It is preliminary sampling step. Suppose we have to examine occurrence of sales. We have to determine our objective (catch fake sales) , audit procedures (match with despatch report) etc are decided in this step.
2. Sample Size	After analysis of various factors it was set as 200 units from each Of East / West / South / North area so total 200 x 4 = 800 from population of 5000
3. Selection of Items for Testing (Sampling Selection Method)	Stratified Random Sampling
4. Performing Audit Procedures	Inspection of documents & Inquiry from sales executive.
5. Nature and Cause of Deviations and Misstatements	Intentional or Unintentional / Manual or Automated
6. Projecting Misstatements	If there are fake sales in sample, then how much in whole population.
7. Evaluating Results of Audit Sampling& Taking Action	Whether misstatements are within tolerable limit? Whether further audit procedures should be applied.

(CNO-SAS30.060) SAMPLE DESIGN

Chart

STEP - 1 SAMPLE DESIGNING

Define Population and its Characteristics	All sales transactions.
Stratification	Area wise bifurcation in East West South North
Consider Purpose	Examining Sales Transaction. Whether any of the transaction is fake.
Consider Audit Procedures	Check sales transaction from customer order, gate pass, transporter report, delivery memo, confirmation.Inquire from sales executive and visit godown.
Nature of Audit Evidence	Documentary / Oral / Visual
What Constitute Misstatement	If essential documents of transaction are missing it can be a misstatement. Different dates in documents is fine if its within 3-4 days of sales transaction.

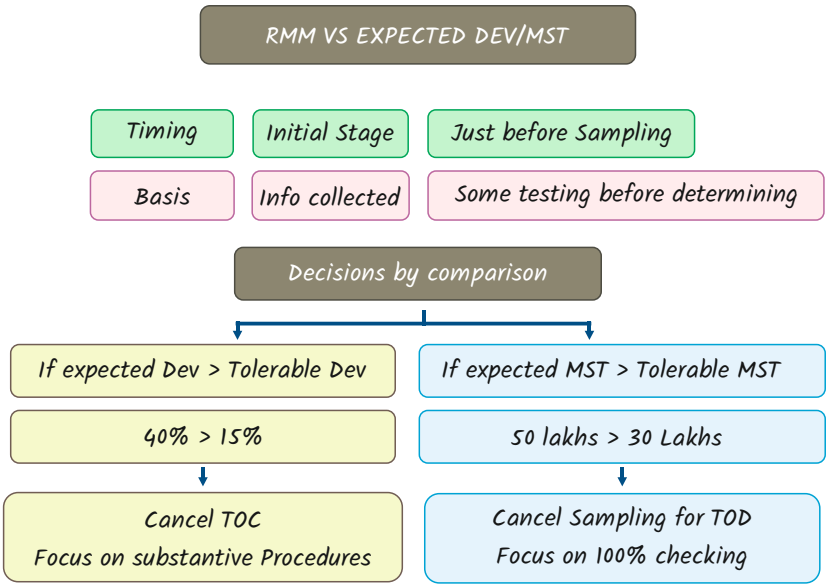
Considerations

(Consider Purpose / Audit Procedures / Nature of Audit Evidence Required / What Constitutes Deviation or Misstatement then Define Population and Consider Characteristic of Population for Stratification)

When designing an audit sample, the auditor's consideration includes;

- the **specific purpose** to be achieved
- and the combination of **audit procedures** that is likely to best achieve that purpose.
- Consideration of the **nature of the audit evidence** sought and
- possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining **what constitutes a deviation or misstatement**
- and what **population** to use for sampling.
- In fulfilling the requirement of SA 500 Audit Evidence, when performing audit sampling, the auditor performs audit procedures to obtain evidence that the population from which the audit sample is drawn is complete.

Chart



Role of Expected Rate of Deviation & Misstatement in Sample Designing

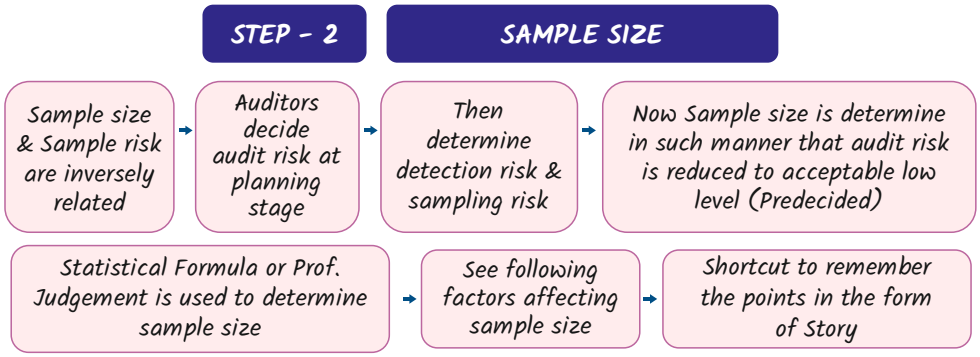
In considering the characteristics of a population, for tests of controls, the auditor makes an assessment of the expected rate of deviation based on the auditor's understanding of the relevant controls or on the examination of a small number of items from the population. This assessment is made in order to design an audit sample and to determine sample size.

If the expected rate of deviation is unacceptably high, the auditor will normally decide not to perform tests of controls.

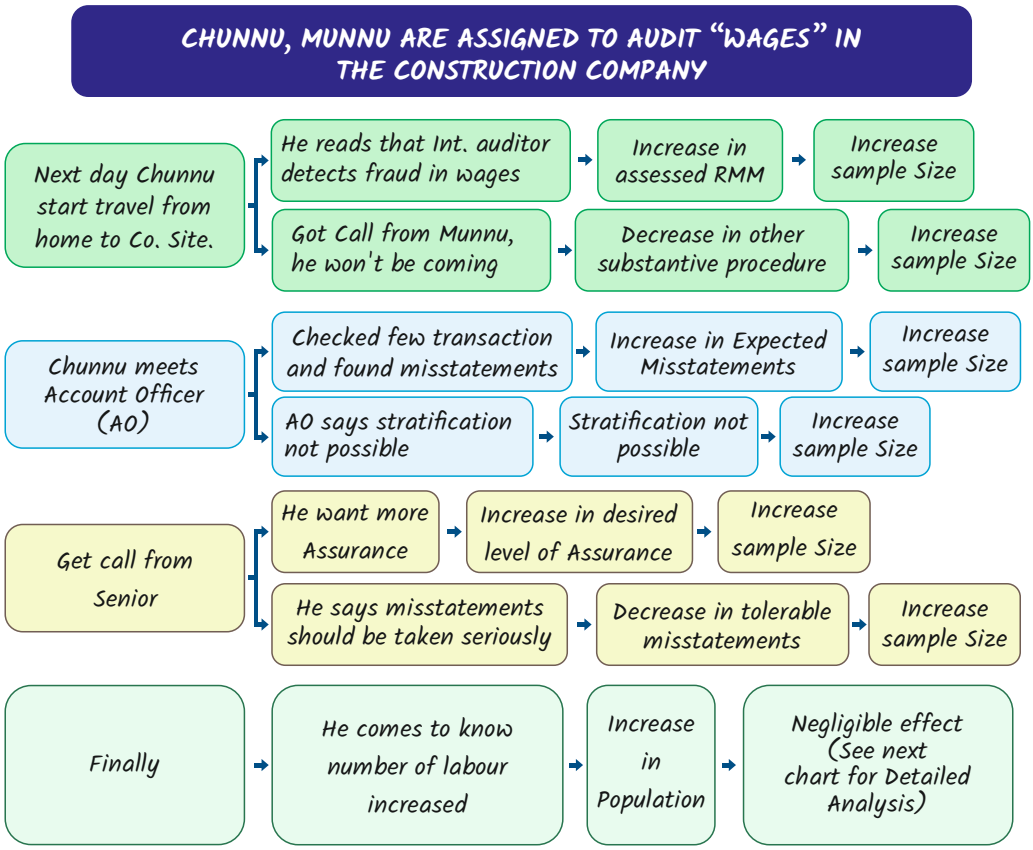
Similarly, for tests of details, the auditor makes an assessment of the expected misstatement in the population. If the expected misstatement is high, 100% examination or use of a large sample size may be appropriate when performing tests of details.

(CNO--SA530.080) SAMPLE SIZE (MCQ-530.3)

Chart

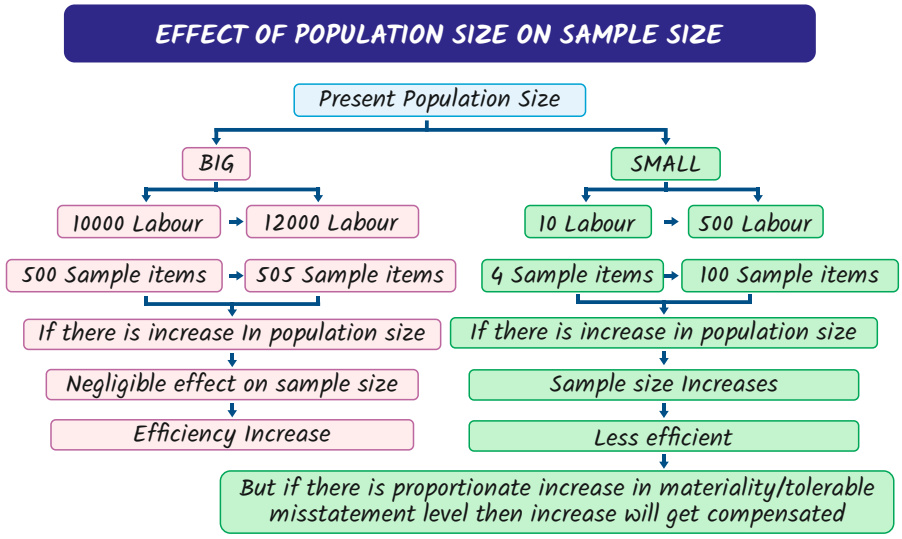


Chart



Above points are presented from point of sampling in test of detail, similar points applicable for sampling in TOC

Chart



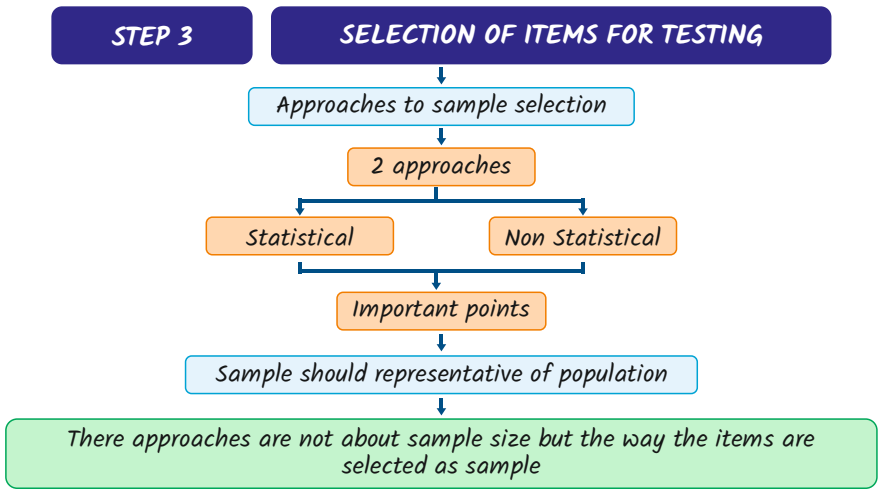
- The auditor shall determine a sample size sufficient to **reduce sampling risk to an acceptably low level.**
- The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.
- The sample size can be determined by the application of a statistically based formula or through the exercise of professional judgment.

Situation	Impact on Sample Size
An **increase** in the auditor's assessment of the **risk of material Misstatement**	The higher the auditor's assessment of the risk of material misstatement, the **larger the sample size** needs to be. The auditor's assessment of the risk of material misstatement is affected by inherent risk and control risk.

Decrease in the use of **other substantive procedures** directed at the same assertion.	The less the auditor is relying on other substantive procedures (tests of details or substantive the same assertion analytical procedures) to reduce to an acceptable level the detection risk regarding a particular population, the **more assurance** the auditor will require from sampling and, therefore, the **larger the sample size can be.**
An increase **in the amount of misstatement the auditor expects to find** in the population	The greater the amount of misstatement the auditor expects to find in the population, the larger the sample size needs to be in order to make a reasonable estimate of the actual amount of misstatement in the population.
	Factors relevant to the auditor's consideration of the expected misstatement amount include the extent, to which item values are determined subjectively, the results of risk assessment procedures, the results of tests of control, the results of audit procedures applied in prior periods, and the results of other substantive procedures.
Stratification of the population when appropriate Decrease	When there is a wide range (variability) in the monetary size of items in the population, it may be useful to stratify the population. When a population cannot be appropriately stratified, the sample size from the population generally will be Higher than the sample size that would have been required to attain a given level of sampling risk, as compared to aggregate of samples from strata.
Change in the number of sampling units in the Population	Negligible effect for large populations, the actual size of the population has little, if any, effect on sample size. Thus, for small populations, audit sampling is often not as efficient as alternative means of obtaining sufficient appropriate audit evidence. However, when using monetary unit sampling, an increase in the monetary value of the population increases sample size, unless this is offset by a proportional increase in Materiality. In MUS $$\text{Sample Size} = \text{Confidence Factor} \times \frac{\text{Population Value}}{\text{Tolerable Misstatement}}$$ From as Population Value increases and also Tolerable Misstatement increases then effect will be nullified.

(CNO—SAS30.090) SELECTION OF ITEMS FOR TESTING

Chart



ADVANTAGES OF STATISTICAL SAMPLING

Benefits of Statistical Sampling " **Large Powerful & MOR**"

L	P	M	O	R
Better description of **L**arge mass of data than complete examination of all data	Sample size does not increase in **p**roportion to increase in size of population	Means to estimate **M**inimum Sample Size with specified risk & precision	More **o**bjective & Defensible	Calculated **R**isk

The advantages of statistical sampling may be summarized as follows –

- It provides a means for deriving a "**calculated risk**" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.
- The method provides a means of estimating the **minimum sample size associated with a specified risk and precision.**
- The amount of testing (sample size) **does not increase in proportion to the increase in the size of the area (universe) tested.**
- The sample selection is more **objective and thereby more defensible.**
  It may provide a **better description of a large mass of data than a complete examination of all the data,** since non-sampling errors such as processing and clerical mistakes are not as large.

(CNO—SA530.120) SAMPLE SELECTION METHODS (QNO-75.100, 75.200) (Incs-53.5)

Chart

SAMPLE SELECTION METHOD

Method should be such that sample should represent population

- Statistical Sampling
  - Simple random sampling
  - Interval Based or Systematic sampling
  - Monetary Unit Sampling (MUS)
- Stratified random sampling
- Cluster Sampling
- Non-Statistical/ Judgement Base Sampling
  - Haphazard Selection
- Block Selection

Sample should be selected in such a manner that it is representative of the population from which the sample is being selected. It will necessitate that each item in the population has an equal chance of being included in the sample.

Some of the important methods of selecting the sample are discussed below

RANDOM SAMPLING

Def :- All items in population or strata have equal chance of selection.
Then we may be use random number table,
random between excel function or anything like this to select sample.

Type

Simple Random	Suitable for homogeneous population	No division of population	Every Unit has unknown/equal chance of selection, random number table, picking numbers from drum etc.
Stratified Random	Suitable for hetero-genous population	Divide population in group called Strata	Each stratum is treated as separate population & random sampling is done. Different percentage selection can be done for different strata (Recall Trade Receivable Example)

Random Sampling (MCQ - S30.4, S30.5 S30.6)

Random selection ensures that all items in the population or within each stratum have a known chance of selection. It may involve use of random number tables.

Random sampling includes two very popular methods which are discussed below: –

- **Simple random sampling:** Under this method each unit of the whole population (E.g., purchase, or sales invoice)has an equal chance of being selected. The mechanics of selection of items may be by choosing numbers from table of random numbers by computers or picking up numbers randomly from a drum.

  It is considered that random number tables are simple and easy to use and also provide assurance that the bias does not affect the selection. This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range.

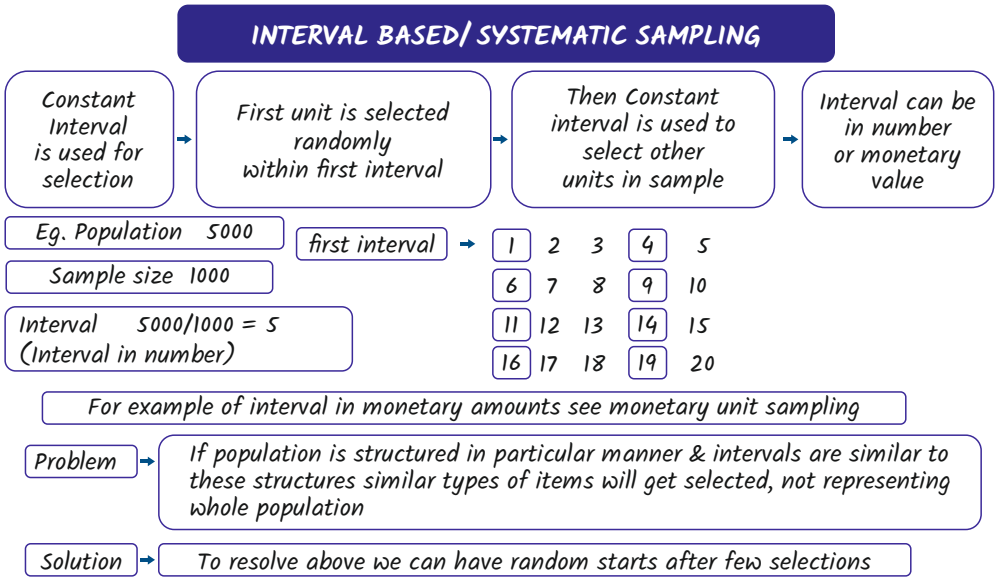
  For example, the population can be considered homogeneous, if say, trade receivables balances fall within the range of Rs 5,000 to Rs 25,000 and not in the range between Rs 25 to Rs 2,50,000.

- **Stratified Sampling:** This method involves dividing the whole population to be **tested in a few separate groups called strata and taking a sample from each of them.** Each **stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratums.** The number of groups into which the whole population has to be divided is determined **on the basis of auditor judgment.**

  For example, in the above case, trade receivables balances may be divided into four groups as follows: -
  - Balances in excess of Rs 1,00,000;
  - Balances in the range of Rs 75,000 to Rs 1,00,000;
  - Balances in the range of Rs 25,000 to Rs 75,000; and
  - Balances below Rs 25,000.

From these above groups the auditor may pick up **different percentage of items from each of the** group. From the top group i.e., balances in excess of Rs 1,00,000, the auditor may examine all the items; from the second group 25 per cent of the items; from the third group 10 per cent of the items; and from the lowest group 2 per cent of the items may be selected.

The reasoning behind the stratified sampling is that for a **highly diversified population, weights should be allocated to reflect these differences.** This is achieved by selecting different proportions from each stratum. It can be seen that the stratified sampling is simply an extension of simple random sampling.



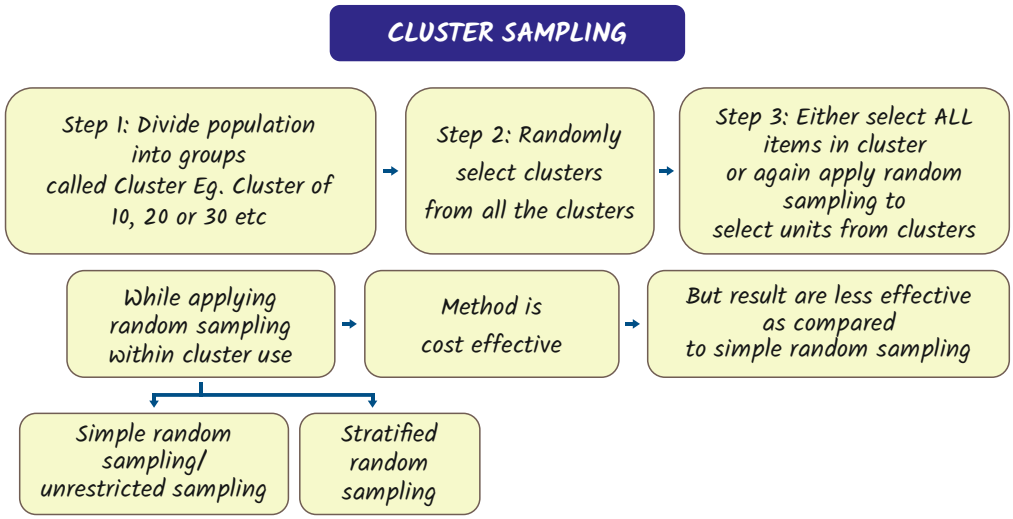
Interval sampling or systematic sampling

It involves selecting items using a constant interval between selections, the first interval having a random start. **The interval might be based on a certain number of items (for example every 20th voucher) or a monetary total (for example every Rs 1,000 in the cumulative value of the population).** When using systematic selection, the auditor should determine that the population is **not structured in such a manner that the sampling interval corresponds with a particular pattern in the population.**

For example, if in a population of branch sales, **particular branch sales occur only as every 100th** item and the sampling interval selected is 100. The result would be that either the auditor would have selected all or none of the sales of that particular branch.

To minimise the effect of the possible known buyers through a pattern in the population, more than one starting point may be taken. The multiple random starting points are taken because it minimises the risk of interval sampling pattern with that of the population being sampled.

Chart



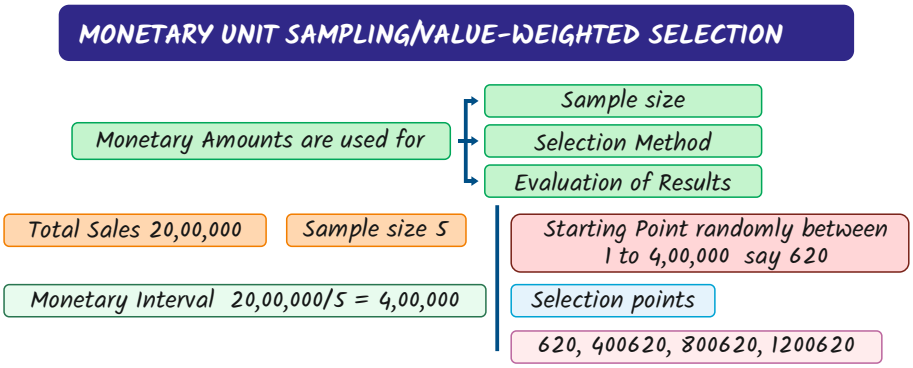
Cluster sampling

This method involves dividing the population into groups of items known as clusters. A number of clusters are randomly selected from all the clusters rather than individual items of the population. Cluster sampling can be used together with both unrestricted random and stratified sampling, for example 500 to 540, 2015 to 2055 etc. The first item i.e., 500, 2015 is randomly selected from random number tables. **The items of selected cluster can either be checked completely or a randomly selected proportion of them can be examined.**

The cluster is **less effective for a given sample size than unrestricted random and stratified samples as items are not individually selected.** However, the time saved can be utilised to have a larger sample to make the sample results more reliable.

As per SA 530, the auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

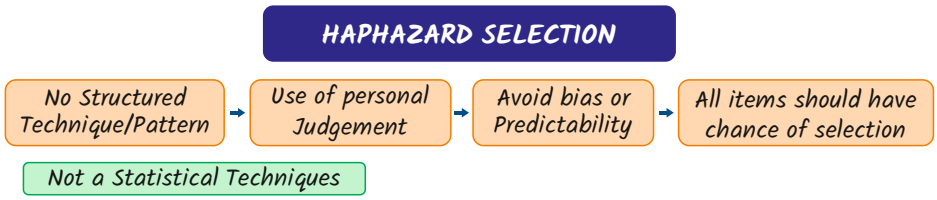
Chart



Monetary Unit Sampling

Bill No	Bill Amount	Cumulative total	Base
1	1,00,000	1,00,000	620
2	40,000	1,40,000	
3	20,000	1,60,000	
4	50,000	2,10,000	
5	20,00,000	4,10,000	4,00,620
6	1,60,000	4,70,000	
7	20,000	4,90,000	
8	70,000	5,60,000	
9	60,000	6,20,000	
10	2,50,000	8,70,000	8,00,620
11	45,000	9,15,000	
12	35,000	9,50,000	
13	1,00,000	10,50,000	
14	65,000	11,15,000	
15	1,50,000	12,65,000	12,00,620
16	20,000	12,85,000	
17	40,000	13,25,000	
18	65000	13,90,000	
19	35,000	14,25,000	
20	95,000	15,20,000	
21	3,50,000	18,70,000	16,00,620
22	40,000	19,10,000	
23	45,000	19,55,000	
24	25,000	19,80,000	
25	20,000	20,00,000	

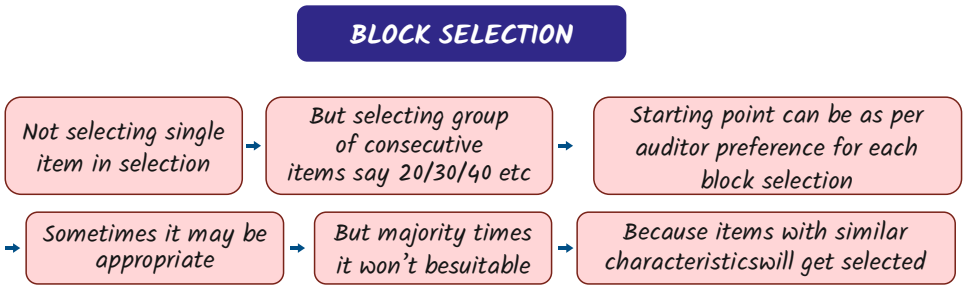
Chart



Haphazard selection (QNO-75.200)

Haphazard selection, in which the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability (for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.

Chart

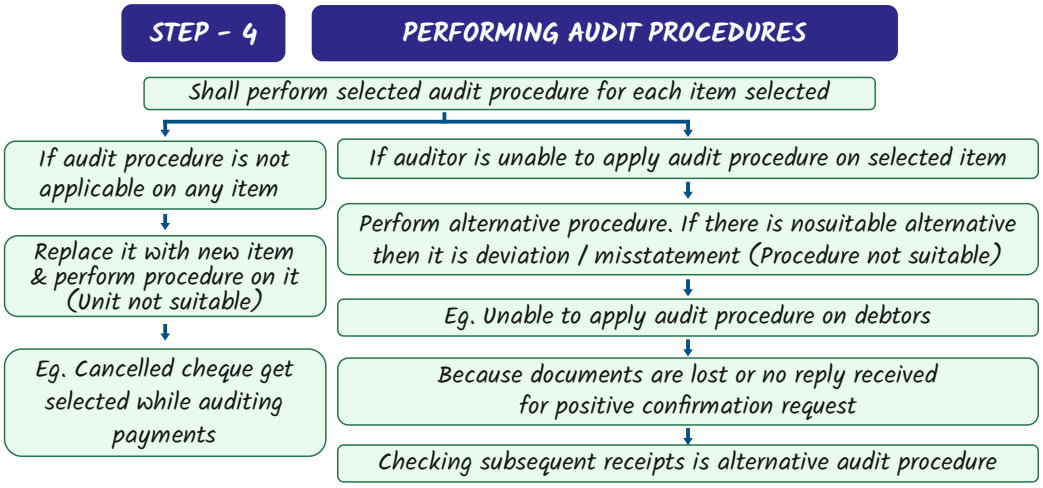


Block selection (MCQ-530.4)

Block selection involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

(CNO—SA530.140) PERFORMING AUDIT PROCEDURES

Chart



The auditor **shall perform audit procedures, appropriate to the purpose, on each item selected.** If the audit procedure **is not applicable to the selected item, the auditor shall perform the procedure on a replacement item.**

An example of when it is necessary to perform the procedure on a replacement item is when a cancelled cheque is selected while testing for evidence of payment authorisation. If the auditor is satisfied that the cheque has been properly cancelled such that it does not constitute a deviation, an appropriately chosen replacement is examined.

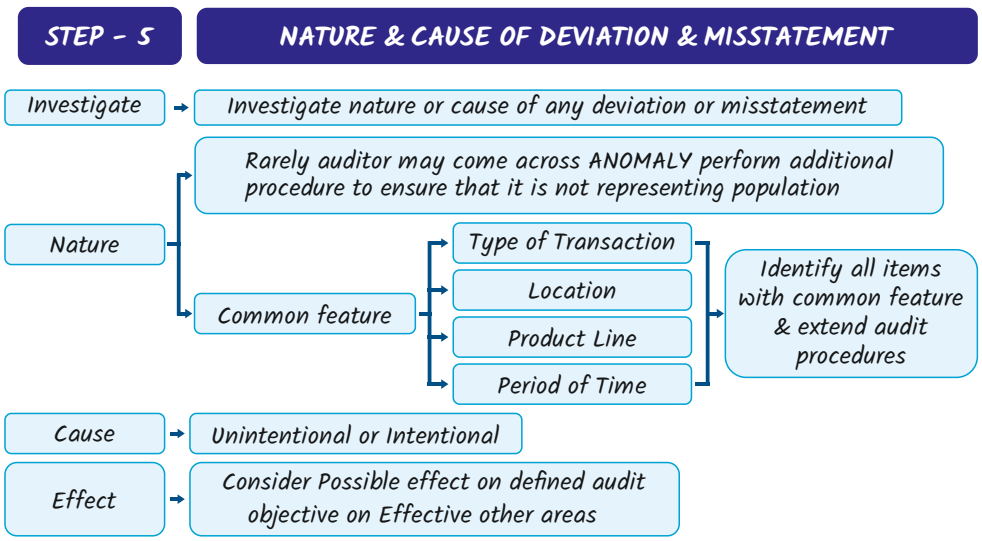
If the auditor is unable to **apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor shall treat that item as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details.**

An example of when the auditor is unable to apply the designed audit procedures to a selected item is when documentation relating to that item has been lost.

An example of a suitable alternative procedure might be the examination of subsequent cash receipts together with evidence of their source and the items they are intended to settle when no reply has been received in response to a positive confirmation request.

(CNOSA530.160) NATURE & CAUSE OF DEVIATION AND MISSTATEMENTS (QNO-78.000) (MCQ-530.2)

Chart



Q **"An auditor while analysing the errors in a sample need not consider the qualitative aspects of errors detected." Please comment)**

Answer

The auditor shall investigate the nature and cause of any deviations or misstatements identified and ***evaluates their possible effect on the purpose of the audit procedure and on other areas of the audit.***

In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population.

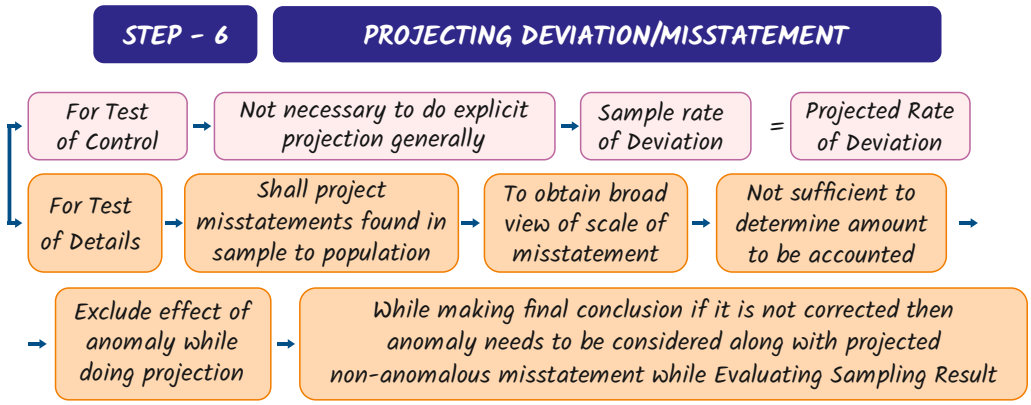
The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.

In analysing the deviations and misstatements identified, the auditor may observe that many have a common feature, for example, type of transaction (Sales vs Interest Income), location (Big Branch vs Small Branch), product line (Old product vs New Product) or period of time (Peak Season vs Slack Season).

In such circumstances, the auditor may decide to identify all items in the population that possess the common feature and extend audit procedures to those items. ***In addition, such deviations or misstatements may be intentional, and may indicate the possibility of fraud.***

(CNO-SA530.180) PROJECTING MISSTATEMENT (MCQ-Incs.25.4)

Chart



For tests of controls

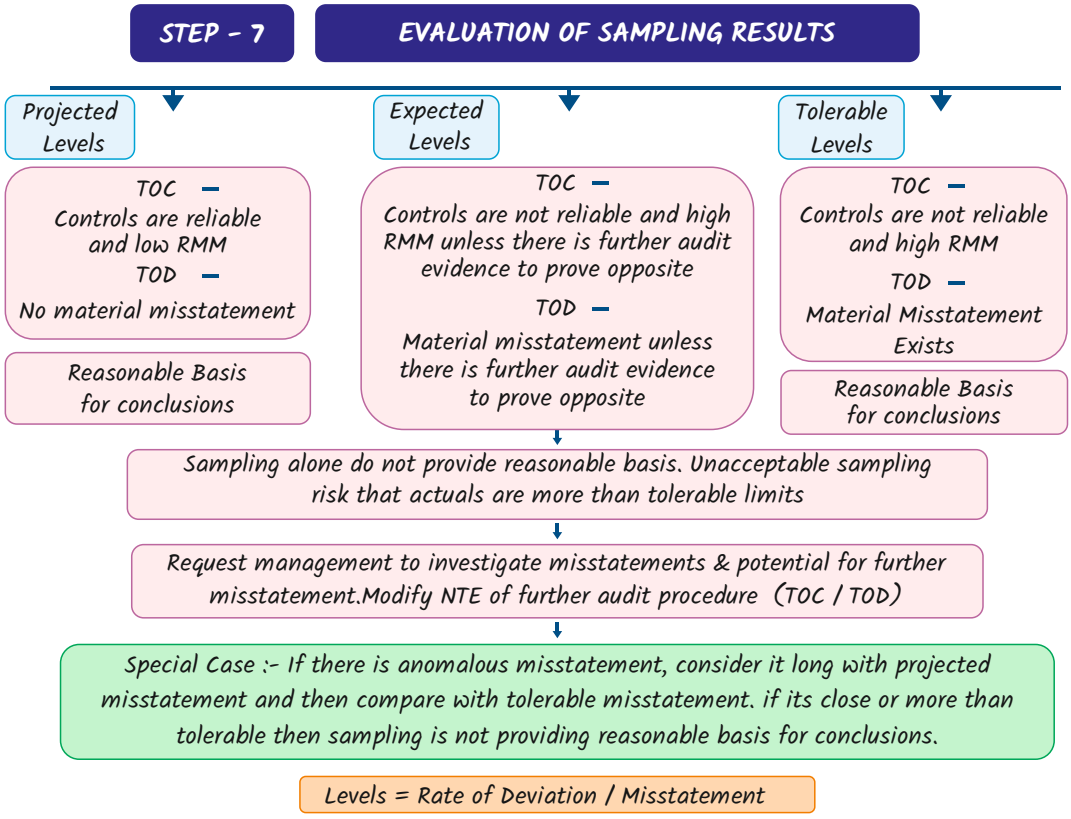
For tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate *for the population as a whole. SA 330 provides guidance when deviations from controls upon which the auditor intends to rely are detected.*

For tests of details

For tests of details, *the auditor shall project misstatements found in the sample to the population. The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement, but this* ***projection may not be sufficient to determine an amount to be recorded.***

When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.

(CNO--SA530.200) EVALUATING SAMPLING RESULTS (QNO-78.500)



Evaluation

The auditor shall evaluate-

- The results of the sample; and
- Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

For tests of controls, an unexpectedly high sample deviation rate may lead to an increase in the assessed risk of material misstatement, **unless further audit evidence** substantiating the initial assessment is obtained.

For tests of details, an unexpectedly high misstatement amount in a sample may cause the auditor to believe that a class of transactions or account balance is materially misstated, in the **absence of further audit evidence** that no material misstatement exists.

Considering the results of other audit procedures helps the auditor to assess the risk that actual misstatement in the population exceeds tolerable misstatement, and the risk may be reduced if additional audit evidence is obtained.

Special Case

In the case of tests of details, the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population. When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested. The closer the projected misstatement plus anomalous misstatement is to tolerable misstatement, the more likely that actual misstatement in the population may exceed tolerable misstatement.

Also, if the projected misstatement is greater than the auditor's expectations of misstatement used to determine the sample size, the auditor may conclude that there is an unacceptable sampling risk that the actual misstatement in the population exceeds the tolerable misstatement.

	In case the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size test an alternative control or modify related substantive procedures.

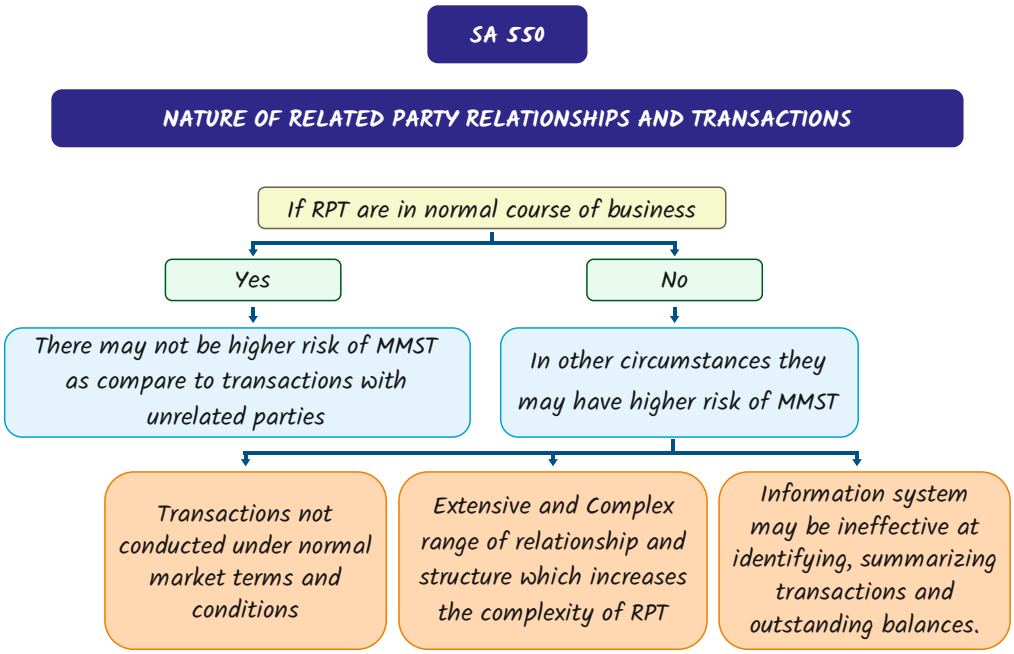
UNIQUE MCQS	
MCQ No.	*530.1 / Incs.35.4 / Incs.42.2*

UNIQUE QUESTION	
QNO 75.000	*Statistical Vs Non-Statistical*
QNO 79.000	*Tolerable Misstatement*

[SA 550] RELATED PARTIES

(CNO--SA550.020) NATURE OF RELATED PARTY RELATIONSHIPS AND TRANSACTIONS

Chart



RPT in normal course doesn't lead to higher RMM

Many related party transactions are in the **normal course of business.** In such circumstances, they may carry **no higher risk of material misstatement** of the financial statements than similar transactions with unrelated parties.

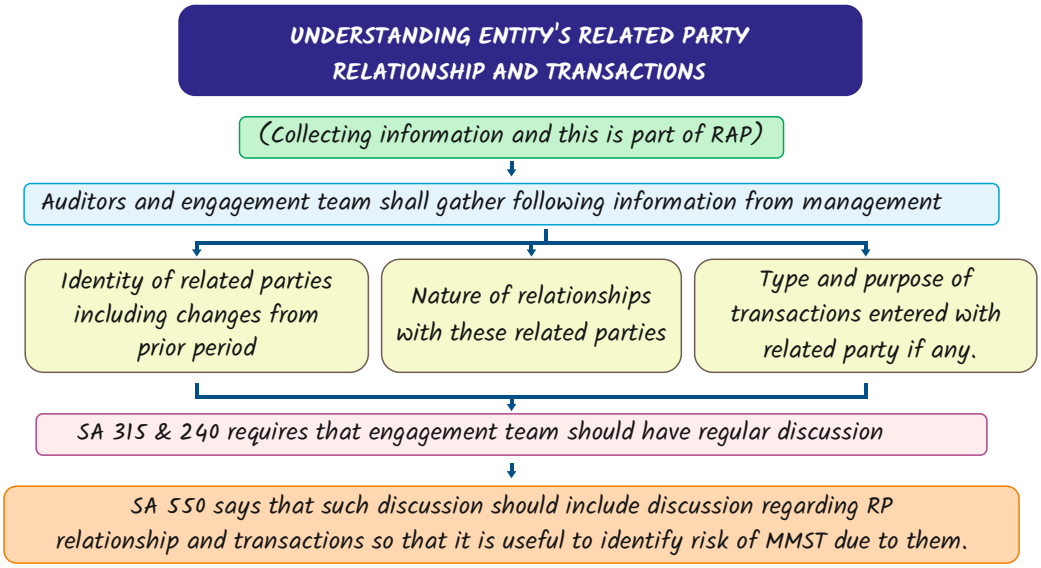
Situation when RPT will lead to higher RMM

However, **the nature of related party relationships and transactions may,** in some circumstances, give **rise to higher risks of material misstatement** of the financial statements than transactions with unrelated parties. For example:

- Related party transactions may **not be conducted under normal market terms and conditions;** for example, some related party transactions may be conducted with no exchange of consideration.
  - (Goods purchased at double the market price from MDs son proprietor firm or goods sold to brother of MD at triple the market price)
- Related parties may operate through an **extensive and complex range of relationships and structures,** with a **corresponding increase in the complexity of related party transactions.**
  - (Indian Company has subsidiary in Canada Canadian subsidiary created trust in MEXICO Trust holds 100% shares of company in srilanka MD of Indian company earns 1 crore consultancy fees from such srilanka company)
- **Information systems may be ineffective** at identifying or summarising transactions and outstanding balances between an entity and its related parties.
  - (Where there are no appropriate employees / register / software (systems) to identify, authorize, record, summaries and disclose related party transactions which may lead to noncompliance of AS 18.)

(CNO-SA550.040) UNDERSTANDING THE ENTITY'S RELATED PARTY RELATIONSHIPS & TRANSACTIONS

Chart



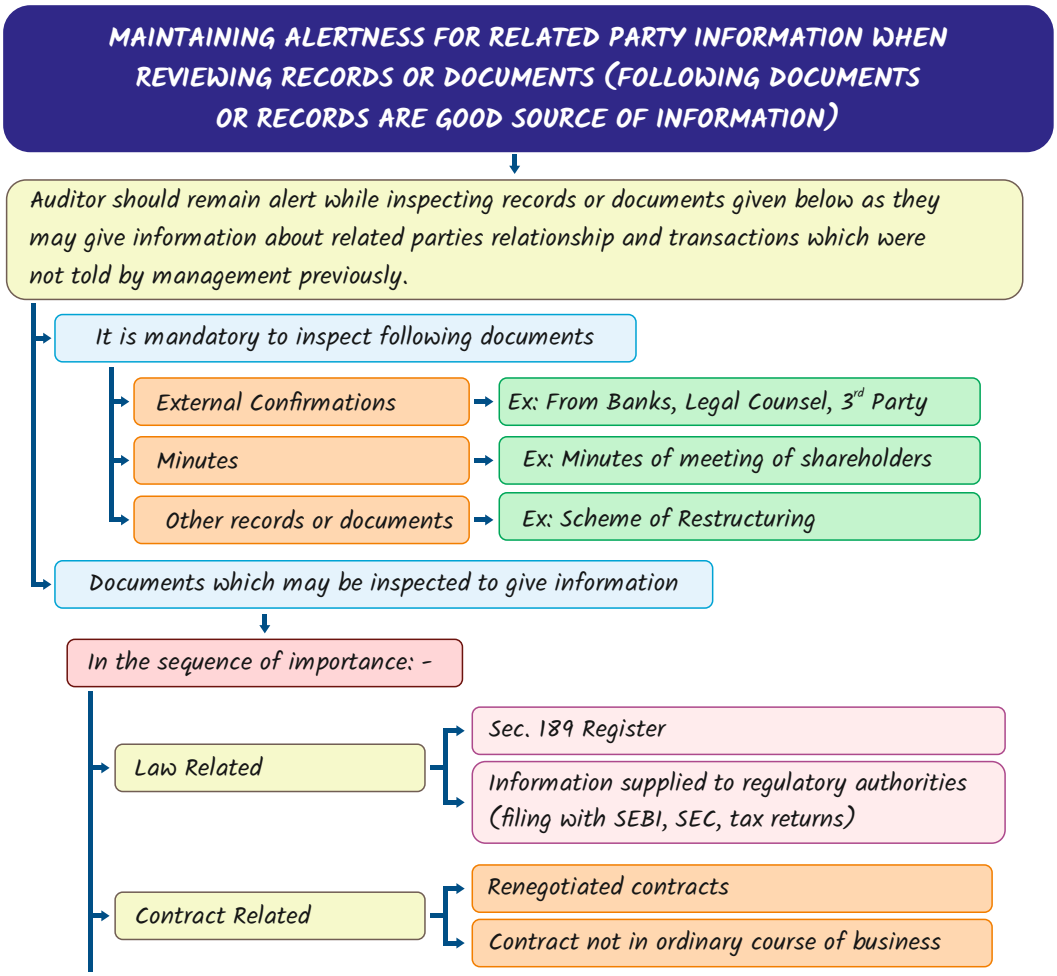
The engagement team discussion that SA 315 and SA 240 require, **shall include specific consideration** of the susceptibility of the financial statements to material misstatement due to **fraud or error that could result from the entity's related party relationships and transactions.**

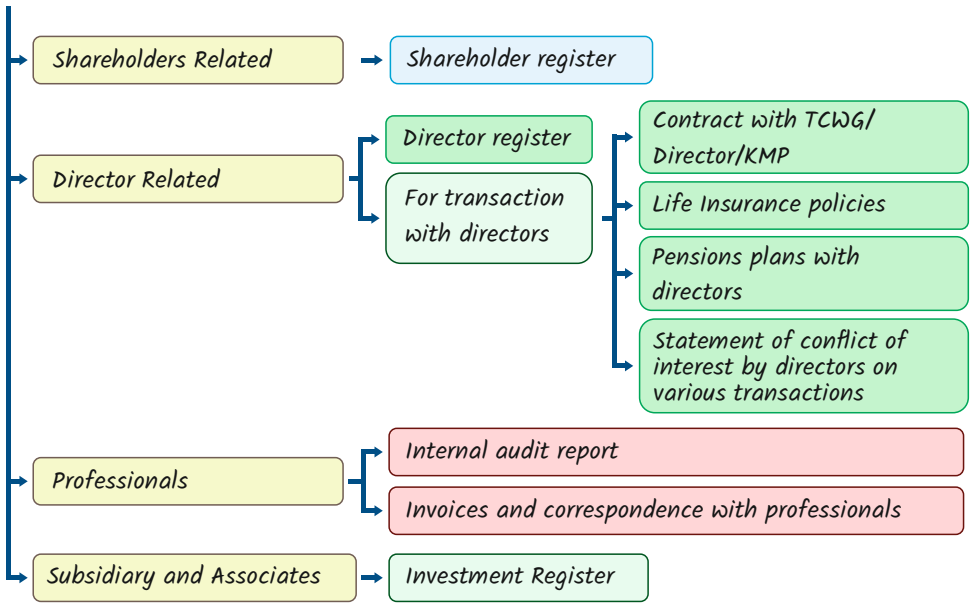
The auditor shall inquire of management regarding:

- The **identity of the entity's related parties,** including **changes from the prior period;**
- The **nature of the relationships between the entity and these related parties;** and
- Whether the entity **entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.**

(CNO—SA550.060) MAINTAINING ALERTNESS FOR RELATED PARTY INFORMATION WHEN REVIEWING RECORDS OR DOCUMENTS (QNO-82.000)

Chart





During the audit, **the auditor shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor.**

Compulsory to see following documents

In particular, the auditor **shall inspect the following for indications** of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor:

➢ Bank, legal and third-party confirmations obtained as part of the auditor's procedures; ▪ Bank – ▪ Legal – ▪ Third Party – ▪ Confirmations	(For guarantees / securities given or taken, arrangements such as minimum balance setoff arrangement / joint holders / nominee) (Contracts / MOUs etc.) (From Directors / Subsidiaries)
➢ Minutes of meetings of shareholders and of those charged with governance; and	(Approvals under Sec 177 & Sec 188)
➢ Such other records or documents as the auditor considers necessary in the circumstances of the entity.	(Approvals under Sec 177 & Sec 188)

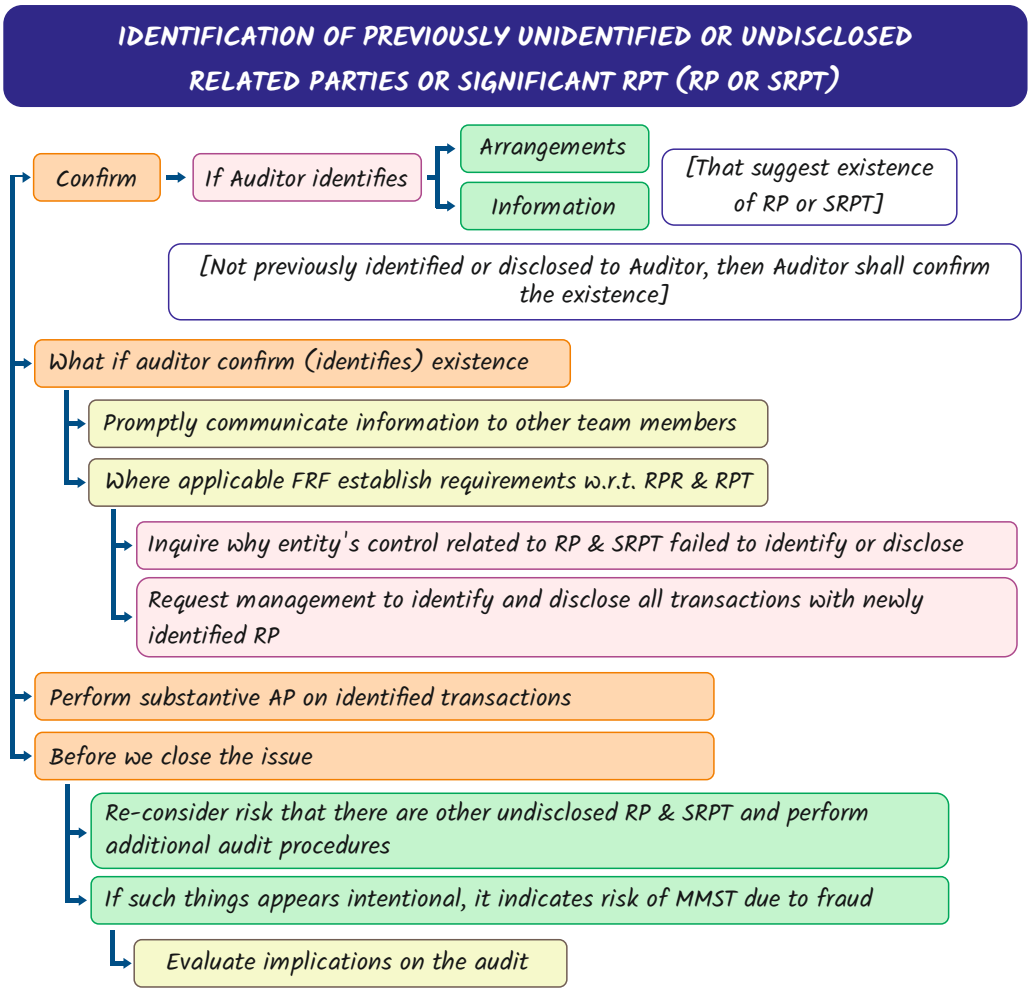
Documents which can give information about related parties

- AS 18 / Schedule III disclosures of Previous Years (Old Records)
- Shareholders register (Control / SI)
- Director's register (SI)
- Contracts with TCWG / Directors / KMP (SI)
- Life insurance policies (SI)
- Records of Entity's pension plans (SI)
- Statements of Conflict of Interest (SI)
- Investment Register (Control / SI)
- Sec 189 Register
- Information supplied to Regulatory Authorities
  - Filing with SEBI / SEC
  - Tax Returns

- Internal Auditor's Report
- Invoices & Correspondence with professional advisor
- Contracts not in ordinary course of business
- Contracts re-negotiated

(CNO--SAS50.080) IDENTIFICATION OF PREVIOUSLY UNIDENTIFIED OR UNDISCLOSED RELATED PARTIES OR SIGNIFICANT RELATED PARTY TRANSACTIONS

Chart



What if auditor identifies information suggesting unidentified or undisclosed RPR or SRPT?

If the auditor identifies arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, the auditor **shall determine whether the underlying circumstances confirm the existence of those relationships or transactions.**

What if auditor confirms existence?

If the auditor **identifies related parties or significant related party transactions that management has not previously identified or disclosed to the** auditor, the auditor shall:

- (Communicate)
  - **Promptly communicate** the relevant information to the **other members** of the engagement team;

- **(Discuss 2 important things with management)**
  Where the applicable financial reporting framework establishes related party requirements:
  - Request management to **identify all transactions** with the newly identified related parties for the auditor's further evaluation; and

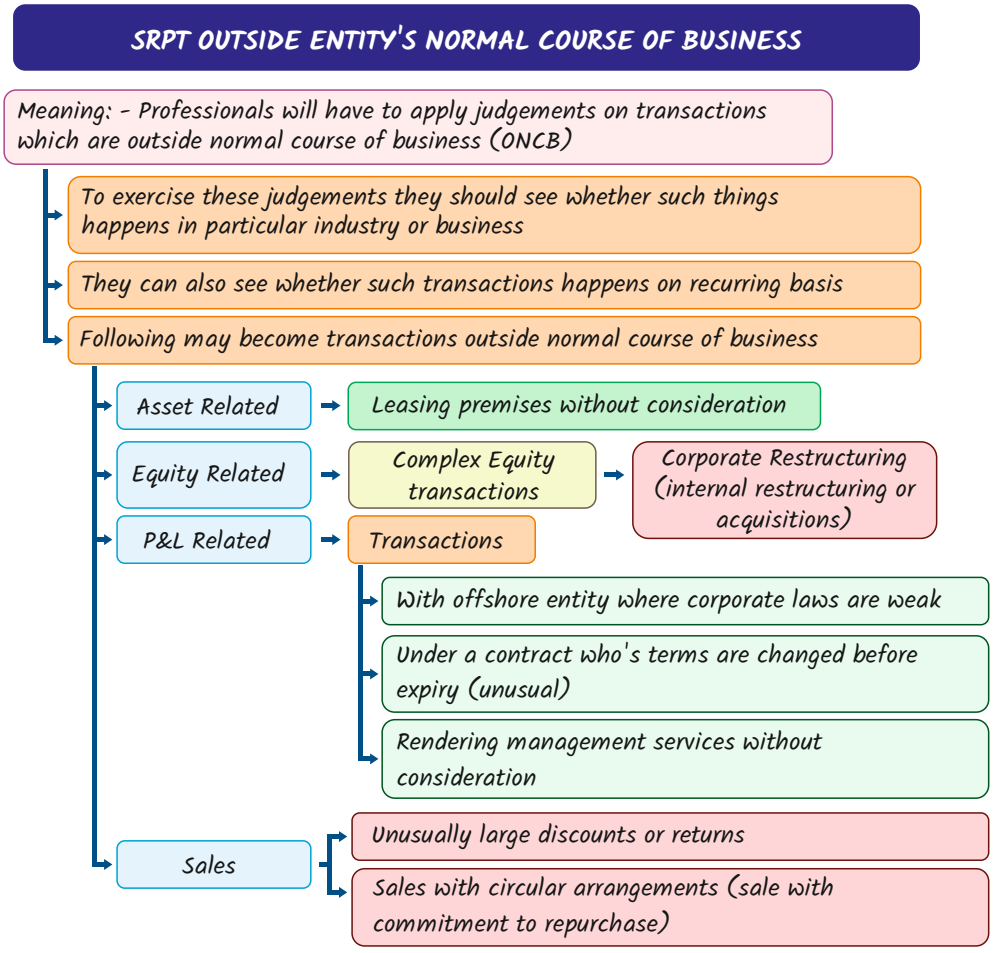
- ***Inquire as to why the entity's controls** over related party relationships and transactions **failed** to enable the identification or disclosure of the related party relationships or transactions;*

- ***(Examine)***
  - ***Perform appropriate substantive audit procedures** relating to such newly identified related parties or significant related party transactions;*

- ***(Before you close issue think about 2 important** things)*
  - *Reconsider the risk **that other related parties or significant related party transactions may exist** that management has not previously identified or disclosed to the auditor, and perform additional audit procedures as necessary; and*
  - *If the **non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit.***

(CNOSA550.100) TRANSACTIONS OUTSIDE THE ENTITY'S NORMAL COURSE OF BUSINESS (QNO 82.500)

Chart

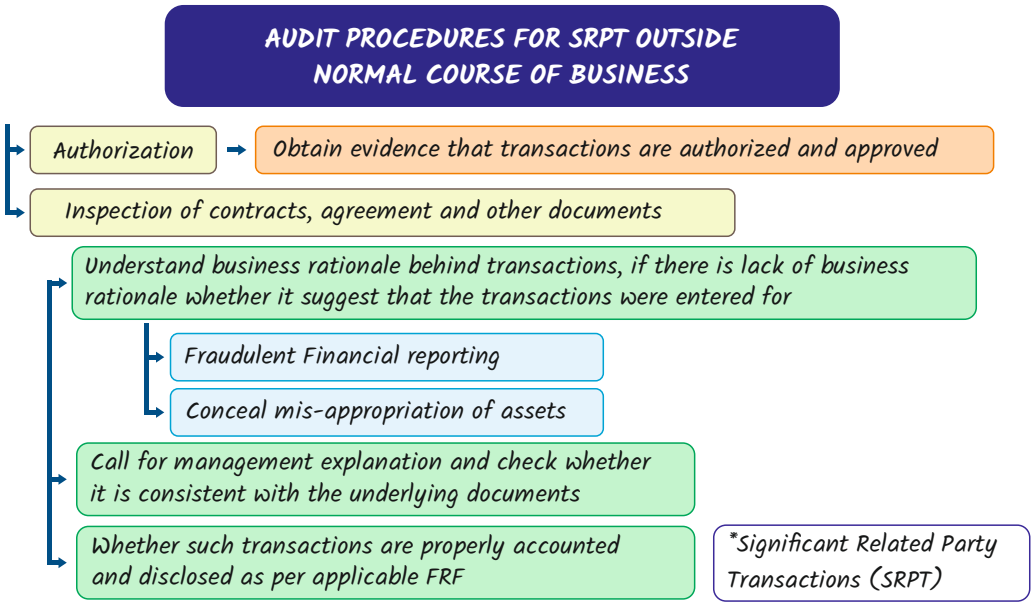


Discussion

- *Examples of transactions outside the entity's normal course of business may include:*
  - *Complex equity transactions, such as corporate restructurings or acquisitions.*
  - *Transactions with offshore entities in jurisdictions with weak corporate laws.*
  - *The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged.*
  - *Sales transactions with unusually large discounts or returns.*
  - *Transactions with circular arrangements, for example, sales with a commitment to repurchase.*
  - *Transactions under contracts whose terms are changed before expiry.*

(CNO--SA550.120) AUDIT PROCEDURES FOR SRPT OUTSIDE NORMAL COURSE OF BUSINESS

Chart



Discussion

For identified significant related party transactions outside the entity's normal course of business, the auditor shall: (Sale to subsidiaries in Mauritius and Dubai then export to various countries for tax saving)

- Obtain audit evidence that the **transactions have been appropriately authorized and approved.**

- Inspect the underlying contracts or agreements, if any, and evaluate whether:
  - **The business rationale** (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;
  - The terms of the transactions are consistent with management's explanations; and (But goods are not exported but sold to local manufacturer)
  - The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework;

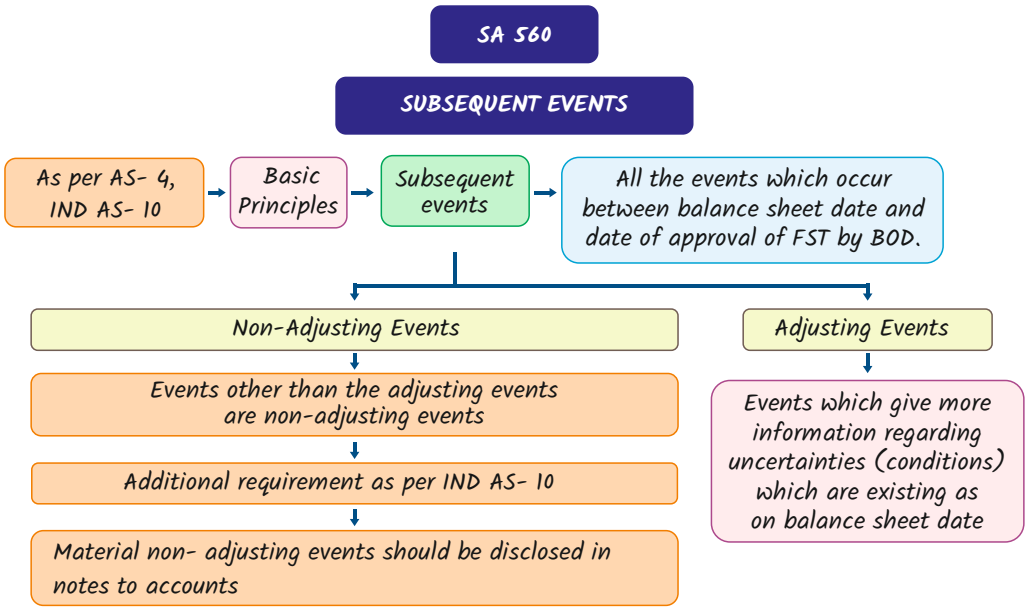
UNIQUE MCQS	
MCQ No.	SS0.1
MCQ No.	SS0.2
MCQ No.	SS0.3 / SS0.4

UNIQUE QUESTION	
QNO 84.000	Related Party Case Study – Approach of Auditor
QNO 84.500	Engagement team discussion-susceptibility of MMST due to related party

[SA 560] SUBSEQUENT EVENTS

(CNO--SA560.020) REQUIREMENT OF AS 4 (QNO-85.000)

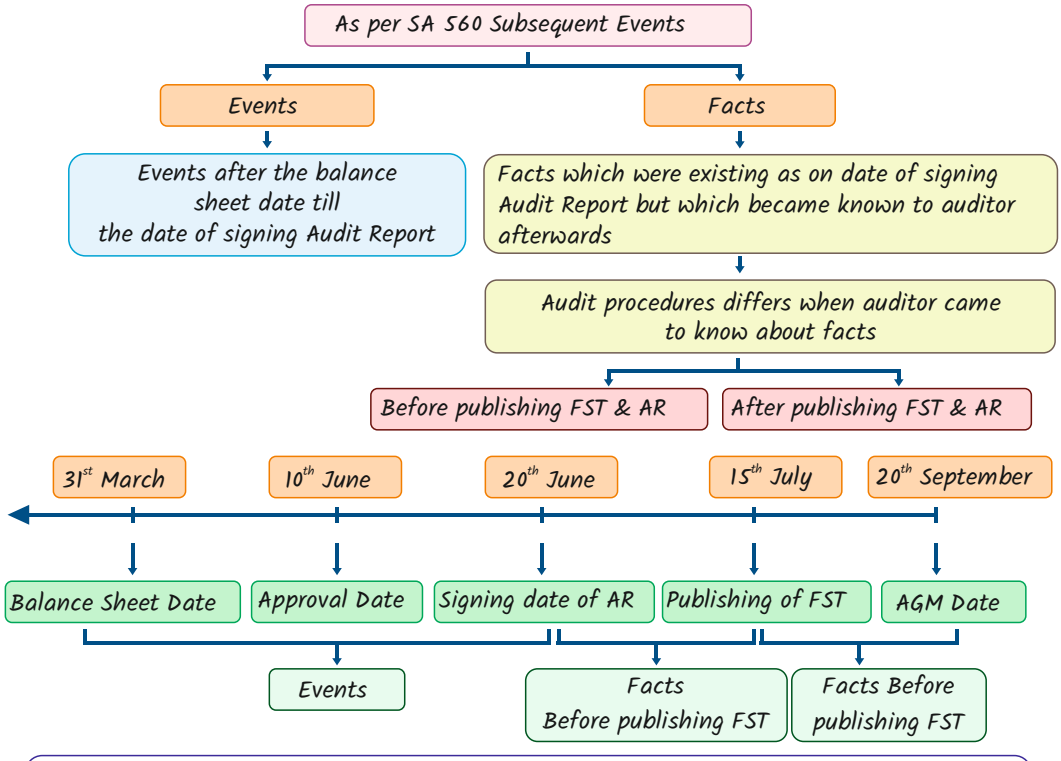
Chart



- **Subsequent Event Definition:** – All significant events / favourable or unfavorable / occur between balance sheet date and date of approval by BOD
- **Types of Events:** – Events giving evidence regarding conditions existing on balance sheet date / Events giving evidence on conditions which arose after balance sheet date
- **3 Exceptions to above:** - Events required to be adjusted by law or AS / Events affecting going concern / Events which are significant, material but not requiring adjustment can be disclosed in BOD report

(CNO--SA560.040) DEFINITION OF SUBSEQUENT EVENTS

Chart

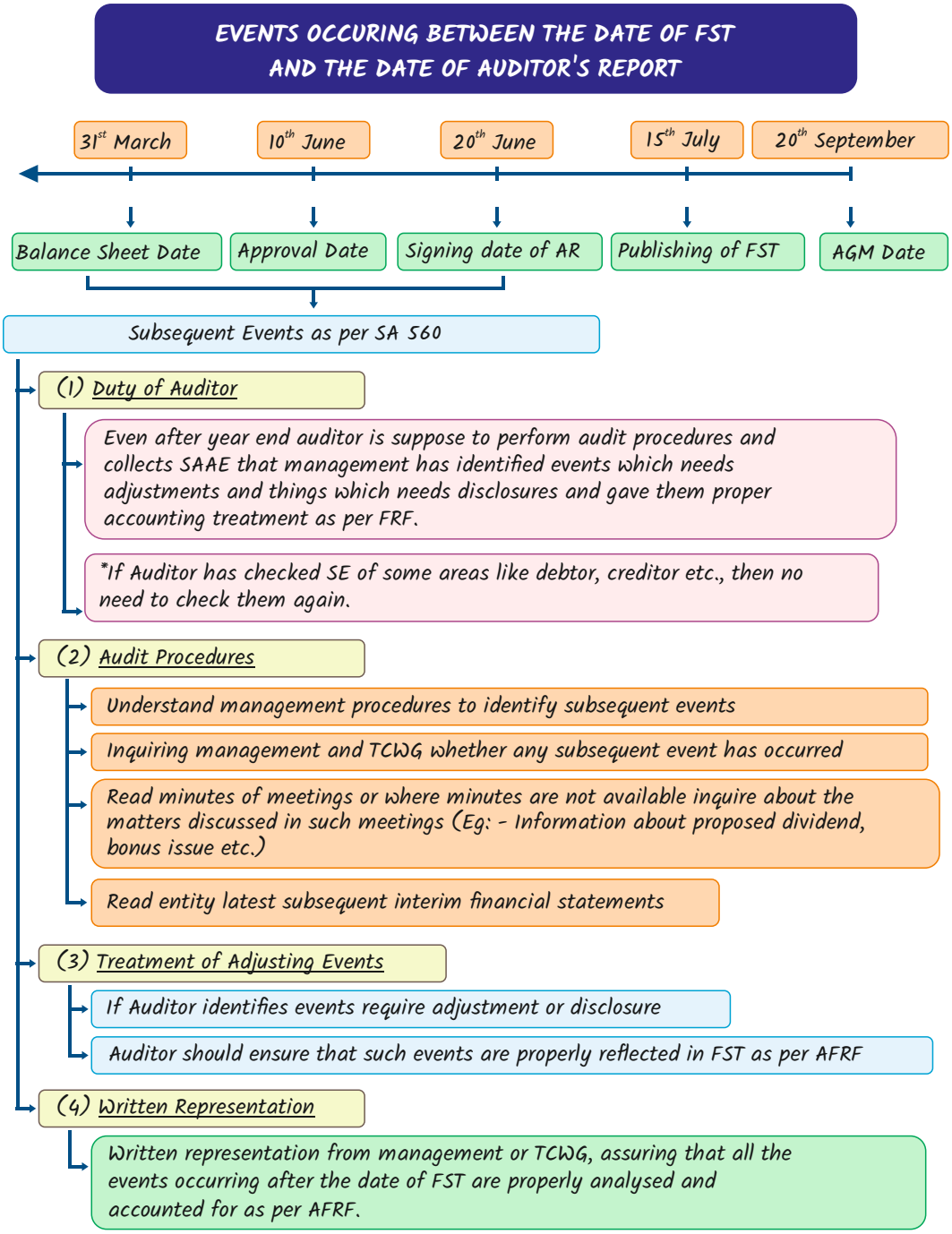


Note: - Auditor may came to know about facts any time in future. If he comes to know facts before AGM then it is easy to amend FST and AR. If he comes to know after AGM, it legally becomes difficult to amend, so it better amend in next year.

SA 560 on **"Subsequent Events"**, defines the term "subsequent events" as events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report. Facts can be further divided in 2 parts facts till date of publishing and facts after date of publishing.

(CNO--SA560.060) EVENTS OCCURRING BETWEEN THE DATE OF THE FINANCIAL STATEMENTS AND THE DATE OF THE AUDITOR'S REPORT (QNO-85.000)

Chart



Duty of Auditor

- ***Auditor should examine subsequent events***

  The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that ***all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.*** The auditor shall perform the procedures so that they cover the period ***from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto.***

- ***No need to check again is some areas are checked in regular audit procedures***

  The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

- ***Nature and extent depends on risk assessment***
  The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such ***audit procedures,*** *which shall include the following:*

Audit Procedures

Summary

Understanding procedures, controls set by Mgt / Inquiry with Mgt, TCWG / Reading minutes / Latest subsequent interim financial statements

Detailed Text

- *Obtaining an understanding of* ***any procedures management has established*** *to ensure that subsequent events are identified.*
- ***Inquiring*** *of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.*
- ***Reading minutes,*** *if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring* ***about matters discussed at any such meetings for which minutes are not yet available.***
- *Reading the entity's latest* ***subsequent interim financial statements,*** *if any.*

Adjusting Event

Summary

If auditor identifies event requiring adjustment / see whether it is adjusted or disclosed in FST / if not then modify the report.

Detailed Text

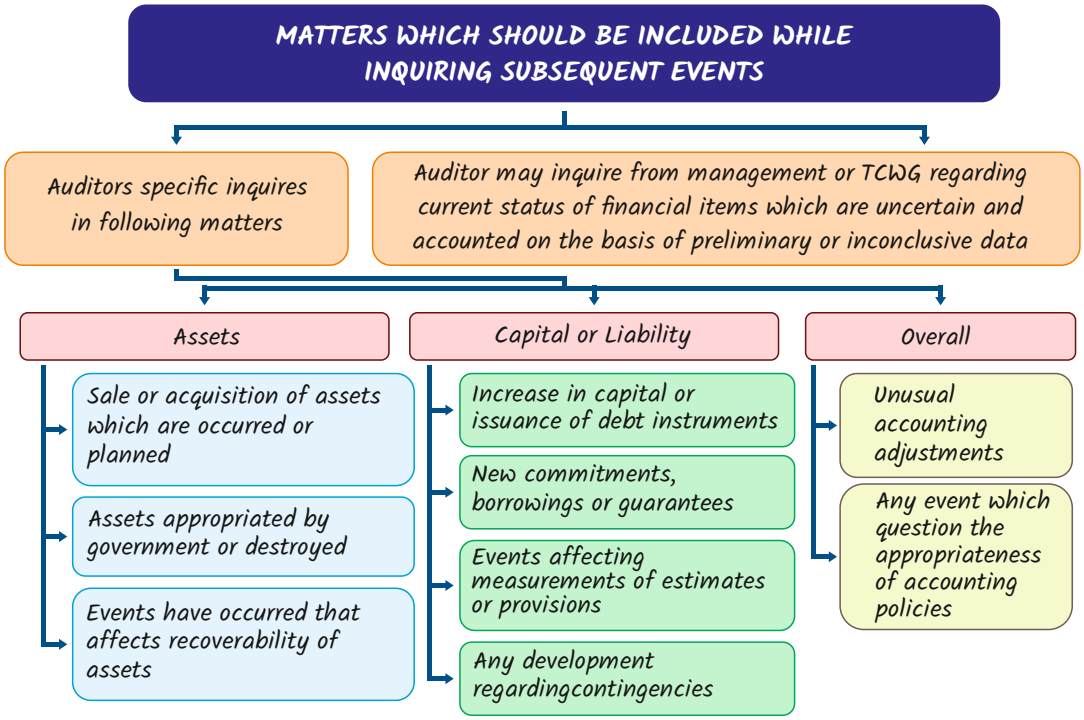
When, as a result of the procedures performed as explained above, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

Written Representations

The auditor shall request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580, "Written Representations" that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

(CNO—SA560.080) EXAMPLES OF INQUIRY FOR SUBSEQUENT EVENT (BASED ON IFRS / IND AS) (QNO 85.050)

Chart



Inquiry About Uncerta-inties

In inquiring of management and, where appropriate, those charged with governance, as to whether any subsequent events have occurred that might affect the financial statements, ***The auditor may inquire as to the current status of items that were accounted for on the basis of preliminary or inconclusive data and***

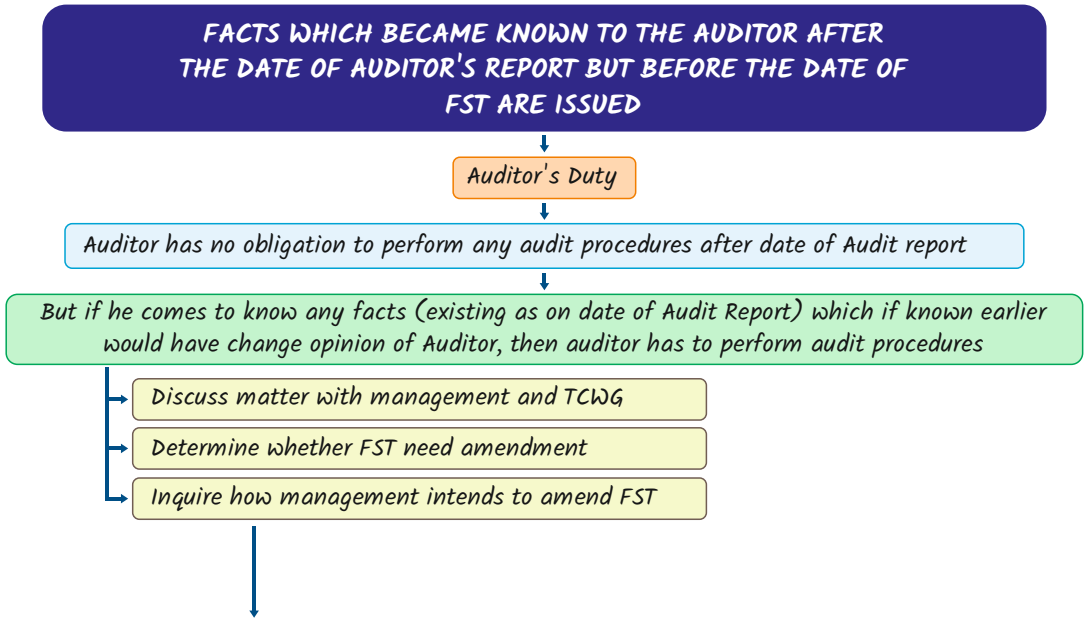
Specific Enquiries (QNO-85.050)

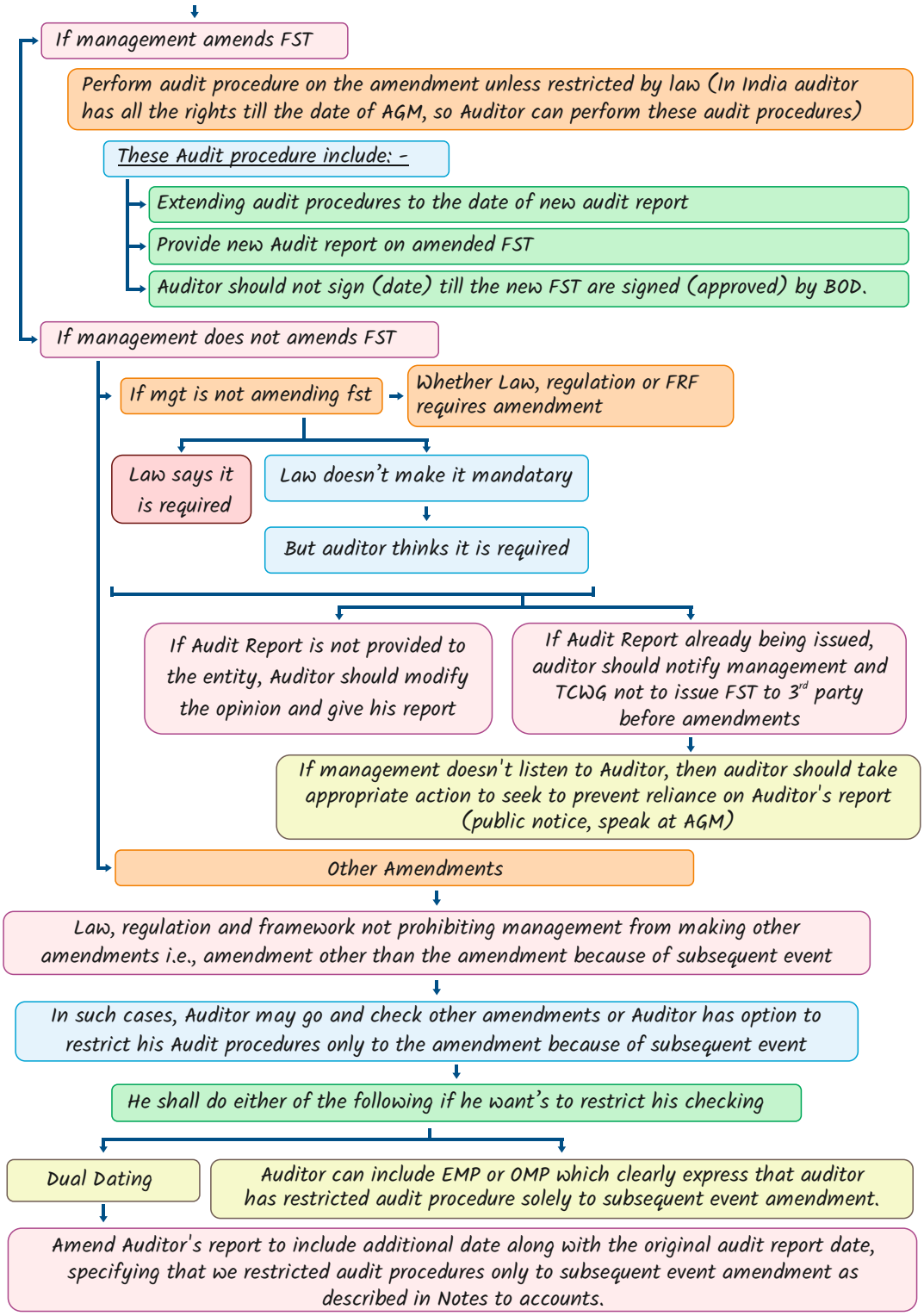
May make specific inquiries about the following matters

- **(Assets – 3)**
  - *Whether* ***sales or acquisitions of assets*** *have occurred or are planned.*
  - *Whether any* ***assets have been appropriated by government or destroyed,*** *for example, by fire or flood.*
  - *Whether any* ***events have occurred that is relevant to the recoverability of assets.***
    - *(E.g., Product Banned Etc)*
- **(Capital & Liability – 4)**
  - *Whether there have been* ***increases in capital or issuance of debt instruments,*** *such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.*
  - *Whether* ***new commitments, borrowings or guarantees*** *have been entered into.*
  - *Whether there have been* ***any developments regarding contingencies.***
  - *Whether any events have occurred that is relevant to the* ***measurement of estimates or provisions*** *made in the financial statements.*
    - *(E.g., Draft royalty rates)*
- **(All items – 2)**
  - *Whether any* ***unusual accounting adjustments have been made or are contemplated.***
    - *(E.g., Heavy sales return)*
  - *Whether any events have occurred or are likely to occur that will bring into* ***question the appropriateness of accounting policies*** *used in the financial statements, as would be the case, for example, if such events call into question the validity of the going concern assumption.*
    - *(E.g., Sale of Long-term Investments)*

(CNO--SA560.100) FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE DATE OF THE AUDITOR'S REPORT BUT BEFORE THE DATE THE FINANCIAL STATEMENTS ARE ISSUED (QNO-87.000/87.500)

Chart





No obligation

No obligation to perform any audit procedures after date of AR / Facts becomes known to the auditor, had it been known to auditor at the at the date of AR, it may have changed audit report, then discuss with management / need for amendment in financial statements / inquire managements intention

The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. *However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report,* ***may have caused the auditor to amend the auditor's report, the auditor shall:***

- ***Discuss the matter with management*** *and, where appropriate, those charged with governance.*
- *Determine* ***whether the financial statements need amendment*** *and, if so,*
- ***Inquire how management intends to address*** *the matter in the financial statements.*

If Management amends FST (QNO-85.100)

If Management amends FST / carry audit procedures to examine amendment / extend subsequent events audit procedures to new audit report date / provide new audit report / date should after FST date

If management amends the financial statements, the auditor shall:

- Carry **out the audit procedures necessary** in the circumstances on the amendment
- Unless the restricted by **LAW:**
  - Extend the **audit procedures** to the **date of the new auditor's report;** and
  - Provide a **new auditor's report on the amended financial statements.** The new auditor's report **shall not be dated earlier than the date of approval of the amended financial statements.**

Mgt does not amend FST (QNO-85.100)

If audit report not provided, then modify it and then give it Mgt / if audit report is provided then notify Mgt & TCWG / Ask them not to issue FST / If still FST are issued take appropriate action to seek to prevent reliance on Audit Report

In some entities, management may not be required by the applicable law, regulation or the financial reporting framework to issue amended financial statements and, accordingly, the auditor need not provide an amended or new auditor's report. However, when management does not amend the financial statements in circumstances where the auditor believes they need to be amended, then:

- If the auditor's report has not yet been provided to the entity, the auditor shall modify the opinion as required by SA 705 and then provide the auditor's report; or
- If the auditor's report has already been provided to the entity, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity, those charged with governance, not to issue the financial statements to third parties before the necessary amendments have been made. If the financial statements are nevertheless subsequently issued without the necessary amendments, the auditor shall take appropriate action, to seek to prevent reliance on the auditor's report.

Other Amendments (MCQ--Incs.40.4 / Incs.45.4)

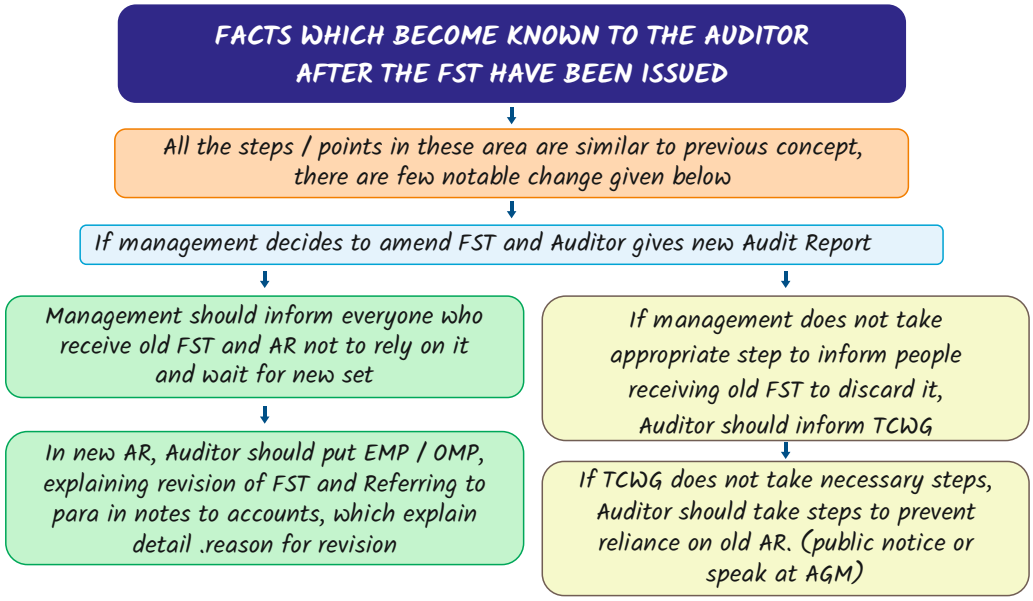
If law doesn't restrict Mgt to do other amendments, other than identified subsequent events / auditor can restrict its checking only to subsequent events requiring amendments / in such scenario auditor shall do either of 2 options / Option 1 Include Additional Date indicating that audit procedures were restricted / Option 2 Include EMP or OMP para

When law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent events or events causing that amendments and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment, the auditor is permitted to restrict the audit procedures on subsequent events required to that amendment. In such cases, the auditor shall either:

- Amend the auditor's report to include an additional date restricted to that amendment that thereby indicates that the auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements described in the relevant note to the financial statements; or
- Provide a new or amended auditor's report that includes a statement in an Emphasis of Matter paragraph or Other Matter(s) paragraph3 that conveys that auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements as described in the relevant note to the financial statements.

(CNO--SA560.120) FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE FINANCIAL STATEMENTS HAVE BEEN ISSUED.

Chart



All Steps of Earlier Point will apply Plus Following Additional Point will be Applicable

Review the **steps taken by management** to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon **is informed of the situation.**

UNIQUE QUESTION

QNO 88.000	Subsequent Event (Salary Case)

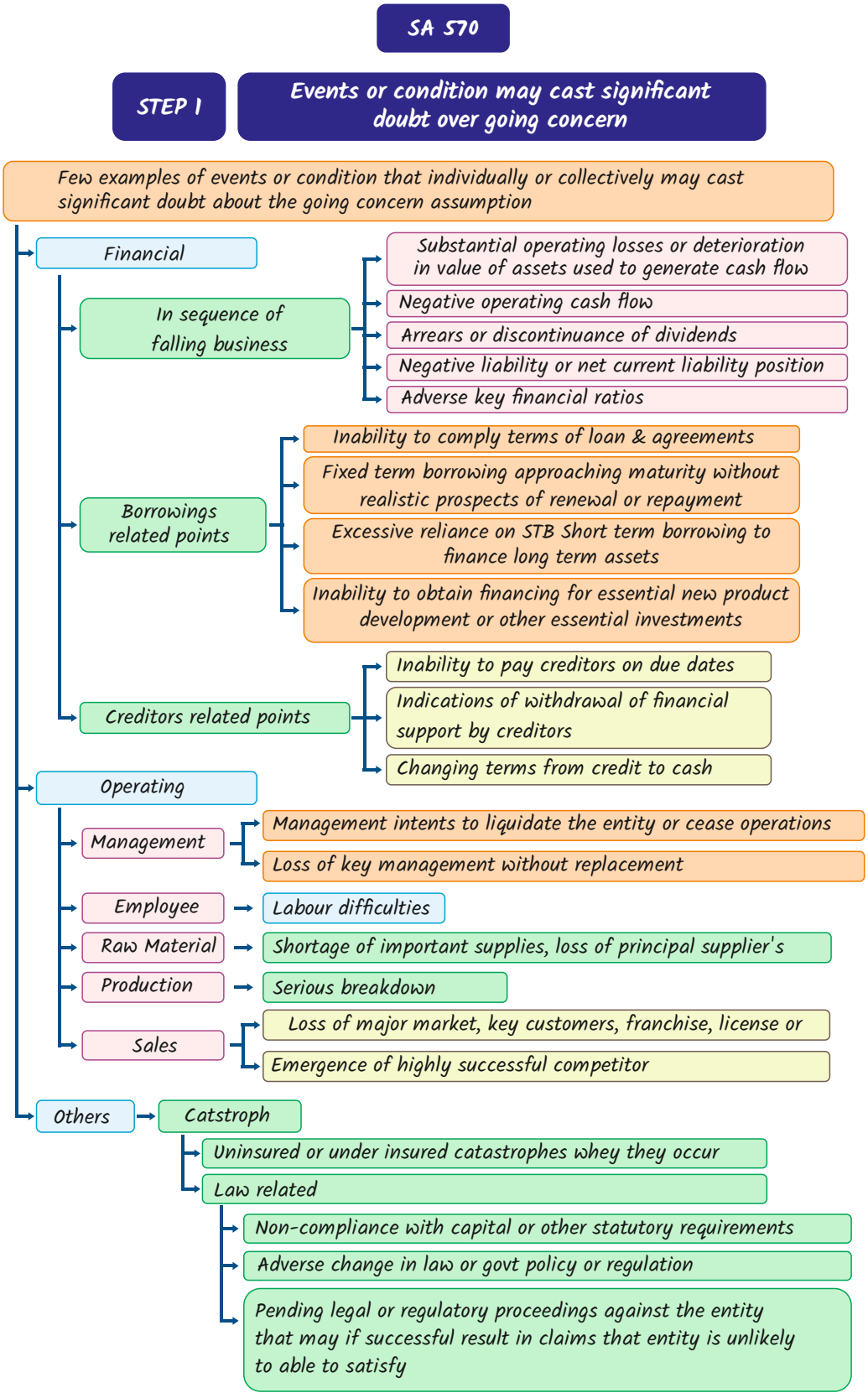
[SA 570] GOING CONCERN

(CNO—SA570.020) STEP 1: - EVENTS OR CONDITIONS CREATING SIGNIFICANT DOUBT OVER GOING CONCERN?

(QNO-89.000)(MCQ-570.4)

*The following are **examples of events or conditions that, individually or collectively**, may cast significant doubt about the going concern assumption. This listing is not all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists.*

Chart



Financial	➢ **(In sequence of falling business)** ▪ Substantial operating losses or significant deterioration in the value of assets used to generate cash flows. ▪ Negative operating cash flows indicated by historical or prospective financial statements. ▪ Arrears or discontinuance of dividends. ▪ Net liability or net current liability position. ▪ Adverse key financial ratios. ➢ **(Borrowing Related Points)** ▪ Inability to comply with the terms of loan agreements. (Maintaining Stock Levels, Margin Money) ▪ Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets. (Kingfisher Airlines) ▪ Inability to obtain financing for essential new product development or other essential investments. (Satyam, Banks refused to give new loans) ➢ **(Creditor Related Points)** ▪ Inability to pay creditors on due dates. ▪ Indications of withdrawal of financial support by creditors. (No extension from creditors) ▪ Change from credit to cash-on-delivery transactions with suppliers.
Operating	➢ Management intentions to liquidate the entity or to cease operations. (E.g. Start-up's) ➢ Loss of key management without replacement. ➢ Shortages of important supplies. (E.g.PowerGenerating Plants) ➢ Labour difficulties. ➢ Loss of a major market, key customer(s), franchise, license, or principal supplier(s). ➢ Emergence of a highly successful competitor. (E.g.Milk Butter Vs Peanut Butter)
Other	➢ Uninsured or underinsured catastrophes when they occur. **(Law related matters)** ➢ Non-compliance with capital or other statutory requirements. (E.g.CAR in Banks) ➢ Changes in law or regulation or government policy expected to adversely affect the entity. ➢ Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.

(CNO—SA570.040) Step 2:- ADDITIONAL AUDIT PROCEDURES WHEN EVENTS OR CONDITIONS ARE IDENTIFIED

(QNO-90.000,90.050) (MCQ-570.1/570.3/Incs-08.1)

If events or conditions have been identified *that may cast significant doubt on the entity's ability to continue as a going concern,* ***the auditor shall obtain sufficient appropriate audit evidence*** *to determine* ***whether or not a material uncertainty exists*** *related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (hereinafter referred to as "material uncertainty") through performing additional audit procedures,* ***including consideration of mitigating factors.*** *These procedures* ***shall include:***

Chart

STEP:- 2 ADDITIONAL AUDIT PROCEDURES WHEN EVENTS OR CONDITIONS ARE IDENTIFIED

If events or conditions identified that may cast significant doubt on entity's ability to continue as going concern, Auditor shall obtain SAAE to determine whether or not a material uncertainty exists through performing additional audit procedures including consideration of mitigating factors

- Compulsory Audit Procedures
  - Management's assessment → Management's assessment if not prepared yet then requesting management to make it assessment
  - Management's plans → Evaluating management's plans for future actions in relation to going concern assessment, whether outcome of such plan is likely to improve the situation
  - Cash flow forecast → Where entity has prepared the CF forecast, analysis of forecast is a significant factor in considering the future outcome of events or conditions in evaluating management plans for future actions
    - Evaluate reliability of underlying data generated
    - Determine whether adequate support for assumption underlying the forecast
  - Additional information → Consider whether any additional facts or information have become available since the date on which management made it assessment
  - WR → Request WR from management & TCWG regarding plan for future actions & its feasibility
- Optional, if required
  - Management & third party plan (in sequence of power)
    - Inquiring of entity's legal counsel regarding existence of litigation & claims and reasonableness of management assessments of outcome and the estimate of their financial implications
    - Obtain & review reports of regulatory actions
    - Reading minutes of share holders & TCWG
    - Determine adequacy of support for any planned disposals of assets
    - Reading terms of debentures and loan agreement & determine whether any have been breached
    - Evaluate entity's plans to deal with unfilled customer orders
  - Cash flow, Forecast & Interim FST
    - Analyzing & discussing CF, profit and other relevant forecasts with management
    - Analyzing & discussing latest interim FST

- Subsequent Event
  - Perform audit procedures regarding SE to identify those that either mitigate or otherwise affect the entity ability to continue as going concern
- W.R. from 3rd parties
  - Confirming the existence, legality and enforceability of arrangement with related and 3rd parties and assessing the financial ability of such parties to provide additional funds
  - Confirming the existing terms and adequacy of borrowing facilities

Compulsory (QNO-90. 050)

- ***Management's Assessment if not prepared yet***

  Where management has not yet performed an assessment of the entity's ability to continue as a going concern, ***requesting management to make its assessment.***
- ***Future Plan***

  Evaluating management's plans for future actions(Introducing new products, cost cutting, sale of assets, sale of investments, issue of shares, taking new loans etc.) in relation to its going concern assessment, whether the outcome of these plans is ***likely to improve the situation.***

  (E.g. Will such funds be sufficient to carry on business) ***and whether management's plans are feasible in the circumstances.*** can they pull off such big changes in given short span)
- ***Cash flow & forecast***

  Where the entity has prepared a cash flow forecast, and ***analysis of the forecast is a significant factor*** in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:
  - Evaluating the ***reliability of the underlying data generated*** to prepare the forecast; and
  - Determining whether there is ***adequate support for the assumptions*** underlying the forecast.
- ***Events***

  Considering whether ***any additional facts or information have become available*** since the date on which management made its assessment.
- ***Written Representation***

  Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

Optional if required

Audit procedures that are relevant to the requirement may include the following:

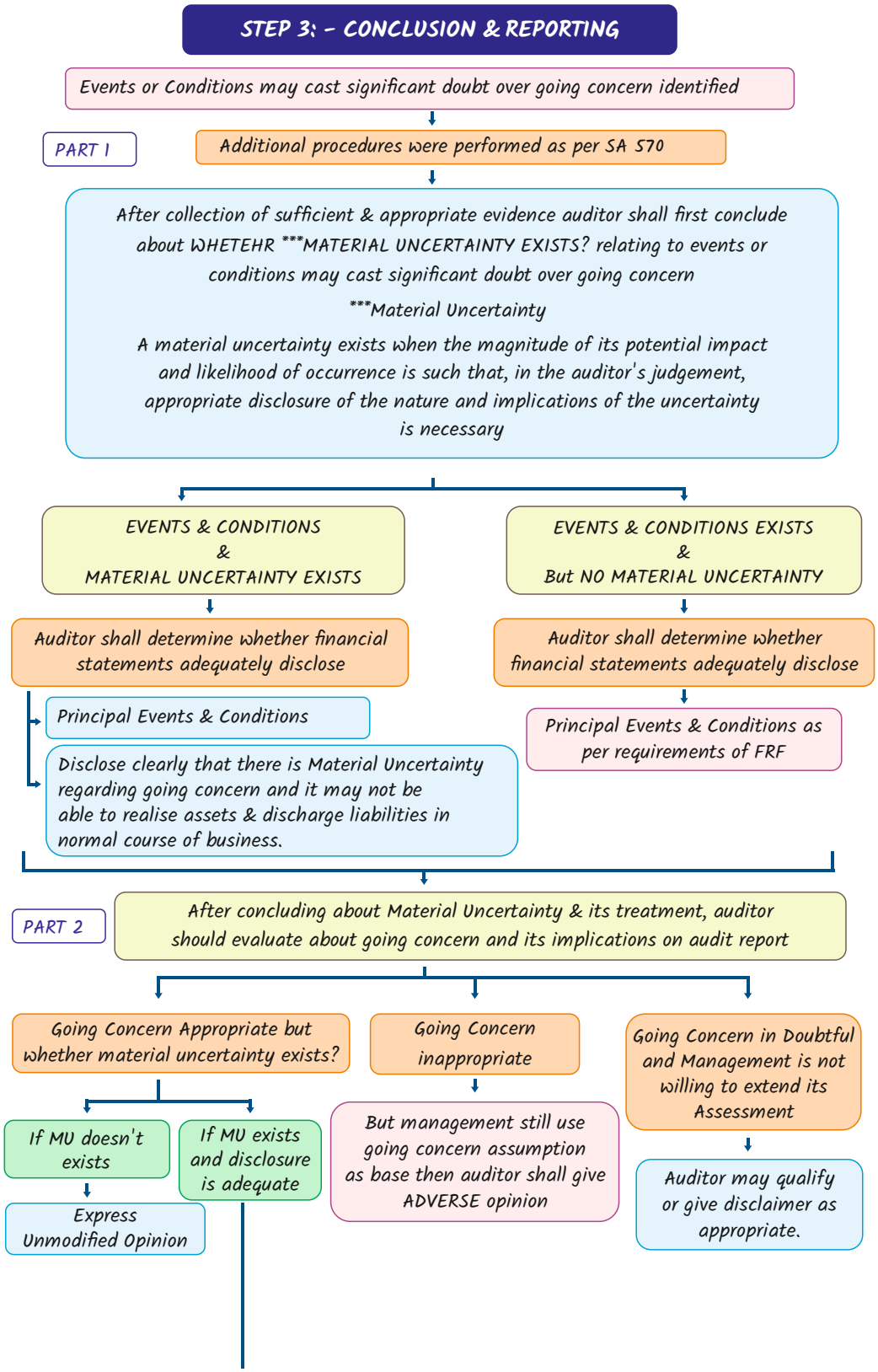
- ***Future Action Plans of Third Parties & Management***

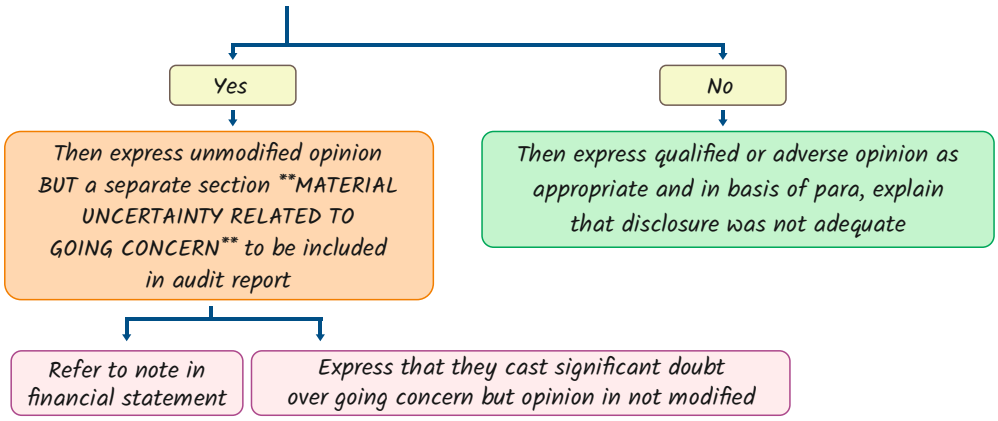
  (In Sequence of Power)
  - Obtaining and reviewing ***reports of regulatory actions.***
  - ***Inquiring of the entity's legal counsel*** regarding the existence of ***litigation and claims*** and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.
  - ***Reading minutes*** of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.
  - Determining the ***adequacy of support for any planned disposals of assets.***
  - Reading the ***terms of debentures and loan agreements*** and determining whether any have been breached.
  - Evaluating the ***entity's plans to deal with unfilled customer orders.***(When there is shortage of raw material)
- ***Cash flow, forecast & interim financial statements***
  - ***Analyzing and discussing cash flow, profit*** and other relevant forecasts with management.
  - Analyzing and discussing the entity's ***latest available interim financial statements.***

- **Subsequent Events**
  - Performing audit procedures regarding **subsequent events to identify those that either mitigate or otherwise affect** the entity's ability to continue as a going concern.
- **Written Representation of Third Parties**
  - Confirming the **existence, legality and enforceability of arrangements** to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.
  - Confirming the **existence, terms and adequacy of borrowing facilities.**

(CNO—SA570.060) Step 3 :- CONCLUSION & REPORTING (QNO 90.050, 94.000, 94.010, 94.600) (MCQ-570.2)

Chart





(CNO-SA570.060) THEORY OF ABOVE CHART (Incs.53.1)

Auditor Conclusions (QNO-90, 050 / 91.000 / 94.000/ 94.010)

The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

Based on the audit evidence obtained, the auditor **shall conclude whether, in the auditor's judgment, a material uncertainty exists** related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for:

(a) In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or

(b) In the case of a compliance framework, the financial statements not to be misleading.

- **Adequacy of Disclosures When Events or Conditions Have Been Identified and a Material Uncertainty Exists.**

  If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:

  - Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
  - Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

- **Adequacy of Disclosures When Events or Conditions Have Been Identified but No Material Uncertainty Exists.**

  If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

Implications for the Auditor's Report (QNO-91.000 /94.000)

- **Use of Going Concern Basis of Accounting Is Inappropriate;**

  If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.

- ***Use of Going Concern Basis of Accounting Is Appropriate but a Material Uncertainty Exists;***
  - ***Adequate Disclosure of a Material Uncertainty Is Made in the Financial Statements;***
    If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:
    - *Draw attention to the note in the financial statements that discloses thematters related to going concern; and*
    - *State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.*

  - ***Adequate Disclosure of a Material Uncertainty Is Not Made in the Financial Statements.***
    If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:
    - *Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and*
    - *In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.*

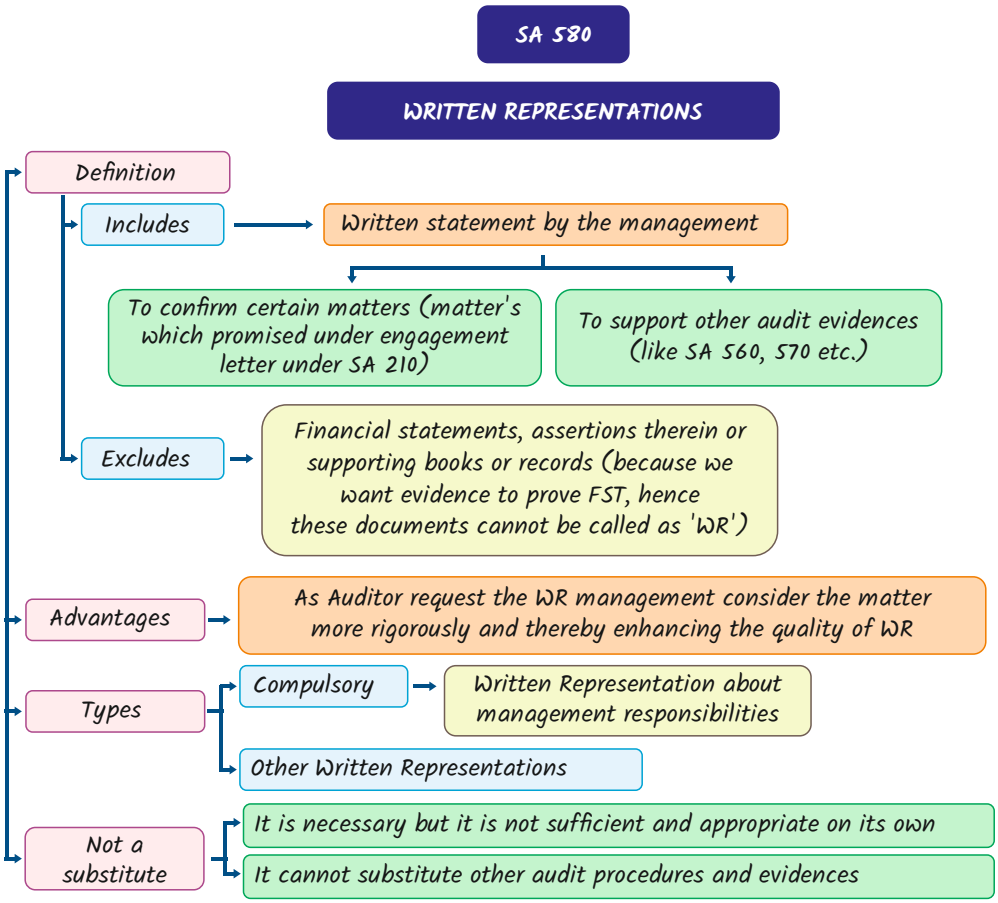
- ***Management Unwilling to Make or Extend Its Assessment.***
  If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the implications for the auditor's report.

UNIQUE QUESTION	
QNO 94.500	Drafting Opinion (Material Uncertainty & No Disclosure in FST)

[SA 580] WRITTEN REPRESENTATIONS

(CNO—SA580.020) WRITTEN REPRESENTATION (QNO-97.000)

Chart



Definition

A written statement by management provided to the auditor to **confirm certain matters or to support other audit evidence.**

(For example, to confirm things which were committed at the start of the audit (preparation of financial statements, inform about all frauds & errors during the audit etc.) or to support / corroborate other audit evidences said orally during the audit (Scrap value is Rs 2 lakhs only).

Enhances Quality of Information from Management

Further, a request for written, rather than oral, representations in many cases may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

Excludes

Written representations in this context **do not include financial statements, the assertions therein, or supporting books and records.**

For purposes of this SA, references to "management" should be read as "management and, where appropriate, those charged with governance."

Types

There are two types of written representations: -

- Written Representations about Management's Responsibilities (Compulsory)
- Other Written Representations.

Not a substitute of regular audit procedure

Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal.

Furthermore, the fact that management has provided reliable written representations **does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's**

responsibilities, or about specific assertions.

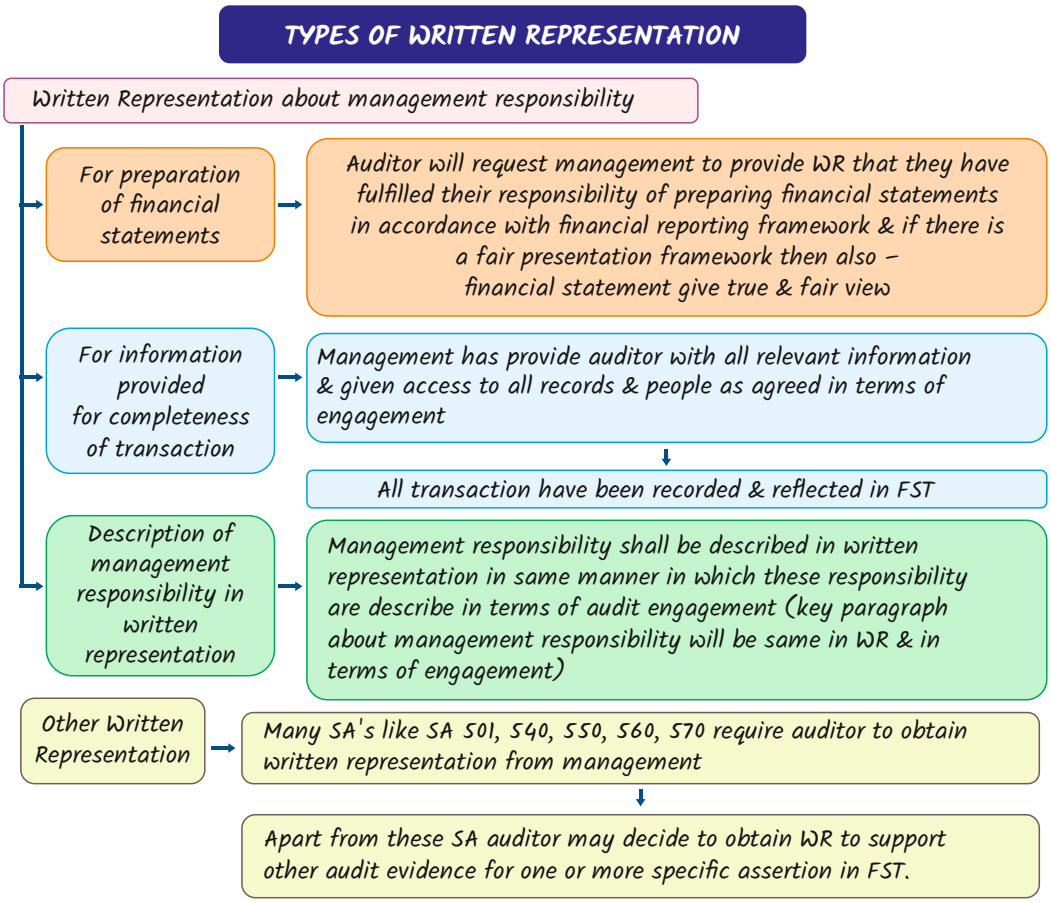
It makes it absolutely clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

Example

For example, a representation by management as to the quantity, existence and cost of inventories is no substitute for adopting *normal audit procedures regarding verification and valuation of inventories.* ***If the auditor is unable to obtain sufficient appropriate audit evidence that he believes would be available regarding a matter which has or may have*** *a material effect on the financial information, this will constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter.*

(CNO--SA580.030) WRITTEN REPRESENTATIONS ABOUT MANAGEMENT'S RESPONSIBILITIES

Chart



WR for Preparation of the Financial Statements

The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement.

Audit evidence obtained during the audit that management has fulfilled the responsibilities is not sufficient without obtaining confirmation from management about the same. This is because the auditor is not able to judge solely on other audit evidence.

For example, *the auditor could not conclude that management has provided the auditor with all relevant information agreed in the terms of the audit engagement without asking it whether, and receiving confirmation that, such information has been provided.*

WR for Information Provided and Completeness of Transactions

The auditor shall request management to provide a written representation that:

- *It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement, and*
- *All transactions have been recorded and are reflected in the financial statements.*

Management Responsibility as per Terms of Engagement

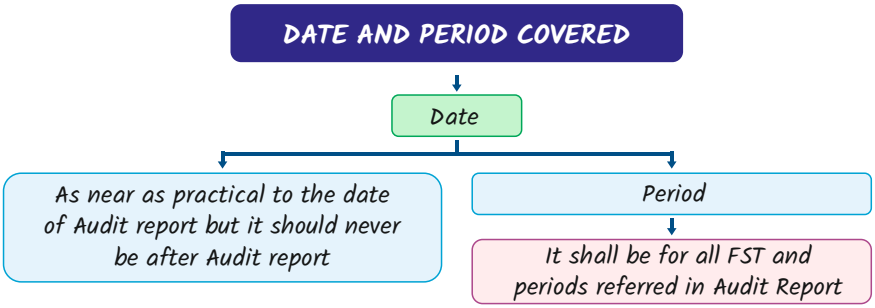
Management's responsibilities shall be described in the written representations in the manner in which these responsibilities are described in the terms of the audit engagement.

The auditor may also ask management to reconfirm its acknowledgement and understanding of those responsibilities in written representations. This is particularly appropriate when:

- Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
- The terms of the audit engagement were prepared in a previous year;
- There is any indication that management misunderstands those responsibilities; or
- Changes in circumstances make it appropriate to do so.

(CNO--SA580.040) DATE OF AND PERIOD(S) COVERED BY WRITTEN REPRESENTATIONS (QNO-97.100)

Chart

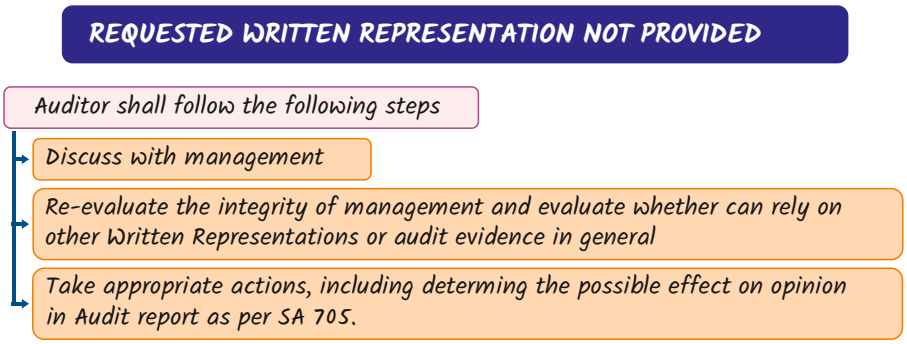


The date of the written representations shall be as **near as practicable to, but not after, the date of the auditor's report** on the financial statements. **The written representations shall be for all financial statements and period(s) referred to in the auditor's report.**

(Even if management has changed still they will have to provide WR for last year as whole FST is there responsibility irrespective of change)

(CNO--SA580.060) REQUESTED WRITTEN REPRESENTATIONS NOT PROVIDED (QNO-98.000) (MCQ-580.1)

Chart

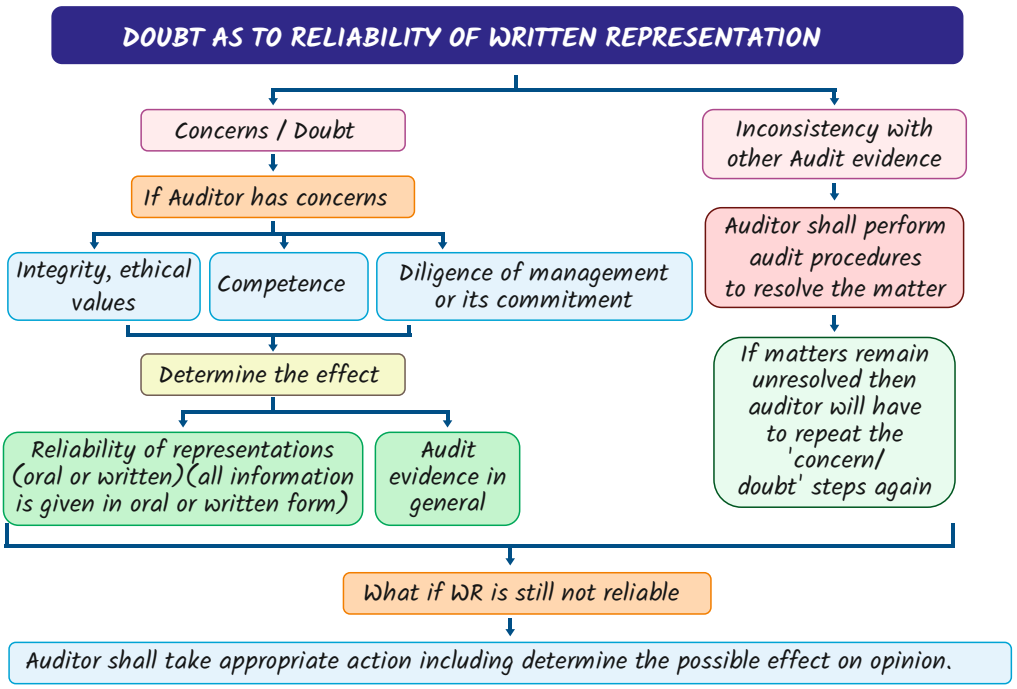


If management **does not provide** one or more of the requested written representations, the auditor shall:

- **Discuss** the matter with management;
- **Re-evaluate the integrity** of management and evaluate the effect that this may have on the reliability of representations and audit evidence in general; and
- **Take appropriate actions,** including determining the possible effect on the opinion in the auditor's report in accordance with SA 705.

(CNO--SA580.080) DOUBT AS TO THE RELIABILITY OF WRITTEN REPRESENTATION

Chart



Concerns over Integrity, Ethics, Competence, Diligence of Management	If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations (oral or written) and audit evidence in general.
Inconsist-ency with other audit evidence	In particular, if written representations are inconsistent with other audit evidence, the auditor shall **perform audit procedures to attempt to resolve the matter**. If the matter remains unresolved, the auditors hall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the **reliability of representations** (oral or written) and audit **evidence in general.**
Auditor concludes WR not reliable	If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705.

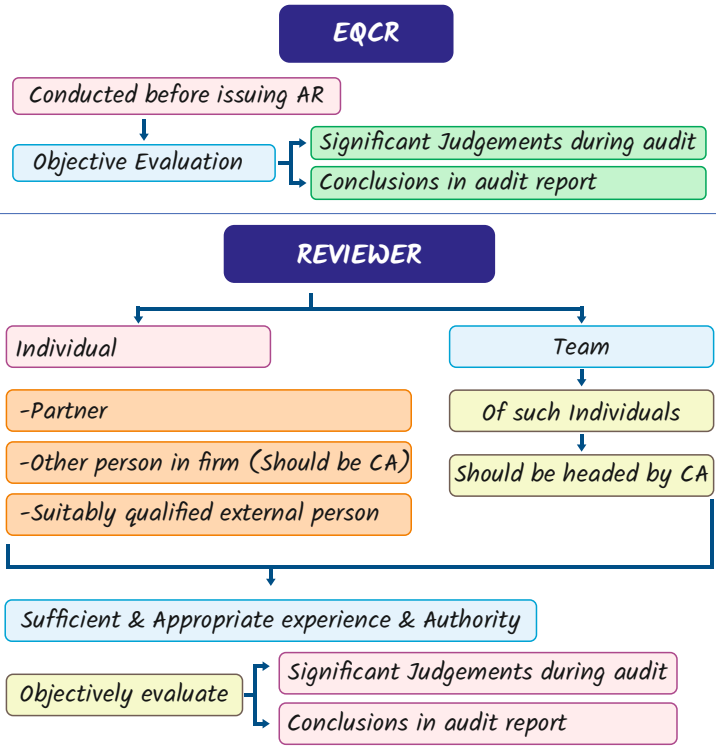
UNIQUE QUESTION

QNO 97.000	Misuse of WR
QNO 97.100	Date of and period covered by written representation

Part 6 – [SQC-1] STANDARDS ON QUALITY CONTROL

(CNO—SQC.020) IMPORTANT DEFINITIONS

Chart



Engagement quality control review

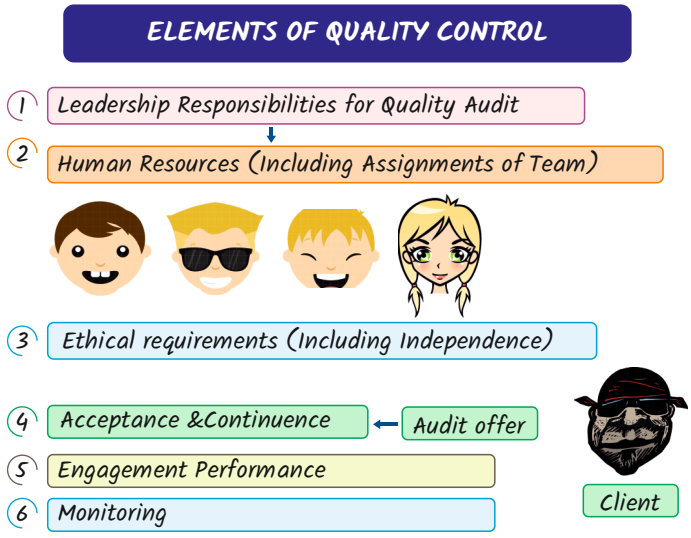
A process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.

Engagement quality control review

A partner, other person (should be a member of the Institute of Chartered Accountants of India) in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report. However, in case the review is done by a team of individuals, such team should be headed by a member of the Institute.

(CNO—SQC.040) ELEMENTS OF A SYSTEM OF QUALITY CONTROL

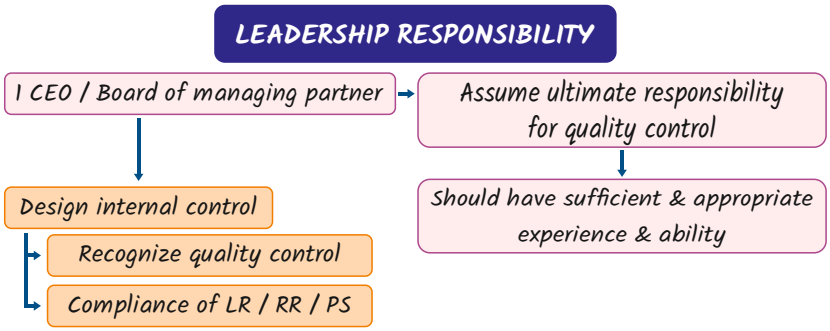
Chart



6 Elements	The firm's system of quality control should include policies and procedures addressing each of the following elements: 1. Leadership responsibilities for quality within the firm. 2. Human resources. 3. Ethical requirements. 4. Acceptance and continuance of client relationships and specific engagements. 5. Engagement performance. 6. Monitoring

(CNO—SQC.060) Elements of the System of Quality Control (Examples of Polices & Procedures at CA Firm)

Chart



Leadership Responsibilities for Quality within the Framework	Establish Policies & Procedures to ➢ Design an internal culture recognising Quality control. ➢ Internal Culture recognising Quality Control includes compliances with Professional Standards, Legal Compliances and Laws and Regulations. ➢ Firm's chief executive officer or, managing board of partners to assume ultimate responsibility for Quality Control ➢ Person assigned has sufficient and appropriate experience and ability to adhere the responsibility.
Relevant Ethical Requirement	Establish Policies and procedures designed to provide that the firm and its personnel comply with relevant ethical requirements of. ➢ Integrity; ➢ Objectivity; ➢ Professional competence and due care; ➢ Confidentiality; and ➢ Professional behaviour
Independence (MCQ-Incs.34.1)	Establish Policies and procedures designed to maintain independence to ➢ Communicate its requirements to the Management. ➢ Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action against them. ➢ Resolutions on Breach of Independence. ➢ Written confirmation of compliance with its policies and procedures on independence from all firm personnel
Acceptance and Continuance of Client Relationships and Specific Engagements	Establish Policies and procedures for the acceptance/ continuance and withdrawal of client relationships and specific engagements, designed to provide the ➢ Firm is Competent to perform the engagement. ➢ Has the capabilities, including time and resources, ethical values ➢ Client integrity is available.

Human Resources & Engagement Performance	Establish Policies and Procedures designed to provide and assign sufficient personnel with the ➢ competence, capabilities, and commitment to perform engagements with professional standards and ➢ to issue reports that are appropriate in the circumstances
Monitoring	Establish policies and procedures for Monitoring. ➢ Firm's Quality Control Policies and Procedures ➢ Evaluating, Communicating and Remedying Identified Deficiencies ➢ Complaints and Allegations
Document-ation of the System of Quality Control	➢ Establish policies and procedures requiring appropriate documentation for ▪ Evidence of the operation of each element of its system ▪ Retention for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation. ▪ Complaints and allegations and the responses to them. ➢ Depending upon the size of the firm and number of office and nature and complexity of the firm. ▪ Large firms may use electronic databases to document matters such as independence confirmations, performance evaluations and the results of monitoring inspections. Smaller firms may use more informal methods in the documentation such as manual notes, checklists and forms.
UNIQUE QUESTION	
QNO 127.500	Examples of the matters to be considered with regard to the integrity of a client by the firm as per the requirements of SQC 1
QNO 127.550	Matters to be addressed after deciding withdrawal in acceptance and continuance procedures.
QNO 127.700	How to deal with complaints & allegations against CA Firm

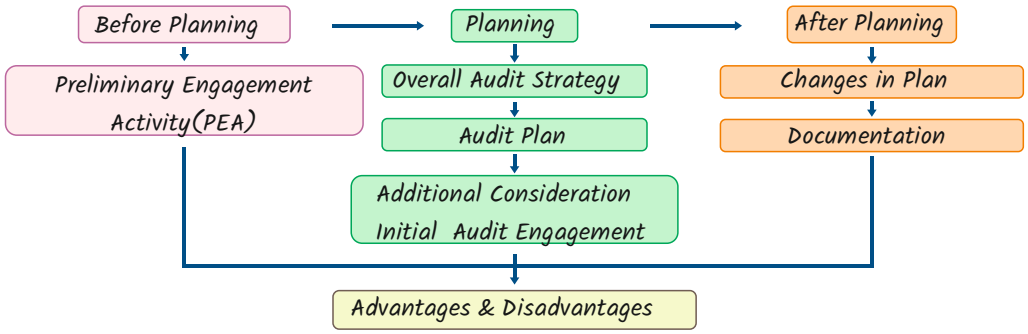
Students Notes

02 AUDIT PLANNING, STRATEGY AND EXECUTION

Part I – [SA 300] PLANNING AN AUDIT OF FINANCIAL STATEMENTS

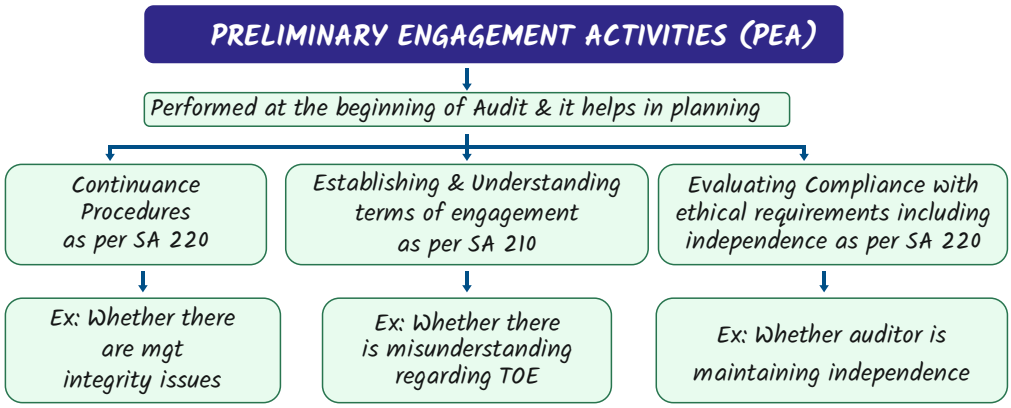
(CNO-SA300.010) Contents of the SA 300

Chart



(CNO-SA300.020) PRELIMINARY ENGAGEMENT ACTIVITIES (PEA)

Chart



The auditor shall undertake the following activities **at the beginning of the current audit engagement:**

- Performing procedures required by SA 220, "Quality Control for an Audit of Financial Statements" **regarding the continuance of the client relationship and the specific audit engagement;**
- Evaluating **compliance with ethical requirements, including independence,** as required by SA 220; and
- Establishing an **understanding of the terms of the engagement,** as required by SA 210.

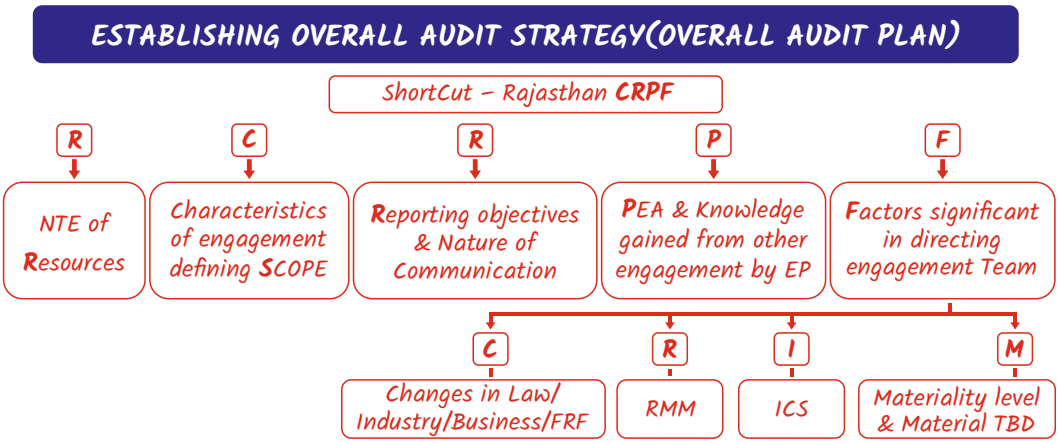
Performing the preliminary engagement activities specified above at the beginning of the current audit engagement assists the auditor in **identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement.**

Performing these preliminary engagement activities enables the auditor to plan an audit engagement for which, for example:

- There are no issues with management **integrity** that may affect the auditor's willingness to continue the engagement.
- The auditor maintains the necessary **independence** and ability to perform the engagement.
- There is **no misunderstanding** with the client as to the terms of the engagement.

(CNO-SA300.040) ESTABLISHING THE OVERALL AUDIT STRATEGY (QNO-30.100)

Overall Audit Strategy



- Identify the **characteristics of the engagement** that define its scope;
- Ascertain the **reporting objectives** of the engagement to plan the timing of the audit and the **nature of the communications** required;
- Consider the **factors** that, in the auditor's professional judgment, are **significant** in directing the engagement team's efforts;
- Consider the results of **preliminary engagement activities** and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- Ascertain the nature, timing and extent of resources necessary to perform the engagement.

(CNO--SA300.050) FACTORS CONSIDERED FOR DETERMINING OVERALL AUDIT STRATEGY (FURTHER DETAILED EXPLANATION OF EACH FACTOR)

Resources

- The selection of the engagement team and the assignment of audit work to the team members.
- Engagement budgeting

Characteristics of the Engagement that define SCOPE

- The financial reporting framework.
- Industry-specific reporting requirements such as reports mandated by industry regulators.
- The expected audit coverage, including the number and locations of components to be included.
- The nature of the control relationships between a parent and its components that determine how the group is to be consolidated.
- The extent to which components are audited by other auditors.
- The entity's use of service organizations and how the auditor may obtain evidence concerning the design or operation of controls performed by them.
- The expected use of audit evidence obtained in previous audits, for example, audit evidence related to risk assessment procedures and tests of controls.
- The effect of information technology on the audit procedures.
- The availability of client personnel and data.

Reporting & Communication (QNO—300.05)

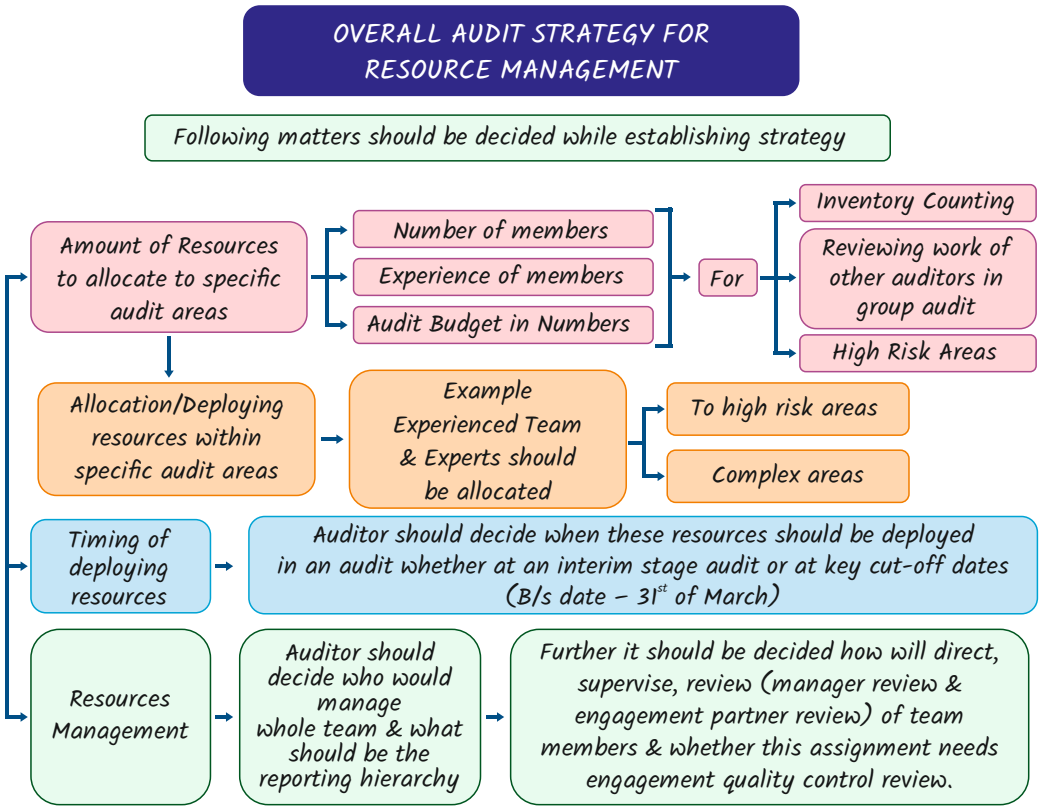
- The entity's timetable for reporting.
- The organization of meetings with management regarding audit work (Nature, timing and extent).
- The discussion with management regarding type and timing of reports to be issued.
- The discussion with management regarding communications on the status of audit work.
- Communication with auditors of components regarding types and timing of reports to be issued.
- The nature and timing of communications among engagement team members.
- Whether there are any other expected communications with third parties, including any statutory or contractual reporting responsibilities arising from the audit.

Preliminary Engagement Activities & Factors Significant in Directing Engagement Team

- The determination of materiality in accordance with SA 320.
  Preliminary identification of areas where there may be a higher risk of material misstatement.
- The impact of the assessed risk of material misstatement at the overall financial statement level on direction, supervision and review.
- The manner in which engagement team members needs to maintain an inquisitive/questioning mind and exercise professional skepticism and unpredictability.
- Results of previous audits including the identified deficiencies and action taken to address them.
- The discussion of matters that may affect the audit with firm personnel responsible for performing other services to the entity.
- Evidence of management's commitment to the design, implementation and maintenance of sound internal controls.
- Volume of transactions which may determine reliance on internal control.
- Importance attached to internal control.
- Significant business developments affecting the entity.
- Significant industry specific developments and development in the economic environment.
- Significant changes in the financial reporting framework, such as changes in accounting standards.
- Other significant relevant developments, such as changes in the legal and regulatory environment affecting the entity.

(CNO--SA300.055) OVERALL AUDIT STRATEGY -- FOR RESOURCES MANAGEMENT

Chart

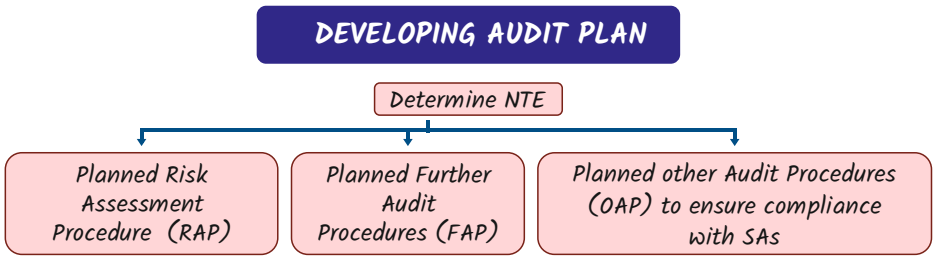


- The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.
- The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as:

- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas;
- The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters;
- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates; and
- How such resources are managed, directed and supervised, such as when team briefing, and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews.

(CNO--SA300.060) DEVELOPING AN AUDIT PLAN (QNO-30.200)

Chart



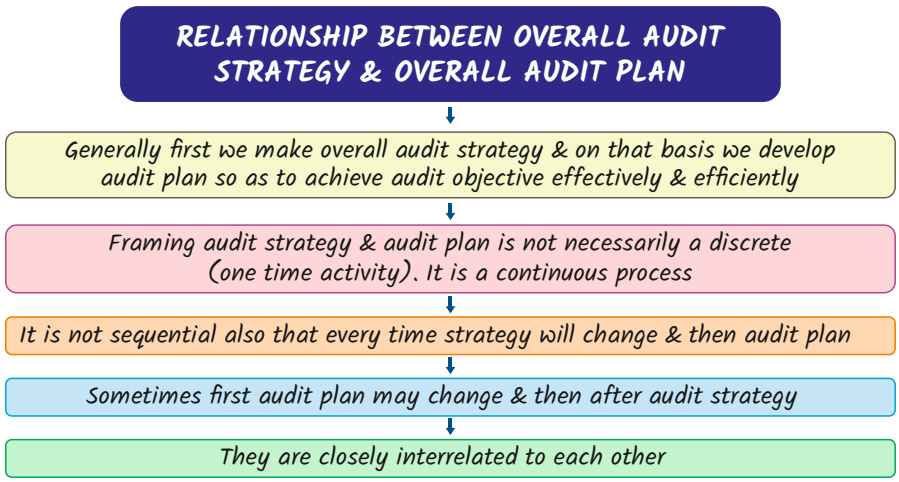
The auditor shall **develop an audit plan** that shall include a description of:

- The nature, timing and extent of **planned risk assessment procedures** as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
- The nature, timing and extent of **planned further audit procedures at the assertion level,** as determined under SA 330 "The Auditor's Responses to Assessed Risks".
- **Other planned audit procedures** that are required to be carried out so that the engagement complies with SAs.

The audit plan **is more detailed than the overall audit strategy** that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures **takes place over the course of the audit** as the audit plan for the engagement develops. For example, **planning of the auditor's risk assessment procedures occurs early in the audit process.** However, planning the nature, timing and extent of specific **further audit procedures depends on the outcome of those risk assessment procedures.** In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

(CNO--SA300.070) RELATIONSHIP BETWEEN OVERALL AUDIT STRATEGY AND AUDIT PLAN (QNO-30.300)

Chart

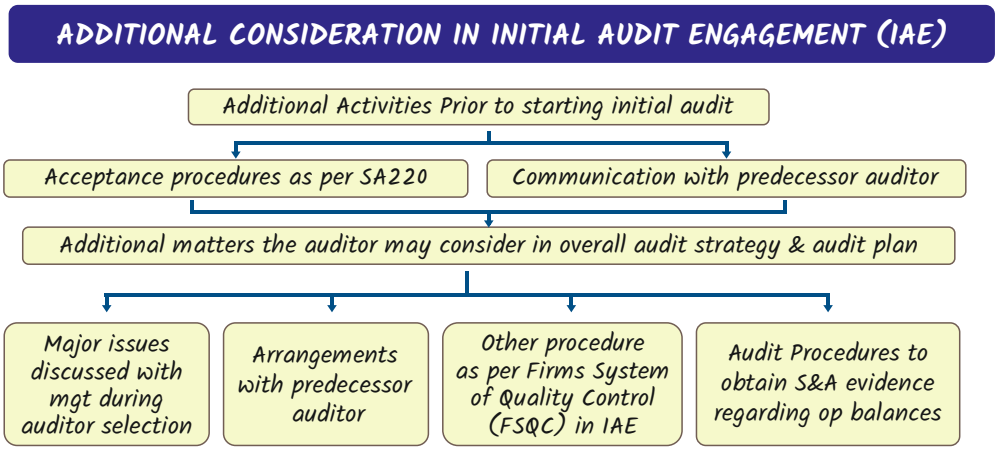


Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes but are closely inter-related since changes in one may result in consequential changes to the other.

(CNO--SA300.080) ADDITIONAL CONSIDERATIONS IN INITIAL AUDIT ENGAGEMENTS

(QNO-30.000) (MCQ-300.4/300.9)

Chart



The auditor shall undertake the following activities prior to starting **an initial audit:**

- Performing procedures required by SA 220 regarding the **acceptance of the client relationship** and the specific audit engagement; and
- **Communicating with the predecessor auditor,** where there has been a change of auditors, in compliance with relevant ethical requirements.

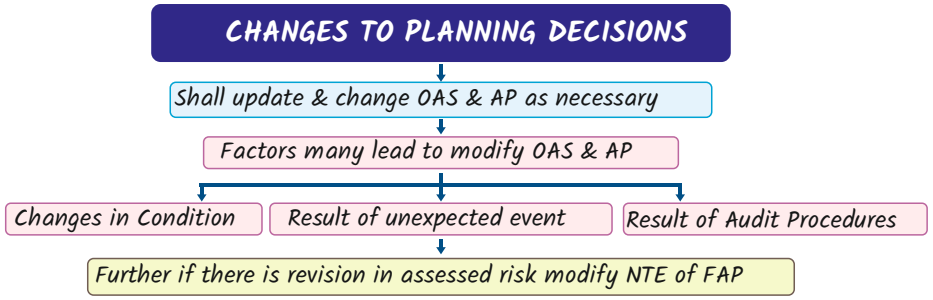
For initial audits, additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following:

- Unless prohibited by law or regulation, **arrangements to be made with the predecessor auditor,** for example, to review the predecessor auditor's working papers.4
- Any **major issues** (including the application of accounting principles or of auditing and reporting standards) **discussed with management** in connection with the initial selection as auditor, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.1
- The audit procedures necessary to obtain sufficient appropriate audit **evidence regarding opening balances** (SA 510)2
- Other procedures required by the **firm's system of quality control for initial audit engagements.**3
  - (for example, the firm's system of quality control may require the involvement of another partner or senior individual to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance).

(CNO--SA300.100) CHANGES TO PLANNING DECISIONS

(QNO-149.030) (MCQ-300.1/300.3/300.6)

Chart



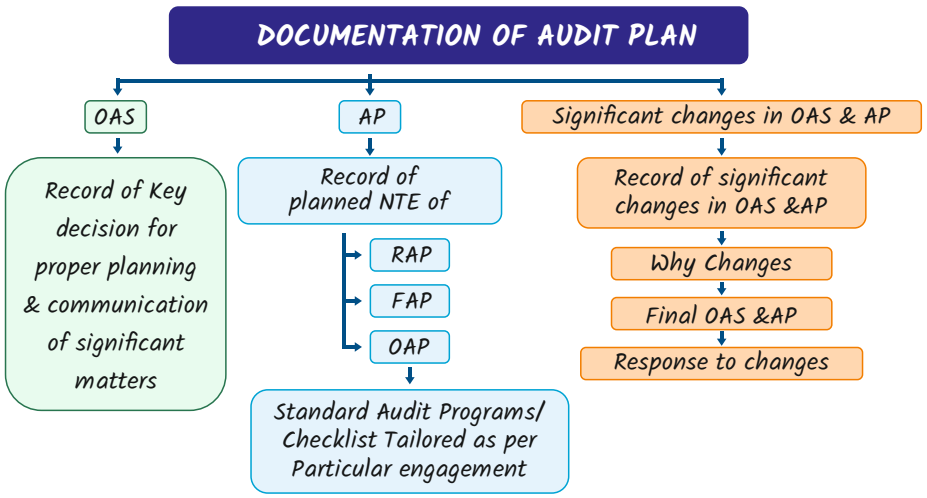
Eco. Growth - Recession Profit Making -Loss Making	-Change in FRF -Demerger	-Weak Control -Frauds

- The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit.
- The auditor may need to modify the overall audit strategy and audit plan due to below mentioned factors-
- Further, the auditor would also modify the nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks.

  This may be the case when information coming to the auditor differs significantly from the information when he planned the audit procedures. For example, audit evidence obtained through the performance of substantive procedures may contradict the audit evidence obtained through tests of controls. In addition to above, there may be a possibility of change in law notifications, Govt. policies which necessitates updating of overall Audit strategy

(CNO—SA300.140) DOCUMENTATION OF AUDIT PLAN (QNO-30.310) (MCQ-300.8)

Chart



What should be Documented?

- The auditor shall document:
  - the overall audit strategy;
  - the audit plan; and
  - any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

Further Explanation

- **Overall Audit Strategy**

  The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team.

  Example- The auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit.

- **Audit Plan**

  The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

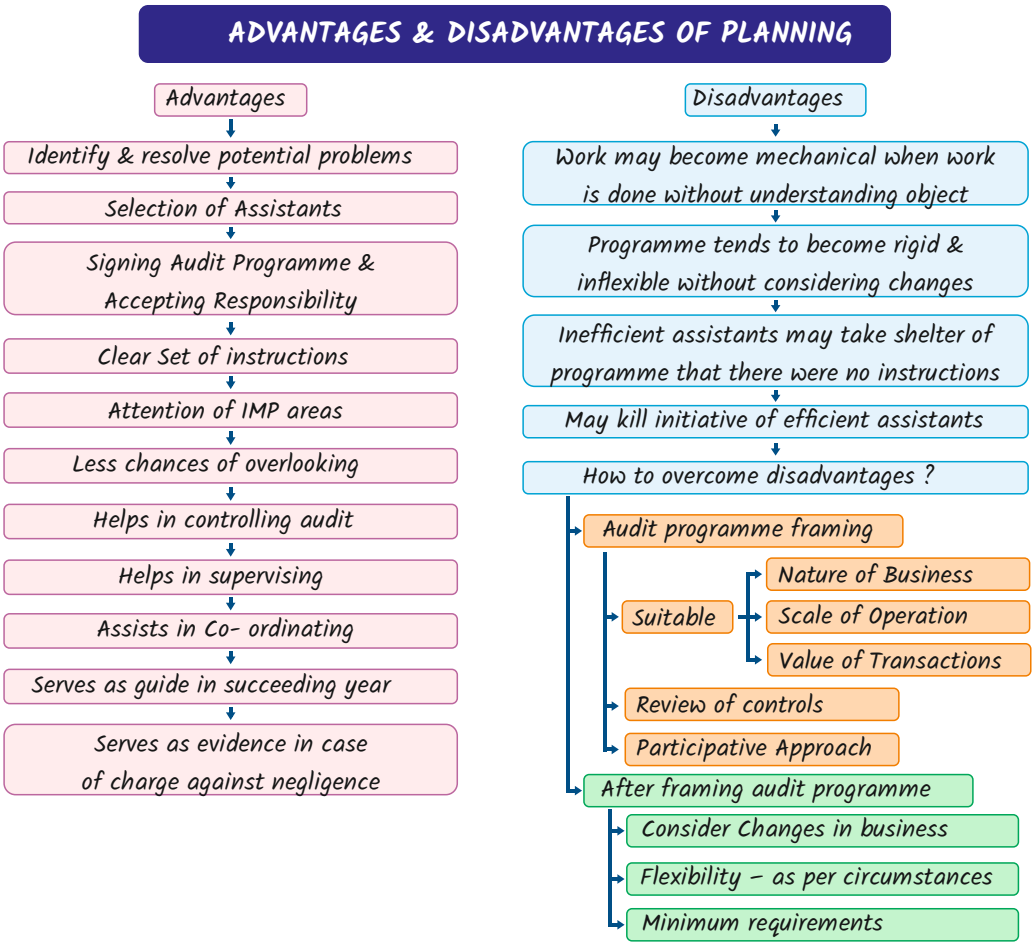
- **Significant Changes**

  A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant

changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit.

(CNO--SA300.120) ADVANTAGES & DISADVANTAGES OF PLANNING & HOW TO OVERCOME THEM (QNO-30.320)

Chart



Advantages

- It provides the assistant carrying out the **audit with total and clear set of instructions** of the work generally to be done.
- **Selection of assistants** for the jobs on the basis of capability **becomes easier when the work is rationally planned,** defined and segregated.
- Without a written and pre-determined programme, **work is necessarily to be carried out on the basis of some 'mental' plan.** In such a situation, there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, **the danger is significantly less and the audit can proceed systematically.**
- The assistants, by **putting their signature on programme, accept the responsibility for the work carried out by them** individually and, if necessary, the work done may be traced back to the assistant.
- Helping the auditor to devote appropriate attention to important areas of the audit.
- Helping the auditor identify and resolve potential problems on a timely basis.
- Assisting, where applicable, in coordination of work done by auditors of components and experts.
- The principal **can control the progress of the various audits in hand by examination of audit programmes** initiated by the assistants deputed to the jobs for completed work.
- It **serves as a guide** for audits to be **carried out in the succeeding year.**
- A properly drawn up audit programme **serves as evidence in the event of any charge of negligence being brought** against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of professional auditor.

Disadvantages

- The **work may become mechanical** and particular parts of the programme may be **carried out without any understanding of the object** of such parts in the whole audit scheme.
- The **programme often tends to become rigid and inflexible following set grooves;** the business may change in its operation of conduct, but the old programme may still be carried on. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.
- **Inefficient assistants may take shelter behind the programme** i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.
- **A hard and fast audit programme may kill the initiative of efficient** and enterprising assistants.

Measures to Overcome Disadvantages of Audit Programme

Suitability	While laying down the audit programme, the Auditor should consider whether the same is commensurate with factors like – ▪ Nature of the entity's business. ▪ Scale of operations, ▪ Volume of transactions and ▪ The efficiency of internal controls.
Review of Internal Controls	Internal Controls should be reviewed and evaluated to obtain knowledge of changes in the controls and systems and procedures. The Auditor can spot weaker aspects of the control and use his knowledge in revising the audit programme.
Changed business operations	The Auditor should obtain information about new lines of business or new systems to carry on the old business. The audit programme should be recast or modified to suit the changed business operations and practices. **Participative approach** The Auditor should encourage his audit assistants to keep an open mind and make suggestions for amending the programmes. The persons doing the actual field work would be in a better position to know the actual changes and requirements of the situation.
Flexibility	The audit programme should not become stereotyped. There should be revision from time to time according to circumstances even though no material change has taken place in the client's business operations and the business practice.
Minimum Requirement	It should be impressed upon the audit assistants that the programme provides for the minimum tests that should be carried out and they should undertake tests and surprise checks, considered appropriate, even though not provided in the programme.

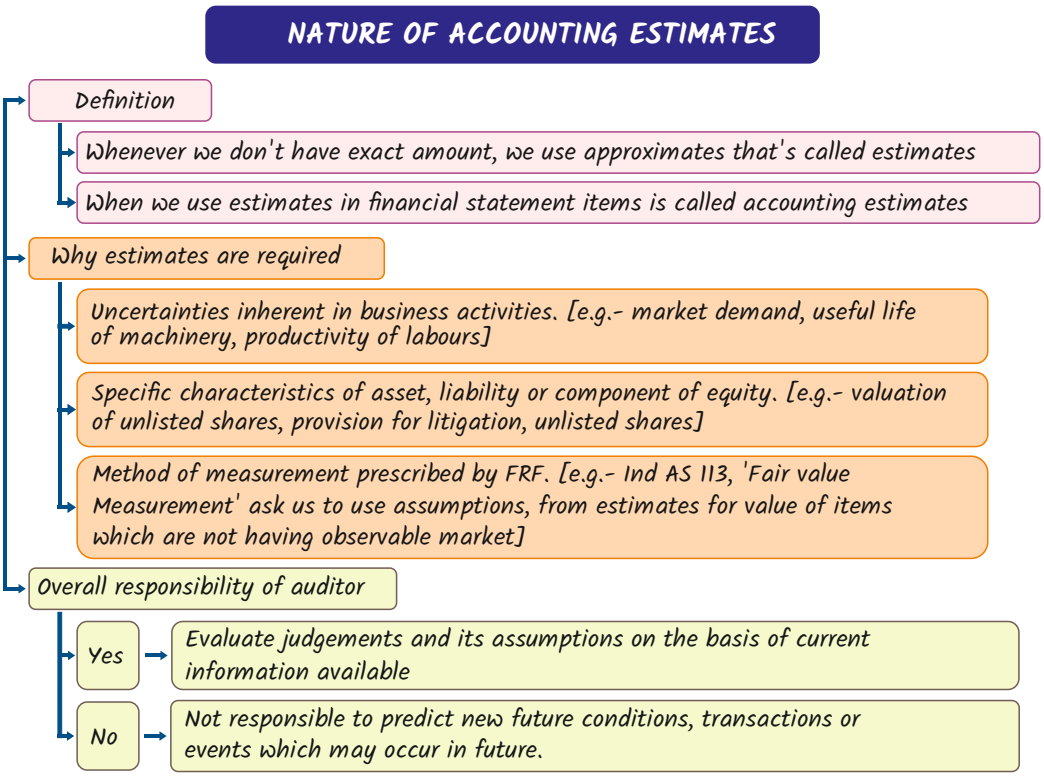
UNIQUE MCQ's	
MCQ No	300.2

UNIQUE QUESTIONS	
QNO 29.000	Continuous Phase
QNO 30.300	Audit Strategy & Audit Plan
QNO 30.320	Benefits of Planning

Part 2 - [SA 540] AUDITING ACCOUNTING ESTIMATES, INCLUDING FAIR VALUE ACCOUNTING ESTIMATES, AND RELATED DISCLOSURES

(CNO--SAS40.020) NATURE OF ACCOUNTING ESTIMATES

Chart



Definition

Some financial statement items cannot be measured precisely but can only be estimated. For purposes of this SA, such financial statement items are referred to as accounting estimates.

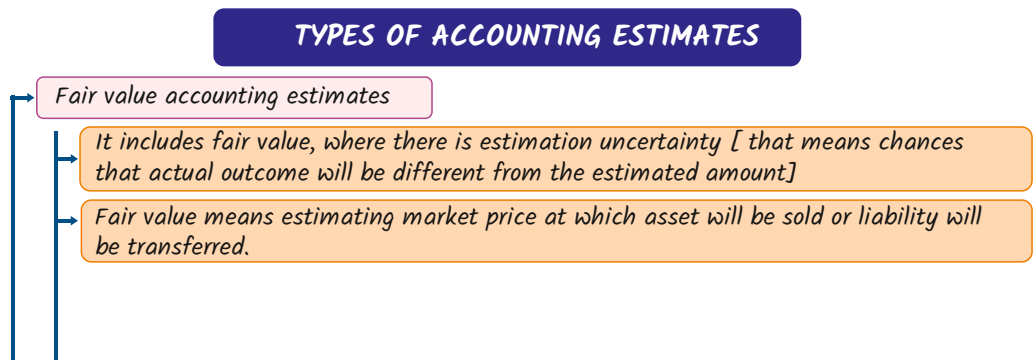
Why stimates are required? - 3 Reasons

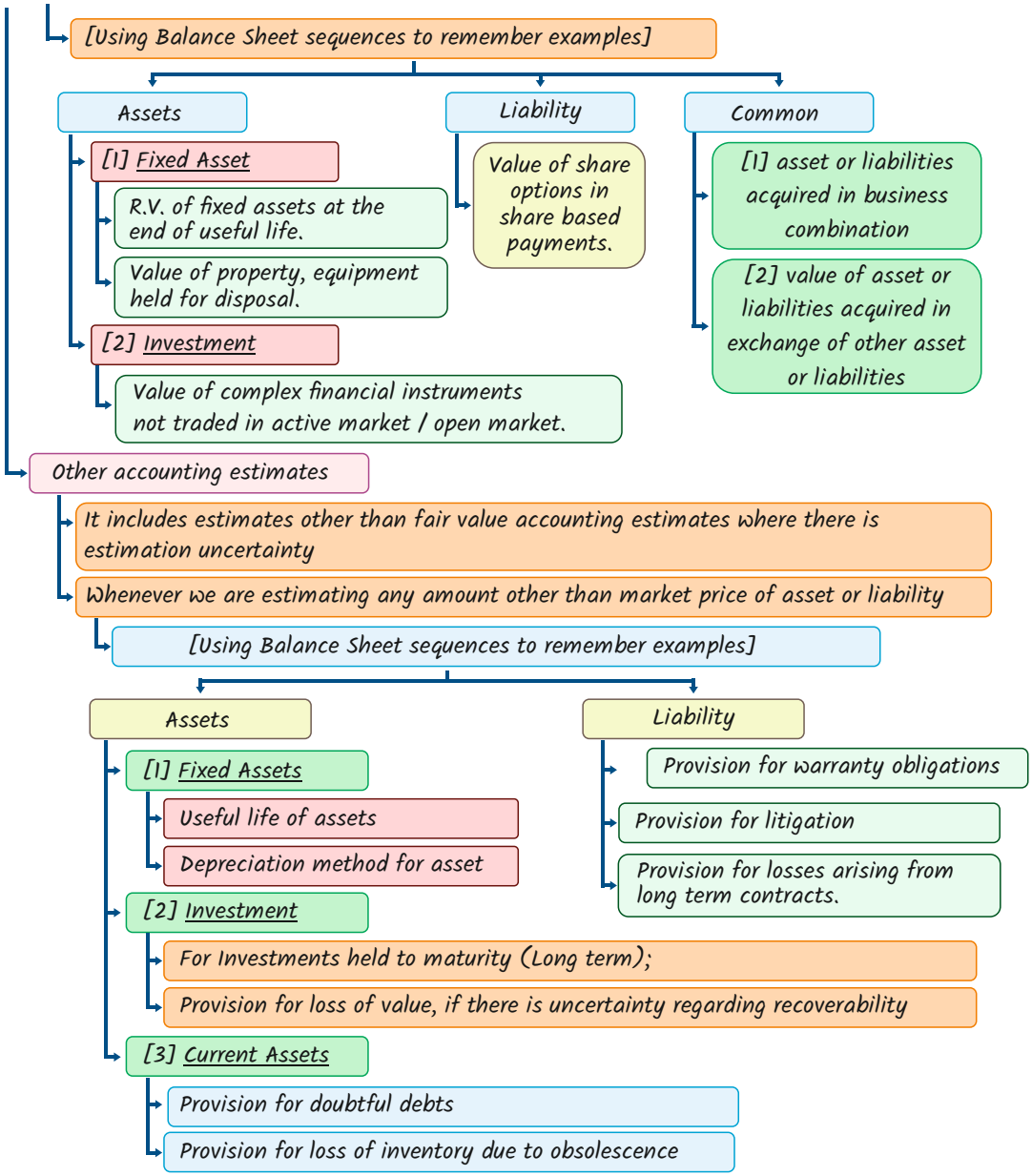
Because of the **uncertainties inherent in business activities** (Utilization of machines, continuity of departments), some financial statement items can only be estimated. Further, the **specific characteristics of an asset, liability or component of equity,** (investments, provisions for litigations) or the **basis of or method of measurement prescribed by the financial reporting framework,** (Value in use in AS 28, Fair Valuation in Ind AS may give rise to the need to estimate a financial statement item. Some financial reporting frameworks prescribe specific methods of measurement and the disclosures that are required to be made in the financial statements, while other financial reporting frameworks are less specific.

Evaluate Judgements / Assumptions But Not Responsible Unknown Events or Conditions

Estimation involves judgments based on **information available** when the financial statements are prepared. For many accounting estimates, these include **making assumptions** about matters that are uncertain at the time of estimation. The **auditor is not responsible for predicting future conditions, transactions or events that,** if known at the time of the audit, might have significantly affected management's actions or the assumptions used by management.

Chart





Types of Estimates

This term (accounting estimate) is used for an amount measured at **fair value** where there is estimation uncertainty, as well as for **other amounts** that require estimation. Where this SA addresses only accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used.

Fair Value Accounting Estimates

Fair value is a rational and unbiased estimate of the potential market price of asset / liability Examples of situations where fair value accounting estimates may be required include:

(Use balance sheet sequence to remember below list of examples)

(Fixed Asset) RV value of fixed asset / Property or equipment held for disposal.	(Old technology machine retired from active use, kept in Godown)
(Investment) Complex financial instruments, which are not traded in an active and open market.	(Investment in Convertible Preference Shares / Debentures of Private Company in E Commerce which is not listed like Flipkart)
(Liability) Share-based payments.	(Accounting for ESOPS etc.)
(Comm) ➢ Certain assets or liabilities acquired in a business combination	(amalgamation, merger, demerger) including goodwill and intangible assets. (Patanjali gave its jeans manufacturing plant to Raymond's and took its food research laboratory)

➢ Transactions involving the exchange of assets or liabilities between independent parties without monetary consideration, for example, a nonmonetary exchange of plant facilities in different lines of business.	

Other Accounting Estimates

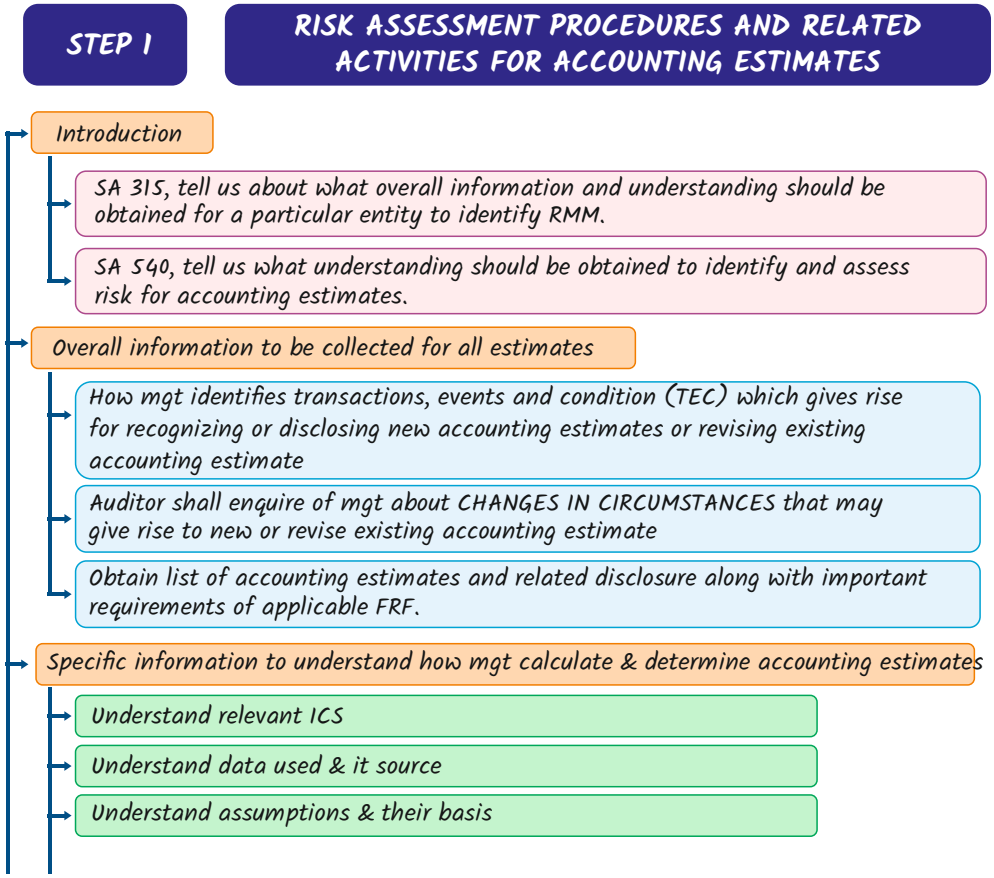
Estimates apart from fair value estimates.

Examples of situations where accounting estimates, other than fair value accounting estimates, may be required include:

(Fixed Asset) Depreciation method or asset useful life.	
(Investment) Provision against the carrying amount of an investment where there is uncertainty regarding its recoverability.	(investment in Debentures, held to maturity category, that company became insolvent, as there is doubt over redemption amount, provision is made) (Some Investments are not for sale but for redemption)
(Current Asset) ➢ Allowance for doubtful accounts. ➢ Inventory obsolescence.	
(Liability) ➢ Warranty obligations. ➢ Financial Obligations / Costs arising from litigation settlements and judgments	(E.g. Settlement amount due for patent infringement claim pending against company)
(P&L) Outcome of long-term contracts.	(Profit / Loss on construction contracts, Percentage Completion etc.)

(CNO--SAS40.040) STEP 1: - RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES (QNO-81.000)

Chart



- Which method or model is used for computing estimates and whether there is any change from prior period method or model
- Whether mgt has used experts

- Special Point
  - Estimation Uncertainty
    - Whether and how management assessed estimation uncertainty
  - Review of Prior Period Estimates
    - It is mandatory for Auditor to review outcome of previous year accounting estimate or their subsequent re-estimation.
    - Nature and extent depend upon nature of accounting estimates & its relevance (connection) with the current period accounting estimates.
    - Review not intended to judge whether prior period estimates properly computed.

When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, as required by SA 315, the auditor **shall obtain an understanding of the following** in order to provide a basis for the identification and assessment of the risks of material misstatement for accounting estimates:

- **How management identifies** those transactions, events and conditions that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements. In obtaining this understanding, the auditor shall make inquiries of management about changes in **circumstances that may give rise to new, or the need to revise existing**, accounting estimates.
- The requirements of the **applicable financial reporting framework** relevant to accounting estimates, including related disclosures.
- How management makes the accounting estimates, and an understanding of the **data on which they are based**, including:
  - Relevant **controls;**
  - **The method,** including where **applicable the model,** used in making the accounting estimate;
  - Whether there has been or ought to have been a **change from the prior period** in the methods for making the accounting estimates, and if so, why; and
  - The **assumptions** underlying the accounting estimates;
  - Whether management has used an **expert;**
  - Whether and, if so, how management has **assessed the effect of estimation uncertainty.**

The auditor shall **review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period.** The nature and extent of the auditor's review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements. **However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at that time.**

(CNO--SAS40.060) STEP 2 - IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT (QNO 81.050)

Chart

STEP 2 — **IDENTIFYING AND ASSESSING THE RISK OF MMST**

- Basic Principle
  - Auditor shall evaluate degree of estimation uncertainty associated with accounting estimates
    - If we identify high estimation uncertainty than it is considered as area of significant risk.

*In identifying and assessing the risks of material misstatement, as required by SA 315, the auditor **shall evaluate the degree of estimation uncertainty associated with an accounting estimate.***

*The auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having **high estimation uncertainty give rise to significant risks.***

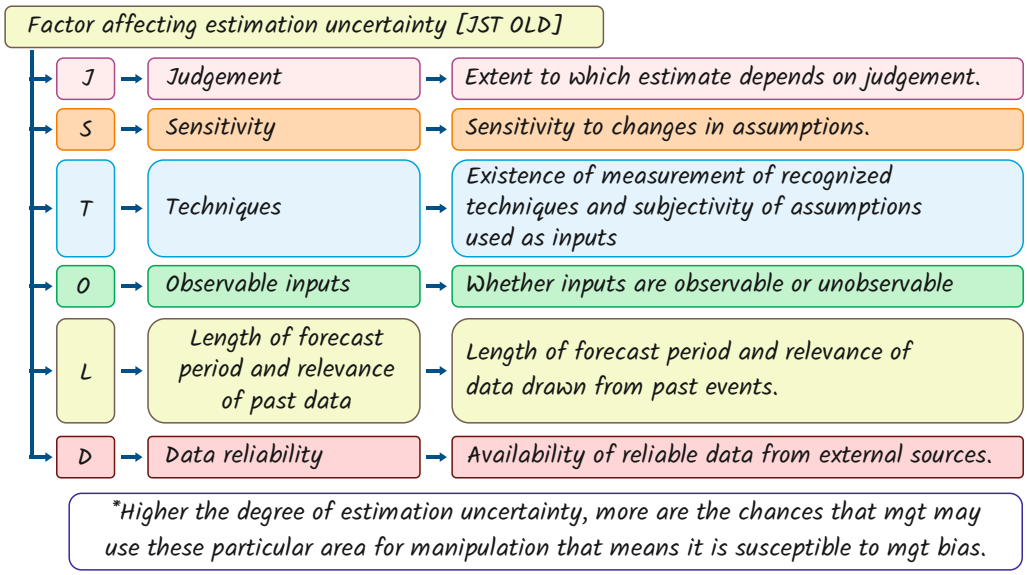
(CNO--SAS40.070) DEGREE OF ESTIMATION UNCERTAINITY

- *The degree of estimation uncertainty varies based on the nature of the accounting estimate, the extent to which there is a generally accepted method or model used to make the accounting estimate, and the subjectivity of the assumptions used to make the accounting estimate. In some cases, estimation uncertainty associated with an accounting estimate may be so great that the recognition criteria in the applicable financial reporting framework are not met and the accounting estimate cannot be made.*

- *Not all financial statement items requiring measurement at fair value, involve estimation uncertainty. For example, this may be the case for some financial statement items where there is an active and open market that provides readily available and reliable information on the prices at which actual exchanges occur, in which case the existence of published price quotations ordinarily is the best audit evidence of fair value. However, estimation uncertainty may exist even when the valuation method and data are well defined. For example, valuation of securities quoted on an active and open market at the listed market price may require adjustment if the holding is significant in relation to the market or is subject to restrictions in marketability. In addition, general economic circumstances prevailing at the time, for example, illiquidity in a particular market, may impact estimation uncertainty.*

(CNO--SAS40.080) FACTORS AFFECTING ESTIMATION UNCERTAINTY

Chart



Factors on which depends estimation uncertainty (Brand Valuation Vs Construction Contract)
***JST-OLD** leads to uncertainty.*

Table

Factor	**Brand Valuation (High Uncertainty)**	**Cost of Construction Contract (Low Uncertainty)**
J-Judgment	Depends on how people judge and give importance to brand. *Similarly result of litigations depends a lot on judgment	Here Judgments are prepared as per well-established principle, so subjectivity is reduced drastically.

S-Sensitivity	It's highly sensitivity to performance and image of other competitive brands. As people's perception change brand value changes drastically.	If prices of cement or still changes as per past data, there will not be significant change in overall project
T-Technique	No accounting standard or guidance note on brand valuation.	We have AS 7 which guides on how to compute % completion.
O-Observable Input	There is no proper source of information for customer opinion and preferences and changes happening in them.	There are cement, steel, labour markets from where we can have observable inputs for prices etc.
L-Length of time period	10 years of forecast for brand valuation on the basis of past 10 years of data in technology industry	2 years of forecast in construction contract on the basis of 20 years data
D-Data	Market data collected and maintained by company itself is less reliable.	Market data collected and maintained by industry association or authorities is more reliable.

Detailed Text

The degree of estimation uncertainty associated with an accounting estimate may influence the estimate's susceptibility to bias.

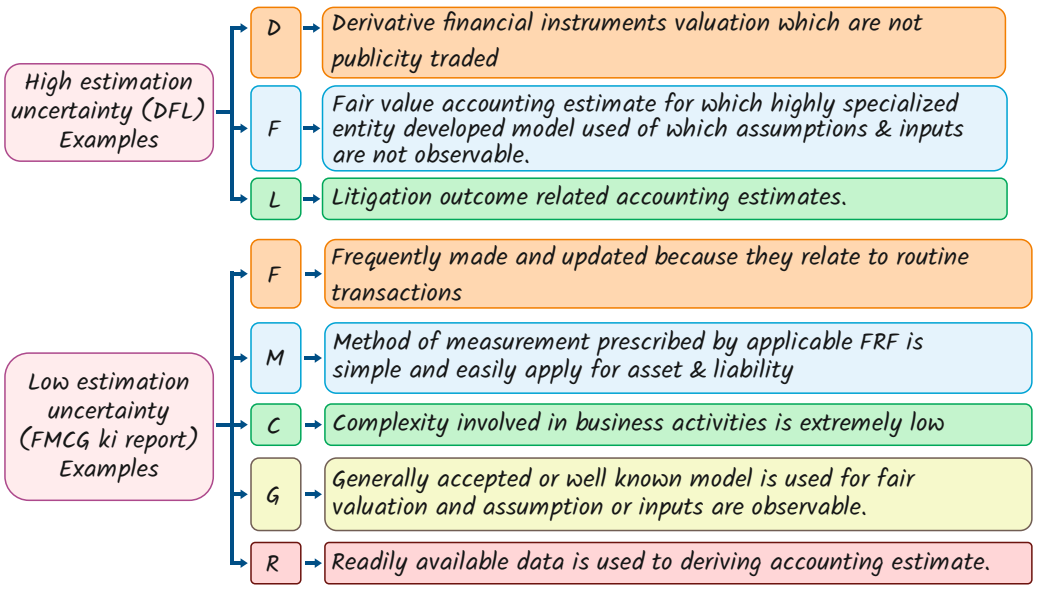
The degree of estimation uncertainty associated with an accounting estimate may be influenced by factors such as:

- The extent to which the accounting estimate depends on **judgment.**
- The **sensitivity** of the accounting estimate to changes in assumptions.
- The existence of recognised measurement **techniques** that may mitigate the estimation uncertainty (though the subjectivity of the assumptions used as inputs may nevertheless give rise to estimation uncertainty).
- The extent to which the accounting estimate is based on **observable or unobservable** inputs.
- The **length** of the forecast period, and the relevance of data drawn from past events to forecast future events.
- The availability of reliable **data** from external sources.
- The degree of estimation uncertainty associated with an accounting estimate may influence the estimate's susceptibility to bias.

(CNO--SAS40.100) EXAMPLES OF HIGH & LOW ESTIMATION UNCERTAINTY

(QNO 80.000, 80.050) (MCQ - Incs.08.2)

Chart



Examples of High Estimation Uncertainty (LSD)

Accounting estimates relating to the outcome of litigation.	(Vodafone Case)
Fair value accounting estimates for derivative financial instruments not publicly traded.	(Dollar swap with euro after 7 months)
Fair value accounting estimates for which a highly specialized entity-developed model is used or for which there are assumptions or inputs that cannot be observed in the marketplace.	(Share valuation depending on internal assessment of new product and efficiency levels.)

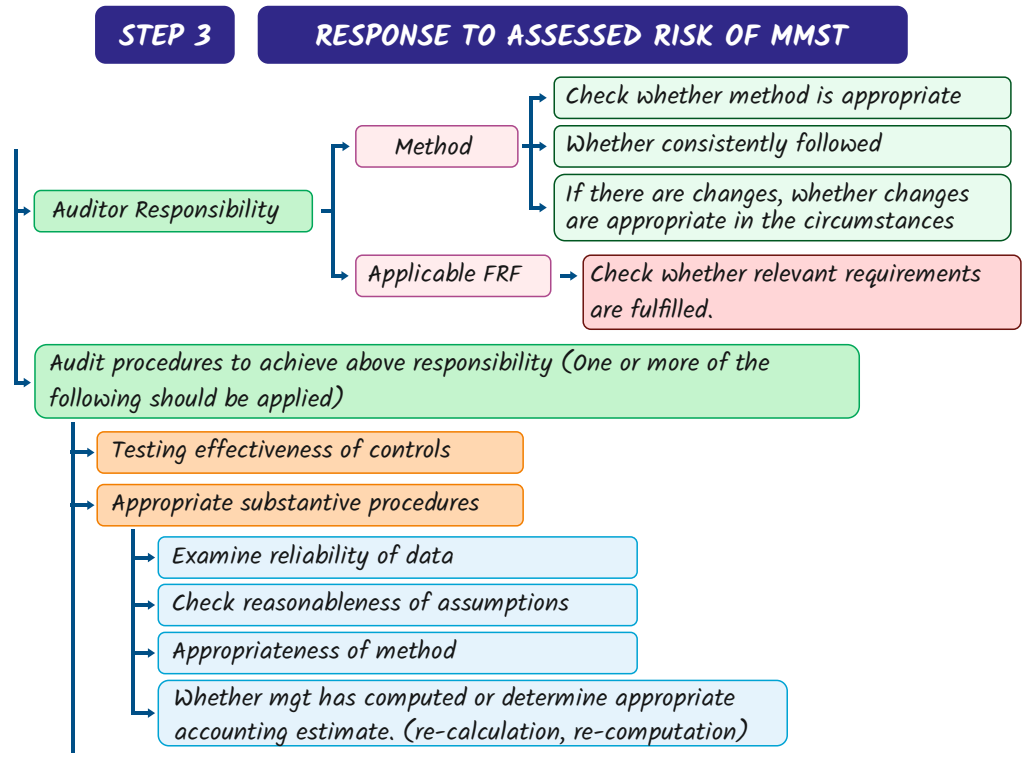
Examples of Low Estimation Uncertainty (QNO-80.050)

FMCG ki Report mine bahut kam uncertainty hai

- Accounting estimates that are **Frequently made and updated because they relate to routine Transactions** (Inventory Valuation)
- Fair value accounting estimates where the **Method of measurement prescribed by the applicable financial reporting framework is simple and applied easily** to the asset or liability requiring measurement at fair value.
  - (E.g. Ind AS 113 gives method of computing fair value, if this is used then it is reliable)
- Accounting estimates arising in entities that **engage in business activities that are not Complex.**
  - (E.g., Depreciation of furniture in trading entity) (Fixed Asset)
- **Fair value accounting estimates** where the model used to measure the accounting estimate is **well known or Generally accepted,** provided that the assumptions or inputs to the model are observable.
  - (E.g., Equity share valuation through net asset method is very simple and well-known method)
- Accounting estimates **derived from data that is Readily available,** such as published interest rate data or exchange-traded prices of securities. Such data may be referred to as "observable" in the context of a fair value accounting estimate.
  - (E.g., Average PE ratio was computed for retail industry from share prices and earnings of listed companies and same was used to value a private company shares in retail industry) (Investment)

(CNO-SAS40.120) STEP -3: - RESPONSES TO THE ASSESSED RISKS OF MATERIAL MISSTATEMENT (QNO-81.050)

Chart



- Point Estimate (Single value) & Range Estimate (Minimum or Maximum value)
  - In this auditor computes point estimate or range estimate using set of assumptions and method which are different from the managemen
  - And then evaluate whether there is significant difference from mgt's estimates. (Auditor should understand mgt assumptions and method to ensure that he has taken all relevant variables while making calculations)
  - If range estimate is used auditor should ensure that range should be sufficiently narrow such that estimates which comes within these range is considered reasonable.
- Subsequent Events → Check whether there are events after balance sheet date which provide additional information for accounting estimates.

Mandatory

Based on the assessed risks of material misstatement, the auditor **shall determine:**

a) Whether the methods for making the accounting estimates are appropriate and have been applied **consistently, and whether changes,** if any, in accounting estimates or in the method for making those from the prior period are appropriate in the circumstances.

b) Whether management has appropriately **applied the requirements of the applicable financial reporting framework** relevant to the accounting estimate; and

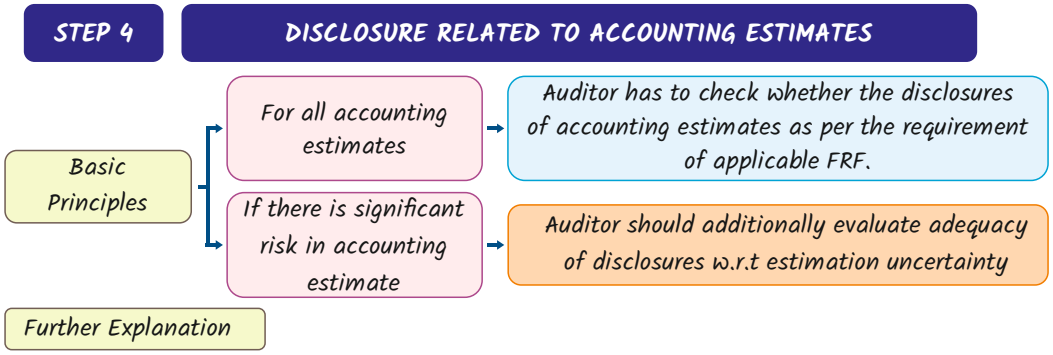
One or More as Appropriate

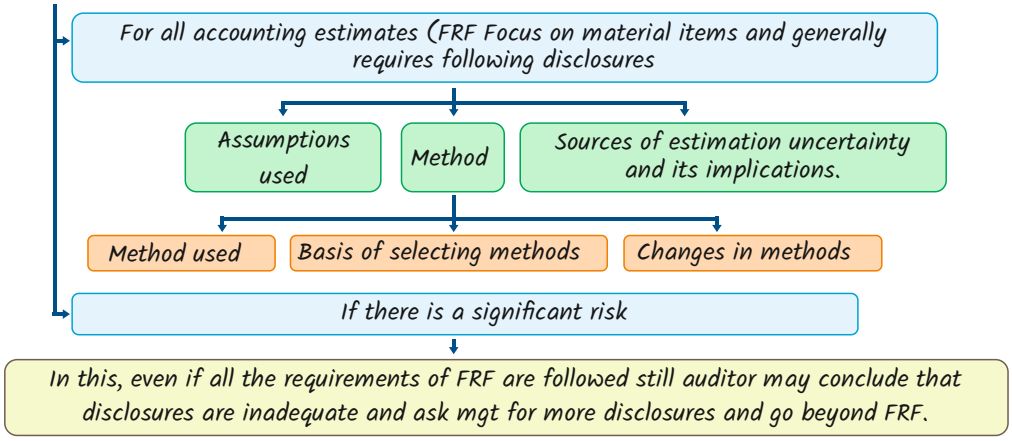
In responding to the assessed risks of material misstatement, as required by SA 330, the auditor shall **undertake one or more of the following, taking account of the nature of the accounting estimate:**

- **Test the operating effectiveness of the controls** over how management made the accounting estimate, together with appropriate substantive procedures.
- Test how **management made the accounting estimate and the data on which it is based.** In doing so, the auditor shall evaluate whether:
  - The **method of measurement used** is appropriate in the circumstances; and
  - The **assumptions used by management** are reasonable in light of the measurement objectives of the applicable financial reporting framework.
- Develop a **point estimate or a range to evaluate management's point estimate.** For this purpose:
  - When the auditor **uses assumptions or methods that differ from management's,** the auditor shall obtain an understanding of management's assumptions or methods sufficient to establish that the auditor's point estimate or range takes into account relevant variables and to evaluate any significant differences from management's point estimate.
  - When the auditor concludes that it is appropriate to use a range, **the auditor shall narrow the range, based on audit evidence available, until all outcomes within the range are considered reasonable.**
- Determine whether **events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate.**

(CNO-SAS40.140) STEP 4:- DISCLOSURES RELATED TO ACCOUNTING ESTIMATES

Chart





If no significant risk -- S&A evidence whether as per FRF

The auditor shall obtain sufficient appropriate audit evidence about whether the disclosures in the financial statements related to accounting estimates are in accordance with the requirements of the applicable financial reporting framework.

If significant risk additional requirement -- evaluate adequacy of disclosures

For accounting estimates that give rise to significant risks, the auditor shall also evaluate the adequacy of the disclosure of their estimation uncertainty in the financial statements in the context of the applicable financial reporting framework.

Disclosures in accordance with the Applicable Financial Reporting Framework (Further Explanation If No Significant Risk)

The presentation of financial statements in accordance with the applicable financial reporting framework includes **adequate disclosure of material matters.** The applicable financial reporting framework may permit, or prescribe, disclosures related to accounting estimates, and some entities may disclose voluntarily additional information in the notes to the financial statements. These disclosures may include, for example:

- The **assumptions** used.
- The **method of estimation** used, including any applicable model.
- The **basis for the selection** of the method of estimation.
- The effect of any **changes to the method of estimation** from the prior period.
- The **sources and implications** of estimation uncertainty.

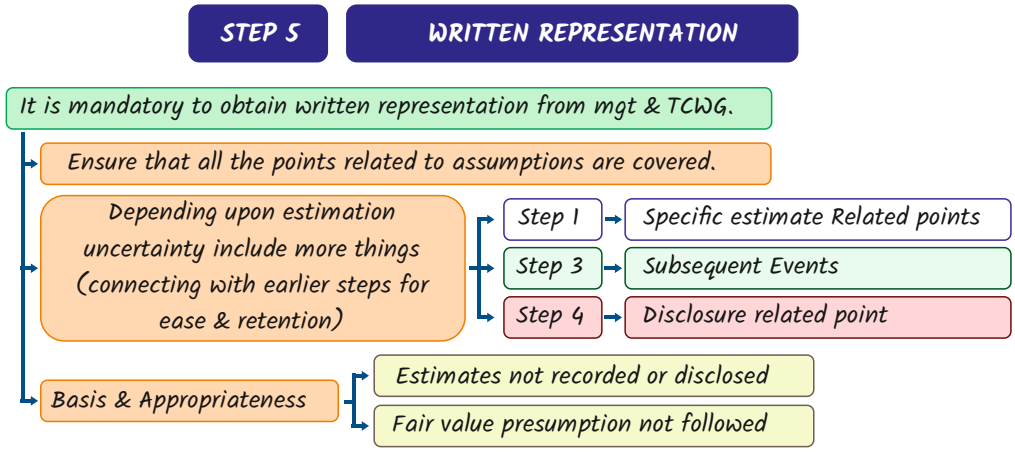
Such disclosures are relevant to users in understanding the accounting estimates recognized or disclosed in the financial statements, and sufficient appropriate audit evidence needs to be obtained about whether the disclosures are in accordance with the requirements of the applicable financial reporting framework.

Disclosures of Estimation Uncertainty for Accounting Estimates that give Rise to Significant Risks (Further Explanation If there is Significant Risk)

In relation to accounting estimates having significant risk, even where the disclosures are in accordance with the applicable financial reporting framework, the auditor may conclude that the disclosure of estimation uncertainty is inadequate in light of the circumstances and facts involved. The auditor's evaluation of the adequacy of disclosure of estimation uncertainty increases in importance the greater the range of possible outcomes of the accounting estimate is in relation to materiality.

(CNO-SAS40.160) STEP 5:- WRITTEN REPRESENTATIONS (QNO-81.100)

Chart

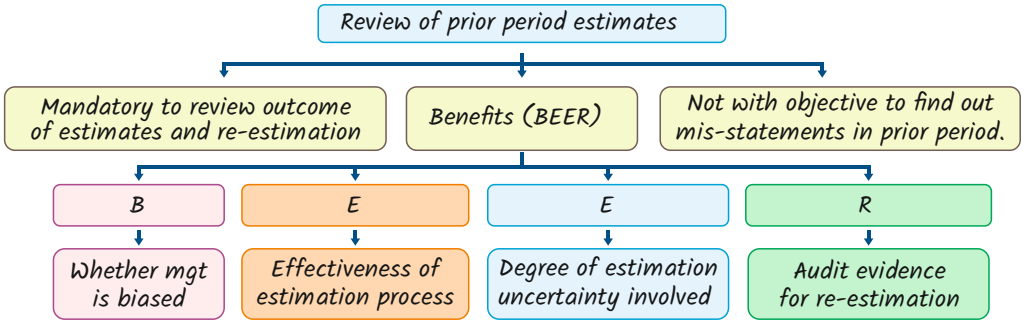


Mandatory

The auditor shall obtain **written representations from management and, where appropriate, those charged with governance** whether they believe **significant assumptions** used in making accounting estimates are reasonable.

(CNO-SAS40.170) REVIEW OF PRIOR PERIOD ESTIMATES (QNO 81.200)

Chart



Discussion

- ***Mandatory to review outcome of prior period estimates***

  As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor **shall review the outcome of accounting estimates** included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. **The nature and extent of the auditor's review** takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.

- ***Benefits of Reviewing outcome of Prior Period Estimates***

  The outcome of an accounting estimate will often differ from the accounting estimate recognised in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:

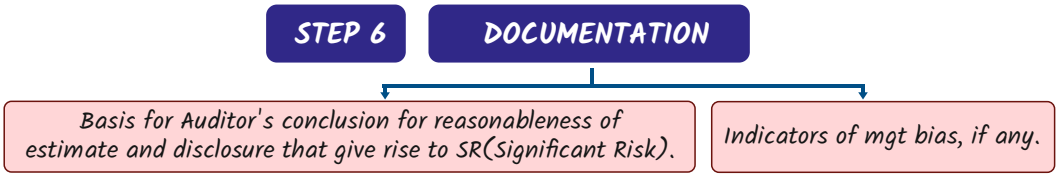
  - Information regarding the **effectiveness of management's prior period estimation process,** from which the auditor can judge the likely effectiveness of management's current process.
  - **Audit evidence that is pertinent to the re-estimation,** in the current period, of prior period accounting estimates.
  - **Audit evidence of matters, such as estimation uncertainty,** that may be required to be disclosed in the financial statements.
  - The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or **indicate the presence of, possible management bias.** The auditor's professional scepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures.

- ***Not Intended to question or doubt prior period estimates***

  However, the review is ***not intended to call into question the judgments made in the prior periods that were based on information available at that time.***

(CNO-SAS40.180) DOCUMENTATION

Chart



The audit documentation shall include:

- *The basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risks; and*
- *Indicators of possible management bias, if any.*

(CNO-SAS40.200) MANAGEMENT BIAS

Discussion

Background & meaning

- *Financial reporting frameworks often call for neutrality, that is, freedom from bias. Accounting estimates are imprecise, however, and can be influenced by management judgment. Such judgment may involve unintentional or intentional management bias (for example, as a result of motivation to achieve a desired result).*

Subjectivity

- *The susceptibility of an accounting estimate to management bias increases with the subjectivity involved in making it.*
- *Unintentional management bias and the potential for intentional management bias are inherent in subjective decisions that are often required in making an accounting estimate. For continuing audits, indicators of possible management bias identified during the audit of the preceding periods influence the planning and risk identification and assessment activities of the auditor in the current period.*

Account level

- *Management bias can be difficult to detect at an account level.*
  - *It may only be identified when considered in the aggregate of groups of accounting estimates or*
  - *all accounting estimates, or*
  - *when observed over a number of accounting periods.*

Intention to mislead

- *Although some form of management bias is inherent in subjective decisions, in making such judgments, there may be no intention by management to mislead the users of financial statements.*
- *Where, however, there is intention to mislead, management bias is fraudulent in nature.*

Unique question

QNO 81.020	*Obtaining Understanding of Assumptions Used for Determining Estimates*

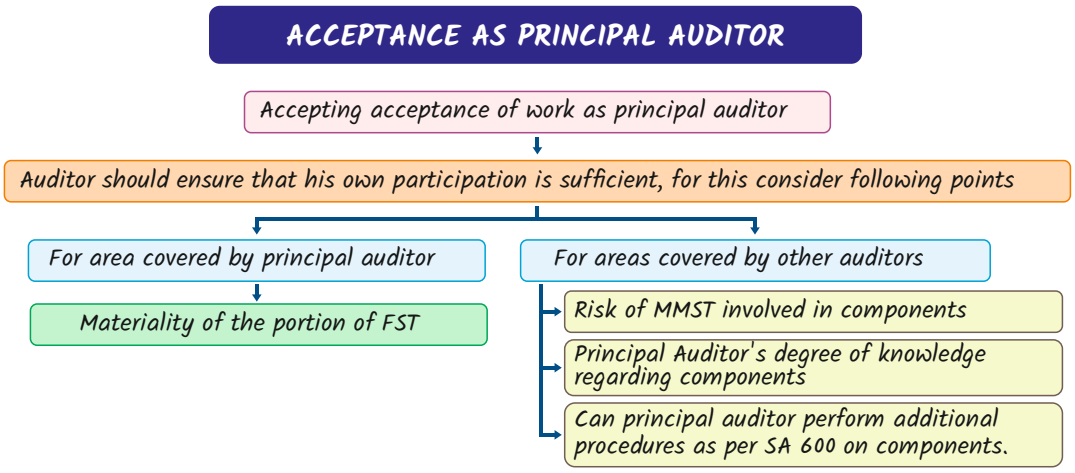
Unique MCQ

MCQ No.	*540.1*

Part 3 - [SA 600] USING THE WORK OF ANOTHER AUDITOR

(CNO-SA600.020) ACCEPTANCE AS PRINCIPAL AUDITOR (QNO-100.400)

Chart

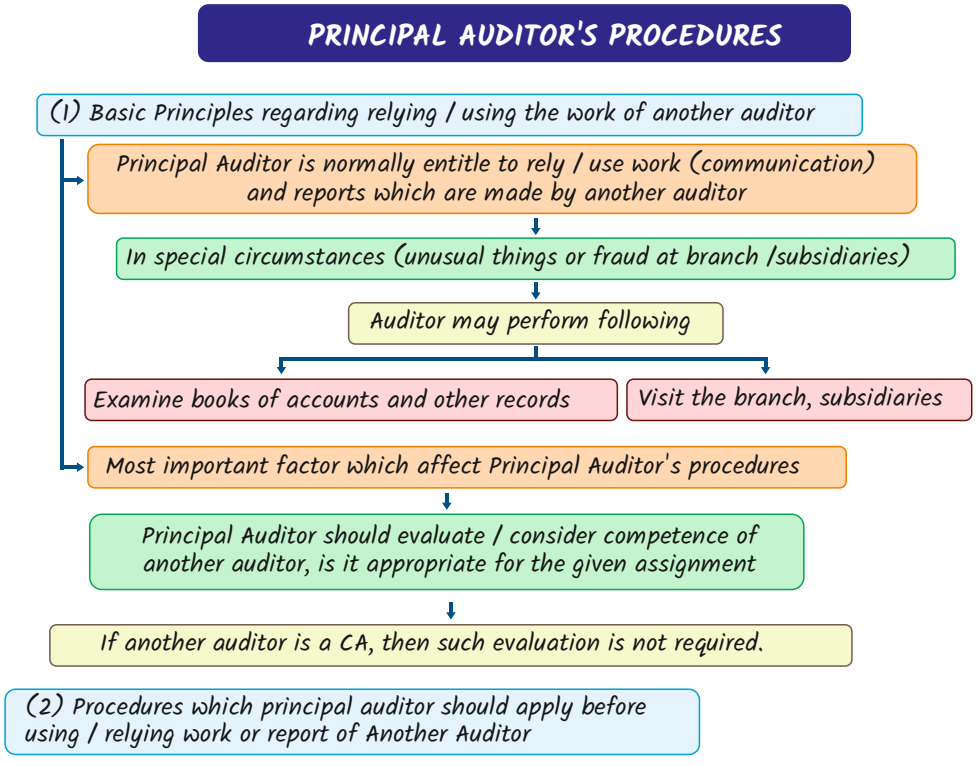


The auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor. For this purpose, the auditor would consider:

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

(CNO-SA600.040) THE PRINCIPAL AUDITOR'S PROCEDURES (QNO- 100.500 / 103.050) (MCQ-600.1 / 600.2)

Chart



- Principle → Principal Auditor is supposed to collect SAAE that work or report of another auditor is adequate and he can rely on them
- Main Procedures → Generally Principal Auditor is suppose to perform following things
  - Inform another auditor what work or report principal auditor is planning to rely / use and make sufficient arrangement among themself for co-ordination at planning stage
  - Inform — Shortcut - SIT
    - Special consideration to be applied by another auditor Eg. treatment of interest during moratorium period given in COVID
    - Procedures which another auditor should perform to ensure Intercomponent transactions (RPT between holding & subsidiaries)
    - Time Table for completion of audit
  - Obtain representation, inform another auditor regarding significant reporting requirements like CARO, Tax Audit Report etc. and obtain representation as to compliance with them.
- Additional procedures that may be applied
  - Might discuss audit procedures applied
  - Review written summary of another auditor's procedures & findings
  - Review findings of completed questionnaire or checklist
  - Visit another auditor
  - Application of above procedures will depend on circumstances of engagement and professional competence of other auditor
  - Principal auditor may not apply all this additional procedures, if he thinks he has SAAE that other auditor has good quality control procedures & policy for conducting their work.

(3) Significant Findings

- Principal auditor should consider significant findings of other auditor
- Principal auditor may perform following things for findings
  - Discuss with other auditor and management of component regarding audit findings
  - Decide supplemental test of records, FST to be performed
  - These tests can be performed either by principal or other auditor

(4) Importance of above procedure in particular circumstances

- If another auditor is not professionally qualified which may happen in case of foreign branches, importance of all the above procedures increases drastically

(5) Documentation

- List of components audited by another auditor's
- Significance of each of these components like there total T/O, Profits, Assets.
- Who performed their audit
- Conclusions and nature of reports received from another auditor
- Audit procedures applied by principal auditor before relying / using the work or reports
- If report from another auditor is modified then how principal auditor dealt with such things while framing his own report.

- *In certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.*

- ***When planning to use the work of another auditor, the principal auditor should consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a member of the Institute of Chartered Accountants of India.***

- ***The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment.*** *When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:*
  - *advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for coordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of intercomponent transactions that may require disclosure and the time-table for completion of audit; and*
  - *advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.*

- *The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.*

- *The principal auditor may conclude that it is not necessary to apply procedures such as those described in paragraph 13 because sufficient appropriate audit evidence previously obtained that acceptable quality control policies and procedures are complied with in the conduct of other auditor's practice.*

- ***The principal auditor should consider the significant findings of the other auditor.***

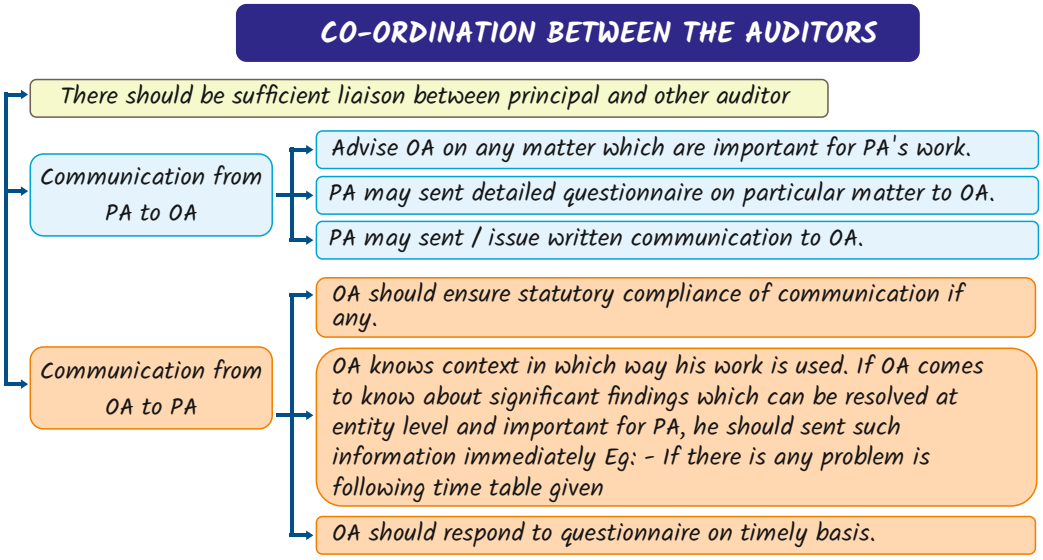
- *The principal auditor may consider it appropriate to discuss with the other auditor and the management of the component, the audit findings or other matters affecting the financial information of the components. He may also decide that supplemental tests of the records or the financial statements of the component are necessary. Such tests may, depending upon the circumstances, be performed by the principal auditor or the other auditor.*

- *In certain circumstances, the other auditor may happen to be a person other than a professionally qualified auditor. This may happen, for instance, where a component is situated in a foreign country and the applicable laws permit a person other than a professionally qualified auditor to audit the financial statements of such component. In such circumstances, the procedures outlined in paragraphs 10 to 16 assume added importance.*

- The principal auditor should document in his working papers the components whose financial information was audited by other auditors; their significance to the financial information of the entity as a whole; the names of the other auditors; and any conclusions reached that individual components are not material. The principal auditor should also document the procedures performed and the conclusions reached. For example, the auditor would document the results of discussions with the other auditor and review of the written summary of the other auditor's procedures. However, the principal auditor need not document the reasons for limiting the procedures in the circumstances described at 14 above, provided those reasons are summarised elsewhere in the documentation maintained by the principal auditor. Where the other auditor's report is other than unmodified3 , the principal auditor should also document how he has dealt with the qualifications or adverse remarks contained in the other auditor's report in framing his own report.

(CNO-SA600.080) CO-ORDINATION BETWEEN AUDITORS (QNO-101.000)

Chart



Sufficient Liaison / May issue written communi-cation to other auditors

There should be **sufficient liaison** between the principal auditor and the other auditor. For this purpose, the principal auditor may find it necessary to **issue written communication(s)** to the other auditor. (P⟶B) (P⟵B)

Advise to other auditors

The principal auditor **should advise the other auditor of any matters** that come to his attention that he thinks may have an important bearing on the other auditor's work. (P⟶B)

Significant findings from other auditors

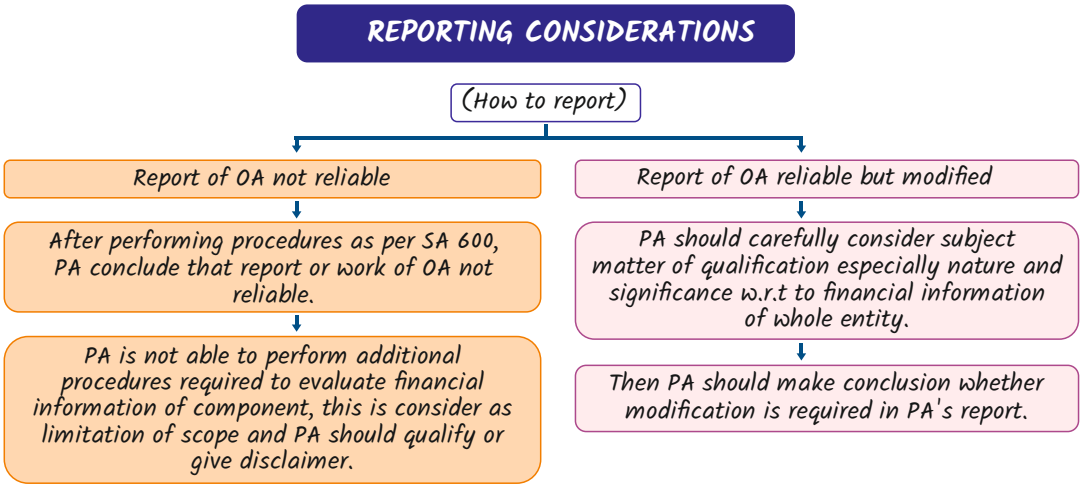
The other auditor, knowing the context in which his work is to be used by the principal auditor, should co-ordinate with the principal auditor. For example, by **bringing to the principal auditor's immediate attention any significant findings** requiring to be dealt with at entity level, adhering to the time-table for audit of the component, etc. He should ensure compliance with the relevant statutory requirements. (P ⟵ B)

Questionnaire if required

When considered necessary by him, the principal auditor may require the other auditor to **answer a detailed questionnaire** regarding matters on which the principal auditor requires information for discharging his duties. **The other auditor should respond to such questionnaire on a timely basis. (P⟶B) (P⟵B)**

(CNO-SA600.100) REPORTING CONSIDERATIONS (QNO-101.000)

Chart



Summary

Work of other auditor cannot be used & PA not able to perform additional procedures then give -- Qualified or Disclaimer

Detailed Text

When the principal auditor concludes, based on his procedures, that the ***work of the other auditor cannot be used, and the principal auditor has not been able to perform sufficient additional procedures*** regarding the financial information of the component audited by the other auditor, the principal auditor ***should express a qualified opinion or disclaimer of opinion*** because there is a limitation on the scope of audit.

Summary

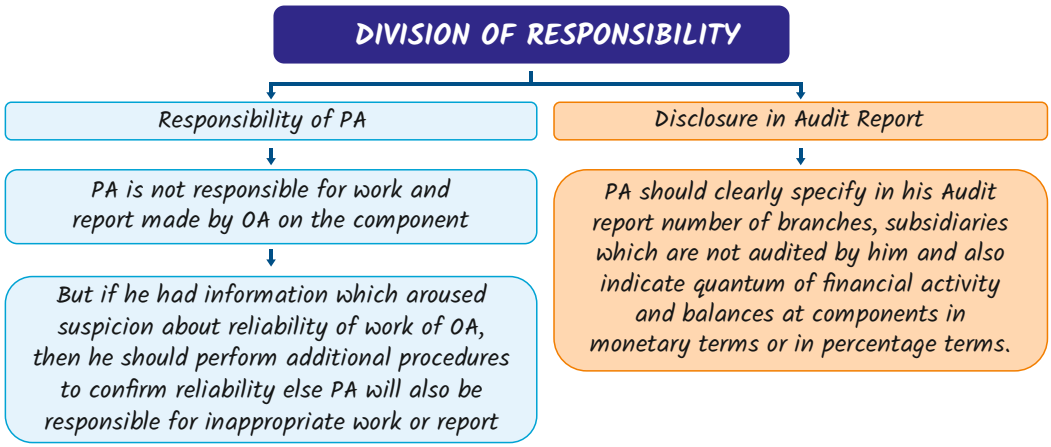
Work of other auditor can be used & his report is modified – subject of modification significant then modify PA's report

Detailed Text

In all circumstances, if the other auditor issues, or intends to issue, a modified auditor's report, the principal auditor should consider whether the ***subject of the modification is of such nature and significance,*** in relation to the financial information of the entity on which the principal auditor is reporting that it ***requires a modification of the principal auditor's report.***

(CNO-SA600.120) DIVISION OF RESPONSIBILITY

Chart



Summary

PA not responsible for work of other auditor unless he has suspicion about reliability of work of OA

Detailed Text

The principal auditor ***would not be responsible*** in respect of the work entrusted to the other auditors, ***except in circumstances*** which should have aroused his ***suspicion about the reliability of the work*** performed by the other auditors.

Summary

PA's report should state clearly division of responsibility, indicating extent of financial information of components

Detailed Text

When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, **his report should state clearly the division of responsibility** for the financial information of the entity by **indicating the extent to which the financial information of components** audited by the other auditors have been included in the financial information of the entity,

E.g.., the number of divisions/ branches/ subsidiaries or other components audited by other auditors.

Summary

Auditor can delegate work but cannot delegate responsibility but in case of other auditor he won't be responsible if exercises adequate skill and care and is not aware of any reason to believe he should not be relied

Detailed Text

"When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his

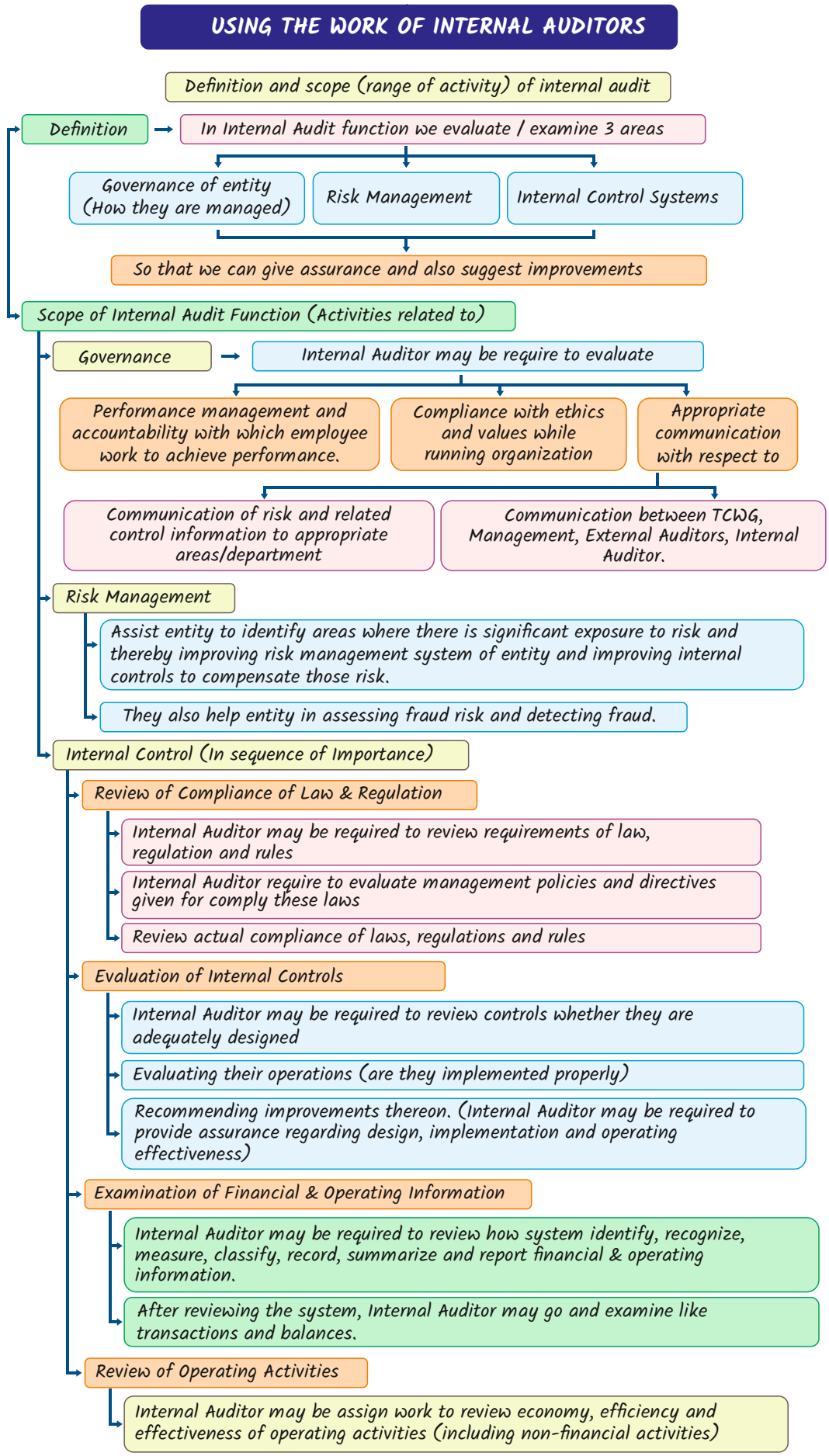
UNIQUE QUESTIONS	
QNO 103.000	Branch Audit (Without Visiting) Visiting)

UNIQUE MCQ's	
MCQ No.	600.3

Part 4 - [SA 610] USING THE WORK OF INTERNAL AUDITORS

(CNO-SA610.020) SCOPE AND OBJECTIVES OF THE INTERNAL AUDIT FUNCTION

Chart



Definition

*Internal audit function – A function of an entity that performs **Assurance and Consulting** activities designed to evaluate and improve the effectiveness of the entity's **governance, risk management and internal control processes.***

Objective & Scope

The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the following:

- ***Activities Relating to Governance***
  The internal audit function may assess the governance process in its accomplishment of objectives on 1ethics and values, 2performance management and accountability, 3communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

- ***Activities Relating to Risk Management***
  The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process).

  The internal audit function may perform procedures to assist the entity in the detection of fraud.

- ***Activities Relating to Internal Control***
  1. ***Review of operating activities.*** *The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including nonfinancial activities of an entity.*
  2. ***Evaluation of internal control*** *the internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit.*
  3. ***Review of compliance with laws and regulations.*** *The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.*
  4. ***Examination of financial and operating information.*** *The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.*

(CNO—SA610.030) INTERNAL AUDITOR & EXTERNAL AUDITOR

Chart

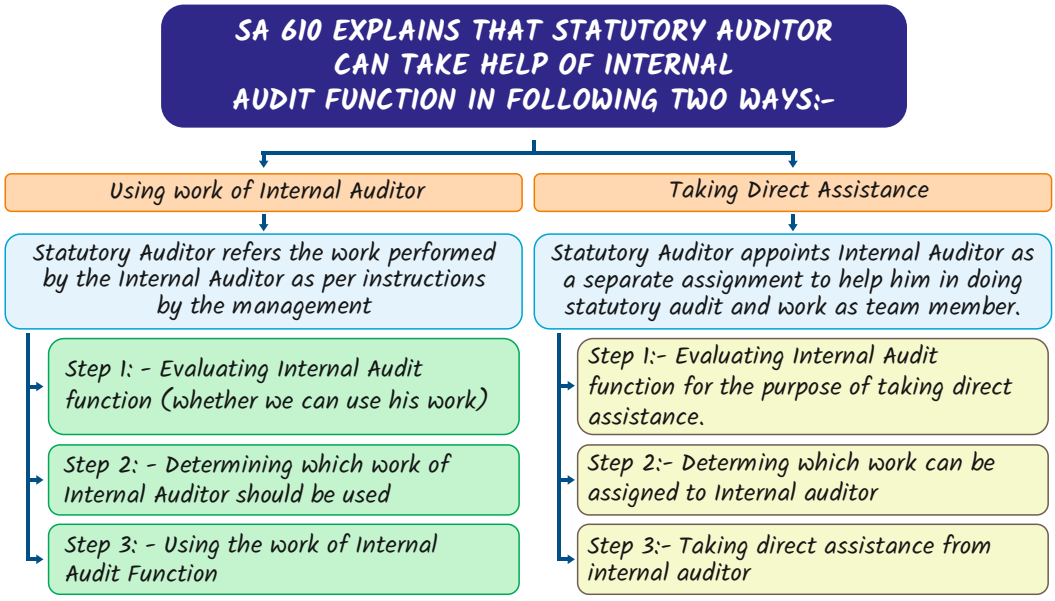
INTERNAL AUDIT AND EXTERNAL AUDIT

Particulars	Internal Audit	External Audit
Definition	In I.A. we evaluate 3 areas: - Governance of entity risk management, Internal control system so that we can give assurance and also suggest improvements	Systematic independent examination of financial records with ultimate objective to give opinion on FST whether they gave True & Fair view or not

Applicability	It is voluntary compulsory to some companies u/s 138	It is compulsory to companies, bank, insurance company, trust etc.
Auditor	CA, CWA such other professionals may or may not be in practice, may be employees	Qualifications and dis-qualifications are given in Companies Act Only CA in practice can do audit
Appointment	By Audit committee or BOD as the case may be	Generally by shareholders
Orientation	Management oriented	Oriented to the needs of users of FST and management
Scope of Work	As determined between management and internal auditor	Depends on law / SA's / terms of engagements
Format of Audit Report	No format prescribed guidelines given in SIA 4	Proper format is given to SA 700
Submission of Report	To the management	To the shareholders

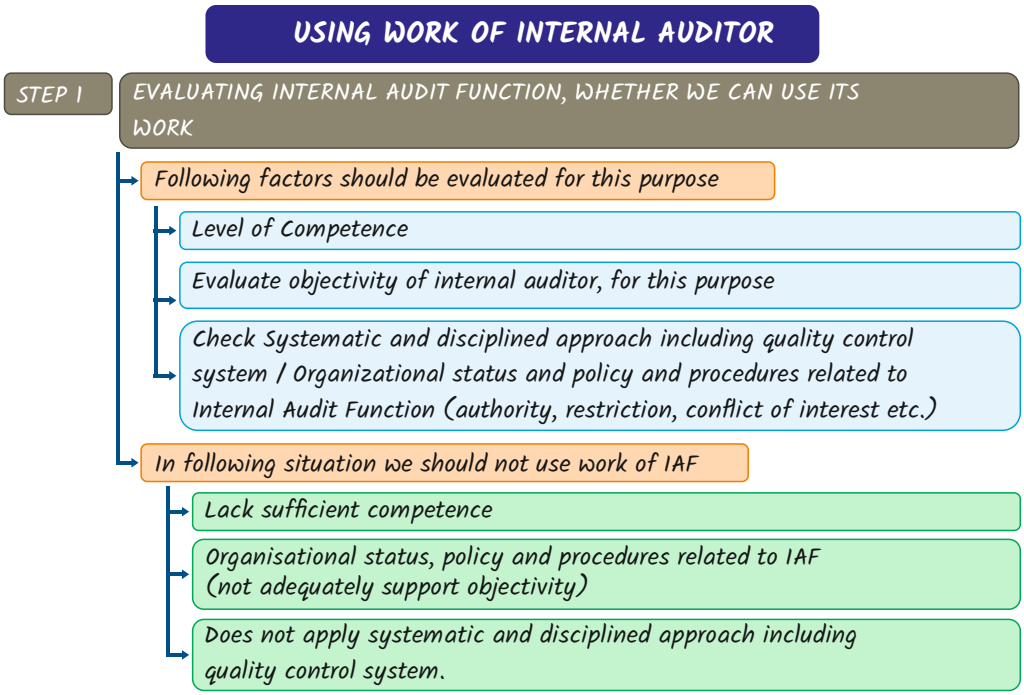
(CNO-SA610.040) 2 WAYS TO USE THE WORK OF INTERNAL AUDITOR

Chart



(CNO-SA610.060) USING WORK OF INTERNAL AUDITOR (QNO 103.100, 103.250)

Chart



STEP-1 -- Evaluating the Internal Audit Function (QNO-103.250) (MCQ – Incs.16.1 / Incs.36.1/ Incs.52.5)

Summary

Statutory auditor shall determine can he rely on Internal Auditor. It depends on following: - Level of Competence / Objectivity of Internal Auditor / Systematic & Disciplined Approach If any of above factor is not fulfilled, then he should not rely on internal auditor.

Detailed Text

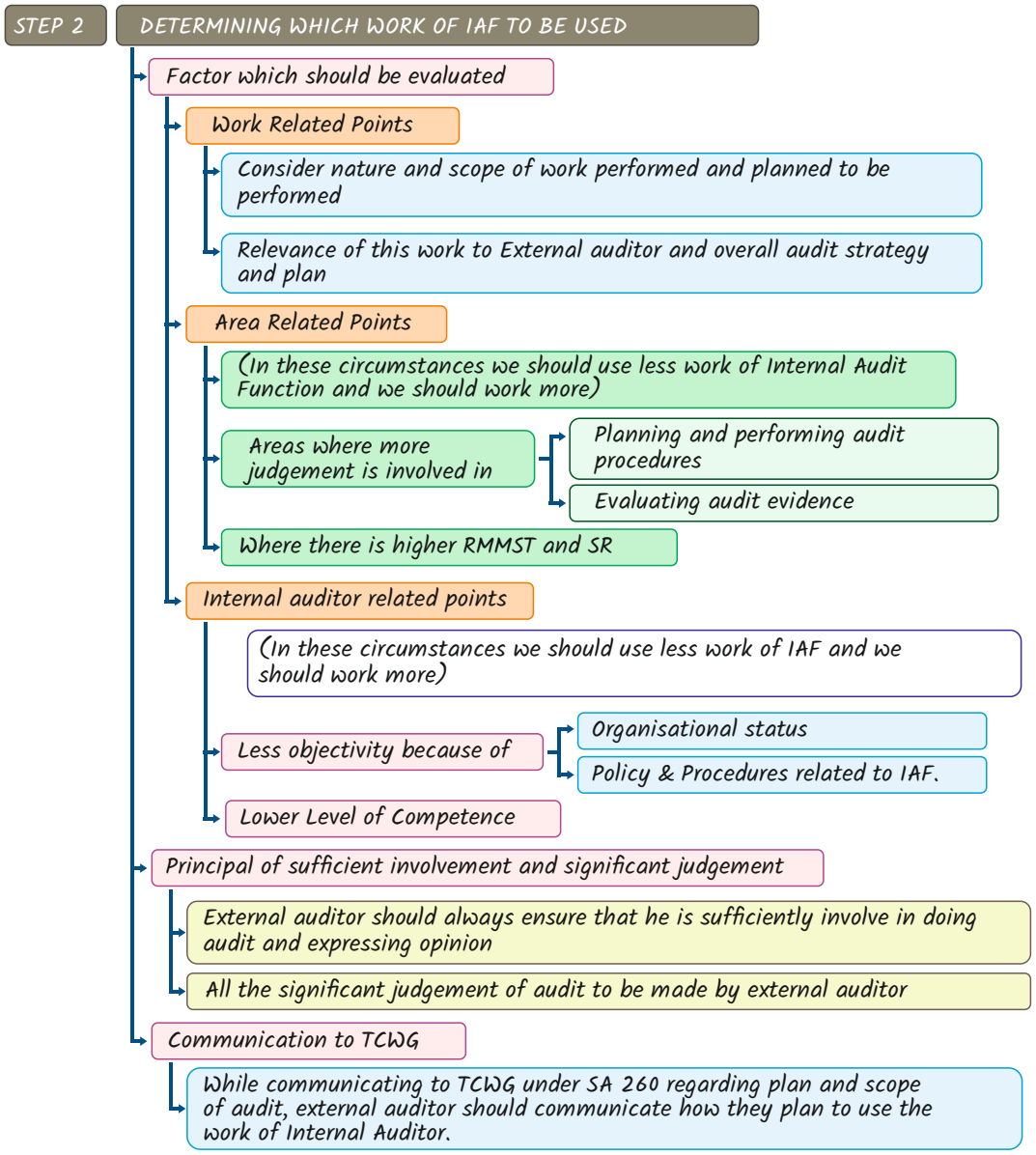
The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following:

- The extent to which the internal audit function's **organizational status and relevant policies and procedures support the objectivity** of the internal auditors;
- The **level of competence** of the internal audit function; and
- Whether the internal audit function applies a systematic and disciplined approach, including quality control.

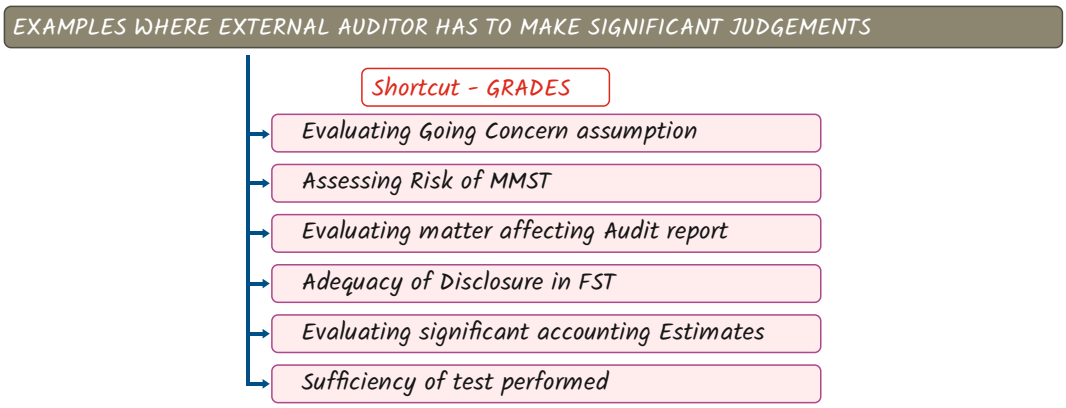
The external auditor **shall not use the work of the internal audit function** if the external auditor determines that:

- The function's organizational status and relevant policies and **procedures do not adequately support the objectivity** of internal auditors;
- The function **lacks sufficient competence;** or
- The function **does not apply a systematic and disciplined approach,** including quality control.

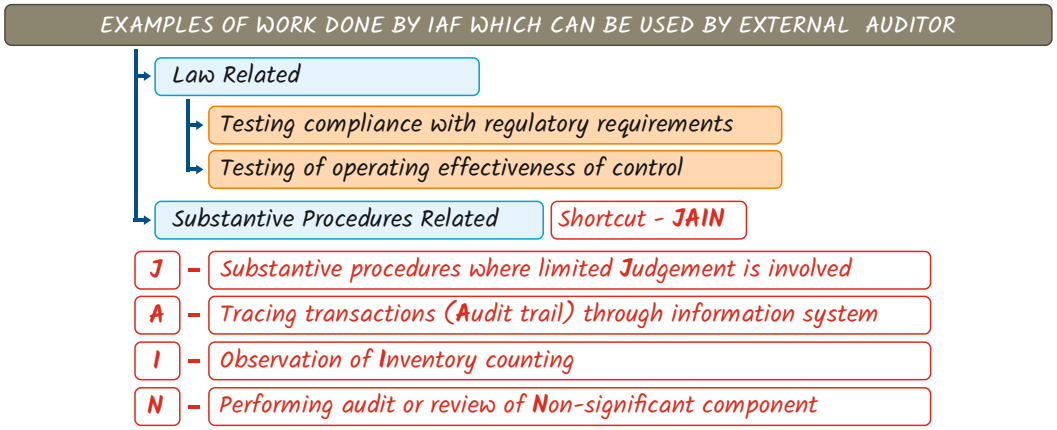
Chart



Chart



Chart



STEP-2 Determining the Nature and Extent of Work of the Internal Audit Function that Can Be Used

Summary

Consider work of internal auditor & its relevance / Examples of work which can be used: -

Ist two points as per flow of audit process Testing Controls, Then Substantive Procedures, Next 3 points are as per relative importance -- Testing Compliance, Tracing transactions to financial reporting & reviewing financial information of subsidiaries which are not significant, Observing Inventory Count

Detailed Text

As a basis for determining the areas and the extent to which the work of the internal audit function can be used, the external auditor shall ***consider the nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and audit plan.***

Examples of work of the internal audit function that can be used by the external auditor include the following:

- Testing of the operating effectiveness of controls.
- Substantive procedures involving limited judgment.
- Testing of compliance with regulatory requirements.
- Tracing transactions through the information system relevant to financial reporting. In some circumstances, audits or reviews of the financial information of subsidiaries that are not significant components to the group (where this does not conflict with the requirements of SA 600)
- Observations of inventory counts.

Summary

Significant Judgments by External Auditor only / Use less of internal auditor work and more of work directly himself where: - More judgment is involved, higher RMM, Lower objectivity, Lower competence

Detailed Text

The external auditor ***shall make all significant judgments*** in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly:

- The more **judgment** is involved in:
  - Planning and performing relevant audit procedures; and
  - Evaluating the audit evidence gathered;
- The higher the **assessed risk of material misstatement** at the assertion level, with special consideration given to risks identified as significant;
- The **less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity** of the internal auditors; and
- The **lower the level of competence** of the internal audit function.

Summary

In aggregate external auditor should be sufficiently involved / Communicate to TCWG planned use of work on internal auditor

Detailed Text

The external auditor shall also evaluate whether, in aggregate, using the work of the internal audit function to the extent planned would still result in the external auditor being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed.

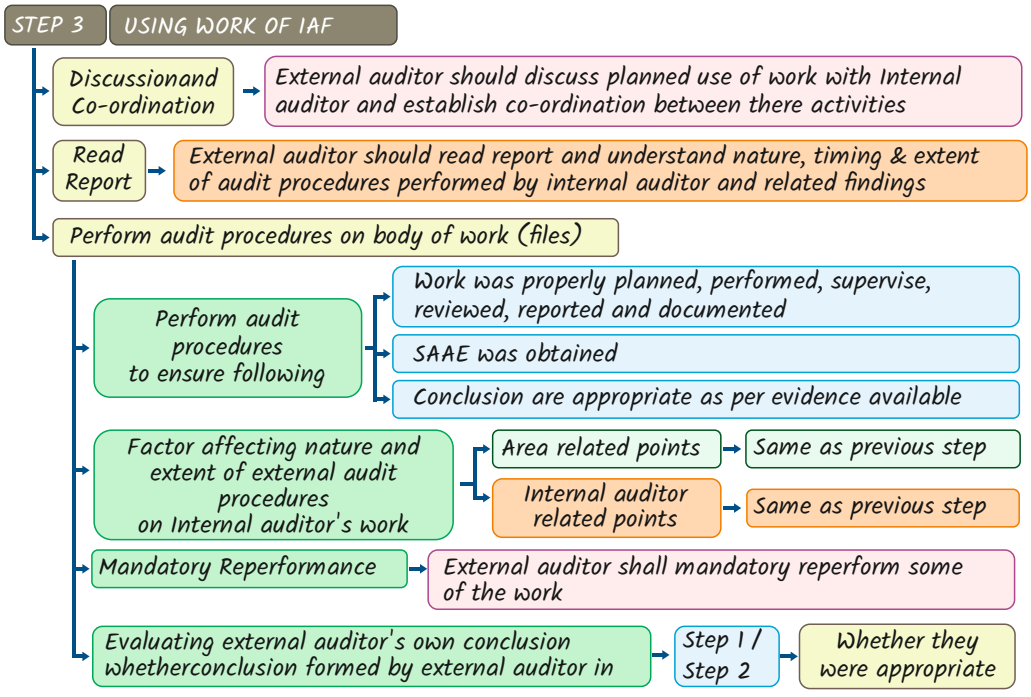
The external auditor shall, in communicating with those charged with governance an overview of the planned scope and timing of the audit in accordance with SA 260, communicate how the external auditor has planned to use the work of the internal audit function.

Significant Judgment is required while giving GRADES

Significant judgments include the following:

- Evaluating the appropriateness of management's use of the **G**oing concern assumption;
- Assessing the **R**isks of material misstatement;
- Evaluating matters affecting the **A**uditor's report.
- Evaluating the adequacy of **D**isclosures in the financial statements, and
- Evaluating significant accounting **E**stimates; and
- Evaluating the **S**ufficiency of tests performed;

Chart



STEP 3- Using the Work of the Internal Audit Function (QNO-103.100)

Summary

- *Discuss planned use & Co-ordinate Activities*
  - *(Auditor will not check salary till 30th May, he will check on Ist June)*
- *Read report to understand NTE and related findings*
  - *(Ist Week Test of Controls, 2nd Week Substantive Testing 3rd Week rectifications & reporting)*
- *Perform Audit Procedures on body of work of Internal Auditor to evaluate whether work is planned / performed / supervised / reviewed / documented / S&A Evidence to draw conclusions / conclusions drawn are consistent with evidence obtained.*
  - *(Read detailed plan, check sign of performer & reviewer, analyse misstatements and conclusion)*
- *His own audit procedures should be responsive depending on factors discussed earlier Judgment / RMM / (Competence / Objectivity / Work Performed by IA) and should always include reperformance of some work.*

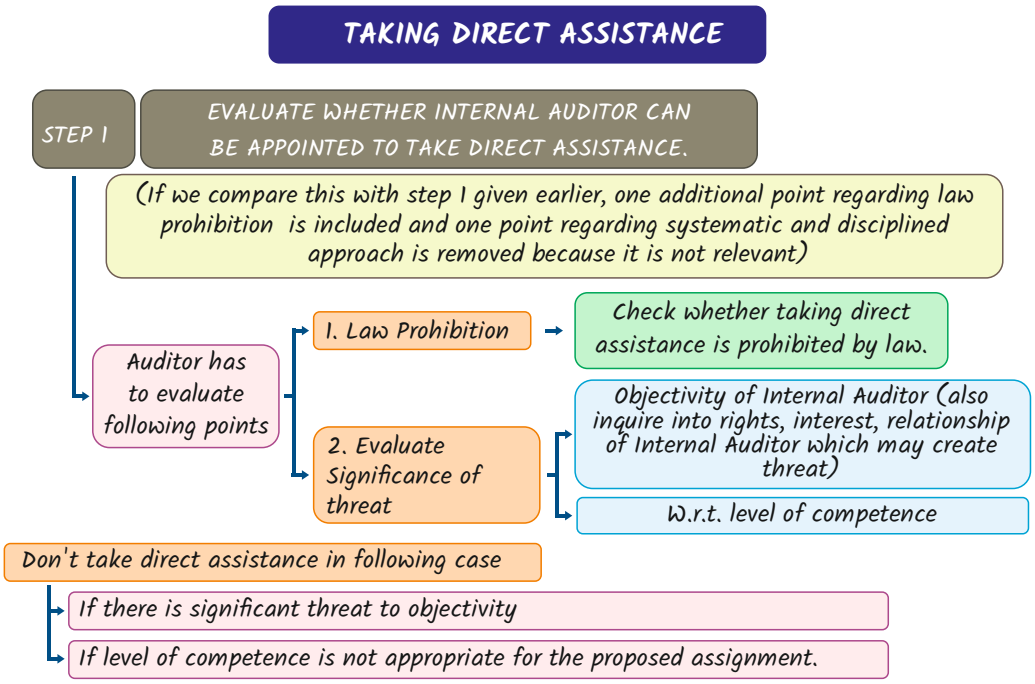
  Evaluate whether his own conclusions regarding internal audit function and its uses remain appropriate as per SAs

Detailed Text

- If the external auditor plans to use the work of the internal audit function, the external auditor shall **discuss the planned use of its work with the function as a basis for coordinating their respective activities.**
- The external auditor **shall read the reports of the internal audit** function relating to the work of the function that the external auditor plans to use to obtain an **understanding of the nature and extent of audit procedures it performed and the related findings.**
- The external auditor shall **perform sufficient audit procedures on the body of work** of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit, including evaluating whether:
  - The work of the function had been **properly planned, performed, supervised, reviewed and documented;**
  - **Sufficient appropriate evidence** had been obtained to enable the function to draw reasonable conclusions; and
  - **Conclusions reached are appropriate** in the circumstances and the reports prepared by the function are consistent with the results of the work performed.
- The nature and extent of the external auditor's audit procedures shall be responsive to the external auditor's evaluation of:
  - The amount of **judgment** involved;
  - The assessed **risk of material misstatement;**
  - The extent to which the internal audit function's **organizational status and relevant policies and procedures support the objectivity** of the internal auditors; and
  - The **level of competence** of the function; and shall include reperformance of some of the work.
- The external auditor shall also evaluate whether the **external auditor's conclusions** regarding the evaluation of internal audit function as per this SA and the determination of the nature and extent of use of the work of the function for purposes of the audit as per this SA remain appropriate.

(CNO-SA610.080) DIRECT ASSISTANCE (QNO 103.300) (MCQ- Incs.41.3/ Incs.46.3/Incs53.2)

Chart



Definition

Direct assistance – The use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

STEP 1: - Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance for Purposes of the Audit (QNO-103.400)

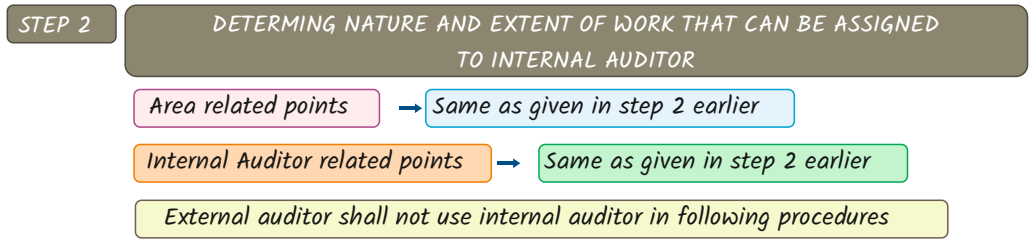
Summary

Statutory auditor can take direct assistance depending on following: - It should not be prohibited by law / Significant threats to Level of Competence / Significant threats to Objectivity of Internal Auditor. If any of above factor is not fulfilled, then he should not rely on internal auditor. Consider whether prohibition extends to component auditor and if yes, communicate to them.

Detailed Text

- The external auditor may be **prohibited by law or regulation** from obtaining direct assistance from internal auditors. If so, then **no need to check other factors**
- If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the existence and significance of **threats to objectivity and the level of competence** of the internal auditors who will be providing such assistance.
- The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall include inquiry of the internal auditors regarding **interests and relationships that may create a threat to their objectivity.**
- The external auditor shall not use an internal auditor to provide direct assistance if:
  - There are significant threats to the objectivity of the internal auditor; or
  - The internal auditor lacks sufficient competence to perform the proposed work.
- In case where the external auditor is prohibited by law or regulation from using internal auditors to provide direct assistance, it is relevant for the principal auditors to consider whether the prohibition also extends to component auditors and, if so, to address this in the communication to the component auditors.

Chart



If **JAR** is **Dirty**

- **J** – Making significant **J**udgement in Audits
- **A** – Work **A**lready done or will be done and reported to management / TCWG
- **R** – **R**elates to higher Risk of material mis-statement where judgement is required in performing audit procedures and evaluating audit evidence
- **D** – Relates to **D**ecisions external auditor makes in accordance with this SA regarding Internal audit function and use of its work and direct assistance.

Communication with TCWG

- Doing communication with SA 260, external auditor should communicate nature and extent of direct assistance which will be given by internal auditor and ensure that it should not be excessive

Principal of sufficient involvement

- External Auditor shall evaluate whether in aggregate he sufficiently involve in performing the audit and it is his sole responsibility to express his opinion.

STEP 2: - Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance (QNO-103.300/103.400) (MCQ No-610.2 / Incs.06.1 / Incs.41.4 / Incs146.4)

Summary

While determining nature & extent of work to be assigned and NTE of DSR consider following: - Judgment, RMM, Objectivity, Competence.

Shall not take direct assistance if it involves significant judgement, higher risk of material misstatement, where internal auditor is involved in the work, decision whether to take direct assistance from internal auditor.

Detailed Text

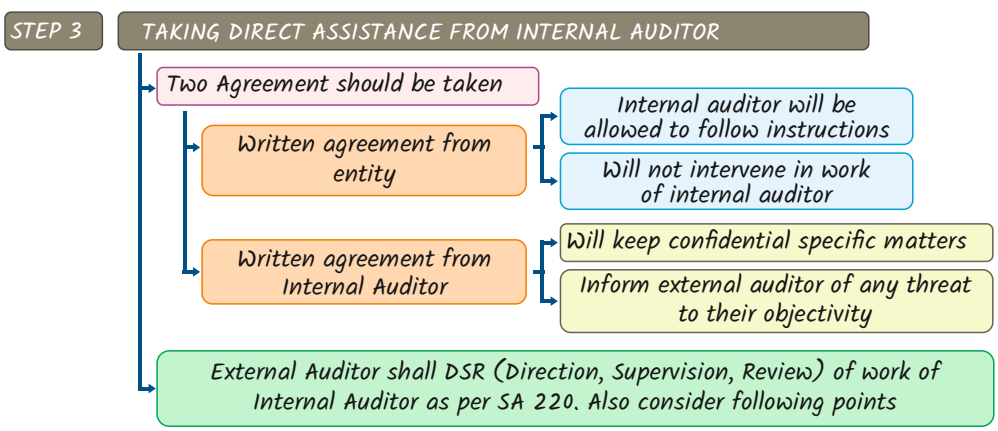
In determining the **nature and extent of work that may be assigned** to internal auditors and the **nature, timing and extent of direction, supervision and review** that is appropriate in the circumstances, the external auditor shall consider:

- The amount of **judgment involved** in:
  - **Planning and performing** relevant audit procedures; and
  - **Evaluating** the audit evidence gathered;
- The assessed **risk of material misstatement;** and
- The external auditor's evaluation of the existence and **significance of threats to the objectivity** and **level of competence** of the internal auditors who will be providing such assistance.

The external auditor **shall not use internal auditors to provide direct assistance** to perform procedures that:

- Involve making **significant judgments** in the audit;
- Relate to **higher assessed risks of material misstatement** where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
- Relate to work with which the **internal auditors have been involved** and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
- Relate to **decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.**

Chart



Chart

Shortcut – I²AS

- **I** – NTE of DSR shall be framed taking into consideration that internal auditor are not Independent and also consider area related and Internal auditor related points
- **I** – Indications → Also consider whether there are indications suggesting that internal audit function is not appropriate as per step 1
- **A** – Audit Evidence
  - External auditor shall check back work performed to underlying Audit evidence
  - External auditor shall evaluate whether Audit evidence is sufficient to draw conclusion from internal auditor work.
- **S** – DSR should be as per SA 220

STEP 3: - Using Internal Auditors to Provide Direct Assistance (MCQ-610.1)

Summary

- *Obtain written agreement from authorised representative of company that internal auditor will be allowed to follow external auditor's instruction & that entity will not intervene in his work*
- *Obtain written agreement from internal auditor that he will keep confidential specific matters as instructed by external auditor and they will inform any threat to objectivity*
- *External Auditor should direct / supervise and review work in internal auditor. He should keep in mind that internal auditor is not independent. It should be responsive of factors considered earlier.*
- *External auditor should check back to the underlying audit evidence for some of the work performed by the internal auditors.*

Detailed Text

- Prior to using internal auditors to provide direct assistance for purposes of the audit, **the external auditor shall:**
  - **Obtain written agreement** from an **authorized representative of the entity that the internal auditors** will be **allowed to follow the external auditor's instructions, and that the entity will not intervene** in the work the internal auditor performs for the external auditor; and
  - **Obtain written agreement** from **the internal auditors** that **they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.**
- The external auditor **shall direct, supervise and review the work performed by internal auditors** on the engagement in accordance with SA 220 In so doing:
  - The nature, timing and extent of direction, supervision, and review **shall recognize that the internal auditors are not independent** of the entity and **beresponsive to the outcome of the evaluation** of the factors in paragraph of this SA; and
  - The review procedures shall include the **external auditor checking back to the underlying audit evidence for some of the work performed by the internal auditors.**

(CNO-SA610.100) DIRECT ASSISTANCE FROM INTERNAL AUDITOR IN CASE OF EXTERNAL CONFIRMATION PROCEDURES

Chart

CAN DIRECT ASSISTANCE FROM INTERNAL AUDITOR IN CASE OF EXTERNAL CONFIRMATION PROCEDURES CAN BE TAKEN ?

↓

As per SA 610, in determing the nature of work that may be assigned to internal auditor, external auditor is careful to limit such work to those areas that would be appropriate to assigned.

↓

As per SA 505, External auditor is required to maintain control over external confirmation requests and evaluate the result of external confirmation procedures, it would not be appropriate to assign this to internal auditor.

↓

However, internal auditor may assist in assembling information necessary for external auditor to resolve exceptions in confirmation responses.

SA 610 "Using the Work of Internal Auditor" provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors. In determining the nature of work that may be assigned to internal auditors, the ***external auditor is careful to limit such work to those areas that would be appropriate to be assigned.***

Further, in accordance with SA 505, ***"External Confirmation" the external auditor is required to maintain control over external confirmation requests and evaluate the results of external confirmation procedures, it would not be appropriate to assign these responsibilities to internal auditors. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.***

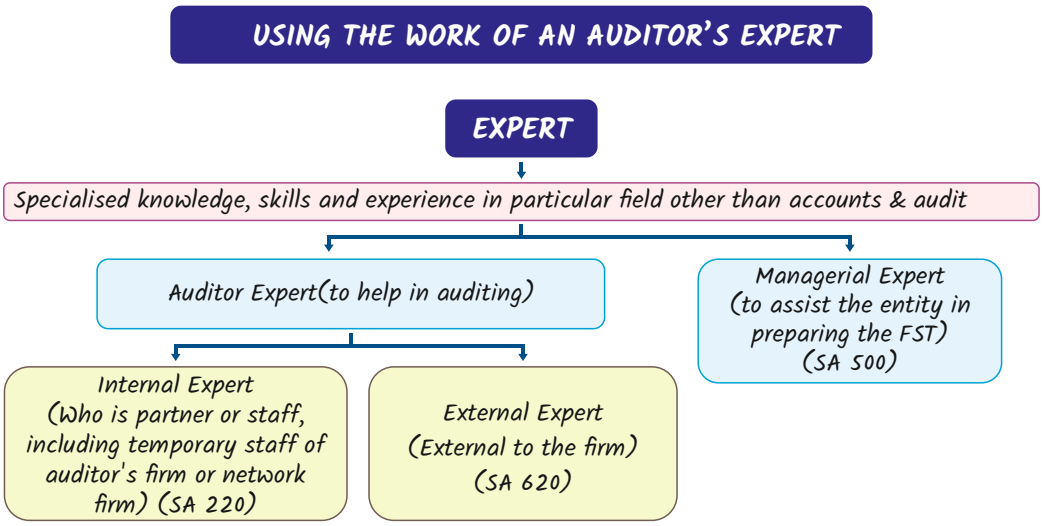
UNIQUE QUESTION

QNO 103.200 *Evaluation of Internal Audit Function (Special)*

Part 5 - [SA 620] USING THE WORK OF AN AUDITOR'S EXPERT

(CNO-SA620.020) EXPERTISE & EXPERTS (MCQ-620.2)

Chart



Expertise

Knowledge, Skills and experience in a particular field.

Auditor's expert

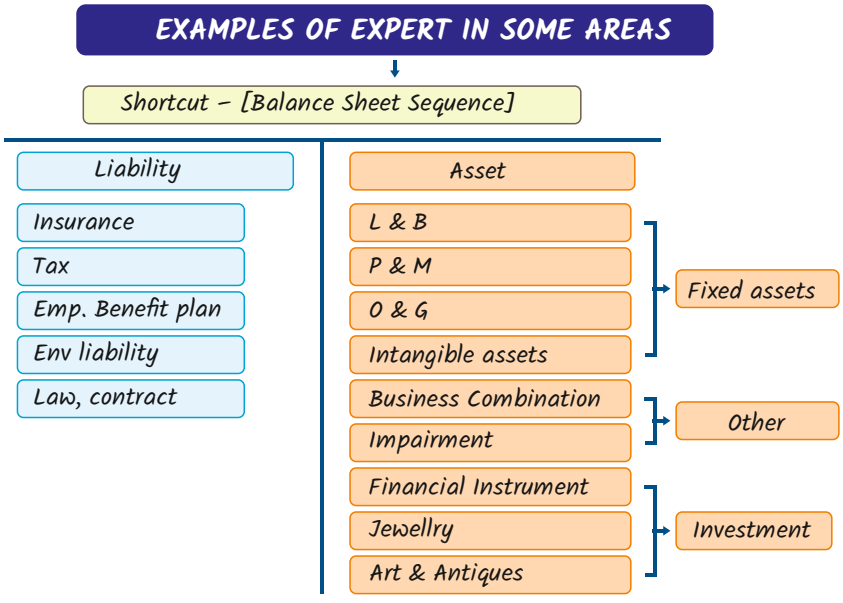
An individual or organisation possessing expertise in a field **other than accounting or auditing,** whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence.

An auditor's expert **may be either an auditor's internal expert (who is a partner or staff, including temporary staff, of the auditor's firm or a network firm), or an auditor's external expert.**

Management's expert

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

Chart



Some areas of expertise (QNO-104.000)

Expertise in a field other than accounting or auditing may include expertise in relation to such matters as:

- The valuation of complex **(I1)financial instruments,(F1)land and buildings,(F2)plant and machinery,(I2) jewellery,(I3)works of art, antiques,(F4)intangible assets,** assets acquired, and liabilities assumed in **(F5) business combinations** and assets that may have been **(F6)impaired.**
- The actuarial calculation of liabilities associated with **(L1) insurance contracts** or **(L2)employee benefit plans.**
- The estimation of **(F3)oil and gas reserves.**
- The valuation of **(L3)environmental liabilities, and site clean-up costs.**

- The interpretation of **(L4) contracts, laws and regulations.**
- The analysis of complex or unusual **(L5) tax compliance issues.**

(CNO-SA620.040) FACTOR AFFECTING NATURE, TIMING & EXTENT OF AUDITOR'S PROCEDURE

Chart

FACTORS AFFECTING NTE OF AUDIT PROCEDURES

1. Significance of expert work
   - Oil well valuation Rs. 8000 cr and total assets Rs. 10000 crore. It account for 80% of B/s
   - Whole work will be done by experts team Auditor is dependent on experts work in this significant matter.
4. Auditor's knowledge of and experience with expert
   - Auditor has work with the expert before, expert sometime works in haste and misses some important point so Auditor should be careful



2. Nature of the matter
   - Valuation depends on depth / width / density / viscosity / soil level of surface / drilling cost / oil burning
3. Risk of MMST
   - 400% change as compared to last year, there is no policy / system on how to value oil well.
5. Quality Control Policies
   - If it is a internal auditor's expert, then he is considered as member and QCPP (Quality control Policies & Procedures) is applicable but if he is external then he is not member therefore QCPP is not applicable, then auditor need to alert and do more evaluation, subject to aggrement

Shortcut:- **SNARQ**

Factor suggest need for different and more extensive procedures
(It is mere repetation of above points, explaining when to perform more procedures)

Significance of expert's work	Expert's work relates to significant matter Expert is performing procedures integral to audit expert is not just a consultant or advisor
Nature of matter	It involve subjectivity and complex judgement
Risk of MMST	Area is having high risk of MMST
Auditor's knowledge of and experience with expert	Auditor doesn't have any previous knowledge of expert's competence, capabilities, objectivity and no prior work experience
If expert is external expert	Such expert is not subject to firm's QCPP

The nature, timing and extent of the auditor's procedures will vary depending on the circumstances.
In determining the nature, timing and extent of those procedures, the auditor shall consider matters including:

(1) The **significance of that expert's** work in the context of the audit;
(2) The **nature of the matter** to which that expert's work relates;
(3) The **risks of material misstatement** in the matter to which that expert's work relates;
(4) The **auditor's knowledge of and experience** with previous work performed by that expert; and
(5) Whether that **expert is subject to the auditor's firm's quality control policies and procedures.**

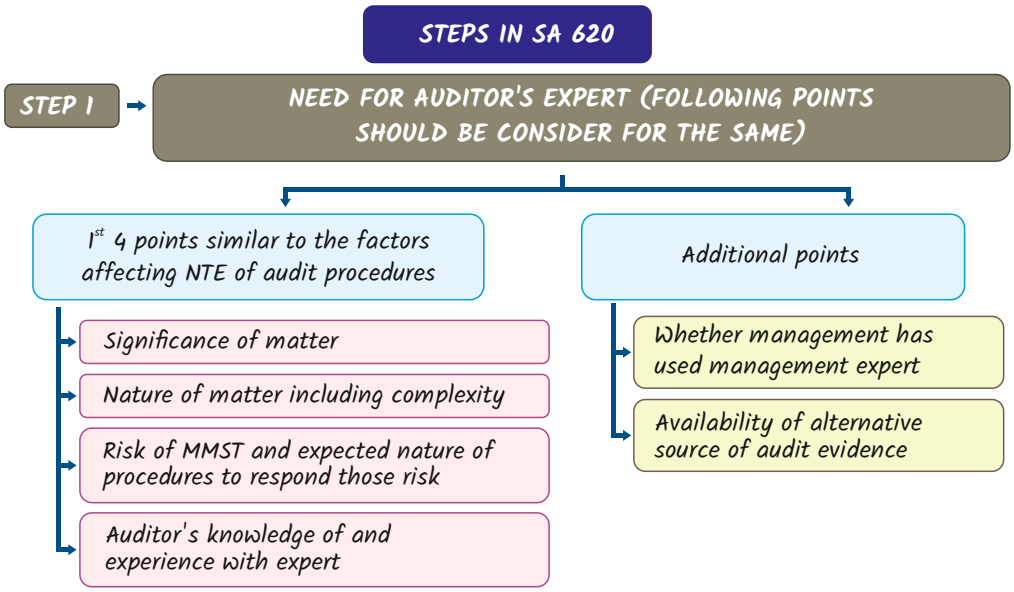
Further explanation (when to have more extensive procedures)

The following factors may suggest the need for different or more extensive procedures than would otherwise be the case:

- The auditor's **expert is performing procedures that are integral to the audit, rather than being consulted to provide advice** on an individual matter. (1)
- The work of the auditor's expert **relates to a significant matter** that involves **subjective and complex judgments.** (2 & 3)
- The auditor has **not previously used the work of the auditor's expert, and has no prior knowledge of that expert's competence, capabilities and objectivity.** (4)
- The expert is an auditor's **external expert and is not, therefore, subject to the firm's quality control policies and procedures.** (5)

(CNO-SA620.060) STEP I: - DETERMINING THE NEED FOR AN AUDITOR'S EXPERT

Chart

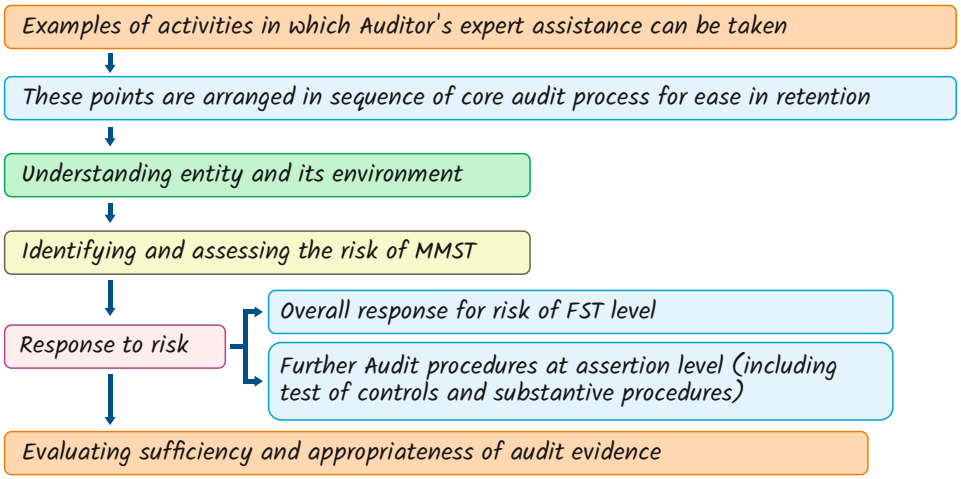


Need for Auditor's Expert (MCQ-620.3 / Incs.14.4/ Incs.49.5)

If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert. Considerations when deciding whether to use an auditor's expert may include:

- The **nature and significance** of the matter, including its **complexity.**
- The **risks of material misstatement** in the matter.
- The expected nature of procedures to respond to identified risks, including the **auditor's knowledge of and experience** with the work of experts in relation to such matters; and the availability of alternative sources of audit evidence.
- Whether management has used a **management's expert** in preparing the financial statements.

Chart



Example of activities in which auditor's help may be required

Summary

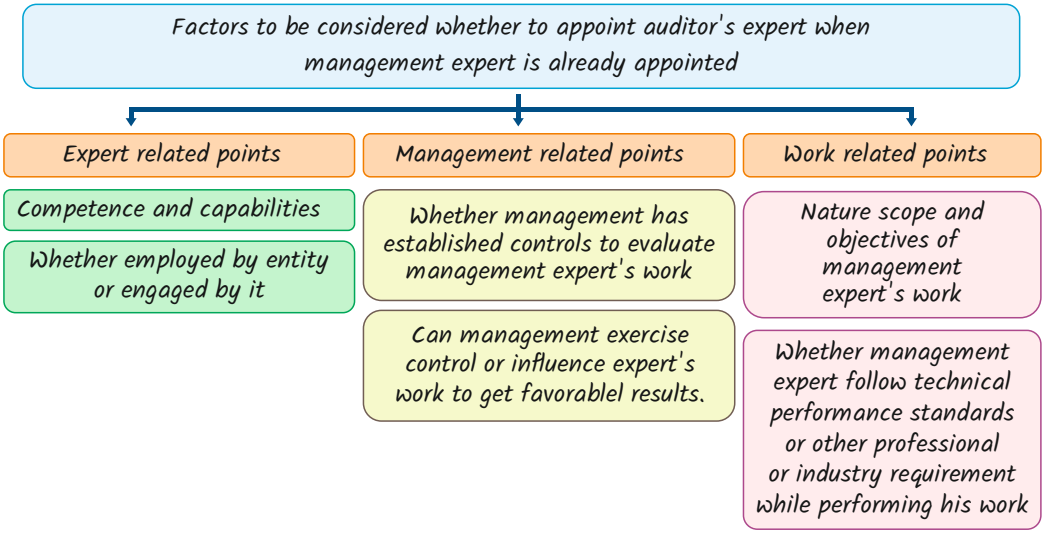
It's in flow of core audit process -- Understanding, Identifying & assessing risk, overall response, further audit procedures, sufficiency & appropriateness

Detailed Text

An auditor's expert may be needed to assist the auditor in one or more of the following:

- **Obtaining an understanding** of the entity and its environment, including its internal control.
- **Identifying and assessing the risks of material misstatement.**
- Determining and implementing **overall responses to assessed risks at the financial statement level.**
- Designing and performing **further audit procedures to respond to assessed risks at the assertion level,** comprising tests of controls or substantive procedures.
- Evaluating the **sufficiency and appropriateness of audit evidence** obtained in forming an opinion on the financial statements.

Chart



When management has used a manageme-nt's expert, whether to use auditor's expert

Summary

Competence & Capability / Employed or Engaged / Technical Standards / Nature, Scope & Objectives / Controls / Management Influence

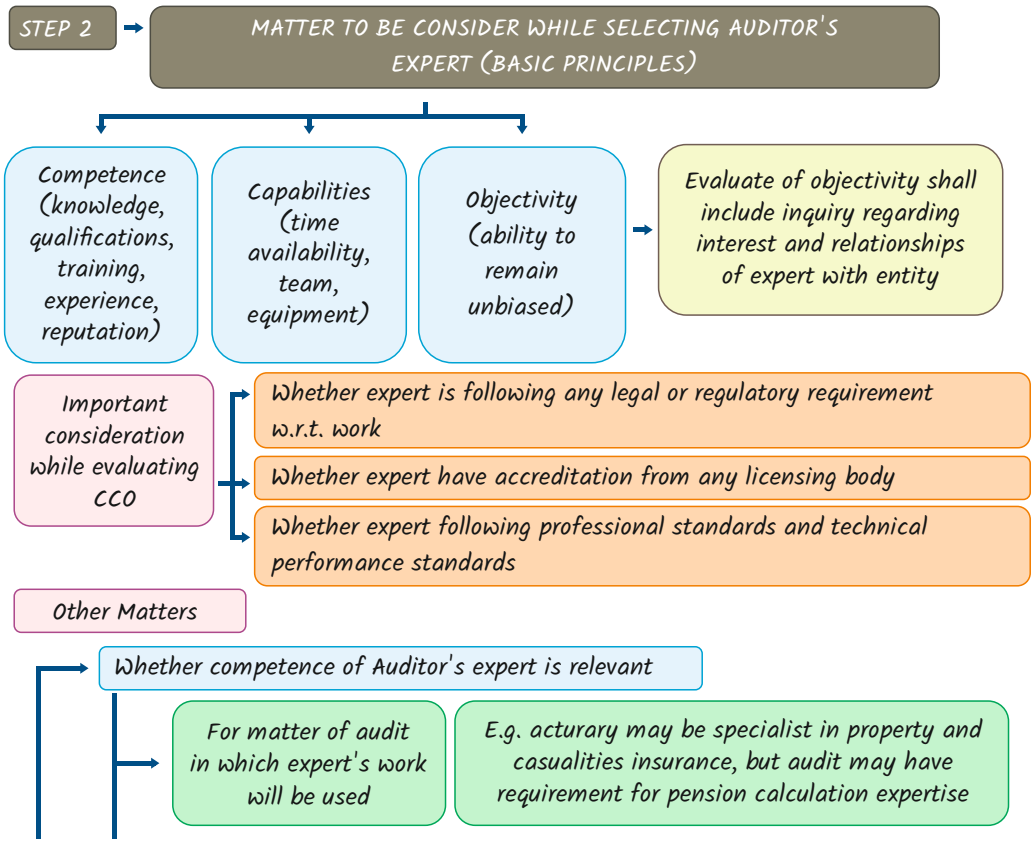
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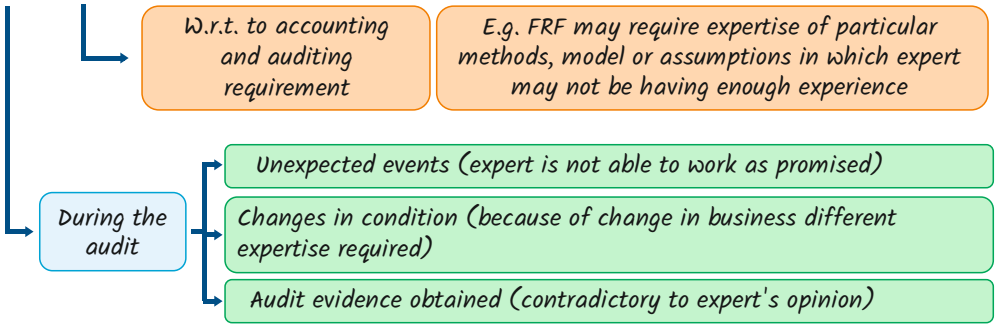
When management has used a management's expert in preparing the financial statements, the auditor's decision on whether to use an auditor's expert may also be influenced by such factors as:

- The management's expert's **competence and capabilities.**
- Whether the management's expert is **employed by the entity, or is a party engaged by it** to provide relevant services.
- The **nature, scope and objectives** of the management's expert's work.
- Whether the management's expert is subject to **technical performance standards or other professional or industry requirements.**
- Any **controls within the entity** over the management's expert's work.
- The extent to which **management can exercise control or influence over the work** of the management's expert.

(CNO-SA620.080) STEP 2: - MATTERS TO BE CONSIDERED WHILE SELECTING AUDITORS EXPERT

Chart





- ***Basic Principle For Selection of Expert***

  The auditor shall evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purposes. In the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity.

- ***Further Explanation***

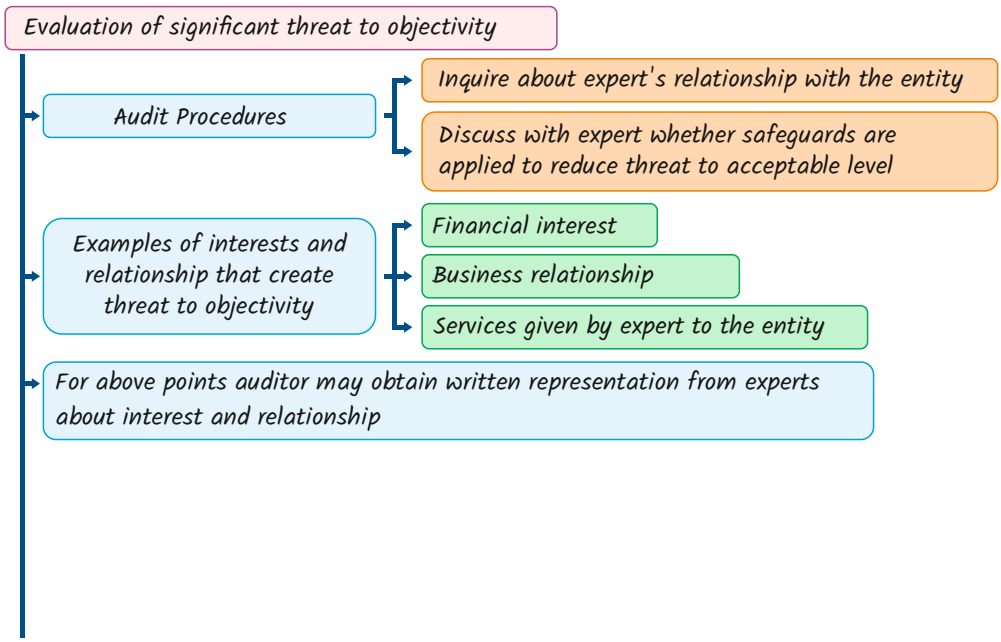
  Matters relevant to evaluating the competence, capabilities and objectivity of the auditor's expert include whether that expert's work is subject to technical performance standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation.

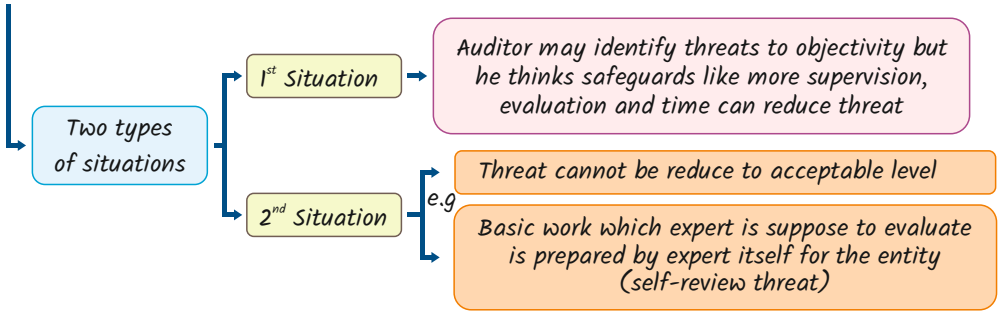
- ***Other matters** that may be relevant include:*
  - *The relevance of the auditor's expert's competence to the matter for which that expert's work will be used, including any areas of specialty within that expert's field. For example, a particular actuary may specialise in property and casualty insurance, but have limited expertise regarding pension calculations.*
  - *The auditor's expert's competence with respect to relevant accounting and auditing requirements, for example, knowledge of assumptions and methods, including models where applicable, that are consistent with the applicable financial reporting framework.*

    Whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider the initial evalusation of the competence, capabilities and objectivity of the auditor's expert as the audit progresses.

(CNO-SA620.90) EVALUATION OF SIGNIFICANT THREAT TO OBJECTIVITY

Chart





Discussion

- When evaluating the objectivity of an auditor's external expert, it may be relevant to:
  (a) Inquire of the entity about any known interests or relationships that the entity has with the auditor's external expert that may affect that expert's objectivity.
  (b) Discuss with that expert any applicable safeguards, including any professional requirements that apply to that expert; and evaluate whether the safeguards are adequate to reduce threats to an acceptable level.

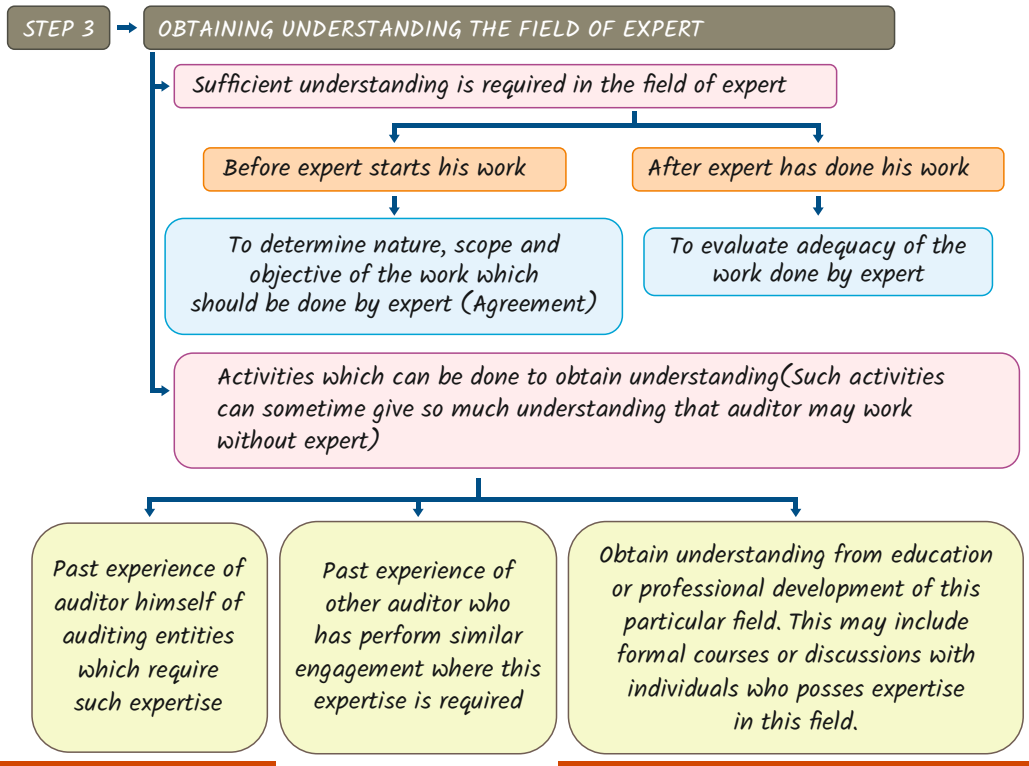
- Interests and relationships that may be relevant to discuss with the auditor's expert include:
  - Financial interests.
  - Business and personal relationships.
  - Provision of other services by the expert, including by the organization in the case of an external expert that is an organization.

- In some cases, it may also be appropriate for the auditor to obtain a written representation from the auditor's external expert about any interests or relationships with the entity of which that expert is aware.

- The evaluation of the significance of threats to objectivity and of whether there is a need for safeguards may depend upon the role of the auditor's expert and the significance of the expert's work in the context of the audit. There may be some circumstances in which safeguards cannot reduce threats to an acceptable level, for example, if a proposed auditor's expert is an individual who has played a significant role in preparing the information that is being audited, that is, if the auditor's expert is a management's expert.

(CNO-SA620.100) STEP 3: - OBTAINING UNDERSTANDING THE FIELD OF EXPERT

Chart



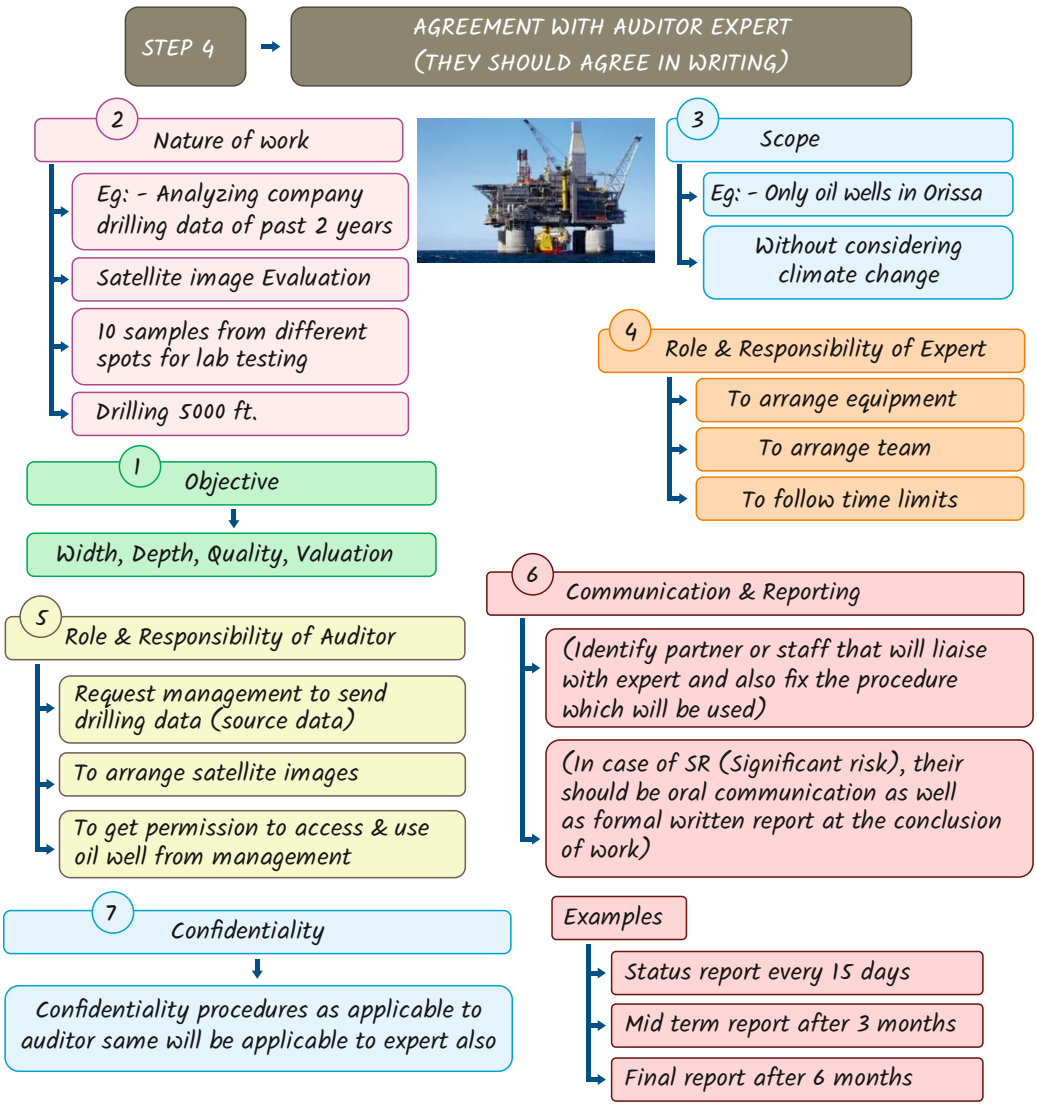
Discussion

- The auditor shall obtain a sufficient understanding of the field of expertise of the auditor's expert to enable the auditor to:
  (a) Determine the nature, scope and objectives of that expert's work for the auditor's purposes; and
  (b) Evaluate the adequacy of that work for the auditor's purposes.

- An auditor who is not an expert in a relevant field other than accounting or auditing May nevertheless be able to obtain a sufficient understanding of that field to perform the audit without an auditor's expert. This understanding may be obtained through, for example:
  - ***Experience in auditing entities*** that require such expertise in the preparation of their financial statements.
  - ***Education or professional development in the particular field.*** This may include formal courses or discussion with individuals possessing expertise in the relevant field for the purpose of enhancing the auditor's own capacity to deal with matters in that field. Such discussion differs from consultation with an auditor's expert regarding a specific set of circumstances encountered on the engagement where that expert is given all the relevant facts that will enable the expert to provide informed advice about the particular matter.
  - ***Discussion with auditors*** who have performed similar engagements.

(CNO-SA620.120) STEP 4: - AGREEMENT WITH THE AUDITOR EXPERT (QNO 105.000)

Chart (QNO-105.100)



Matters to Be considered In Agreement (QNO-105.100)

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

- The **nature, scope** and **objectives** of that expert's work;
- The **respective roles and responsibilities** of the auditor and that expert;
- The nature, timing and extent of **communication** between the auditor and that expert, including the form of any report to be provided by that expert; and
  When the work of the auditor's expert relates to the auditor's conclusions regarding a **significant risk,** both a **formal written report at the conclusion of that expert's work, and oral reports as the work progresses, may be appropriate.** Identification of specific partners or staff who will liaise with the auditor's expert, and procedures for communication between that expert and the entity, assists timely and effective communication, particularly on larger engagements.
- The need for the auditor's expert to observe **confidentiality requirements.**
- **It is necessary for the confidentiality provisions of relevant ethical requirements that apply to the auditor also to apply to the auditor's expert.** Additional requirements may be imposed by law or regulation. The entity may also have requested that specific confidentiality provisions be agreed with auditor's external experts.

Chart

Factors which may lead to more detailed agreement as compare to normally required

Shortcut - Nuclear **DEAL** is **C**omplex

N	–	**N**ot previously used work of this expert
D	–	**D**ifferent roles and responsibility as compared to normal
E	–	**E**xtent of expert's work is more and its significant
A	–	Expert have **A**ccess to sensitive and confidential information
L	–	Multi-jurisdictional **L**egal and regulatory requirement
C	–	Work is highly **C**omplex

Circumstances / Factors which may lead to more detailed agreement (QNO-105.000)

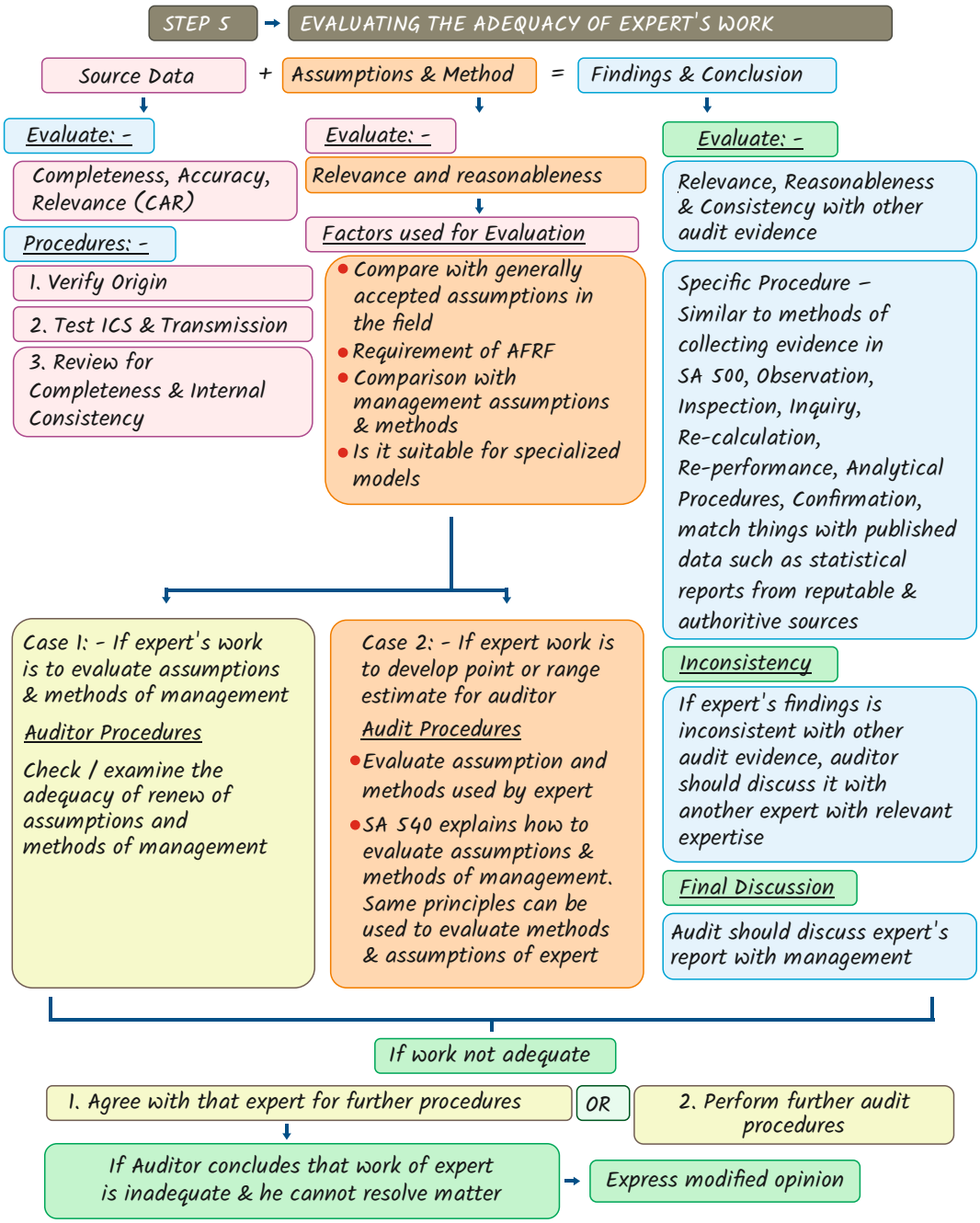
As per SA 620, "Using the work of an Auditor's Expert", some of the matters may affect the level of detail and formality of the agreement between the auditor and the auditor's expert, including whether it is appropriate that the agreement be in writing. For example, the following factors may suggest the need for more a detailed agreement than would otherwise be the case, or for the agreement to be set out in writing:

N-DEAL should have detailed agreement as they are Complex

- The auditor has **Not previously used work performed by that expert.**
- The respective **roles or responsibilities of the auditor and the auditor's expert are Different from those normally expected.**
- The greater the **Extent of the auditor's expert's work,** and its significance in the context of the
- audit.
- The auditor's expert will have **access to sensitive or confidential entity information.**
- **Multi-jurisdictional Legal or regulatory requirements** apply.
  The matter to which the **auditor's expert's work relates is highly Complex.**

(CNO-SA620.140) STEP 5: - EVALUATING THE ADEQUACY OF THE AUDITOR'S EXPERT'S WORK
(QNO-104.000/106.000/106.100)(MCQ-620.4)

Chart



Source Data

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

- ***Source Data – Relevance, Accuracy & Completeness***
  - *If that expert's work involves the **use of source data** that is significant to that expert's work, **the relevance, accuracy, and completeness of that source data.***
- ***Procedures for Source Data – Verify Origin & Internal Controls / Review Data***

When an auditor's expert's work involves the use of source data that is significant to that expert's work, procedures such as the following may be used to test that data:

- *Verifying the **origin of the data,** including obtaining an understanding of, and where applicable testing, the **internal controls over the data** and, where relevant, its transmission to the expert.*
- ***Reviewing the data** for completeness and internal consistency.*

Assumptions & Methods

- ***Assumptions & Methods – Relevance & Reasonableness***

*If that expert's work involves use of **significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and***

- ***Case 1: -Experts work is to evaluate assumptions & method -- Adequate Review of Assumptions & Review***

When the auditor's expert's work is to evaluate underlying assumptions and methods, including models where applicable, used by management in developing an accounting estimate, the auditor's procedures are likely to be primarily directed to evaluating whether the auditor's expert has adequately reviewed those assumptions and methods.

- **Case 2: – Experts work is to develop point or range estimate for auditor-Evaluate assumptions & methods used by auditor / Use of SA 540-Use it in context of expert** When the auditor's expert's work is to develop an auditor's point estimate or an **auditor's range for comparison with management's point estimate,** the auditor's procedures may be primarily directed to evaluating the assumptions and methods, including models where appropriate, used by the auditor's expert.

  SA 540 discusses the assumptions and methods used by management in making accounting estimates, including the use in some cases of highly specialised, entity-developed models. Although that discussion is written in the context of the auditor obtaining sufficient appropriate audit evidence regarding management's assumptions and methods, it may also assist the auditor when evaluating an auditor's expert's assumptions and methods.

- **Factors used for evaluation – Compare with Generally Accepted / FRF / Management's / Specialised Models**

  When an auditor's expert's work involves the use of significant assumptions and methods, factors relevant to the auditor's evaluation of those assumptions and methods include whether they are:

  - **Generally accepted** within the auditor's expert's field
  - Consistent with the requirements of the applicable **financial reporting framework;**
  - **Consistent with those of management,** and if not, the reason for, and effects of, the differences.
  - Dependent on the use of specialised models; and

Findings & Conclusion

- **Findings or Conclusions- Relevance, Reasonableness & Consistency with another audit evidence**
  - The relevance and reasonableness of that expert's findings or conclusions, and their consistency with another audit evidence;

- **Specific Procedures** – Similar to methods of collecting evidence in SA 500 Observation, Inspection, Inquiry, Recalculation, Reperformance, Analytical Procedures, Confirmation, WR with 2 extra statistical reports & another experts.

- **Specific procedures to evaluate the adequacy of the auditor's expert's work** for the auditor's purposes may include:
  - **Inquiries** of the auditor's expert.
  - **Reviewing** the auditor's expert's **working papers and reports.**
  - Corroborative procedures, such as:
    - **Observing** the auditor's expert's work;
    - Examining published data, such as **statistical reports from reputable, authoritative sources;**
    - Confirming relevant matters with **third parties;**
    - Performing **detailed analytical procedures;** and
    - **Re-performing** calculations.
- Discussing the auditor's expert's report with management.
- Discussion with **another expert** with relevant expertise **when, for example, the findings or conclusions of the auditor's expert are not consistent with other audit evidence.**

Inadequate Work (CNO-106.100)

Summary

If work not adequate – 1. Agree with that expert for further audit procedures OR 2. Perform further audit procedures

If auditor concludes that work of expert is inadequate & he cannot resolve matter – express modified opinion

Detailed Text

If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall:

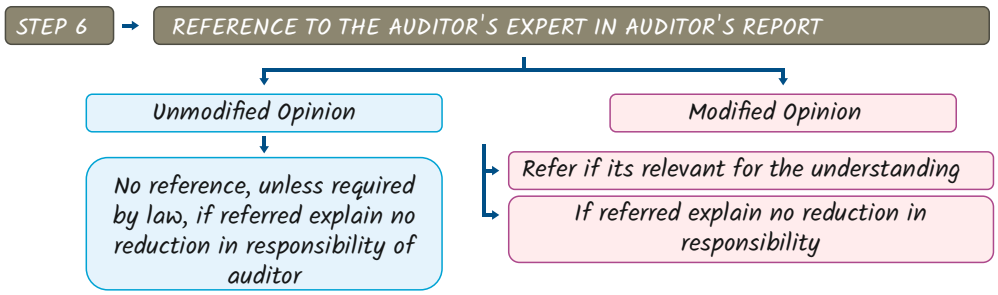
- **Agree with that expert** on the nature and extent of **further work** to be performed by that expert; or
- **Perform further audit procedures** appropriate to the circumstances.

If the auditor concludes that the work of the auditor's expert is not adequate for the auditor's purposes and the auditor cannot resolve the matter through the **additional audit procedures, which may involve further work being performed by both the expert and the auditor, or include employing or engaging another expert,** it may be necessary to express **a modified opinion in the auditor's report in accordance with SA 705 because the auditor has not obtained sufficient appropriate audit evidence.**

(CNO-SA620.160) STEP 6: - REFERENCE TO THE AUDITOR'S EXPERT IN THE AUDITOR'S REPORT

(QNO-106.100) (MCQ-620.1 / Incs.42.1)

Chart



Unmodified Opinion

- **Unmodified Opinion -- No reference unless required by law, if referred explain no reduction in responsibility.**

  The auditor **shall not refer to the work of an auditor's expert** in an auditor's report containing an **unmodified opinion** unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor's report that the reference does not reduce the auditor's responsibility for the audit opinion.

Modified Opinion

- **Modified Opinion – Refer if its relevant for understanding if referred explain no reduction in responsibility;**

  If the auditor makes reference to the work of an auditor's expert in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, **the auditor shall indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion.**

PART 6 - OTHER CONCEPTS

(CNO—CH20C.020) Nature and Extent of Planning (QNO-149.030)

Discussion	So far as the nature of planning is concerned, it would vary according to-
Size and Complexity of the Auditee	If the size and complexity of organization of which audit is to be conducted is large, then much more planning activities would be required as compared to an entity whose size and complexity is small.
Past Experience & Expertise	The key engagement team members' previous experience & expertise also contributes towards variation in planning activities.
Change in Circums-tances	Another factor contributing towards variation in planning activities is change in circumstances.

(CNO--C20C.040) PLANNING - A CONTINUOUS PROCESS (QNO-29.000)

Chart



Planning is not a discrete phase of an audit but rather a continual and iterative process. It often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning includes consideration of the timing of certain activities and audit procedures. It also involves Audit Programming.

- Planning includes the need to consider such matters as:
  - Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
  - The determination of materiality.
  - The analytical procedures to be applied as risk assessment procedures.
  - The performance of other risk assessment procedures.
  - The involvement of experts.

(CNO–CH2OC.060) AUDIT PROGRAMME FORMULATION

Definition

An audit programme is commonly prepared to ***allocate work to team members which may include the list of audit procedures and instructions*** *to be followed by the member.* ***It also estimates the duration for completing an audit task.***

Formulating an Audit Programme:

It is very useful for students to know how to plan an audit programme. The programme may contain audit objectives for each area and should have sufficient detail to serve as a set of instructions to the assistants involved in the audit and as a means to control the p roper execution of work. It may be emphasized that a clear spelling out of audit objectives for each area is important to link up the procedures with audit objectives and to ensure a purposeful audit.

The important matters which need to be considered in this regard are

Overall plan	*Overall plan for the audit programme should be drawn up to ensure a systematic approach to the work.* ***If in drawing the audit programme, any divergence from the overall plan becomes necessary, first the overall plan should be modified after due consideration and thereafter only the matter may be taken in the audit programme.*** *The frame provided by the overall plan should be strictly adhered to.*
Nature of business in which the organization is engaged	***In the case of an industrial concern, he must also visit the factory*** *to acquaint himself with the different processes of manufacture, the quantitative records maintained and the manner in which statistics are compiled in respect of losses in process.* *On his first appointment, the auditor should examine in detail the* ***financial and accounting organization of the business by visiting the client's office;*** *by observing different stages through which papers pass before each transaction is authorized and recorded; the record that is kept and the titles of books in which it is kept.* *The auditor, therefore, should draw up the programme of audit on a consideration of the technical, financial and accounting set-up of the company.*
Information as regards organization of the business	*To plan audit programme, it is necessary that the auditor should* ***obtain from his client information as regards the client's history and business, purpose and nature of engagement and time schedule for the completion of audit.***
Accounting and management policies	*The auditor should review the financial statements of the past several years, audited by his predecessors specially those of the immediately preceding previous year.* ***This would reveal to him a great deal of information regarding accounting and management policies which have been followed in the past and whether these have been employed consistently.***
Increase in Size of the organization and structure of its management	*An increase in the size of the organization enhances the complexity of the examination of its accounting records specially when it has a number of branches, deals in several products or has a very large turnover.*
System of internal control and accounting procedures	*The existence of a system of internal control ensures that both financial and statistical records are checked continuously; it also unearths errors, both of omission and of commission. The auditor, in framing his opinion on financial statements needs reasonable assurance that transactions are properly authorized and recorded in the accounting records and that transactions have not been omitted.* ***The study and evaluation of internal control helps the auditor to establish the reliance he can place on the internal control in determining the nature, timing and extent of his substantive auditing procedures.***

The auditor's examination of the system of internal control should have three features - review and preliminary evaluation, testing of compliance and evaluation.

Example: - The reports of the Comptroller and Auditor General on audit of accounts of Public Enterprises show that some of them have a very poor system of internal control. In such cases, the magnitude of the tasks of the auditor increases considerably.

(CNO—CH20C.080) ALTERATION OF AUDIT PROGRAMME (MCQ-CH20C.1)

Discussion

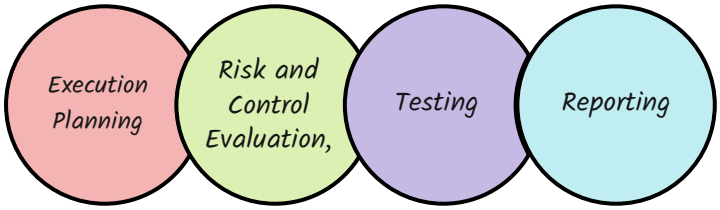
Given below are a few circumstances where in the audit programme would have to be suitably altered:

- If the audit procedures were designed for a certain volume of turnover and subsequently the volume have substantially increased. Also, when there have been significant changes in the accounting organisation, procedures and personnel subsequent to the audit procedures.
- Where during the course of an audit, it has been discovered that internal control procedures were not as effective as assumed at the time the audit programme was framed.
- Where there has been an extraordinary increase in the amount of book debts or that in the value of stocks as compared to that in the previous year.
- When a suspicion has aroused during the course of audit or information has been received that assets of the company have been misappropriated.

It may be noted that the audit plan and related programme should be reconsidered as the audit progresses. Such re-consideration is based on the auditor's review of internal control, his preliminary evaluation thereof and the result of his compliance and substantive procedures

(CNO—CH20C.100) AUDIT EXECUTION (QNO - 149.010)

Chart



Execution Planning

Prior to commencement of an audit engagement, it is important to lay down the **roadmap for audit execution** to ensure timely and quality audit results. The auditors need to plan their work in order to carry out the audit in an effective, efficient and timely manner.

A detailed audit program is prepared laying down the

- **Audit objectives,**
- **Scope and Audit approach.**
- **The manpower requirement, audit team qualifications, and the time element, etc.** are some of the important considerations during execution planning? In order to plan effectively, the auditor may need some more information about the audit area. A preliminary survey would help in gathering the required information.

Risk and Control Evaluation

For each segment of audit, the auditors should conduct a **detailed risk and control assessment** i.e. **list the risks** that must be reviewed in that segment, **capture for each risk the controls that exist** or those that are needed to protect against the risk and **show for each control, the work steps required to test the effectiveness of the controls.** While making Risk & Control assessment it is necessary to borne in mind Materiality levels as the same is linked with Audit Risks.

Testing

Once a comprehensive understanding is gained of the key risks and the controls to be evaluated in a given audit area, **the auditors should test the operating effectiveness of the controls to determine whether controls are operating as designed. There are multiple test methods which can be used to arrive at the conclusions on the effectiveness of the controls**

Reporting	SA 700, "Forming an Opinion and Reporting on Financial Statements" establishes standards on the form and content of the auditor's report issued as a result of an audit performed by an auditor of the financial statements of an entity. **The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements. This review and assessment involve considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit.** It is also necessary to consider whether the financial statements comply with the relevant statutory requirements such as compliance of Provisions & Enactments of the Company Law, Accounting Standards framed by ICAI, latest Guidelines etc. The auditor's report should **contain a clear written expression of opinion on the financial statements taken as a whole.** A measure of uniformity in the form and content of the auditor 's report is desirable because it helps to promote the reader's understanding of the auditor's report and to identify unusual circumstances when they occur. A statute governing the entity, or a regulator may require the auditor to include certain matters in the audit report or prescribe the form in which the auditor should issue his report.

Unique question	
QNO 149.040	Changes to Audit programme.
QNO 153.000	Audit Programme for Multiplex & Sale of Tickets
QNO 160.000	Audit Strategy for Online Business

Students Notes

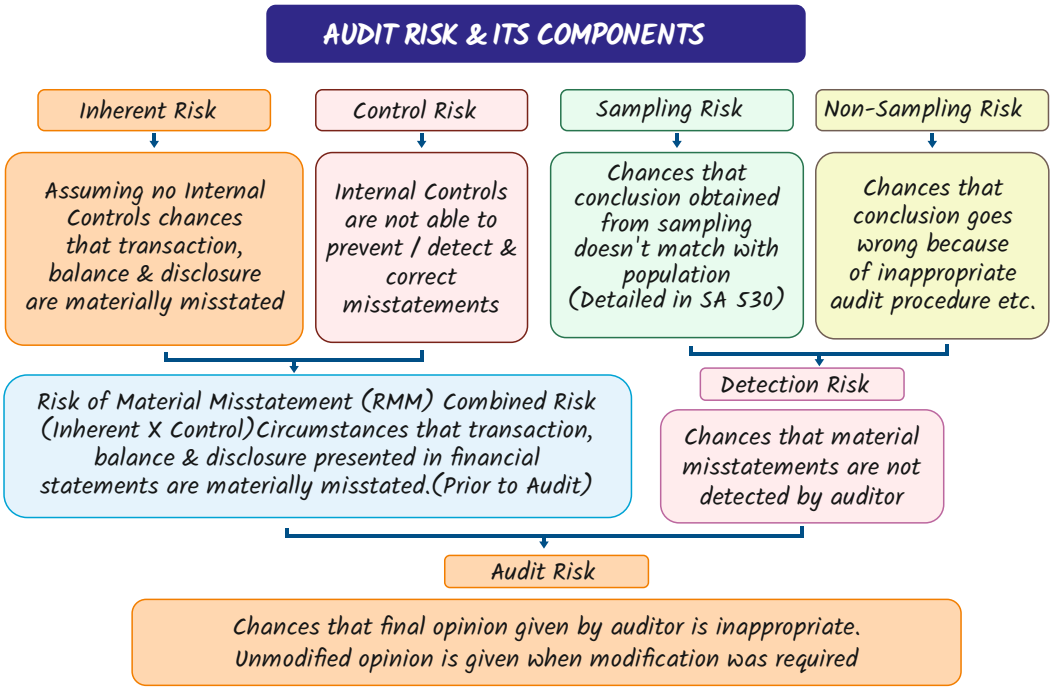
03 RISK ASSESSMENT AND INTERNAL CONTROL

Part I – [SA 315] IDENTIFYING AND ASSESSING THE RISK OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT (Risk Related Section)

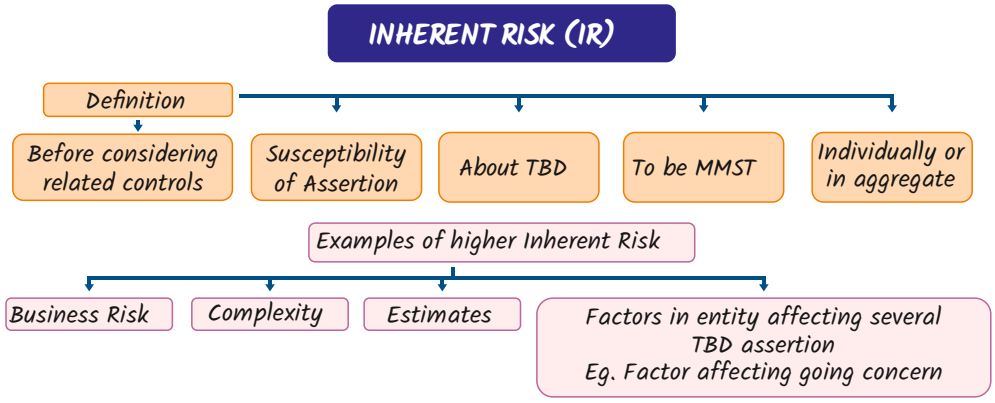
*Control related concepts are covered in next section after this

(CNO-SA315-RISK.020) AUDIT RISK & ITS COMPONENTS (QNO-31.000) (MCQ-315.14)

Chart



Chart



Inherent Risk (MCQ-315.08 / 315.15)

- **Definition**
  The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, **before consideration of any related controls.**
  (E.g., Retail, Jewellery, Telecom)

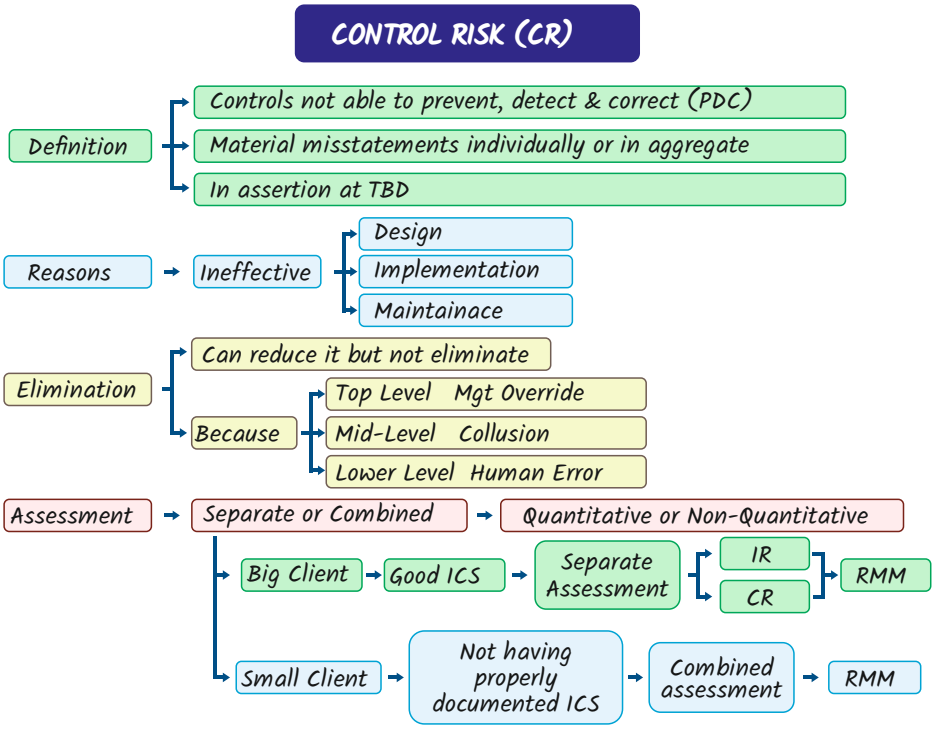
- **Examples of Higher Inherent Risk**
  It is higher for some assertions and related classes of transactions, account balances, and disclosures than for others.
  - **Complexity:** – For example, it may be higher for **complex calculations** or
    (E.g., Cost computation of inventory in factory with multiple products)

- ***Estimates:*** *– For accounts consisting of amounts derived from* ***accounting estimates*** *that are subject to significant estimation uncertainty.*
  (E.g., Research & Development Expenditure)

- ***Business Risk:*** *– External circumstances giving rise to* ***business risks*** *may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement.*
  (E.g., Fashion Industry, Mobile Industry)

- ***Factors in the entity and its environment*** *that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterised by a large number of business failures.*
  (E.g., They will affect going concern which will in turn affect valuation assertion of many assets which are carried on historical basis)

Chart



Control Risk (MCQ-315.5 / Incs.17.2)

- ***Definition***

  The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, ***will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.***

- *It is a function of the effectiveness of the* ***design, implementation and maintenance*** *of internal control by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation of the entity's financial statements.* ***(Design Problem: – No monthly stock counting rule, Implementation Problem: – Rule exists but not followed, Maintenance Problem:– Counting sheets and procedures not updated as per new products)***

- ***100% Elimination Not Possible***

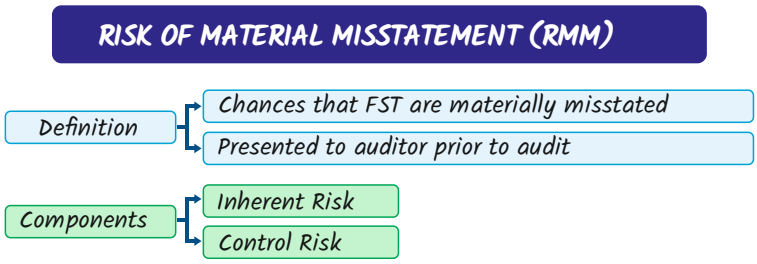
  However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of internal control. These include, ***for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override.***

Accordingly, some control risk will always exist. The SAs provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures to be performed.

- ***Combined Vs Separate Assessment***

The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made. ***(In big assignments go for separate analysis, further if auditor is relying extensively on test of controls then separate analysis id preferred)***

Chart



Risk of Material Misstate-ment

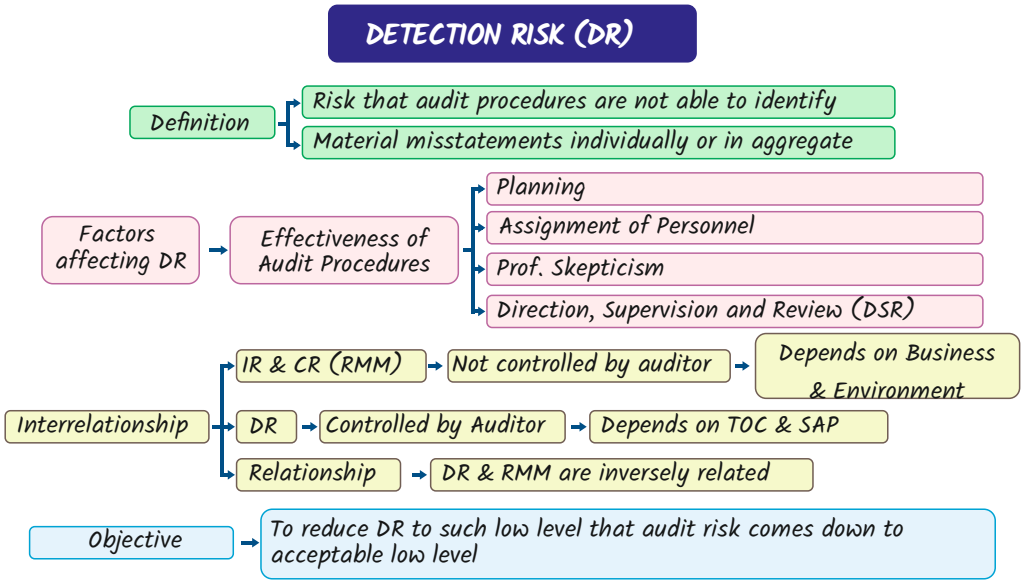
- ***Definition***

The risk that the financial statements are materially misstated ***prior to audit.***

- ***Components***

As per SA 200, the risks of material misstatement at the assertion level consist of two components: inherent risk and control risk. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements. The nature of each of these types of risk and their interrelationship is discussed below;

Chart



Detection Risk (MCQ-315.3)

- ***Meaning:-***

The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements. ***(Detection Risk is also called as Engagement Risk)***

- **Factors affecting Detection Risk;**

  Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. Matters such as:

  - adequate planning;
  - proper assignment of personnel to the engagement team;
  - the application of professional scepticism; and
  - supervision and review of the audit work performed, assist to enhance the effectiveness of an audit procedure and of its application and reduce the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results.

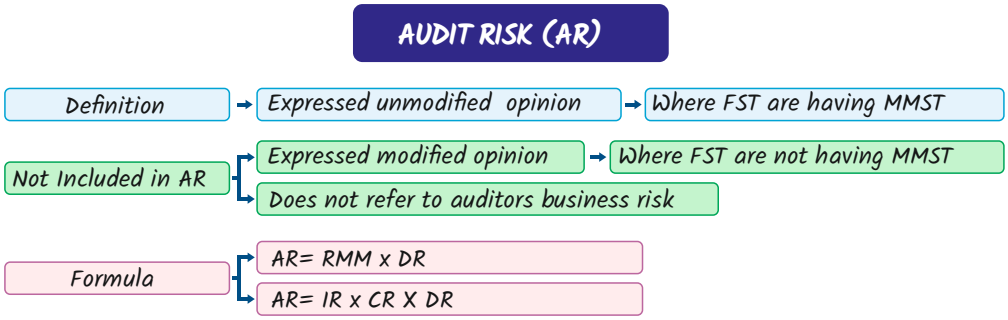
- **Interrelationship of the components of audit risk:**

  Inherent and control risks differ from detection risk in that they exist independently of an audit of financial information. Inherent and control risks are functions of the entity's business and its environment and the nature of the account balances or classes of transactions, regardless of whether an audit is conducted.

  Even though inherent and control risks cannot be controlled by the auditor, the auditor can assess them and design his substantive procedures to produce an acceptable level of detection risk, thereby reducing audit risk to an acceptably low level.

  For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor.

Chart



Audit risk (QNO-36.500)

The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

From the above, it is clear that –

Audit Risk = Risk of Material Misstatement x Detection Risk------(1)

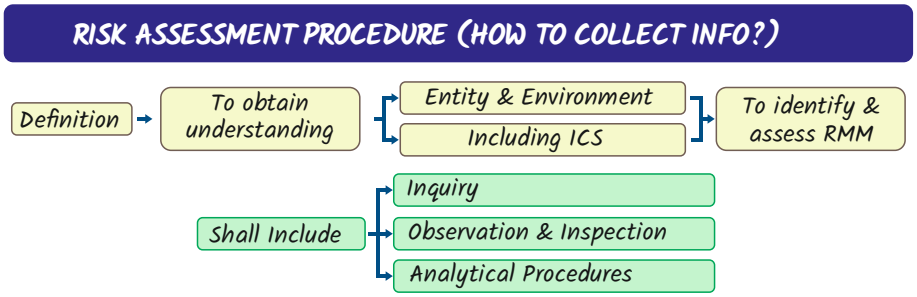
Further Risk of Material Misstatement= Inherent Risk x Control Risk------(2)

From (1) and (2), we arrive at Audit Risk = Inherent Risk x Control Risk x Detection Risk

- **What is not included in Audit Risk?**
  - Audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant.
  - Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

(CNO—SA315-RISK.040) RISK ASSESSMENT PROCEDURE (How to collect information?) (MCQ-315.11/315.12)

Chart



Definition

The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

- ***Risk assessment procedure – a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels***
  The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.

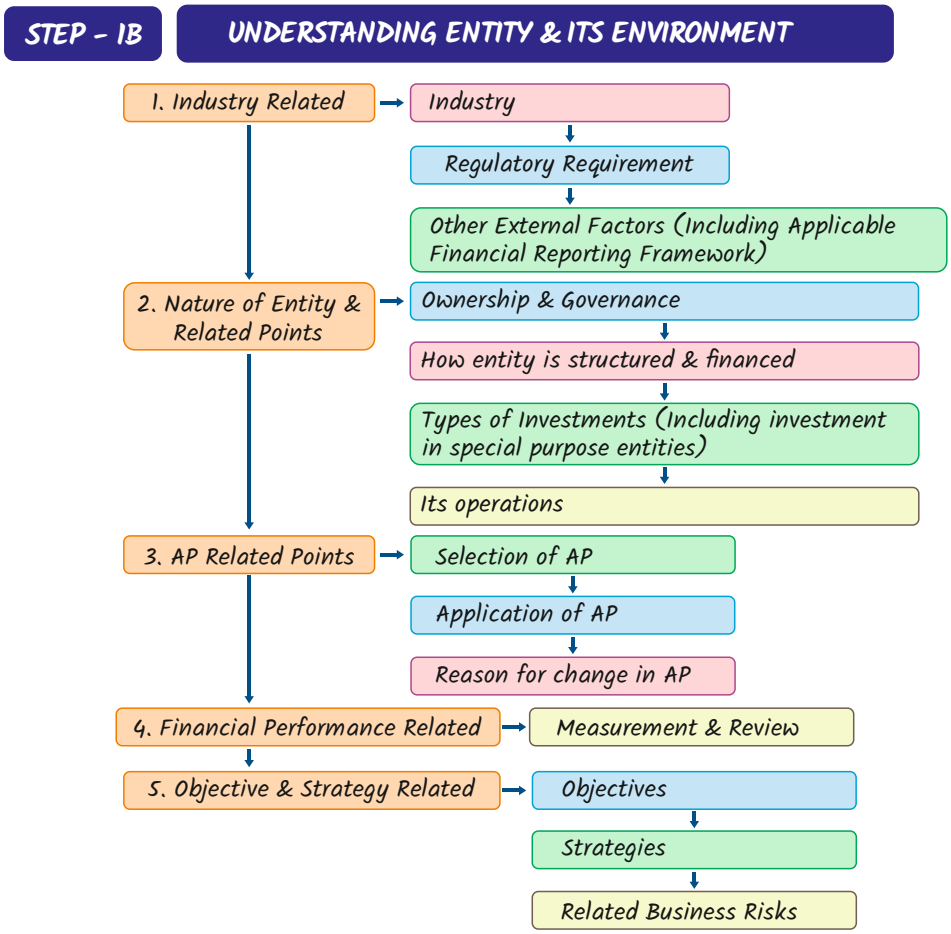
What is included in Risk Assessment Procedures?

The risk assessment procedures shall include the following:

- *Observation and inspection.*
- *Inquiries of management and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.*
- *Analytical procedures.*

(CNO-SA315-RISK.060) UNDERSTANDING OF THE ENTITY AND ITS ENVIRONMENT (Which basic information should be collected?) (QNO-39.000/39.100)

Chart



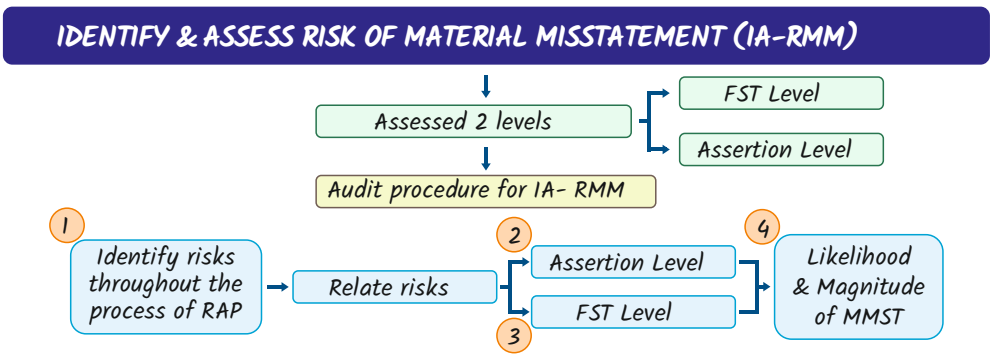
Detailed Text

*The auditor shall **obtain an understanding** of the following:*

- *Relevant **industry, regulatory,** and other **external factors** including the applicable **Financial reporting framework**.*
- *The **nature of the entity**, including:*
  - *its **operations**;*
  - *its **ownership and governance** structures;*
  - *The **types of investments** that the entity is making and plans to make, including investments in special-purpose entities; and*
  - *The way that the **entity is structured and how it is Financed**; to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.*
- *The entity's **selection and application of accounting policies**, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.*
- *The entity's **objectives and strategies**, and those **related business risks** that may result in risks of material misstatement.*
- *The measurement and review of the **entity's Financial performance**.*

(CNO- SA315-RISK.080) IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT (QNO-40.100)

Chart



RMM at 2 Levels

The auditor shall identify and assess the risks of material misstatement at:

- *The **Financial statement level;** and*
- ***The assertion level for classes of transactions, account balances, and disclosures; to provide a basis for designing and performing further audit procedures.***

  For this purpose, the auditor shall:
- ***Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;***

  (Har information collect karne ke bad risk ke baarein mien sochtein raho)
- *Relate the **identiFied risks to what can go wrong at the assertion level, taking account of relevant controls** that the auditor intends to test; and*

  (Kahi assertion level pet oh nahi)
- *Assess the identified risks, and evaluate whether they relate more **pervasively to the financial statements as a whole and potentially affect many assertions;***

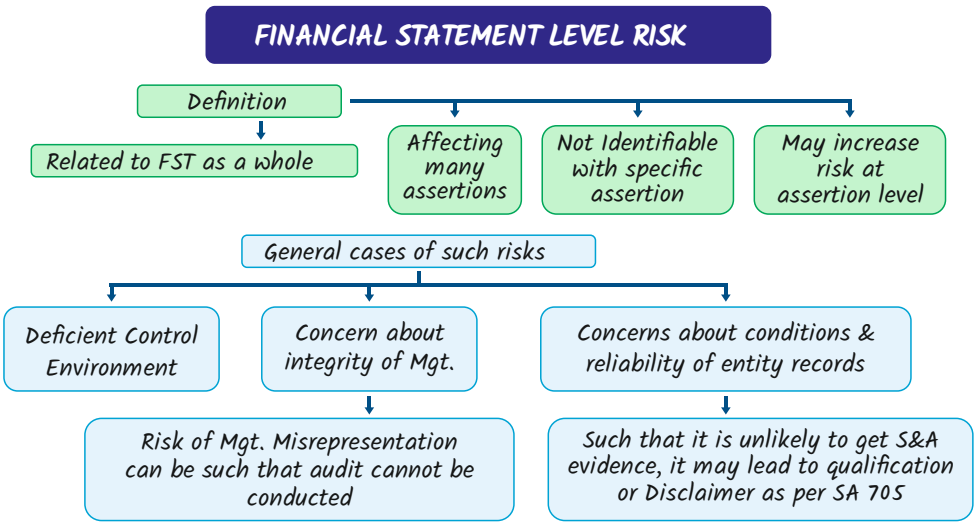
  (Yaa Financial statement level pet oh nahi)
- ***Consider the likelihood of misstatement, including the possibility of multiple misstatements, and***

whether the potential misstatement is of a magnitude that could result in a material misstatement. (Badi risk toh nahi hai , with big amount and more probability)

Example only for reference no need to include in answer

Understanding Entity & Its Environment (RAP)	State of Economy (Downturn in Economy)	State of Economy (Downturn in Economy)	Ownership & Governance (80% of shares belong to one family + Family Management + Past History of Manipulation)
Description of Risk (Identifying)	Difficult to collect Receivables	Inventory may remain unsold	There are chances that some related party transactions are manipulated to increase profits.
Impact (Assessing)	Valuation	Valuation	Anywhere in financial statements
Probability (Points)	5	6	8
Amount (Points)	2	4	5
Combined Effect	10	24	40
SigniFicant Risk (Above 20 SigniFicant Risk)	No	Yes	Yes

Financial Statement Level (QNO-34.000)



Assessment of Risks of Material Misstatement at the Financial Statement Level

- **Meaning**

  Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level, for example, through management override of internal control. Financial statement level risks may be especially relevant to the auditor's consideration of the risks of material misstatement arising from fraud.

- **Effect of Control Environment**

  Risks at the financial statement level may derive in particular from deficient control environment

(although these risks may also relate to other factors, such as declining economic conditions). For example, deficiencies such as management's lack of competence may have a more pervasive effect on the financial statements and may require an overall response by the auditor.

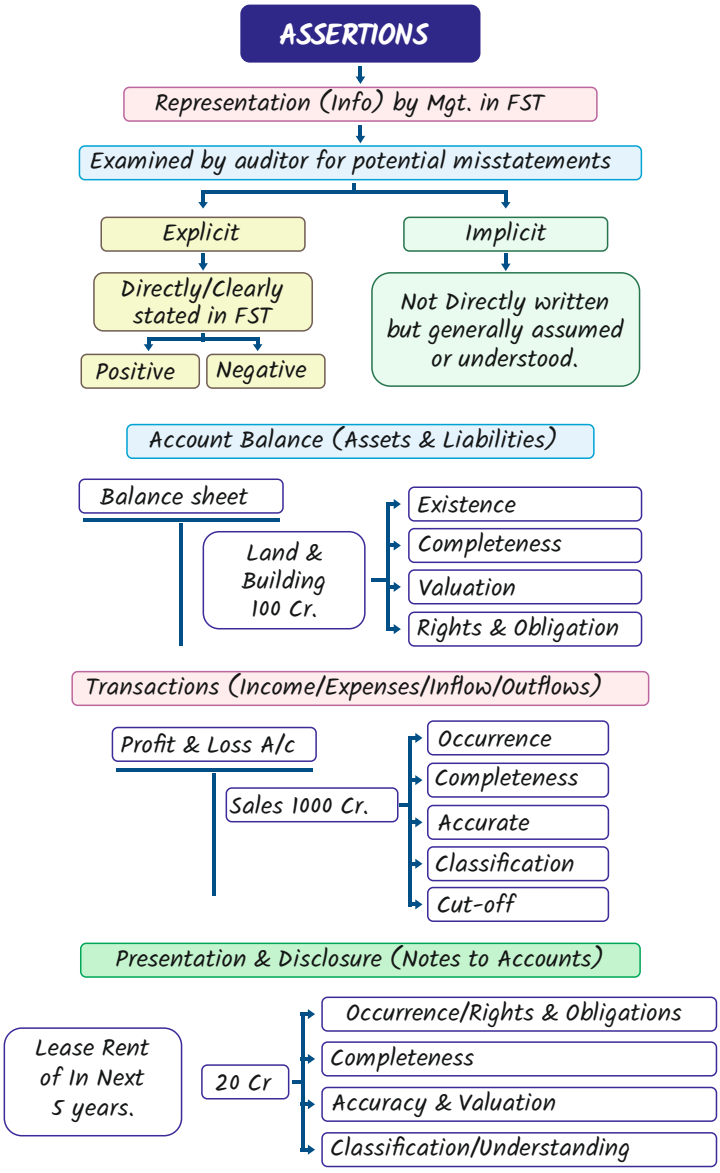
- ***Auditability of Financial Statements***

  Understanding of Internal Control System may result in following

  - Concerns about the ***integrity of the entity's management*** may be so serious as to cause the auditor to conclude that the risk of management misrepresentation in the financial statements is such that an audit cannot be conducted.
  - Concerns about the ***condition and reliability of an entity's records*** may cause the auditor to conclude that it is unlikely that sufficient appropriate audit evidence will be available to support an unqualified opinion on the financial statements.

SA 705, "Modifications to the Opinion in the Independent Auditor's Report" establishes requirements and provides guidance in determining whether there is a need for the auditor to consider a qualification or disclaimer of opinion or, as may be required in some cases, to withdraw from the engagement where this is legally possible.

Assessment of Risks of Material Misstatement at the Assertion Level (QNO-33.000)



Risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient

appropriate audit evidence. In identifying and assessing risks of material misstatement at the assertion level, the auditor may conclude that the identified risks relate more pervasively to the financial statements as a whole and potentially affect many assertions.

- *Assertions*

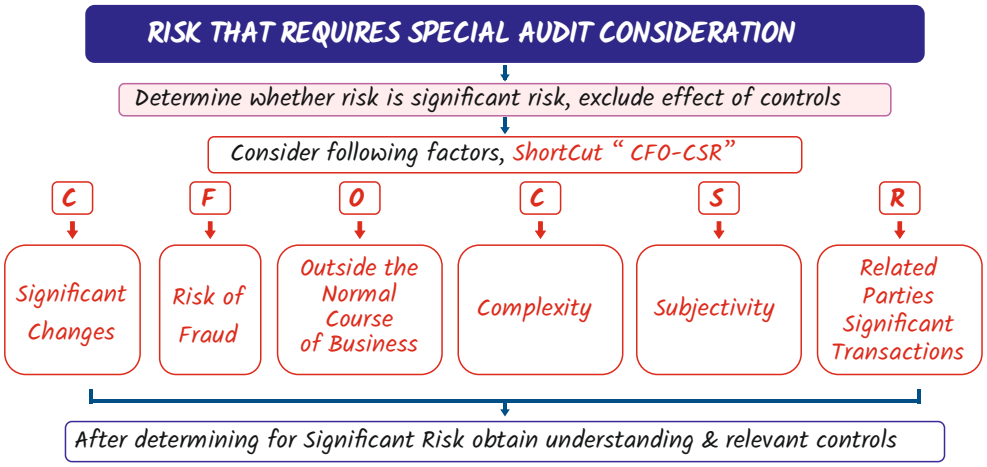
  In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation and disclosure of the various elements of financial statements and related disclosures.

  Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may take the following forms-

  - *Assertions about **account balances** at the period end:*
    - ***Existence**-assets, liabilities, and equity interests exist.*
    - ***Completeness**-all assets, liabilities and equity interests that should have been recorded have been recorded.*
    - ***Valuation and allocation**-assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.*
    - ***Rights and obligations**-the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.*
  - *Assertions about **classes of transactions and events** for the period under audit:*
    - ***Occurrence**-transactions and events that have been recorded have occurred and pertain to the entity.*
    - ***Completeness**-all transactions and events that should have been recorded have been recorded.*
    - ***Accuracy**-amounts and other data relating to recorded transactions and events have been recorded appropriately.*
    - ***Cut-off**-transactions and events have been recorded in the correct accounting period.*
    - ***ClassiFication**-transactions and events have been recorded in the proper accounts.*
  - *Assertions about **presentation and disclosure**:*
    - *Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.*
    - ***Completeness**-all disclosures that should have been included in the financial statements have been included.*
    - ***Accuracy and valuation**-financial and other information are disclosed fairly and at appropriate amounts.*
    - ***ClassiFication and understandability**-financial information is appropriately presented and described, and disclosures are clearly expressed.*

(CNO-SA315-RISK.100) RISKS THAT REQUIRE SPECIAL AUDIT CONSIDERATION (QNO-38.000 / Incs.18.4)

Chart



As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, **a signiffcant risk.** In exercising this judgment, **the auditor shall exclude the effects of identified controls related to the risk.**

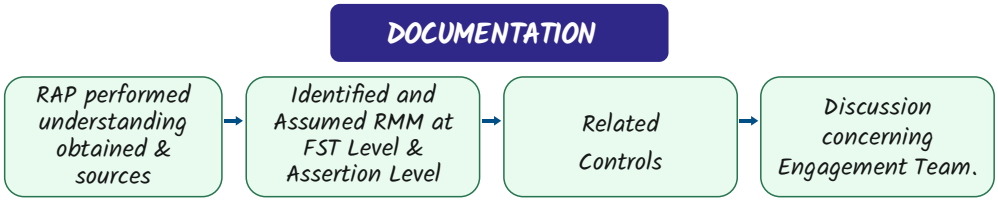
In exercising judgment, as to which risks are significant risks, the auditor shall consider at least the following:

(CFO-CSR)

- Whether the risk is related to recent significant economic, accounting, or other developments like **Changes** in regulatory environment, etc., and, therefore, requires specific attention;
- Whether the risk is a risk of **Fraud**;
- Whether the risk involves significant transactions that are **Outside the normal course of business** for the entity, or that otherwise appear to be unusual.
- The **Complexity** of transactions;
- The degree of **Subjectivity** in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- Whether the risk involves significant transactions with **Related parties**;
- When the auditor has determined that a **signiFicant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk.**

(CNO-SA315-RISK.120) DOCUMENTING THE RISK

Chart



The auditor shall document:

- Key elements of the **understanding obtained** regarding each of the aspects of the entity and its environment and of each of the internal control components, the sources of information from which the understanding was obtained; and the risk assessment procedures performed;
- The **identiFied and assessed risks of material misstatement** at the financial statement level and at the assertion level ; and
- The risks identified, and **related controls about which the auditor has obtained an understanding**.

  The **discussion among the engagement team** and the significant decisions reached;

Appendix, only for reference not important for exams			
Understanding Entity & Its Environment	**Examples**	**Impact**	**Assertion Level / Financial Statement Level**
State of Economy	Downturn in economy	Receivables may be difficult to collect-	Can affect provision for doubtful debts → Assertion Level Risk
		Inventory write-downs may be required	Can affect Inventory Valuation → Assertion Level Risk
Nature of Industry	Fast changing technology	Fixed Assets (Machines) may become obsolete	Can affect valuation of fixed assets, can lead to impairment → Assertion Level Risk (High Likelihood & Impact Hence Significant Risk)
Regulatory Requirement	Stringent rules of TRAI regarding call drops & other matters	Can lead to heavy penalties.	Provision for penalties can be inadequate (in complete) → Assertion level risk
Ownership & Governance	80% of shares belong to one family and there are multiple subsidiaries & associates	Many related party transactions take place	There are chances that some related party transactions are not identified or not properly recorded it can affect many financial items → Financial Statement Level Risk (High Likelihood & Impact Hence Significant Risk)
Financing & Structure	Heavy debt financing, with stringent debt covenants regarding debt: equity, inventory levels, cash flows etc. Derivative Contracts are also used	Management may resort to manipulations to satisfy debt covenants	Can affect many items in financial → statements Financial Statement Level Risk
Types of Investments	Invested huge amount in African countries	These are risky investments.	Affects Investment Valuation → Assertion Level Risk
Nature of Operations	30% Revenue from Government & 40% from Corporates	Government may not give money on time. Corporates may change contract anytime	Affects revenue recognition → Assertion Level Risk (High Likelihood & Impact Hence Significant Risk)
Financial Reporting Framework	Shift to Ind AS is required	Many ambiguities in implementation	Can affect many items in financial statement → Financial Statement Level Risk (High Likelihood & Impact Hence Significant Risk)
Selection & Application of Accounting Policies	Senior accountant not trained properly	Errors because of his inexperience & others may take advantage and fraud.	Can affect many items in financial statements → Financial Statement Level Risk

Financial Performance	Monthly sales are compared to 3 competitors who are doing good.	Managers will try to show better picture.	Can affect revenue recognition → Assertion Level Risk
Objectives & Strategies	Introduction of a new product during the year	Errors in cost allocation and inventory valuation.	Can Affect Inventory Valuation → Assertion Level Risk
		Management may be tempted to manipulate financial statements to ensure compliance with the bank covenants.	Can affect many items in financial statements → Financial Statement Level Risk

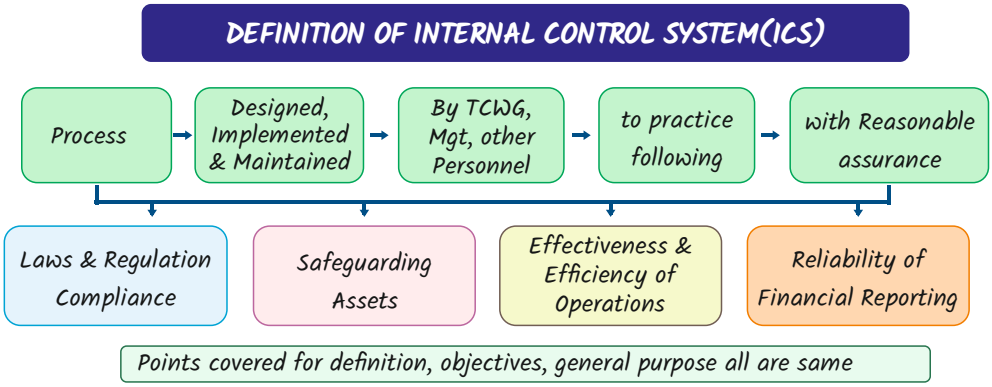
UNIQUE QUESTIONS	
QNO 36.000	Reduction of Detection Risk

UNIQUE MCQ	
MCQ	315.10, 315.13, Incs.35.1, Incs.35.2

[SA 315] INTERNAL CONTROL SYSTEM (Control Related Section)

(CNO-SA315-ICS.020) DEFINITION & OBJECTIVES OF INTERNAL CONTROL (SA 315)

Chart



Definition

As per SA-315, "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment" the internal control may be defined as"The process designed (made), implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to :(Mnemonic - LOAF)

safeguarding of Assets,	(Insurance, Restricted Access, Approval before Sale etc.)
effectiveness and efficiency of Operations,	(use of the asset to achieve objectives of production and sale)
compliance with applicable Laws and regulations,	(Environmental & Other approvals, Taxes etc.)
reliability of Financial reporting	(books of accounts, trial balance, consolidations etc.)

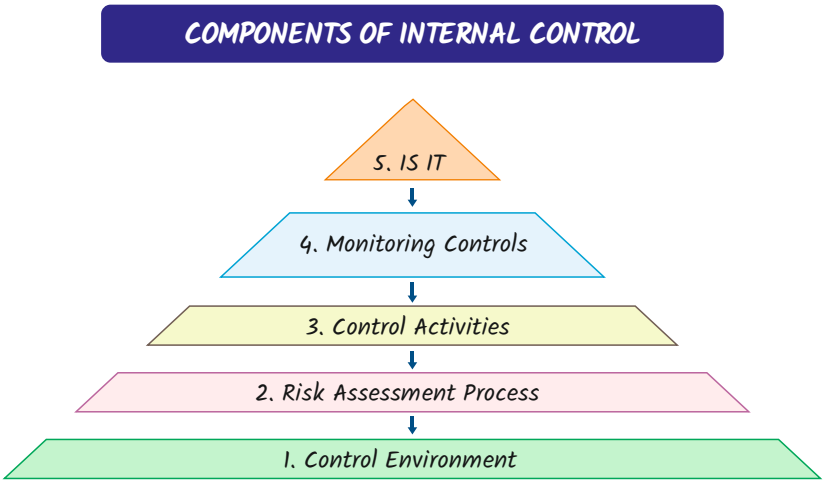
The term "controls" refers to any aspects of one or more of the components of internal control.

Objectives of Internal Control: (Mere repetition & elaboration)

- **Assets**
  - assets are safeguarded from unauthorized access, use or disposition; and
  - the recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences.
- **Operations**
  - transactions are executed in accordance with managements general or specific authorization;
  - Transactions are efficient &effective
- **Law Compliance**
  - Rules & Regulations are followed while executing transactions
- **Financial Reporting**
  - all transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;

(CNO—SA315-ICS.040) COMPONENTS OF INTERNAL CONTROL (QNO-40.000)

Chart



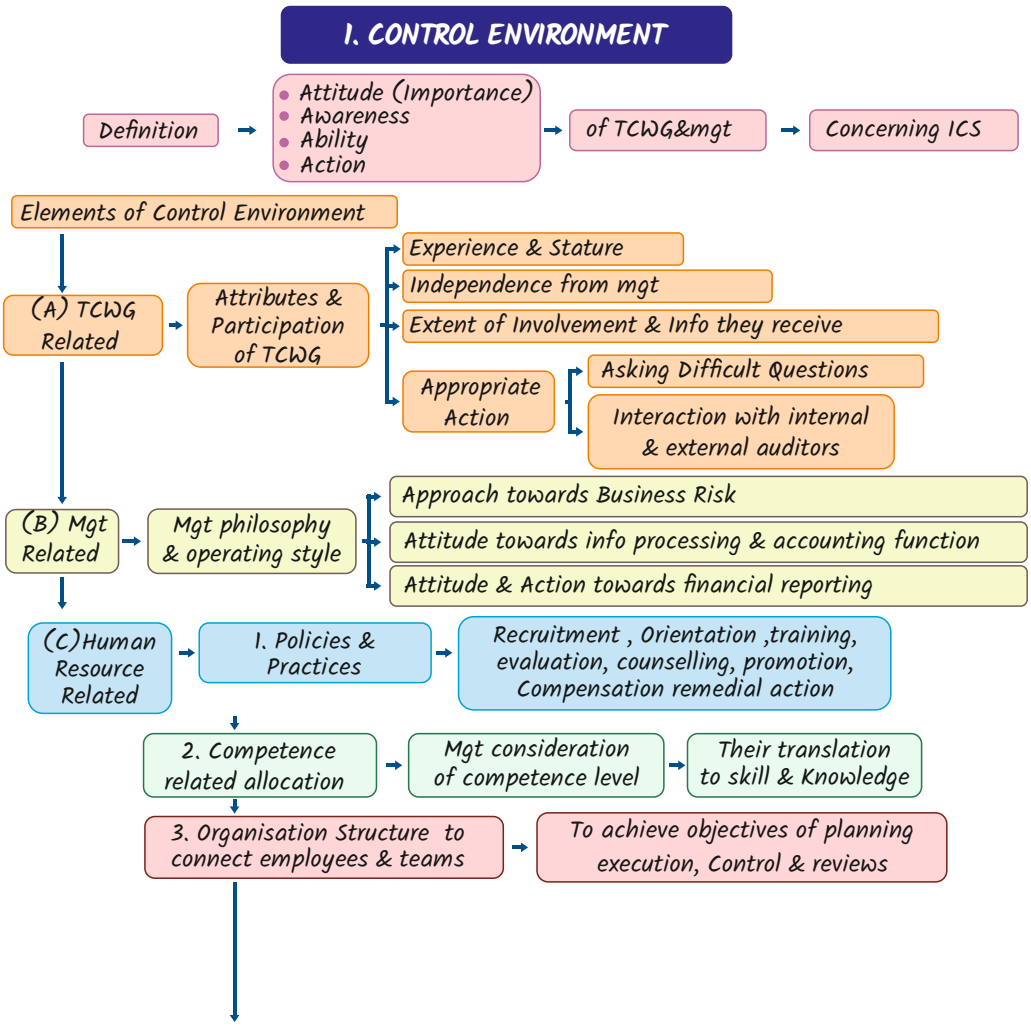
Division of Internal Control into Components

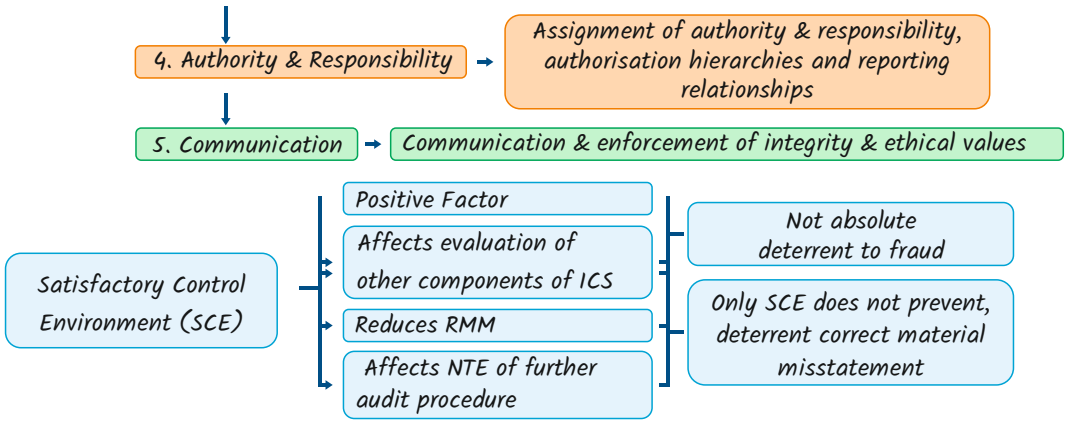
The division of internal control into the following five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit:

- The control environment;
- The entity's risk assessment process;
- Control activities; and
- The information system, including the related business processes, relevant to financial reporting, and communication;
- Monitoring of controls.

(CNO-SA315-ICS.060) CONTROL ENVIRONMENT' COMPONENT OF INTERNAL CONTROL (QNO-40.010)

Chart





Definition	Control environment - Attitudes, awareness, ability and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity also includes the governance and management functions. The control environment is a component of internal control.

Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:

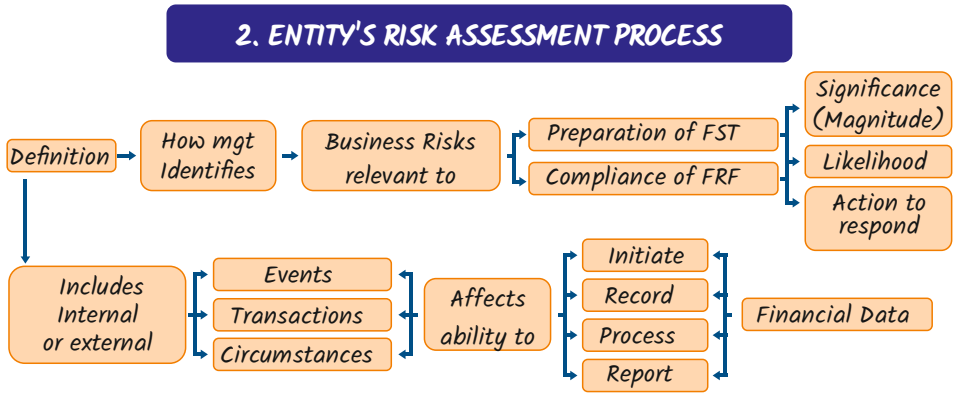
TCWG Related	Participation by those charged with governance – Attributes of those charged with governance such as: ➢ Their **independence** from management. ➢ Their **experience** and **stature** (Reputation). ➢ The **extent of their involvement** and the information they receive, and the scrutiny of activities. ➢ The appropriateness of their actions, including the degree to which **difficult questions** are raised and pursued with management, and their interaction with internal and external auditors.
Management Related	Management's philosophy and operating style – Characteristics such as management's: ➢ Approach to taking and **managing business risks.** ➢ Attitudes toward **information processing and accounting functions** and personnel. ➢ Attitudes and actions toward **financial reporting.**
Human Resource	Human resource policies and practices – Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.
Competence	Commitment to competence – Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.
Organisation Structure	Organisational structure – The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed.
Assignment of Authority	Assignment of authority and responsibility - Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established.
Communic-ation	Communication and enforcement of integrity and ethical values – These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.
Satisfactory Control Environment – not an abso-lute deterrent to fraud:	The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. However, although it may help reduce the risk of fraud, a **satisfactory control environment is not an absolute deterrent to fraud.** Conversely, deficiencies in the control environment may undermine the effectiveness of controls, in particular in relation to fraud. **For example,** management's failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or to data, or unauthorized transactions to be processed. As explained in SA 330, the control environment also influences the nature, timing, and extent of the auditor's further procedures.

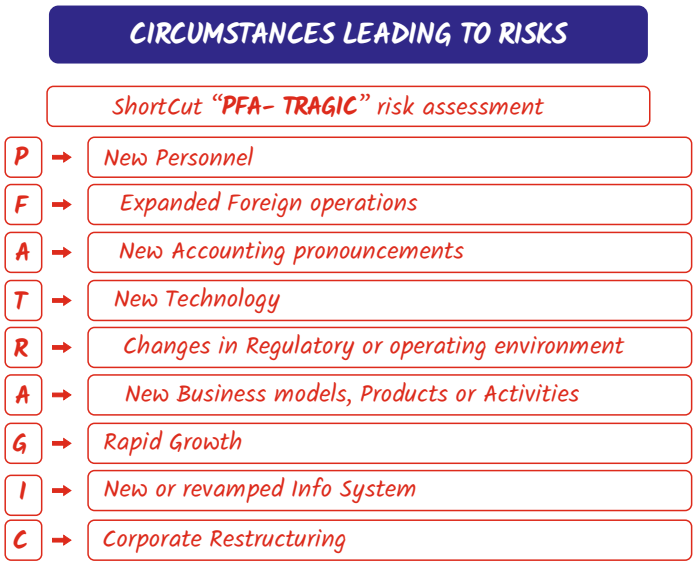
The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement.

(CNO—SA315-ICS.080) THE ENTITY'S RISK ASSESSMENT PROCESS' COMPONENT OF INTERNAL CONTROL

(QNO-40.150)

Chart





- ***Entity's process from point of view of financial reporting' Business Risk—RMM***

  For financial reporting purposes, *the entity's risk assessment process includes how management* ***identifies business risks relevant to the preparation of financial statements*** *in accordance with the entity's applicable financial reporting framework, estimates their* ***significance, assesses the likelihood of their occurrence, and decides upon actions to respond*** *to and manage them and the results thereof.*

  For example, the entity's risk assessment process may address how the entity considers the possibility of unrecorded transactions or identifies and analyses significant estimates recorded in the financial statements. (E.g., Business Risk of Product Warranties, Guarantees leading to RMM in Financial Statements)

- ***Can be internal or external / management's plans to mitigate.***

  Risks relevant to reliable financial reporting include external and internal events, transactions or circumstances that may occur and adversely affect an entity's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Management may initiate plans, programs, or actions to address specific risks or it may decide to accept a risk because of cost or other considerations.

Risks can arise or change due to circumstances such as the following:(Shortcut PFA – TRAGIC risk assessment)

(a) New Personnel. *New personnel may have a different focus on or understanding of internal control.*

(b) Expanded Foreign operations. *The expansion or acquisition of foreign operations carries new and often unique risks that may affect internal control, for example, additional or changed risks from foreign currency transactions.*

(c) New Accounting pronouncements. *Adoption of new accounting principles or changing accounting principles may affect risks in preparing financial statements*

(d) New Technology. *Incorporating new technologies into production processes or information systems may change the risk associated with internal control.*

(e) Changes in Regulatory or operating environment. *Changes in the regulatory or operating environment can result in changes in competitive pressures and significantly different risks. (E.g. Change in NPA Norms, Change in Loan Processing System Etc.)*

(f) New business models, products, or Activities. *Entering into business areas or transactions with which an entity has little experience may introduce new risks associated with internal control.*

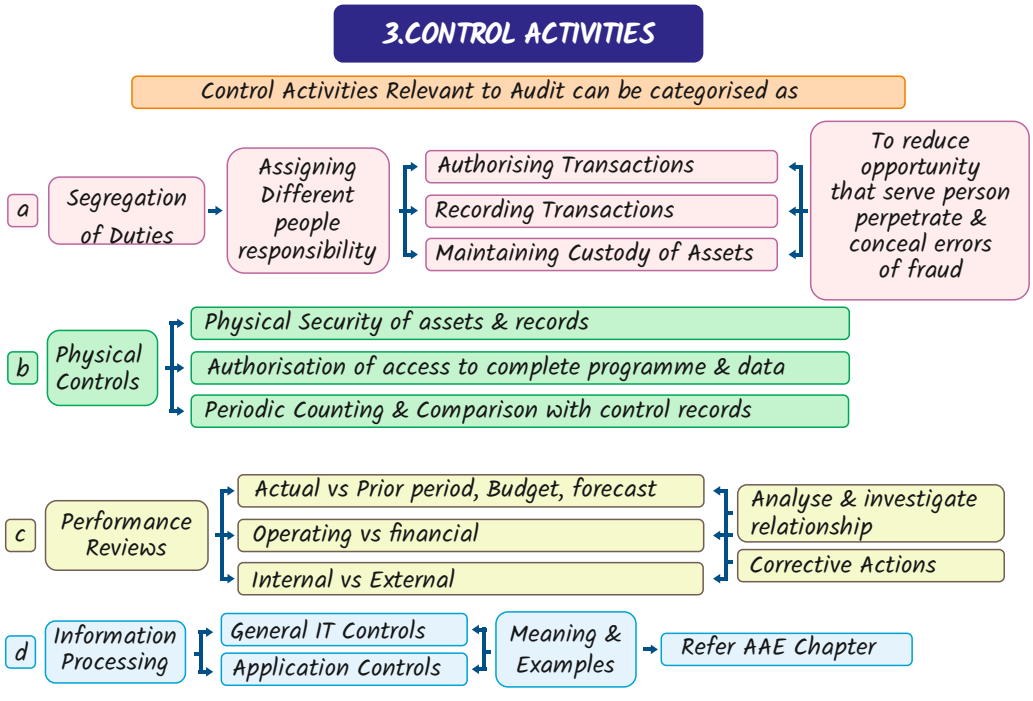
(g) Rapid Growth. *Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.*

(h) New or revamped Information systems. *Significant and rapid changes in information systems can change the risk relating to internal control.*

(i) Corporate restructurings. *Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with internal control.*

(CNO—SA315-ICS.100) CONTROL ACTIVITIES- COMPONENT OF INTERNALCONTROL (MCQ-315.1/315.4/315.6/315.7)

Chart



Generally, control activities that may be relevant to an audit may be categorised as policies and procedures that pertain to the following:

(a) Segregation of duties:

Assigning different people, the responsibilities of authorising transactions, recording transactions, and maintaining custody of assets. Segregation of duties is intended to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of the person's duties.

(b) Physical controls:

Controls that encompass:

--The physical security of assets, including adequate safeguards such as secured facilities over access to assets and records.

--The authorisation for access to computer programs and data files.

--The periodic counting and comparison with amounts shown on control records (for example, comparing the results of cash, security and inventory counts with accounting records). The extent to which physical controls intended to prevent theft of assets are relevant to there liability of financial statement preparation, and therefore the audit, depends on circumstances such as when assets are highly susceptible to misappropriation.

(c) Performance reviews:

These control activities include reviews and analyses of actual performance versus budgets, forecasts, and prior period performance; relating different sets of data – operating or financial – to one another, together with analyses of the relationships and investigative and corrective actions; comparing internal data with external sources of information; and review of functional or activity performance.

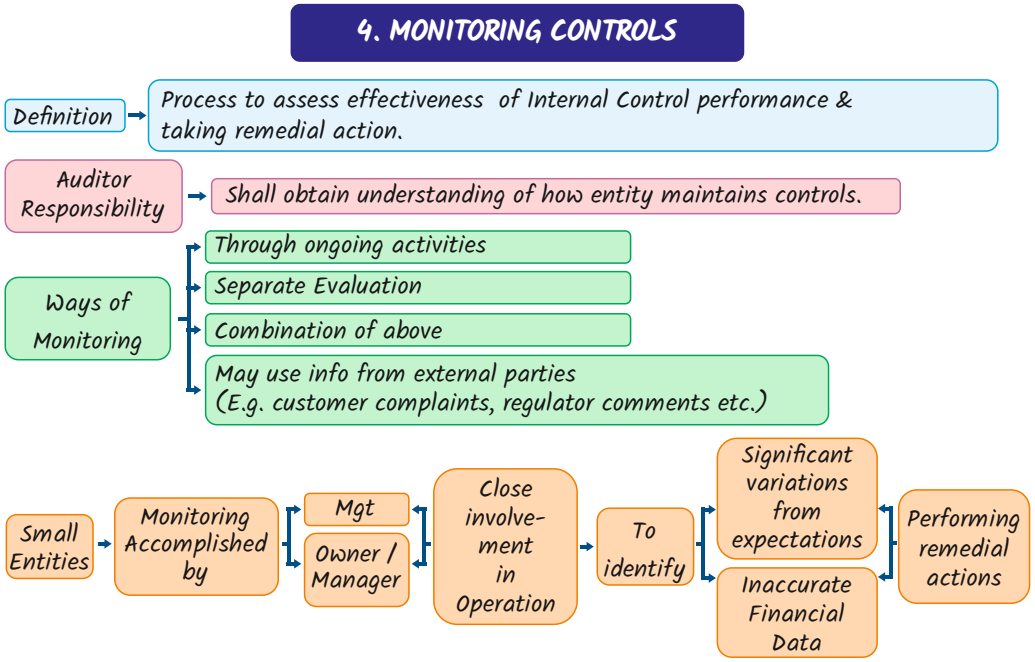
(d) Information processing:

The two broad groupings of information systems control activities are application controls, which apply to the processing of individual applications, and generalIT-controls, which are policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. Examples of application controls include checking the arithmetical accuracy of records, maintaining and reviewing accounts and trial balances, automated controls such as edit checks of input data and numerical sequence checks, and manual follow-up of exception reports. Examples of general IT-controls are program change controls, controls that restrict access to programs or data, controls over the implementation of new releases of packaged software applications, and controls over system software that restrict access to or monitor the use of system utilities that could change financial data or records without leaving an audit trails.

Certain control activities may depend on the existence of appropriate higher-level policies established by management or those charged with governance. For example, authorisation controls may be delegated under established guidelines, such as, investment criteria set by those charged with governance; alternatively, non-routine transactions such as, major acquisitions or divestments may require specific high-level approval, including in some cases that of shareholders.

(CNO—SA315-ICS.140) MONITORING OF CONTROLS- COMPONENT OF INTERNAL CONTROL

Chart

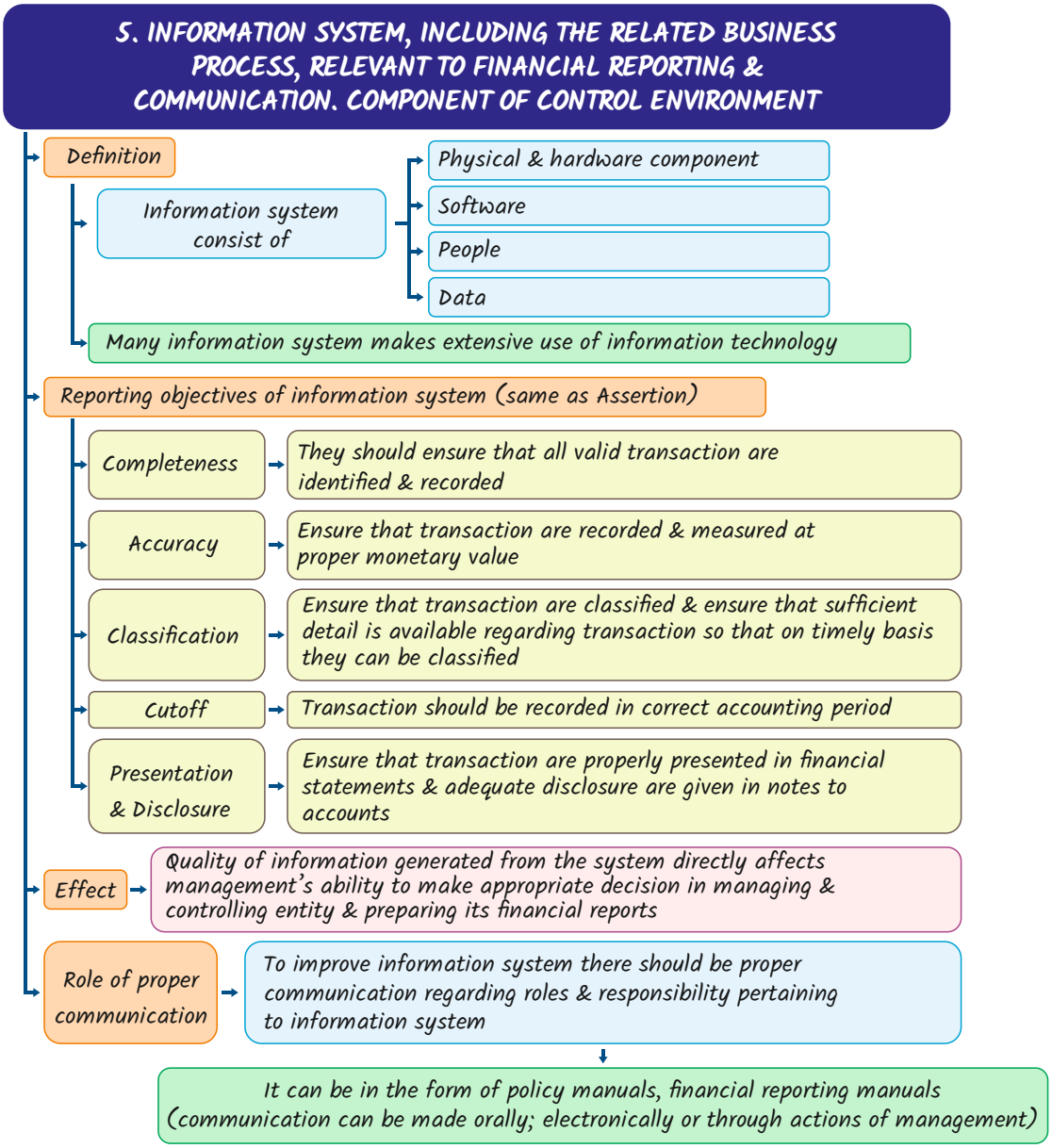


The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting.

- **Monitoring of controls Defined:** Monitoring of controls is a process to assess the e ectiveness of internal control performance overtime.
- **Helps in assessing the eFfectiveness of controls on a timely basis:** It involves assessing the eFfectiveness of controls on a timely basis and taking necessary remedial actions.
- **Management accomplishes through ongoing activities, separate evaluations etc.:** Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.
- **Management's monitoring activities include:** Management's monitoring activitiesmayincludeusinginformationfromcommunicationsfromexternal parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.
- **In case of Small Entities:** Management's monitoring of control is often accomplished by management's or the owner-manager's close involvement in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to remedial action to the control.

(CNO—SA315-ICS.120) THE INFORMATION SYSTEM, INCLUDING THE RELATED BUSINESS PROCESSES, RELEVANT TO FINANCIAL REPORTING AND COMMUNICATION– COMPONENT OF CONTROL ENVIRONMENT

Chart



An information system consists of infrastructure (physical and hardware components), software, people, procedures, and data. Many information systems make extensive use of information technology (IT).

The information system relevant to financial reporting objectives, which includes the financial reporting system, encompasses methods and records that:

(a) Identify and record **all valid transactions. (Completeness)**

(b) Describe on a timely basis the transactions in sufficient detail to permit proper **classification of transactions** for financial reporting. (Classification)

(c) **Measure the value of transactions** in a manner that permits recording their proper monetary value in the financial statements. **(Accuracy)**

(d) Determine the time period in which transactions occurred to permit recording of transactions in the **proper accounting period. (Cut off)**

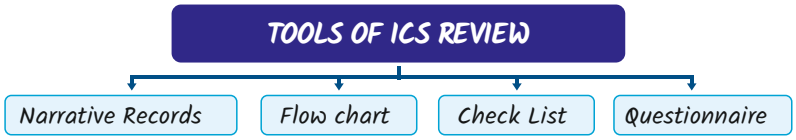
(e) **Present properly the transactions and related disclosures** in the financial statements. **(Presentation & Disclosure)**

The quality of system-generated information **affects management's ability to make appropriate decisions in managing and controlling the entity's activities and to prepare reliable financial reports.**

Communication, which involves **providing an understanding of individual roles and responsibilities** pertaining to internal control over financial reporting, may take such forms as policy manuals, accounting and financial reporting manuals, and memoranda. Communication also can be made electronically, orally, and through the actions of management.

(CNO—SA315-ICS.160) TOOLS FOR INTERNAL CONTROL REVIEW

Chart

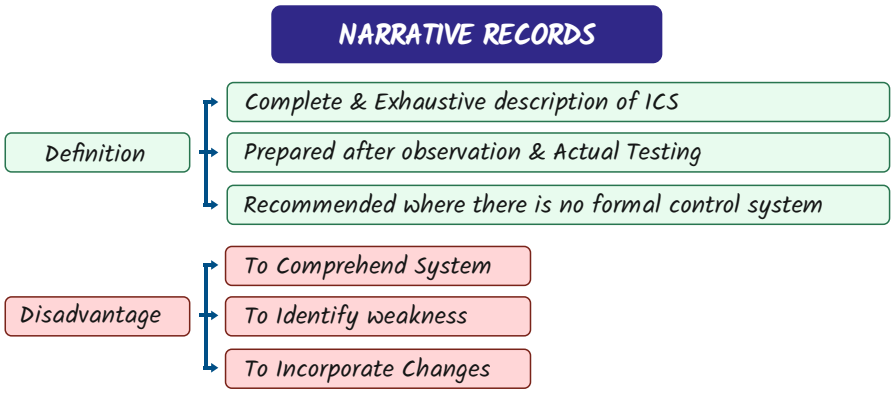


To facilitate the accumulation of the information necessary for the proper review and evaluation of internal controls, the auditor can use one of the following to help him to know and assimilate the system and evaluate the same:

- **Narrative record;**
- **Flow chart.**
- **Check List;**
- **Questionnaire;**

(CNO—SA315-ICS.180) THE NARRATIVE RECORD

Chart



- This is a **complete and exhaustive description** of the system as found in operation by the auditor.
- Actual testing and observation are necessary before such a record can be developed.
- It may be **recommended in cases where no formal control system** is in operation and would be more suited to small business.

The basic disadvantages of narrative records are:

- To **comprehend the system in operation is quite difficult.**
- To **identify weaknesses or gaps in the system.**
- To incorporate **changes arising on account of reshuffling of manpower, etc.**

Example of Narrative Records

Collection can happen in the form of cash sales, cash collection after credit sales, collection through cheques, collection through online bank account.

In cash sales Ramesh first prepares sales invoice. Then at next counter suresh collects money and issues receipt to customer. Then on the basis of carbon copies mahesh posts collection in C&B book, then ganesh does posting on the basis of this primary books.

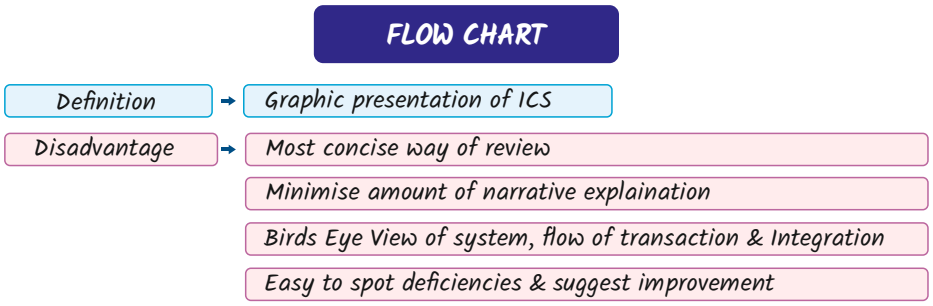
In cash collection after sales, customer directly goes to Suresh and above procedure continues.

In case of cheques, Sonia Receives all cheques & opens daily posts and segregates all cheques. She makes list of all cheques received during the day. Monica prepares deposits slips and raghu office boy deposits them and get stamp in counter foil. Mahesh passes entries on the basis of these deposit slips and same process as above continues

In online money transfer. Clients informs debtor manager Rakesh through email. Rakesh forwards email to Jainesh who has bank access. and Mahesh will continue same process as above

(CNO—SA315-ICS.200) FLOW CHART (QNO 168.000)

Chart

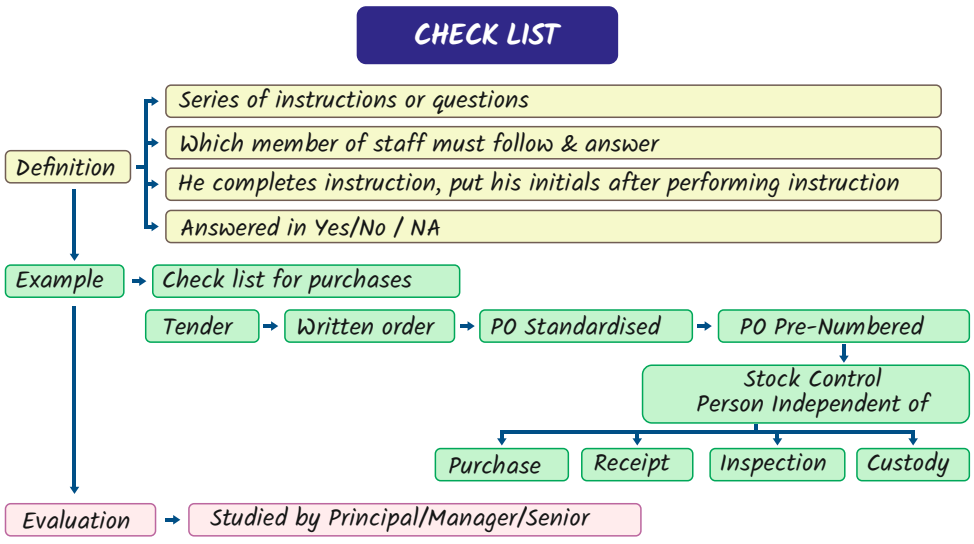


- **It is a graphic presentation of each part of the company's system** of internal control. A flow chart is considered to be the most concise way of recording the auditor's review of the system.
- It minimises the amount of narrative explanation and thereby achieves a consideration or presentation not possible in any other form.

It gives bird's eye view of the system and the flow of transactions and integration and in documentation, **can be easily spotted and improvements can be suggested.**

(CNO—SA315-ICS.220) CHECK LIST

Chart



- This is a series of ***instructions and/or questions which a member of the auditing staff must follow and/or answer.***
- When he completes instruction, he initials the space against the instruction.
- Answers to the check list instructions are ***usually Yes, No or Not Applicable.*** This is again an on the job requirement and instructions are framed having regard to the desirable elements of control.

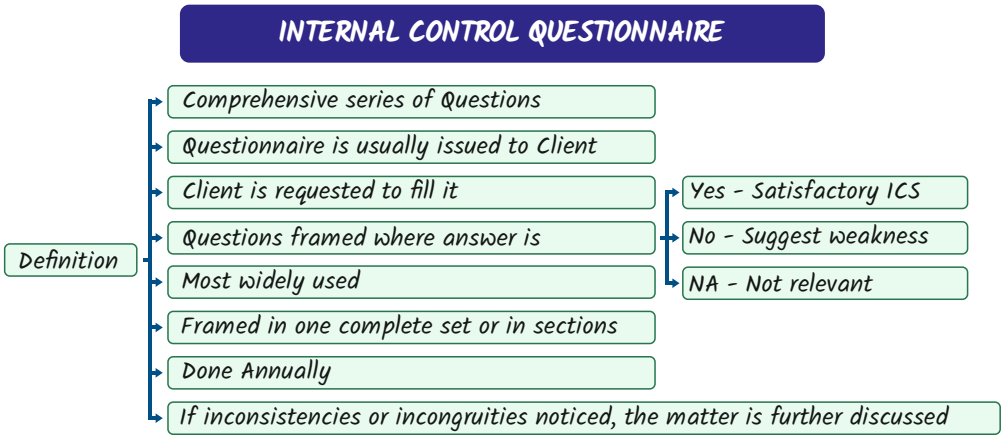
A few examples of check list instructions are given hereunder

- Are tenders called before placing orders?
- Are the purchases made on the basis of a written order?
- Is the purchase order form standardised?
- Are purchase order forms pre-numbered?
- Are the stock control accounts maintained by persons who have nothing to do with:
  - custody of work;
  - receipt of stock;
  - inspection of stock; and
  - Purchase of stock?

The complete check list is studied by the Principal/Manager/Senior to ascertain existence of internal control and evaluate its implementation and efficiency.

(CNO—SA315-ICS.240) INTERNAL CONTROL QUESTIONNAIRE (MCQ – 315.16)

Chart



- ***The questionnaire is usually issued to the client*** and the client is requested to get it filled by the concerned executives and employees.
- In the questionnaire, generally questions are so framed that a ***'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness.*** Provision is made for an explanation or further details of 'No' answers. In respect of questions not relevant to the business, 'Not Applicable' reply is given.
- This is a ***comprehensive series of questions*** concerning internal control.
- This is the ***most widely used form for collecting information*** about the existence, operation and efficiency of internal control in an organisation.
- With a proper questionnaire, all internal control evaluation can be ***completed at one time or in sections.***
- ***It*** is the general practice to ***review the internal control system annually and record the review in detail.***
- If on a perusal of the answers, ***inconsistencies or apparent incongruities are noticed, the matter is further discussed*** by auditor's staff with the client's employees for a clear picture.
- The concerned auditor then prepares a report of deficiencies and recommendations for improvement.

Example

Sr No	Question	Not Applicable	Yes	No	Elaborate	Remarks
1	Do you think your collection system is deficiency free?					
2	Whether all collections transactions are real and they have occurred?					
3	Whether transactions recorded promptly?					
4	Whether transactions recorded accurately?					
5	Whether transactions are recorded in current account?					
6	Whether transactions are recorded in current period?					

(CNO—SA315-ICS.250) BASIC ASSUMPTIONS ABOUT ELEMENTS OF GOOD CONTROL WHILE USING ICQ

Discussion

In the use of standardized internal control questionnaire, certain basic assumptions about elements of good control are taken into account. These are -

- Certain procedures in general used by most business concerns are essential in achieving reliable internal control. This is a time-tested assumption. Deposit into bank of the entire receipts of a day or daily balancing of the cash book and ledgers or periodic reconciliation with the control accounts are examples of widely used practices which are considered good internal control practices. Besides, basic operations giving rise to these practices exist in all businesses irrespective of their nature.
- Organisations are such that permit an extensive division of duties and responsibilities. The larger the organisation, the greater is the scope of such division.
- Employees concerned with accounting function are not assigned any custodial function.
- No single person is thrust with the responsibility of completing a transaction all by himself.
- There should always be evidence to identify the person who has done the work whether involving authorisation, implementation or checking.
- The work performed by each one is expected to come under review of another in the usual course of routine.
- There is proper documentation and recording of the transactions

(CNO—SA315-ICS.255) Distinction between internal control questionnaire and check list

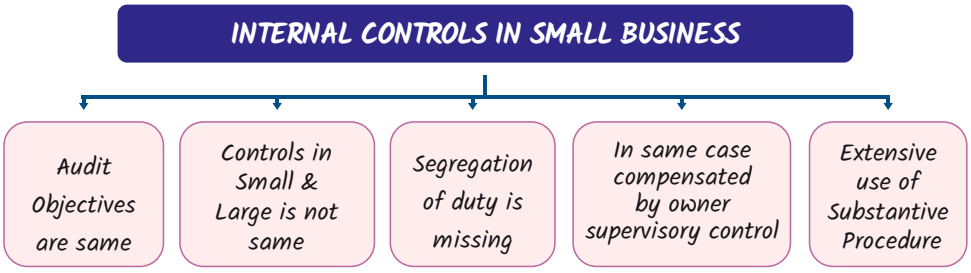
Discussion

The basic distinction between internal control questionnaire and check list are as under:

- The ICQ incorporates a large number of detailed questions but the check list generally contains questions relating to the main control objective with the area under review.
- ICQ, the weaknesses are highlighted by the 'Yes' while in the check list, it is indicated by 'No'.
- The significance of 'No' in an ICQ does indicate a weakness but the significance of that weakness is not revealed automatically. However, in the check list, a specific statement is required where an apparent weakness may prove to be material in relation to the accounts as a whole.

(CNO—SA315-ICS.260) INTERNAL CONTROL IN SMALL BUSINESS

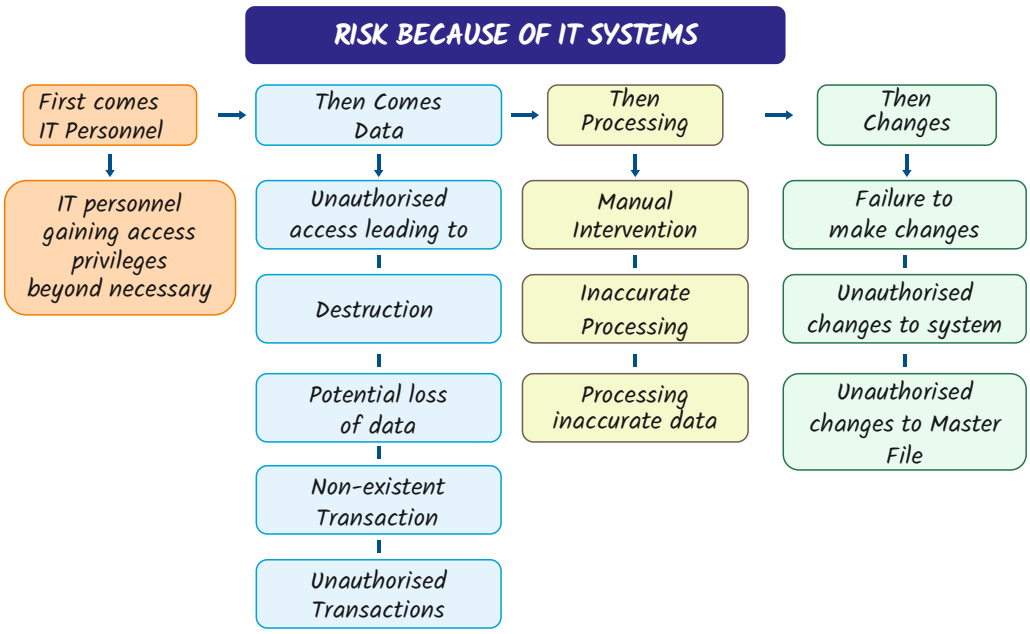
Chart



Audit objectives are Same	The auditor needs to obtain the same degree of assurance in order to give an unqualified opinion on the financial statements of both small and large entities.
Controls in Small & Large are not Same	However, many controls which would be relevant to large entities are not practical in the small business
Example: – Segregation of Duty	For example, in small business, accounting work may be performed by only a few persons. These persons may have both operating and custodial responsibilities, and segregation of functions may be missing or severely limited. Inadequate segregation of duties may, in some cases, be offset by owner/manager supervisory controls which may exist because of direct personal knowledge of the business and involvement in the business transactions.
Extensive use of substantive procedures	In circumstances where segregation of duties is limited, or evidence of supervisory controls is lacking, the evidence necessary to support the auditor's opinion on the financial information may have to be obtained largely through the performance of substantive procedures
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(CNO—SA315-ICS.280) RISKS BECAUSE OF IT SYSTEMS (QNO-37.000)

Chart



IT system also poses specific risks to an entity's Internal Control. They are–

(First Comes IT Personnel)

- **IT Personnel gaining access, Privileges beyond necessary**
  - The possibility of **IT personnel gaining access privileges** beyond those necessary to perform their assigned duties thereby breaking down segregation of duties. (Approved Purchase & Payment)

(Then comes Data)

- ***Unauthorised Access to Data leading to destruction, unauthorised transaction, non-existent transaction / Potential loss of Data***
  - *Unauthorised* ***access to data*** *that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.*
  - ***Potential loss of data or inability to access data as required. (Ransomware)***

(Then happened processing)

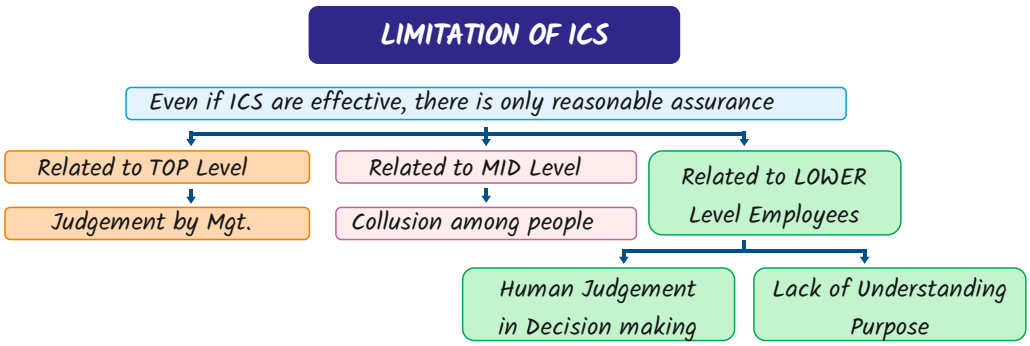
- ***Manual Intervention / Inaccurate Processing / Processing Inaccurate Data***
  - ***Inappropriate manual intervention.***
  - *Reliance on systems or programs that are* ***inaccurately processing data, processing inaccurate data,*** *or both. (TDS Calculator / NPA Calculator)*

(If required Changes)

- ***Failure to make Changes / Unauthorised changes to systems / Unauthorised changes to Master Files***
  - ***Failure*** *to make necessary* ***changes to systems or programs.*** *(Boss shifted to Office 365, Rest of the office on Office 2007)*
  - *Unauthorised* ***changes to systems or programs.***
  - *Unauthorised* ***changes to data in master*** *files.*
  -
  -

(CNO—SA315-ICS.300) LIMITATIONS OF INTERNAL CONTROL (QNO 170.000 / MCQ— 315.17)

Chart



Internal control can provide only reasonable assurance

Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by inherent limitations of internal control.

Judgements by Management (Top Level)

Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.
Management's consideration that the cost of an internal control does not exceed the expected benefits to be derived.
The possibility that a person responsible for exercising an internal control could abuse that responsibility, for example, a member of management overriding an internal control.

Collusion among People (Mid-Level)

Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.

Manipulations by management with respect to transactions or estimates and judgements required in the preparation of financial statements.

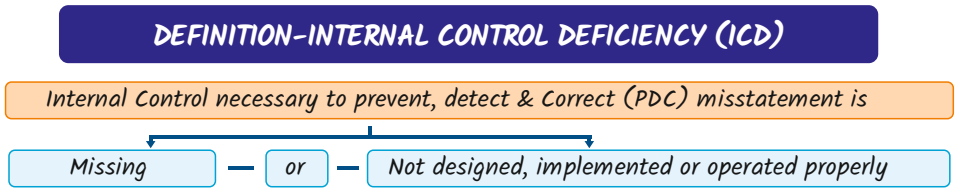
Human judgment indecision-making (Lower Level)	*Realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error* *The fact that most internal controls do not tend to be directed at transactions of unusual nature.*
Lack of understanding the purpose (Lower Level)	*Equally, the operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.*
Limitations in case of Small Entities	*Smallerentitiesoftenhavefeweremployeesduetowhichsegregationofdutiesis not practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more e ective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties.* *On the other hand, the owner-manager may be more able to override controls becausethesystemofinternalcontrolislessstructured.Thisistakenintoaccount by the auditor when identifying the risks of material misstatement due to fraud.*

UNIQUE MCQS	
MCQ No.	*315.10 / Incs.35.1 /Incs.35.2*

Part 2 – [SA 265] COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT

(CNO--SA265.020) DEFINITION OF INTERNAL CONTROL DEFICIENCY

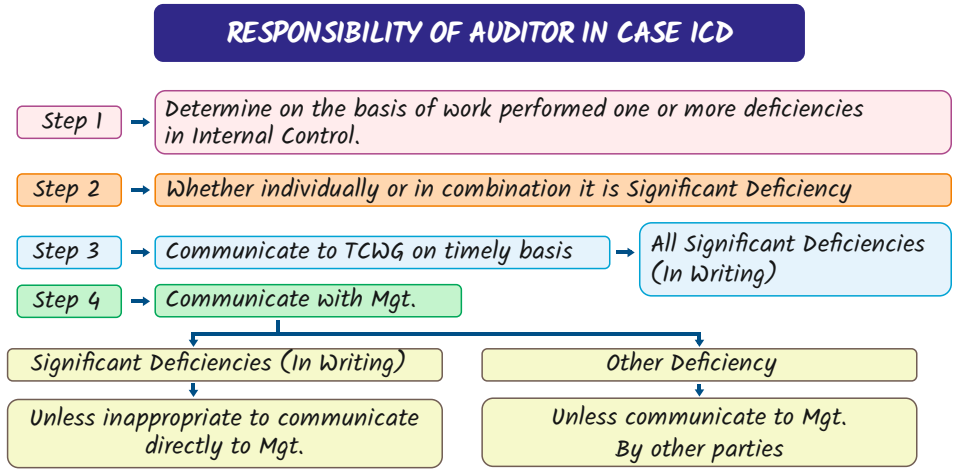
Chart



- **Deficiency in internal control— This exists when:**
  - A control necessary to prevent, or detect and correct, misstatements in the financial statements on a **timely basis is missing.**
    (E.g., No one checks status of goods in transit before finalising financial statements)
  - A control is designed, implemented or operated in such a way that it is unable to prevent, or **detect and correct,** misstatements in the financial statements on a timely basis; or
    (E.g., No prevention No approval required to place purchase order, E.g. No DetectionNo GRN when goods received, E.g. No CorrectionNo physical verification to identify & return or write off such stock)

(CNO--SA265.040) WHAT IS RESPONSIBILITY OF AUDITOR IF HE IDENTIFIES INTERNAL CONTROL DEFICIENCY?

Chart (MCQ-Incs.52.4)



Responsibility to Communicate Not to Perform additional procedures

This Standard on Auditing (SA) deals with the auditor's responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements. The objective of the auditor is to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

This SA does not impose additional responsibilities on the auditor regarding obtaining an understanding of internal control and designing and performing tests of controls over and above the requirements of SA 315 and SA 330.

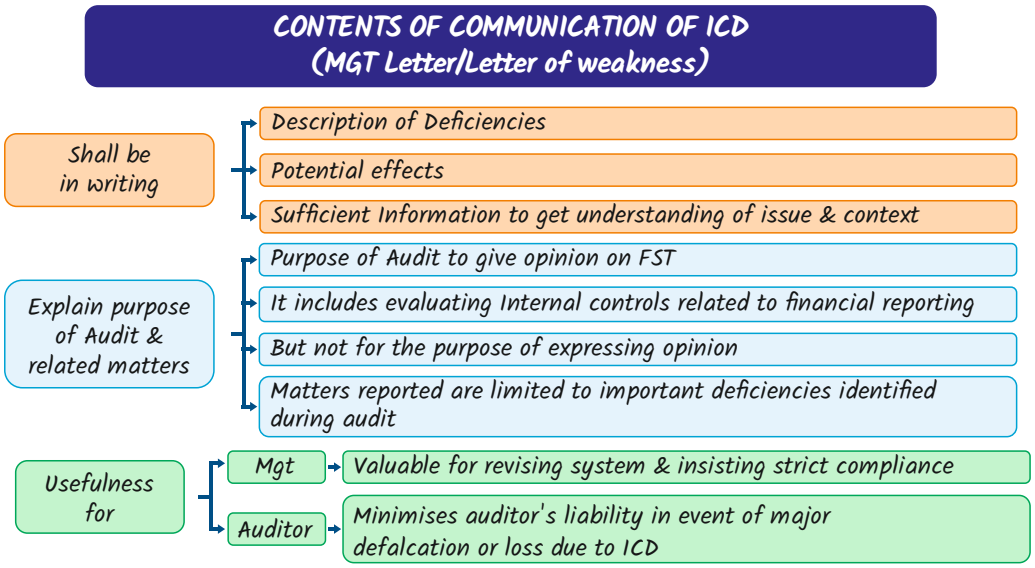
Step 1 Identify Deficiency

The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control.
If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed.

Step 2 Is it Significant Deficiency or Other Deficiency?	Whether, ***individually or in combination, they constitute significant deficiencies.*** (No approval before purchase is a significant deficiency as quantity / rate / quality / specification can go wrong having material impact on purchases, but not maintaining records for drums received through purchases which are scrapped)
Step 3 Communicate to TCWG (MCQ-265.2)	The auditor shall ***communicate in writing significant deficiencies*** in internal control identified during the audit to ***those charged with governance on a timely basis.***
Step 4 Communicate to Management	The auditor shall also communicate to ***management at an appropriate level of responsibility on a timely basis:*** ➢ ***In writing, significant deficiencies*** in internal control that the auditor has communicated or intends to communicate to those charged with governance, ***unless it would be inappropriate to communicate directly to management in the circumstances;*** and (Don't inform if management is also involved) ***Other deficiencies*** in internal control identified during the audit that have ***not been communicated to management by other parties*** and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention. (if already covered in internal auditor report then no need to communicate again)

(CNO--SA265.060) WHAT SHOULD BE CONTENTS OF LETTER EXPLAIN INTERNAL CONTROL DEFICIENCY? (QNO-26.000)

Chart



The auditor shall ***include in the written communication*** of significant deficiencies in internal control:

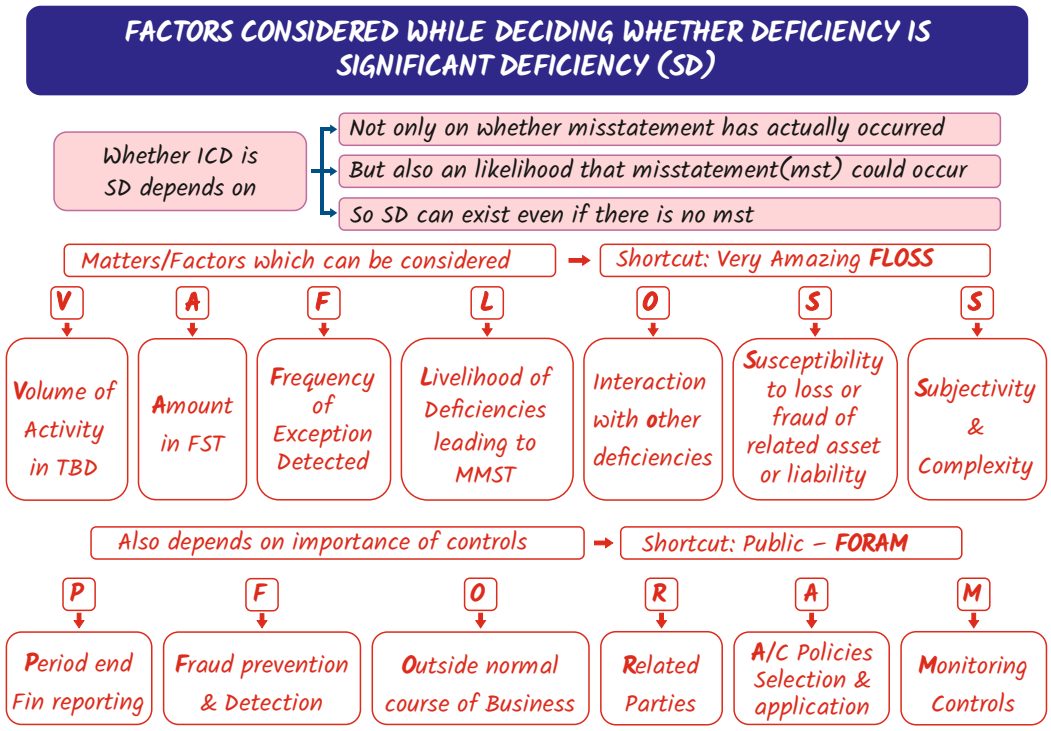
- A ***description of the deficiencies*** and an explanation of their ***potential effects;*** and
- ***Sufficient information*** to enable those charged with governance and management to understand the context of the communication.

In particular, the auditor ***shall explain*** that:

- The ***purpose of the audit*** was for the auditor to express an ***opinion on the financial statements;***
- The audit included consideration of ***internal control relevant to the preparation of the financial statements*** in order ***to design audit procedures*** that are appropriate in the circumstances, ***but not for the purpose of expressing an opinion on the effectiveness of internal control;*** and
- The matters being reported are ***limited to those deficiencies that the auditor has identified*** during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.

(CNO--SA265.080) FACTORS CONSIDERED WHILE DECIDING WHETHER DEFICIENCY IS SIGNIFICANT DEFICIENCY? (QNO-27.000)

Chart



Misstatement not necessary

The significance of a deficiency or a combination of deficiencies in internal control depends **not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude of the misstatement. Significant deficiencies may therefore exist even though the auditor has not identified misstatements during the audit.**

Examples

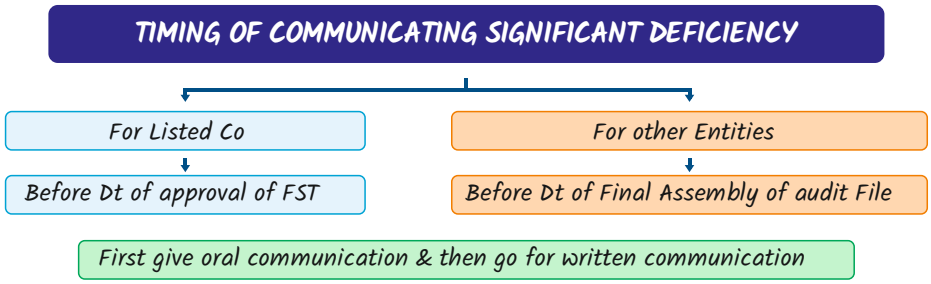
- Examples of matters that the auditor may consider in determining whether deficiency or combination of deficiencies in internal control constitutes a significant deficiency include: Very Amazing FLOSS

➢ The Volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.	(Coal is purchased 5 times in a week, wooden blocks are purchased once a week)
➢ The financial statement Amounts exposed to the deficiencies	(Coal accounts for 80% of fuel while wooden blocks account for 5% of fuel)
➢ The cause and Frequency of the exceptions detected as a result of the deficiencies in the controls.	(Many misstatements in past, with respect to coal)
➢ The Likelihood of the deficiencies leading to material misstatements in the financial statements in the future.	(if purchase system are weak notorious employees will quickly take advantage)
➢ The interaction of the deficiency with Other deficiencies in internal control.	(There is no fixed policy of coal quality assessment & there is no experienced, knowledgeable supervisor also)
➢ The Susceptibility to loss or fraud of the related asset or liability.	(Moisture level in coal has huge impact on coal weight as compared to wooden blocks)
➢ The Subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates	(Quality determination is difficult in coal as compared to wooden blocks)

- The **importance of the controls** to the financial reporting process; for example:
  - Controls over **significant transactions with related parties.**
  - Controls over significant transactions **outside the entity's normal course of business.**
  - Controls over the **prevention and detection of fraud.**
  - Controls over the **selection and application of significant accounting policies.**
  - Controls over the **period-end financial reporting process** (such as controls over non-recurring journal entries).
  - General **monitoring controls** (such as oversight of management).

(CNO--SA265.100) TIMING OF COMMUNICATING SIGNIFICANT DEFICIENCY (MCQ— Incs.34.3)

Chart



Discussion

- In determining when to issue the written communication, the auditor may consider whether receipt of such communication would be an important factor in enabling those charged with governance to discharge their oversight responsibilities. In addition, in case of listed entities, those charged with governance may need to receive the auditor's written communication before the date of approval of the financial statements in order to discharge specific responsibilities in relation to internal control for regulatory or other purposes. For other entities, the auditor may issue the written communication at a later date.

- Nevertheless, in the latter case, as the auditor's written communication of significant deficiencies forms part of the final audit file, the written communication is subject to the overriding requirement for the auditor to complete the assembly of the final audit file on a timely basis. SA 230 states that an appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.
- A14. Regardless of the timing of the written communication of significant deficiencies, the auditor may communicate these orally in the first instance to management and, when appropriate, to those charged with governance to assist them in taking timely remedial action to minimize the risks of material misstatement. Doing so, however, does not relieve the auditor of the responsibility to communicate the significant deficiencies in writing, as this SA requires.

UNIQUE MCQS

MCQ No.	265.3

PART 3 – OTHER CONCEPTS

(CNO—CH30C.020) STEPS FOR RISK IDENTIFICATION (QNO – 163,500)

Inherent Risks	➢ Consider the existence of any particular characteristics (inherent risks) in the class of transactions, account balance or disclosure that need to be addressed in designing further audit procedures. Consider any unique characteristics of the risk. ➢ Examples could include high value inventory, complex contractual agreements, absence of a paper trail on certain transaction streams or a large percentage of sales coming from a single customer.
Nature of Controls	➢ Consider the **nature of the internal control system** in place and its possible effectiveness in mitigating the risks involved. ▪ Ensure the controls : ▾ Routine in nature **(occur daily)** or periodic such as monthly. ▾ Designed to **prevent or detect and correct** errors. ▾ **Manual or automated.**
Impact on Assertions	➢ Consider the impact of the risk on each of the assertions (completeness, existence, accuracy, validity, valuation and presentation) relevant to the account balance, class of transactions, or disclosure.
Likelihood of Risk	➢ Determine the **likelihood for assessed risk** to occur and its impact on our auditing procedures.
Significance of Risk	➢ Assess the **significance of the assessed risk,** impact of its occurrence and also **revise the materiality** accordingly for the specific account balance.
Degree of significant risks that required separate attention	➢ Identify the degree of **Significant risks** that would require separate attention and response by the auditor. Planned audit procedures should directly address these risks.
Document	➢ **Document** the assertions that are effected.
Manageme-nt's Response	➢ Enquire and document the **management's response.**

(CNO—CH30C.040) POSSIBLE POTENTIAL MISSTATEMENTS – INDICATORS

Completeness	➢ Transactions not identified. ➢ Source documents not prepared. ➢ Source documents not captured. ➢ Rejected source documents not represented
Existence	➢ Fictitious or Unauthorised transactions entered on source documents. ➢ Source documents overstated. ➢ Transactions duplicated on source documents. ➢ Capture of source documents duplicated. ➢ Invalid source documents captured on subsidiary ledgers.
Recording	➢ Source Documents captured inaccurately. ➢ Processing of transactions is inaccurate. ➢ Inaccurate Adjustments made in subsidiary ledgers.
Cut-Off Procedures	➢ Transactions that occur in one period are recorded in another period

(CNO—CH3OC.060) GENERAL STEPS IN THE CONDUCT OF RISK BASED AUDIT (QNO - 162.000 / 163.000)

Concept of RBA

- ***Auditor's Objective***

  The auditor's objective in a risk-based audit is to obtain reasonable assurance that no material misstatements whether caused by fraud or errors exist in the financial statements.

- ***3 Key Steps***

  This involves the following three key steps:
  - ***Assessing the risks of material misstatement** in the financial statements*
  - ***Designing and performing further audit procedures** that respond to assessed risks and reduce the risks of material misstatements in the financial statements to an acceptably low level; and*
  - *Issuing an **appropriate audit report** based on the audit findings.*

- ***3 Phases***

  The risk-based audit process is presented in three distinct phases:
  - *Risk assessment.*
  - *Risk response; and*
- *Reporting.*

Risk Assessment

The risk assessment phase of the audit involves the following steps:

- ***Acceptance or Continuance***

  *Performing **client acceptance or continuance** procedures.*

- ***Planning***

  ***Planning** the overall engagement.*

- ***Understanding Business***

  *Performing risk assessment procedures to **understand the business and identify inherent and control risks.***

- ***Relevant Controls***

  *Identifying **relevant internal control procedures** and assessing their design and implementation (those controls that would prevent material misstatements from occurring or detect and correct misstatements after they have occurred).*

- ***Financial Statement Level Vs Assertion Level***

  ***Assessing the risks** of material misstatement in the financial statements.*

  ***Making an informed assessment** of the risks of material misstatement at the financial statement level and at the assertion level.*

- ***Significant Risk***

  *Identifying **the significant risks** that require special audit consideration and those risks for which substantive procedures alone are not sufficient.*

- ***Communication***

  ***Communicating any material weaknesses** in the design and implementation of internal control to management and those charged with governance; and*

Risk / Response

This phase of the audit is to design and perform further audit procedures that respond to the assessed risks of material misstatement and will provide the evidence necessary to support the audit opinion

Some of the matters the auditor should consider when planning the audit procedures include:

- ***Audit procedures designed** to address the assessed risks could include a mixture of:*
  - *Tests of the operational effectiveness of internal control; and*

- Substantive procedures such as tests of details and analytical procedures.

- The need to perform further audit procedures to **address the potential for management override of controls or other fraud scenarios.**
- Existence of **internal control** that, if tested, could reduce the need / scope for other substantive procedures.
- The potential for **substantive analytical procedures** that would reduce the need/scope for other types of procedures.
- Assertions that **cannot be addressed by substantive procedures alone.** This can occur where there is highly automated processing of transactions with little or no manual intervention.
- The need to perform **specific procedures to address ,,significant risks†** that have been identified.
- The need to incorporate an **element of unpredictability** in procedures performed

Reporting

The final phase of the audit is to assess the audit evidence obtained and determine whether it is sufficient and appropriate to reduce the risks of material misstatement in the financial statements to an acceptably low level.

It is important at this stage to determine:

- If there had been a **change in the assessed level of risk;**
- Whether **conclusions** drawn from work performed are appropriate; and
- If **any suspicious circumstances** have been encountered.
- **Any additional risks** should be appropriately assessed, and further audit procedures performed as required.
- When **all procedures have been performed and conclusions reached:**
- **Audit findings** should be reported to management and those charged with governance; and
- **An audit opinion** should be formed, and a decision made on the appropriate wording for the auditor's report.

(CNO--CH30C.070) INTERNAL CONTROL STRUCTURE (QNO - 40.120)

The Internal Control structure in an organization is referred to as the policies and procedures established by the entity to provide reasonable assurance that the objectives are achieved. The control structure in an organization basically has the following components:



Control Environment 1

Control environment covers the effect of various factors like management **attitude; awareness and actions for establishing, enhancing or mitigating the effectiveness of specific policies and procedures.**

Accounting System 3

Accounting system means the series of task and records of an entity by which **transactions are processed for maintaining financial records.** Such system identifies, assemble, analyze, calculate, classify, record, summarize and report transactions and other events.

Control Procedure 2

Policies and procedures means those policies and procedures **in addition to the control environment and accounting systems which the management has established to achieve the entity's specific objectives.**

In this regard, the management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent that they are appropriate to the size and nature of the business. There should be reasonable assurance for the auditor that the accounting system is adequate and that all the accounting information required to be recorded has in fact been recorded.

(CNO—CH30C.080) OBJECTIVES OF INTERNAL CONTROL SYSTEM

Discussion

The objectives of internal control systems are determined by the management, after considering the nature of business, scale operations, the extent of professionalism of the management etc.

The objectives of internal controls relating to the accounting system are:

- Transactions are executed through general or specific management authorization.
- All transactions are promptly recorded in an appropriate manner to permit the preparation of financial information and to maintain accountability of assets.
- Assets and records are safeguarded from unauthorized access, use or disposition.
- Assets are verified at reasonable intervals and appropriate action is taken with regard to the discrepancies.

(CNO—CH3OC.100) ACCOUNTING CONTROL OBJECTIVES (QNO - 165.100 / 168.018)

Discussion

The basic accounting control objectives which are sought to be achieved by any accounting control system are:

Ensure all transactions are

- Recorded
- Real
- Properly Valued
- Recorded Timely
- Properly Posted
- Properly Classified and Disclosed
- Properly Summarized

(CNO—CH3OC.140) STRUCTURE OF INTERNAL CONTROL (IMPORTANT CONTROL ACTIVITIES)

Segregation of duties
2
(MCQ—Incs.17.3 / Incs.17.5)

In order to achieve the objectives of internal controls, it is necessary to establish adequate control policies and procedures. Most of these policies and procedures cover:

- Transaction processing is allocated to different persons in such a manner that **no one person can carry through the completion of a transaction from start to finish or the work of one person is made complimentary to the work of another person.** The purpose is to minimize the occurrence of fraud and errors and to detect them on a timely basis, when they take place. The following functions are segregated
  - **authorization** of transactions;
  - **execution** of transactions;
  - physical **custody of related assets;** and
  - maintenance of **records and documents,** while allocating duties, the **considerations of cost and efficacy** should be kept in mind as there is a tendency to stretch the allocation of tasks involved in a job to more persons than what is required resulting in cumbersome procedures, overelaboration of records and unduly high cost of administration.
- Apart from segregation of duties, **periodic rotation of duties of personnel is also desirable.** The rotation of duties seeks to ensure that if a fraud and error is committed by a person, it does not remain undetected for long. It also ensures that a person cannot develop vested interest by holding a position for too long. Rotation of duties also ensures that each employee keeps his work up to date. This also makes an employee to be careful because he is aware that his performed tasks will be reviewed by others when duties are rotated.

Authorization of Transaction
3

Delegation of authority to different levels and to particular persons are required to establish by the management for **controlling the execution of transaction in accordance with prescribed conditions. Authorization may be general, or it may be specific** with reference to a single transaction. It is necessary to establish procedures which provide assurance that authorizations are issued by persons acting within the scope of their authority, and that the transactions conform to the terms of the authorizations. **This objective can be achieved by making independent comparison of transaction document with general or specific authorizations, as the case may be.**

Adequacy of Records and Documents – Accounting controls should ensure that 4	• Transactions are executed in accordance with management's general or specific authorization.2 • Transactions and other events are promptly recorded at correct amounts.1 • Records of assets such as sufficient description of the assets (to facilitate identification) its location should also be maintained so that the assets could be physically verified periodically.5 • Transactions should be classified in appropriate accounts and in the appropriate period to which it relates.3 • Transaction should be recorded in a manner so as to facilitate preparation of financial statements in accordance with applicable accounting standards, other accounting policies and practices and relevant statutory requirements.4 • Assets and records are required to be protected from unauthorized access, use or disposition.6 For prompt, accurate, complete and appropriate recording of accounting transaction, several procedures are often established by the management. The assurance that transactions have been properly recorded can also be obtained through a comparison of records with an independent source of information which provides an indication of the execution of the relevant transactions.
Accountability and Safeguarding of Assets 1	***The process of accountability of assets commences from acquisitions of assets its use and final disposal. Safeguarding of assets requires appropriate maintenance of records, their periodic reconciliation with the related assets. Assets like cash, inventories, investment scrips require frequent physical verification with book records.*** The frequency of reconciliation would differ for different assets depending upon their nature and amount. Assets which are considered sensitive or susceptible to error need to be reconcile more frequently than others. For proper safeguarding of assets, only authorized personnel should be given access to such asset. This not only means physical access but also exercising control over processing of documents relating to authorization for use and disposal of assets. It is essential to have effective controls over physical custody of cash, inventories, investments and other fixed assets. In some cases, as per requirement, special procedures regarding physical custody of assets may have to be designed by the management.
Independent Checks 5	Independent verification of the control systems, designed and implemented by the management, involves periodic or regular review by independent persons to ascertain whether the control procedures are operating effectively or not. Such process may be carried out by specially assigned staff under the banner of external audit.

(CNO—CH30C.160) INTERNAL CHECK SYSTEM (QNO171.000)

Overall Systems	The overall systems of internal control comprise of Administrative Control and Accounting Controls, Internal Checks and Internal Audit are important constituents of Accounting Controls.
Internal Check	Internal check system implies organization of the overall system of book-keeping and arrangement of Staff duties in such a way that no one person can carry through a transaction and record every aspect thereof. It is a part of overall control system and operates basically as a built-in-device as far as organization and job-allocation aspects of the controls are concerned. The system provides existence of checks on the day-to-day transactions which operate continuously as part of the routine system whereby the work of each person is either proved independently or is made complimentary to the work of another.
Objectives	The following are the objectives of the internal check system: • To ***avoid and minimize the possibility of commission*** of errors and fraud by any staff. • To prevent and avoid the misappropriation or embezzlement of cash and falsification of accounts. • To ***detect error and frauds*** with ease. • To ***increase the efficiency*** of the staff working within the organization. • To ***locate the responsibility area or the stages*** where actual fraud and error occurs. • To ***protect the integrity of the business*** by ensuring that accounts are always subject to proper scrutiny and check.

General Implement-ation of Internal Check System

The general condition pertaining to the internal check system may be summarized as under:

(First Few points are related to System Designing Points)

- **No Single Person Complete Control**

  No single person should have complete control over any important aspect of the business operation. **Every employee's action should come under the review of another person.**

- **Distribution of Power with Periodic Review**

  The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.

- **Mechanical Device**

  Mechanical devices should be used, wherever practicable to prevent loss or misappropriation of cash.

- **Asset Custody— Book Maintenance Separation**

  Persons having **physical custody of assets must not be permitted to have access to the books of accounts.**

- **Independent Accounting Control**

  There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.

(Start of the Year Point)

Budgetary Control

Budgetary control should be exercised, and wide deviations observed should be reconciled.

(During the Year Point)

- **Rotation**

  Staff duties should be **rotated from time to time** so that members do not perform the same function for a considerable length of time.

- **Compulsory Leave**

  Every member of the staff should be encouraged to go on **leave at least once a year.**

- **Periodical Review of Accounting Records**

  Procedures should be laid down for **periodical verification** and testing of different sections of accounting records to ensure that they are accurate.

(End of the Year Point)

- **Independent Stock Taking**

  For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.

  The scope of statutory audit is limited by both time and cost. Therefore, it is increasingly being recognized that for an audit to be effective especially in case of large organization, the existence of a system of internal check is essential.

(CNO—CH30C.180) EVALUATION OF CONTROL ENVIRONMENT (QNO166.200)

The quality & effectiveness of internal controls is directly dependent on the Organizational environment. The tone at the top (the Board & Executive Management) & the credibility of the message on internal controls from top plays an important role in establishing strong control environment. Following are some of the key components to assess & evaluate the controls environment. Shortcut –Delegation leads to RIS^{2}E of financial powers in control environment.

Enterprise Risk Management

An organization which has robust process to identify & mitigate risks across the enterprise & its periodical review will assist in early identification of gaps & taking effective control measures. In such organizations, surprises of failures in controls is likely to be few.

Standard Operating Procedures (SOPs)

A well-defined set of SOPs helps define role, responsibilities, process & controls & thus helps clearly communicate the operating controls to all touch points of a process. The controls are likely to be clearly understood & consistently applied even during employee turnover

Segregation of Job Responsib-ilities	A key element of control is that multiple activities in a transaction/decision should not be concentrated with one individual. Segregation of duties is an important element of control such that no two commercial activities should be conducted by the same person. **Example** A buyer should not be involved in receiving of materials or passing of bills. Similarly bank reconciliation should be prepared by a person other than the one who maintains bank book.
Delegation of Financial Powers Document	As the organization grows, it needs to delegate the financial & other powers to their employees. A clearly defined document on delegation of powers allows controls to be clearly operated without being dependent on individuals.
Job Rotation in Sensitive Areas	Any job carried out by the same person over a long period of time is likely to lead to complacency & possible misuse in sensitive areas. It is therefore important that in key commercial functions, the job rotation is regularly followed to avoid degeneration of controls. **For example,** if the same buyer continues to conduct purchase function for long period, it is likely that he gets into comfort zone with existing vendors & hence does not exercise adequate controls in terms of vendor development, competitive quotes etc.
Information Technology based Controls	With the advent of computers & enterprise resource planning (ERP) systems, it is much easier to embed controls through the system instead of being human dependent. The failure rate for IT embedded controls is likely to be low, is likely to have better audit trail & is thus easier to monitor. For example, at the stage of customer invoicing, application of correct rates in invoices or credit control can all be exercised directly through IT system improving control environment.

(CNO—CH30C.190) INTERNATIONAL INTERNAL CONTROL FRAMEWORKS (QNO - 175.500)

COSO

- COSO's Internal Control – Integrated Framework was introduced in 1992 as guidance on how to establish better controls so companies can achieve their objectives. COSO categorizes entity -level objectives into operations, financial reporting, and compliance. The framework includes more than 20 basic principles representing the fundamental concepts associated with its five components: control environment, risk assessment, control activities, information and communication, and monitoring. Some of the principles include key elements for compliance, such as integrity and ethical values, authorities and responsibilities, policies and procedures, and reporting deficiencies.
- Five Components of COSO are as follows:
  (i) Control Environment
  (ii) Risk Assessment
  (iii) Control Activities
  (iv) Information and Communication
  (v) Monitoring
- The COSO Framework is designed to be used by organizations to assess the effectiveness of the system of internal control to achieve objectives as determined by management. the Framework lists three categories of objectives as below:
  - Operations Objectives – related to the effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss.
  - Reporting Objectives – related to internal and external financial and non-financial reporting to stakeholders, which would encompass reliability, timeliness, transparency, or other terms as established by regulators, standard setters, or the entity's policies.
  - Compliance objectives – In the Framework, the compliance objective was described as "relating to the entity's compliance with applicable laws and regulations." The Framework considers the increased demands and complexities in laws, regulations, and accounting standards.

CoCo

- CoCo was introduced in 1992 with the objective of improving organizational performance and decision-making with better controls, risk management, and corporate governance.
- The Criteria of Control (CoCo) framework was developed by the Canadian Institute of Chartered Accountants with the objective of improving organisational performance and decision making with better controls, risk management, and corporate goverance. In 1995, Guidance on Control was produced and described the CoCo framework and defining controls. The framework includes 20 criteria for effective control in four areas of an organization: purpose (direction), commitment (identity and values), capability (competence), and monitoring and learning (evolution).
- The framework emphasizes that control involves the entire organization but begins on an individual level, with the employee.
- The CoCo framework outlines criteria for effective control in the following four areas:
  - Purpose
  - Commitment
  - Capability
  - Monitoring and Learning

Turnbull Report

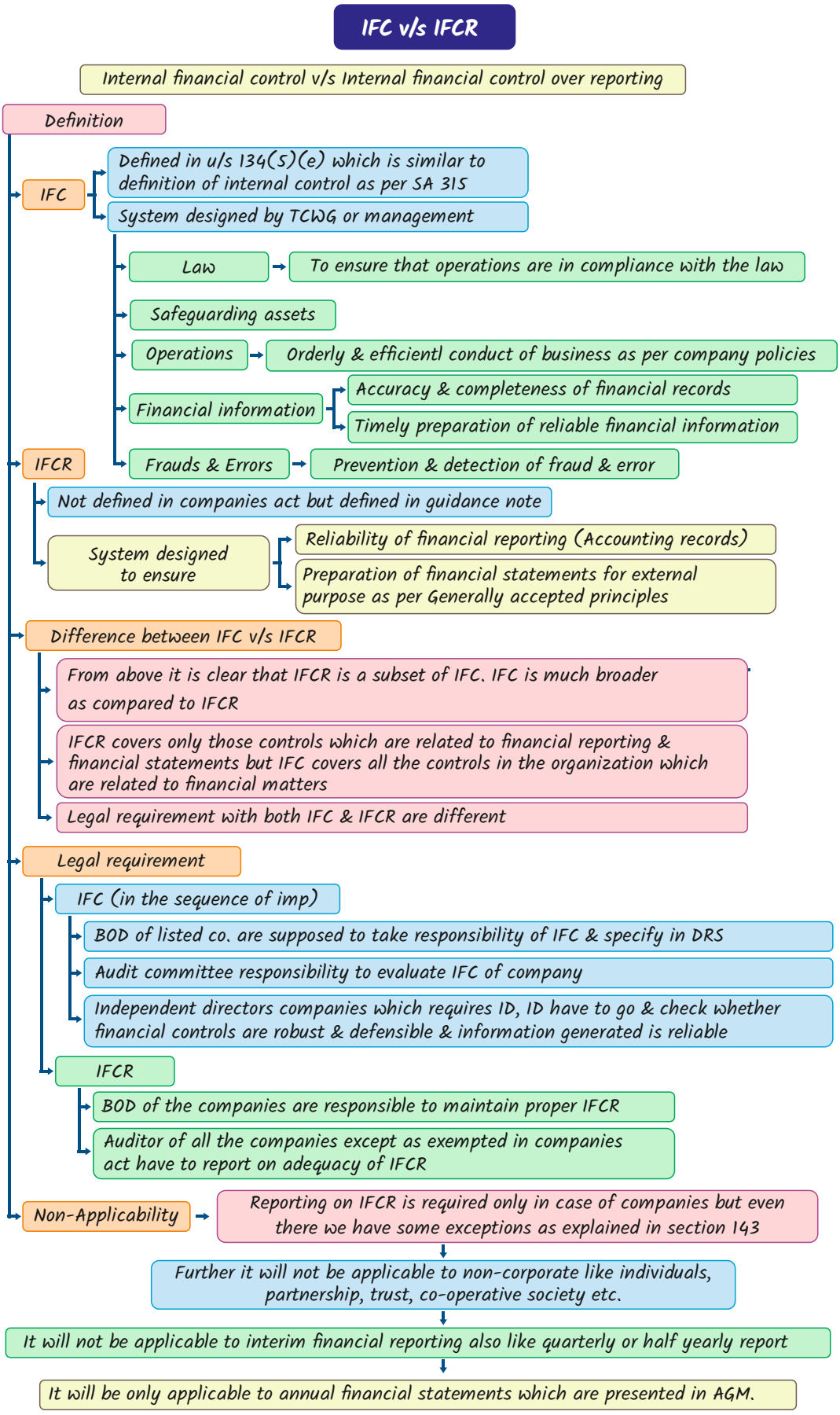
- When the Combined Code of the Committee on Corporate Governance (the Code) was published, the Institute of Chartered Accountants in England & Wales agreed with the London Stock Exchange that it would provide guidance to assist listed companies to implement the requirements in the Code relating to internal control. The key principles of the Code are enunciated as below:
  - The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.
  - The directors should, at least annually, conduct a review of the effectiveness of the group's system of internal control and should report to shareholders that they have done so. The review should cover all controls, including financial, operational and compliance controls and risk management.
  - Companies which do not have an internal audit function should from time to time review the need for one.

Sarbanes Oxley Section 404

- SOX Section 404 (Sarbanes-Oxley Act Section 404) mandates that all publicly-traded companies must establish internal controls and procedures for financial reporting and must document, test and maintain those controls and procedures to ensure their effectiveness. The purpose of SOX is to reduce the possibilities of corporate fraud by increasing the stringency of procedures and requirements for financial reporting. The Sarbanes Oxley Act, signed into law in 2002, has revamped federal regulations pertaining to publicly traded companies' corporate governance and reporting obligations. The PCAOB followed with AS 2, which was approved by the SEC in June 2004. AS 2 was replaced in May 2007 by AS 5.
- The SEC rules and PCAOB standard require that:
  - Management perform a formal assessment of its controls over financial reporting including tests that confirm the design and operating effectiveness of the controls.
  - Management include in its annual report an assessment of ICFR.
  - The external auditors provide two opinions as part of a single integrated audit of the company:
    - An independent opinion on the effectiveness of the system of ICFR.
    - The traditional opinion on the financial statements.

(CNO—CH30C.200) IFC V (QNO-175.600

Chart



Definition of IFC (Similar to Definition of Internal Control as per SA 315)	➢ **Source** Clause (e) of Sub-section 5 of Section 134 explains the meaning of internal financial controls. ➢ **Definition** ▪ the **safeguarding of its assets,** (E.g., Units purchased are marked with company logo & kept under CCTV surveillance) ▪ **orderly and efficient conduct** of its business including adherence to company's policies, (E.g., It is companies' policy to purchase from vendors with at least 5 years of experience in the business) ▪ The **prevention and detection of frauds and errors,** (E.g., Purchase price & quality is approved by 2 purchase managers and GRN is checked by Store Manager) ▪ the **accuracy and completeness of the accounting records,** (E.g., Barcode reader is used for recording purchases) ▪ and the **timely preparation of reliable financial information** (E.g., Weekly Purchase report is prepared by locations & consolidated)
Definition of IFCR	➢ **Source** Not defined in Company's Act but defined in Guidance Note over IFCR ➢ **Definition** ➢ A process designed to provide reasonable assurance regarding the **reliability of financial reporting and the preparation of financial statements** for external purposes in accordance with generally accepted accounting principles.
Difference between IFC Vs IFCR	➢ IFC covers all controls have financial impact on entity, but IFCR covers only those controls which affect financial reporting. ➢ IFC is much broader concept as compared to IFCR. So IFCR is subset of IFC. ➢ Legal Requirements also differ
Legal Requirements Regarding IFC	➢ **Responsibility of Board** **Sec 134 (5) (e):** – Board of director has to specify in Director Responsibility Statement annexed to BOD Report that IFC are adequate & operating effectively in Listed Companies. ➢ **Responsibility of Audit Committee** **Sec 177 (4) (vii):** – Companies in which audit committee is applicable, AC has to evaluate Internal Financial Controls. ➢ **Responsibility of Independent Directors** **Sec 149(8) & Sch IV:** – In case of all companies where Independent Directors are required, IDs to satisfy themselves on the integrity of financial information and that financial controls are robust and defensible.
Legal Requirements Regarding IFCR	➢ **Responsibility of Board** **Sec 134 Companies Accounts Rules 2014, Rule 8 (v) (vii): – All companies should specify following in BOD report:** – the details in respect of adequacy of internal financial controls with reference to the Financial Statements. (That means IFCR) ➢ **Responsibility of Auditor** ▪ **Sec 143 (3) (i):** – Auditors to report if the company has adequate IFC systems and that they are operating effectively. (Word used is IFC, but guidance notes say that it should be read as IFCR taking into account role of auditor & similar requirement in other countries also. (Again, related to IFCR) ▪ **Not Applicable** entities other than company such as individual, partnership, trust, co-operative society etc.

	It may be noted that auditor's reporting on internal financial controls is a requirement specified in Company Act and, therefore, will apply only in case of reporting on financial statements prepared under the Act and reported under Section 143. Accordingly, reporting on internal financial controls will not be applicable with respect to interim financial statements, such as quarterly or half-yearly financial statements, unless such reporting is required under any other law or regulation. And also, not applicable to

Unique question	
QNO 168.010	ICQ - Assumptions
QNO 168.020	Internal Control Weakness Identified in Purchase & Account Payable, what audit procedure should be performed?
QNO 174.000	Internal Controls (Multiple Location Business)

Unique MCQ	
MCQ	Incs.48.1

Students Notes

04 SPECIAL ASPECTS OF AUDITING IN AN AUTOMATED ENVIRONMENT

(CNO—AAE.020) KEY FEATURES OF AN AUTOMATED ENVIRONMENT

Computer Based & Process Combines People & Computers

Typically, the automated environment is driven by computer-based systems which are also known as information technology (IT) systems or information systems (IS).An automated environment is an ecosystem that combines people, processes and technology within an overall business environment.

Many Applications are Used

There are several types of applications that could exist in a business depending on several factors including the nature, size, location of a business.

- **(Example)**
  In a hotel there could be one application for front desk & reservations, another application for restaurant & kitchen orders, a guest billing system, and an accounting system. In large multinational companies, specifically in the financial services, the number of applications could be hundreds and even thousands of applications.

- **(Types of Application)**
  Business applications can be broadly categorized as follows:

Category of Business Applications	Example of Category
Packaged software (also called off-the-shelf applications) used by micro and small business.	For example, QuickBooks, Tally.
Small ERPs used in small to medium business.	For example, Tally ERP, Focus ERP, SAP Business One
ERP applications used in medium to large companies.	For example, SAP R/3, Oracle R12 Enterprise Business Suite.

Layers of Automated Environment

The applications described above form one layer of the overall automated environment. The other layers are made up of the technology infrastructure and the physical & environmental aspect including: (In the Sequence of establishing Automated Environment)

- Physical and environmental – access to IT facilities, CCTVs, temperature control, firefighting equipment, etc.
- Storage devices - disks, tapes, network storage;
- Operating systems - Windows, Unix, Linux;
- Databases - Oracle 12g, MS-SQL Server;
- Network devices - switches, routers and firewalls;
- Networks - local area networks, wide area networks, virtual private networks, etc.

(CNO—AAE.040) KEY CONCEPTS OF AUDITING IN REAL-TIME ENVIRONMENT SUCH AS E-COMMERCE, ERP, CORE BANKING, ETC. (QNO 204.020)

Definition – Transactions happen immediately, without any delay

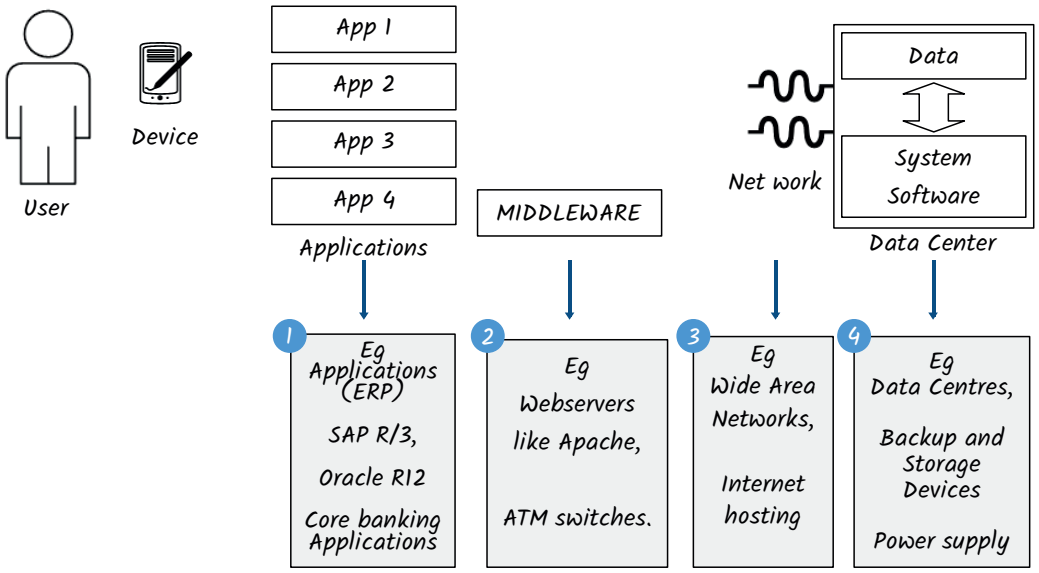
A real-time environment is a type of automated environment in which business operations and transactions are initiated, processed and recorded immediately as they happen without delay.

Example of Real Time Environment

In a bank that is using core banking system a customer account balance is instantly updated when the customer withdraws cash from an ATM. If there is a time delay in updating the customer account, there is a risk that the customer may initiate another transaction through internet or mobile banking channel, and this could result in withdrawing more than account balance. Similarly, when a customer makes an online order on a shopping e-commerce portal using credit card, the credit limit of the customer will be reduced immediately.

Components of Real Time Automated Environment (QNO-204.020)

A real-time environment has several critical IT components that enable anytime, anywhere transactions to take place. They include:



One Component Fails, Whole System Fails

To facilitate transactions in real-time, it is essential to have the systems, networks and applications available during all times. Any failure even in one component could render the real -time system unavailable and could result in a loss of revenue.

(Example of Failure)

If an e-commerce portal that normally processes a several hundred of orders per day goes down for an hour due to a malware attack on one of the webservers hosting the portal, the revenue loss could be significant.

Vulnerable to Attacks

Most real-time systems and environments are accessible through public domain and internet and hence, they are more likely to be vulnerable to network and cyber-attacks including denial of service (Flooding from One Source), distributed denial of service (Flooding from Multiple Sources).

Hence, it is critical for a company that operates in a real -time environment to constantly monitor all the IT components to identify and resolve issues and failures. Understanding of the automated environment, the risks and controls that should be considered and audit approach will be covered in the following sections of this chapter.

(CNO—AAE.060) UNDERSTANDING AND DOCUMENTING AUTOMATED ENVIRONMENT (QNO 204.090) (MCQ—AAE.3, AAE.5)

Matters to be Understood (QNO-204.090)

- Understanding of the automated environment of a company is required as per SA 315.
  The auditor's understanding of the automated environment should include the following:
  - The **organisation structure and governance;**
  - The **policies, procedures and processes** followed;
  - The **applications** that are being used by the company
  - Details of the **IT infrastructure components** for each of the application
  - IT **risks and controls.**
- The **auditor is required to document the understanding of a company's automated environment**

Example (no need to mention in exam unless specifically asked)

Application should have -SOUND automated environment

Application	Storage	Operating	Used for	Network Nature	Database
SAP R/3	NAS	HP-UX	Financial Accounting	LAN, WAN	Oracle 12g
REVS	Server Internal HDD	Windows 2012 Server	Front Desk, Guest Reservations	In-house developed	MS-SQL Server 2008
KOTS	Server Internal HDD	Windows 2012 Server	Restaurant and Kitchen Orders	In-house developed	MS-SQL Server 2008
BILLSYS	Server Internal HDD	Windows 2008 Server	Billing	Packaged Software	Oracle 11i

(CNO—AAE.080) CONSIDERATION OF AUTOMATED ENVIRONMENT AT EACH PHASE OF AUDIT CYCLE (QNO 204.040)

- **Phases of Audit**
  In a controls-based audit, the audit approach can be classified into three broad phases comprising of: -
  - Planning,
  - Execution, and
  - Completion.

- **Relevance of Automated Environment**
  In this approach, the considerations of automated environment will be relevant at every phase as given below:

Planning Phase

- When obtaining an understanding of the business process and performing walkthroughs the use of **IT systems and applications should be considered;** (Which locations & Processes are Computerized?)
- While assessing the **entity level controls** the aspects related to IT governance need to be understood and reviewed; (How IT system are used for Decision Making & Monitoring?)
- **Pervasive controls** including segregation of duties, general IT controls and applications should be considered and reviewed; (Affects many users & applications, such as job rotation, access passwords
- During **risk assessment,** the auditor should consider risk arising from the use of IT systems at

Execution / Testing

- During testing phase, the results of general IT controls would impact the nature, timing and extent of testing;
- When testing of reports and information produced by the entity (IPE) generated through IT systems and applications;

Completion / Reporting

At completion stage, evaluation of control deficiencies may require using data analytics and CAATs.

(CNO—AAE.100) GENERAL IT CONTROLS (AS PER SA 315) (QNO 204.050, 204.024)

Definition

General IT controls includes infrastructure, policies and procedures that support, affects IT system of organization and relate to many applications and support the eFfective functioning of application controls. They apply to mainframe, and end-user environments.

Objective

General IT-controls that maintain the Integrity of information (Accuracy), Safety & Security of Data

Mitigates Risk

These are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes.

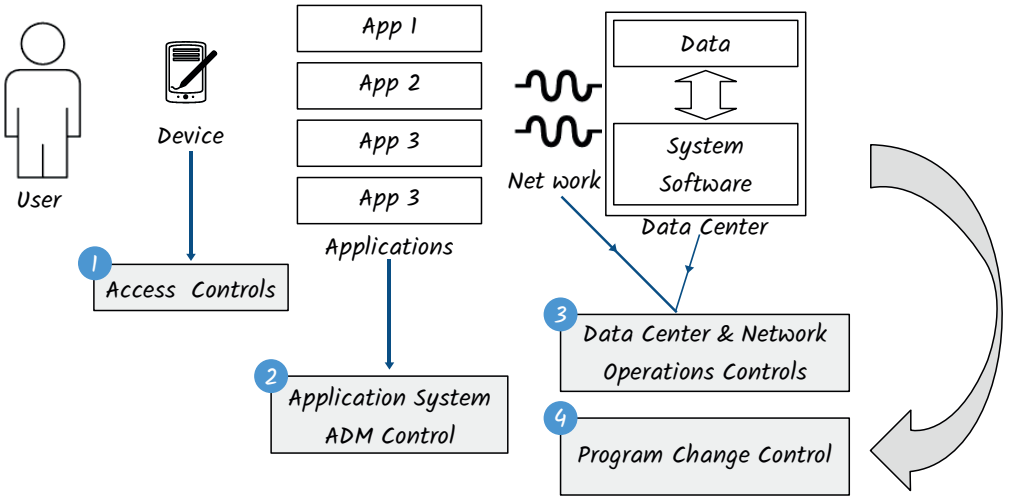
Pervasive / Indirect Controls

Hence, General IT controls are known as "pervasive" controls or "indirect" controls.

Types of General IT Controls

Commonly include controls over the following:

- Access security Controls
- Application system acquisition, development, and maintenance (Business Applications) Controls
- Data center and network operations Controls
- Program change Controls



Let us now learn about each of the General IT controls in more detail.

(CNO—AAE.120) 6A. ACCESS SECURITY (MCQ - Incs.28.2)

Objective

To ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives.

Activities

(Auditor Met Security Team)

- Security Organization & Management (Adequate People, Knowledge, Skills of Team)
- Security Policies & Procedures (Well defined roles & responsibility)
- System Administration & Privileged Accounts – Sysadmins, DBAs, Super users (Track of these accounts & powers)

(Auditor Entered IT Department)

- Physical Security – access controls, environment controls (Id controlled doors, guard, entry register, temperature controls, water control)
- Network Security – internal network, perimeter network (boundary between private & public network)

(Auditor accesses Computer)

- Operating System Security (Boot Password / Windows Password)
- Data Security (Id wise data access)
-

(CNO—AAE.140) 6B. APPLICATION SYSTEM ACQUISITION, DEVELOPMENT, AND MAINTENANCE (BUSINESS APPLICATIONS) CONTROLS

Objective

To ensure that systems are developed, configured and implemented to meet financial reporting objectives.

Activities

- **(Company Level Meeting)**
  Overall Mgmt. of Development Activities (GST Proposed / Development Head called for cross section meeting of different departments / Briefed Everyone / Called for fortnightly meetings)
- **(Committee Formation)**
  Project Initiation (Formed committee consisting CA / Lawyer / IITian)

- **(Progress)**
  Analysis & Design (After analysis of act & rules changes in design were proposed)
- **(Coding)**
  Construction (Coding started)
- **(Testing)**
  Testing & Quality Assurance (beta version was checked through dummy entries by employees of various departments)
- **(Data Migration)**
  Data Conversion (All entries were completed by 30th June & Data conversion started 12pm on 30th June)
- **(New software live)**
  Go-Live Decision (After testing by all department heads between 12pm to 3pm on 1st July)
- **(Documentation)**
  Documentation & Training (One week training of employees & documentation of whole process)

(CNO—AAE.160) 6C. DATA CENTER AND NETWORK OPERATIONS

Objective	To ensure that information systems are processed to meet financial reporting objectives.
Activities	• Overall Management of Computer Operations Activities (Number of computers, servers, its allocation, identification, safety and Security) • Batch jobs – preparing, scheduling and executing (Daily transaction processing) • Help Desk Functions – recording, monitoring & tracking (Error Solving) • Performance Monitoring – operating system, database and networks (Quantum processing / Speed of Processing / Response Time etc.) • Backups – monitoring, storage & retention • Recovery from Failures – BCP, DRP • Service Level Agreements – monitoring & compliance (System Audit) • Documentation – operations manuals, service reports

(CNO—AE.180) 6D. PROGRAM CHANGE

Objective	To ensure that modified systems continue to meet financial reporting objectives.
Activities (Similar to Application System ADM)	• Change Management Process – definition, roles & responsibilities 2 • Change Requests – record, manage, track 1 • Making Changes – analyse, design, develop 3 • Test Changes – test plan, test cases, UAT Apply Changes in Production Emergency & Minor Changes 4 • Documentation – user/technical manuals 6 • User Training 5

(CNO—AE.200) APPLICATION CONTROLS & IT DEPENDENT CONTROLS (QNO 204.050) (MCQ—Incs.40.1)

Application Controls (QNO 204.050)	Application controls include both automated and manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems. Examples of automated applications include edit checks and validation of input data, sequence number checks, user limit checks, reasonableness checks, mandatory data fields.
IT Dependent Controls	IT dependent controls are basically manual controls that make use of some form of data or information or report produced from IT systems and applications. In this case, even though the control is performed manually, the design and effectiveness of such controls depends on the reliability of source data.

Due to the inherent dependency on IT, the effectiveness and reliability of Automated application controls and IT dependent controls require the General IT Controls to be effective.

(CNO—AAE.220) GENERAL IT CONTROLS VS. APPLICATION CONTROLS

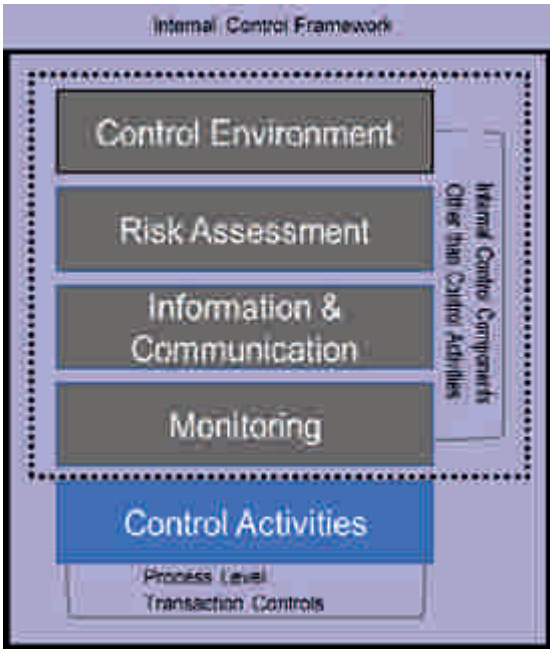
- These two categories of control over IT systems are interrelated.
- The relationship between the application controls and the General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems.

(CNO—AAE.240) EVALUATING RISKS AND CONTROLS AT ENTITY LEVEL AND PROCESS LEVEL (QNO 204.010) (MCQ - AAE.7, AAE.11 / Incs.12.1)

Entity Level Risks and Controls

The controls that operate across a company at all levels i.e., from board and top management to the department and transaction level are known as entity level controls or ELCs. The characteristics of ELCs include the following:

- Entity Level controls are known as pervasive controls since they operate across all organization levels.
- ELCs are part of a company's overall internal control framework and relate to the internal control components other than control activities.
- Entity level controls are subjective by nature and hence require application of more professional judgement in their evaluation and testing.



(Hiring Ethical People / Having Adequate Team / All use company hardware & software)

Direct V/s Indirect (QNO-204.010)

There are direct entity level controls and indirect entity level controls.

- Direct **ELCs operate at a level higher than business activity or transaction level such as a business process or sub-process level,** account balance level, at a sufficient level of precision, to prevent, detect or correct a misstatement in a timely manner.
  Examples include:
  - Business performance reviews;
  - Monitoring of effectiveness of controls activities by Internal Audit function;
- **Indirect ELCs do not relate to any specific business process, transaction or account balance and hence, cannot prevent or detect misstatements.** However, they contribute indirectly to the effective operation of direct ELC and other control activities.
  Examples include:
  - Company code of conduct and ethics policies;3
  - Human resource policies;2
  - Employee job roles & responsibilities.1

As per these examples, a company that has established policies and procedures, hires people with good background, promotes a culture of fairness and follows ethical practices, is less likely to see the occurrence of a fraud being committed in the company.

(CNO—AAE.250) WHISTLE-BLOWER POLICY (ENTITY LEVEL CONTROL) (QNO - 204.055)

Discussion

The following example shows how the auditor performs an understanding and evaluation of the whistle-blower policy in a company:

- Does the company have a whistle-blower policy?
- Is this policy documented and approved?
- Has the whistle-blower policy been communicated to all the employees?
- Are employees aware of this policy and understand its purpose and their obligations?
- Has the company taken measures viz., training, to make the employees understand the contents and purpose of the policy?
- Does the company monitor effectiveness of the policy from time-to-time?
- How does the company deal with deviations and non-compliance?

(CNO—AAE.260) PROCESS LEVEL RISKS AND CONTROLS (MCQ—Incs.28.3)

In an audit of financial statements, the auditor determines the significant account balances and disclosures. Auditing standards (SA 315) require the auditor to understand the business process that makes up an account balance or financial statement line item (FSLI). A business process is a sequence of activities that take place from the initiation of a transaction, recording it, approving, posting accounting entries and reporting. A business process is typically made up of sub-process - a logical grouping of related activities.

Domestic Sales account balance in the financial statements is an example of an FSLI. The Domestic Sales account balance represents all the sales transactions that were processed during an accounting period. The illustration below shows the business process, sub process and activities for the Domestic Sales Process - also known as Revenue or OTC (Order to Cash) Process.

Domestic Sales Account

Order Processing	Deliver	Invoicing	Receipts
Receive Order Request	Pick	Generate billing due list	Track Open Invoices
Check Customer File	Packaging	Create	Receive Customer
Obtain	Create Delivery	Verify	Match to
Credit Control	Shipping	Accounting	Accounting
Create Sale	Update Inventory		

Understanding the business process helps the auditor in identification of risks and controls within each process, sub-process and activity. The auditor should document this understanding of the company's business process and flow of transactions in the audit file in accordance with SA 230.

(CNO—AAE.280) USING RELEVANT ANALYTICAL PROCEDURES AND TESTS USING DATA ANALYTICS (QNO-204.060) (MCQ –AAE.5/AAE.6)

Discussion

- (Data saved in IT systems can give Insights)
  In an automated environment, the data stored and processed in systems can be used to get various insights into the way business operates.

- (Can be used for MIS)
  This data can be useful for preparation of management information system (MIS) reports and

electronic dashboards that give a high -level snapshot of business performance.

- (Definition of Data Analytics)
  Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics.

- (Use of Data Analytics for Audit)
  The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs.

Uses in Audit

When auditing in an automated environment, auditors can apply the concepts of data analytics for several aspects of an audit including the following:

- Preliminary analytics; (Comparison with Own Estimates)1
- Risk Assessment; (Identify fluctuating Items)2
- Control Testing; (% Rejections in Quality control checks)4
- Non-Standard Journal Analysis; (Identifying frequent entries, its nature and effect)6
- Evaluation of Deficiencies; (Control failure in Northeast, how many transactions will get Affected)5
- Fraud Risk Assessment. (Unusual Trends in Income / Expense)3

Steps (QNO-204.062)

There are several steps that should be followed to achieve success with CAATs and any of the supporting tools. A suggested approach to benefit from the use of CAATs is given in the illustration below:

- Understand Business Environment including IT (Business uses ERP)
- Define the Objectives and Criteria (Use of analytical procedures to verify cash discount)
- Identify Source and Format of Data (ERP, CSV File)
- Extract Data (Export Data from ERP)
- Verify the Completeness and Accuracy of Extracted Data (Match total from ERP)
- Apply Criteria on Data Obtained (Identify transactions eligible for cash discount and check whether only these transactions are given cash discount)
- Validate and Confirm Results (See documentary evidence for few items)
- Report and Document Results and Conclusions (Document Results)

(CNO—AAE.300) ENTERPRISE RISK MANAGEMENT OVERVIEW (MCQ - Incs.28.1)

Risk (QNO-204.070)

- **What do you mean by Risk?**
  Risk is the possibility that something could go wrong. In other words, Risk is the possibility that an event will happen which prevents a company from achieving business objectives.

- **Dynamic Business Environment**
  Businesses today operate in a dynamic environment. The volatility, unpredictability and pace of changes that exist in the business environment today is far greater than in the past.

- **Reason for Dynamic Environment**
  Some of the reasons for this dynamic environment include globalization, use of technology, new regulatory requirements, etc. Because of this dynamic environment the associated risks to business have also increased and companies have a need to continuously manage risks.

  Examples of risks include:
  - Market Risks;1
  - Regulatory & Compliance Risks;2
  - Business Partner Risk;3
  - Technology & Security Risks;4
  - Product or Project Risk;5
  - Operational Risks;7
  - Credit Risk;8
  - Environmental Risks.6
  - Financial Reporting Risks;9

(CNO—AAE.320) International IT related Standards, Guidelines and Framework. (QNO-204.095)

Discussion

Shortcut to Remember: C²LAP-for-International-Standard

- **C- Control Objectives for Information and Related Technologies (CoBIT)** is best practice IT Governance and Management framework published by Information Systems Audit and Control Association. CoBIT provides the required tools, resources and guidelines that are relevant to IT governance, risk, compliance and information security.

- **C-The Cybersecurity Framework (CSF)** published by the National Institute of Standards and Technology is one of the most popular frameworks for improving critical infrastructure cybersecurity. This framework provides a set of standards and best practices for companies to manage cybersecurity risks.

- **L- ITIL (Information Technology Infrastructure Library) and ISO 20000**
  It provide a set of best practice processes and procedures for IT service management in a company. For example, change management, incident management, problem management, IT operations, IT asset management are some of the areas that could be relevant to audit.

- **A-The American Institute of Certified Public Accountants** has published a framework under the Statements on Standards for Attest Engagements (SSAE) No.16 for reporting on controls at a service organisation that include
  - SOC 1 for reporting on controls at a service organization relevant to user entities' internal control over financial reporting (ICFR).
  - SOC 2 and SOC 3 for reporting on controls at a service organization relevant to security, availability, processing integrity, confidentiality or privacy i.e., controls other than ICFR.
  - While SOC 1 and SOC 2 are restricted use reports, SOC 3 is general use report.

- **P-The Payment Card Industry – Data Security Standard or PCI-DSS,**
  It is the most widely adopted information security standard for the payment cards industry. Any company that is involved in the storage, retrieval, transmission or handling of credit card/debit card information are required to implement the security controls in accordance with this standard.

- **I -ISO 27001:2013**
  It is the Information Security Management System (ISMS) standard issued by the International Organization for Standardization (ISO). This standard provides the framework, guidelines and procedures for implementing information security and related controls in a company. For example, this standard cover password security, application security, physical security, backup and recovery, that are relevant when auditing in an automated environment.

- **S- Sarbanes Oxley Act of 2002,**
  Commonly known as SOX, is a requirement in America. Section 404 of this act requires public listed companies to implement, assess and ensure effectiveness of internal controls over financial reporting and auditors' independent opinion on the design and operating effectiveness of internal controls over financial reporting (ICFR) – which is similar to the requirements of IFC-FR for Indian companies. Similar legal and statutory requirements over internal controls exist in several

UNIQUE CNO's	
QNO 204.005	Approach to identify risks associated with the IT systems.
QNO 204.030	Manual vs. automated control

UNIQUE MCQS	
MCQ No.	AAE.1
MCQ No.	AAE.2
MCQ No.	AAE.4
MCQ No.	AAE.8 (Related to SA 315 Controls)
MCQ No.	AAE.9 (Related to SA 315 Controls)
MCQ No.	AAE.10 / Incs.45.1

05 COMPANY AUDIT

Part I – Company Audit (Sec 139 to 148)

After lot of research and analysis, we have carefully divided company audit notes in 2 sections. 1st Section is in the form simplified text, charts and memory techniques with key words. It is easy to understand, remember and reproduce. 2nd Section contains detailed text which can be used for reference purpose as and when required as dictionary. This strategy will be helpful in volume management. It also helps all category of students as per their preferences. This is Section A; Section B is given after it.

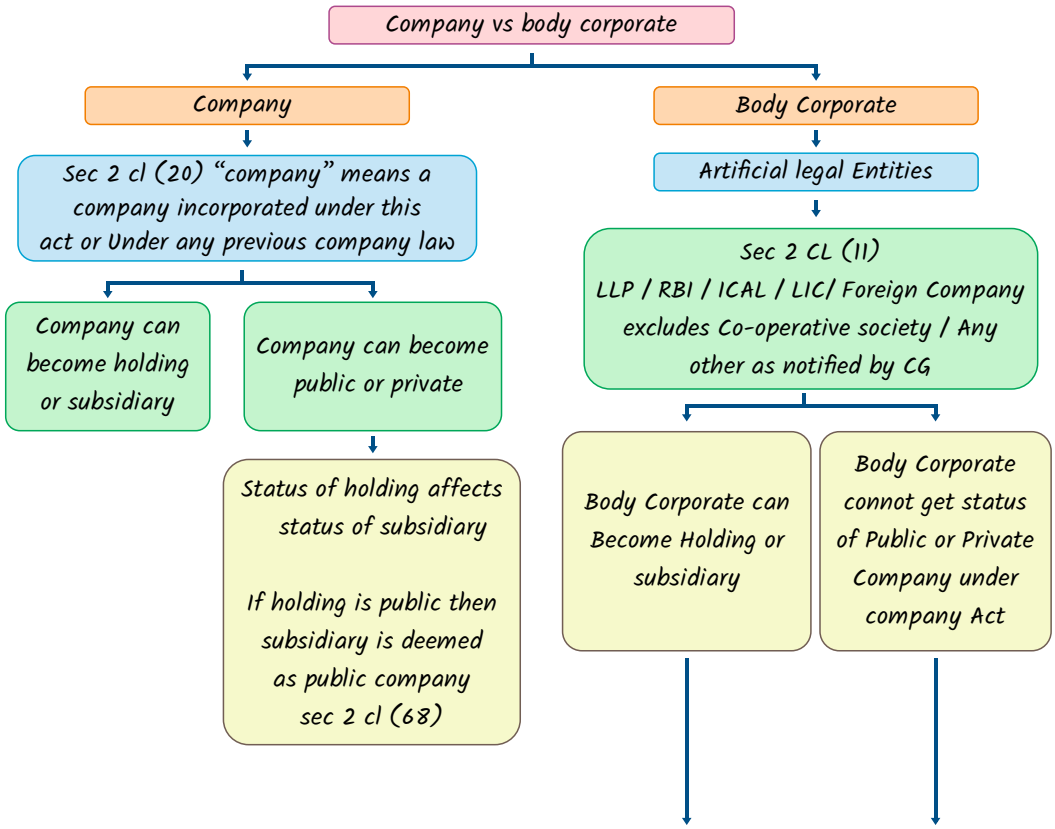
Section –A:- Simplified Notes

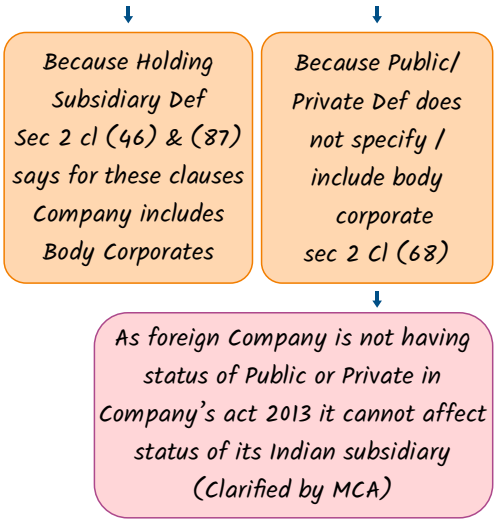
(CNO--CA.020) SECTION 2:- DEFINITIONS

Sec 2 Cl (6) Associate Company

- Not a Subsidiary
- Under Significant Influence from another company
  - Significant Influence
    - At least 20% of Voting Power
    - Participation in business decisions under an agreement
- Includes Joint Venture Company
  - Joint Venture Company where there is
    - Joint Control &
    - Right to Net Assets by Parties

- Sec 2 Cl (11)Body Corporate & Sec 2 Cl (20) Company





Sec 2 Cl (28)

Cost Accountant

Cost Accountant + Having COP as per CWA Act 1959

Sec 2 Cl (41)

Financial Year

- FY = 1st Apr to 31st Mar
- If DOI (Date of Incorporation) from 1st Jan to 31st March then FY = DOI to next 31st Mar
- 2 Years as transition period, that means FY 14-15 & FY 15-16 which have already passed.
- Companies / Body Corporates can apply for different FY year to Tribunal, if holding / subsidiary / associate / JV of company is incorporated outside India with different FY and there is problem in consolidation. If tribunal is satisfied it was grant different FY

Sec 2 Cl (46)

Holding Company

- Holding Co = Co which has subsidiaries
- Co includes body corporate i.e. foreign companies which are body corporates will be considered as holding also LLP can become holding.

Sec 2 Cl (51)

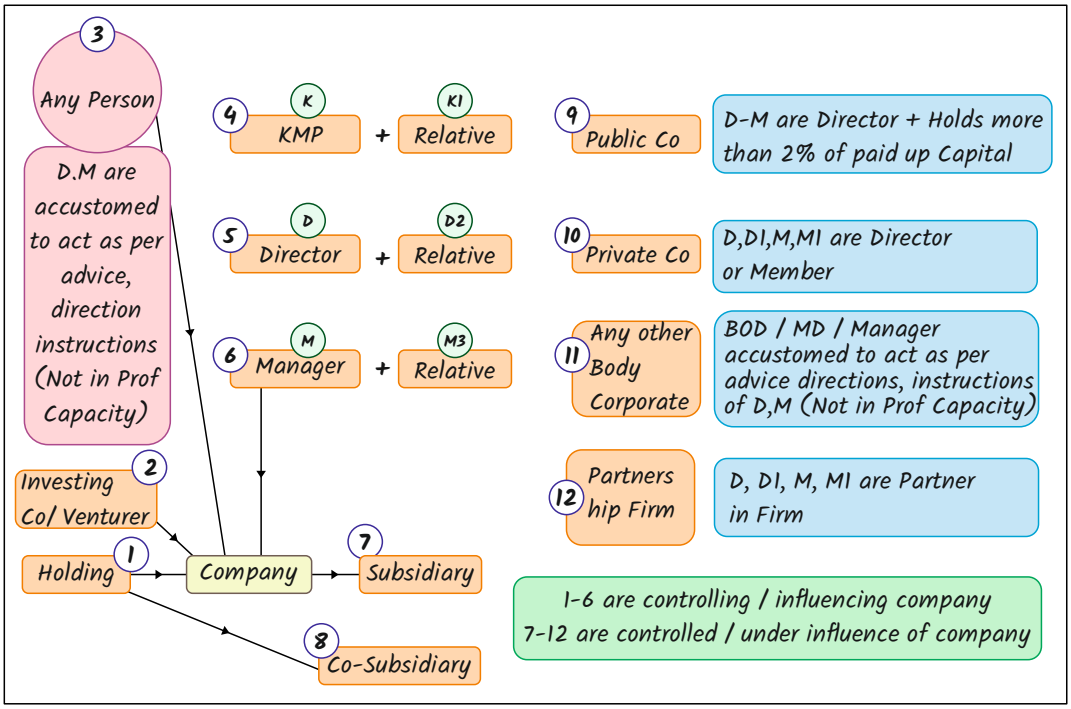
Key Management Person (KMP)

KMP means

(In sequence of power)

- Managing Director
- Whole Time Director
- CEO / Manager
- CFO
- CS
- One level below Director + Whole Time Employment + Designated KMP by Board

Sec 2 Cl (76) - Related Parties



Sec 2 Cl (85)

Small Company

- **Nature**
  - Not a Public Company
  - Not having Holding or Subsidiary
  - Not governed by Special Act
  - Not a Sec 8 Co
- **Limits**
  - Paid up Capital not exceeding 4 crore (higher amount can be prescribed not exceeding 10 crores) &
  - Turnover of PFY not exceeding 40 crore (higher amount can be prescribed not exceeding 100 crore)

Sec 2 Cl (87) Subsidiary Company

Definition of Subsidiary Company Sec 2 (87) Company Includes Body Corporate

If composition of board is controlled by other company

Composition of Board is Controlled :- if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors

Other company holds more than 50% Total Voting Power alone or along with its other subsidiary companies

Restriction on Number of Layers below holding company - Layers means Subsidiaries
Applicable from 20th Sept 2017

Company connot have more than 2 Layers below holding company

Counting Rule :- Wholly owned subsidiary will not be counted as layer

Exception "1" to restriction of 2 layers Banking Co / Insurance Co / Government Co / NBFC

Exception "2" to restrictions of 2 layers:- if such layers are created while acquiring company incorporated outside India, provided there is no problem as per laws in such countries

If company has layers in excess as on 20th Sept, except exempted companies - Return in form CRL - 1/ Don't Increase Layer / If layer reduced then never cross reduced layers or maximum allowed which ever is higher — Fine 10,00 & 1000 per Day if Default Continues Other company holds more than 50% Total Voting Power alone or along with its other subsidiary companies

APPLICABILITY AND SECTION 141

(CNO--CA.040) APPLICABILITY OF AUDIT

- As per sec 129 (2) – Board of Directors has to present financial statement in AGM.
- As per sec 143 (2) -- Financial statements presented in AGM should be audited & reported to shareholders.
- AGM takes place each year, so automatically FST should be audited each year for "All COMPANIES".

(CNO--CA.060) QUALIFICATIONS (Incs.18.3)

Chart

SEC 141(1) & (2) QUALIFICATIONS

Sec 141(1) Individual Chartered Accountant holding COP

Sec 141(2) Partnership Firm including LLP (Majority Partners should be CA holding COP) Only partners who are CA+COP can perform audit and sign FST & Audit report

- **Sec 141 (1)**
  Chartered Accountant

- **Sec 141 (2)**
  Partnership Firm (Including LLP)
  - Majority of partners should be CA + COP
  - Only partners who are CA + COP can perform audit and sign financial statement and audit report.

- **2(17)**
  As per section 2(17) unless otherwise provided Chartered Accountant means CA having COP

- **Certificate of Practice**



The Institute of Chartered Accountants of India

Certificate of Practice

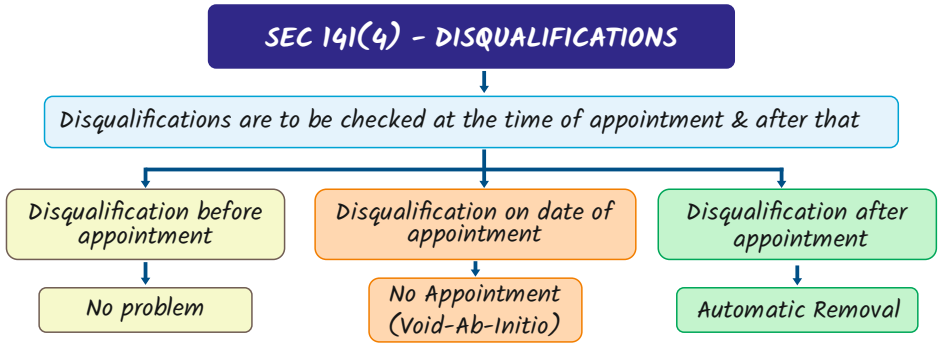
This is to certify that
Singh Binod Kumar, FCA
Son of Dasai Singh
Membership No. 058722 of New Delhi
is entitled to practise as Chartered Accountant.
This Certificate is issued subject to the provisions of
the Chartered Accountants Regulations, 1988,
or modifications and/or amendments thereof.
The Certificate shall be effective from
Twenty ninth day of December, 2003.
Given under the Common Seal of the
Institute of Chartered Accountants of India,
this Twenty ninth day of February, 2004.

(ASHOK HALDIA)
Secretary

(SUNIL GOYAL)
President

(CNO--CA.080) DISQUALIFICATIONS (QNO - 298.700)(MCQ - 57.3)

Chart

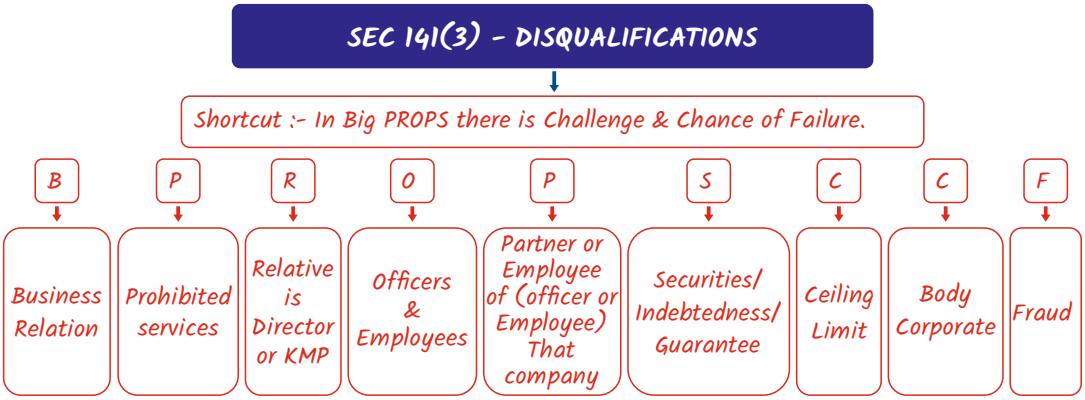


- Section 141 (4)
  - Disqualifications should be checked at the time of appointment and after date of appointment.
    It doesn't matter whether auditor was disqualified before appointment.

  - If person is disqualified at the time of appointment:- Appointment is Invalid or Void Ab Initio.

If gets disqualified after appointment then he is automatically removed from office of auditor, he ceases to be auditor of the company

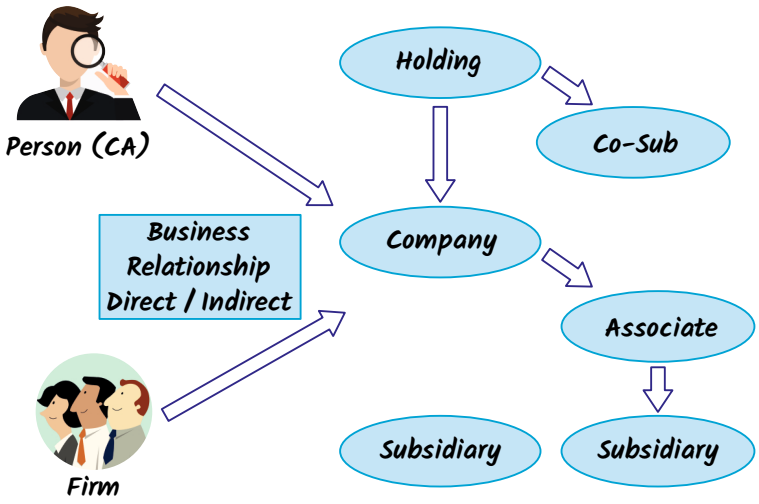
Chart



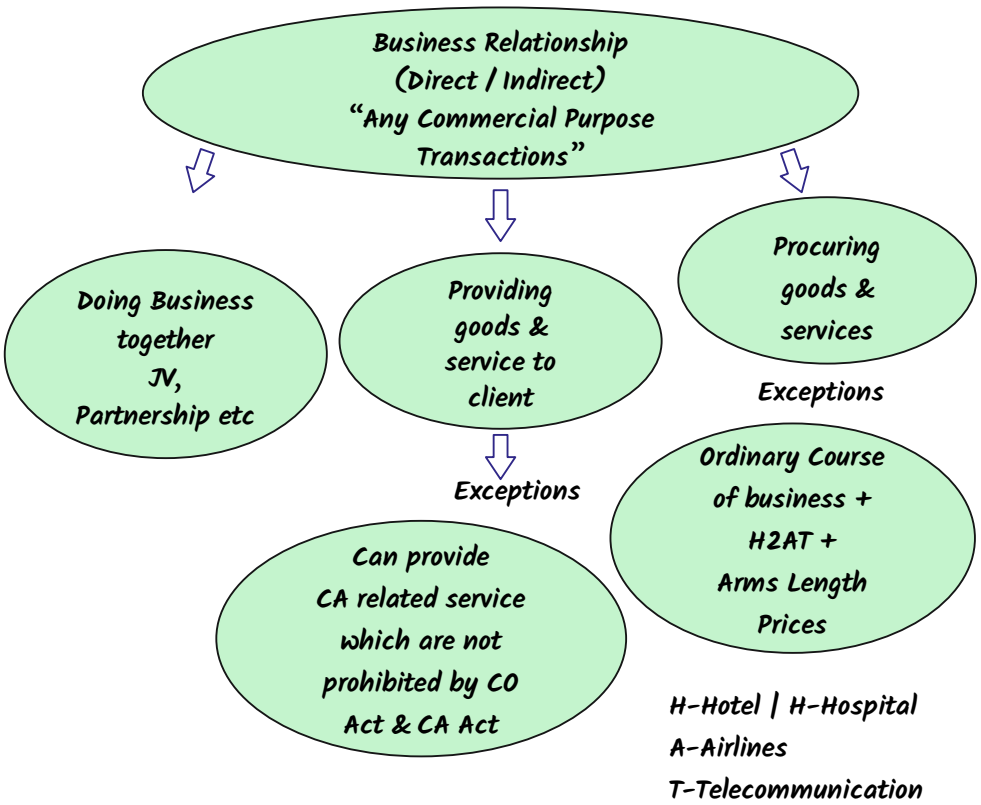
B-Business Relation (QNO-299,100)

(MCQ 14,CA I 18,CA I / 22,CA II/ Incs.26.3)

- Sec 141 (3)(e) -- Chart for Business Relationship Clause



- Meaning of Business Relationship

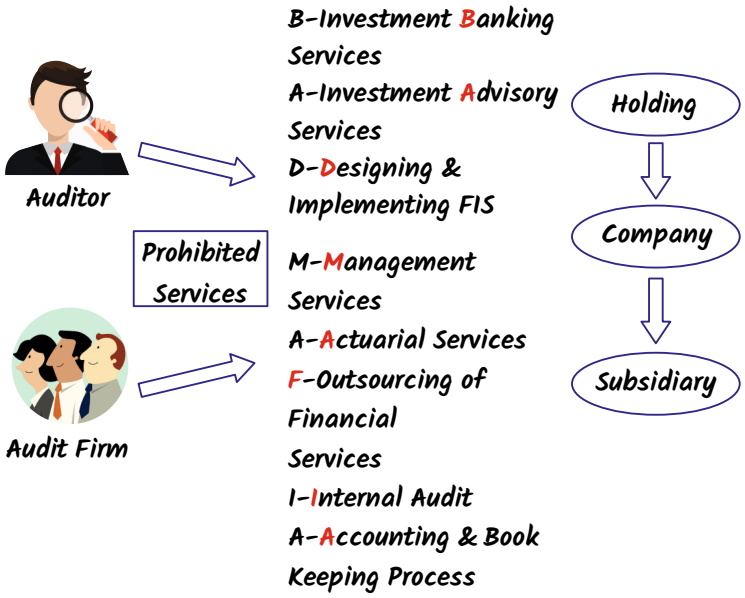


For Direct / Indirect refer Sec 144

P-Providing Prohibited Services (QNO-309.000/ 310.000) (MCQ-10.CA I / 15.CA I / 19.CA I / Incs.18.3)

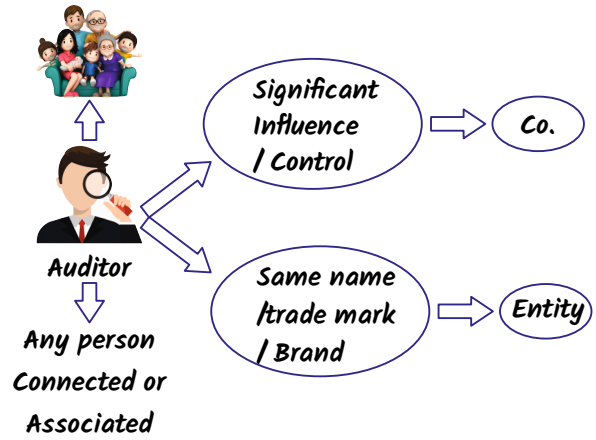
- Sec 141 (3) (i)
  a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.

- Sec. 144-- Auditor not to render certain services



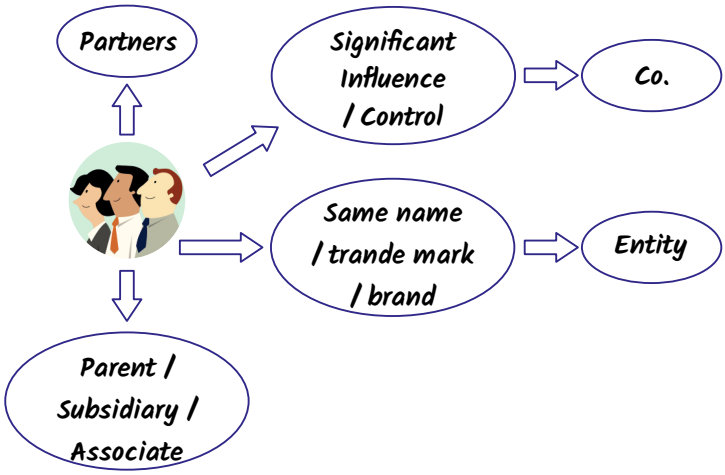
- Meaning of Directly / Indirectly if Auditor is Individual CA

Meaning of directly / Indirectly in case of INDIVIDUAL AUDITOR



- Meaning of Directly / Indirectly if Auditor is Audit Firm

Meaning of directly / indirectly in case of AUDIT FIRM

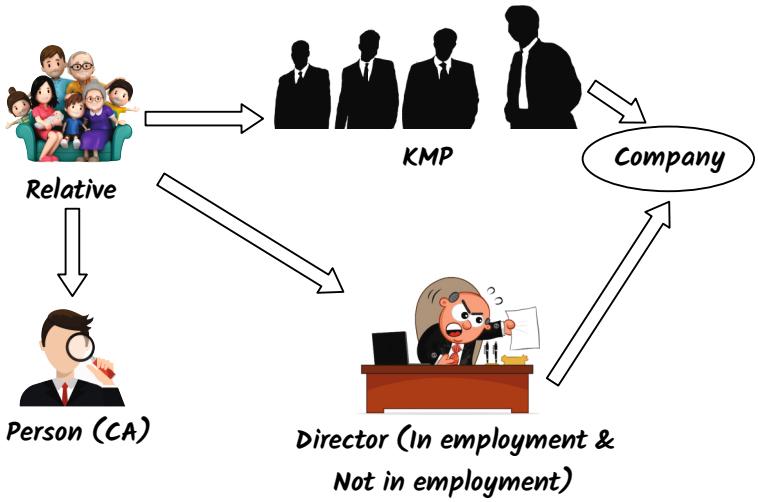


- **Providing Services other than Prohibited**
  If auditor wants to provide any service ,other than prohibited as discussed before,he will have to take prior approval from audit committee or board of directors as the case may be.

- **Initial Exemption**
  There was exemption for 1 year from date of notification (This section was notified on 26th March 2014, so exemption was for FY 14-15 i.e. one year after commencement).

R- Relative is Director /KMP (QNO-306.000/ 311.100)

- **Sec 141(3) (f) – Chart for Relative as Director / KMP**



- **Sec 2 (77) – Definition of Relative**

RELATIVE MEANS

FATHER & STEP FATHER — MOTHER & STEP MOTHER

BROTHER & STEP BROTHER — SPOUSE — SISTER & STEP SISTER

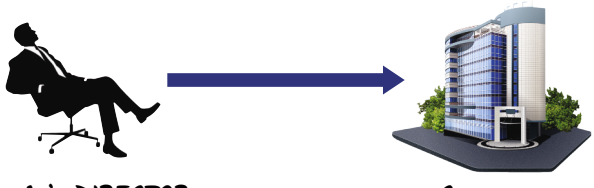
DAUGHTER + HUSBAND — SON & STEP SON + WIFE

Also HUF members if auditor has HUF (As per Income Tax)

O ->Officer or Employee of that company P -> "Partner or Employee" of "Officer or Employee of that company (QNO-308.000)

- **Sec 141(3) (b) -- Officer or Employee of that company**
- **Sec 141 (3) (c) -- "Partner or Employee" of "Officer or Employee of that company.**
  - **Officer** includes KEY Management Personnel /Directors / Manager / Any person on whose instructions board is accustomed
  - **"of that company"** Means officers or employees of A Ltd cannot perform audit of A Ltd, if qualified or not disqualified else where they can audit other companies.
  - As per company's act director of holding / subsidiary / associate are not disqualified to do audit of company, which is a loophole in company's act. But ICAI has plugged on loophole as per **announcement**, Director of holding company cannot do audit of company so this one loophole is plugged.
- **Case**

CASE



	Can they perform audit?
A	✗
ABC & Co	✗
B	✗
BPQ & CO	✗
P	✓
PLM & CO	✓

If partner is disqualified firm will get disqualified, but if firm is disqualified, then also individual partner may not be disqualified.

If any partner gets disqualified → *Firm will get disqualified*

But even if firm disqualified → *If is possible that individual partner on their own may be eligible to do audit, if not covered under any disqualification.*

S- Securities / Indebted-ness/ Guarantee (QNO- 302.000/ 303.000/ 304.000/ 306.000/ 312.000/ 313.000/ 319.000/ 319.010/ 319.020) (MCQ- Incs.01.2/ Incs.09.5 / Incs.33.5 / Incs.35.3/ Incs.47.5)

- ***Sec 141(3)(d) – Chart on Securities / Indebtedness/ Guarantee Clause.***



Relative



Person (CA)

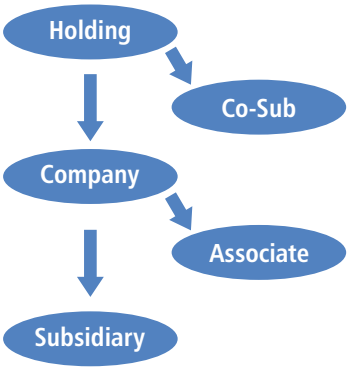


(PARTNERS)

Securities or Interest

Indebtedness > 5,00,000

Guarantee/ Security >1,00,000



- ***IMPORTANT POINTS***

1. *"Relatives" as discussed before.*
2. *"Securities" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956*

   Preference Shares/ Equity Shares / Debentures / Bonds / Any Marketable Securities / Derivative / Right or Interest in Securities
   - *Both the joint holders of shares will be disqualified.*
   - *Only registered shareholders are disqualified, beneficial shareholders are not covered.*
   - *Nominees of shares are not disqualified.*
3. *"Interest" word is relevant for membership without holding shares like membership by giving guarantee in company.*
4. *Exemption in case of relatives*

   Relative may hold security or interest (Guarantee) in the company of face value not exceeding 1,00,000
   - ***Corrective action***

     In the event of acquiring any security or interest by a relative, above 1,00,000, the corrective action to maintain the limits as specified above shall be taken by the auditor within 60 days of such acquisition of shares or interest.
   - ***Analysis***
     - *It may also be noted that the condition of Rupees 1,00,000 shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities.*

       The value of shares of Rupees 1,00,000 that can be held by relative is the face value not the market value.
     - *The limit of Rupees 1,00,000 would be applicable where the securities are held by the relative of an auditor and not where the securities are held by an auditor himself or his partner. In case of an auditor or his partner,*

securities of even small value shall be a disqualification.
Grace period of 60 days for corrective action shall apply only in respect of securities held by relatives. This would not apply to auditor or his partner.

- **Application of limit of Rupees 1,00,000**
  - For all company's taken together
  - For all relatives taken together
  - For both Shares & Guarantee taken together
- 60 days is from Date of Acquisition & not Date of Appointment

- **Controversy**

In exemptions to relatives there is small controversy: - if you read language carefully then as per literal interpretation you will notice that relatives can hold securities only in "that company" and not subsidiaries, associate.

But as per reasonable interpretation if holding is allowed in that company where audit is being conducted other companies such as subsidiaries and associate should be covered.

I will suggest give both the point of views in exams.

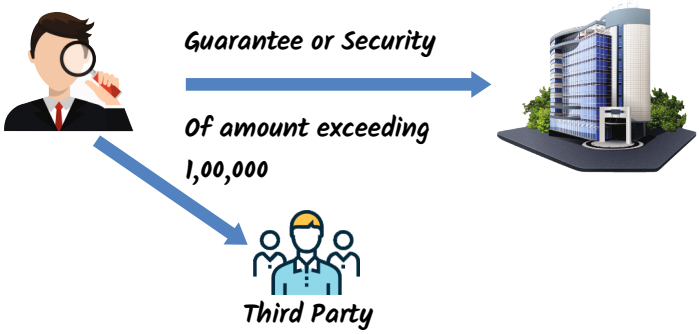
5. **Significance of word INDEBTEDNESS**

(i) Indebtedness can arise because of credit purchase, borrowing money or any other obligation.
(ii) If auditor gives advance and then buys goods of 10,00,000 then he is-- --Not Disqualified
(iii) Cash Purchase of 6,00,000-- Not Disqualified
(iv) Credit Period is 2 months, so person gets disqualified immediately on date of purchase or at the end of credit period---- Immediately because word is "indebted" not "overdue" so don't want for due date.
(v) Hire Purchase of Car of Rs. 20,00,000, all installments paid within time--- Disqualified
(vi) Purchase of Rs 6,00,000 from company and paid through credit card---- Not Disqualified.
(vii) Audit Fees of 10 Lakhs taken in advance on day 1 of audit, is auditor disqualified? --- YES
(viii) As per ICAI advance can be taken only on PROGRESSIVE BASIS.
(ix) If Auditor takes advance for Audit Expenses of Rs. 10,00,000—Disqualified.
(x) If Auditor incurs Expenses of Rs. 10,00,000 and then claims reimbursement from company—Not Disqualified
(xi) Loan taken- Ist Jan 24
Loan Repaid – Ist July 24
Appointment for FY 24-25 as auditor- Ist Aug 24
Is appointment valid? --- VALID
(xii) Limit of Audit Firm is also 5,00,000 because firm indebted means each partner indebted.
(xiii) Only net amount should be considered, if there is Receivable & Payable Balances
(xiv) Limit of 5,00,000 is aggregate limit
(xv) No automatic appointment even if amount is repaid and indebtedness is removed.

6. **Significance of Guarantee or Security**

- Security or Guarantee given to company for amount exceeding 1,00,000 on behalf of third party.

- Auditor accepts guarantee or security from company or its officials-Not Disqualified.



Case



	Can they perform audit?
A	✗
ABC & Co	✗
B	✗
BPQ & CO	✗
P	✓
PLM & CO	✓

C ->Ceiling Limit (QNO-300.000/ 300.200/ 301.000) (MCQ-13. CA 1)

- **Sec 141(3)(g)**

Person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies;

- **Zero Limit**
  - (i) If CA is in full time employment his limit will be ZERO.
  - (ii) If he is in part time practice, then also limit is ZERO

- **Firm Related**
  - (iii) Limit of firm will be 20 multiplied by number of partners
  - (iv) If CA is partner in multiple firms, then, total audits in his name should not exceed limit of 20.
  - (v) If there is Non-CA Partner he will not be considered
  - (vi) Limit of one CA cannot be used by another CA, number of signatures of each CA cannot exceed 20.

- **Exemption**
  - (vii) Exemptions while counting OPC / Small Co. / Dormant Co. / Pvt Co. paid up capital below 100 crores.

- **Council Guidelines, 2008**
  - (viii) Further there are ICAI Guidelines 2008, which says ceiling limit should be 30 excluding only two types of companies OPC & Dormant company. So, if we take combined interpretation, then CA can do 20 audits excluding 4 types of companies specified above and 30 companies excluding two types as mentioned above. But this point can be given at the end as additional knowledge. Solve problems as per limit of 20 only, unless specifically mentioned about guidelines.

- **Tax Audit Limit**

  (ix) Ceiling on Tax Audit Assignments: The specified number of tax audit assignments that an auditor, as an individual or as a partner of a firm, can accept is 60 numbers. ICAI has notified that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he accepts in a financial year, more than the specified number of tax audit assignments u/s 44AB.

- **Maintaining Records**

  A chartered accountant in practice as well as firm of chartered accountants in practice **shall maintain a record of the audit assignments accepted by him or by the firm of chartered accountants, or by any of the partner of the firm in his individual name or as a partner of any other firm as far as possible, in the prescribed manner.**

C -> BODY CORPORATE

- **Sec 141(3)(a)**

  (a) Accounts & audit is a sensitive job, responsibility should be on individual for better delivery rather than on artificial legal entity. (i.e., Body Corporate)
  But there is exception to above disqualification.
  LLP (Limited Liability Partnership) is a body corporate as per LLP Act, but it is exempted here.

  (b) On the same lines CA ACT 1949 has prohibited accountancy practice by CA in the form of company.

  (c) Co-Operative society is excluded from definition from BODY CORPORATE, but they cannot do audit as they are not qualified

  (d) CA's can incorporate Management Consultancy Company (MCC) for giving consultancy / advisory services, but cannot do audit & accountancy.

F-Fraud

- **Sec 141(3)(h)**

  A person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction;

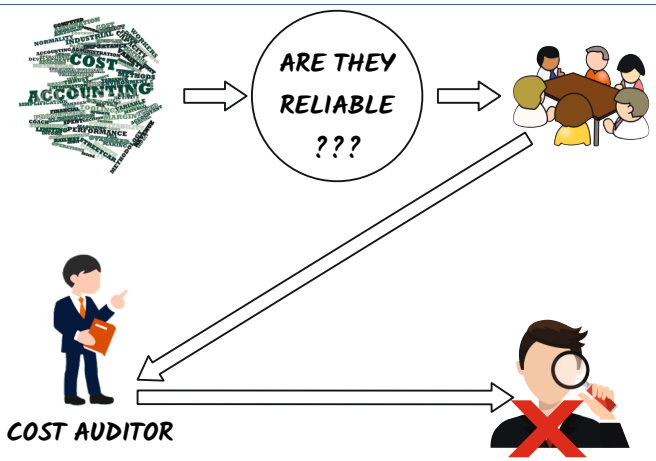
(CNO--CA.100) OTHER DISQUALIFICATIONS

- **As per Other Sections/CA Act & Guidelines.**

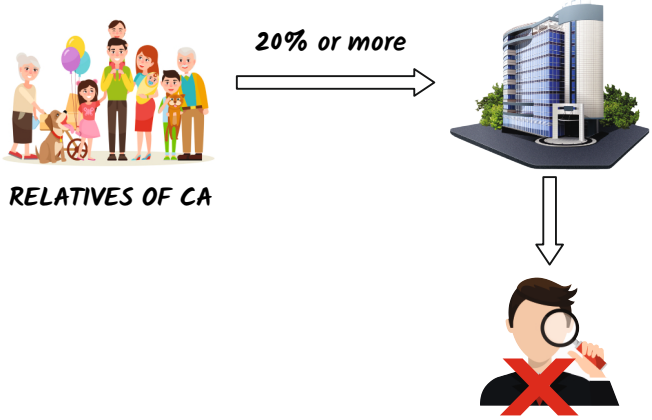
  CAR RALLY is PLANNED UNANIMOUSLY on MELTING ICE with Liquidator

  C- Cost Auditor
  R- Relatives holding 20% or more
  P- Partner or Firm holding 20% or more
  U- Unsound Mind
  M- Membership Removal
  I-Insolvent
  L-Liquidator

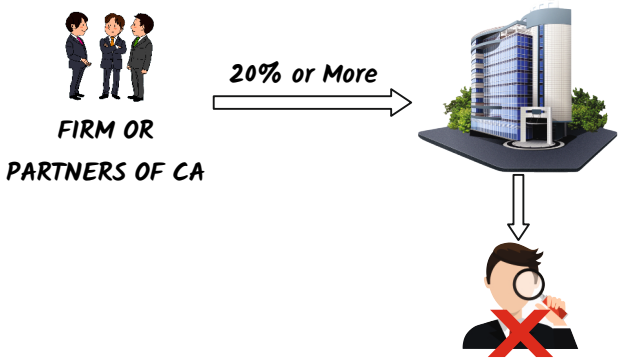
Cost Auditor Sec 148



Relatives of auditor hold 20% or more

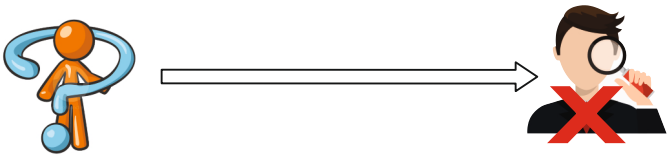


Partners or firm of auditor hold 20% or more

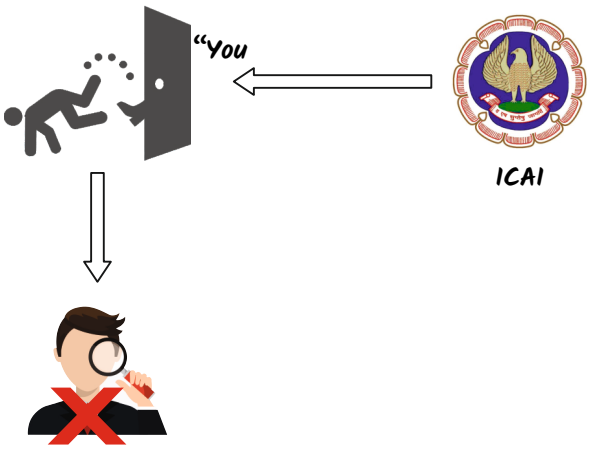


Note:- Now this point is not relevant because in companies act even one share is not allowed

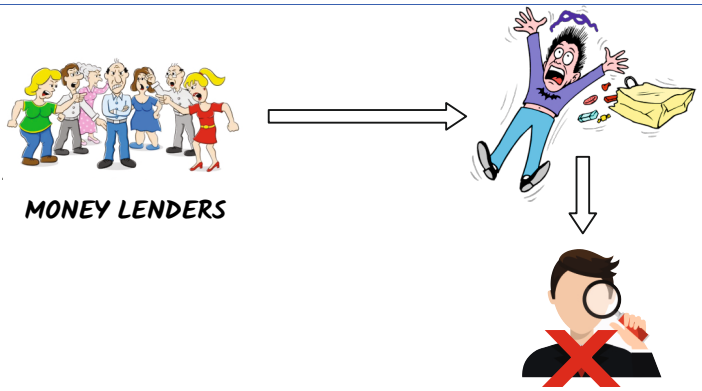
Unsound Mind



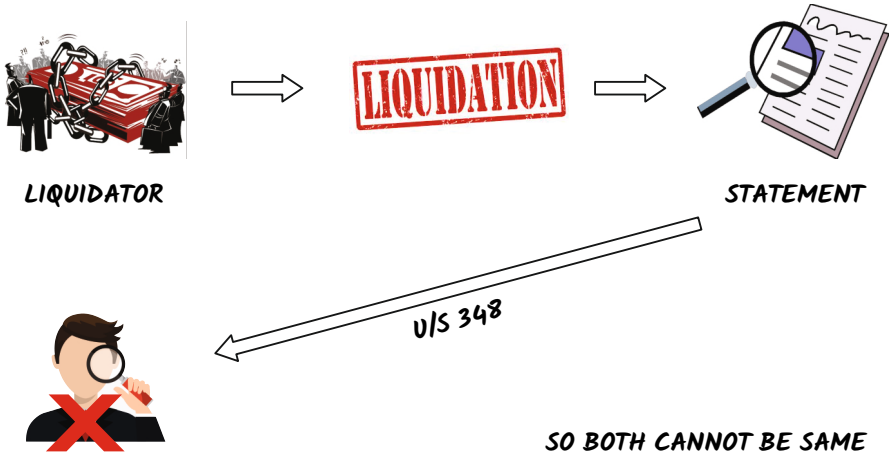
Membership Removal



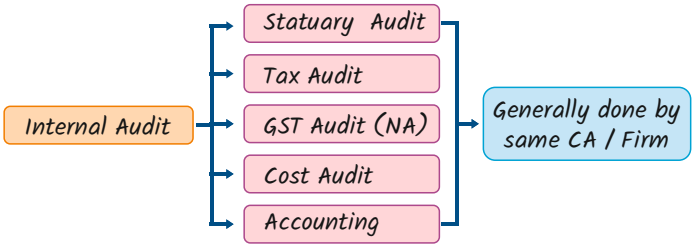
Insolvent



Liquidator



Chart



Announcement by ICAI

1. Directors cannot become auditor for 2 years after leaving directorship.
2. Tax Auditor and Company Auditor CAN BE SAME.
3. Internal Auditor and Cost Auditor cannot be same.
4. TAX auditor and internal auditor cannot be same.

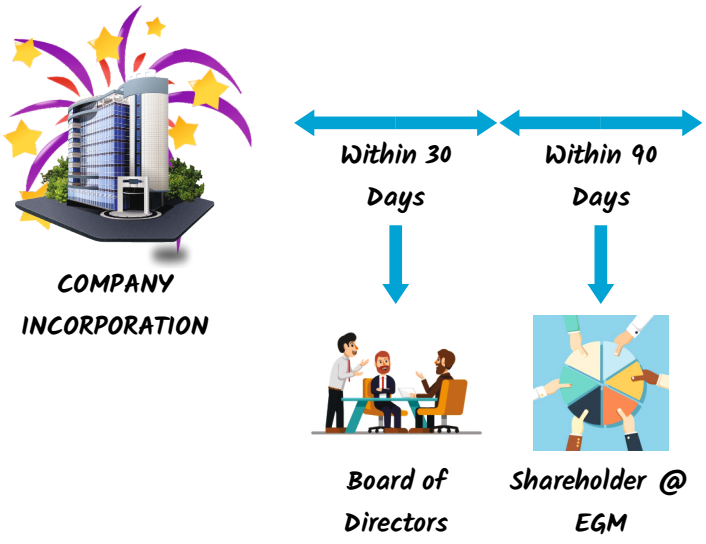
SECTION 139 - APPOINTMENT OF AUDITOR AND ROTATION

(CNO--CA.120) **FIRST AUDITOR** (QNO 282.000) (MCQ-16.CAI, Incs.50.4)

- **Meaning**
  First person to be appointed auditor after incorporation of company
- **Focus**
  We want auditor as soon as possible because huge transactions like issue of shares and setting up factory, office initially.

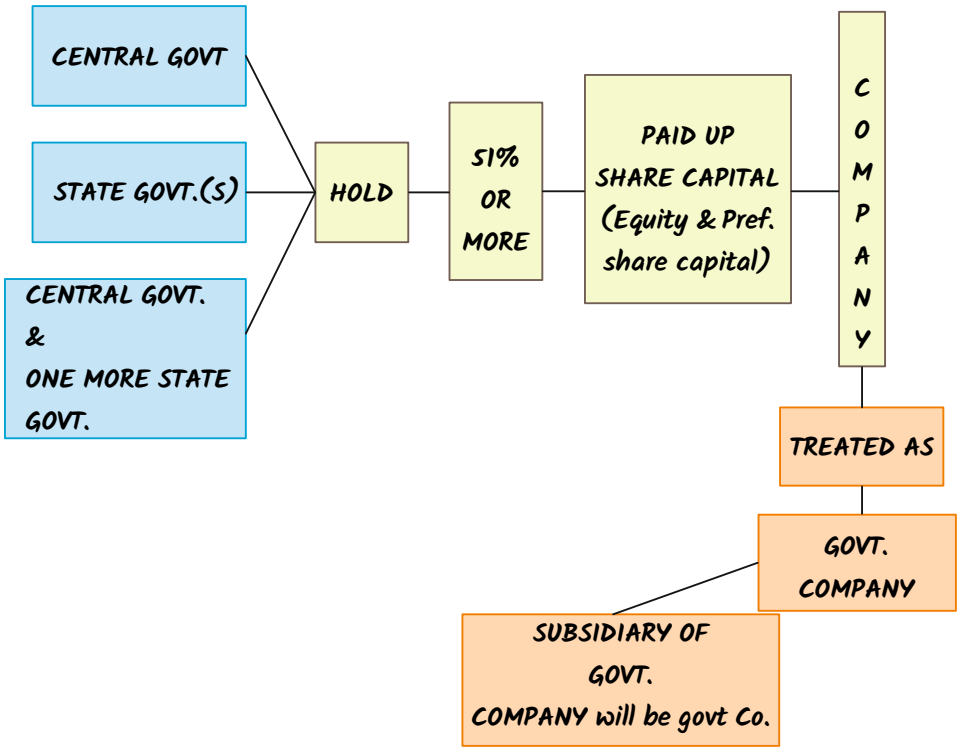
Company other than Government Company (QNO-282.000/286.000)

- **SECTION 139(6): - Appointment of Auditor for company other than Government Company**



Government Company (QNO- 284.000 / 285.000)

- SEC 2(45) Definition of Government Company



- Directly/Indirectly

Sec 139 (7) covers company owned or controlled directly or indirectly by central / state or partly by both. As per General circular issued on 26th Mar 2014 it is further clarified that concept of deemed government company of old companies act 1956 will be covered here that means 51% holding by CG / SG / Government Companies by one of them or in any combination.
(i.e. CG + SG ≥ 51% or more Direct) (CG + SG + Other Govt. Co. ≥ 51% or more Indirect)

- Sec 139(7): - Appointment of Auditor of Government Company



COMPANY INCORPORATION

Within 60 Days → CAG (Comptroller and Auditor General of India)

Within 30 Days → Board of Directors

Within 60 Days → Shareholders @ EGM

- Case Study

GOVERNMENT OF MAHARASHTRA → 40%
Centrak Government → 50%
ICICI → 10%

New Company Incorporated on 5th Jan



BOD appointed auditor on 1st Feb

Is appointment valid ?

No it is a Government company so First auditor will be appointed by C&AG within 60 Days

- Further Clarifications

Following are not proper appointments of First Auditor

	Other than Government Company
By MD/ WTD	X
Power delegated to MD	X
By AOA or MOA	X

Power to appoint auditor cannot be delegated.
General rule applicable to all appointments.

- Tenure of First Auditor – Till conclusion of first AGM

(CNO--CA.140) SUBSEQUENT AUDITORS

Company Other than Government Company (MCQ-6 CA I)

- SEC 139(1): - Approval of Subsequent auditor for company other than Government Company

Appointment of First Auditor ← Tenure of First Auditor → FIRST AGM (Annual General Meeting) ← TENURE

TENURE
TILL conclusion of NEXT 5 AGMs
If AGM of Appointment - 1st Then till the conclusion of 6th AGM



Incoming Subsequent Auditor



Retiring First Auditor

- Ratification

~~Ratification means to confirm act / decision which has happened before.~~

- ~~Appointment shall be subject to ratification in every annual general meeting till the sixth such meeting by way of passing of an ordinary resolution.~~
- ~~Clarified that, if the appointment is not ratified by the members of the company, the Board of Directors shall appoint another individual or firm as its auditor or auditors after following the procedure laid down in this behalf under the Act. (That means it will be treated as casual vacancy)~~

- **No AGM**
  If no AGM is conducted for 3 years same auditor will continue for 3 years. Because tenure is not in terms of years but in terms of next 5 AGMs. He will do audit for only those AGMs for which he was appointed. After his 5 AGMs get over same auditor or new auditor will be appointed to do audit of years passed.

Government Company (QNO-284.000)

- **SEC 139(5): - Appointment of Auditor of Government Company**



COMPANY INCORPORATION

Within 180 Days from START of Financial Year

TENURE upto conclusion of NEXT AGM

CAG

(CNO--CA.160) **CASUAL VACANCY** (QNO-287.000) (MCQ-Incs.04.2 / Incs.38.5)

- **SEC 139(8): - Appointment of Auditor in Casual Vacancy**
  (a) Casual Vacancy is Not defined in company's act.
  (b) So, it is any vacancy after proper appointment of Auditor.

- **Examples**
  - Incapacity to contract under Indian Contract Act 1872,
  - Ceasing to be a member of ICAI under Section 8 of Chartered Accountant Act 1949 (Unsound Mind / Insolvent etc.)
  - Subsequent disqualification of auditor after valid appointment
  - Resignation of the auditor,
  - Death of the auditor,
  - Dissolution of a firm



Other than Government Company

30 days



Board of Directors
If it is due to resignation

Approval within 3 months



Shareholders @ AGM / EGM





Government Company

30 days

CAG

30 days



Board of Directors

Special Case –Improper Appointment Void Ab Intio No Appointment Automatic Reappointment (Not a Casual Vacancy)

(CNO--CA.180) AUTOMATIC REAPPOINTMENT (QNO 281.100, 294.500)

- **Sec 139(10): - Automated Reappointment**

  Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company. (Till next AGM)

- **139 (9): -Restriction on Re-appointment**

  Retiring auditor may be reappointed at an annual general meeting, if—

  1. He is not disqualified for re-appointment;
  2. He has not given the company a notice in writing of his unwillingness to be re-appointed;
  3. A special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed."

Procedure of Appointment

- **Sec 139 (11): -Role of Audit Committee**

  Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

- **Section 177: - Requirements/Constitutions of Audit Committee**

  1. The Board of Directors of every listed public company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee.

     - **Rules**
       - All public companies with a paid-up capital of ten crore rupees or more;
       - All public companies having turnover of one hundred crore rupees or more;
       - All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees

         As existing on the last date of latest audited financial statements shall be taken into account.

     - **Exemptions**
       - Wholly owned subsidiary
       - Joint Venture
       - Dormant Company

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

     Provided that majority of members of audit committee including its Chairperson shall be persons with ability to read and understand, financial statements.

     Every Audit Committee of a company existing immediately before the commencement of this Act shall, within one year of such commencement be reconstituted in accordance with sub-section (2).

Steps

1. Selection & Recommendation of Auditor
2. Consent & Certificate by Auditor
3. Passing Resolution & Intimation of Appointment

Step-1:- Selection & Recommend-ation of Auditor (QNO 281.100)





Selection **Board of Directors**

- **Factors that should be considered**
  1. Qualification
  2. Experience
  3. Whether competence & capabilities are commensurate with requirement of company.

4. Orders of misconduct passed against auditor.
5. Misconduct proceedings pending against CA.
6. They can call for more information from CA or CA Firm.

- **Recommendation Process (Audit Committee- Applicable)**

If Section 177 regarding Audit Committee is applicable.



Recommend Name of Auditor



Board of Directors

If BOD agree Recommend Name of Auditor



Shareholders @ AGM

If BOD disagree Refer Back + Reason

If AC doesn't reconsider, then BOD will send its own recommendation and also record reason for rejecting AC recommendation

If AC reconsiders, then they will recommend new name and process wil continue.

- **Recommendation Process (Audit Committee- Not Applicable)**



Board of Directors

If BOD agree Recommend Name of Auditor



Shareholders @ AGM

Step-2:- Consent & Certificate





Board of Directors



Consent

I/ We agree to become auditor of the company

He should communicate to previous auditor before sending Consent as per CA Act 1949

Certificate

I certify that following is true & Correct.

- I am qualified u/s 141.
- I am not disqualified u/s 141.
- Appointment is correct as per other sections of companies Act, & CA Act 1949.
- I have limit to accept audit.
- List of orders & proceedings provided to company is True & Correct.



CA



CA Firm

Step-3:- Resolution at AGM & Intimation of Appointment



AGM

Resolution will be passed in AGM
(Special Notice will be required for no reappointment or new appointment)

"Form ADT-1 is not required to be filled in case of First Auditor"



Intimate ROC in 15 days
FORM ADT-1



ROC

(CNO--CA.200) ROTATION OF AUDITOR (QNO-293.000/294.000)

Reason

- It has been observed that as tenure increases auditor's understanding of company and actions improves and he is in better position to comment on financial statement.
- But there is risk also if tenure is too long, familiarity threat will arise, and auditor may protect client by suppressing reporting points. Hence company's act has brought this concept of compulsory rotation.



Analysis

1.	Hindalco (Singhi & Co)	50+ Years
2.	Reliance (Chaturvedi & Shah)	35+ Years
3.	L&T (Sharp & Tannan)	30+ Years
4.	Grasim (GP Kapadia)	20+ Years
5.	Tata Power / Steel / Motors (Deloitte)	15+ Years
6.	Maruti Suzuki (PWC)	15+ Years

Applicability (QNO-291.000/292.000) (MCQ – Incs.11.3 / Incs.31.1)

CLASS OR CLASSES OF COMPANIES (APPLICABLE)	OTHER THAN CLASS OR CLASSES OF COMPANIES (NOT APPLICABLE)
1. LISTED COMPANY; 2. PUBLIC COMPANY WHOSE PAID UP SHARE CAPITAL IS Rs. 10 Cr. OR MORE ; OR 3. PRIVATE COMPANY WHOSE PAID UP CAPITAL IS Rs. 50 CR. OR MORE ; OR 4. ANY COMPANY HAVING PUBLIC BORROWING FROM FI, BANK OR PUBLIC DEPOSIT OF Rs. 50 CRORES OR MORE	1. ONE PERSON COMPANY; OR 2. SMALL COMPANY; OR 3. DORMANT COMPANY

Maximum Tenure and Colling Period (QNO- 291.000/ 292.000/ 293.000/ 294.000)

Maximum Tenure



CA — 1 Term of 5 Consecutive Years

CA Firm — 2 Term of 5 Consecutive Years

COOLING PERIOD

After maximum tenure CA/Firm will not be eligible for next 5 years.

Manner of Rotation (QNO- 293.000/ 293.500 / 294.000)

- **Key Point-0**

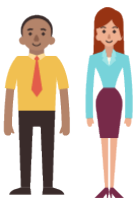
Rule 6 of the Companies (Audit and Auditors) Rules, 2014 prescribes the following manner of Rotation of Auditors by the Companies:

1. The Audit Committee shall recommend to the Board, the name of an individual Auditor or of an Audit Firm who may replace the incumbent Auditor on expiry of the term of such incumbent.
2. Where a Company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of Auditors and make its recommendation for appointment of the next auditor by the members in Annual General Meeting.
3. Break in term (Auditor vacates his office)
   - If there is break in term because of any reason, it will be assumed that his term of 5 AGM's is over.
     - In case of Individual—Cooling Period will get applicable immediately
     - In case of Firm—if it is end of 2nd term cooling period will get applicable immediately
   - Break of 5 years—if there is break of 5 years because of any reason it will be assumed that auditor has served cooling period of 5 years. He will get eligible for maximum tenure again.

- **Key Point-1 (Delhi)**

All the firms where partners of the rotating firm are partners (common partners) will be ineligible for appointment of that company for 5 years.

We have to check common partner **on date of appointment.**



AB & Associates (CA Firm)

If they are not eligible for 5 years



A B C D Associates (CA Firm)

Other firms with common partners will also get disqualified.

- **Key Point-2 (Kolkata)**

If a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm (New / Existing both are covered) of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.



This firm was not eligible for 5 years as they completed there maximum tenure.



Partner who was in-charge of firm and signing financial statement left the firm.



Firm (New / Existing) will not be eligible for 5 years.

- **Key Point-3 (Chennai)**

The incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

Term "same network" includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

pwc ⟷ Lovelock & Lewis

Deloitte	PwC
• Deloitte Haskins & Sells, • P C Hansotia, • C C Chokshi & Co, • SB Billimoria, • M.Pal & Co., • Fraser & Ross • Toucher Ross & Co. • A.F Ferguson	• Price Waterhouse, • Price Waterhouse & Co., • Lovelock & Lewes, • RSM & Co. • Dalal & Shah

Ernst & Young (E&Y)	KPMG
• SR Batliboi & Co, • SR Batliboi & Associates, • SV Ghatalia & Associates, • P D Desai & Co, • SRBC & Co LLP	• BSR & Co • BSR & Associates

- **Key Points-4 (Bengaluru)**

Gap of 1 year
Gap should be 5 years or more. Else it will be counted as consecutive

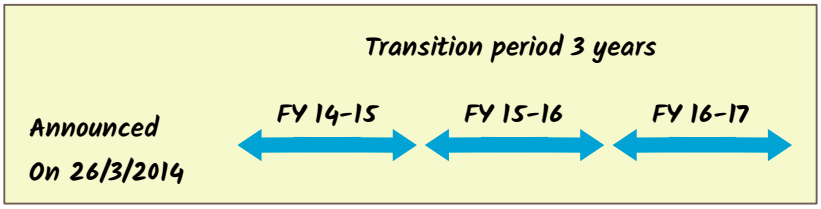
1st Term ⟷ **2nd Term**

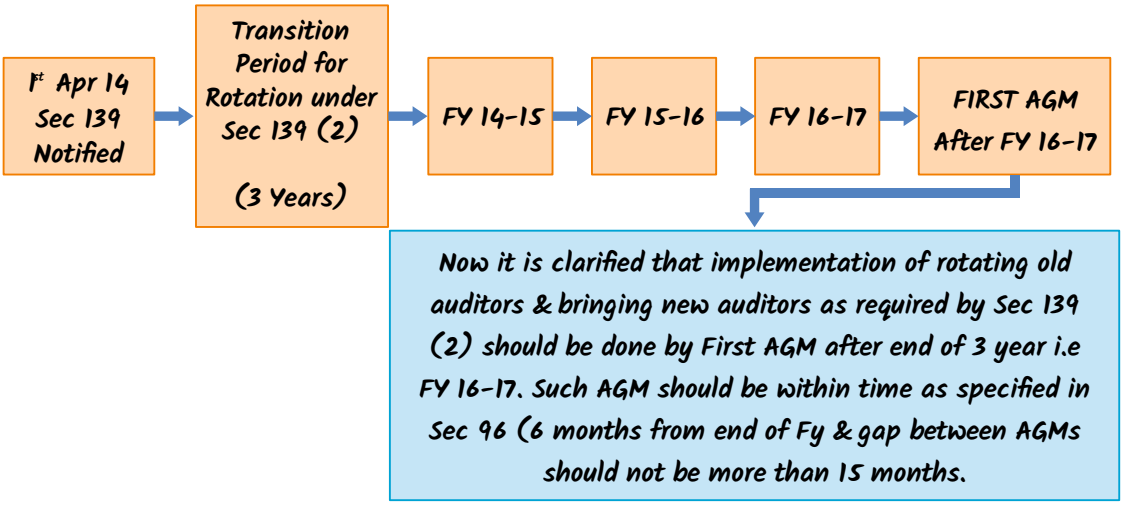
In above example it will be counted as consecutive 5 years.

Consecutive years shall mean all the financial years for which the auditor has been the auditor until there has been a break by five years or more.

- **Key Point-5 (Mumbai)**
  Number of years completed by auditor before commencement of act will be counted to implement rotation of auditor.

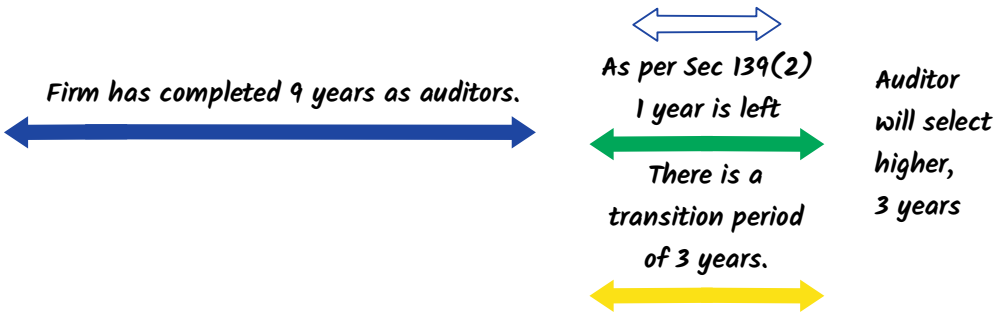
Company act has given 3 years for transition, that means rotation of auditor should be complied within 3 years. i.e. FY 14-15, FY 15-16, FY 16-17





Example 1.

Suppose there is a firm which has completed 9 consecutive years before commencement of act, then as per 139(2) they have 1 more left to do audit, but transition period is 3 years so they will select higher of 2 and do audit for 3 years.



Example 2.

Suppose there is a firm which has completed 4 consecutive years before commencement of act, then as per 139(2) they have 6 more left to do audit, but transition period is 3 years so they will select higher of 2 and do audit for 6 years.

Firm has completed 4 years as auditor.

As per Sec 139(2) 6 years are left

There is a transition period of 3 years.

Auditor will select higher, 6 years

- **Key Points-6 (Jaipur)**

Internal partner Rotation: – If company wants company can implement internal rotation of partners by ordinary resolution by members.

Internal Rotation (Voluntary)

↓

Example there is a firm ABCDE & Associate

↓

Company passes resolution to change partners every year

A	B	C	D	E
FY 16-17	FY 17-18	FY 18-19	FY 19-20	FY 20-21

- **Key Points-7 (Jammu)**

If company wants company can keep joint auditors.

Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

SECTION 140 REMOVAL & RESIGNATION OF AUDITOR

(CNO--CA.220) REMOVAL OF AUDITOR (QNO 295.000)

Removal by Shareholders



REMOVAL OF AUDITOR BY SHAREHOLDERS

- BEFORE AGM (Before end of the term)
- AT AGM (After end of the term)

Removal of Auditor before AGM (MCQ- 7 CA II/ 23.CA I)

- Sec 140 (1) & CAAR Rule 7






Step 1	Step 2	Step 3	Step 4
Auditor should be given opportunity of being heard before taking any action	Board Resolution should be passed and CG should be informed within 30 Days in form ADT-2	Central Government Approval for removal.	Special Resolution should be passed within 60 Days of receipt of Approval.

Removal of Auditor at AGM (QNO- 295.000)

- (AGM) Sec 140 (4)
  - Step-1



SPECIAL NOTICE



Company

PROPOSAL TO REMOVE ATLEAST 14 CLEAR DAYS BEFORE AGM

Not earlier than 3 months.

If rotation is applicable i.e maximum term is over, then special notice will not be required.

*CERTAIN MEMBERS
Either individually or collectively by such number of members holding at least 1% of total voting power; or
Holding shares not less than Rs 5 lakhs paid up capital.

  - Step-2

IMMEDIATELY SEND COPY OF SPECIAL NOTICE



Company



Auditor

  - Step-3

AUDITOR WILL SEND REPRESENTATION LETTER OF REASONABLE LENGTH (SHOULD NOT BE USED FOR NEEDLESS PUBLICITY OR DEFAMING COMPANY



COMPANY

Complaint to NCLT --> Right is abused by auditor --> If NCLT satisfied --> Stop circulation



AUDITOR

- **Step-4**



Company

SEND COPY OF "SPECIAL NOTICE" ATLEAST 7 DAYS BEFORE MEETING
+
SPECIFY THAT REPRESENTATION IS MADE
+
COPY OF REPRESENTATION BY AUDITOR

If representation is not circulated because received too late or because of mistake of company --> It should be read at AGM & Copy should be sent to ROC.



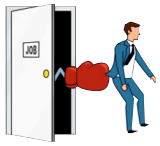
Shareholders

- **Step-5**



AGM

Resolution will be passed in AGM



AUDITOR REMOVED

- **Important Observation**
  - (a) Procedures of section 140(4) are applicable in following cases (Removal)
    - 1.No re appointment of retiring auditor at AGM
    - 2.Appointing auditor other than retiring auditor at AGM
  - (b) Reconstitution of audit firm does not mean automatic removal of auditor. If there is dissolution, then it means removal.
  - (C)If any of the joint auditor is not re-appointed, then it will lead to removal of that joint auditor and section 140(4) will be applicable.

Resignation (MCQ- Incs.01.1 / Incs.38.4 / Incs.42.4)

- **Sec 140 (2)**



AUDITOR

RESIGNATION



File statement giving reasons in ADT-3 within 30 Days.

Inform CAG only in case Government Companies



Company



ROC

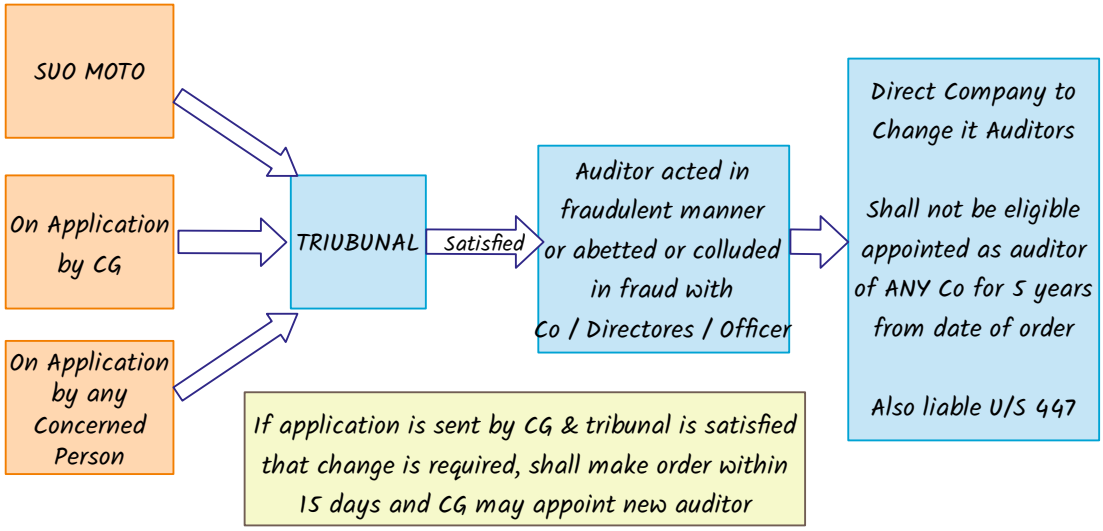


CAG

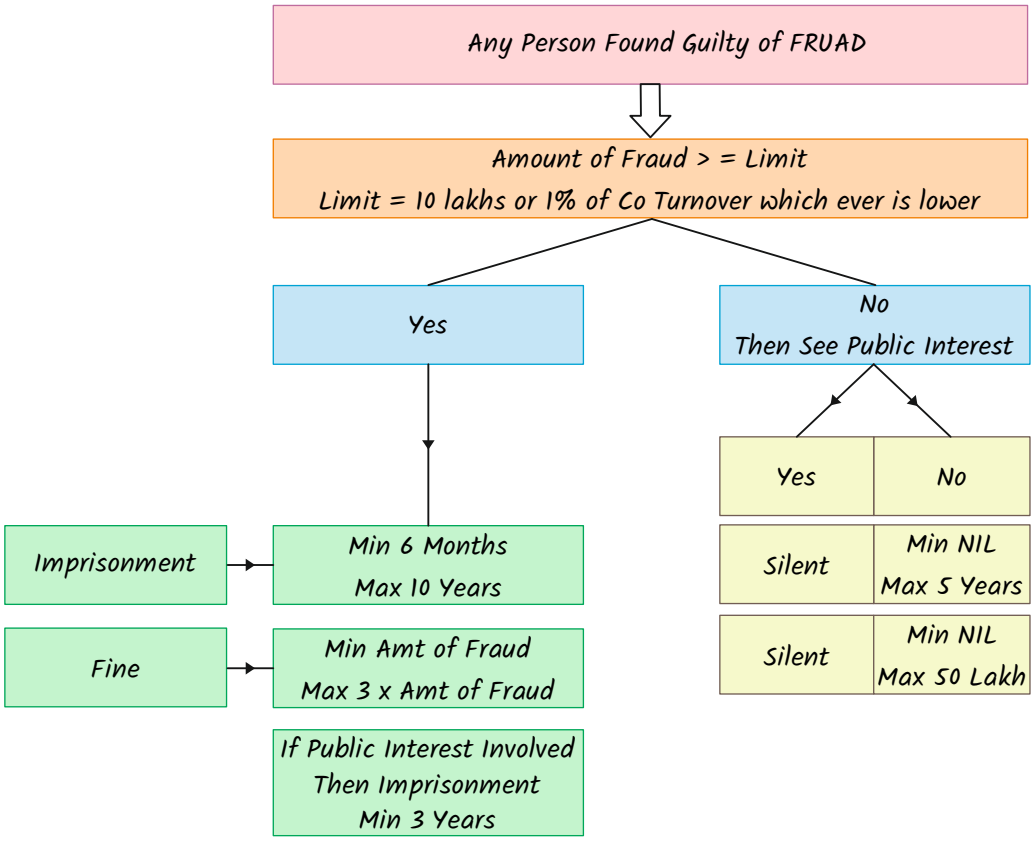
- **Penalty**
  - Non-Compliance will lead to penalty of 50,000 or remuneration of auditor whichever is lower.
  - In case of continuing failure, with a further penalty of 500 per day after the first day of non-compliance during which such failure continues, subject to a maximum of 2,00,000

Removal by Tribunal (QNO-298.000 / 298.200)

- **Sec 140 (5)**



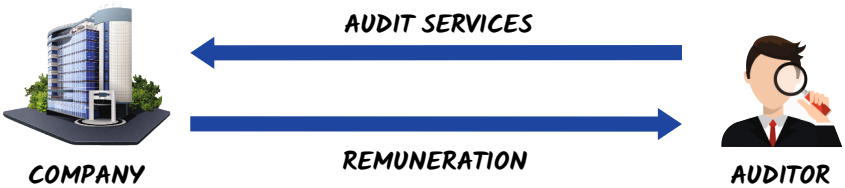
- **Sec 447 Punishment for Fraud**



SECTION 142 TO SECTION 147

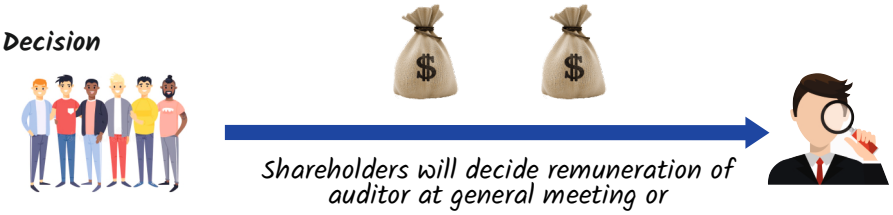
(CNO--CA.240) REMUNERATION (MCQ-12.CA.1)

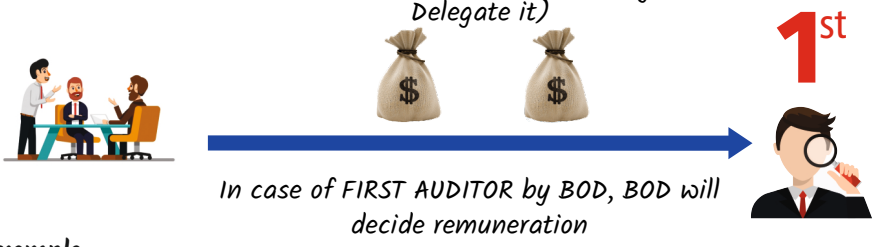
- **Sec 142 (1) & (2)**
  - **Meaning**



Remuneration =
Audit Fees + Perquisites + Out of pocket Expenses + Value of facilities for audit (Direct Expenses)

- **Decision**





- **Example**

Resolution at AGM of WIPRO

To appoint Auditors and in this regard to consider and if thought fit, to pass with or without modification, the following resolution as ORDINARY RESOLUTION:

RESOLVED that M/s. BSR & Co LLP (Registration Number 101248W with the Institute of Chartered Accountants of India) be and is hereby re-appointed as Auditors to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting of the Company at a ***remuneration to be decided by the Audit/Risk and Compliance Committee of the Board in consultation with the Auditors, which fee may be paid on a progressive billing basis to be agreed between the Auditor and the Audit/Risk and Compliance Committee of the Board or such other officer of the Company as may be approved by the Board/Committee.***

- **Disclosure**

DETAILS OF REMUNERATION SHOULD BE SHOWN IN NOTES TO ACCOUNTS AS PER SCHEDULE III

The Profit and Loss Account must disclose the amounts paid to the Auditors as fees, expenses or otherwise for services rendered, in the following manner –

A. As Auditor
B. As Advisor, or in any other capacity, in respect of –
   Taxation Matters
   Company Law Matters
   Management Services
C. In any other manner.

Example

NOTES ON FINANCIAL STATEMENTS FOR THE YEAR ENDED 31ST MARCH, 2015

26.2 Payment to Auditors as :

(₹in crore)

		2014-15	2013-14
(a)	Auditor:		
	Statutory Audit Fees	9	8
	Tax Audit Fees	1	1
(b)	Certification and Consultation Fees	11	8
(c)	Cost Audit Fees	1	1
	TOTAL	22	18

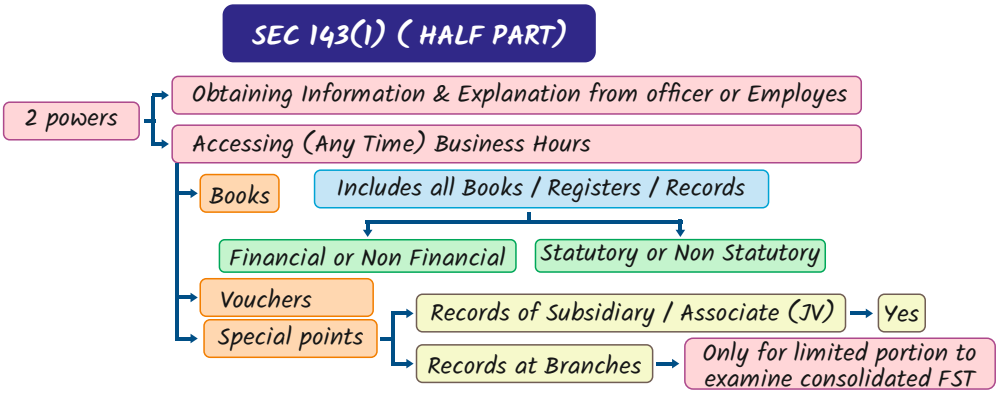
(CNO--CA.260) SECTION 143

- **Sec 143**
  1. Powers of auditor 143 (1)
  2. Duty to report 143 (1) / (2) / (3) / (4)
  3. Duty of auditor in Government Company & Powers of C&AG 143 (5) / (6) / (7)
  4. Powers & Duties of Branch Auditor 143 (8)
  5. Duty to comply with Auditing Standards 143 (9) / (10)
  6. Government has power to issue CARO (11)
  7. Duty to report fraud 143 (12) / (13) / (14) / (15)

(CNO--CA.280) POWERS OF AUDITOR

(QNO 323.100) (MCQ – Incs.24.1)

Chart



Shortcut for Rights of Auditor

A-GIRL has right to do Audit

- Right to Access Books & Vouchers
- Right to receive notices and to attend General meeting
- Right to obtain Information and explanation from officers
- Right to Report to the members on the accounts examined by him
- Right to Lien

Right to access books and Vouchers (QNO-323.100)

The auditor has the following powers/rights while conducting an audit:

- **Section 143(1)** of the Act provides that the auditor of a company, at all times, shall **have a right of access to the books of account and vouchers** of the company, whether kept at the registered office of the company or at any other place and he is **entitled to require from the officers of the company such information and explanation as he may consider necessary** for the performance of his duties as auditor.

  It may be noted that according to section 2(59) of the Act, the term **'officer' includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act;**

  The phrase 'books, accounts and vouchers' include all books which have any bearing, or are likely to have any bearing on the accounts, whether these be the usual financial books or the statutory or statistical books; memoranda books,

  (**E.g.,** inventory books, costing records and the like may also be inspected by the auditor.)

  Similarly, the term **'voucher' includes all or any of the correspondence which may in any way serve to vouch for the accuracy of the accounts.** Thus, the right of access is not restricted to books of account alone and it is for the auditor to determine what record or document is necessary for the purpose of the audit.
  The right of access is not limited to those books and records maintained at the registered or head office so that in the case of a company with branches, the right also extends to the branch records, if the auditor considers it necessary to have access thereto as per Section143(8).

- **Question**

  X Ltd. restrains its company auditor from visiting another branch at different location and having access to the inventory records maintained at that branch because the branch is already audited by another auditor and the report has been received.

  Answer

  Here, it may be noted that the company auditor has right to visit the branch, even if the branch accounts are audited by another auditor, if he considers it necessary to do so for the performance of his duties as auditor.

- **Recent Amendment**

  Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries and associate companies in so far as it relates to the consolidation of its financial statements with that of its subsidiaries and associate companies.

  Auditor can access books of Subsidiaries & Associates (Including JV) which are related to consolidation of these companies with holding company.

Right to receive notices and to attend General meeting (Sec 146)

The auditors of a company are entitled to attend any general meeting of the company (the right is not restricted to those at which the accounts audited by them are to be discussed); also to receive all the notices and other communications relating to the general meetings, which members are entitled to receive and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.

Section 146 of the Companies Act, 2013 discusses right as well as duty of the auditor. According to the section 146:

"all notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor."

Thus, it is right of the auditor to receive notices and other communications relating to any general meeting and to be heard at such meeting, relating to the matter of his concern, however, it is duty of the auditor to attend the same or through his authorised representative unless otherwise exempted.

Right to obtain Information and explan-ation from officers; {Sec 143(1)}

This right of the auditor to **obtain from the officers of the company such information and explanations as he may think necessary** for the performance of his duties as auditor is a wide and important power.

In the absence of such power, the auditor would not be able to obtain details of amount collected by the directors, etc. from any other company, firm or person as well as of any benefits in kind derived by the directors from the company, which may not be known from an examination of the books.

It is for the auditor to decide the matters in respect of which information and explanations are required by him.

When the auditor is not provided the information required by him or is denied access to books, etc., **his only remedy would be to report to the members** that he could not obtain all the information and explanations he had required or considered necessary for the performance of his duties as auditors.

Right to Report to the members on the accounts examined by him

The auditor shall make a **report to the members** of the company on the accounts examined by him and on **every financial statements** which are required by or under this Act to be **laid before the company in general meeting** and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under this section and **to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs** as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

Right to Lien

- **Requirements of General Principles of Law**
  General Principles of Law – Person with lawful possession of property and worked on it, can exercise lien for non-payment of his dues – Same logic can be applied to Client Books.
- **ICAEW Conditions**
  The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions: – Auditor Can exercise lien subject to Conditions – Possession as per Authority of Client / Documents belong to Client / Client Owes Money / Fees Money is Connected with Work on those documents.
- **Requirements of Sec 128**
  Sec 128 of Company Act – Books should be kept at registered office / So it is impractical for auditor to keep possession / Company has to allow access to auditor / directors / authorized persons.
  Requirements of Saxena Vs Sharma & ICAI ESB Announcement
  In Saxena Vs Sharma Case Supreme Court Said that professionals should not exercise line on client documents as it would lead to a problem in running client business. ICAI ESB also said if CA exercises lien, it will be misconduct.
- **Conclusion**
  As per general principles & ICAEW exercising lean may seem logical but as per Sec 128 / Supreme Court Judgement / ESB Announcement it is impractical to exercise lien and it will lead to misconduct.

Rights Cannot Be Restricted

If powers are supported by sections of law, then they cannot be restricted by AOA / MOA / Resolution, other powers are exercised as per discussion & agreement between auditor & company.

(CNO--CA.300) DUTY TO REPORT (QNO 324.000)

- **143 (1) / (2) / (3) / (4)**
  These sub sections require auditor to comment on additional points in audit report. Hence a separate section is added "Report on other legal & regulatory requirement"
- **Let's study with the help of a story.**



AUDITOR (HRITHIK)



MD (DANNY)



CFO (KANCHA)



MANAGER (BAD MAN)



EMPLOYEE (KATRINA)

Sec 143 (1)
(QNO- 324.000/ 326.000/ 327.000 / 327.500)

- Inquiry by Auditor



Auditor
(Hrithik)

Will do INQUIRY under Sec 143 (1) before making audit report.

- Meeting with MD



Auditor
(Hrithik)

Mujhe aap se kuch puchtaach karni hai !!!

Don't worry I will report under 143(1) only if findings / result are adverse



MD
(DANNY)

Auditor has to comment only if outcome is adverse.



1.If SHARES are issued for CASH-
→ Whether cash is received,
→ Whether accounting & presentation is proper if cash not received



2.In case of Secured Loans & advance Given-
→ Adequancy of security
→ Whether terms are prejudicial to terms of company



3.Whether Personal Expenses are charged to Revenue Account



4. If assets such as Shares / Debentures & Other securities are sold Below Cost-
→ Not applicable to Banking & Investment Company



5. Transaction presented merely by book entry (Fake Book Entry) are they prejudicial (Harmful)



6. Whether loans and advances made by the company have been shown as deposits

Sec 143 (2)
(MCQ-9. CA I)

- Making Audit Report



Auditor
(Hrithik)

→ Shall Make report to Members
→ On every Financial Statement placed in General Meeting
→ To best of his Information & Knowledge
→ Whether Financial Statement gives true & fair view

Sec 143 (3)
(MCQ-1.CA.1/
Incs.03.1/
Incs.03.5/
Incs.52.2/
Incs.54.3)

- Meeting with CFO
  - Matters to be Incorporated in Audit Report
  - Compulsory to report on all matters unless Not Applicable



Auditor
(Hrithik)



CFO
(KANCHA)



1. **ACCOUNTING STANDARDS or Ind AS** U/S 133 follow kiya kya (Also see detailed report ahead)

2. Whether Balance Sheet / P&L is in **AGREEMENT WITH BOOKS OF ACCOUNTS & RETURNS** (Branches)



3. **PROPER BOOKS & RETURNS** are maintained as per law,
   PROPER MEANS [SEC 128(1)]
   a. Accrual basis
   b. Double entry system
   c. True & Fair View



BOOKS OF ACCOUNTS

a. Receipts & Payments
b. Sales & Purchases
c. Assets & Liabilities
d. Cost Records (If 148 is applicable)

4. Adequacy of Internal Financial Control System Over Financial Reporting
   Exemption from IFCR Reporting
   - No IFCR Reporting to Private Company If its
   - OPC or Small Company

   - Turnover < 50 Crores as per latest audited FST and Aggregate borrowing from Banks, FIs, Any Body Corporates during the FY < 25 Crores.
     No exemption to any private company if these is default in filling annual return under sec 92 & financial statement under sec 137

5. Sec 164(2) is for financial irregularity.



Director

Tenure ⇒ FINANCIAL STATEMENT / ANNUAL RETURN

Not filed for continuous period of 3 financial years

Deposit / Debenture / Interest / Declared Dividend Unpaid for continuous period of 1 years or more

⇓

Company

Disqualified for appointment and reappointment for 5 years (All Companies)

New Director-
Such director shall not incurre the disqualification for a period of six months from the date of his appointments.

- **Meeting with Manager**

Rule 11 → Shortcut -L^2AF^2Da

L - Litigation → Pending litigation impact
- Probability more than 50% → Provision
- Other cases → Contingent liability disclosure

L - Losses → Adequate provision for losses on long term contract, including derivative contracts

A - Accounting software → If using A/c software
- Whether it records audit trail (edit log) → For all terms actions throughout the year & for Books of accounts
- Maintained as per legal requirement → not tampered.

Applicable from 1st April 23

F - Funds given as received* → Whether mgt has represented properly in notes to A/c as per sch III

- Funds given → To Intermediary → To pay / To give guarantee for → To Ultimate beneficiary on behalf of company
- Funds received → By funding party → To pay / To give guarantee for → To ultimate beneficiary on behalf of funding party

Based on audit procedure nothing has been noticed which suggest that there is material misstatement

F - Fund transfer* → Whether there is delay in trf of funds to Inv Education & protection fund (IEPF)

D - Dividend* → Whether dividend declared and paid is as per sec 123



Auditor (Hrithik)



EMPLOYEE (KATRINA)

(MCQ – Incs.32.2)

FROM EMPLOYEE

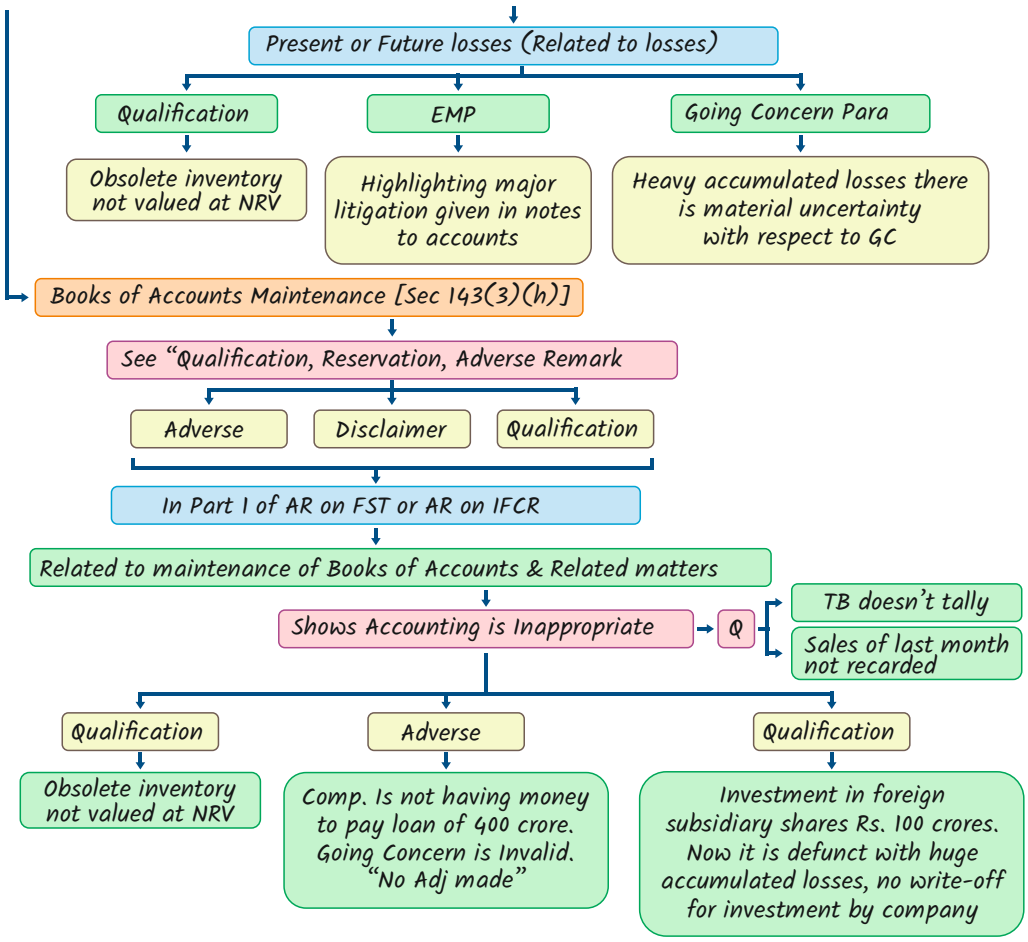
- All Info & Explanation → Whether received all info & explanation necessary for doing audit → If not give details there of
- Branch Report → Whether branch audit report is sent to him & whether it is properly dealt
- Adverse Effect on Functioning[Sec 143(3)(f)]

→ See "Observations or Comments of Auditor"

Adverse / Disclaimer / Qualification / EMP/OMP / Other Para's

→ In Part I of AR on FST or AR on IFCR (AR- Audit Report)

→ Whether it shows Adverse impact on functioning of company



Sec 143(4)

- ***Reasons for Negative Comments***
  If there is any negative comment or qualification, ***reason should be stated in report. Sec 143(4)***



Sec 197 (MCQ - 17.CA I / Incs.31.2)

- *Sec 197 (16) The auditor of the company shall, in his report under section 143, make a statement as to whether the* ***remuneration paid by the company to its directors is in accordance with the provisions of this section,*** *whether remuneration paid to any director is in excess of the limit laid down under this section and give such other details as may be prescribed.*

(CNO--CA.320) IFC VS IFCR (QNO - 332.200)

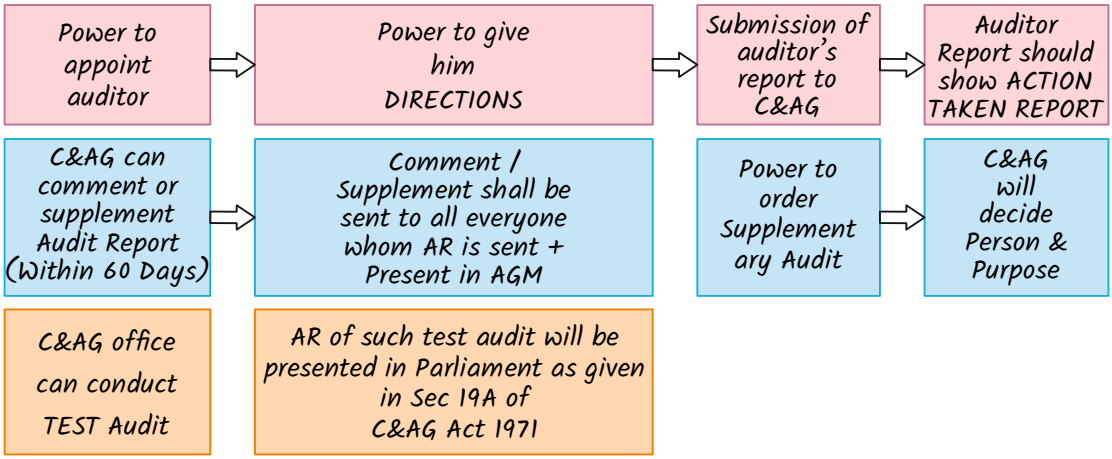
Refer Chapter 3 PART 3 OTHER CONCEPTS for this Point

(CNO--CA.340) POWERS OF C&AG IN CASE OF GOVERNMENT COMPANY

Sec 143 (5) / (6) / (7) (QNO-334.000/ 335.100/ 335.200 597.000)

(MCQ-3.CA.I / 11.CA.I)

Following are powers of C&AG in case of government companies & companies controlled or owned directly or indirectly by central or state government.



(CNO--CA.360) BRANCH AUDIT (QNO 336.000)

Section 143 (8) (QNO-336.000 /337.000/ 338.000/ 339.000) (MCQ-2.CA 1)

1. What do you mean by branch?
2. Who can become branch auditor?
3. Who appoints branch auditor?
4. Powers & Duties of branch auditor?
   Presentation in audit report in case of separate branch auditor?

What do you mean by branch?

Section 2(14) "branch office", in relation to a company, means any establishment described as such by the company.

E.g. letter head, information on board, visiting cards etc.

Who can become branch auditor?

- ***In case of Local Branches***
  1. The Company's Auditor appointed u/s 139.
  2. A person qualified for appointment as an Auditor u/s 141.



- ***In case of Foreign Branches***
  1. The Company's Auditor appointed u/s 139.
  2. An accountant duly qualified to act as an Auditor in accordance with the laws of that foreign country.



Who can appoint branch auditor?

- Appointment will be similar to appointment of auditor U/S 139

Powers & Duties of branch auditor? Rule 12 of CAAR 2014.

Audit Powers	• Same as Company's Statutory Auditor
Reporting	• To the Company's Auditor (Fraud Reporting will be applicable to Branch Auditor also)
Remuneration	• Same as Company's Statutory Auditor

Presentation in audit report in case of separate branch auditor?

- SA 600 is applicable if there are separate branch auditors, we will have to put Other Matter Paragraph (SA 706) to highlight that branch audit is done by other auditor.

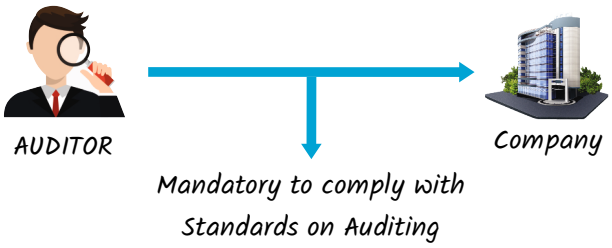
Example of ICICI Bank is given below.

OTHER MATTER

We did not audit the financial statements of Singapore, Bahrain, Hong Kong, Dubai, Qatar, Sri Lanka and New York-USA branches, whose financial statements reflect total assets of Rs 1,630,498 million as at 31 March 2014, the total revenue of Rs 69,223 million for the year ended 31 March 2014 and net cash flows amounting to Rs 209,916 million for the year ended 31 March 2014. These financial statements have been audited by other auditors, duly qualified to act as auditors in the country of incorporation of the said branches, whose reports have been furnished to us, and our opinion is based solely on the report of other auditors.

(CNO--CA.380) AUDITING STANDARDS

Sec 143 (9) / (10)



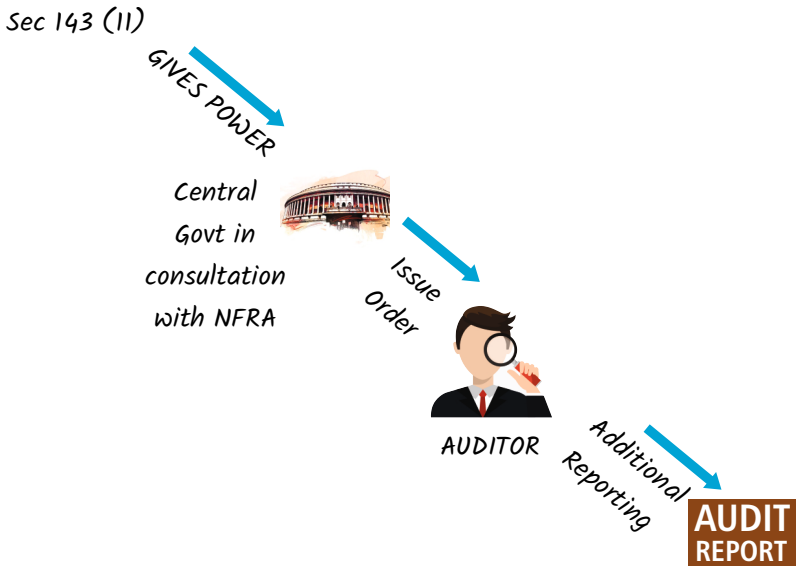
STANDARD APPROVAL PROCESS



(CNO--CA.400) ORIGIN OF CARO

Sec 143(11)

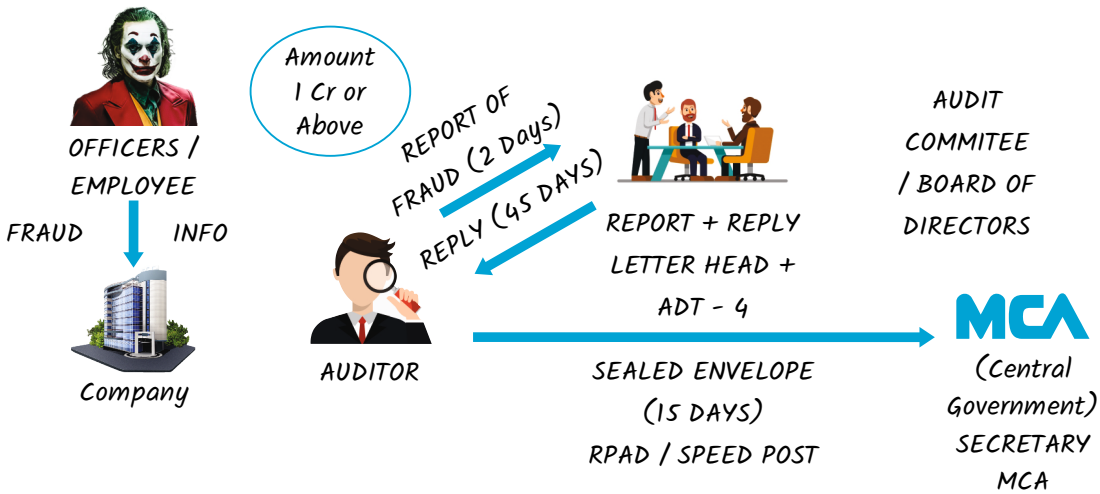
Origin of CARO 2020-143(11)



(CNO--CA.420) FRAUD REPORTING (QNO-340.000) (MCQ – Incs.13.2, Incs52.3)

Sec 143 (12) / (13) / (14) / (15) (MCQ-4.CA I / 20.CA I)

- **Amount of Fraud or Expected Fraud is Rs 1 Crore or above**



***Reason to believe that fraud is being committed / already committed

***also applicable to Cost Auditor (CMA) & Company Secretary (CS) (Secretarial Auditors)

***Will not be considered as breach of principle of confidentiality

***Fine

For Listed Company Rs 5,00,000

For Any Other Company 1,00,000

- **Amount of Fraud or Expected Fraud is below Icrore.**
  - The auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following: —
    (a) Nature of Fraud with description;
    (b) Approximate amount involved; and
    (c) Parties involved
  - The following details of each of the fraud reported to the Audit Committee or the Board as reported above during the year shall be disclosed in the Board's Report: —
    (a) Nature of Fraud with description;
    (b) Approximate Amount involved;
    (c) Parties involved, if remedial action not taken; and
    (d) Remedial actions taken.

- Guidance Note on Fraud Reporting
  - Auditors appointed under the following statutes not covered under Sec 143(12) for reporting under Fraud.

    Tax Audit under Income Tax Act 1961 / Sales Tax Audit / Vat Audit / Internal Auditors under Sec 138.

  - Reporting of fraud by auditor- only if auditor is the first person to identify/note such instance in the course of performance of his duties as an auditor.

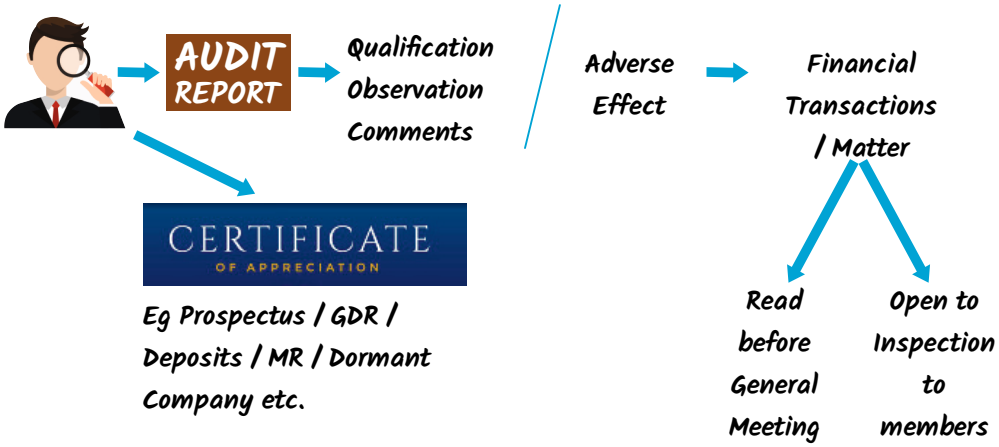
    The requirements for reporting by auditors under Section 143(12) would apply even if the fraud is required to be/has been reported under any other statute or to any other Regulator (Like reporting to RBI).

  - Reporting of fraud by an auditor relating to prior period-
    Fraud of previous year found during the FY beginning on or after April 1, 2014 which was not dealt with in the prior financial years in the financial statements/ audit report/ board's report should also be reported.

    No need to report to CG if auditor is satisfied that fraud has not taken place have persuasive evidence for the same.

(CNO--CA.440) SIGNING AUDIT REPORT

Sec 145



(CNO--CA.460) ATTENDING GENERAL MEETING (MCQ – Incs.13.1, Incs.51.2)

Sec 146


Company

Notice of General Meeting




Auditor


Authorized person qualified to do audit


AGM

COMPANY can exempt auditor from attendance

Auditor shall have right to be heard at such meeting on any part of the \business which concerns him as the auditor.

(CNO--CA.480) PENALTIES

Sec 147

Sec 139 to 146


Company

Fine
Min 25,000
Max (5,00,000)

Officer of Company

Fine
Min 10,000 Max 1,00,000



Refund Remuneration
+
Pay for damage to the company, statutory bodies or authorities or to member or creditors for loss arising out of incorrect or misleading statements audit report.

Sec 139 / 144 / 145


Auditor

Fine
Min 25,000 Max (5,00,000 or 4 x the audit fees whichever is less)

If knowingly / willfully / Intention

Fine
Min – 50000
Max (25,00,000 or 8 x Audit Fees whichever isless)

Imprisonment of 1 year BOTH

If convicted for any contraventions

- The Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons and such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.
- Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.
- In case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.

UNIQUE QUESTIONS	
MCQ No.	S.CA 1 / Incs.3.5, Incs.12.4 / Incs.21.1 (Covered in Bank Audit)

UNIQUE QUESTION	
QNO 288.000	Sec 139--Appointment of Statutory Auditor Verification
QNO 332.100	Sec 143-- EMP having adverse effect on functioning of company

After lot of research and analysis, we have carefully divided company audit notes in 2 Sections. 1st Section is in the form of simplified text, charts, and memory techniques with key words. It is easy to understand, remember and reproduce. 2nd Section contains detailed text which can be used for reference purpose as and when required as dictionary. This strategy will be helpful in volume management. It also helps all category of students as per their preferences. This is Section B

Section – B: – DETAILED TEXT

IMPORTANT DEFINITIONS

SECTION 2: – DEFINITIONS

Sec 2 Cl (6)

Associate Company

"Associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation.—For the purpose of this clause,—

(a) the expression "significant influence" means control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement;

(b) the expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement;

Sec 2 Cl (11) & Sec 2 Cl (20)

- **Sec 2 Cl (11) Body Corporate**

"body corporate" or "corporation" includes a company incorporated outside India, but does not include—

I. a co-operative society registered under any law relating to co-operative societies; and

II. any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf;

- **Sec 2 Cl (20) Body Corporate**

"company" means a company incorporated under this Act or under any previous company law;

Sec 2 Cl (28)

Cost Accountant

"Cost Accountant" means a cost accountant as defined in clause (b) of sub-section (1) of section 264 of the Cost and Works Accountants Act, 1959 (23 of 1959) **and who holds a valid certificate of practice under sub-section (1) of section 6 of that Act;**

Sec 2 Cl (41)

Financial Year

"financial year", in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up:

Provided that on an application made by a company or body corporate, which is a holding company or a subsidiary **or associate company of a company incorporate outside India** and is required to follow a different financial year for consolidation of its accounts outside India, the Tribunal may, if it is satisfied, allow any period as its financial year, whether or not that period is a year:

Provided further that a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause;

Sec 2 Cl (46)

Holding Company

"holding company", in relation to one or more other companies, means a company of which such companies are subsidiary companies.

***Explanation.**—For the purposes of this clause, the expression "company" includes anybody corporate;*

Sec 2 Cl (51)

Key Management Person (KMP)

"key managerial personnel", in relation to a company, means—

(i) the Chief Executive Officer or the managing director or the manager;

(ii) the company secretary;

(iii) the whole-time director;

(iv) the Chief Financial Officer

*(v) **such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board;*** and

Sec 2 Cl (76)

Related Party

"related party", with reference to a company, means—

(i) a director or his relative;

(ii) key managerial personnel or his relative;

(iii) a firm, in which a director, manager or his relative is a partner;

(iv) a private company in which a director or manager [or his relative] is a member or director;

(v) a public company in which a director or manager is a director [and] holds along with his relatives, more than two per cent of its paid-up share capital;

(vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

(vii) any person on whose advice, directions, or instructions a director or manager is accustomed to act:

***Provided** that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;*

(viii) anybody corporate which is—

- ***A.** a holding, subsidiary, or an associate company of such company;*
- ***B.** a subsidiary of a holding company to which it is also a subsidiary; or*
- ***C.** an investing company or the venturer of the company.*

***Explanation.**—For the purpose of this clause, "the investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an*

Sec 2 Cl (85)

Small Company

*"**Small company**" means a company, other than a public company,—*

*(i) paid-up share capital of which does not exceed four crore rupees, or such higher amount as may be prescribed which shall not be more than **ten crore rupees;** and*

*(ii) turnover of which **as per profit and loss account for the immediately preceding financial year** does not exceed fourty crore rupees or such higher amount as may be prescribed which shall not be more than **one hundred crore rupees:***

***Provided** that nothing in this clause shall apply to—*

- *A. a holding company or a subsidiary company;*
- *B. a company registered under section 8; or*
- *C. a company or body corporate governed by any special Act;*

Sec 2 Cl (87)

Subsidiary Company

"subsidiary company" or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the **composition of the Board of Directors;** or

(ii) exercises or controls more **than one-half of the [total voting power] either at its own or together with one or more of its subsidiary** companies:

Provided that such class or classes of holding companies as may be prescribed **shall not have layers of subsidiaries beyond such numbers as may be prescribed.**

Explanation.—For the purposes of this clause,

(a) a company shall be **deemed to be a subsidiary company** of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company's Board of Directors shall be deemed to be controlled by another company **if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;**

(c) the expression "**company**" **includes anybody corporate;**

(d) "**layer**" **in relation to a holding company means its subsidiary or subsidiaries;**

SECTION 139 TO SECTION 148

APPLICABILITY OF AUDIT

- Same as per Part A

QUALIFICATIONS

- **Sec 141 (1)**
  A person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant:

  Provided that a firm whereof majority of partners practicing in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

- **Sec 141 (2)**
  Where a firm including a limited liability, partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.

- **2(17)**
  "chartered accountant" means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) who holds a valid certificate of practice under sub-section (1) of section 6 of that Act;

DISQUALIFICATIONS

- **Section 141 (4)**
  Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

- **Sec 141(3)**
  The following persons shall not be eligible for appointment as an auditor of a company, namely:—

(a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008 (6 of 2009);

(b) an officer or employee of the company;

(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(d) a person who, or his relative or partner—

(i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company:

Provided that the relative may hold security or interest in the company of face value not exceeding one thousand rupees or such sum as may be prescribed

(ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed; or

(iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed

(e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;

(f) a person whose relative is a director or is in the employment of the company as director or key managerial personnel;

(g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

(h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

(i) a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.

Explanation.—For the purposes of this clause, the term "directly or indirectly" shall have the meaning assigned to it in the Explanation to section 144.]

- **Rule – 10, Companies (Audit and Auditors) Rules, 2014**

Disqualifications of auditor

(1) For the purpose of proviso to sub-clause (i) of clause (d) of sub-section (3) of section 141, a relative of an auditor may hold securities in the company of face value not exceeding rupees one lakh:

Provided that the condition under this sub-rule shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities:

Provided further that in the event of acquiring any security or interest by a relative, above the threshold prescribed, the corrective action to maintain the limits as specified above shall be taken by the auditor within sixty days of such acquisition or interest.

(2) For the purpose of sub-clause (ii) of clause (d) of sub-section (3) of section 141, a person who or whose relative or partner is indebted to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh shall not be eligible for appointment.

(3) For the purpose of sub-clause (iii) of clause (d) of sub-section (3) of section 141, a person who or whose relative or partner has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of one lakh rupees shall not be eligible for appointment.

(4) For the purpose of clause (e) of sub-section (3) of section 141, the term "business relationship" shall be construed as any transaction entered into for a commercial purpose, except –

(i) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;

(ii) commercial transactions which are in the ordinary course of business of the company at arm's length price -like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

Business Relationship

- **Sec 141 (3)(e)**

a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;

P-Providing Prohibited Services

- **Sec 141 (3) (i)**

a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.

- **Sec. 144**

Auditor not to render certain services.

An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:—

(a) accounting and bookkeeping services;
(b) internal audit;
(c) design and implementation of any financial information system;
(d) actuarial services;
(e) investment advisory services;
(f) investment banking services;
(g) rendering of outsourced financial services;
(h) management services; and
(i) any other kind of services as may be prescribed:

Provided that an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act shall comply with the provisions of this section before the closure of the first financial year after the date of such commencement.

Explanation. —For the purposes of this sub-section, the term "directly or indirectly" shall include rendering of services by the auditor;

(i) in case of auditor being an individual, either himself or through his relative or any other

person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trademark or brand is used by such individual;

(ii) in case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.

R- Relative is Director /KMP

- **Sec 141(3) (f) – Chart for Relative as Director / KMP**

a person whose relative is a director or is in the employment of the company as director or key managerial personnel;

- **Sec 2 (77) – Definition of Relative**

"relative", with reference to any person, means anyone who is related to another, if—

(i) they are members of a Hindu undivided family;

(ii) they are husband and wife; or

(iii) one person is related to the other in such manner as may be prescribed

O -> Officer or Employee of that company

P ->"Partner or Employee" of "Officer or Employee

- **Sec 141(3) (b) -- Officer or Employee of that company**

an officer or employee of the company;

- **Sec 141 (3) (c) -- "Partner or Employee" of "Officer or Employee**

a person who is a partner, or who is in the employment, of an officer or employee of the company;

S- Securities / Indebtedness/ Guarantee

- **Sec 141(3)(d) – Chart on Securities / Indebtedness/ Guarantee Clause**

a person who, or his relative or partner—

(i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company:

Provided that the relative may hold security or interest in the company of face value not exceeding one thousand rupees or such sum as may be prescribed;

(ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed or

(iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed.

C ->Ceiling Limit

- **Sec 141(3)(g)**

a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

C -> BODY CORPORATE

- **Sec 141(3)(a)**

a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008 (6 of 2009);

F-Fraud

- **Sec 141(3)(h)**

a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

OTHER DISQUALIFICATIONS

Same as Part A

SECTION 139 APPOINTMENT OF AUDITOR AND ROTATION

FIRST AUDITOR

Company other than Government Company

- **Section 139(6)**

  Notwithstanding anything contained in sub-section (1), the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within thirty days from the date of registration of the company and in the case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

Government Company

- **SEC 2(45) Definition of Government Company**

  "Government company" means any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company;

- **Sec 139(7)**

  Notwithstanding anything contained in sub-section (1) or sub-section (5), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within sixty days from the date of registration of the company and in case the Comptroller and Auditor-General of India does not appoint such auditor within the said period, the Board of Directors of the company shall appoint such auditor within the next thirty days; and in the case of failure of the Board to appoint such auditor within the next thirty days, it shall inform the members of the company who shall appoint such auditor within the sixty days at an extraordinary general meeting, who shall hold office till the conclusion of the first annual general meeting.

SUBSEQUENT AUDITORS

Company Other than Government Company

- **SEC 139(1)**

  Subject to the provisions of this Chapter, every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as may be prescribed.

  Provided further that before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor:

  Provided also that the certificate shall also indicate whether the auditor satisfies the criteria provided in section 141:

  as Provided also that the company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within fifteen days of the meeting in which the auditor is appointed.

Explanation. —For the purposes of this Chapter, "appointment" includes re-appointment.

- ***Rule – 3, Companies (Audit and Auditors) Rules, 2014***

Manner and procedure of selection and appointment of auditors

(1) In case of a company that is required to constitute an Audit Committee under section 177, the committee, and, in cases where such a committee is not required to be constituted, the Board, shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company:

Provided that while considering the appointment, the Audit Committee or the Board, as the case may be, shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India or any competent authority or any Court.

(2) The Audit Committee or the Board, as the case may be, may call for such other information from the proposed auditor as it may deem fit.

(3) Subject to the provisions of sub-rule (1), where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment.

(4) If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the annual general meeting.

(5) If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.

(6) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, the Board shall record reasons for its disagreement with the committee and send its own recommendation for consideration of the members in the annual general meeting; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the annual general meeting.

(7) The auditor appointed in the annual general meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.

- ***Rule – 4, Companies (Audit and Auditors) Rules, 2014***

Conditions for appointment and notice to Registrar

(1) The auditor appointed under rule 3 shall submit a certificate that –

(a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;

(b) the proposed appointment is as per the term provided under the Act;

(c) the proposed appointment is within the limits laid down by or under the authority of the Act;

(d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

(2) The notice to Registrar about appointment of auditor under fourth proviso to sub-section (1) of section 139 shall be in Form ADT-1.

Government Company	➢ **SEC 139(5)** *Notwithstanding anything contained in sub-section (1), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of one hundred and eighty days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.*
CASUAL VACANCY	
	➢ **SEC 139(8)** *Any casual vacancy in the office of an auditor shall—* *(I) in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within thirty days, but if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting;* *(ii) in the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within thirty days:* *Provided that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next thirty days.*
AUTOMATIC REAPPOINTMENT	
	➢ **Sec 139(10)** *Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.* ➢ **139 (9)** *Retiring auditor may be reappointed at an annual general meeting, if—* *(a) He is not disqualified for re-appointment;* *(b) He has not given the company a notice in writing of his unwillingness to be re-appointed;* *(c) A special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed."*
Procedure of Appointment	➢ **Sec 139 (11)** *Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.* ➢ **Sec 177** *Same as Part A*
Steps	*Same as Part A*
Step-1:- Selection & Recommen-dation of Auditor	*Same as Part A*
Step-2:- Consent & Certificate	*Same as Part A*

Step-3:- Resolution at AGM & Intimation of Appoint-ment	Same as Part A
ROTATION OF AUDITOR	
Reason	Same as Part A
Analysis	Same as Part A
Applicability	**Rule 5** **Class of Companies** For the purposes of sub-section (2) of section 139, the class of companies shall mean the following classes of companies excluding one person companies and small companies: - (a) all unlisted public companies having paid up share capital of rupees ten crore or more; (b) all private limited companies having paid up share capital of rupees 1[fifty] crore or more; (c) all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks, or public deposits of rupees fifty crores or more.
Maximum Tenure and Cooling Period	➢ **Sec 139 (2)** No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint, or re-appoint— (a) an individual as auditor for more than one term of five consecutive years; and (b) an audit firm as auditor for more than two terms of five consecutive years: **Provided that—** (i) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term; (ii) an audit firm which has completed its term under clause (b), shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term: Provided further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years: Provided also that every company, existing on or before the commencement of this Act which is required to comply with the provisions of this sub-section, shall comply with requirements of this sub-section within a period which shall not be later than the date of the first annual general meeting of the company held, within the period specified under sub-section (1) of section 96, after three years from the date of commencement of this Act :] Provided also that, nothing contained in this sub-section shall prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.
Manner of Rotation	**Rule 6 of Companies (Audit & Auditor) Rule 2014** ➢ **Manner of rotation of auditors by the companies on expiry of their term** 1. The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent. 2. Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

3. For the purpose of the rotation of auditors-
   (I) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;
   (ii) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

   Explanation. I – For the purposes of these rules the term "same network" includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

   Explanation. II – For the purpose of rotation of auditors, -
   (a) a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;
   (b) if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

4. Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

SECTION 140 REMOVAL & RESIGNATION OF AUDITOR

REMOVAL OF AUDITOR

Removal by Shareholders

Same as Part A

Removal of Auditor before AGM

- **Sec 140 (1)**

  The auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner:

  Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

- **CAAR Rule 7**

  Removal of the auditor before expiry of his term

  1. The application to the Central Government for removal of auditor shall be made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.
  2. The application shall be made to the Central Government within thirty days of the resolution passed by the Board.
  3. The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.

Removal of Auditor at AGM

- **(AGM) Sec 140 (4)**

  (I) Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139.

(ii) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.

(iii) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so,—

(a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and

(b) send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company, and if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting:

Provided that if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar:

Provided further that if the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.

Resignation

- **Sec 140 (2)**

The auditor who has resigned from the company shall file within a period of thirty days from the date of resignation, a statement in the prescribed form with the company and the Registrar, and in case of companies referred to in sub-section (5) of section 139, the auditor shall also file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other facts as may be relevant with regard to his resignation.

- **Rule – 8, Companies (Audit and Auditors) Rules, 2014**

Resignation of auditor

For the purposes of sub-section (2) of section 140, when an auditor has resigned from the company, he shall file a statement in **Form ADT-3.**

- **Penalty**

If the auditor does not comply with the provisions of sub-section (2), he or it shall be liable to a penalty of fifty thousand rupees or an amount equal to the remuneration of the auditor, whichever is less, and in case of continuing failure, with a further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees

Removal by Tribunal

- **Sec 140 (5)**

Without prejudice to any action under the provisions of this Act or any other law for the time being in force, the Tribunal either suo-moto or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors:

Provided that if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place:

Provided further that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any

company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

Explanation I.—It is hereby clarified that the case of a firm, in liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.

Explanation II. —For the purposes of this Chapter the word "auditor" includes a firm of auditors.

- **Sec 447 Punishment for Fraud**

Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud [involving an amount of at least ten lakh rupees or one per cent of the turnover of the company, whichever is lower], shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years:

[Provided further that where the fraud involves an amount less than ten lakh rupees or one per cent of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to [fifty lakh rupees] or with both. **]**

Explanation. —For the purposes of this section—

(i) "fraud" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;

(ii) "wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled;

(iii) "wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.

SECTION 142 TO SECTION 147

SECTION 142 TO SECTION 147

- **Sec 142 (1) & (2)**

1. The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein:
   Provided that the Board may fix remuneration of the first auditor appointed by it.
2. The remuneration under sub-section (1) shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.

POWERS & DUTIES OF AUDITOR

- **Sec 143**

1. Powers of auditor 143 (1)
2. Duty to report 143 (1) / (2) / (3) / (4)
3. Duty of auditor in Government Company & Powers of C&AG 143 (5) / (6) / (7)
4. Powers & Duties of Branch Auditor 143 (8)
5. Duty to comply with Auditing Standards 143 (9) / (10)
6. Government has power to issue CARO (11)
7. Duty to report fraud 143 (12) / (13) / (14) / (15)

Powers of auditor	Same as Part A	
Duty to report	Same as Part A	
	➢ Sec 143 (1)	➢ Inquiry by Auditor Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor and amongst other matters inquire into the following matters, namely:— (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members; (b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company; (c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company; (d) whether loans and advances made by the company have been shown as deposits; (e) whether personal expenses have been charged to revenue account; (f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading: Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all [its subsidiaries and associate companies] in sofar as it relates to the consolidation of its financial statements with that of [its subsidiaries and associate companies].
	➢ Sec 143 (2)	➢ Making Audit Report The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under sub-section (11) and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

➢ Sec 143 (3)	➢ Matters to be Incorporated in Audit Report The auditor's report shall also state— (a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements; (b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him; (c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report; (d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns; (e) whether, in his opinion, the financial statements comply with the accounting standards; (f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company; (g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164; (h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith; (i) whether the company has adequate [internal financial controls with reference to financial statements] in place and the operating effectiveness of such controls; (j) such other matters as may be prescribed.
➢ Sec 143(4)	➢ Reasons for Negative Comments Where any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons therefor.

IFC VS IFCR

Same as Part A

Powers of C&AG in case of Government Company

➢ **Sec 143 (5) / (6) / (7)**

Sec 143 (5)

[In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 and direct such auditor the manner in which the accounts of the company are required to be audited and]thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the

	Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company. ***Sec 143 (6)*** *The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report under sub-section (5) have a right to, —* *(a) conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorized in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and* *(b) comment upon or supplement such audit report:* *Provided that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.* ***Sec 143 (7)*** *Without prejudice to the provisions of this Chapter, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A87 of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971 (56 of 1971), shall apply to the report of such test audit.*
Branch Audit	➢ ***Section 143 (8)*** *Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:* *Provided that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.*
What do you mean by branch?	*Section 2(14) "branch office", in relation to a company, means any establishment described as such by the company.*
Who can become branch auditor?	*Same as Part A*
Who can appoint branch auditor?	➢ *Appointment will be similar to appointment of auditor U/S 139*

Powers & Duties of branch auditor? Rule 12 of CAAR 2014.	➢ **Rule – 12, Companies (Audit and Auditors) Rules, 2014.** **Duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor.** (1) For the purposes of sub-section (8) of section 143, the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143. (2) The branch auditor shall submit his report to the company's auditor. (3) The provisions of sub-section (12) of section 143 read with rule 12 hereunder regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.
Presentation in audit report in case of separate branch auditor?	Same as Part A
Auditing Standards	➢ **Sec 143 (9)** Every auditor shall comply with the auditing standards. ➢ **Sec 143 (10)** The Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 390 of the Chartered Accountants Act, 1949 (38 of 1949), in consultation with and after examination of the recommendations made by the National Financial Reporting Authority: Provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.
Origin of CARO	➢ **Sec 143(11)** The Central Government may, in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein:
Fraud Reporting	➢ **Sec 143 (12) / (13) / (14) / (15)** **Sec 143 (12)** Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed: Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed: Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.] **Sec 143 (13)** No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) if it is done in good faith.

Sec 143 (14) The provisions of this section shall mutatis mutandis apply to—

(a) the 92[cost accountant] conducting cost audit under section 148; or

(b) the company secretary in practice conducting secretarial audit under section 204.

Sec 143 (15)

If any auditor, cost accountant, or company secretary in practice does not comply with the provisions of sub-section (12), he shall, —

a) in case of a listed company, be liable to a penalty of five lakh rupees; and

b) in case of any other company, be liable to a penalty of one lakh rupees.]

- **Rule – 13, Companies (Audit and Auditors) Rules, 2014**

[Reporting of frauds by auditor and other matters.

(1) If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

(2) The auditor shall report the matter to the Central Government as under:

(a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five days;

(b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;

(c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

(d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

(e) the report shall be on the letterhead of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and

(f) the report shall be in the form of a statement as specified in Form ADT-4.

(3) In case of a fraud involving lesser than the amount specified in sub-rule (1), the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:—

(a) Nature of Fraud with description

(b) Approximate amount involved; and

(c) Parties involved

(4) The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year shall be disclosed in the Board's Report: —

(a) Nature of Fraud with description;

(b) Approximate Amount involved;

(c) Parties involved if remedial action not taken; and

(d) Remedial actions taken.

(5) The provision of this rule shall also apply, mutatis mutandis, to a Cost Auditor and a Secretarial Auditor during the performance of his duties under section 148 and section 204, respectively.]

SIGNING AUDIT REPORT

- **Sec 145**

Auditor to sign audit reports, etc.

The person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of sub-section (2) of section 141, and the qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

ATTENDING GENERAL MEETING

- **Sec 146**

Auditors to attend general meeting.

All notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorized representative, who shall also be qualified to be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

PENALTIES

- **Punishment for contravention- Sec 147**

1) If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees, but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable [***] with fine which shall not be less than ten thousand rupees, but which may extend to [one lakh rupees].

2) If an auditor of a company contravenes any of the provisions of section 139 [***], section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees, but which may extend to five lakh rupees [or four times the remuneration of the auditor, whichever is less]:

Provided that if an auditor has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year [and with fine which shall not be less than fifty thousand rupees, but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, whichever is less].

3) Where an auditor has been convicted under sub-section (2), he shall be liable to—

   i. refund the remuneration received by him to the company; and
   ii. pay for damages to the company, statutory bodies, or authorities 55[or to members or creditors of the company] for loss arising out of incorrect or misleading statements of particulars made in his audit report.

4) The Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

5) *Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally:*

*[**Provided** that in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.]*

COST AUDIT

(CNO-COST.020) APPLICABILITY OF COST RECORDS & COST AUDIT (QNO-342.100/342.200)

Provisions of Sec 148 & Cost Audit Rules

(MCQ – Incs.27.5)

Cost records are mandatory to all companies including foreign companies Engaged in production of goods or providing services

Cost Records if overall TO = > 35 Crores

A
Regulated Sector
Telecom/ Electricity/ Petroleum/ Drugs & pharmaceuticals/ Fertilizers / Sugar

Cost Audit if Overall TO > = 50 Crores and Aggregate Individual TO > = 25 Crores

B
Non regulated Sector
There are around 33 different industries which are covered

Cost Audit if overall TO > = 100 Crores and Aggregate Individual TO > = 35 Crores

All turnovers referred above are of PRECEDING YEARS.

Sec 2 Cl (11) & Sec 2 Cl (20)

NOTE: -Cost Records / Cost Audit will not be applicable in first year of newly formed Company.

Shortcut to Remember Industries in Regulated Sector **SET – PDF**
S- Sugar / **E** – Electricity / **T** – Telecom
P- Petroleum / **D**- Drugs / **F** – Fertilizers

Examples for Non-Regulated Sectors
Iron & Steel / Cement / Rubber /
Edible Oil / Textile / Paper / Plastic

Exemption from Cost Records

- Nothing should apply to foreign companies having liaison office in India
- Not applicable to company which is classified as **MICRO or SMALL** as per **MSMED** Act.
  No exemption to MEDIUM enterprises.

Exemptions from Cost Audit

- If whose revenues from, exports, in foreign exchange, exceeds 75% of its total revenue; or
- Which is operating from a Special Economic Zone
- Rule 4 One more exemption from Cost Audit, earlier there were 2 now its total 3 Company which is engaged in generation of electricity for captive consumption through Captive Generating Plant. For this purpose, the term "Captive Generating Plant" shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005.

  Captive Generating Plant:- 26% or more of ownership with captive users & 51% or more power is used by captive users.

Numerical on Applicability & Exemption of Cost Record and Cost Audit

- **Cost Records Applicability:** - At least one Regulated / Non-Regulated product service + LY Overall Turnover 35 CR or more (Record should be kept only for regulated & unregulated products)
- **Cost Audit (Regulated):-** LY Overall turnover 50 CR or more + aggregate individual 25 CR or more
- **Cost Audit (Non-Reg):-** LY Overall turnover 100 CR or more + aggregate individual 35 CR or more

Situations	I	II	III	IV	V
Regulated Sector					
Sugar	5	15	5	15	
Electricity	10	25	10	25	120
Aggregate Individual (Reg)	15	40	15	40	120
Non-Regulated					
Cement	5	5	30	30	-
Edible Oil	10	10	25	25	-
Aggregate Individual (Reg)	15	15	55	55	-
Other					
Cloth	10	10	10	10	-
Herbal Products	20	20	40	40	-
Aggregate Individual (Others)	30	30	50	50	-
Overall Turnover (Reg + Non-Reg + Others)	60	85	120	145	120
Cost Records (Only Reg & Non-Reg)	Yes	Yes	Yes	Yes	Yes
Cost Audit (Reg)	No	Yes	No	Yes	Yes
Cost Audit (Non-Reg)	No	Yes	No	Yes	No
Exemption related details.	-	Exports 70 (82.35%)	SEZ-40 (33.33%)	-	Captive Generating Plant
Exemption from Cost Audit	-	Yes	Yes	-	Yes

(CNO-COST.040) COST AUDIT (QNO-342.300)

Who Can Do Cost Audit? (MCQ 21.CA I)

- Practicing **CWA/CMA**
- Disqualifications of 141 are applicable
- Company Auditor cannot be appointed as cost auditor
- This audit is in addition to company financial audit

Appointment of Cost Auditor

- Before appointment take written consent of the cost auditor to such appointment, and a certificate from him.

  Contents of Certificate: -

  - the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Cost and Works Accountants Act, 1959 (23 of 1959) and the rules or regulations made thereunder;

- the individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Act, so far as may be applicable;
- the proposed appointment is within the limits laid down by or under the authority of the Act; and
- the list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

- Company (BOD) shall within one hundred and eighty days (180) of the commencement of every financial year, appoint a cost auditor
- Every company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in **form CRA-2**, along with the fee as specified.

Cost Audit Report

- The cost statements, including other statements to be annexed to the cost audit report, shall be approved by the Board of Directors before they are signed on behalf of the Board by any of the director authorized by the Board, for submission to the cost auditor to report thereon.
- Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in **form CRA-3.**
- Every cost auditor shall forward his duly signed report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report, particularly any reservation or qualification contained therein.
- Every company covered under these rules shall, within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in **Form CRA-4** in Extensible Business Reporting Language format.
  Provided that the Companies which have got extension of time of holding Annual General Meeting under section 96 (1) of the Companies Act, 2013, may file form CRA-4 within resultant extended period of filing financial statements under section 137 of the Companies Act, 2013
- Every cost auditor appointed as such shall continue in such capacity till the expiry of one hundred and eighty days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed

Removal of Cost Auditor

- The cost auditor appointed under these rules may be removed from his office before the expiry of his term, through a board resolution after giving a reasonable opportunity of being heard to the Cost
- Auditor and recording the reasons for such removal in writing:
  Provided further that the **Form CRA-2** to be filed with the Central Government for intimating appointment of another cost auditor shall enclose the relevant Board Resolution to the effect
- Provided also that nothing contained in this sub-rule shall prejudice the right of the cost auditor to resign from such office of the company.

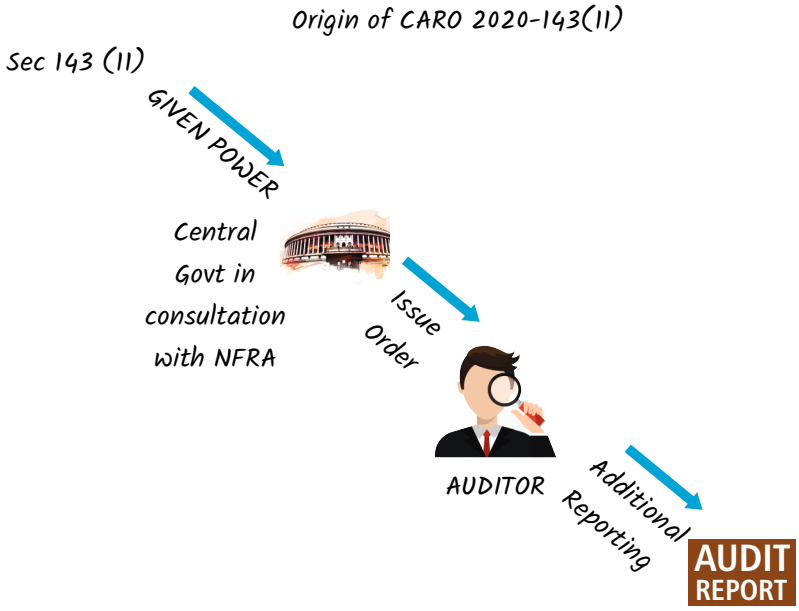
Casual Vacancy of Cost Auditor

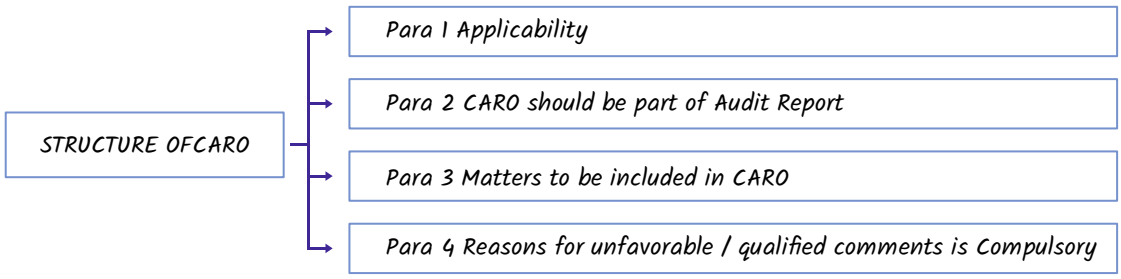
- Any casual vacancy in the office of a cost auditor, whether due to resignation death or removal, shall be filled by the Board of Director, within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.
- The provisions of sub-section (12) of section 143 of the Act and the relevant rules made thereunder shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules.

Various Cost Record / Audit Related Forms at One Place	➢ CRA 1 – Format of Cost Records / CRA 2 – Intimation of Appointment to CG / CRA 3 – Format of Cost Audit Report / CRA 4 – Intimation of Cost Audit Report.

PART - 2 COMPANIES AUDITOR REPORT ORDER (CARO) 2020

(CNO--CARO.020) ORIGIN & PARAGRAPHS OF CARO REPORTING





(CNO--CARO.040) APPLICABILITY & EXEMPTIONS FROM CARO REPORTING

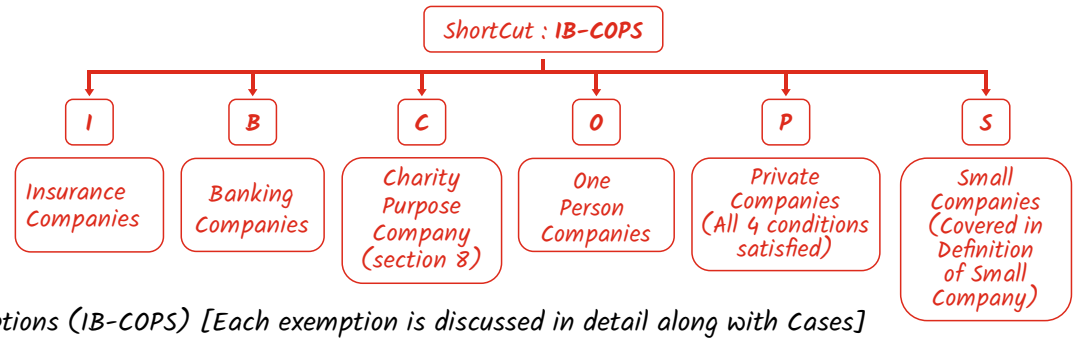
(QNO-379.000 / 380.000 /381.000 / 382.000 / 382.010 / 383.000 / 385.000 /386.000 / 386.010) (MCQ-CARO.06 , CARO.07, CARO.08, CARO.11, Incs.02.1 / Incs.04.4 / Incs.11.7 / Incs.30.3)

Sec 2 Cl (28)

Applicable from Financial Year 21-22

It shall apply to every company including a foreign company as defined under Sec 2 (42).

Exemptions



Exemptions (IB-COPS) [Each exemption is discussed in detail along with Cases]

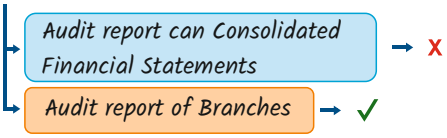
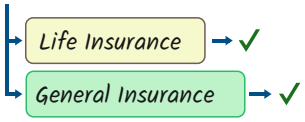
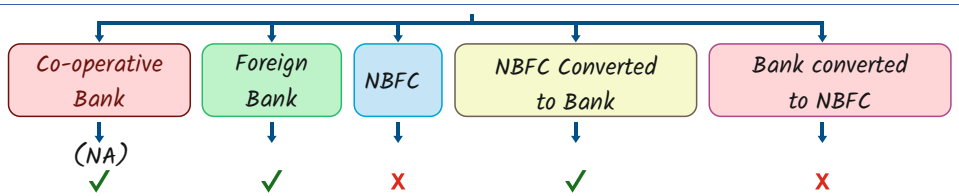
- Insurance Company
- Banking Company
- Section 8 Company (Charitable Purpose)
- One Person Company
- Private Limited Company (All conditions below should be satisfied)
  - Not Subsidiary or Holding of Public Company
    (i.e. Holding or Subsidiary should not be public)

- Paid up capital + Reserves **not exceeding 1 Crore B/S Date**
- Loan from Banks & FIs **not exceeding 1 Crore** -- At any point of time during the year
- **Total Revenue** not exceeding 10 crores -- During the Financial Year
  (As disclosed in Schedule III)

➢ Small Company

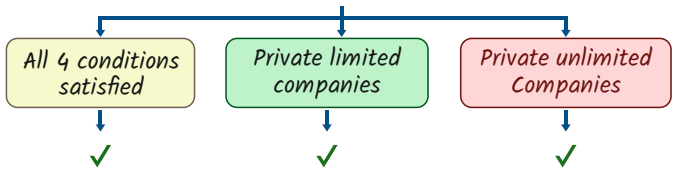
- **Definition of Small Company** (Other than Public Company)
  - Paid-up share capital of which **does not exceed 2 Crores** or such higher amount as may be prescribed which shall **not be more than ten crore rupees.**
  - **Turnover** of which as per its last profit and loss account **does not exceed 20 crores** or such higher amount as may be prescribed which **shall not exceeding 100 crore rupees**
  - Provided that nothing in this clause shall apply to: -
    - A holding company or a subsidiary company; (In short there should be no holding or subsidiary company)
    - A company registered under section 8; or
    - A company or body corporate governed by any special Act (SBI / SIDBI etc)

CASES ON APPLICABILITY OF CARO

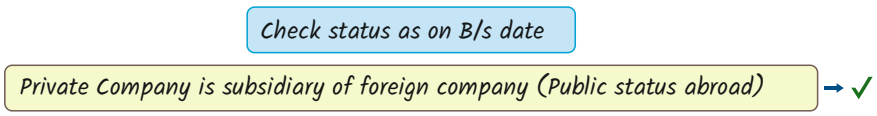
CASE	EXEMPTION
GENERAL CASES	
	
This order is on the company or auditors of the company?	This order is issued by CG on the auditors of the company, which they have to follow while doing their audit and preparing audit report. It is a reporting order. Company Auditor Report Order.
Is a consolidated financial statement exempt from CARO?	This Order shall not apply to the auditor's report on consolidated financial statements except clause (xxi). That means, in audit report of consolidated financial statements, we will provide CARO report but only for Clause (xxi), rest of the 20 clauses wont be applicable.
Are branch audit reports exempt from CARO?	No, they are not exempt. It is applicable to branch auditors while preparing their report. As their reports will be studied and merged to make final audit report of the company.
INSURANCE COMPANIES	
	
Is exemption available for both life insurance & general insurance?	**Yes,** exemption is for both.
BANKS	
	

Will co-operative bank get exemption?	**Yes,** it is not a company not governed by company act, it is co-operative society, so CARO is as such not applicable
Will Foreign Bank get exemption?	**Yes,** As per Banking Regulation Act. Definition of bank covers foreign bank also. * Similarly, exemption is available to payment bank also.
Will NBFC get exemption?	**No,** Exemption is only to Banks.
In December NBFC was converted into Bank? Will it get exemption?	**Yes,** we have to see status as on year end and it is a bank at year end.
In December Bank was converted into NBFC? Will it get exemption?	**No,** we have to see status as on year end and it is a NBFC at year end.
SECTION 8	
Company was licensed under Sec 25 of company Act 1956, will it get exemption	**Yes,** they will get exemption as specified in Guidance Note on CARO 2016
When to check status of Insurance Company / Banking Company / Section 8 Company / Small Company for exemption?	No specific instructions are provided in CARO,As per Guidance Note on CARO we have to check status of these companies at the year-end on balance sheet date.

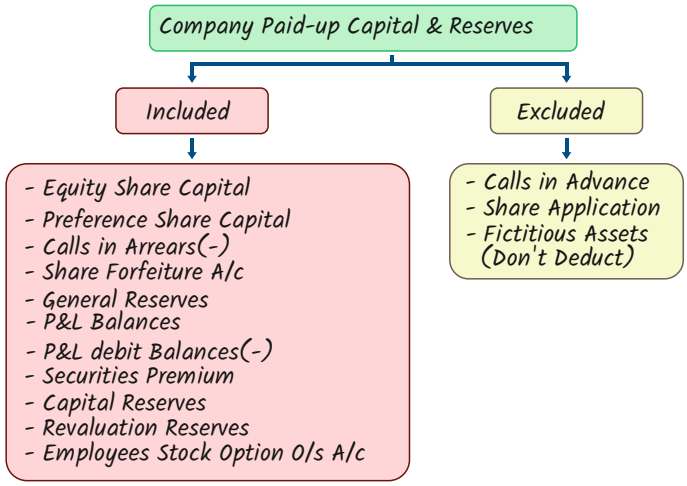
PRIVATE COMPANY (QNO-383.0/385.0/386.0/386.01 / Incs.33.2)



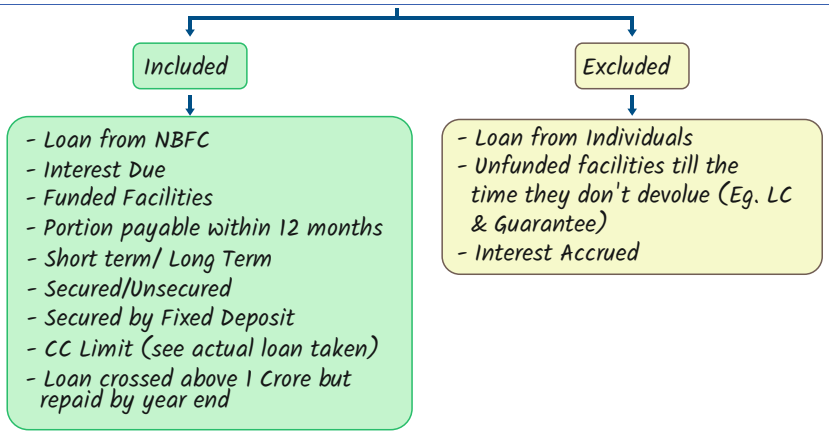
1ST CONDITION- HOLDING/SUBSIDIARY SHOULD NOT BE A PUBLIC COMPANY



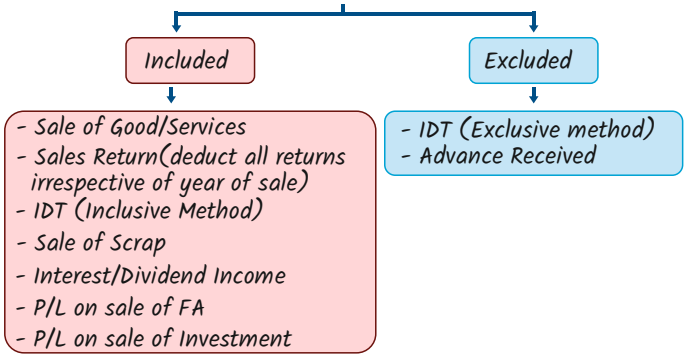
2ND CONDITION- PAID UP CAPITAL & RESERVES SHOULD NOT EXCEEDS 1 CRORE AS ON BS DATE



3RD CONDITION LOAN FROM BANKS AND FI'S SHOULD NOT EXCEED 1 CRORE ANYTIME DURING THE YEAR



4TH CONDITION TOTAL REVENUE SHOULD NOT EXCEED 10 CRORE



Private company satisfies all conditions except one will they get exemption?	**No,** all conditions should be satisfied to get exemption.
75% equity shares of private company were held by public company till 15th Jan, on this date 30% were sold in open market, Will such private company get exemption ?	**Yes,** we have to see status as on balance sheet date, here as on balance sheet date percentage holding will be 45%, so it is not subsidiary of public company, so they will get exemption.
Private unlimited company has paid up capital of 90 lakhs, outstanding loans 85 lakhs, turnover of 7 crores and it is not subsidiary or holding of public company. Will it get exemption?	**Yes,** it will get exemption, as per guidance note "Private Limited Company" should be construed to mean a company registered as a "private company" {as defined in sub-section (68) of section 2 of the Act} which includes limited as well as unlimited. So, private limited as well as unlimited both will get exemption. This is exactly opposite of the point of view taken by earlier Statement on CARO. (Very important for exams)
Private company is subsidiary of public foreign company or its holding company of public foreign company, will they get exemption?	Foreign companies are covered in definition of holding & subsidiary as they use word body corporate. But they cannot get status of public or private as definition of public or private does not cover word "body corporate" On this basis MCA has clarified that foreign companies even if public in their foreign country will not affect status of private company in India, this is done to promote foreign companies to come and open private companies in India with less compliances. **Conclusion** A public holding changes the status of private company to public company however if such public holding is a foreign company the status of private company remains unchanged. if Pvt Ltd was a subsidiary of a public company incorporated in India the status of Pvt Ltd would have got changed to public company and exemption would have not been available ,however since the holding company is a foreign company , status of private company remains unchanged and exemption shall be available to Pvt Ltd.

Private limited company has equity share capital of 60 lakhs, preference share capital of 10 lakhs, general reserves of 30 lakhs, P&L debit balance (60) lakhs, Securities Premium of 10 lakhs, Capital Reserve of 15 Lakhs, Share Application 20 lakhs, Share Forfeiture 5 lakhs, Revaluation Reserve 8 lakh, Capital Redemption Reserve 3 lakhs, Share Option Outstanding Account 6 lakhs will this company get exemption?	Computation of paid up capital & reserves: - Eq 60 + Pref 10 + Gen Res 30 – Debit bal of P&L (60) + Sec Premium 10 + Capital Reserve 15 + Share Forfeiture 5 + Revaluation Reserve 8 + Capital Redemption Reserve 3 + Share Option Outstanding 6 = 87, As it is not crossing 1 crore and if other conditions satisfied company can get exemption.
Loan 40 lakhs, Interest Accrued as on balance sheet date 8 lakhs, Interest due and unpaid 12 lakhs, how much will be counted for the purpose of exemption?	In case of term loans, interest accrued and due is considered as a borrowing whereas interest accrued but not due is not considered as a borrowing. So 40 +12 = 52 lakhs will be counted.
Fund based facilities from bank Rs 20 lakhs and non-fund-based facilities Rs 10 lakhs which are not yet devolved, how much should be counted in borrowings?	Non-fund-based credit facilities (E.g. Letter of Credit / Guarantee etc.), to the extent such facilities have devolved and have been converted into fund-based credit facilities, should also be considered as outstanding borrowings. That means 20 will be considered and 10 will be left as no money is taken till date under it.
Out of loan 30 lakhs, 5 lakhs is due within 12 months from date of balance sheet hence it is shown in short term borrowing as current maturity of long term loan. So how much loan should be considered 30 lakhs or 25 lakhs?	Current maturity of long term borrowings will also form part of borrowings. Moreover, outstanding dues in respect of credit cards would also be considered while calculating the limit of Rs. one crore; in respect of borrowings outstanding from a bank or financial institution. So here we will consider 25+5=30 whole loan amount outstanding irrespective of where it is shown in balance sheet.
Will borrowing cover short term loans?	There is no stipulation in the Order that the borrowing should be a long-term borrowing or a short-term borrowing or that it should be a secured borrowing or an unsecured borrowing. So it will be covered.
Overdraft facility fully covered by FD will it be covered in borrowing?	Notwithstanding the fact that the company has been granted an overdraft facility against, say, fixed deposits, of the company with the concerned bank, we will include whole overdraft amount in borrowing.
Private limited company has following borrowings from Mr Mukesh Ambani 80 lakhs, Mr Aziz Premji 10 lakhs, ICICI Bank 5 lakhs, IFCI 10 lakhs is exemption available?	We have to consider borrowings only from Banks & FIs so total is ICICI 5 + IFCI 10 = 15 lakhs, it is below 100 lakhs (1 cr.) so exemption is available.
Will loan from NBFC will be counted?	Yes, the term "financial institution" shall also cover a non-banking financial company (NBFC). No exemption to NBFC and NBFC loan will also be counted.
Private Limited company has taken CC of 300 lakhs and balance outstanding as on date is 80 lakhs?	We don't have to see limit, we have to see actual amount taken and outstanding any time during the year, it is not exceeding 100 lakhs (1 cr.), Exemption is available.
Loan during the year rose to 1.6 crore but it was repaid regularly and as on balance sheet date it has reduced to nil, will such private company get exemption?	No, in case of loan outstanding we have to see balance during the year and if any time it exceeds 1 crore condition required for exemption will be broken.
Whether revenue will include other income?	The term, "revenue", has been defined by the Order as total revenue disclosed in Schedule III of the Act. Accordingly, the total revenue would include other income as per Schedule III. Here revenue will also include revenue from discontinuing operations as specified in the Order.

Private limited company has Sale of petrol Rs 4 Crore, Sale of services Rs 2 Crore, Sales return Rs 1.5 Crore (Including 0.5 Crore from previous year) Excise Duty included in sale of petrol Rs 75 lakhs, Interest on Investment 20 lakhs, Profit on sale on Investments 30 lakhs, Scrap Sales Rs 40 lakhs, GST on sales included above 20 lakhs, is CARO applicable?	Computation of Turnover Sale (Petrol) 4 crore + Sale (Services) 2 Crore – Sales Return (1.5 Crore) – *Excise Duty 75 lakhs – *GST on Sales 20 lakhs + Interest on Investments 0.2 + Profit on sale of Investments 0.3 + Scrap sales 0.4 = 4.45 Crores *If excise and GST are accounted separately then they will not be included. We have assumed that accounting will be on separate basis and hence they are excluded. *In problem, it is said that excise and gst amount are included in given sales they doesn't comment on method of accounting, so we have to take popular assumption and solve the case. As Total Revenue is below 10 Crores CARO not applicable.

SMALL COMPANY

SMALL COMPANY DEFINITION

(Other than public co.(Pvt. Co.)

- Not Section 8 Company
- Not having holding or Subsidiary
- Not governed by special Act

Paid up capital should not exceed 4 crore (Limit can be increased to 10 crore)

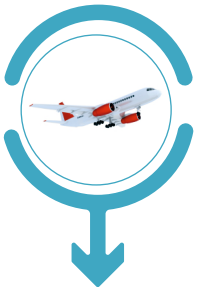
Turnover of LY should not exceed 40 Crore (Limit can be increased to 100Crore)

***If Private company satisfies either 4 conditions or definition of small company they will get exemption

A Pvt Ltd is small company but it does not fulfil all exemption conditions of private company?	Yes, such company will get exemption. It may also be noted that in case a company is covered under the definition of small company, it will remain exempted from the applicability of the Order even if it doesn't fulfil conditions of exemption for private company.
What is difference between exemption of private company and exemption of small company?	In small company, there should not be holding or subsidiary but in private company holding or subsidiary should not be public company. In small company, we see only paid up capital but in private company we see both paid up capital and reserves. In small company, we see TURNOVER of last year, in private company we see TOTAL Revenue during the year.



Flipkart to buy professional accessories
Cl 1 Plant, Property & Equip.



Indian Airlines to book flight tickets
Cl 2 Inventory



LinkedIn to search contacts for job application
Cl 3 Loans given

Continue on next Page...



Live.com to send emails for jobs
Cl 4 Loans given under Sec 185 186 (Directors & Others)



Dropbox to get soft copy of his documents
Cl 5 Deposits Taken



CNN to get updated about current affairs
Cl 6 Cost Records



Will listen music on spotify to chill.
Cl 7 Reporting on statutory dues

SLIDE 2 (Job Interviews)



One of the biggest steel manufacturing company of India
Cl 8 Unrecorded transaction



LIC biggest insurance company of India
Cl 9 Loan Repayment



Infosys India's Biggest Software Company
Cl 10 Application of funds from IPO / FPO/ Preferential allotment or private placement



Finolex biggest cable company of India
Cl 11 Fraud



India's biggest network, Network 18
Cl 12 Nidhi Company



India's biggest Company
Cl 13 Related Party Transactions



India's biggest petrol manufacturer
Cl 14 Internal Audit

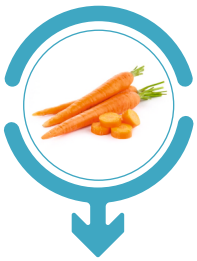
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Slide 3 (Good Food V/s Bad Food)



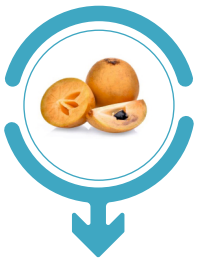
Nuts

Cl 15 Non Cash Transaction



Carrot

Cl 16 Certificate of Registrations by RBI



Chikoo

Cl 17 Cash Losses



Rabdi

Cl 18 Resignation of the statutory auditors



Madira

Cl 19 Material Uncertainty



Chocolate

Cl 20 CSR



Avocado

Cl 21 Adverse remarks/ Qualification w.r.t consolidated entities

21 CLAUSES OF CARO 2020

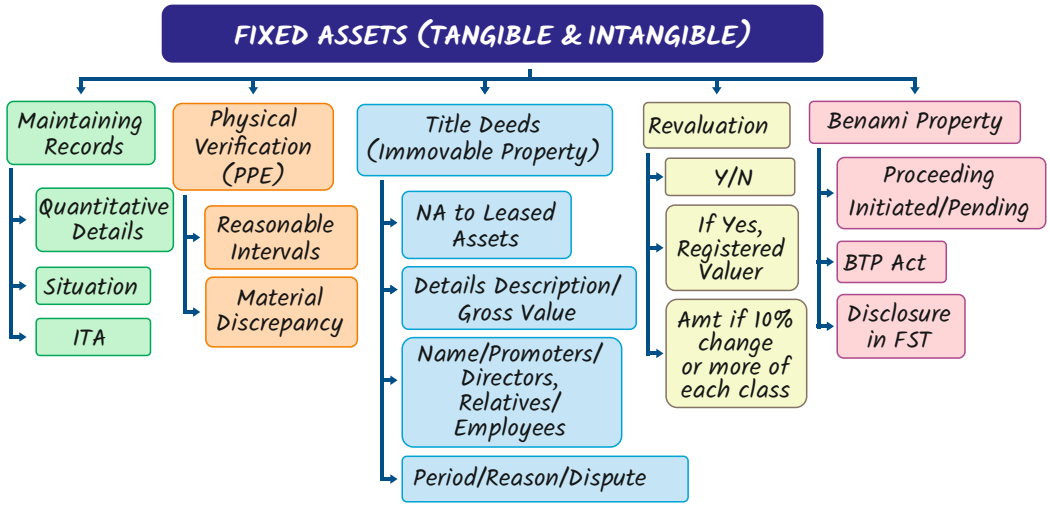
(CNO-CARO.080)

Clause I Reporting on Property, Plant and Equipment and Intangible Assets

(Flipkart)

(QNO-388.000/ 389.000/ 391.000/ 392.000/ 392.010 / 392.200)

(MCQ-CARO.02/ Incs.32.1 Incs.50.2)



a) Whether the company is maintaining proper records showing full particulars
   - including quantitative details and situation of Property, Plant and Equipment;
   - intangible assets;

b) whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account.

c) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the following details:
   - Description of property
   - Gross carrying value
   - Asset held in name of
   - Whether held in name of promoter, director or their relative or employee
   - Period during which it was not held in name of the Company
   - Reason for not being held in name of company
   - Where ownership of the Asset is in dispute, details of such dispute;

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held indicate range, where appropriate	Reason for not being held in name of company
-	-	-	-	-	also indicate if in dispute

d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;

e) whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements;

Some Key Points of Clause I

- 1st Maintenance

Maintenance of proper records including Quantity & Situation of FA

- **Inclusion Cases**
  - *Record should be kept for all assets whether constructed or acquired or taken on finance lease*
  - *It should include fully depreciated, amortised, impaired assets*
- **Location Cases**
  - *Location of moving assets can be kept in separate records, mention this in report*
  - *In case assets are located at home of staff then indicate name & designation in location of field*

- **2nd Physical verification**

Reasonableness of physical verification & If there are material discrepancies, is it properly adjusted in books of accounts

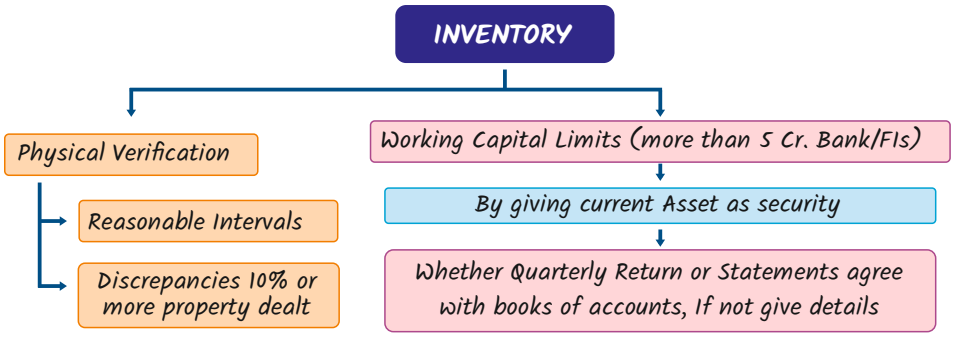
- *Reasonable Interval of Time*
  - *Annual verification is reasonable for Fixed Assets*
  - *It can be extended up to 3 years but in such case, mention this in report*

- **3rd Title Deeds**
  - *Whether title deed of immovable properties is in name of the company if not details should be given*
  - *Discrepancies generally arise in conversion from proprietor, partnership to company or amalgamation*
  - *If documents are lost see certified copies, FIR, take written representation*

- **4th Revaluation**
  - *Fair valuation of PPE upon first time adoption of Ind AS shall not be reported under this clause*
  - *Retain copy of valuation report of registered valuer, using such report will be covered in SA 500 and not SA 620*

- **5th Benami Transactions**
  - *Clause Refers to Benami Transaction (Prohibition) Act (BTP Act) 1988 but this act is renamed to Prohibition of Benami Property Transaction Act (PB-PT Act) 1988 in 2016 so while reporting refer to the amended name.*
  - *Various Standards Applicable*
    - *SA 250 – Apply if auditor comes to know that there is suspected or actual non-compliance of Prohibition of Benami Property Transaction Act 1988.*
    - *SA 501 – Apply if auditor comes to know litigation related to PB-PT Act 1988*
    - *SA 560 – Apply if order is initiated under PB-PT Act after year end before financial statement finalisation*
    - *SA 580 – Obtain written representation regarding details required for reporting*

(CNO-CARO.090) Clause II Reporting on Inventory (Indian Airlines) (QNO-393.000) (MCA-CARO.9)



a) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account.

b) whether during any point of time of the year, the company has been sanctioned working capital limitsin excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

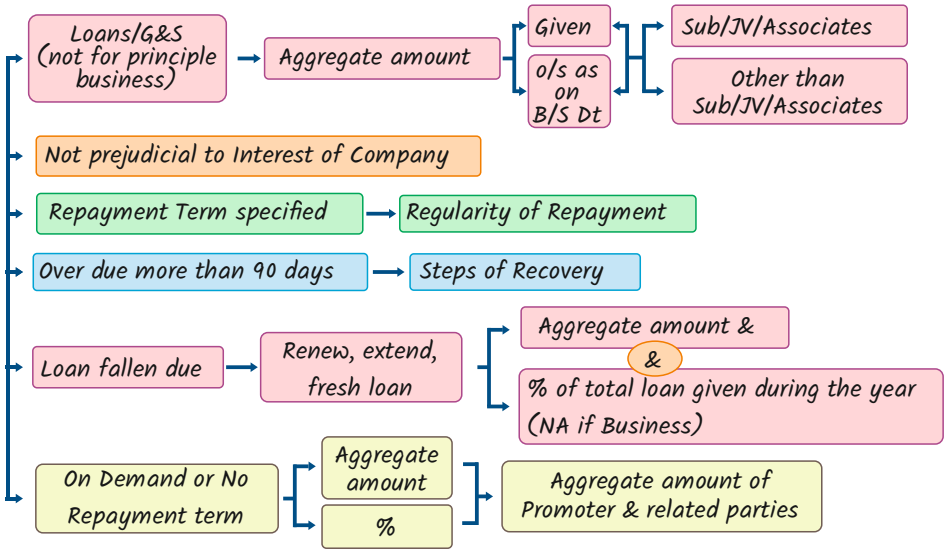
Some Key Points of Clause II

- Physical Verification
  - Reasonableness
    - Reasonableness of physical verification of inventory & If any material discrepancies observed, then whether it is adjusted.
      Reasonable interval of time for inventory is generally 1 year
  - Class of Inventory
    - Common classification of Inventory as per AS 2 and IND AS 2 is raw material, stores and spares , work in progress , finished goods and merchandise (held for resale).
  - Discrepancies
    - It should be computed on net basis.

- Working Capital Limits
  - Exclusion
    - However, this would exclude any working capital limits which are sanctioned without the security of the company's current assets.

(CNO-CARO.100)

Clause III Reporting on Loans, Investments, Guarantees, Securities and Advances in nature of Loan: (LinkedIn) (QNO-397.000)



- whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so,-
  a) whether during the year the company has provide loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate
     1. the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates

II. the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates;

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

c) in respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

d) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

e) whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, if so, specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];

f) whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013

Some Key Points of Clause III

- **Aggregate Amount, outstanding disclosure.**
  - Not Applicable to companies whose principal business is to give loans (FI's, NBFC's etc)
  - Guarantees will include those which are given to banks and financial institutions on behalf of third party.
  - Squared up loans should be counted for amount given .
- **Prejudicial**
  - Whether terms of condition are prejudicial
    - Terms generally includes interest, security, repayment schedule, restrictive covenants of agreement.
    - Concessional rates of interest to its employees who are related to directors as per policy of company are not prejudicial.
- **Repayment**
  - Whether schedule of repayment is specified & Whether repayment or receipt is regular If there is no repayment schedule specify in report
- **Steps of Recovery**
  - Total amount overdue for more than 90 days then comment on reasonableness of steps taken for recovery.
  - Steps can be in the form of reminders, meetings, ceasing transactions, lawyers notice, auction etc. they may not be only legal steps, legal steps are one of steps expected
- **Loans fallen due during the year**
  - Not Applicable to companies whose principal business is to give loans (FI's, NBFC's etc)
  - This clause is inserted to identify instances of 'evergreening of loans/advances in nature of loans.

    [Note: The term 'evergreening' is not defined in the Act. However, in general parlance it implies an attempt to mask loan default by giving new loans to help delinquent borrowers to

repay/adjust principal or pay interest on old loans.

- **Example –**

  Company A has an opening loan of Rs. 100 and granted 3 more loans of Rs. 200, 300 and 400 during the year. Company extended tenure in respect of two loans (Rs. 100 and Rs. 200) when fell due for payment. Percentage of the aggregate to the total loans or advances in the nature of loans granted during the year in the instant case would be 33%.

- **Loans repayable on demand or without repayment terms**

	All Parties	Promoters	Related Parties
Aggregate amount of loans/ advances in nature of loans Repayable on demand (A) Agreement does not specify any term or period of repayment (B)			
Totoal (A+B)			
Percentage of loans/ advances in nature of loan to the total loans			

AS 18 & SA 550

Whenever clause (iii) of Para 3 of CARO, 2020 is applicable, reporting under AS 18 (In detail) will also be applicable and to do audit SA 550 shall also be applied.

(CNO-CARO.110) **Clause IV Reporting on Compliance of Section 185 and 186 w.r.t Loans given: (Live.Com)** (QNO-397.100)

LOAN/INVESTMENT/GUARANTEE & SECURITIES



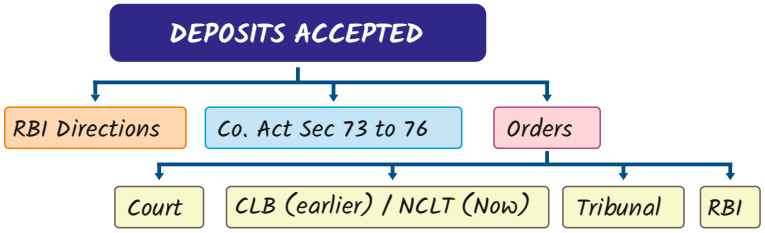
In respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.

Some Key Points of Clause IV

- **Sec 185 & 186**
  - Loans, Investments, Guarantee & Security is in Compliance with Sec 185 & 186
    - Sec 185 - Loan to directors
    - Sec 186 - Loan and Investment by Company
  - If non-compliance, then concerned details

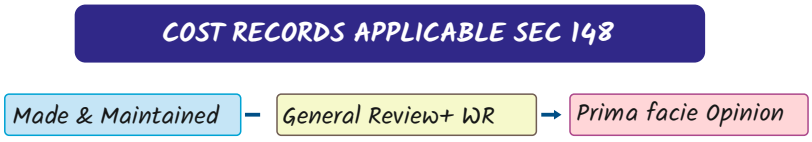
Sr.No.	Non-compliance of Section 186				Remarks, if any
		Name of company / Party	Amount involved	Balance as at balance sheet Date	
1.	Investment through more than two layers of investment companies				
2.	Loan given or guarantee given or security provided or acquisition of securities exceeding the limits without prior approval by means of a special resolution				
3.	Loan given at rate of interest (should not be less than govt bond interest rate) lower than prescribed				
4.	Any other default				

(CNO-CARO.120) Clause V Deposits (Dropbox)



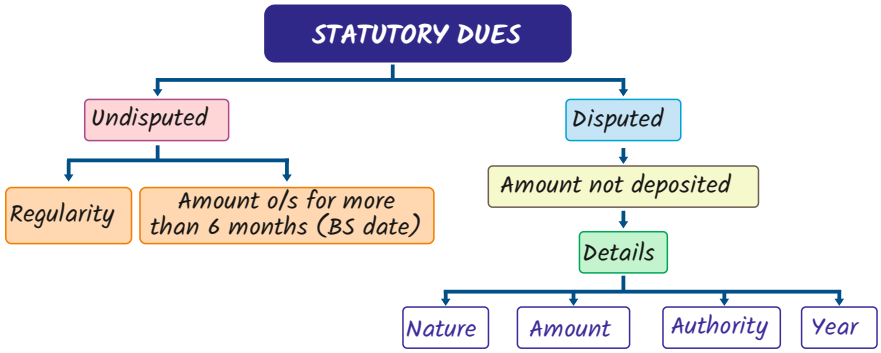
in respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules made thereunder , where applicable, have been complied with, if not, the nature of such contraventions be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not;

(CNO-CARO.130) Clause VI Cost Records (CNN) (QNO-399.000) (MCQ – Incs.33.3)



Whether maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.

(CNO-CARO.140) Clause VII / 7 Reporting on statutory dues (Spotify) (QNO-399.500 / 400.000/ 401.000/ 402.000) (MCQ-CARO.03/ CARO.10/ Incs.10.2 / Incs.31.3)



- *Whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;*
- *Where statutory dues referred to in subclause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).*

Key Points of Clause VII

- **Statutory Dues**
  - *Payment to government under agreement for goods and services purchased won't be covered. For Example – Electricity charges.*
  - *Further only those statutory dues which are payable to authorities are covered here. Payments to employees under payment of bonus act and payment of dividend to shareholders under companies act are not considered statutory dues, but when bonus ad dividend has to be transferred to authorities under some circumstances it will become statutory due.*
  - *Not restricted to list given in clause as it uses words "any other statutory dues" at the end*

- **1st Point Undisputed Dues -- Regularity**

  Regularity in depositing undisputed statutory dues including PF, ESIC, Direct Taxes, Indirect Taxes etc.
  - Such reporting is required where periodic payments are required i.e. monthly, quarterly etc.
  - For example, no need to comment on custom duty here but rent & interest to be paid regularly under customs act will be covered
  - Non-Payment of advance tax on due dates and later on paying it along with interest because of windfall gain is not irregularity
  - Paying all dues at year end with interest will be considered irregular

- **2nd Point Undisputed Dues – Outstanding Amount**

  Arrears of undisputed statutory dues outstanding more than 6 months as on balance sheet date.
  - Date till which we can pay amount without attracting penalties or interest should be considered as due date
  - if authority has granted additional time, stay then last date of such stay can be considered as due date

- **3rd Point Dispute**

  Details of taxes not been deposited on account of any dispute, specify amount &forum
  - Demand order from department is not dispute
  - Company asking clarification on notice or orders will not be considered as dispute
  - Company appealing against demand order will be considered dispute Or there should be positive evidence to prove that sustainable appeal can be made
  - Application to rectify order passed u/s 154 is also considered as dispute as we are going against order (Mistake apparent from records)
  - Details of dispute should be given irrespective of whether provision is made in books or not
  - Report only if amount is not deposited
- **Amount**

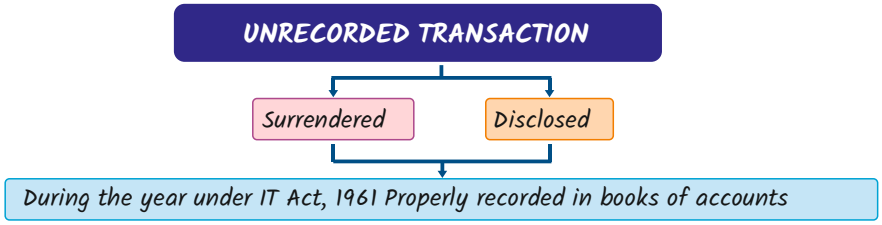
  All amounts disclosed should include penalty & interest amount.
- **SA 250 (Refer if question is related to non-compliance of law)**
  - **Responsibility of Management**

    Ensure that operations are as per Law & Regulations Including Law affecting financial statements
  - Responsibility of Auditor
    - **Overall Responsibility-**

      Obtain a reasonable assurance that FST as a whole are free from material misstatement considering applicable legal and regulatory framework.
    - **Non-Compliance**
      - During conduct of audit, audit procedures may bring instances of non-compliance or suspected non-compliance. Auditor shall remain alert to such instances and
      - If found auditor shall discuss the matter with management /TCWG. (In this case show cause notice may be an indication of non-compliance)
      - If Management/TCWG do not provide sufficient information that supports compliance with laws and regulations and, if it considered material to the FST, the auditor shall consider the need to obtain legal advice.
      - If non-compliance, has material effect on the FST, and has not been adequately reflected in the financial statements express a qualified or adverse opinion

- **AS 29 (Refer if question is related to non-compliance)**
  - Create provision of probable liability
  - Remaining may be disclosed as the contingent liability

(CNO-CARO.150) Clause VIII/8 Reporting on unrecorded transaction (TATA Steel)

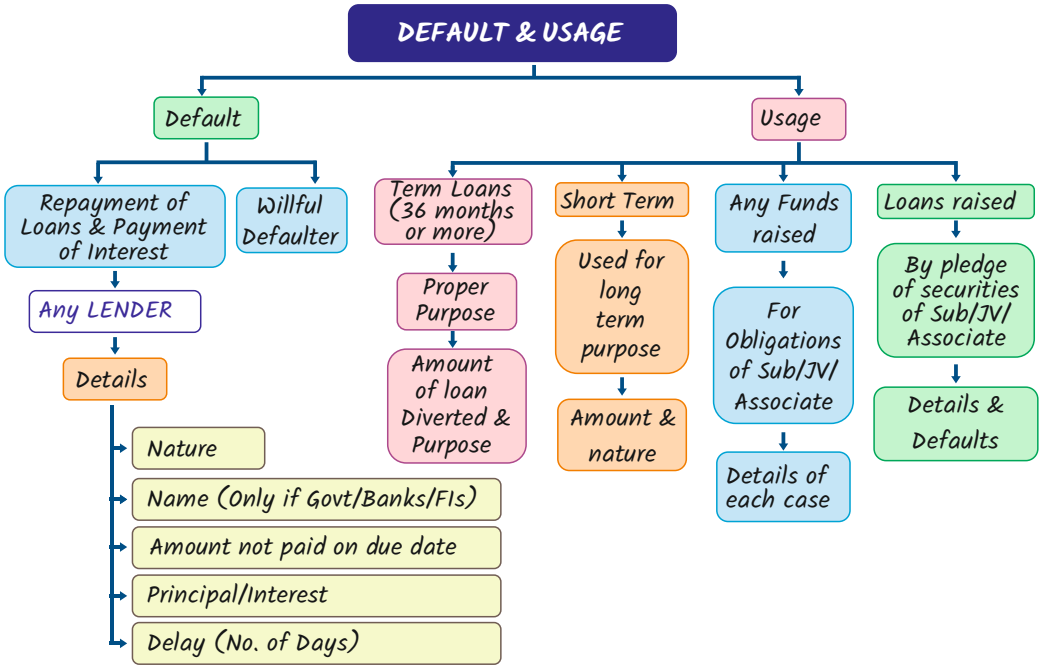


whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year;

Key Points of Clause VIII

- Transactions which are voluntarily reported (irrespective of before or after the raid), are reported here. Additions made by income tax authorities on there own without any admission by company is not to be reported.
- Such items are shown as extra ordinary in P&L as per AS 5 and IND AS 8.

(CNO-CARO.160) Clause IX / 9 Reporting on repayment and usage of Borrowings (LIC) (QNO-403.000/ 404.000/ 404.500/ 406.000/ 406.010/ 407.000) (MCQ-CARO.05/ Incs.08.5 / Incs.11.1 Incs.58.1)



- **whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as below:**
  - **Nature of borrowing, including debt securities**
  - **Name of lender (Lender wise details to be provided in case of defaults to banks, financial institutions and Government)**
  - **Amount not paid on due date**
  - **Whether principal or interest**
  - **No. of days delay or unpaid**
  - **Remarks, if any**
- **whether the company is a declared willful defaulter by any bank or financial institution or other lender;**
- **whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported**
- **whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated;**
- **whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case;**
- **whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised;**

Some Key Points of Clause IX

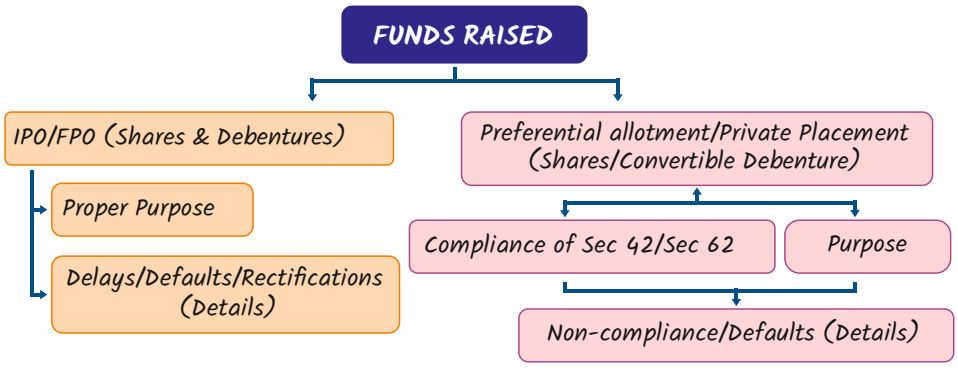
- ***Default***
  - ***Dispute*** *– In case of disputes, present prevailing terms should be considered, default should be reported & also explained dispute*
  - ***Rescheduling*** *– All defaults should be reported even if later on reschedulement or restructuring happens fact should be specified*
  - ***Declaration after balance sheet date*** *– If company is declared wilful defaulter, after balance sheet date till the date of audit report even that will be considered for reporting in CARO, this is as per principles of SA 560 as explained in GN on CARO.*
  - ***Show Cause Notice*** *– As per GN of CARO, if company receives show cause notice from RBI for wilful defaulter declaration, auditor may disclose this fact in this clause.*
- ***Usage***
  - ***One to One*** *– It is not necessary to establish a one-to-one relationship with the amount of term loan and its utilisation.*
  - ***Temporary Investment*** *– Sometimes companies invest surplus funds temporarily in mutual funds etc as funds were lying idle and then use it ultimately for proper purpose, such fact should be disclosed in report and it is not misutilisation of funds.*
  - ***Reporting –***

    A suggested reporting format under this clause is as follows:

    In our opinion and according to the information and explanations given to us, the company has utilized the money obtained by way of term loans during the year for the purposes for which they were obtained, except for following cases:

Nature of the fund raised	Name of the lender	Amount diverted (Rs.)	Purpose for which amount was sanctioned	Purpose for which amount was utilised	Remark

(CNO-CARO.170) Clause X Reporting on Application of funds from IPO / FPO/ Preferential allotment or private placement (Infosys) (MCQ-Incs.47.3)



- ***whether money is raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;***
- ***whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance;***

Some Key Points of Clause X

- *IPO / FPO*
  - *GDR, ADR are not IPOs but offer for sale. It is private placement / pref. allotment*
  - *Fund Utilisation*
    - *No need to see one to one relationship, its ok if money is deposited in common account, overall receipts of fund and utilization should be appropriate*
    - *Spending on improved version of asset is proper application*
    - *If loan is not yet utilised and kept in short term investments, then such fact should be disclosed in report.*
  - *Reporting*

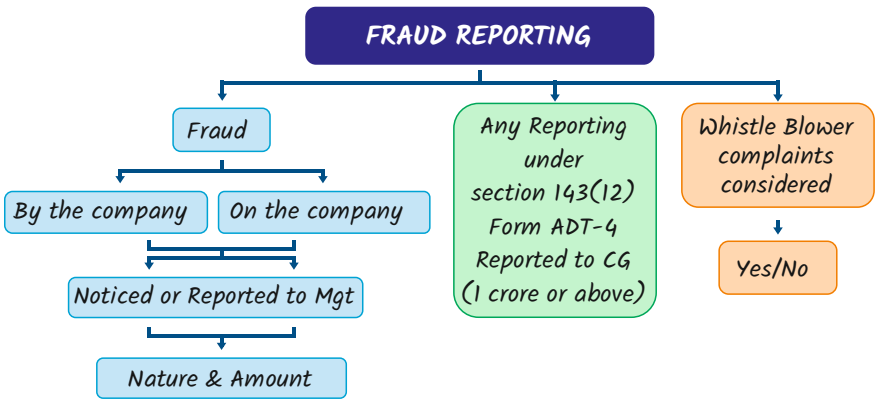
    A suggested reporting format under this clause is as follows:

    In our opinion and according to the information and explanations given to us, the company has utilised the money raised by way of initial public offer/ further public offer (including debt instruments) for the purposes for which they were raised, except for the following cases: (Only for defaults & non compliance)

Nature of the fund raised	Purpose for which funds were raised	Total Amount Raised / opening unutilized balance	Amount utilized for the other purpose	Unutilized balance as at balance sheet date	Details of default (Reason/ Delay)	Subsequently rectified (Yes/No) and details

- *Preferential allotment or private placement of shares*
  - *Overview of terminology*
    - *Private placement means when any company offers shares to selected group of persons. Such issue should be in accordance with Sec 42 of Companies Act.*
    - *Preferential Allotment is a specific type of private placement where listed entity issues share to selected group of persons. Such issue is principally governed by SEBI*

(CNO-CARO.180) Clause XI / II Reporting on Fraud (Finolex Cable) (QNO-407.010/ 407.020) (MCQ – Incs.18.1)

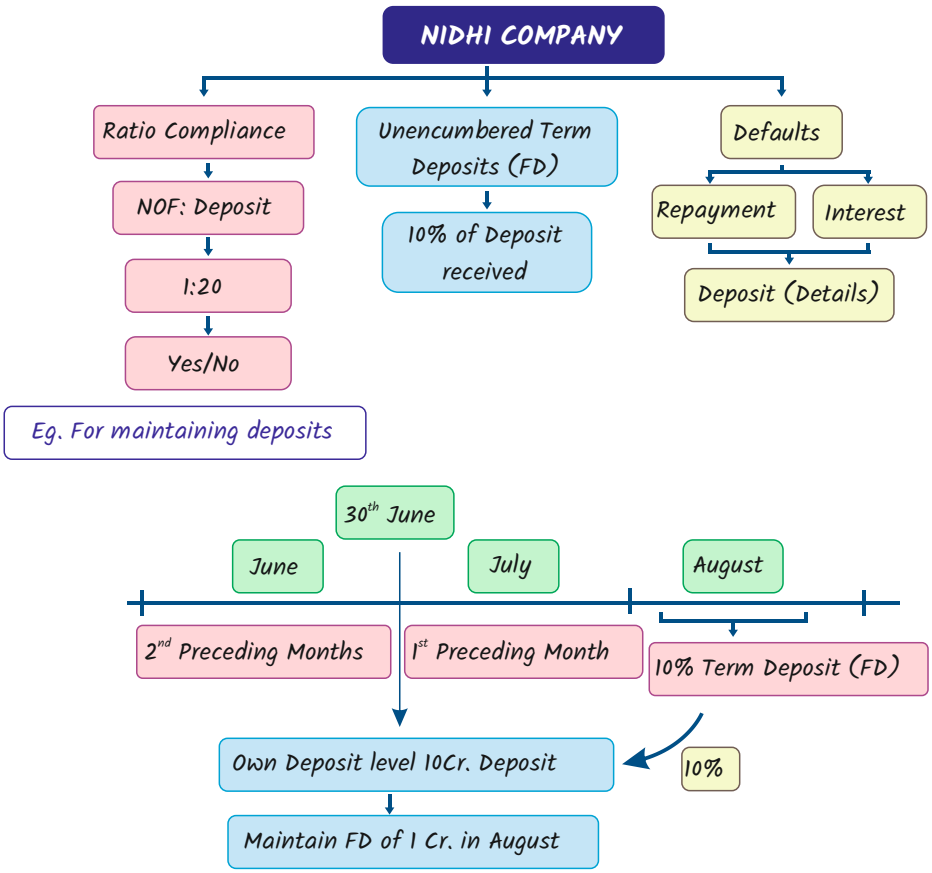


- *whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated;*
- *whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;*
- *whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;*

Key Points of Clause XI

- **Frauds**
  - *Term "Noticed or Reported" means either noticed by management or reported to management by anyone including statutory auditor, internal auditor etc. So basically, it means all the frauds known to management should be reported in this clause.*
  - *It should be noted that it covers all the frauds on the company and not just frauds by officers or employees on the company.*
- **Section 143(12)**
  - *Reporting is required only when ADT-4 is filed by auditor.*
- **Whistle Blower mechanism**
  - *Auditor has to only comment about complaints received during the year.*

(CNO-CARO.190) Clause XII /12 Reporting on Nidhi Company (Network 18)



*** 10% Term Deposit has to be maintained as per level of deposits received as on last working date of second preceding month

- **whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability;**
- **whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;**
- **whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof;**

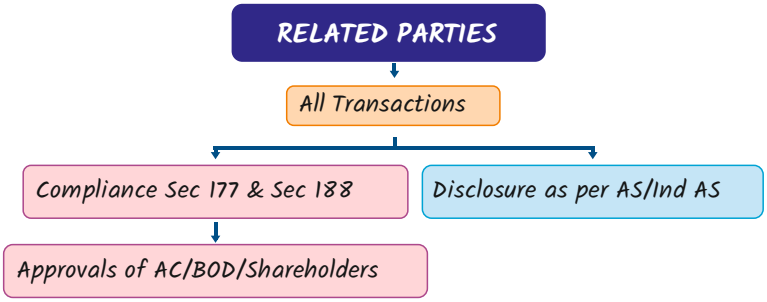
Key Points of Clause XII

Applicable only to Nidhi Company (mutual benefit company)

- **Ratio**
  - *Maintaining Net Owned Funds: Deposits 1:20. Comment whether it is maintained.*
- **Deposits**
  - *10% Unencumbered Term Deposits*
  - *Term Deposits should be as outstanding on last working day of second preceding month.*
- **Default**

- In case of default of either payment of interest on deposit or repayment thereof or both, the auditor may report:
  - Nature of default,
  - Amount of default,
  - Period of default,
  - Number of persons to whom there was default in payment,
  - Any other detail.

(CNO-CARO.200) Clause XIII /13 Reporting on Related Party Transactions (Reliance) (QNO-409.010/ 409.020)



Whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards.

Key Points of Clause XIV

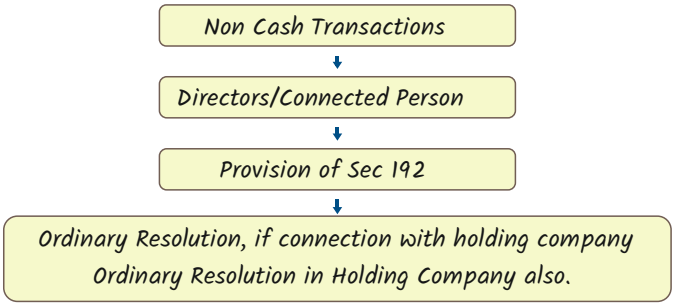
- **Related Parties**
  Its only about transactions with **related parties** [Related Party means as defined under Sec 2 (76)]
- **Compliance**
  - We have to comment on compliance with **Sec 177 & Sec 188**
  - Sec 177—Approval of Audit Committee
  - Sec 188—Approval of BOD / Ordinary Resolution if specific limit is crossed
- **Disclosure**
  We have to comment on **disclosures of related party in financial statement.** Compliance of AS 18 disclosures.

(CNO-CARO.210) (Clause XIV / 14 Reporting on Internal Audit (Indian Oil) (MCQ-Incs.48.2 Incs.56.5)



- **whether the company has an internal audit system commensurate with the size and nature of its business;**
- **whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor;**

(CNO-CARO.220) Clause XV / 15 Reporting on Non-cash transactions with Directors (Nuts) (QNO-411.000) (MCQ-Incs.55.5)



Whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with.

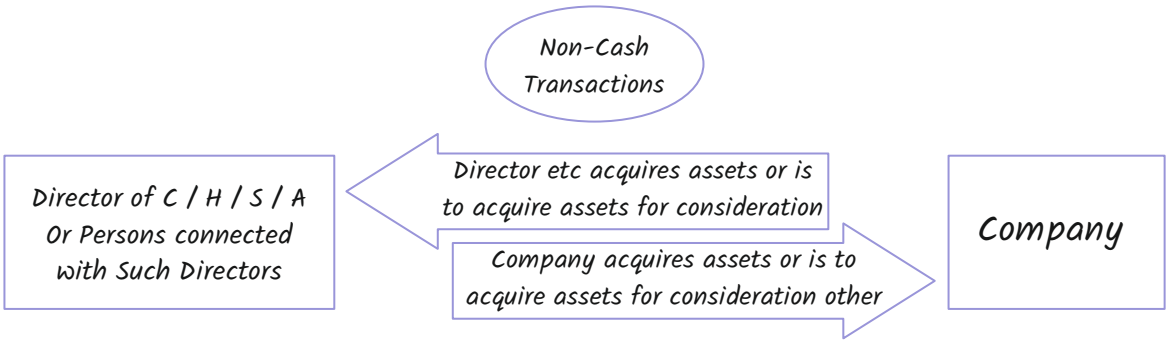
Key Points of Clause XV

- **Non-Cash Transactions**

  Whether there are non-cash transactions with directors or persons connected with him
  - Transactions for cash or cash equivalent are not covered
  - Mergers not covered here subject to approval by court

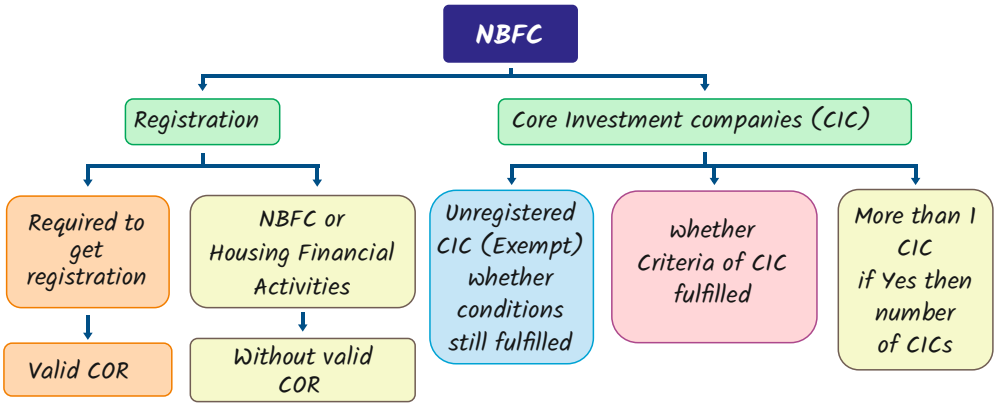
- **Section 192**

  If answer to first question is yes, then whether there is compliance of section 192.



Above transactions / agreements are allowed **only if there is prior approval by shareholders in general meeting and if such director is director in holding company then resolution will be required in holding**

(CNO-CARO.230) **Clause XVI / 16 Reporting on Registration u/s 45-IA of RBI Act (Carrot)** (QNO-412.000/412.500) (MCQ-CARO.01)



***COR-Cretificate of Registration

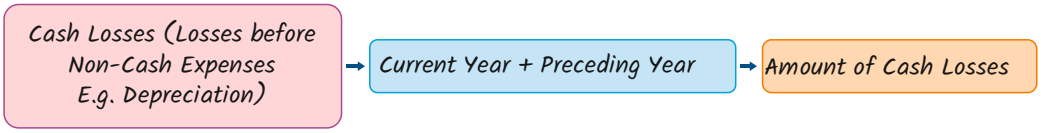
- **Whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.**
- **whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration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

- **Core Investment Company (CIC)**
  - It broadly means company formed for raising finance and investing in particular business group companies.
  - CIC having total assets 100 crores or more individually or in aggregate along with other CIC

investing in same group are called systematically important CIC.

- CIC are not required to get registered with RBI, only CIC which is systematically important are required to get registered with RBI.
- Exempted CIC can continue to operate as unregistered CIC.

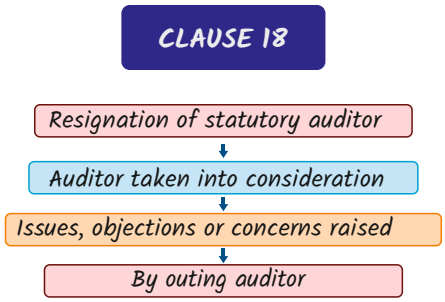
(CNO-CARO.240)
Clause XVII / 17
Reporting on Cash Losses (Chikoo)
(QNO-415.000)



whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses;

- **What if Cash loss is only in one year out of current year and immediately preceding year?**
  A situation may be there where the company has suffered cash losses in only one of the years referred to in this clause. In such a situation, the auditor is well advised to comment on the two years separately. Thus, for example, it would be proper to report that the company has incurred cash losses only during the immediately preceding financial year but has not incurred any cash losses during the current financial year.

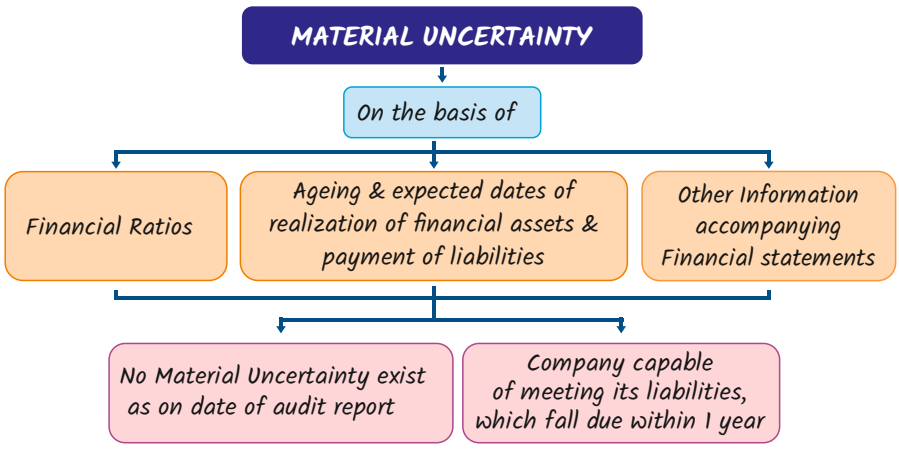
(CNO-CARO.250)
Clause XVIII / 18
Reporting on Resignation of statutory auditors (Rabdi)
(QNO-402.500)
(MCQ-CARO.12)



whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors;

- **Important Documents**
  Incoming auditor should obtain a copy of letter of resignation stating the reasons as submitted to the management and copy of Form ADT 3 as submitted to ROC. In case of listed companies, incoming auditor should also obtain copy of Annexure A(Submitted to Stock Exchange as per SEBI circular on auditor resignation) from the listed company.

(CNO-CARO.260)
Clause XIX / 19
Reporting on Material Uncertainty (Madira)



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

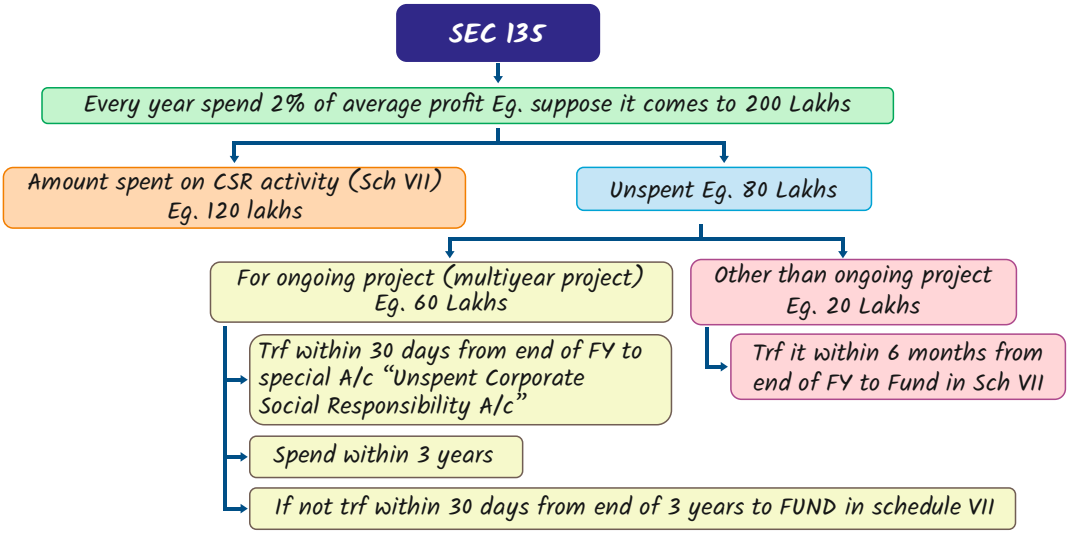
- ***Material uncertainty***

  As per SA 570 it is uncertainty on going concern of company, which is significant enough requiring disclosure to users of financial statement.

- ***Ability to pay liabilities.***

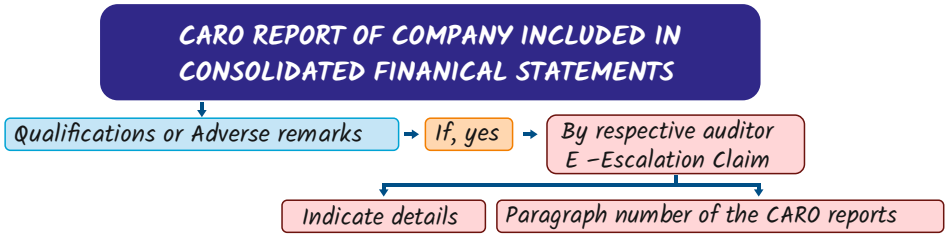
  Auditor has to comment whether company will be able to pay its liabilities falling due within 1 year from balance sheet.

(CNO-CARO.270) Clause XX / 20 Reporting on CSR Compliance (Chocolate)



- ***whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act;***
- ***whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of sub-section (6) of section 135 of the said Act;***

(CNO-CARO.280) Clause XXI / 21 Reporting on qualifications or adverse remark of Consolidated entities. (Avocado)



- ***Whether there have been any qualifications or adverse remarks by the respective auditors in the CARO reports of the companies included in the consolidated financial statements, if yes,***
  - ***indicate the details of the companies and***
  - ***the paragraph numbers of the CARO report containing the qualifications or adverse remarks.***

- ***Qualification or Adverse remark***
  - *No need to consider CARO report of Group companies which are not consolidated.*
  - *Even adverse remarks of parent company should be considered.*
  - *No need to consider materiality such remarks from consolidation perspective, all such adverse remarks should be considered.*
  - *For the purpose of reporting the qualifications/adverse remarks, the principal auditor may report in the following manner in the consolidated audit report–*

Sr. No.	Name	CIN	Holding Company / subsidiary/ Associate/ Joint Venture	Clause number of the CARO report which is qualified or adverse

PART - 3 DIVIDEND

(CNO--DIV.020) CONCEPT OF DIVIDEND







Distribute as Dividend



Transfer to Reserves
1. Free Reserves → General Reserves etc
2. Restricted Reserves → Capital Redemption Reserve etc



Retain it in P&L Appropriation A/C

(CNO--DIV.040) PROCESS OF DIVIDEND DECLERATION & DISTRIBUTION (Sec 123) (QNO - 367.000 / 368.000)

(MCQ- Incs.13.6, Incs.31.5)

Sec 123 (Declaration of Dividend)

It's END OF FINANCIAL YEAR!



BOD

MEET to Propose Dividend

Sources of Dividend
1. CY Profits (After Dep)
*AS per Sch II
2. Accumulated Profits (After Dep)(Only Free Reserves) Gen Res & P&L App
3. Money provided by CG / SG

1.No Restriction on payment of dividend out of P&L Appropriation Account
2.But there are rules for payment out of General Reserves (Discussed Later)
3. Losses shall be ADJ (Discussed Later)

BOD Prop Dividend (May also decide trf also Gen Res not mandatory)

NOTICE
IT is included in AGM notice as Ordinary Business

Shareholder Pass Resolution &Declare Dividend. Cannot Declare on Eq sh if failure to comply with sec 73 & sec 74

**Trf money in Separate bank a/c in 5 days

Dividend is calculated as per share holders register on record date
+
Details entered in dividend register. cash / chq / Warrant / elec trf within 30 Days (Dividend cannot be paid in kind)

Section related to dividend doesn't restrict capitalisation of profits or reserves by issuing fully paid bonus shares or paying unpaid amount on shares

** Not Applicable to Government Company where entire paid up share capital is held by CG / SG other Govt Comp

(CNO--DIV.060) INTERIM DIVIDEND (QNO - 366.000) (MCQ - Incs.31.5, Incs.37.1)



AGM
ANNUAL GENERAL MEETING

Interim Dividend is paid between 2 AGMs



AGM
ANNUAL GENERAL MEETING

1. Declared by Board of directors before year end, between 2 AGMs
2. Source can be the surplus in the profit and loss account and out of profits of current financial year. (General Reserve or any other reserve cannot be used)
3. As per definition of dividend "dividend includes interim dividend" So all other sections 123-127 are also applicable.
4. If company incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.
5. Interim or Final Dividend can be cancelled if dividend is Illegal / Out of fake profits or when company ceases to be going concern.
6. If final dividend is just proposed and not yet declared at AGM it can be rolled back.

(CNO--DIV.080) SECTION 124 UNPAID DIVIDEND (MCQ – Incs.31.4, Incs.37.2)

After 30 days, if dividend remains unpaid then amount should be transferred within 7 days to divdend account.

People can apply and take dividend from this account

→ IF amount is not transferred within 7 days then company will have to pay 12% interest which will paid proportionately unpaid dividend amount.

→ Within 90 days of transfer of money , names, address of people to whom dividend is unpaid should be uploaded on company website or as instructed by government.

If Amount remains unoaid for 7 years from date of transfer. Dividend + Accrued interest should be transferred to investor protection Fund And send Details to administrator of fund

→ Shares where dividend has not been paid or claimed for 7 consecutive years or more shall be trf to IEPF along with details.

Any claimant of shares shall be entitled to transferred as per procedure prescribed

- At the time of transfer to IEPF, company shall send details in Form-DIV 5.
- Penalty on Company of 100,000 and in case of continuing failure further penalty of 500 per day upto Rs 10,00,000.
- Penalty on Officer who is in default of Rs 25000, and in case of continuing failure further penalty of 100 per day upto Rs 2,00,000

(CNO--DIV.100) SECTION 125: -INVESTOR EDUCATION & PROTECTION FUND

(1) The Central Government shall establish a fund to be called the Investor Education and Protection Fund (hereafter in this section referred to as the "Fund").

(2) There shall be credited to the Fund the following amounts, namely:

(a) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;

(b) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;

(c) the amount in the Unpaid Dividend Account of companies transferred to the Fund under sub-section (5) of section 124 of the Companies Act, 2013;

(d) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act;
(e) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;
(f) the interest or other income received out of investments made from the Fund;
(g) the amount received under sub-section (4) of section 38;
(h) the application money received by companies for allotment of any securities and due for refund;
(i) matured deposits with companies other than banking companies;
(j) matured debentures with companies;
(k) interest accrued on the amounts referred to in clauses (h) to (j);
(l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;
(m) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and
(n) such other amount as may be prescribed

It is provided that no such amounts referred to in clauses (h) to (j) shall form part of the Fund unless such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment.

(3) The Fund shall be utilised for the following purposes in accordance with such rules as may be prescribed-:
(a) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;
(b) promotion of investors' education, awareness and protection;
(c) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement
(d) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and
(e) any other purpose incidental thereto.
It is provided that the person whose amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C of the Companies Act, 1956, transferred to Investor Education and Protection Fund, after the expiry of the period of seven years as per provisions of the Companies Act, 1956, shall be entitled to get refund out of the Fund in respect of such claims in accordance with rules made under this section.

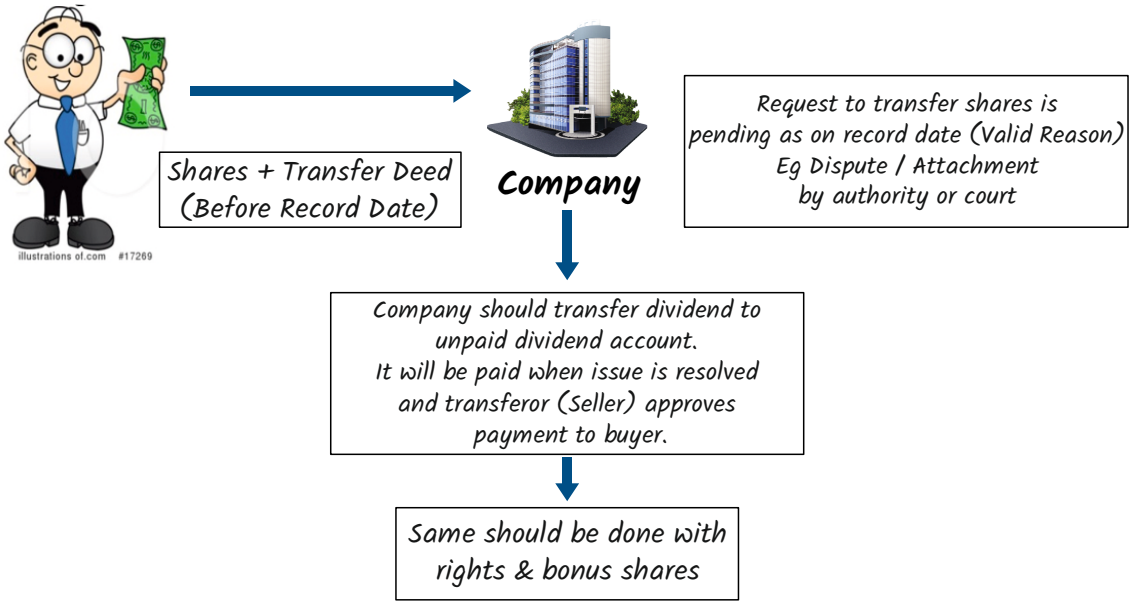
Explanation- The disgorged amount refers to the amount received through disgorgement or disposal of securities.

(4) Any person claiming to be entitled to the amount referred in section 125(2) may apply to the authority constituted under section 125(5) for the payment of the money claimed.
(5) The Central Government shall constitute, by notification, an authority for administration of the fund consisting of a chairperson and such other members, not exceeding seven and a chief executive officer, as the Central Government may appoint.
(6) The manner of administration of the Fund, appointment of chairperson, members and chief executive officer, holding of meetings of the authority shall be in accordance with such rules as may be prescribed.

(7) The Central Government may provide to the authority such offices, officers, employees and other resources in accordance with such rules as may be prescribed.
(8) The authority shall administer the Fund and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed after consultation with the C&AG of India.
(9) It shall be competent for the authority constituted under sub-section (5) to spend money out of the Fund for carrying out the objects specified in sub-section (3) of 125.

The accounts of the Investor Education and Protection Fund is required to be audited by the C&AG of India at such interval as may be specified by him and such audited accounts together with the audit report thereon shall be forwarded annually by the authority to the Central Government. The authority is required to prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government. The Central Government shall cause the annual report and the audit report given by the C&AG of India to be laid before each House of Parliament.

(CNO--DIV.120) SECTION 126: - DIVIDEND IN ABEYANCE (MCQ-Incs.37.3)



(CNO--DIV.140) SECTION 127: - PUNISHMENT FOR NON-PAYMENT OF DIVIDEND (MCQ - DIV.1, Incs.37.4)

According to Section 127 of the Companies Act, 2013, where a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted, within 30 days from the date of declaration to any shareholder entitled to the payment of the dividend, following shall be punishable:
(i) every director of the company, if he is knowingly a party to the default, be punishable with imprisonment which may extend to 2 years and with fine which shall not be less than one thousand rupees for every day during which such default continues and,
(ii) the company shall be liable to pay simple interest at the rate of 18% per annum during the period for which such default continues.

No offence in following cases: - (In sequence of LawShare HolderCompanyThird PartyDispute)

1. Reason of the operation of any law; (Enforcement Directorate has stopped payment)
2. Shareholders directions cannot be complied with and the same has been communicated to him; (He asks for payment in US Dollars)
3. Dividend has been adjusted by the company against any sum due. (Calls in Arrers)
4. Not due to any default on the part of the company. (Bank transferred amount to wrong account)
5. Dispute regarding the right to receive the dividend; (Seller Vs Buyer, Interim dividend announced just before transfer, not know at the time of transfer)

(CNO--DIV.160) DIVIDEND DISTRIBUTION AND PAYMENT OF DIVIDEND RULE 2014 OUT OF RESERVES (DAPD RULES 2014)

(QNO - 369.000, 369.010)

In case of inadequacy or absence of profits in any year, FREE RESERVES can be used subject to

1) The rate of dividend =<average of the rates of dividend (Past 3 Years) This condition is Not applicable if no dividend is declared in past 3 years

2) The total amount to be drawn from such accumulated profits general reserve shall not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

3) The balance of general reserves after such withdrawal shall not fall below fifteen per cent of its paid-up share capital as appearing in the latest audited financial statement.

Above rules Shall not apply to a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments. (That means they can pay dividend without any restrictions, there has been little controversy as RTP misinterpreted this amendment, that such companies cannot pay dividend out of general reserve, I don't agree with it)

Adjustment of Losses

1. All past year losses (If any) should be adjusted if dividend is paid out of CURRENT YEAR profits. Logic behind such provision is simple, as company's position is improving it is better to adjust all past losses.

2. Only CY Loss (If any) should be adjusted if dividend is paid out of GENERAL Reserves. Logic behind such is simple, as company is not in good financial position, forced to use General Reserves, let's make things less difficult by adjusting only CY losses

Question: - Due to inadequacy of profits during the year ended 31st March 2015, From the following particulars, ascertain the maximum amount that can be utilized from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

17,500 9% Preference shares of Rs 100 each, fully paid up	17,50,000
8,00,000 Equity shares of Rs 10 each, fully paid up	80,00,000
General Reserves as on 1.4.2014	25,00,000
Capital Reserves as on 1.4.2014	3,00,000
Revaluation Reserves as on 1.4.2014	3,50,000
Net profit for the year ended 31st March 2015	3,00,000
Average rate of dividend during the three year has been	12%.

Condition I

Average dividend rate of past 3 years is 12 %, so dividend rate cannot exceed 12%.

Preference Dividend 17,50,000 x 9 % =	1,57,500
Equity Dividend (Max) 80,00,000 x 12% =	9,60,000
Total Dividend	**=11,17,500**

CY profit available	3,00,000
So withdrawal from reserves	=11,17,500 – 3,00,000
	= 8,17,500

Condition II

Withdrawal from reserves = 10 % (Paid up Capital + Reserves)

= 10 % (17, 50, 000 + 80,00,000 + 25,00,000) **= 12,25,000**

Condition III

Minimum balance required in General Reserve = 15 % (Paid up capital)

= 15 % (17,50,000 + 80,00,000)

= 14,62,500

So we can withdraw 25,00,000 – 14,62,500 = **10,37,500**

We have to select lowest of above, So 8,17,500 can be withdrawn from general reserve.

Question: – Due to inadequacy of profits during the year ended 31st March 2015, From the following particulars, ascertain the **maximum rate of dividend** that can be utilized from general reserves, according to the Companies (Declaration of dividend out of Reserves) Rules, 2014:

17,500 9% Preference shares of Rs 100 each, fully paid up	17,50,000
8,00,000 Equity shares of Rs 10 each, fully paid up	80,00,000
General Reserves as on 1.4.2014	25,00,000
Capital Reserves as on 1.4.2014	3,00,000
Revaluation Reserves as on 1.4.2014	3,50,000
Net Loss for the year ended 31st March 2015	**(75,000)**
Average rate of dividend during the last three years has been 12%.	
Accumulated loss of previous year	**(1,25,000)**

Condition I

Average dividend rate of past 3 years is 12 %, so dividend rate cannot exceed 12%.

Preference Dividend 17,50,000 x 9 % = **1,57,500**

Equity Dividend (Max) 80,00,000 x 12% = 9,60,000

Total Dividend **= 11,17,500**

CY Loss (75,000)

So total profit required 11,17,500 + 75,000 = 11,92,500 (Withdrawal)

Condition II

Withdrawal from reserves = 10 % (Paid up Capital + Reserves)

= 10 % (17, 50, 000 + 80,00,000 + 25,00,000)

= 12,25,000

Condition III

Minimum balance required in General Reserve = 15 % (Paid up capital)

= 15 % (17,50,000 + 80,00,000)

= 14,62,500

So we can withdraw 25,00,000 – 14,62,500 **= 10,37,500**

We have to select lowest of above, So 10,37,500 can be withdrawn from general reserve.

Profit available from withdrawal	**10,37,500**	
Adjustment of CY		**(75,000)**
Profit available for Dividend	**9,62,500**	
Preference Dividend		**(1,57,500)**
Equity Dividend		**8,05,000**

So Maximum Rate = 8,05,000 / 80,00,000 X 100 = 10.0625%

(CNO--DIV.200) POWER TO CLOSE REGISTER OF MEMBERS OR DEBENTURE-HOLDERS OR OTHER SECURITY HOLDERS

- As per section 91 of the Act, a company may close the register of members or the register of debenture-holders or the register of other security holders for any period or periods not exceeding in the aggregate 45 days in each year, but not exceeding 30 days at any one time, subject to giving of previous notice of at least 7 days or such lesser period as may be specified by Securities and Exchange Board for listed companies or the companies which intend to get their securities listed, in such manner as may be prescribed

(CNO--DIV.220) DIVIDEND VERIFICATION (QNO - 365.000)

- The auditor may take the following steps to ensure that the dividend has been paid only out of profits
  Check whether the dividend was declared out of profits arrived at after providing for depreciation as per Section 123(2) of the Companies Act, 2013 (herein after referred as the Act).
- Check whether-
  - The depreciation was provided according to provision of Schedule II to the Act
  - A board resolution recommending dividend was passed.
  - The dividend was declared only in the Annual General Meeting.
  - No dividend declared in general meeting exceeds the amount recommended by the Board
  - Amount paid or credited as paid on a share in advance of calls is not treated for the purpose of this regulation as paid on the share.
  - Register of members was closed as per the provisions of section 91 of the Act.
  - Dividend has been paid in the prescribed manner within 30 days of time to the registered holder or their order for the compliance of Section 127 of the Act.
  - Amount of dividend deposited in a separate bank account within five days from the date of declaration of dividend.
  - Intimation sent to Stock Exchange in the case of listed company
  - Were there any complaints of non-payment/delayed payment of dividend? If so, whether corrective action was taken.

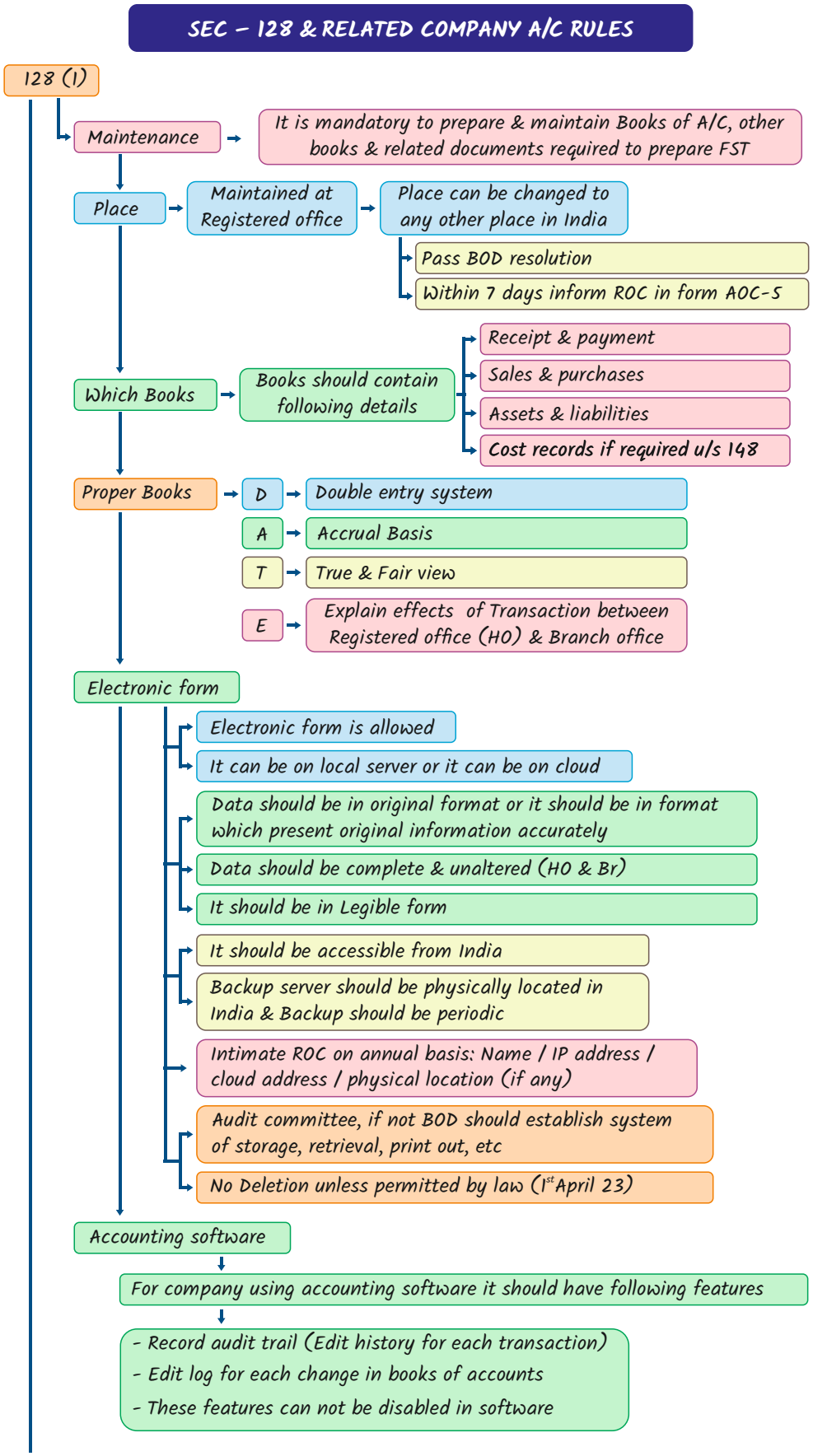
UNIQUE MCQ

MCQ	Incs.37.5

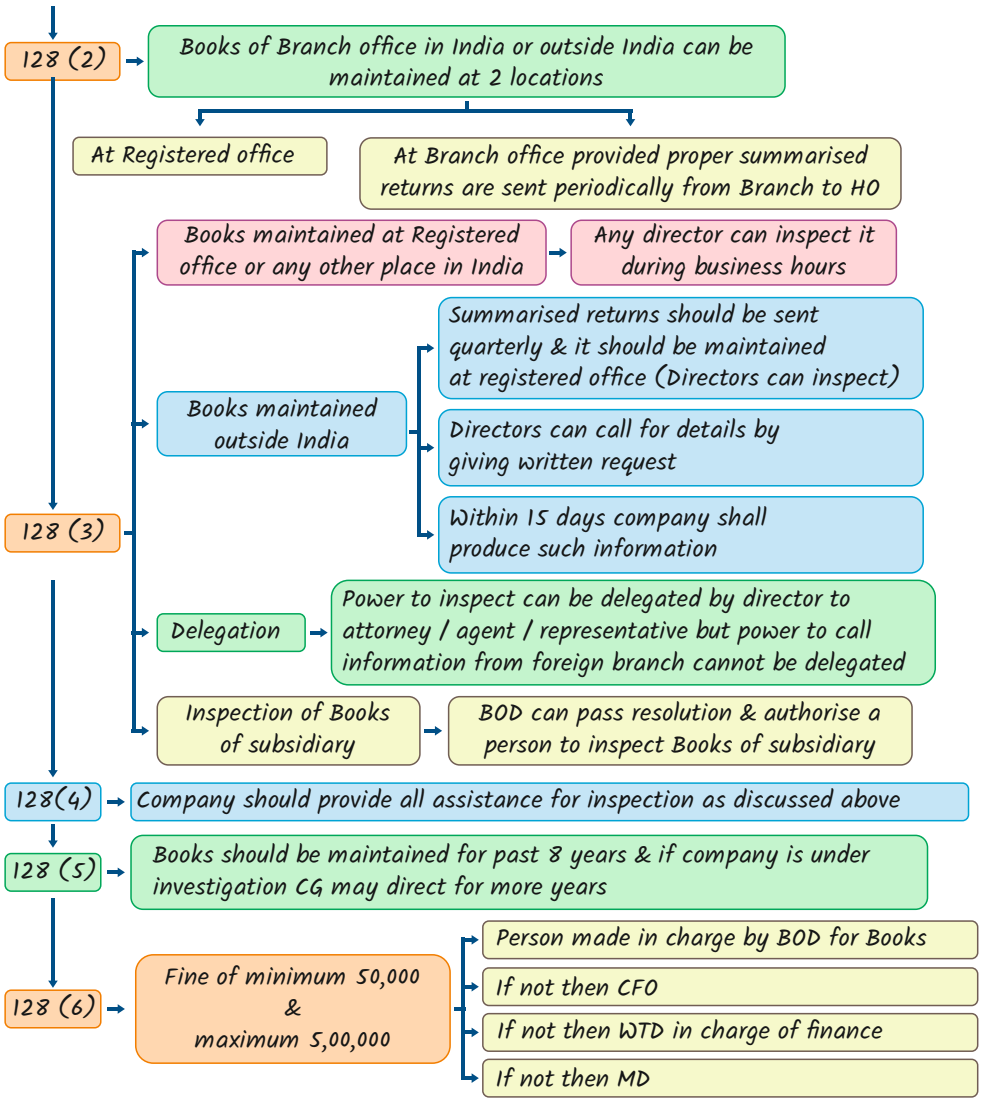
Part 4 – COMPANY ACCOUNTS & MISC (LLP)

(CNO--COACC.020) SECTION 128 BOOKS OF ACCOUNT, ETC., TO BE KEPT BY COMPANY.

Chart



Continue on next Page...



(CNO--COACC.040) SECTION 129A PERIODICAL FINANCIAL RESULTS.

Bare act

Periodical financial results.

129A. *The Central Government may, require such class or classes of unlisted companies, as may be prescribed,—*

(a) to prepare the financial results of the company on such periodical basis and in such form as may be prescribed;

(b) to obtain approval of the Board of Directors and complete audit or limited review of such periodical financial results in such manner as may be prescribed; and

(c) file a copy with the Registrar within a period of thirty days of completion of the relevant period with such fees as may be prescribed.]

(CNO--COACC.060) SECTION 130 RE-OPENING OF ACCOUNTS ON COURT'S OR TRIBUNAL'S ORDERS

(QNO - 349.500)(MCQ - Incs.43.5)

130(1) & (2)

Sec 130 (1)

A company shall not re-open its books of account and not recast its financial statements, unless an application in this regard is made by the Central Government, the Income-tax authorities, the Securities and Exchange Board, any other statutory regulatory body or authority or any person concerned and an order is made by a court of competent jurisdiction or the Tribunal to the effect that:-

(i) the relevant earlier accounts were prepared in a fraudulent manner; or

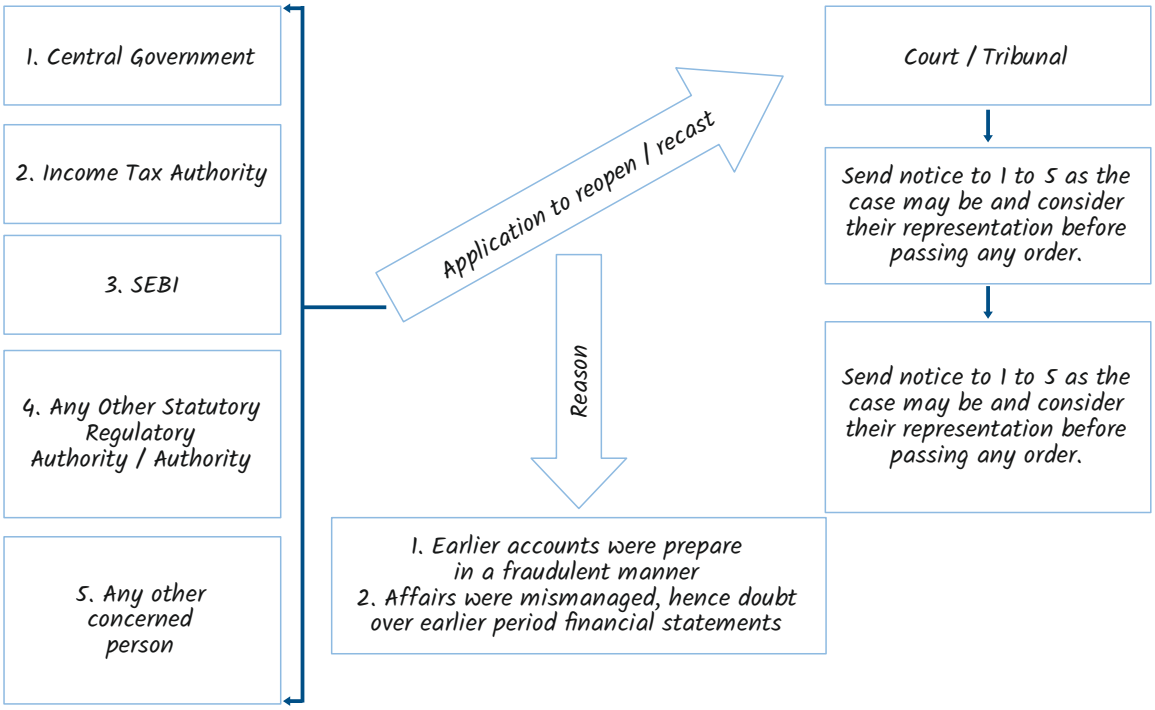
(ii) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements;

Provided that the court or the Tribunal, as the case may be, shall give notice to the Central Government, the Income-tax authorities, the Securities and Exchange Board or any other statutory regulatory body or authority concerned [or any other person concerned] and shall take into consideration the representations, if any, made by that Government or the authorities, Securities and Exchange Board or the body or authority concerned[or any other person concerned] before passing any order under this section.

Sec 130 (2)

(2) Without prejudice to the provisions contained in this Act the accounts so revised or re-cast under sub-section (1) shall be final.

under sub-section (1) shall be final.



Sec 130 (3)

(3) No order shall be made under sub-section (1) in respect of re-opening of books of account relating to a period earlier than eight financial years immediately preceding the current financial year:

Provided that where a direction has been issued by the Central Government under the proviso to sub-section (5) of section 128 for keeping of books of account for a period longer than eight years, the books of account may be ordered to be re-opened within such longer period.

(In Short) – Sec 130 (3)

Cannot open FST earlier than 8 FYs preceding CFY. If CG directs to keep books for longer than 8 years then such longer period will be available.

(CNO--COACC.080) SECTION 131 VOLUNTARY REVISION OF FINANCIAL STATEMENTS OR BOARD'S REPORT.

Sec 131 (1) (MCQ – Incs.13.3)

(1) If it appears to the directors of a company that—

(a) the financial statement of the company; or

(b) the report of the Board,

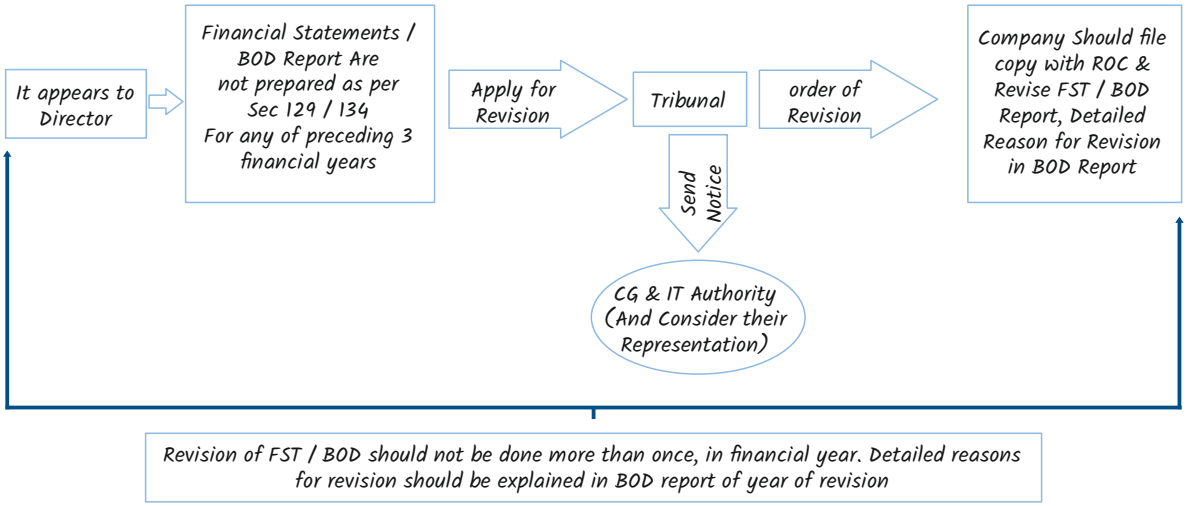
do not comply with the provisions of section 129 or section 134 they may prepare revised financial statement or a revised report in respect of any of the three preceding financial years after obtaining approval of the Tribunal on an application made by the company in such form and manner as may be prescribed and a copy of the order passed by the Tribunal shall be filed with the Registrar:

Provided that the Tribunal shall give notice to the Central Government and the Income-tax authorities and shall take into consideration the representations, if any, made by that Government or the authorities before passing any order under this section:

Provided further that such revised financial statement or report shall not be prepared or filed more than once in a financial year;

Provided also that the detailed reasons for revision of such financial statement or report shall also be disclosed in the Board's report in the relevant financial year in which such revision is being made.

In Short -- Sec 131 (1)



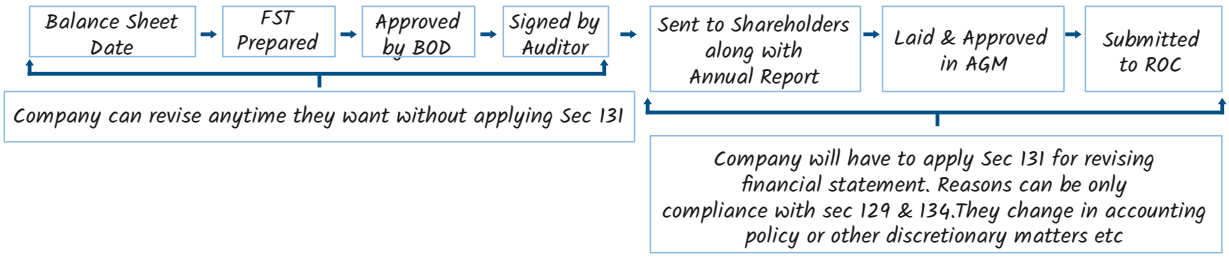
Sec 131 (2)

(2) Where copies of the previous financial statement or report have been sent out to members or delivered to the Registrar or laid before the company in general meeting, the revisions must be confined to—

(a) the correction in respect of which the previous financial statement or report do not comply with the provisions of section 129 or section 134; and

(b) the making of any necessary consequential alternation.

In Short -- Sec 131 (2)



Sec 131 (3)

(3) The Central Government may make rules as to the application of the provisions of this Act in relation to revised financial statement or a revised director's report and such rules may, in particular:-

(a) make provisions with respect to the functions of the company's auditor in relation to the revised financial statement or report;

(b) make different provisions according to which the previous financial statement or report are replaced or are supplemented by a document indicating the corrections to be made;

(c) require the directors to take such steps as may be prescribed.

In Short -- Sec 131 (3)

CG to makes rules for

Auditor – Function of auditor with respect to revised financial statements

Company – Replacing old FST or Supplementing it by document indicating Correction

Directors –Steps to be taken by Directors

(CNO--COACC.100) SEC 132 (1) CONSTITUTION OF NATIONAL FINANCIAL REPORTING AUTHORITY

SEC 132 (1) CG has power to form NFRA - to look after matters related to AS & SAs

SEC 132 (1A) The National Financial Reporting Authority shall perform its functions through such divisions as may be prescribed.";

SEC 132 (2) FUNCTIONS

SEC 132 (2)

- Recommendation on Formulation and Laying Down of Accounting & Auditing Policies & Standards **(Further Elaborated in RULE 6, NFRA RULES, 2018)**
- Monitor and Enforce the compliance of Standards **(Further Elaborated in RULE 7 & 8, NFRA RULES, 2018)**
- Oversee Quality of services & Suggest measures for improvement **(Further Elaborated in RULE 9, NFRA RULES, 2018)**

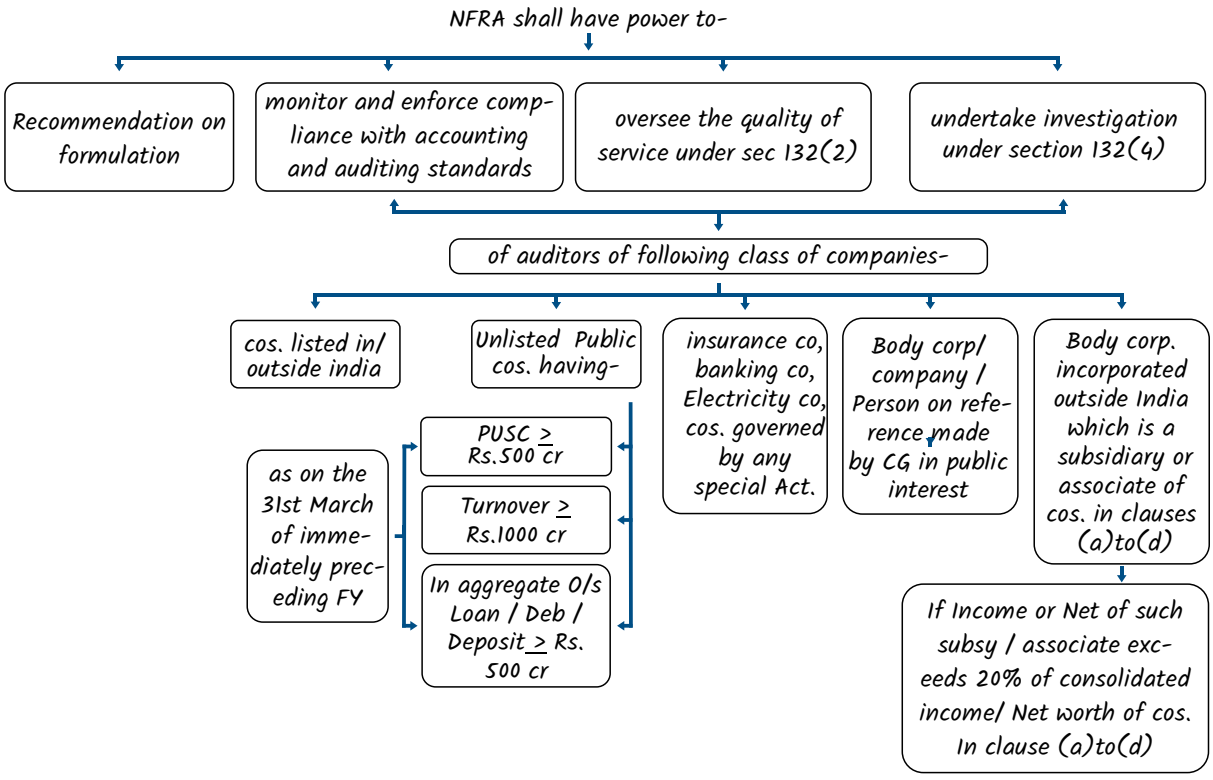
Such other Functions as Prescribed

NFRA RULES 2018

In exercise of the powers conferred under sub-sections (2) and (4) of section 132, the Central Government made the National Financial Reporting Authority Rules, 2018 (NFRA Rules) (MCA Notification dated 13 November 2018).

RULE 3, NFRA RULES 2018 CLASSES OF COMPANIES AND BODIES CORPORATE GOVERNED BY THE AUTHORITY

(QNO 350.000)



RULE 3(1) of NFRA Rules, 2018

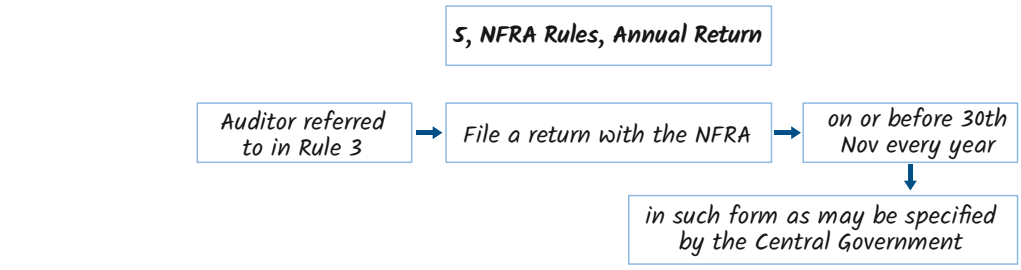
2) Every existing **body corporate other than a company governed by these rules,** shall inform the NFRA **within 30 days of the commencement of NFRA rules, in Form NFRA-1,** the **particulars of the auditor** as on the date of commencement of these rules.

3) Every body corporate, other than a company as defined in clause (20) of section 2 of the Act, formed in India and governed under NFRA Rules shall, **within 15 days of appointment of an auditor**

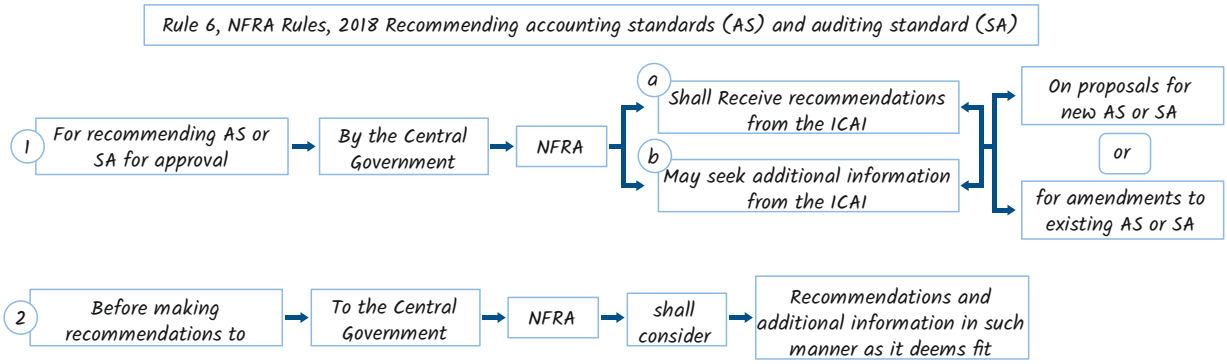
*under sub-section (1) of section 139, inform the NFRA in **Form NFRA-1**, the particulars of the auditor appointed by such body corporate. Provided that a body corporate governed under clause (e) of sub-rule (1) of NFRA Rules shall provide details of appointment of its auditor in Form NFRA-1.*

*4. A company or a body corporate other than a company governed under NFRA Rules shall continue to be governed by the NFRA for a **period of 3 years after it ceases to be listed or its paid-up capital or turnover or aggregate of loans, debentures and deposits falls below the limit stated therein (i.e. mentioned in points (a) & (b) above).***

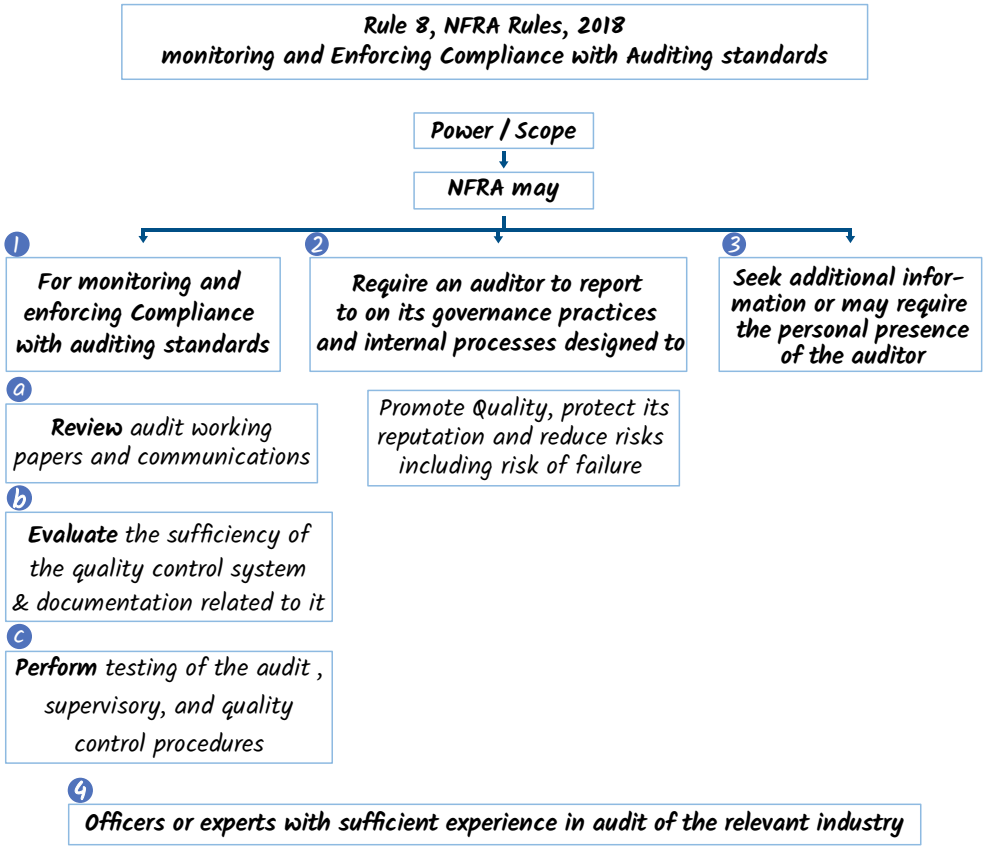
RULE 5, NFRA RULES, 2018 ANNUAL RETURN



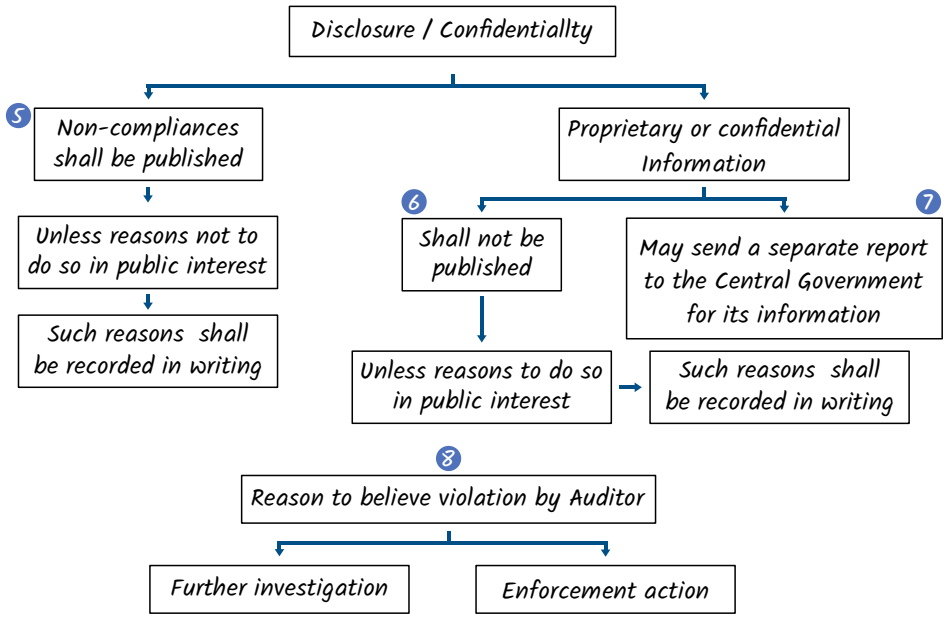
RULE 6, NFRA RULES, 2018 RECOMMENDING ACCOUNTING STANDARDS (AS) AND AUDITING STANDARDS (SA)



RULE 8, NFRA RULES, 2018 MONITORING AND ENFORCING COMPLIANCE WITH AUDITING STANDARDS



Continue on next Page...



RULE 9, NFRA RULES, 2018 OVERSEEING THE QUALITY OF SERVICE AND SUGGESTING MEASURES FOR IMPROVEMENT

Rule 9, NFRA Rules, 2018 Overseeing the quality of service and suggesting measures for improvement

Direction by NFRA

1. After review, the NFRA may direct auditor to take measures for improvement of audit quality
   - Including changes in their audit processes, quality control, and audit reports and
   - & Specify a detailed plan with time - limits.

Execution by Auditor

2. Auditor shall make the required improvements and send a report to the NFRA
   - Explaining the compliance with directions made .

Monitor by NFRA

3. The NFRA shall monitor the improvements made by the auditor
   - Take action depending on the progress made by the auditor

4. NFRA may
   - Refer cases w. r.t overseeing the quality of service of auditors of companies or bodies corporate referred to in rule 3 — To Quality Review Board
   - or
   - call report or information in respect of such auditors of companies or bodies corporate as it may deem appropriate. — From Quality Review Board

5. The NFRA may take the assistance of experts for its oversight and monitoring activities

6. Punishment in case of non - compliance
   - Company and every officer of the company who is in default or the auditor or such other person who contravenes with NFRA rules shall be punishable as per the provisions of section 450 of the Act (Fine may extend to 10000 and in case of continuing contravention with a further fine of 1000 per day till it continues.)

7. Financial reporting advocacy and education
   - Education, training, seminars, workshops, conferences and publicity shall be undertaken for promotion of awareness and significance of AS, SA, auditors responsibilities, audit quality and such other matters

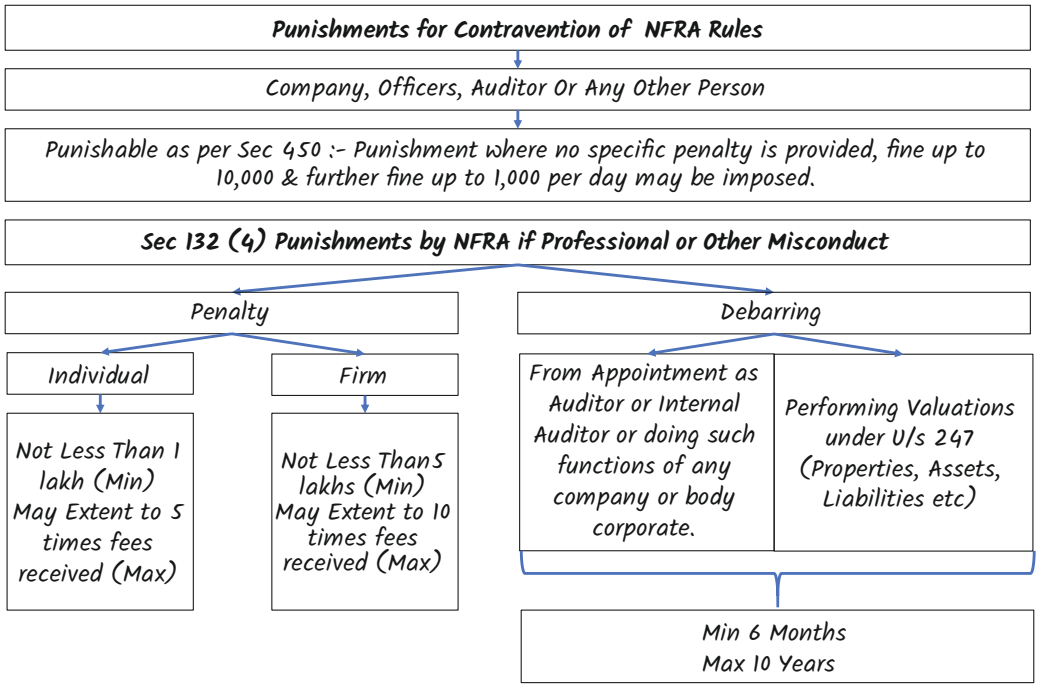
(CNO--COACC.120) PUNISHMENT IN CASE OF NON-COMPLIANCE (QNO 350.000)

Penalties & Debarring

If a **company or any officer of a company or an auditor or any other person** contravenes any of the provisions of NFRA Rules, **the company and every officer of the company who is in default or the auditor or such other person** shall be punishable as **per the provisions of section 450 of the Act.**
(As per Sec 450, Punishment where no specific penalty is provided, fine up to 10,000 and further fine up to 1,000 per day may be imposed)
Further, as per Section 132(4) of the Companies Act, 2013 as amended by the Companies Amendment Act, 2019, National Financial Reporting Authority, where **professional or other misconduct is proved,** have the power to make order for :

(A) imposing **penalty** of—
I. not less than one lakh rupees, but which may extend to five times of the fees received, in case of individuals; and
II. **not less than five lakh rupees, but which may extend to ten times of the fees received, in case of firms;**
(B) **debarring the member or the firm from:**
I. being appointed as an **auditor or internal auditor or undertaking any audit** in respect of financial statements or internal audit of the functions and activities **of any company or body corporate;** or
II. **performing any valuation** as provided under section 247,
for a **minimum period of six months or such higher period not exceeding ten years** as may be determined by the National Financial Reporting Authority.

Chart



(CNO--COACC.140) SECTION 133

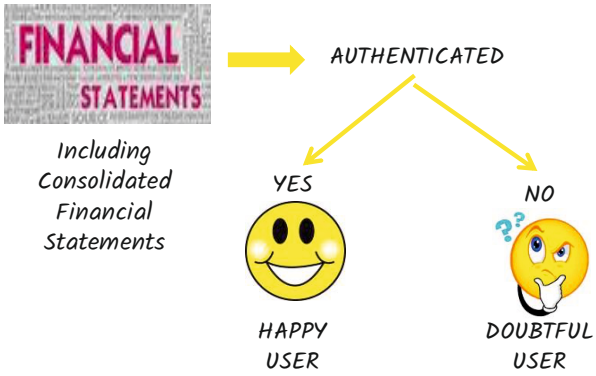
Discussion

- The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India (ICAI), constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority (NFRA).
  In exercise of the powers conferred under sub-sections (2) and (4) of section 132, the Central
- Government made the National Financial Reporting Authority Rules, 2018 (NFRA Rules).
  - As per NFRA rules, NFRA shall have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the prescribed class of companies and bodies corporate.

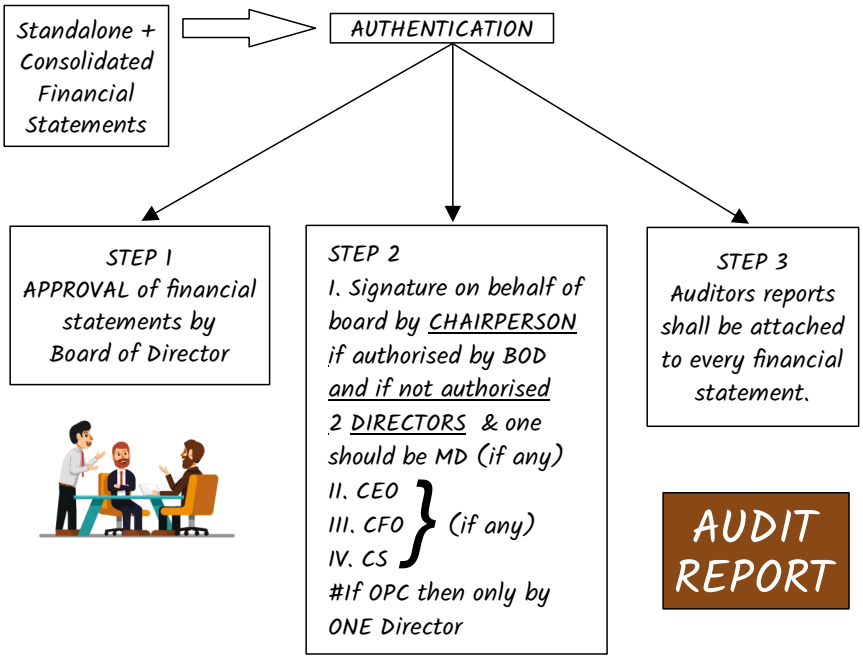
The Central Government has also notified Companies (Indian Accounting Standards) Rules, 2015 dated 16.02.2015 in exercise of the powers conferred by section 133. The said rules list the Indian Accounting Standards (Ind AS) and the class of companies required to comply with the Ind AS while preparation of their financial statements.

(CNO--COACC.160) SECTION 134 (QNO-350.500)

Section 134(1) & (2) Authentication of financial statements



Authentication of financial statement is compulsory before they are presented in general meeting



→Legally it is not required that auditor should sign financial statements, but it is done as per largely followed CUSTOMS

Sec 134 (3) (Contents of BOD report)

BOD	Company	Other
•Policy Regarding Directors (If Covered U/S 178)	•Change in Nature of Business	•CSR policy & Implementation (Composition of CSR committee & Unutilized fund)
•Directors / KMP Appointed / Resigned	•Change in Sub / JV / ASSO	•Conservation of Energy / Forex (NA to GC in DEFENCE)
•Statement on Declaration by IDs	•State of affairs	•Deposits Chapters V
•No of meeting – BOD	•Financial Summary & Highlights	•Loans / Guarantee Investment U/S 186
•Formal annual Evaluation (Listed & Public Co PC>=25 Crores / NA to GC	•Material changes (after B/S Date)	•Orders by court / regulators affecting Going Concern
•Risk management Policy	•Transfer to General Reserve	•Frauds not reportable U/S 143(12)
•Contracts with Related Party U/S 188	•Proposed dividend	
	•Annual Return (Extract)-Web address, if any	
	•Director Responsibility Statement	
	•Comments on negative (Statutory / Secretarial Audit Report)	

- **Sec134(3)** provides matters to be specified in BOD report. Clause (q) gives power to central government to specify additional matters in rules.

- Under these rules CG has issued 2 additional requirements to be specified in BOD report.

  - (xi) the details of
    - **application made or any proceeding pending under the Insolvency and Bankruptcy Code, 2016** (31 of 2016) during the year
    - along with their **status as at the end of the financial year.**

  - (xii) the details of **difference** between amount of the
    - valuation done **at the time of one-time settlement** and
    - the valuation done **while taking loan** from the Banks or Financial Institutions (So it is change in value of security which was offered for taking such loan) along with the **reasons** thereof.

Proviso to Sec 134 (3)

Provided that where disclosures referred to in this sub-section (3) have been included in the financial statements, such disclosures shall be referred to instead of being repeated in the Board's report:

Provided further that where the policy referred to in clause (e) (Director Appointment & Remuneration) or clause (o) (CSR Expenditure) is made available on company's website, if any, it shall be sufficient compliance of the requirements under such clauses if the salient features of the policy and any change therein are specified in brief in the Board's report and the web-address is indicated therein at which the complete policy is available.

Proviso to Sec 134 (3A) & (4)

(3A) The Central Government may prescribe an abridged Board's report, for the purpose of compliance with this section by One Person Company or small company.

Points in italics and underlinedare the points which are requiredin case of OPC & Small Company (Refer Contentsof BOD Report)

(4) The report of the Board of Directors to be attached to the financial statement under this section shall, in case of a One Person Company, mean a report containing explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.

BOD Report (DIRECTOR RESPONSIBILITY STATEMENT)

- Whether financial statements gives true & fair view.
- For Listed co- Internal Financial Controls were followed are adequate and operating effectively.

  Note: "Internal Financial Controls "means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accountingrecords, and the timely preparation of reliable financial information.
- Maintenance of adequate accounting records for safeguarding of assets & preventing and detecting frauds.
- Compliance with AS & explanation for material departures.
- Consistency of A/c policy, Reasonableness of estimate
- Application of Going Concern
- Adequate & Effective system for compliance with laws & reg.

Section 134 (7)



MANY USERS DESPERATELY WANT FULL INFORMATION

ISSUE / CIRCULATE / PUBLISH FINANCIAL STATEMENT (INCLUDING CONSOLIDATED)



COMPANY

(Mandatory to include below items)

Board of Directors Report | Auditor Report | Notes to Accounts

Contravention of section 134 (8) (PENALTIES)

Company	Officer in Default
Fine=RS.3,00,000	Fine=RS. 50,000

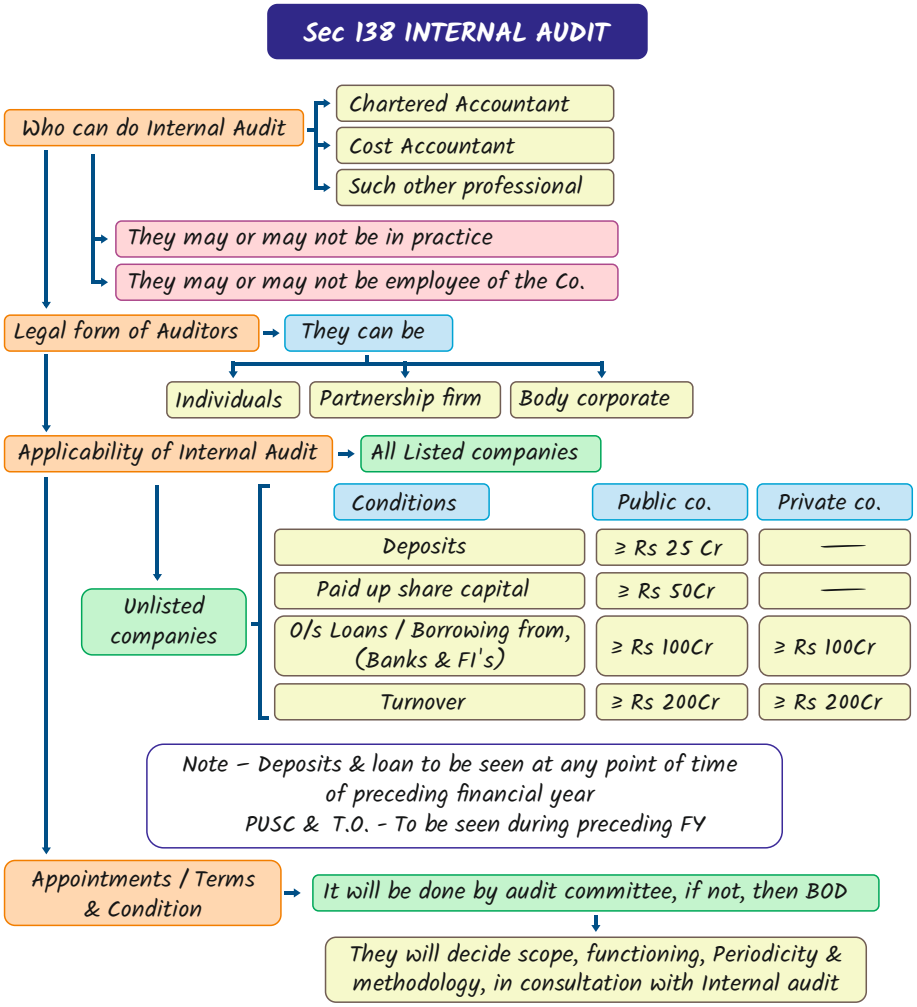
Amendment

If a company is in default in complying with the provision of this section, the company shall be liable to a penalty of three lakh rupees and every officer of the company who is in default shall be liable to a penalty to fifty thousand rupees.

*The Board's Report shall be prepared based on the stand alone financial statements of the company and shall report on the highlights of performance of subsidiaries, associates and joint venture companies and their contribution to the overall performance of the company during the period under report.

(CNO--COACC.180) SECTION 138 INTERNAL AUDIT (QNO 352.000, 353.000, 354.000, 354.500)

(MCQ – Incs.20.5, Incs48.3)



(CNO--COACC.200) FORM OF THE BALANCE SHEET (QNO – 414.020,414.025, 414.030)

Discussion

- Only vertical format of balance sheet and statement of profit and loss is prescribed under Schedule III to the Companies Act, 2013. Only vertical format is allowed and hence, becomes compulsory. There is no option to prepare balance sheet and statement of profit and loss in horizontal format ('T Form')
- **Schedule III to the Companies Act, 2013 –**

  The Schedule III to the Companies Act, 2013 applies to all the companies (except to the companies as referred to in the second proviso to section 129(1) of the Companies Act, 2013) uniformly for the financial statements to be prepared.

  The companies excused in the second proviso to section 129(1) of the Companies Act, 2013, are:
  - an insurance company; or
  - banking company; or
  - a company engaged in the generation or supply of electricity; or
  - any other class of companies for which a form of financial statement has been specified in or under the Act governing such class of companies.

- **Some of the features of Schedule III are as under:**

- The disclosure requirements specified in the Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards prescribed under the Companies Act, 2013. For the purpose of the Schedule, the terms used therein shall be as per the applicable Accounting Standards.
- The Schedule does not recognize presenting information in Schedules. Instead it requires presenting the information in details through notes to account.
- Each item on the face of the Balance Sheet and Statement of Profit and Loss shall be cross referenced to any related information in the notes to accounts.
- The corresponding amount for the immediately preceding year for all the items shown in the financial statement including notes shall also be given [excluding the cases where first financial statement are prepared by the company (after its incorporation)]

- The Schedule III to the Companies Act, 2013 has been divided into two divisions:
  - Division I deals with those financial statements which are required to comply with the Companies (Accounting Standards) Rules, 2006 (as amended); and
  - Division II deals with those financial statements which are drawn up in compliance with the Companies (Indian Accounting Standards) Rules, 2015.

- Division I has been divided as follows:.
  - Part I contains the form in which the Balance Sheet of a company should be drawn up, and states the general instructions as regards the presentation of different assets and liabilities.

(CNO—COACC.220) CONCEPT OF TRUE AND FAIR

Discussion

The concept of true and fair is a fundamental concept in auditing. The phrase "true and fair" in the auditor's report signifies that the auditor is required to express his opinion as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit. This requires that the auditor should examine the accounts with a view to verify that all assets, liabilities, income and expenses are stated as amounts which are in accordance with accounting principles and policies which are relevant and no material amount, item or transaction has been omitted.

SA 700 "Forming an Opinion and Reporting on Financial Statements", requires the auditor to form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and express clearly that opinion through a written report that also describes the basis for the opinion. The auditor is required to express his opinion on the financial statements that, the accompanying financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with Accounting Standards.

What constitutes a 'true and fair' view is a matter of an auditor's judgement in the particular circumstances of a case. In more specific terms, to ensure true and fair view, an auditor has to see:
(i) that the assets are neither undervalued or overvalued, according to the applicable accounting principles,
(ii) no material asset is omitted;
(iii) the charge, if any, on assets are disclosed;
(iv) material liabilities should not be omitted;
(v) the profit and loss account and balance sheet discloses all the matters required to be disclosed;
(vi) accounting policies have been followed consistently; and
(vii) all unusual, exceptional or non-recurring items have been disclosed separately.

PART-4
AUDIT OF COMPANY (LLP) ADDITION

(CNO--LLP.020) SALIENT FEATURES OF LIMITED LIABILITY PARTNERSHIPS (LLP) AUDIT

(MCQ – Incs.20.5)

- ***Maintenance of Accounts***

  An LLP shall be under obligation to maintain annual accounts reflecting true and fair view of its state of affairs.

- ***Audit of LLP***

  i. The accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009.

  ii. Such rules, inter-alia, provides that any LLP, whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty-five lakh rupees, is not required to get its accounts audited.

  iii.However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rule.

- ***No Mandatory Insurance***

  No mandatory insurance has been proposed in the Act. It would be difficult to assess insurance requirements of different types and sizes of LLPs. This would depend upon the nature of commercial risk attached with work or assignment handled by each. Applying common insurance requirements across a class of LLPs would result in increasing their costs of operation. Therefore, the underlying concern as to the credit worthiness of the LLP in the event of a contractual default is being addressed through statutory provisions for solvency declaration, disclosure of financial information and audit.

- ***Annual Return***

  Every LLP would be required to file annual return in Form 11 with ROC within 60 days of closer of financial year. The annual return will be available for public inspection on payment of prescribed fees to Registrar.

- ***SAS***

  A "Statement of Accounts and Solvency" in prescribed form shall be filed by every LLP with the Registrar every year.

  Statement of Account and Solvency in Form 8 which shall be filed within a period of thirty days from the end of six months the financial year to which the Statement of Account and Solvency relates.

- ***Fees***

  The provisions of the Act require LLPs to file the documents like Statement of Account and Solvency (SAS) and Annual Return (AR) and notices in respect of changes among partners etc. within the time specifically indicated in relevant provisions. The Act contains provisions for allowing LLPs to file such documents after their due dates on payment of additional fees. It has been provided that in case LLPs file relevant documents after their due dates with additional fees upto 300 days, no action for prosecution will be taken against them. In case there is delay of 300 days or more, the LLPs will be required to pay normal filing fees, additional fee and shall also be liable to be prosecuted

The Act also contains provisions for compounding of offences which are punishable with fine only.

- ***Obtaining Information & Summon from Registrar***

  Registrar would have power to obtain such information which he may consider necessary for the purposes of carrying out the provisions of the Act, from any designated partner, partner or employee of the LLP. He would also have power to summon any designated partner, partner or employee of any LLP before him for any such purpose, in case the information has not been furnished to him or in case the Registrar is not satisfied with the information furnished to him.

- **Public Inspection**

The following documents/information will be available for inspection by any person: -

- Incorporation document,
- Names of partners and changes, if any, made therein,
- Statement of Account and Solvency
- Annual Return

The fees for such inspection of an LLP is Rs 50/- and fees for certified copy or extract of any document u/s 36 shall Rs. 5/- per page.

(CNO—LLP.040) BOOKS OF ACCOUNTS (QNO - 507.250)

LLP's are required to maintain books of accounts which shall contain -

1. Particulars of all sums of money received and expended by the LLP and the matters in respect of which the receipt and expenditure takes place,
2. Statements of costs of goods purchased, inventories, work-in-progress, finished goods and costs of goods sold,
3. A record of the assets and liabilities of the LLP,
4. Any other particulars which the partners may decide.

(CNO—LLP.060) APPOINTMENT OF AUDITOR (QNO - 507.250)

The auditor may be appointed by the designated partners of the LLP -

1. At any time for the first financial year but before the end of first financial year,
2. At least thirty days prior to the end of each financial year (other than the first financial year),
3. To fill the causal vacancy in the office of auditor,
4. To fill the casual vacancy caused by removal of auditor.

The partners may appoint the auditors if the designated partners have failed to appoint them.

(CNO—LLP.080) ADVANTAGES / PURPOSE / NEED OF AUDIT

1. Auditing the accounts of a LLP helps in detecting errors & frauds & verification of financial statements
2. Periodical visits & suggestions by the auditor will be helpful in improving the management of the LLP
3. For settling accounts between partners at the time of admission, death, retirement, insolvency, insanity, etc. audited accounts are accepted by those concerned who have dealings with the LLP
4. Disputes, if any between any partners in the matter of accounts can be settled with the help of audited accounts.
5. Banks & financial institutions lend money to the firms only on the basis of audited accounts.

(CNO—LLP.100) AUDITOR'S DUTY REGARDING AUDIT OF LLPDIT

1. The auditor should get definite instructions in writing as to the work to be performed by him.
2. The auditor should mention
   a. Whether any restriction was imposed upon him
   b. Whether he was able to obtain all information & explanation necessary for his work
   c. Whether the records of the firm appear to be correct & reliable
3. The auditor should read the LLP agreement & note the following provisions
   d. Nature of the business of the LLP
   e. Duration of partnership
   f. Borrowing powers of the LLP
   g. Amount of capital contributed by each partner
   h. Interest - in respect of additional capital contributed
   i. Salaries, commission etc payable to partners
   j. Profit sharing ratio
   k. Drawings allowed to the partners
   l. Rights & duties of partners

m. Method of settlement of accounts between partners at the time of admission, retirement, admission etc.

n. Any loans advanced by the partners

4. If partners maintain minute book he shall refer it for any resolution passed regarding the accounts

UNIQUE QUESTIONS	
QNO 344.000	Sec 52--Securities Premium (Adjustment of Loss)
QNO 351.200	Sec 135--Business Related

UNIQUE MCQs	
MCQ No	Misc.1 (Covered in Professional Ethics), Incs.13.5, Incs.26.1 Incs.40.5, Incs.49.2,

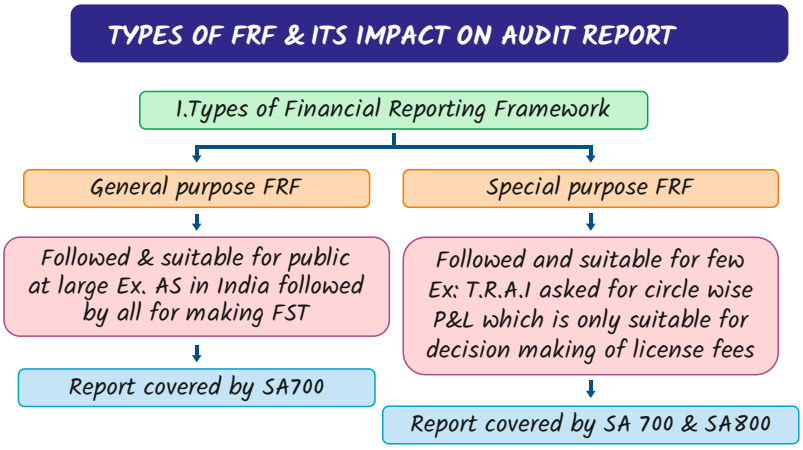
Students Notes

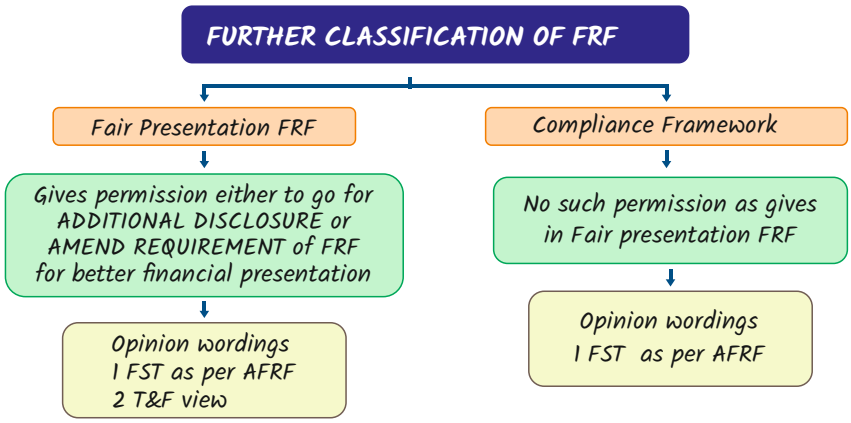
06 AUDIT REPORTS

Part I – [SA 700 Revised] FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

(CNO--SA700.020) TYPES OF FRF & ITS IMPACT ON AUDIT REPORT

Chart





UnmodiFed

The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

ModiFied

If the auditor:

(a) concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

(b) is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor shall modify the opinion in the auditor's report in accordance with SA 705(Revised).

Modification in Fair Presentation Framework?

If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor's report in accordance with SA 705 (Revised).

(For example, in notes to account, useful life is giving as 10 years and with star mark, they have written that machine will work for 30 years as per past experience, no such disclosure will confuse people and it is not fair

presentation
Suppose company is incorporated in 15-16 and it is operating for 8 months but if they simply write 15-16 in year then it won't be fair)

Modification in Compliance Framework?

When the financial statements are prepared in accordance with a compliance framework, the auditor is not required to evaluate whether the financial statements achieve fair presentation.
However, if in extremely rare circumstances the auditor concludes that such financial statements are misleading, the auditor shall discuss the matter with management and, depending on how it is resolved, shall determine whether, and how, to communicate it in the auditor's report.

(CNO--SA700.040) BASIC ELEMENTS OF THE AUDITOR REPORT (QNO-108.000) (MCQ- Incs.54.5)

The auditor's report shall be in writing.
Auditor's Report for Audits Conducted in Accordance with Standards on Auditing. (Below are the basics elements as Format of Audit Report)

I. Title → Clearly Indicate report of Independent Auditor (Generally used "Independent Auditor's Report")

II. Addressee → Addressed as Per Circumstances (It may be prescribed in Law / Regulation / Terms of Engagement, if not it can be addressed to TCWG or Shareholders) (Sec 143(2) asks auditor to report to share holders)

III. Auditor's Opinion →

Heading → Opinion

Initial Content

1. Intro – We have Audited FST
2. Identify which Entity
3. Identify title of each statement in set of FST.
4. Refer to notes, including summary of significant accounting policies.
5. Dates / Period covered by FST

Ultimate Content (Opinion)

Wordings
If Fair FRF - Whether FST are as per applicable FRF (Fair FRF)
- Whether FST give True & Fair view/Presents Fairly in all material respect
If Compliance FRF - Whether FST are as per Applicable FRF .(Compliance FRF)

IV. Basis of Opinion →

Why Opinion is Reliable ?

1. Declaration by auditor that he is independent as per code of ethics and also fulfilling other ethical requirements (Such as Integrity / Objectivity / Professional Competence & Due Care / Professional Behaviour & Confidentiality)
2. Audit is conducted as per SA's , Issued under Sec 143(10)
3. For Further details on how work was conducted refer "Auditor Responsibility Section"
4. To assure everyone statement that, auditor obtained sufficient and appropriate evidence to provide auditor's opinion

V. Going Concern (If Required) → Where applicable, the auditor shall report in accordance with SA 570 (Revised)(This is generally required if there exists material uncertainty, unless it is covered in basis of opinion paragraph).

VI. Key Audit Matter (If applicable) → As per requirements of SA 701

Continue on next Page...

VII. Respons-ibilities of Management for the FST →

Heading → Depending on circumstances (law applicable , nature of entity etc) heading can refer to management or also TCWG as the case may be.

I. Description of Responsibility for FST (BASIC)

If compliance framework → Preparation of FST as per compliance FRF

If fair presentation framework → Preparation of FST as per Fair FRF

- Ensure FST give True & Fair View

(2 MORE TO SUPPORT ABOVE)

2. Also responsibility to create & maintain internal control system to support above.

3. Responsibility to Assess whether going concern assessment is appropriate, disclosure of issues regarding going concern and statement on appropriateness of going concern

4. Identify people who are responsible for oversight of financial reporting process. If TCWG is responsible include their name in heading. (As per co. Law IFCR is responsibility of BOD)

VIII. Auditor Responsibility → 3 Para's Govern This Section

Para 37 Objectives

Reasonable Assurance + FREE FROM Material Misstatement & Issue Audit Report

- Meaning of Reasonable Assurance
--Meaning of Materiality
- Comment about Misstatement

Include always in Audit Report, No Other Option

Para 38 Scope

Auditor related points
- Professional Judgement & Skepticism (alert)

Process related points
- Identify RMM
- RMM due to Fraud may involve omission, misrepresentation, forgery, collusion & override of ICS
- Design & Perform Audit Procedures
- Obtain Audit Evidence

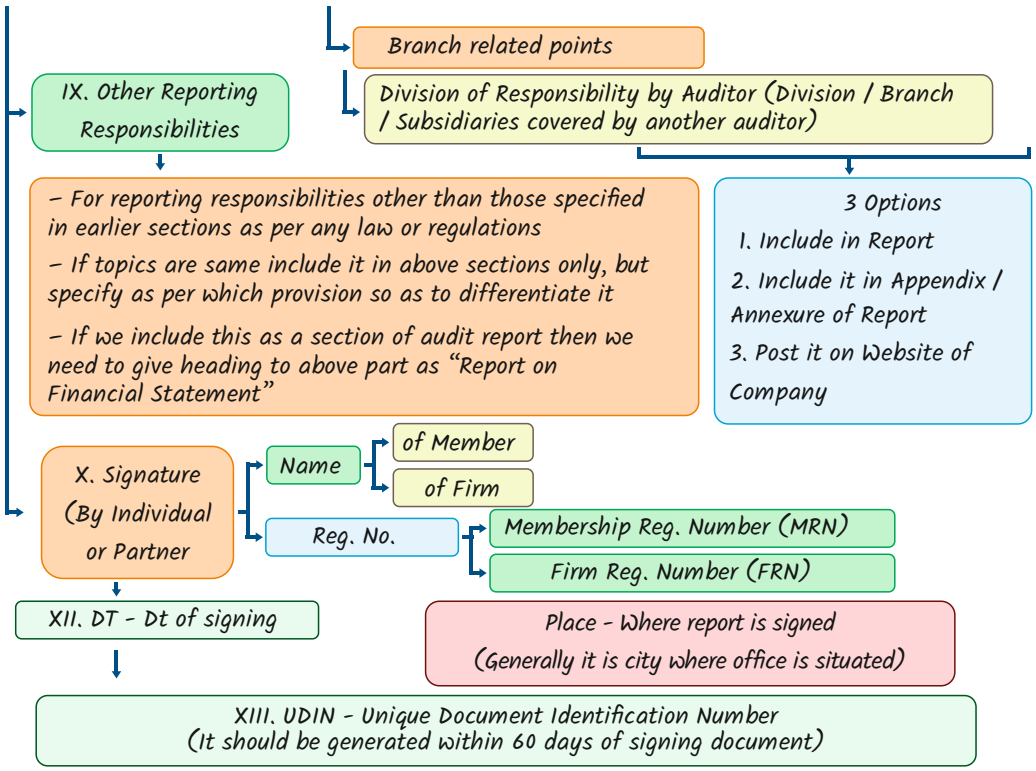
IMP Points
- Evaluate Accounting Policy / Reasonableness of Estimates & Disclosures
- IF Fair FRF, evaluate overall presentation, structure, content & disclosures
- Appropriateness of Going Concern

Internal Control System related points
- Non Corporates
  - We Understand ICS, but not for expressing opinion
- Corporates
  - Because of legal requirement to report on IFCR above \statement (regarding not expressing opinion) cannot be written in company audit report

Para 39 Communication

1. Statement on communication regarding ethical requirements & independence
2. Planned scope & timing of audit, significant audit findings (including significant deficiencies)
3. If KAM applicable, explain matters in KAM are most significant selected from communication to TCWG

Continue on next Page...



***Note : Generally questions are not asked in CA Final but we have included this for knowledge.

Title

The auditor's report shall have a title that **clearly indicates** that it is the **report of an independent auditor.** ("Independent Auditor's Report)

Addressee

The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement. (It may be prescribed in Law / Regulation / Terms of Engagement, if not it can be addressed to TCWG or Shareholders)

Auditor's Opinion

The first section of the auditor's report shall include the auditor's opinion and shall have the heading "Opinion."

The Opinion section of the auditor's report shall also:

(a) State that the **financial statements have been audited;**
(b) **Identify the entity** whose financial statements have been audited;
(c) Identify the **title of each statement** comprising the financial statements;
(d) **Refer to the notes,** including the summary of significant accounting policies; and
(e) Specify the **date of, or period covered** by, each financial statement comprising the financial statements.

WORDINGS

- **Fair Presentation Framework**

  When **expressing an unmodified opinion** on financial statements prepared in accordance with a fair presentation framework, the auditor's opinion shall, unless otherwise required by law or regulation, **use one of the following phrases,** which are regarded as being equivalent:

  (a) In our opinion, the accompanying financial statements **present fairly, in all material respects,** [...] in accordance with [the applicable financial reporting framework];

  OR

  (b) In our opinion, the accompanying **financial statements give a true and fair view** of [...] in accordance with [the applicable financial reporting framework].

- ***Compliance Framework***

  When expressing an unmodified opinion on financial statements prepared in accordance with a compliance framework, the auditor's opinion shall be that the ***accompanying financial statements are prepared, in all material respects,*** *in accordance with [the applicable financial reporting framework].*

  If the reference to the applicable financial reporting framework in the auditor's opinion is not to Accounting Standards, the auditor's opinion shall identify the origin of such other framework.

Basis for Opinion

(MCQ-700.1)

The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

(a) ***Includes a statement*** *that the* ***auditor is independent*** *of the entity in accordance with the relevant ethical requirements relating to the audit and has* ***fulfilled the auditor's other ethical responsibilities*** *in accordance with these requirements. The statement shall refer to the Code of Ethics issued by ICAI.*

(b) *States that the audit was conducted in* ***accordance with Standards on Auditing;***

(c) ***Refers to*** *the section of the auditor's report that describes the* ***auditor's responsibilities*** *under the SAs;*

(d) *States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.*

Going Concern

Where applicable, the auditor shall report in accordance with SA 570 (Revised).

Key Audit Matters (Please refer SA 701 for detailed discussion)

(a) *For audits of* ***complete sets of general-purpose Financial statements of listed entities,*** *the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701.*

(b) *When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.*

(b) *When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.*

Responsibilities for the Financial Statements

The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." The auditor's report shall use the term that is appropriate in the context of the legal framework applicable to the entity and need not refer specifically to "management". In some entities, the appropriate reference may be to those charged with governance.

This section of the auditor's report ***shall describe management's responsibility for:***

- ***Preparing the financial statements*** *in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and*

  When the financial statements are prepared in accordance with a fair presentation framework, the description of responsibilities for the financial statements in the auditor's report shall refer to "the preparation and fair presentation of these financial statements" or "the preparation of financial statements that give a true and fair view," as appropriate in the circumstances.

- ***Assessing the entity's ability to continue as a going concern*** *and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a*

description of when the use of the going concern basis of accounting is appropriate.

This section of the auditor's report shall also identify those responsible for the oversight of the financial reporting process (See last line of management responsibility paragraph), when those responsible for such oversight are different from those who fulfill the responsibilities above. In this case, the heading of this section shall also refer to "Those Charged with Governance" or such term that is appropriate in the context of the legal framework applicable to entity.

Auditor's Responsibilities for the Audit of the Financial Statements (QNO-109.000)

- **This part focuses on objectives given in Paragraph 37**

The auditor's report shall include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."

This section of the auditor's report shall:

(a) State that the **objectives of the auditor** are to:

(i) Obtain reasonable assurance about whether the financial statements as a whole are **free from material misstatement,** whether due to fraud or error; and

(ii) **Issue an auditor's report** that includes the auditor's opinion.

(b) State that **reasonable assurance is a high level of assurance, but is not a guarantee** that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and

(c) State that **misstatements can arise from fraud or error, and either:**

(i) Describe that **they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users** taken on the basis of these financial statements; or

(ii) Provide a definition or description of materiality **in accordance with the applicable Financial reporting framework.**

- **This part focuses on scope of audit, how audit was performed given in Paragraph 38.**

The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report shall further:

(a) State that, as part of an audit in accordance with SAs, the auditor exercises **professional judgment and maintains professional skepticism** throughout the audit; and

(b) Describe an audit by stating that the auditor's responsibilities are:

(i) To **identify and assess the risks of material misstatement** of the financial statements, whether due to fraud or error; **to design and perform audit procedures** responsive to those risks; and to **obtain audit evidence** that is sufficient and appropriate to provide a basis for the auditor's opinion. **The risk of not detecting a material misstatement resulting from fraud** is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

(ii) To obtain an **understanding of internal control relevant** to the audit in order to design audit procedures that are appropriate in the circumstances, **but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor shall omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.**

(iii) To **evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.**

(iv) To conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If the auditor concludes that a material uncertainty exists, the auditor is required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify the opinion. The auditor's conclusions are based on the audit evidence obtained up to the date of the auditor's report. However, future events or conditions may cause an entity to cease to continue as a going concern.

(v) When the financial statements are prepared in accordance with a fair presentation framework, to evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

(c) When SA 600 applies, further describe the auditor's responsibilities in a group audit engagement by stating: **The division of responsibility for the Financial information of the entity by indicating the extent to which the Financial information of components is audited by the other auditors have been included in the Financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditor.**

Other Matter Paragraph

- ***This part focuses on Communication given in Paragraph 39***

The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report also shall:

(a) State that the auditor **communicates with those charged with governance regarding,** among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that the auditor identifies during the audit;

(b) State that the auditor provides those charged with governance with a statement that the auditor has complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters that may reasonably be thought to bear on the auditor's independence, and where applicable, related safeguards; and

(C) For audits of financial statements of all such entities for which key audit matters are communicated in accordance with SA 701, state that, from the matters communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. In accordance with the requirements of SA 701, the auditor describes these matters in the auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, the auditor determines that a matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

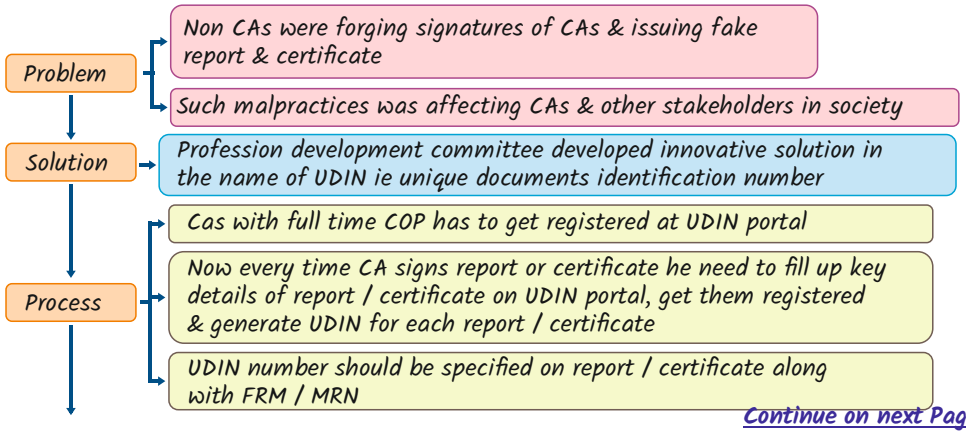
- ***Only for Scope (Para 38) & Communication Responsibilities (Para 39) Above***

Location of the description of the auditor's responsibilities for the audit of the financial statements. The description of the auditor's responsibilities for the audit of the financial statements shall be included:

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

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

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

	When the auditor refers to a description of the auditor's responsibilities on a website of an appropriate authority, the auditor shall determine that such description addresses, and is not inconsistent with, the requirements of this SA.
Other Reporting Responsibilities	If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled "Report on Other Legal and Regulatory Requirements" or otherwise as appropriate to the content of the section, **unless these other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the SAs in which case the other reporting responsibilities may be presented in the same section as the related report elements required by the SAs.** If other reporting responsibilities are presented in the same section as the related report elements required by the SAs, the auditor's report **shall clearly differentiate the other reporting responsibilities from the reporting that is required by the SAs.** (E.g. Company Act 2013 requires auditor to comment whether financial statements give true & fair view, so this comment is made in opinion paragraph and reference to company act is made there itself) If the auditor's report contains a separate section that addresses other reporting responsibilities, **the requirements all content till auditor's responsibility of this SA shall be included under a section with a heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" shall follow the "Report on the Audit of the Financial Statements."**
Signature of the Auditor	The auditor's report **shall be signed.** The report is signed by the auditor (i.e. the engagement partner) in his personal name. Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm. The partner/proprietor signing the audit report also needs to **mention the membership number assigned by the Institute of Chartered Accountants of India. They also include the registration number of the firm,** wherever applicable, as allotted by ICAI, in the audit reports signed by them.
Place of Signature	The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.
Date of the Auditor's Report	The auditor's report shall be dated **no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence** on which to base the auditor's opinion on the financial statements, **including evidence that:** (a) **All the statements** that comprise the financial statements, including the related notes, **have been prepared;** and (b) Those with the recognized authority have asserted that they **have taken responsibility for those financial statements.** (That means first management should sign and then auditor)
UDIN	

Continue on next Page...

Implemented in phased manner

- 1st Feb 2019 → For all certificates
- 1st Apr 2019 → For GST & Tax audit reports
- 1st Jul 2019 → For all other Audit, Attest & Assurance function

It was noticed that financial documents/ certificates attested by third person misrepresenting themselves as CA Members were misleading the Authorities and Stakeholders. ICAI also received number of complaints of signatures of CAs being forged by non CAs. To curb the malpractices, the Professional Development Committee of ICAI implemented in phased manner an innovative concept of UDIN i.e. Unique Document Identification Number. All Certificates were made mandatory with effect from 1st February, 2019 as per the Council decision taken at its 379th
Meeting held on 17th – 18th December, 2018.
Chartered Accountants having full-time Certificate of Practice can register on UDIN Portal and generate UDIN by registering the certificates attested/certified by them.
Accordingly, an auditor is required to mention the UDIN with respect to each audit report being signed by him, along with his membership number while signing an audit report.

(CNO--SA700.060) AUDITOR REPORT PRESCRIBED BY LAW OR REGULATION

Chart

AUDIT REPORT PRESCRIBED BY LAW

↓ If law prescribes format of audit report then as law overrides standards. Hence auditor will have to follow format given by law

↓ He will give reference to standards on auditing in his audit report only if

↓ Audit reports includes basic elements which we have discussed earlier (Other than conditional element)

↓ Which means all elements from title to date

↓ In India, we don't refer to standards in tax audit report because it does not contain management responsibility & auditor responsibility paragraph

{E.g. Format of tax audit report prescribed by law}
Refers to Standards on Auditing only if the auditor's report includes, at a minimum, Basic Elements of Audit Report, except that going concern / key audit matter / other reporting requirements only if required.

In India we don't refer to SA 700 while preparing tax audit report because it is not having management responsibility & auditor responsibility paragraph.
ICAI Clarification on tax audit report
http://www.icai.org/new_post.html?post_id=9687

(CNO--SA700.080) STANDARDS AUDITING IN ONE AUDIT REPORT (QNO-111.050)

Chart

REFERENCE TO MULTIPLE STANDARDS ON AUDITING & MULTIPLE FRF IN AUDIT REPORT

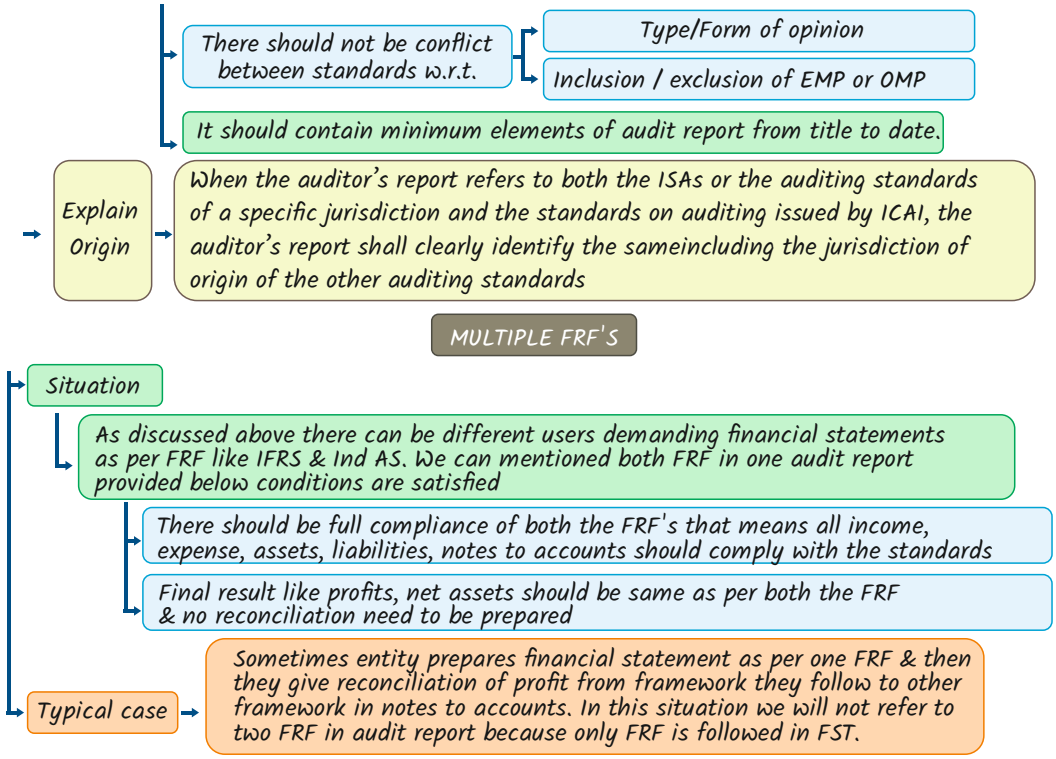
MULTIPLE SA's

Situation → There can be situation where there are investor from different region

For Ex- US, Japan, India. They will demand audit as per international standards on auditing, Japanese standards, Indian Standards. It is possible that we refer to multiple standards on auditing in audit report & say that audit was conducted according to them if following conditions are satisfied

↓

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Relevance to more than one SA

An auditor may be required to conduct an audit in accordance with, in addition to the Standards on Auditing issued by ICAI, the International Standards on Auditing or auditing standards of any other jurisdiction. If this is the case, the auditor's report may refer to Standards on Auditing in addition to the International Standards on Auditing or auditing standards of such other jurisdiction, but the auditor shall do so only if:

(a) There is no conflict between the requirements in the ISAs or such auditing standards of other jurisdiction and those in SAs that would lead the auditor
   i) to form a different opinion, or
   ii) not to include an Emphasis of Matter paragraph or Other Matter paragraph that, in the particular circumstances, is required by SAs; and

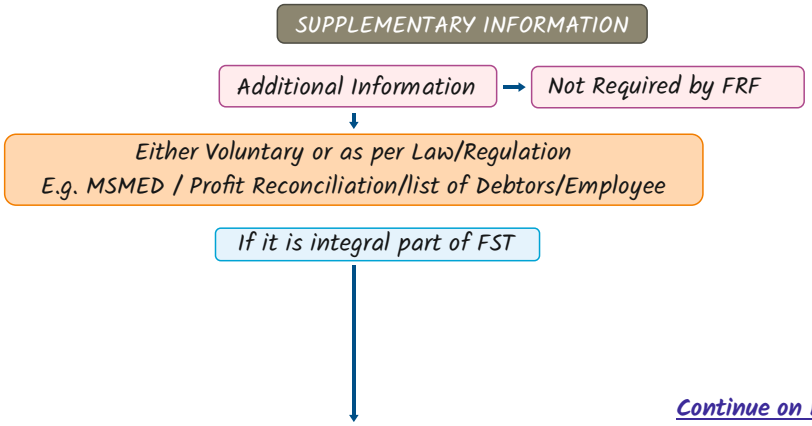
(b) The auditor's report includes, at a minimum, each of the elements set out is previous concept for audit report as per law.
When the auditor's report refers to both the ISAs or the auditing standards of a specific jurisdiction and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.

Further Reference to More than One Financial Reporting Framework

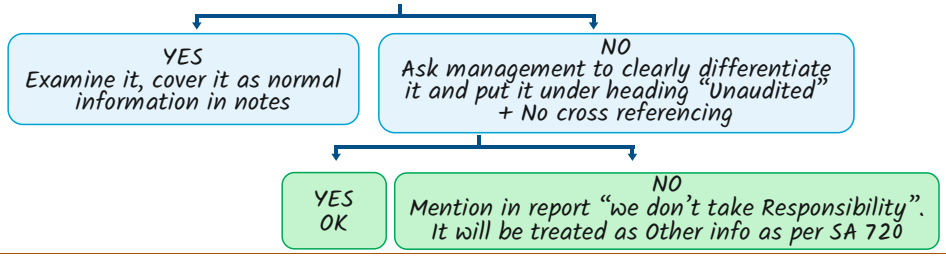
- Entity may decide to present financial statement as per 2 FRF, for example as per AS & IFRS.
- So, description will contain both FRFs provided both the FRFs should be fully complied (i.e. can't use particular FRF only for one or two items of FST) &no need for reconciliation between both.
- If only one FRF is followed & there is only reconciliation from FRF to another or just disclosure how much other FRF is Compiled no need to refer both?

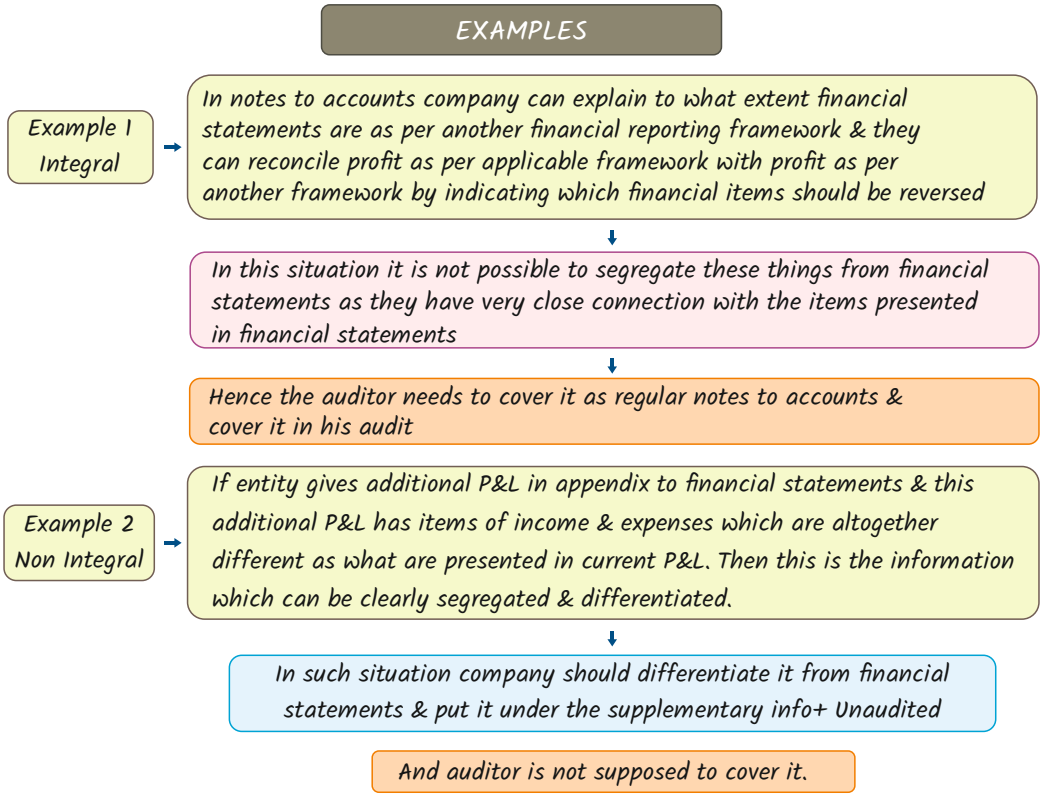
(CNO--SA700.100) SUPPLEMENTARY INFORMATION (QNO - 111.060)

Chart



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Detailed Text

If supplementary information that is not required by the applicable financial reporting framework is:

- *presented with the audited financial statements, the auditor shall evaluate whether, in the auditor's professional judgment, supplementary information is nevertheless an integral part of the financial statements due to its nature or how it is presented. When it is an integral part of the financial statements, the supplementary information shall be covered by the auditor's opinion.*
  not considered an integral part of the audited financial statements, the auditor shall evaluate
- *whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements. If this is not the case, then the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall identify the unaudited supplementary information and explain in the auditor's report that such supplementary information has not been audited.*

- ***For Example***

  When the notes to the financial statements include an explanation or the reconciliation of the extent to which the financial statements comply with another financial reporting framework, the auditor may consider this to be supplementary information that cannot be clearly differentiated from the financial statements. The auditor's opinion would also cover notes or supplementary schedules that are cross referenced from the financial statements.

  When an additional profit and loss account that discloses specific items of expenditure is disclosed as a separate schedule included as an appendix to the financial statements, the auditor may consider this to be supplementary information that can be clearly differentiated from the financial statements.

(CNO--SA700.105) FORMING OPINION ON FINANCIAL STATEMENTS & SPECIFIC EVALUATIONS

Chart

FORMING OPINION ON FINANCIAL STATEMENTS

- What opinion Auditor has to frame?
  - User expects FST as per standard principles and format, that means they should be as per AS, IND AS, IFRS etc.
  - So, auditor has to make opinion whether FST is as per applicable FRF.
  - If it is a fair presentation framework
    - Auditor also needs to express whether FST give true & fair view
- How to frame opinion
  - To frame opinion on FST, auditor will have to make a conclusion about all material items in FST whether material items in FST are free from MMST may be because of fraud or error.
  - While making this conclusions, auditor should be reasonably assured (high level of confidence)
- How to draw conclusions
  - For drawing conclusions following should be done
  - 1. Perform audit procedures and obtain sufficient and appropriate audit evidence for all material items
  - 2. On the basis of evidence, identify misstatements in FST and ask mgt to rectify them and then make list of uncorrected misstatements, now auditor have to check these misstatements individually or in aggregate.
  - 3. Apart from quantitative misstatements it is important for auditor to understand the quality of FST / accounting practices / mgt bias to form opinion on FST.

Chart

SPECIFIC EVALUATION BY AUDITOR'S

SA 700, makes some evaluation mandatory for auditor because they are extremely important and they don't want auditor to miss it in any manner

Shortcut – **MASTER** (Auditor has to evaluate following)

- **M** – Material transactions and events are properly accounted and disclosed in the FST, so that user understand their nature and financial effects
- **A** – Whether applicable FRF is followed consistently while selecting and implementing accounting policies
- **S** – Whether significant accounting policies are properly disclosed in notes to accounts
- **T** – Whether terminology used in FST including the title of FST is appropriate (e.g. title for profit oriented and non-profit oriented company is different)
- **E** – Whether estimates made by the mgt appear reasonable (realistic)
- **R** – Whether FST as a whole are relevant, reliable, comparable and understandable.

***Note : Generally questions are not asked in CA Final but we have included this for knowledge.

(CNO--SA700.110) EVALUATION OF QUALITATIVE ASPECTS INCLUDING MANAGEMENT BIAS

Chart

EVALUATION OF QUALITATIVE ASPECTS INCLUDING MGT BIAS

- Qualitative aspects of accounting practices / FST.
  - SA 260, explains what are the qualitative aspects of accounting practices and they majorly focus on 3 things
    - Significant accounting policies
    - Mgt estimates & judgements
    - Disclosures in FST
- Management Bias
  - Mgt has to make many judgement while doing accounting and preparing FST. There is a possibility that they misuse this opportunity and enforce there hidden agenda of manipulating FST.
  - So auditor should be careful and understand whether mgt appear bias.
  - To understand whether mgt is biased or lack neutrality, auditor should see following: -
    - Whether there are selective correction by mgt w.r.t. misstatements identified by auditor which may either only increasing earnings or decreasing earnings
    - Mgt is not rectifying deficience in the system which are focusing on particular transaction, balances or disclosures leading to in inappropriate reporting
    - whether there is possible Mgt bias while determine accounting estimates. Now, how to understand whether Mgt is bias in estimate is explained in SA 540 which gives examples and circumstances of Mgt is bias in making accounting estimates.
- Effect of low quality accounting practices and mgt bias
  - if we identity that quality of accounting practices is low or mgt is biased, this in itself is not a material misstatement which should be reported
  - But while evaluating misstatements then we should consider effect to low quality accountingpractice and mgt bias while drawing opinion and because of this we may draw opinion which is unfavorable, so they effect opinion making process.

***Note : Generally questions are not asked in CA Final but we have included this for knowledge.

(CNO--SA700.120) CERTIFICATE FOR SPECIAL PURPOSE VS. AUDIT REPORT (QNO-110.000)

Chart

AUDIT REPORT V/S AUDIT CERTIFICATE

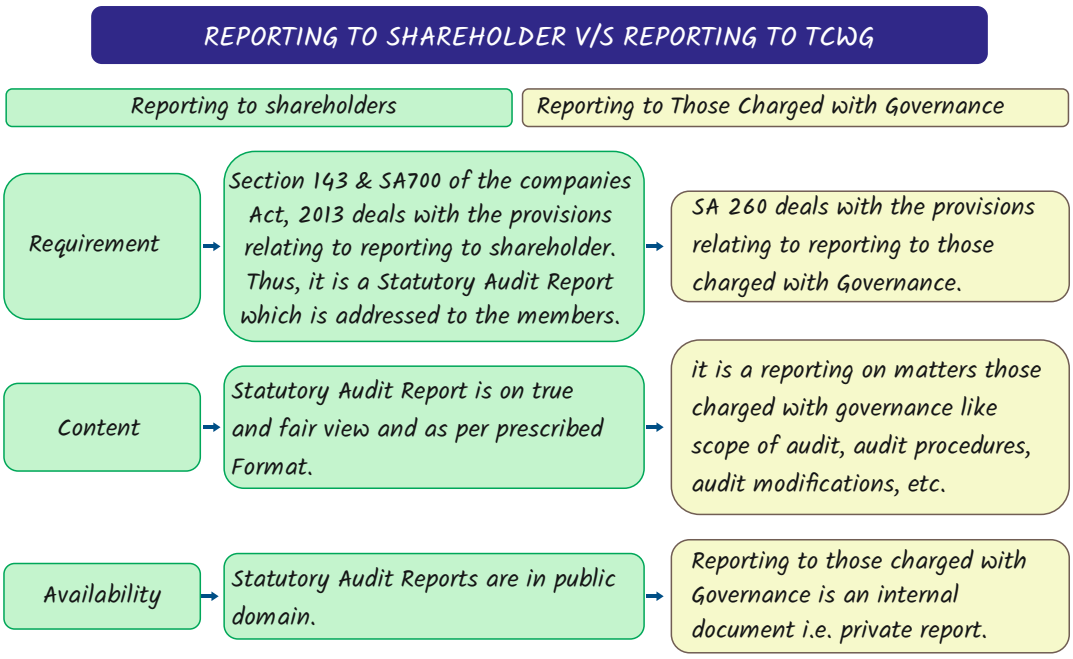
	Audit Report	Audit Certificate
Coverage	Generally whole FST	Limited Info
Procedures & Evidence	Similar methods	Similar methods
Use of Judgement	Yes	No
Final Result	Opinion with reasonable Assurance	Vouch Accuracy
Facts	Opinion is based on facts	Here we comment on accuracy of facts itself
Examples	Examples : the report under section 143 of the Companies Act, 2013 is an opinion based report and not a certificate	Examples: As per Section 66 of the Companies Act, 2013, an auditor is required to file a certificate in the tribunal where company is proposing for the reduction of capital

Presentation in Table Form

Audit Report	Audit Certificate
➢ A report is a formal statement made after an enquiry of matter specified.	➢ Certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion.
➢ The 'report' involves expression of opinion which may differ from one professional to another	➢ The term 'certificate' is used where the auditor verifies the accuracy of facts stated therein.
➢ He is responsible for ensuring that the report is based on factual data. Example : However, the report under Section 143 of the Companies Act, 2013, is an opinion-based report and is not a certificate	➢ He is responsible for the factual accuracy of what is stated therein. Example : As per Section 66 of the Companies Act, 2013, an auditor is required to file a certificate in the tribunal where company is proposing for the reduction of capital.

(CNO--SA700.140) REPORTING TO SHAREHOLDERS V/S REPORTING TO TCWG (QNO-111.000)

Chart



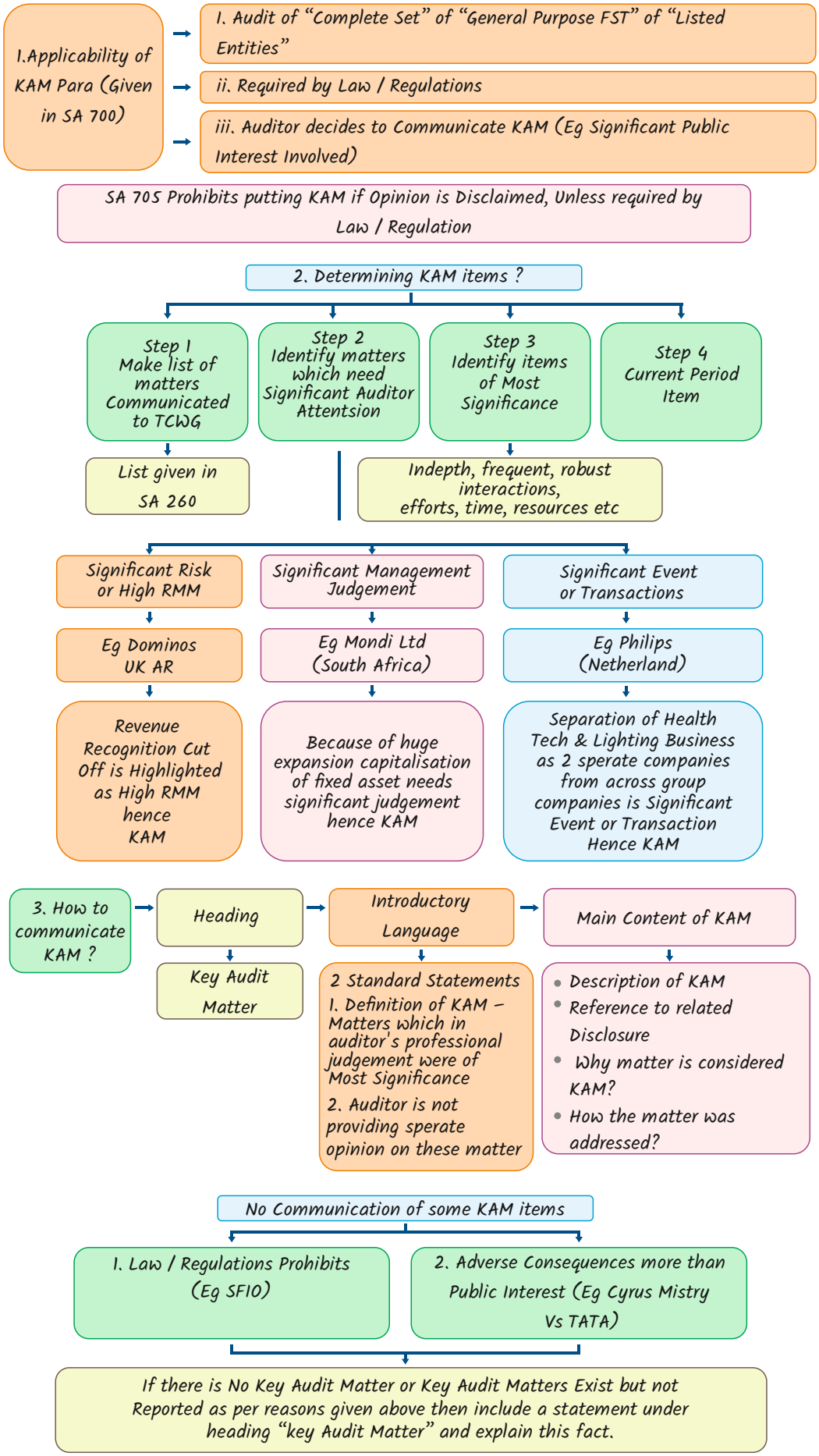
Unique question

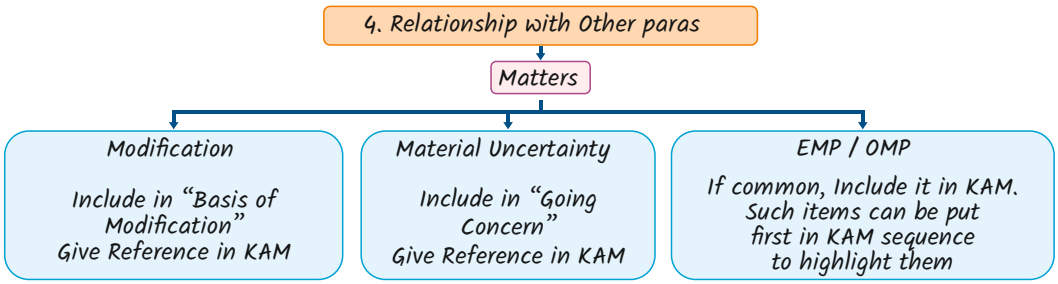
QNO 108.500	Draft Opinion & Basis Of Opinion Para
QNO 111.080	True & Fair

Part 2 - [SA 701] COMMUNICATING KEY AUDIT MATTERS IN THE INDEPENDENT AUDITOR'S REPORT

(CNO--SA701.020 TO CNO—SA701.080) MASTER CHART COVERING FULL SA 701 (QNO-112.300)

Chart





(CNO--SA701.020) IN WHICH CIRCUMSTANCES, AUDITOR SHOULD THINK/CONSIDER ABOUT KEY AUDIT MATTER PARAGRAPH?

Chart

Answer: -

This point is explained in SA 700 and not SA 701, so be careful while quoting SA number

(a) For audits of complete sets of general-purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701. (So above 3 things are must for compulsory consideration about KAM)

(b) When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.

Apart from compulsory consideration these two situations are possible;

1st if required by law for example if made mandatory TRAI or

2nd Auditor decides to communicate if entity is of significant public interest for example because they have a large number and wide range of stakeholders and considering the nature and size of the business. Examples of such entities may include financial institutions (such as banks, insurance companies, and pension funds), and other entities such as charities.

Public sector entities, even where not listed, may be significant due to size, complexity or public interest aspects. In such cases, an auditor of a public-sector entity may be required by law or regulation or may otherwise decide to communicate key audit matters in the auditor's report.

However, SA 705 (Revised) prohibits the auditor from communicating key audit matters when the auditor disclaims an opinion on the financial statements, unless such reporting is required by law or regulation.

(CNO--SA701.040) WHAT DO YOU MEAN BY KEY AUDIT MATTER (KAM) AND HOW TO DETERMINE KAM? (QNO - 112.150) (MCQ-701.1 / 701.3/ 701.4/ Incs.49.4)

Key audit matters

Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

1st It should from matters communicated to TCWG

2nd Required SIGNIFICANT AUDITOR ATTENTION

3rd It should be of MOST SIGNIFICANCE

4th It is should be from audit of CURRENT Period)

Significant Auditor Attention (QNO-112.100)

The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit.

In making this determination, the auditor shall take into account the following:

(It gives us guidance on matters where there is generally Significant Auditor Attention)

(a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.

(Now real-life example of Dominos, where E&Y UK as specified revenue recognition risk as RMM specifically highlighting Cut Off as a big risk in audit report)

(b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
(E.g. In Mondi Limited a South African Company auditor Deloitte has specified Capitalization of Fixed Asset as Key audit matter as it involves significant judgement by management regarding which expenses should be capitalized and till what time and what should be economic useful life.)

(c) The effect on the audit of significant events or transactions that occurred during the period.
(E.g. In Philips Netherland KPMG has specified Separation of Health Tech Business & Lighting Opportunities as separate company as Key Audit Matter, Also Acquisition of Volcano Corporation)

Most Significance (QNO-112.100)

The auditor shall determine which of the matters determined in accordance with above points were of **most significance** in the audit of the financial statements of the current period and therefore are the key audit matters.

(Matters involving in-depth, frequent, robust interactions , important to users, complex, subjective, material etc. For example, GST implementation may be of most significance as compared to IDT cases pending against company)

(CNO--SA701.050) EXAMPLES OF KEY AUDIT MATTERS:

Discussion

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

(CNO--SA701.060) HOW TO COMMUNICATE KAM IN AUDIT REPORT? (QNO-112.300 / 112.400)

Introductory Language (QNO-112.000 / 112.200)

The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters,". The **introductory language in this section** of the auditor's report shall state that:

(a) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and

(b) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.
(Above 2 are general statements, they should be specified at the start every time auditor specifies KAM)

Descriptions (MCQ – 701.5)

Descriptions of Individual Key Audit Matters

The description of each key audit matter in the Key Audit Matters section of the auditor's report **shall include a reference to the related disclosure(s)**, if any, in the financial statements and **shall address:**

(a) **Why the matter was considered** to be one of most significance in the audit and therefore determined to be a key audit matter; and

(b) How the matter was addressed in the audit.

Not Communicated (QNO-112.000)

Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report

The auditor shall describe each key audit matter in the auditor's report unless:

(a) Law or regulation precludes public disclosure about the matter;

(E.g. Suppose SFIO investigations are going against company for money laundering and NCLT directs auditor not to disclose details as it may affect investigations adversely, in such circumstances auditor will not disclose KAM)

or

(b) In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter.

(E.g. Cyrus Mistry was removed as chairman of TATA Sons and there will be change in management along with legal tussle between Cyrus Mistry (Shapoorji Pallonji Group) and Ratan Tata Group now this is big event and may qualify for KAM but auditor may decide not to give details as it will lead to speculations and tarnishing Tata group companies)

Other Circumstances

Form and Content of the Key Audit Matters Section in Other Circumstances

If the auditor determines, depending on the facts and circumstances of the entity and the audit, that there are ***no key audit matters to communicate*** *or that the* ***only key audit matters communicated are those matters which are not to be communicated in audit report, the auditor shall include a statement to this effect in a separate section of the auditor's report under the heading "Key Audit Matters."***

(CNO--SA701.080) WHAT IS RELATIONSHIP BETWEEN KEY AUDIT MATTERS, THE AUDITOR'S OPINION AND OTHER ELEMENTS OF THE AUDITOR'S REPORT? (QNO - 112.500, 112.350) (MCQ-701.2)

Key audit matters

Answer

- ***Interaction between Descriptions of Key Audit Matters and Other Elements Required to Be Included in the Auditor's Report;***

  A matter giving rise to a modified opinion in accordance with SA 705 (Revised), or a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised), are by their nature key audit matters. However, in such circumstances, these matters shall not be described in the Key Audit Matters section of the auditor's report and the requirements of specific disclosure as KAM. Rather, the auditor shall:

  - *Report on these matter(s) in accordance with the applicable SA(s); and*
  - *Include a reference to the Basis for Qualified (Adverse) Opinion or the Material Uncertainty Related to Going Concern section(s) in the Key Audit Matters section.*

- ***Key Audit Matters Not a Substitute for Expressing a Modified Opinion;***

  The auditor shall not communicate a matter in the Key Audit Matters section of the auditor's report when the auditor would be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter.

  (Qualified under SA 705 ⟶ Don't include in KAM just give reference of Basis of Qualification in KAM para
  Adverse under SA 705 ⟶ Don't include in KAM just give reference Basis of Qualification in KAM para
  Disclaimer under SA 705 ⟶ Don't give KAM para as audit was not conducted.

  EMP / OMP under SA 706 ⟶ If matter of EMP / OMP is also KAM, include it in KAM you can highlight more by putting it first in sequence and describing it more. then no need to put separate EMP / OMP. Apart from this there can be separate matters where only EMP / OMP is required and no need to include them in KAM, this concept is explained in detail in SA 706)

(CNO--SA701.100) Scope of KAM / Don't Misuse KAM

Shortcut – Fast Moving Goods & Services

- F – Not a substitute for disclosure in financial statement
- M – Not a substitute for expressing Modified opinion
- G – Not a substitute for reporting on material uncertainty over Going concern
- S – Not a Separate opinion on individual matters

Discussion

- Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not:
  - A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
  - A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
  - A substitute for reporting in accordance with SA 570 (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
  - A separate opinion on individual matters.

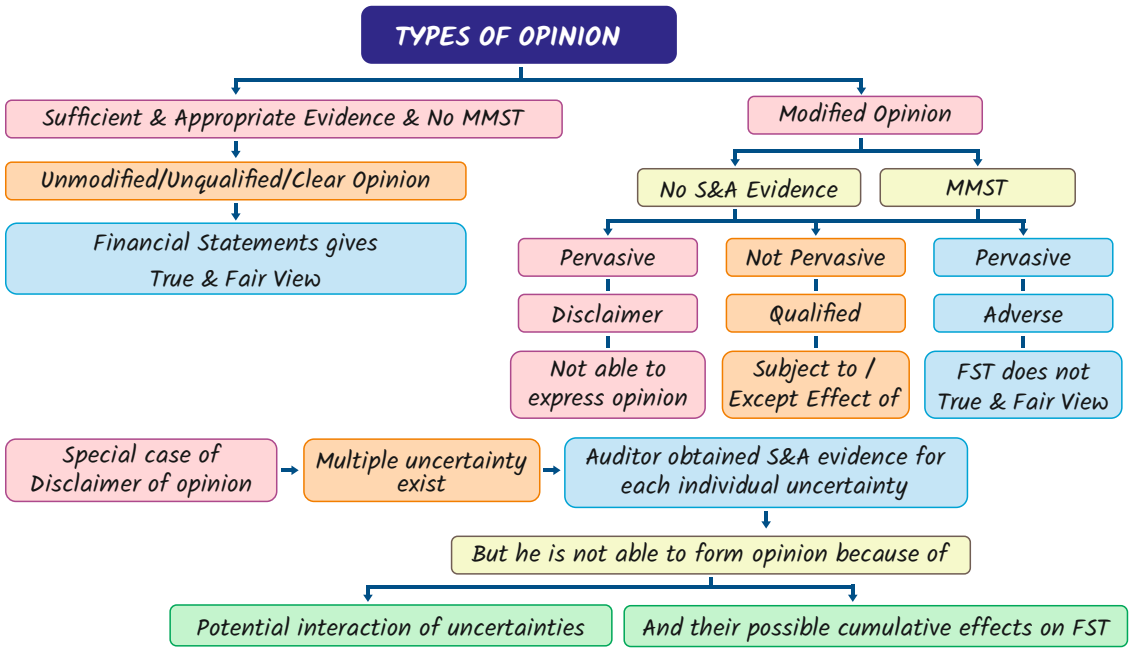
UNIQUE QUESTION

QNO 111.100	Purpose of KAM

Part 3 – [SA 705] MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S

(CNO—SA705.020) WHEN TO MODIFY? TYPES OF MODIFICATIONS & OTHER CONSIDERATIONS (QNO-113.000) (MCQ-705.1)

Chart



Circumstances When a Modification to Auditor's Opinion is Required

- The auditor **shall modify the opinion** in the auditor's report when:
  - (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are **not free from material misstatement;** or
  - (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Determining the Type of Modification to the Auditor's Opinion (QNO- 113.030, 119.120, 119.500)

(MCQ-705.2/ 705.3/ 705.7 / 705.8 / 705.09/ 705.11 Incs.03.2/ Incs.7.1/ Incs.07.4 / Incs.13.7 / Incs.28.4 / Incs.28.5 / Incs.35.5)

- **Qualified Opinion**
  The auditor **shall express a qualified opinion** when:
  - (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that **misstatements, individually or in the aggregate, are material, but not pervasive,** to the financial statements; or
  - (b) The auditor is **unable to obtain sufficient appropriate audit evidence** on which to base the opinion, but the auditor concludes that the **possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.**

- **Adverse Opinion**
  The auditor **shall express an adverse opinion** when the auditor, having obtained sufficient appropriate audit evidence, concludes that **misstatements, individually or in the aggregate, are both material and pervasive** to the financial statements.

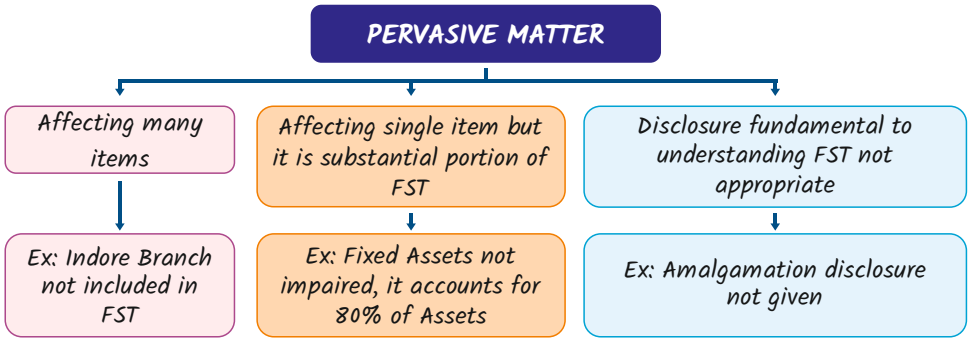
- **Disclaimer of Opinion**
  The auditor shall disclaim an opinion when the auditor is **unable to obtain sufficient appropriate audit evidence** on which to base the opinion, and the auditor **concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.**

  The auditor **shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties,** the auditor concludes that, **notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties,** it is not possible to form an opinion on the financial statements due to the **potential interaction of the uncertainties and their possible cumulative effect on the financial statements.**
  (Example of Indosolar Ltd)

Nature of Matter giving rise to the Modification	Auditor's Judgment about the Pervasiveness of the Effects, or Possible Effects on the Financial Statements	
	Material but Not Pervasive	Material but Pervasive
Financial Statements are materially misstated	Qualified Opinion	Adverse Opinion
Inability to obtain sufficient appropriate audit evidence	Qualified Opinion	Disclaimer of Opinion '

(CNO—SA705.030) MEANING OF TERM PERVASIVE

Chart



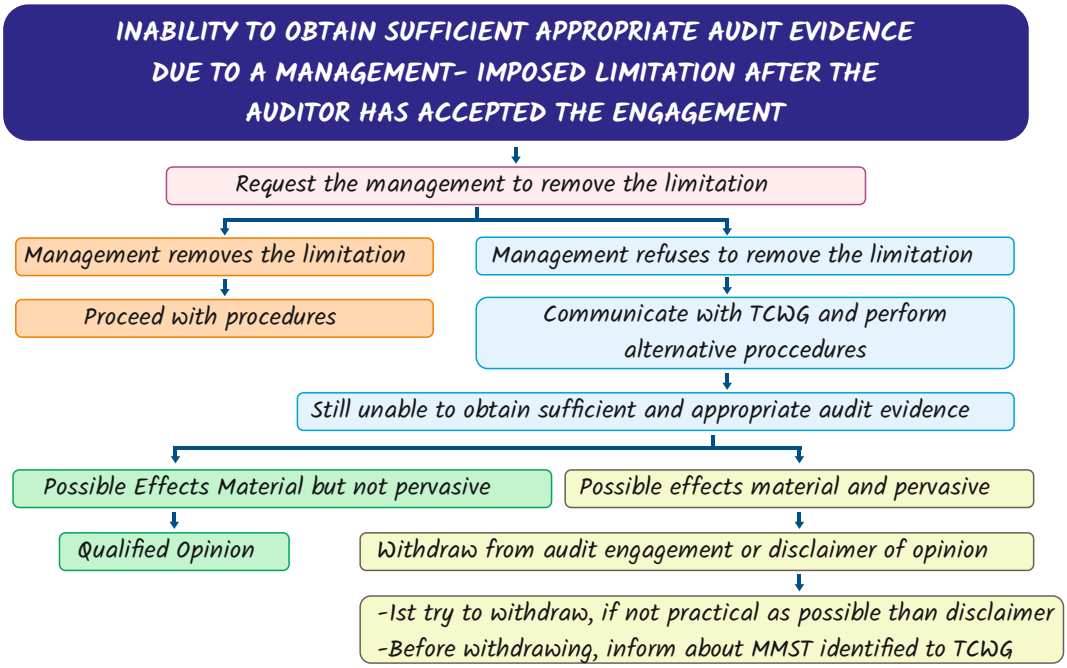
Definition of Pervasive – A term used, in the **context of misstatements,** to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. **Pervasive effects on the financial statements are those that, in the auditor's judgment:**

- Are **not confined to specific elements, accounts or items** of the financial statements;
  (E.g. Trial Balance of particular branch not included while preparing financial statements)
- If so confined, represent or could represent a **substantial proportion of the financial statements**; or
  (E.g. Impairment of a factory is not done which represents 60% of total assets)
- In relation to disclosures, are **fundamental to users' understanding of the financial** statements.
  (E.g. Key disclosures of amalgamation & discontinuing operations are omitted)

(CNO—SA705.040) CONSEQUENCE OF AN INABILITY TO OBTAIN SUFFICIENT APPROPRIATE AUDIT EVIDENCE DUE TO A MANAGEMENT-IMPOSED LIMITATION AFTER THE AUDITOR HAS ACCEPTED THE ENGAGEMENT

(QNO-119.000 / 119.030) (MCQ-705.5)

Chart



Detailed Text

- If, **after accepting the engagement,** the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers **likely to result in the need to express a qualified opinion or to disclaim an opinion** on the financial statements, the auditor **shall request that management remove the limitation.**
- If management **refuses to remove the limitation** referred to in above paragraph, the auditor **shall communicate the matter to those charged with governance,** unless all of those charged with governance are involved in managing the entity and determine **whether it is possible to perform alternative procedures** to obtain sufficient appropriate audit evidence.
- If the auditor is **unable to obtain sufficient appropriate audit** evidence, the auditor shall determine the implications as follows:
  - (a) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be **material but not pervasive, the auditor shall qualify the opinion; or**
  - (b) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
    - (i) **Withdraw from the audit, where practicable and possible** under applicable law or regulation; or
    - (ii) If withdrawal from the audit before issuing the auditor's report is **not practicable or possible, disclaim an opinion** on the financial statements.

      If the auditor withdraws as discussed above, **before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.**

(CNO—SA705.050) Reasons for No S & A Evidence (QNO-113.020)

Discussion

- Reasons (R)

The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

R1 - Circumstances beyond the control of the entity;

R 2 - Circumstances relating to the nature or timing of the auditor's work; or

R 3 - Limitations imposed by management.

- R1 – Fault of External Factors

  Examples of circumstances **beyond the control of the entity include when:**
  - The entity's accounting records have been **destroyed.**
  - The accounting records of a significant component have been **seized indefinitely by governmental authorities.**

- R2 – Fault of Management

  Examples of an inability to obtain sufficient appropriate audit evidence arising from a **limitation on the scope of the audit imposed by management** include when:
  - Management prevents the auditor from observing the counting of the physical inventory.
  - Management **prevents the auditor from requesting external confirmation** of specific account balances.
- R3 – No one's Fault

  Examples of circumstances **relating to the nature or timing of the auditor's work include** when:
  The entity is required to use the equity method of accounting for an associated entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial

information to evaluate whether the equity method has been appropriately applied.

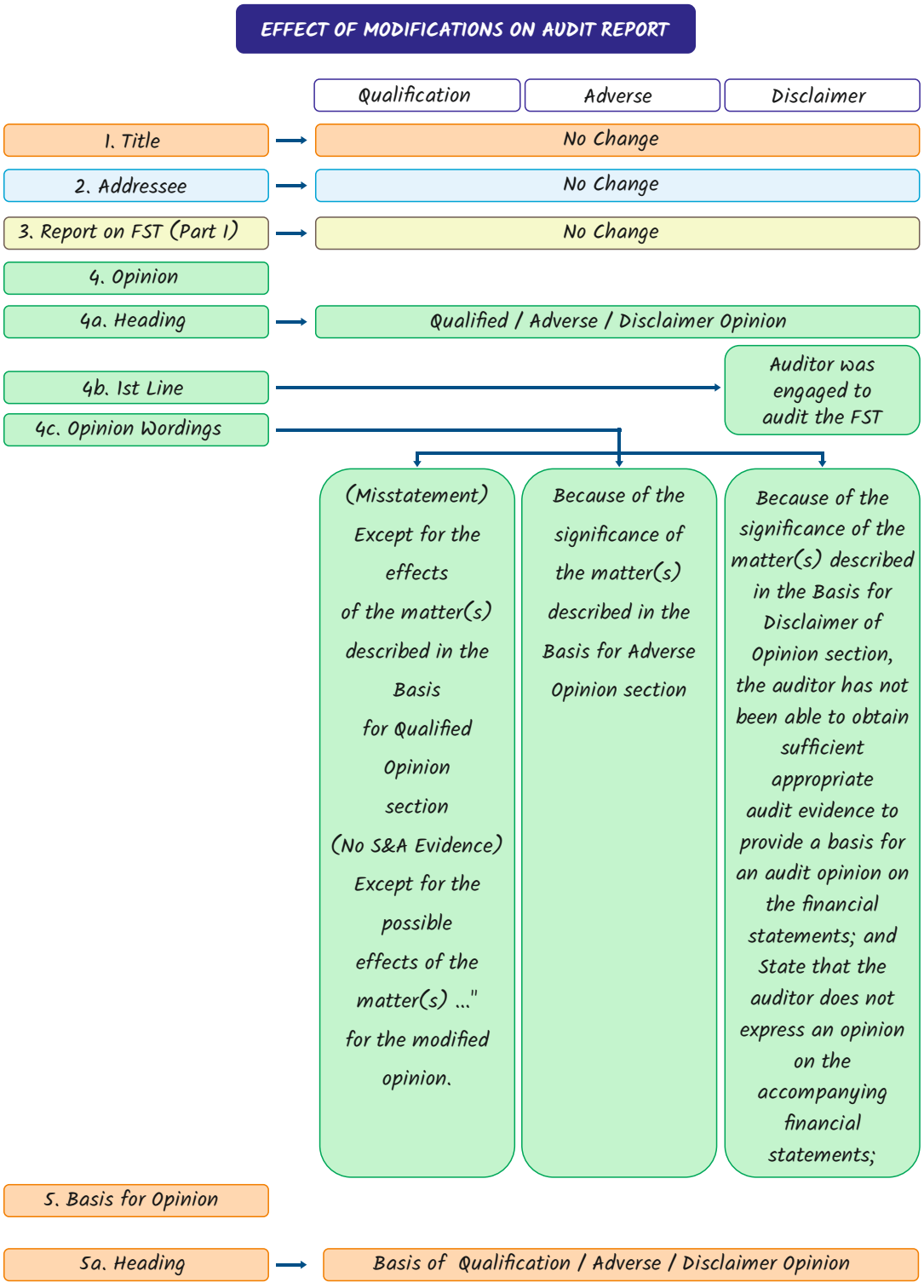
- The **timing of the auditor's appointment** is such that the auditor is unable to observe the counting of the physical inventories.
- The auditor determines that **performing substantive procedures alone is not sufficient, but the entity's controls are not effective.**

- **What if there is LOS**

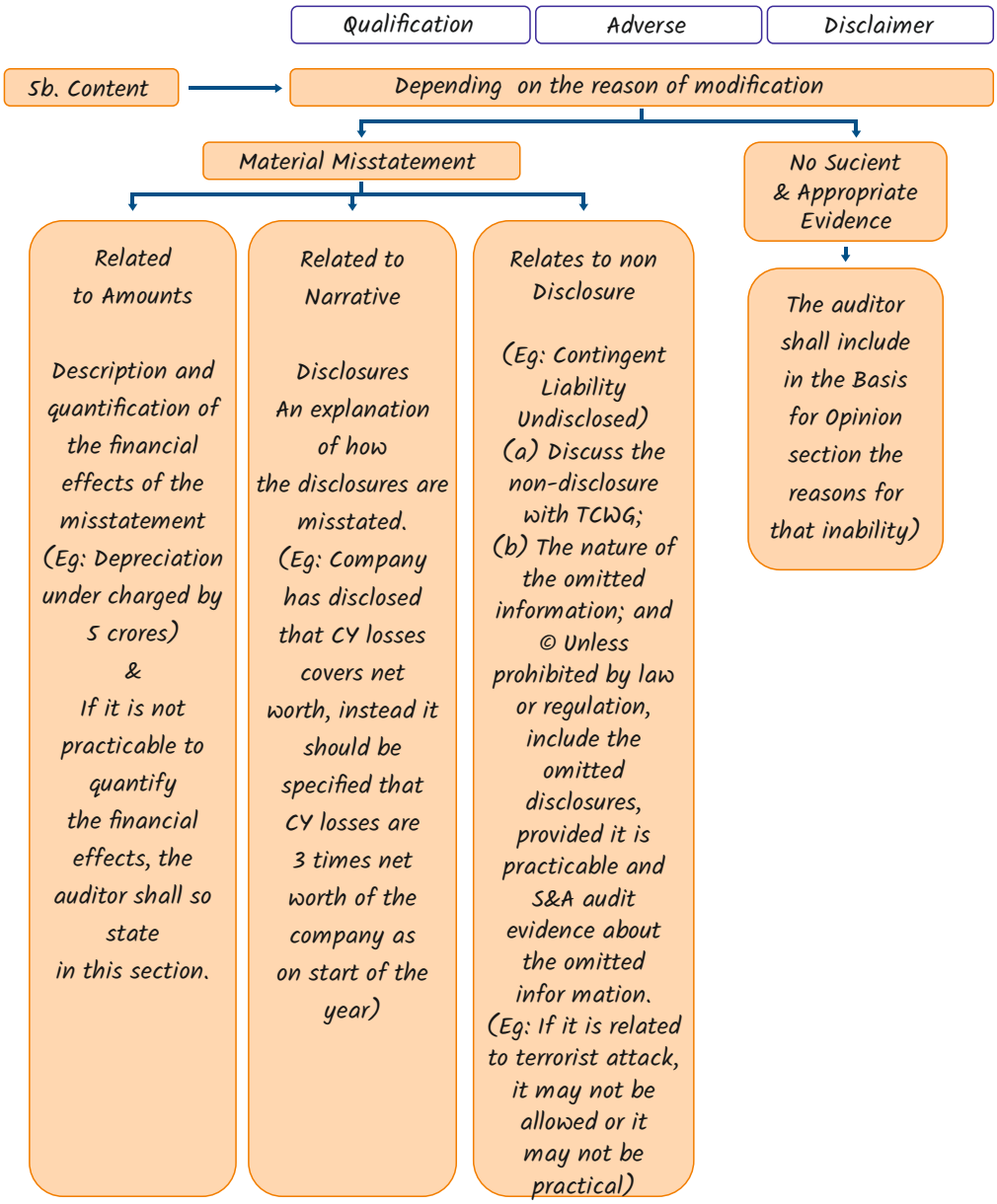
An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of fraud risks and consideration of engagement continuance.

(CNO—SA705.060) FORM AND CONTENT OF THE AUDITOR'S REPORT WHEN THE OPINION IS MODIFIED

Chart



Continue on next Page...



Sc. Last Line →

When the auditor expresses a qualified or adverse opinion, the auditor shall amend the statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion to include the word "qualified" or "adverse", as appropriate.

When the auditor disclaims an opinion on the financial statements, the auditor's report shall not include the following Those elements are:
(a) A reference to the section of the auditor's report where the auditor's responsibilities are described;
and
(b) A statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the Basis for Opinion section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof.

Continue on next Page...

	Qualification	Adverse	Disclaimer
6. Material Uncertainity related to Going concern	No Change		
7. Key Audit Matters	No Change (No KAM in case of disclaimer)		
8. MGT Responsibility	No Change		
9. Auditor Responsibility	If there is disclaimer only following will be written Our responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report. However, because of the matters described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements. We are independent of the entity in accordance with the ethical requirements in accordance with the requirements of the Code of Ethics		
10. Other Matter	No Change		
11. Report on other legal and regulatory requirements (Part II)	No Change		
12. Signature/Place/Date	No Change		
13. UDIN	No Change		

Title

(In exams express only those areas where there is change)

No Change

Addressee

No Change

Auditor's Opinion (QNO 113.010)

When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section.

- ***Qualified Opinion***

  When the auditor expresses a qualified opinion ***due to a material misstatement*** in the financial statements, the auditor shall state that, in the auditor's opinion, ***except for the effects of the matter(s) described in the Basis for Qualified Opinion section:***

  (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or

  (b) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

  (c) When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase ***"except for the possible effects of the matter(s) ..." for the modified opinion.***

- ***Adverse Opinion***

  When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, ***because of the significance of the matter(s) described in the Basis for Adverse Opinion section:***

  (a) When reporting in accordance with a fair presentation framework, the accompanying

*financial statements **do not present fairly (or give a true and fair view of)** [...] in accordance with [the applicable financial reporting framework]; or*

(b) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

- ***Disclaimer of Opinion***

When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:

*(a) Amend the statement in Opinion paragraph, which indicates that the financial statements have been audited, **to state that the auditor was engaged to audit the financial statements.***

*(b) State that, **because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section,** the auditor has not been able to obtain sufficient appropriate audit evidence to **provide a basis for an audit opinion on the financial statements;** and*

*(c) State that **the auditor does not express an opinion** on the accompanying financial statements;*

Basis for Opinion

When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

*(a) **Amend the heading** "Basis for Opinion" required by paragraph 28 of SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and*

*(b) Within this section, **include a description of the matter** giving rise to the modification.*

MATERIAL MISSTATEMENT

- ***Related to amount***

*If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures in the notes to the financial statements), the auditor shall include in the Basis for Opinion section **a description and quantification of the financial effects of the misstatement,***

*(E.g. Depreciation under charged by 5 crores) unless impracticable. **If it is not practicable to quantify the financial effects, the auditor shall so state in this section.***

(E.g. Company as changed from FIFO to LIFO which is in appropriate but there is no facility to quantify the change)

- ***Related to Narrative Disclosures***

*If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the Basis for Opinion section **an explanation of how the disclosures are misstated.***

(E.g. Company has disclosed that CY losses covers net worth, instead it should be specified that CY losses are 3 times net worth of the company as on start of the year)

- ***Relates to non-disclosure***

If there is a material misstatement of the financial statements that relates to the nondisclosure of information required to be disclosed, the auditor shall:

(E.g. Contingent Liability Undisclosed)

*(a) **Discuss the non-disclosure** with those charged with governance;*

	(b) Describe in the Basis for Opinion section the **nature of the omitted information;** and (c) Unless prohibited by law or regulation, **include the omitted disclosures,** provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (E.g. If it is related to terrorist attack, it may not be allowed, or it may not be practical) **INABILITY TO OBTAIN SUFFICEINT & APPROPRIATE EVIDENCE** If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the Basis for Opinion section the reasons for that inability. When the auditor **expresses a qualified or adverse opinion,** the auditor shall **amend the statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion to include the word "qualified" or "adverse", as appropriate.** When **the auditor disclaims an opinion** on the financial statements, the auditor's report shall not include the following Those elements are: (a) A reference to the section of the auditor's report where the auditor's responsibilities are described; and (b) A statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion. Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, **the auditor shall describe in the Basis for Opinion section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof.**
Going Concern	No Change
Key Audit Matter	**Considerations When the Auditor Disclaims an Opinion on the Financial Statements** Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.
Management Responsibility	No Change
Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements. (QNO- 119.030)	When the auditor **disclaims an opinion on the financial statements** due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities to include only the following: (a) The **statement about auditor independence and other ethical responsibilities** required by SA 700 (Revised). (b) A statement that the auditor's responsibility is **to conduct an audit of the entity's financial statements in accordance with Standards on Auditing** and to issue an auditor's report; (c) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, **the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion** on the financial statements; and
Report on other legal & regulatory requirement	No Change
Signature	No Change

Place	No Change
Date	No Change

(CNO—SA705.080) COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification.

APPENDIX
LIST OF SITUATIONS / EXAMPLES (NOT RELEVANT FOR EXAMS)

Qualified Opinion

- **QUALIFIED OPINION SHOULD BE GIVEN IN FOLLOWING SITUATIONS, PROVIDED THEY ARE MATERIAL BUT NOT PERVASIVE**
  1. Depreciation is not charged.
  2. Interest wrongly capitalized with fixed assets.
  3. Long term investments are not properly valued as per FRF
  4. Auditor not allowed to visit
  5. Revenue expense shown as receivables

Adverse Opinion

- **ADVERSE OPINION SHOULD BE GIVEN IN FOLLOWING SITUATIONS, PROVIDED THEY ARE MATERIAL & PERVASIVE:**
  1. Going concern assumption is inappropriate but still it is followed, no adjustment for historical cost to realizable and payable value
  2. Contractor followed completion method but AS 7 specifies percentage completion method.
  3. Major subsidiary is not consolidated with holding company financial statements.
  4. Company prepares financial statements as per cash basis, going against accrual principle.
  5. Combination of points mentioned in qualified affecting major part of financial statements (pervasive)

Disclaimer Opinion

- **DISCLAIMER OPINION SHOULD BE GIVEN IN FOLLOWING SITUATIONS, PROVIDED THEY ARE MATERIAL & PERVASIVE:**
  1. Multiple uncertainties exist and auditor is unable to determine possible effect on financial statements
  2. Books of accounts and related documents are seized by government authorities and there is no other means to get them.
  3. Going concern is doubtful and this information is not specified in notes to accounts.
  4. Only Xerox copies are available but o other reliable evidence to support it.
  5. Limitation imposed by management has possible pervasive effect on financial statements

Multiple Opinion

- **Can I Audit Report have all Qualified / Adverse / Disclaimer together?**

  Answer: -

  Yes, it is possible, for example we are doing audit of consolidated financial statement and we come across following issues;

  1. One subsidiary is not consolidated, and we don't have any information about it, there is sufficient and appropriate evidence and many elements in financial statements may be affected but it may not be major portion of financial statement. (So, this is material + Pervasive + Not a major part of financial statement) ⟶ Disclaimer for this point.
  2. One subsidiary is not consolidated, and we have all information about it, there is material misstatement and many elements in financial statements may be affected but it may not be major portion of financial statement. (So, this is material + Pervasive + Not a major part of financial statement) ⟶ Adverse for this point.

3. *Inventory is overvalued ⟶ (Material + Not Pervasive + Not major part of financial statements) ⟶ Qualified opinion for this point.*

ILLUSTRATIONS

- ***MNO Ltd. is a power generating company having its plants in the north eastern states of the country. For the FY 2020-21, M/s PRT & Associates are the statutory auditors of the company. During the course of audit, the audit team was unable to obtain sufficient appropriate audit evidence About a single element of the consolidated financial statements. That is, the auditor was also unable to obtain audit evidence about the financial information of a joint venture investment (in XYZ Ltd.) that represents over 90% of the entity's net assets. What kind of opinion should the statutory auditors issue in such case?***

  Solution:

  M/s PRT & Associates are unable to obtain sufficient appropriate audit evidence about the financial information of a joint venture investment that represents over 90% of the entity's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are both material and pervasive to the consolidated financial statements.

  Therefore, the statutory auditor should issue a disclaimer of opinion.

  The relevant extract of the Disclaimer of Opinion Paragraph and Basis for Disclaimer of Opinion paragraph is as under:

  Disclaimer of Opinion

  We do not express an opinion on the accompanying financial statements of MNO Ltd. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

  Basis for Disclaimer of Opinion

  The Group's investment in its joint venture XYZ Company is carried at ` 95 crores on the Group's consolidated balance sheet, which represents over 90% of the Group's net assets as at March 31, 2021. We were not allowed access to the management and the auditors of XYZ Company, including XYZ Company's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Group's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ's income and expenses for the year, (and the elements making up the consolidated statement of changes in equity) and the consolidated cash flow statement.

- ***CA Yash is the statutory auditor of Laksmi Vardhan Limited for the FY 2020-21. In respect of loans and advances of ` 55,00,000/- given to Sarvagya Private Limited, the Company has not furnished any agreement to CA Yash and in absence of the same, he is unable to verify the terms of repayment, chargeability of interest and other terms. What kind of opinion should CA Yash give in such situation?***

  Solution:

  In the present case, with respect to loans and advances of ` 55,00,000/- given to Sarvagya Private Limited, the Company has not furnished any agreement to CA Yash. In absence of such agreement, CA Yash is unable to verify the terms of repayment, chargeability of interest and other terms. For an auditor, while verifying any loans and advances, one of the most important audit evidences is the loan agreement. Therefore, the absence of such document in the present case, tantamount no SAAE in the financial statements of the company. However, the inability of CA Yash to obtain such audit evidence is though material but not pervasive so as to require him to give a disclaimer of opinion.

Thus, in the present case, CA Yash should give a qualified opinion
The relevant extract of the Qualified Opinion Paragraph and Basis for Qualified Opinion paragraph is as under:

Qualified Opinion
In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the financial statements of Laksmi Vardhan Limited give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as on 31.03.2021 and profit/ loss for the year ended on that date.

Basis for Qualified Opinion
The Company is unable to furnish the loan agreement with respect to loans and advances of `55,00,000/- given to Sarvagya Private Limited. Consequently, in absence of such agreement, we are unable to verify the terms of repayment, chargeability of interest and other terms.

- ***CA Sameer is the statutory auditor of Tram Fram Ltd. for the FY 2020-21. While concluding the audit CA Sameer decided to issue an unmodified opinion, though he also concluded that a material uncertainty exists with respect to the company's ability to continue as a going concern on account of a pending litigation related to labour laws. He is of the view that the company has made appropriate disclosures with respect to such pending litigation in the notes to accounts annexed to the financial statements of Tram Fram Ltd. for the FY 2020-21. Explain how CA Sameer will deal with the above situation in his auditor's report (draft the relevant portion of the auditor's report.)***

  Solution:
  Material Uncertainty Related to Going Concern
  We draw attention to Note 10 in the financial statements, which indicates that the outcome of a litigation on account of labor laws is pending in case of the company during the year 31 March, 2021. As stated in Note 11, this event or condition, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

- ***XYZ Ltd. is a company engaged in the manufacture of cranes. CA Sudhir is the statutory auditor of the company for the FY 2020-21. The company has taken long term funding for fixed capital requirements and short term funding for its working capital requirements. During the course of audit, CA Sudhir found that the company's financing arrangements are about to expire and the company is unable to re- negotiate or obtain the replacement financing. As such the company may be unable to realize its assets and discharge its liabilities in the normal course of business. Notes to accounts annexed to the financial statements discuss the magnitude of financing arrangements, the expiration and the total financing arrangements; however the financial statements do not include discussion on the impact or the availability of refinancing. Thus, the financial statements (and notes thereto) do not fully disclose this fact. What kind of opinion should CA Sudhir issue in case of XYZ Ltd.?***

  Solution:
  In the present case, XYZ Ltd. is unable to re- negotiate or obtain the replacement financing for its long term and short term funding requirements. This situation indicates the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore, XYZ Ltd. may be unable to realize its assets and discharge its liabilities in the normal course of business. Further, the financial statements of XYZ Ltd. do not disclose this fact adequately. Thus, the financial statements of XYZ Ltd. are materially misstated due to the inadequate disclosure of the material uncertainty. CA Sudhir will express a qualified opinion as the effects on the financial

statements of this inadequate disclosure are material but not pervasive to the financial statements. The relevant extract of the Qualified Opinion Paragraph and Basis for Qualified Opinion paragraph is as under:

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the incomplete disclosure of the information referred to in the Basis for Qualified Opinion section of our report, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of XYZ Ltd. as at March 31, 2021, and profit/loss, for the year ended on that date.

Basis for Qualified Opinion

As discussed in Note 6, the Company's financing arrangements are about to expire and the Company has been unable to conclude renegotiations or obtain replacement financing. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this matter.

- ***ABC Ltd. is a company engaged in the manufacture of iron and steel bars. PP & Associates are the statutory auditors of ABC Ltd. for the FY 2020-21. During the course of audit, CA Prakash, the engagement partner, found that the Company's financing arrangements have expired and the amount outstanding was payable on March 31, 2021. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact. What opinion should CA Prakash express in case of ABC Ltd.?***

Solution:

In the present case based on the audit evidence obtained, CA Prakash has concluded that a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, and the entity is considering bankruptcy. The financial statements of ABC Ltd. omit the required disclosures relating to the material uncertainty. In such circumstances, CA Prakash should express an adverse opinion because the effects on the financial statements of such omission are material and pervasive.

The relevant extract of the Adverse Opinion Paragraph and Basis for Adverse Opinion paragraph is as under:

Adverse Opinion

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of the entity as at March 31, 2021, and of its financial performance and its cash flows for the year then ended in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India.

Basis for Adverse Opinion

The financing arrangements of ABC Ltd. has expired and the amount outstanding was payable on March 31, 2021. The entity has been unable to conclude re-negotiations or obtain replacement financing and is considering filing for bankruptcy. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this fact.

- ***Basis for Qualified Opinion***

  The Company is unable to furnish the loan agreement with respect to loans and advances of `55,00,000/- given to Saraiya Private Limited. Consequently, in absence of such agreement, we are unable to verify the terms of repayment, chargeability of interest and other terms.

  In the financial year 2020-21, MSD Ltd. faced an extraordinary event (earthquake), which destroyed a lot of business activity of the company. These circumstances indicate material uncertainty on the company's ability to continue as going concern. Due to such event it may not be possible for the company to realize its assets or pay off the liabilities during the regular course of its business. The financial statement and notes to the financial statements of the company do not disclose this fact. What kind of opinion should the statutory auditor of MSD Ltd. issue in such circumstances?

  Solution:

  In the present case, there exists a material uncertainty that cast a significant doubt on the company's ability to continue as going concern and the same is not disclosed in the financial statements of MSD Ltd. As such, the financial statements of MSD Ltd. for the FY 2020-21 are materially misstated and the effect of the misstatement is so material and pervasive on the financial statements that giving only a qualified opinion will be insufficient and therefore the statutory auditor of MSD Ltd. Should issue an adverse opinion.

  The relevant extract of the Adverse Opinion Paragraph and Basis for Adverse Opinion paragraph is as under:

- ***Adverse Opinion***

  In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of MSD Ltd. as at March 31, 2021, and of its financial performance and its cash flows for the year then ended in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India.

Basis for Adverse Opinion

MSD Ltd. has faced an extraordinary event (earthquake), which destroyed a lot of business activity of the company. Due to such event it may not be possible for the company to realize its assets or pay off the liabilities during the regular course of its business. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statement and notes to the financial statements of the company do not disclose this fact.

- ***CA Abhimanyu is the statutory auditor of PQR Ltd. for the FY 2020-21. During the course of audit CA Abhimanyu noticed the following:***

1. With respect to the debtors amounting to` 150 crores, no balance confirmation was received by the audit team. Further, there have been defaults on the payment obligations by debtors on the due dates during the year under audit. The Company has created a provision for doubtful debts to the tune of` 25 Cr. during the year under audit. The Company has stated that the provision is based on receivables which are older than 36 months, which according to the audit team is inadequate and as such the audit team is unable to ascertain the carrying value of trade receivables.

2. Further, in respect of Inventories (which constitutes 40% of the total assets of the company), during the reporting period, the management has not undertaken physical verification of inventories at periodic intervals. Also, the Company has not maintained adequate inventory records at the factory. The audit team was unable to undertake the physical inventory count as such the value of inventory could not be verified. Under the above circumstances what kind of opinion should CA Abhimanyu give?

Solution:

In the present case, CA Abhimanyu is unable to obtain sufficient and appropriate audit evidence with respect to the following:

1. The balance confirmation with respect to debtors amounting to` 150 crores is not available. Further there has been default in payment by the debtors and the provision so made is not adequate. The audit team is also unable ascertain the carrying value of trade receivables.

2. With respect to 40% of the company's inventory, neither the physical verification has been done by the management nor are adequate inventory records maintained. The audit team is also unable to undertake the physical inventory count as such the value of inventory could not be verified.

In the above two circumstances the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

Thus, CA Abhimanyu should give a Disclaimer of Opinion.

The relevant extract of the Disclaimer of Opinion Paragraph and Basis for Disclaimer of Opinion paragraph is as under:

Disclaimer of Opinion

We do not express an opinion on the accompanying financial statements of PQR Ltd. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion

We are unable to obtain balance confirmation with respect to the debtors amounting to` 150 crores. Further, there have been defaults on the payment obligations by debtors on the due dates during the

	year under audit. The Company has created a provision for doubtful debts to the tune of `25 Cr. during the year under audit which is inadequate in the circumstances of the company. The carrying value of trade receivables could not be ascertained. Further, in respect of Inventories (which constitutes 40% of the total assets of the company), during the reporting period, the management has not undertaken physical verification of inventories at periodic intervals. Also, the Company has not maintained adequate inventory records at the factory. We were unable to undertake the physical inventory count and as such the value of inventory could not be verified.

UNIQUE MCQS	
MCQ No.	705.6
MCQ No.	705.10

UNIQUE QUESTIONS	
QNO 118.000	Q Vs E
QNO 119.100	Drafting Disclaimer of opinion .
QNO 119.200	Drafting Adverse opinion .
QNO 119.300	Draft Opinion (Not Given Agreement)

Part 4 - [SA 706] EMPHASIS OF MATTER PARAGRAPHS & OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

(CNO--SA706.020) EMPHASIS OF MATTER PARAGRAPH (EMP)(QNO-123.500)(MCQ-706.1/706.2/ Incs.08.3/ Incs.38.2)

Chart

EMPHASIS OF MATTER PARAGRAPH

- 1. Definition → If auditor wants to highlight any matter which is presented or disclosed in FST so that it improves users understanding of the FST, then auditor should put EMP.
- 2. Examples → (We have arranged in chronological flow so that it is easy to remember)
  - Last year related → Major prior period item
  - CY related
    - Major amalgamation
    - Major catastrophe having significant impact on FST (Extra Ordinary)
  - End of year
    - Early application of new accounting standard
    - Uncertainty related to litigation or regulatory action
  - After year end → Significant subsequent event between date of FST and date of AR
- 3. Conditions → Auditor should include EMP, provided following conditions are satisfied: -
  - (I) Matter of EMP should not be a matter which needs modification of opinion
  - (ii) Matter of EMP should not be determined as key audit matter as per SA 701.
- 4. Content
  - (i) Heading → Separate section with heading EMP
  - (ii) If multiple EMP's, we can differentiate one from another by appropriate addition to the heading. → (e.g. :- EMP for subsequent event)
  - (iii) Description of matter
  - (iv) There should be clear reference to the matter in FST which we are highlighting generally, note no. FST is provided for the same.
  - (v) Auditor should clearly specify that though he is highlighting matter in FST, auditor opinion is not modified w.r.t. this matter.
- 5. Placement
  - If EMP relates to applicable FRF
    - E.g. :- If it is related to shift from AS to Ind AS, then in such circumstances it should be placed immediately below 'basis of opinion' section to increase its importance.
  - In other cases, EMP can be presented either before or after 'key audit matter' based on auditor's judgement as to relative significance given in EMP.
    - E.g. :- If prior period item is very significant, changing profits drastically than EMP may be placed before 'key audit matter'.

Definition (QNO-120.000) (MCQ - Incs.07.5, Incs.54.1 Incs.56.4)

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

Examples (QNO-120.000/ 122.050)

- Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:
  - Major prior period items.

- *Major amalgamation during the year.*
- *A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.*
- *Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.*
- *An uncertainty relating to the future outcome of exceptional litigation or regulatory action.*
- *A significant subsequent event that occurs between the date of the financial*
- *statements and the date of the auditor's report*

Conditions (QNO-120.000)

If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, ***the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:***

(a) The auditor would ***not be required to modify the opinion*** *in accordance with SA 705 (Revised) as a result of the matter; and*

(b) When SA 701 applies, ***the matter has not been determined to be a key audit matter*** *to be communicated in the auditor's report.*

Content

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

(a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";

(b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and (No need to give reference of BOD report, Annual Report etc.)

(c) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

Placement

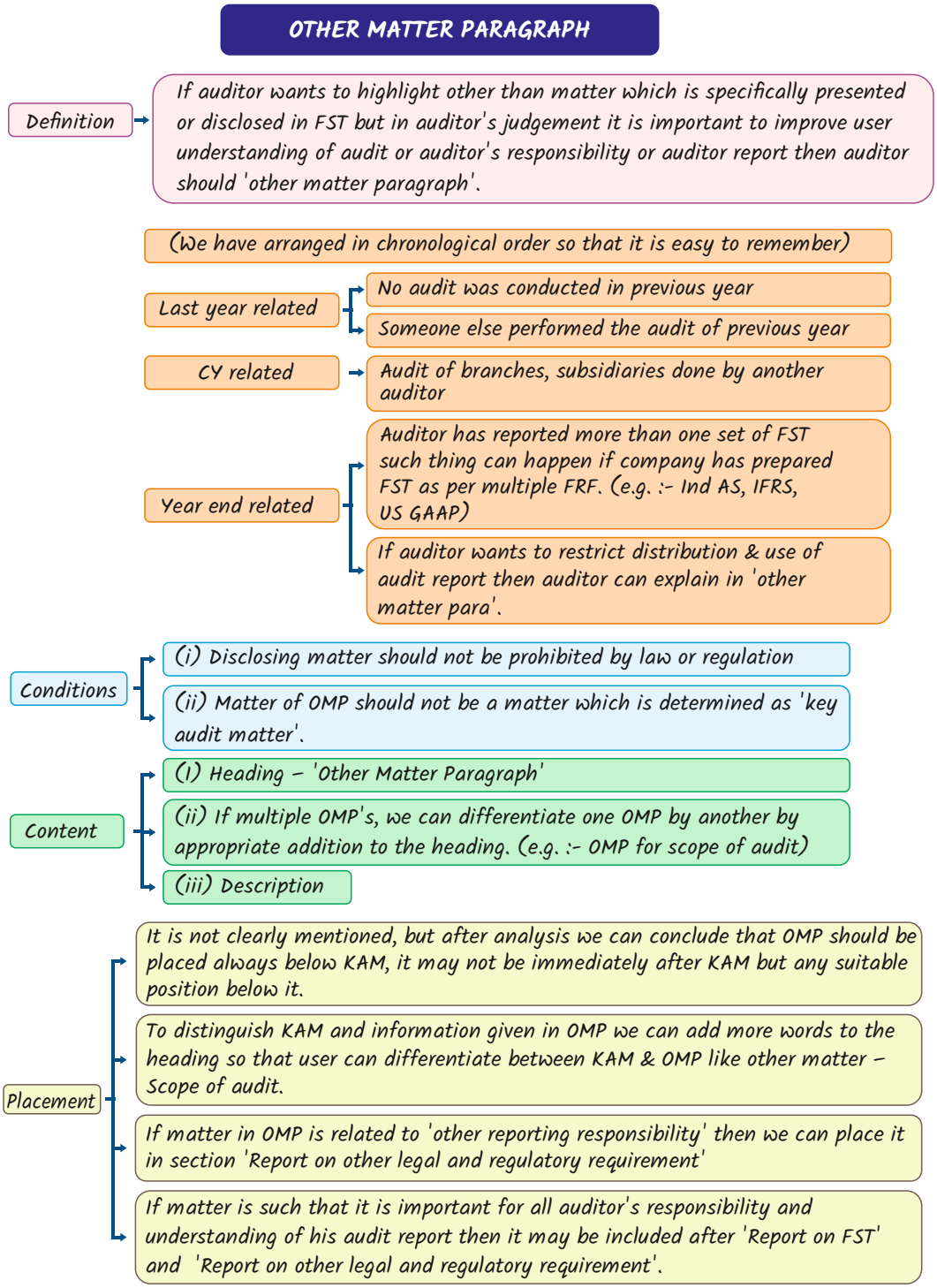
When the Emphasis of Matter paragraph ***relates to the applicable financial reporting framework,***

(For example, shift from AS to IND AS or new AS) including circumstances where the auditor determines that the financial reporting framework prescribed by law or regulation would otherwise be unacceptable, the auditor may consider it necessary to place the paragraph ***immediately following the Basis of Opinion section to provide appropriate context to the auditor's opinion.***

When a ***Key Audit Matters section is presented in the auditor's report,*** *an Emphasis of Matter paragraph may be presented* ***either directly before or after the Key Audit Matters section, based on the auditor's judgment as to the relative significance*** *of the information included in the Emphasis of Matter paragraph. The auditor may also add further context to the heading "Emphasis of Matter", such as "Emphasis of Matter – Subsequent Event", to differentiate the Emphasis of Matter paragraph from the individual matters described in the Key Audit Matters section.*

(CNO--SA706.040) OTHER MATTER PARAGRAPH (MCQ – 706.3)

Chart



Definition

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

Circumstances

(a) Audit was not conducted in previous financial year
(b) Someone else did audit in previous financial year
(c) Audit of branches, subsidiaries etc is done by someone else
(d) Reporting on more than one set of financial statements
(e) Restriction on distribution or use of the auditor's report

Conditions

If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, the auditor shall include an Other Matter paragraph in the auditor's report, provided:

(a) This is **not prohibited by law or regulation;** and

(E.g. No confidential information)

(b) When SA 701 applies, **the matter has not been determined to be a key audit matter** to be communicated in the auditor's report.

Content

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

Placement

- **Other Matter Paragraphs**
  - **When a Key Audit Matters section is presented** in the auditor's report and an Other Matter paragraph is also considered necessary, the auditor may add further context to the heading "Other Matter", such as **"Other Matter – Scope of the Audit", to differentiate** the Other Matter paragraph from the individual matters described in the Key Audit Matters section.
  - When an Other Matter paragraph is included to draw users' attention to a matter relating to **Other Reporting Responsibilities** addressed in the auditor's report, the paragraph may be included in the Report on Other Legal and Regulatory Requirements section.

    (E.g. Relating to investor to education & protection fund etc)

  - When relevant to all the auditor's responsibilities or users' understanding of the auditor's report, the **Other Matter paragraph may be included as a separate section following the Report on the Audit of the Financial Statements and the Report on Other Legal and Regulatory Requirements.**(E.g. Revision in Financial Statements)

(CNO--SA706.060) COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

Chart

COMMUNICATION WITH TCWG

- If auditor plan's to include EMP or OMP, then auditor should communicate with TCWG proposed wordings of EMP or OMP.
- It will make TCWG aware of such matter, TCWG / auditor may obtain further clarification on such matters.
- If OMP is recurring in each successing engagement then its repeated communication to TCWG may be unnecessary

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

Such communication enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report and provides them with an opportunity to obtain further clarification from the auditor where necessary. Where the inclusion of another Matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement.

(CNO--SA706.080) DIFFERENCE BETWEEN KEY AUDIT MATTER AND EMPHASIS OF MATTER PARAGRAPH

Chart

DIFFERENCE BETWEEN 'KEY AUDIT MATTER' AND 'EMPHASIS OF MATTER' PARAGRAPH

If any matter is identified as Key audit matter then such matter will be included in 'KAM' only it will not be covered in 'EMP'.	We can distinguish between KAM & EMP related to definition, purpose and placement.

➢ ***Key audit matters***— Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance. [SA 701]	➢ ***Emphasis of Matter paragraph*** – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. [SA 706]
➢ ***Common Matter*** Matters that are determined to be key audit matters in accordance with SA 701 may also be, in the auditor's judgment, fundamental to users' understanding of the financial statements. In such cases, in communicating the matter as a key audit matter in accordance with SA 701, the auditor may wish to highlight or draw further attention to its relative importance. ***Provides Additional Information*** Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit and may also assist them in understanding the entity and areas of significant management judgment in the audited financial statements.	➢ ***Should not be a KAM*** There may be a matter that is not determined to be a key audit matter in accordance with SA 701 (i.e., because it did not require significant auditor attention), but which, in the auditor's judgment, is fundamental to users' understanding of the financial statements (e.g., a subsequent event). If the auditor considers it necessary to draw users' attention to such a matter, the matter is included in an Emphasis of Matter paragraph in the auditor's report in accordance with this SA. ***Effect of Widespread*** A widespread use of Emphasis of Matter paragraphs may diminish the effectiveness of the auditor's communication about such matters. ***Not a substitute*** Use of Emphasis of Matter paragraphs is not a substitute for a description of individual key audit matters where SA 701 is applicable.
➢ ***Further Basis to Engage with Management*** The communication of key audit matters in the auditor's report may also provide intended users a basis to further engage with management and those charged with governance about certain matters relating to the entity, the audited financial statements, or the audit that was performed.	➢ ***More prominent than KAM*** The auditor may do so by presenting the matter more prominently than other matters in the Key Audit Matters section (e.g., as the first matter) or by including additional information in the description of the key audit matter to indicate the importance of the matter to users' understanding of the financial statements.

ILLUSTRATION

- ***In respect of the audit of BDS Ltd., the statutory auditor of the company noticed some matters. The statutory auditor wants to draw the user's attention towards such matters, though his opinion is not modified in respect of such matters. Draft the relevant paragraphs of the audit report for the following matters:***

i. The company has a plan to resume its construction activities with respect to one of its thermal power project, The activity of such power plant was suspended in the FY 2018-19. The thermal power project comprises of the plant and equipment amounting to` 5.95 crore and capital work in progress of` 147.50 crore.

ii. The financial statements of 5 branches are included in the Standalone Financial Statements of BDS Ltd. whose financial statements reflect total assets of` 90 crores as at 31.03.2021 and total revenue from operations of` 40 crores for the year ended on that date. The financial statements of these branches have been audited by the branch auditors.

Solution:

Emphasis of Matter

We draw attention to the following note of the standalone financial statements: Note 27 regarding the plans of the Company to resume construction/developmental activities of a thermal power project. The carrying amounts related to the project as at 31st March, 2021 comprise of plant and equipment of` 5.95 crore and capital work in progress of` 147.50 crore.

Our opinion is not modified in respect of this matter.

Other Matter

We did not audit the financial statements of 5 branches included in the Standalone Financial Statements of the company whose financial statements reflect total assets of` 90 crores as at 31.03.2021 and total revenue from operations of` 40 crores for the year ended on that date. The financial statements of these branches have been audited by the branch auditors whose reports have been furnished to us, and our opinion in so far as it relates to the amounts and disclosures included in respect of these branches, is based solely on the report of the branch auditors.

Our opinion is not modified in respect of this matter.

Unique QUESTIONS

QNO 121.000	EMP Case Study with Drafting (Income Tax)
QNO 123.000	OMP (Report)

Part 5 – [SA 710] COMPARATIVE INFORMATION, CORRESPONDING FIGURES & COMPARATIVE FINANCIAL STATEMENTS

(CNO--SA710.020) AUDIT PROCEDURES FOR COMPARATIVES (MCQ- Incs.07.2) (QNO-125.000)

Chart

AUDIT PROCEDURES FOR COMPARATIVES / COMPARATIVES FINANCIAL STATEMENTS / CORRESPONDING FIGURES

- Basic Evaluation of Comparative Information
  - Auditor should understand requirements of AFRF w.r.t. to comparative information and check whether this information is appropriately presented in FST
  - Agree comparative information with amount and disclosures presented in prior period FST.
  - Ensure that accounting policies reflected in comparative information are consistently followed and if there is a change it is properly accounted, disclosed and presented in current period
- Additional procedures in case of possible material misstatements
  - If auditor become aware of possible material misstatement in comparative information while doing audit the auditor can perform additional audit procedures as suitable to draw conclusion whether material misstatement exists
  - If material misstatement exist then either previous year FST should be revised and such revision should be done as per requirements of SA 560 which deals with subsequent events. It will be auditor's responsibility if he was auditor of previous year. Generally this is possible before AGM easily In other cases rectification are done in current period as prior period items.
- Written Representations
  - The Auditor shall request WR for all the periods which are refer in opinion para.
  - CFS → In case of comparative financial statements we will request WR for current period & as well as prior periods which are referred in audit report. Even if we have taken WR in previous year we will take it again to ensure that information is appropriate as on current year (today)
  - Corresponding figures → WR will be requested only for current period
  - Specific WR may be obtained if there is any prior period financial items if disclosed in current year's P&L.

Comparative information		The amounts and disclosures included in the financial statements in **respect of one or more prior periods** in accordance with the applicable financial reporting framework.
Audit procedures	➢ **Basic Evaluation of comparative information:**	(a) The Auditor shall determine whether the Financial Statements include the Comparative Information **required by the Applicable Financial Reporting Framework** and whether such information is appropriately classified. (b) For this Purpose, the Auditor shall evaluate whether ▪ The comparative Information **agrees with the amounts & other disclosures presented in the prior period,** and ▪ The **Accounting Policies reflected in the Comparative Information** are consistent with those applied in the current period or, if there have been changes in Accounting Policies, whether those **changes have been properly accounted for and adequately presented and disclosed.**

➢ **Additional procedures in case of Material Misstatement:**	(a) If the Auditor becomes aware of a **possible material misstatement** in the Comparative Information while performing the current period audit, he shall perform such additional audit procedures as are necessary in the Circumstances, to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. (b) If the Auditor **had audited the Prior Period's Financial Statements, he shall also follow the relevant requirements of SA 560** on the effect of Subsequent Events.
➢ **Written Representations:**	**(a) The Auditor shall** ▪ Request Written Representations for all periods referred to in the opinion. ▪ Obtain a specific Written Representation regarding any Prior Period Item that is separately disclosed in the current year's Statement of Profit and Loss. **(b) In case of comparative financial statements** Written Representations are requested for all periods referred to in the Auditor's Opinion because Management needs to reaffirm that the Written Representations it previously made with respect to the prior period remain appropriate. **(c) In case of corresponding figures** Written Representations are requested for the Financial Statements of the current period only, because the Auditors Opinion IS on those Financial Statements, which include the Corresponding Figures.

(CNO--SA710.040) APPROACHES TOWARDS COMPARATIVES

Chart

COMPARATIVES AND WAYS OF PRESENTING COMPARATIVES

Amount and disclosures of one or more prior periods as per AFRF are called as comparative information

Ways of presenting comparatives

Particular	Comparative financial statements	Corresponding figures
Extent of Information	If detailed information is given for 1 or more prior periods.	If detailed information is not given for prior periods
	Importance given to prior period is same as current period.	Not given importance similar to current year
Is it a separate FST?	Prior period information treated as separate FST.	Information of prior year is just a comparison not treated as separate FST, infact it is considered as integral part of current year FST.
Audit Report	In intro and opinion para, we refer both current year and prior year e.g.:- Prospectus	In Intro and opinion para, we refer only current year. e.g.:- Company audit report

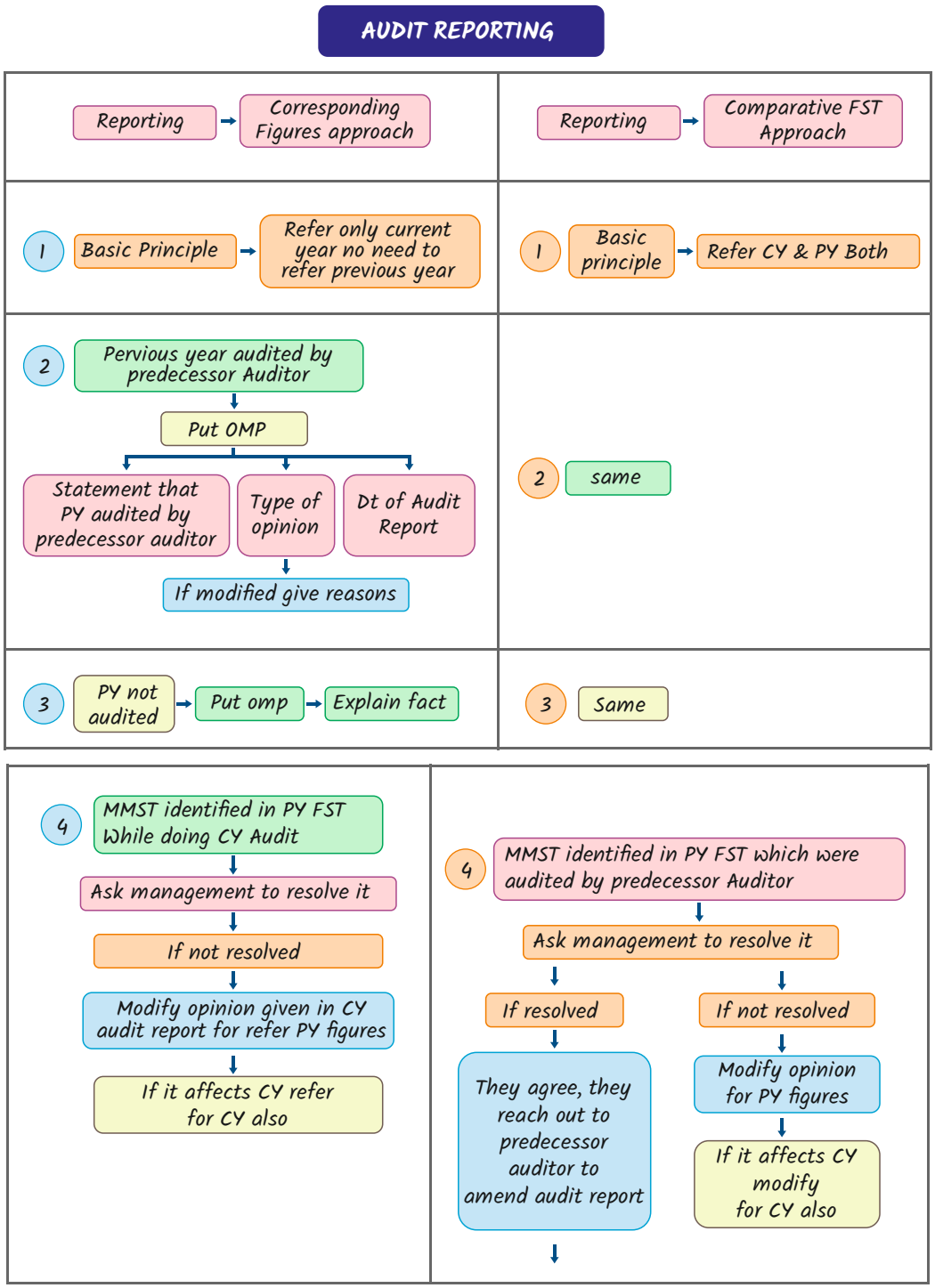
Continue on next Page...

Note 1 :- Corresponding figure approach is popular across the world, generally FRF specify that where ever current year amounts are given we should provide previous year amounts also which shows that importance is given to current year and previous year amounts is just for comparison nothing more. Same thing is given in Schedule III

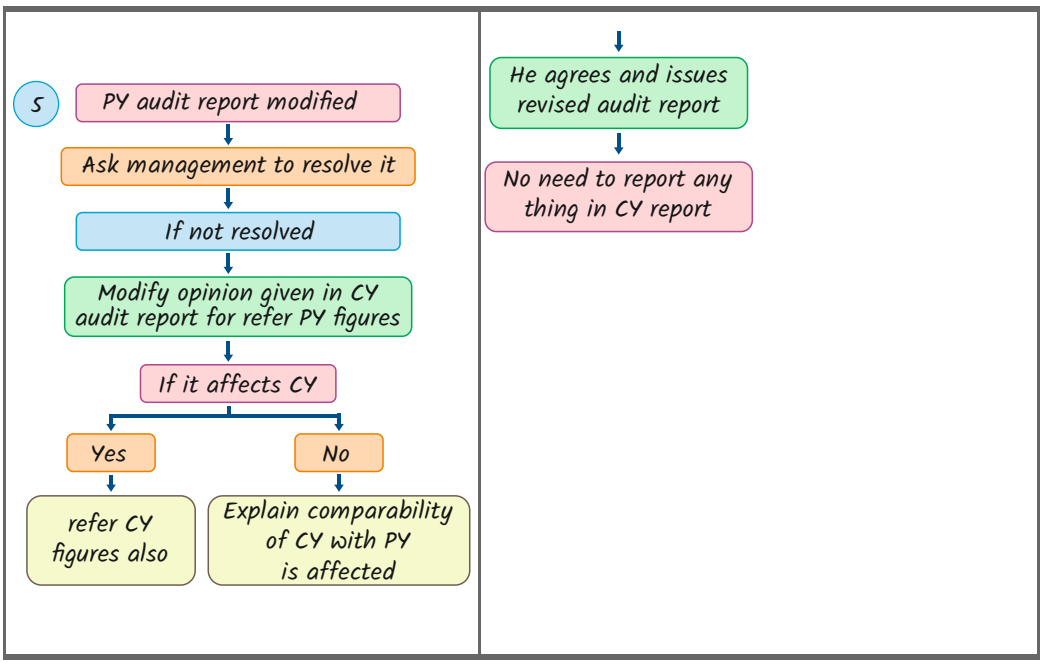
Note 2 :- This standard gives reporting approach. It doesn't say that we are suppose to do audit of 2 years in comparative financial statement approach. That means if we have done audit of 2 years, then only we will able to refer current year and previous year in opinion and intro para. If we have not done audit of previous year, we will have to put OMP explaining either previous year audit was not done or it was done by predecessor auditor, also provide the type of opinion with reason if it is modified and date of audit report.

(CNO--SA710.080) AUDIT REPORTING (QNO-126.000/127.000) (MCQ-710.1 / 710.2 / 710.03 / 710.4 / Incs.07.3)

Chart



Continue on next Page...



AUDIT REPORTING REGARDING CORRESPONDING FIGURES

Definition of Corresponding Figures

Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements, and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as "current period figures"). The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.

Don't refer Corresponding Figures

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the circumstances described in below given exceptions.

Audit Report on Prior Period Modified

If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

(a) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or

(b) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

Auditor Identifies Material Misstatement in Prior Period During Current Year Audit

If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.

Prior Period Financial Statements Audited by a Predecessor Auditor	If the financial statements of the prior period were audited by a predecessor auditor and the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report: (a) That the financial statements of the prior period were audited by the predecessor auditor; (b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and (c)The date of that report.
Prior Period Financial Statements Not Audited	If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

AUDIT REPORTING REGARDING COMPARATIVE FINANCIAL STATEMENTS

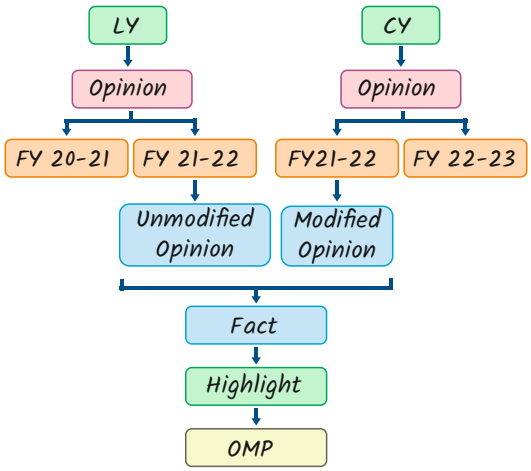
Refer Each Period	When comparative financial statements are presented, the auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed.
Change of Opinion on Prior Period Financial Statement	When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph in accordance with SA 706.
Auditor Identifies Material Misstatement in Prior Period During Current Year Audit	If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor shall communicate the misstatement with the appropriate level of management and those charged with governance and request that the predecessor auditor be informed. If the prior period financial statements are amended, and the predecessor auditor agrees to issue a new auditor's report on the amended financial statements of the prior period, the auditor shall report only on the current period.
Prior Period Financial Statements Audited by a Predecessor Auditor	If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph: (a) That the financial statements of the prior period were audited by a predecessor auditor; (b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and (c) The date of that report, Unless the predecessor auditor's report on the prior period's financial statements is revised with the financial statements.
Prior Period Financial Statements Not Audited	If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph that the comparative financial statements are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

(CNO--SA710.100) CHANGE IN OPINION

Chart

CHANGE IN OPINION

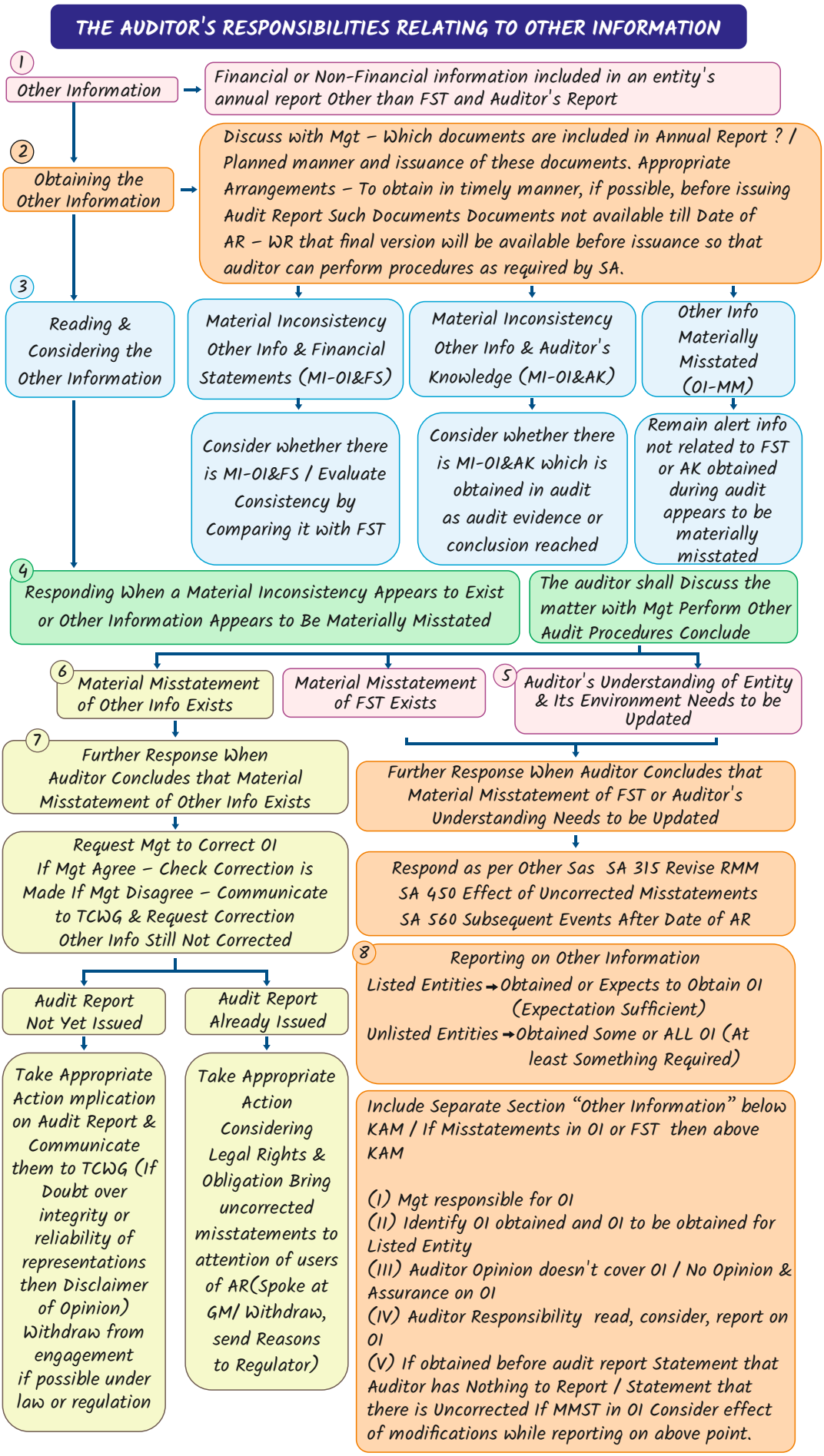
In case of comparative financial statement approach, if auditor has given one opinion on previous year in last year's audit report and then auditor has changed opinion of previous year in current year audit report because of additional information which he got during current period audit then to explain such fact auditor has to put other matter para.



Part 6 – [SA 720] THE AUDITOR'S RESPONSIBILITY IN RELATION TO OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

(CNO--SA720.020 TO CNO—SA720.140) MASTER CHART COVERING FULL SA 720

Chart



(CNO--SA720.020) OTHER INFORMATION

Financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report

(CNO--SA720.040) OBTAINING THE OTHER INFORMATION (QNO-127.050)

The auditor shall:

(a) *Determine, through discussion with management,* ***which document(s) comprises the annual report, and the entity's planned manner and timing of the issuance of such document(s);***

(b) *Make* ***appropriate arrangements with management*** *to obtain in a* ***timely manner and, if possible, prior to the date of the auditor's report,*** *the final version of the document(s) comprising the* ***annual report;*** *and*

(c) *When* ***some or all of the document(s) determined in (a) will not be available until after the date of the auditor's report, request management to provide a written representation that the final version of the document(s) will be provided to the auditor when available, and prior to its issuance by the entity, such that the auditor can complete the procedures required by this SA.***

(CNO--SA720.060) READING AND CONSIDERING THE OTHER INFORMATION (QNO-127.050)

- *The auditor* ***shall read the other information*** *and, in doing so shall:*
  - **(a)** *Consider whether there is a* ***material inconsistency between the other information and the financial statements.*** *As the basis for this consideration, the auditor shall, to evaluate their consistency,* ***compare selected amounts or other items in the other information (that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements) with such amounts or other items in the financial statements;*** *and*
  - **(b)** *Consider whether there is a* ***material inconsistency between the other information and the auditor's knowledge*** *obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit.*
- *While reading the other information in accordance with above paragraphs,* ***the auditor shall remain alert for indications that the other information not related*** *to the financial statements or the auditor's knowledge obtained in the audit* ***appears to be materially misstated.***

(CNO--SA720.080) MATTERS ARISING FROM MATERIAL INCONSISTENCY

- *If the auditor identifies that a* ***material inconsistency appears to exist (or becomes aware that the other information appears to be materially misstated),*** *the* ***auditor shall discuss the matter with management*** *and, if necessary,* ***perform other procedures*** *to conclude whether:*
  - **(a)** ***A material misstatement of the other information exists;***
  - **(b)** ***A material misstatement of the financial statements exists;*** *or*
  - **(c)** *The* ***auditor's understanding of the entity and its environment needs to be updated.***

(CNO--SA720.100) RESPONDING WHEN THE AUDITOR CONCLUDES THAT A MATERIAL MISSTATEMENT OF THE OTHER INFORMATION EXISTS (QNO 127.200)

- *If the auditor concludes that a material misstatement of the other information exists, the auditor* ***shall request management to correct the other information.*** *If management:*
  - **(a)** ***Agrees to make the correction, the auditor shall determine that the correction has been made;*** *or*
  - **(b)** ***Refuses to make the correction,*** *the auditor* ***shall communicate the matter with those charged with governance and request that the correction be made.***
- *If the auditor concludes that a material misstatement exists in other information obtained prior to the date of the auditor's report, and the* ***other information is not corrected after communicating with those charged with governance, the auditor shall take appropriate action,*** *including:*

(a) Considering the **implications for the auditor's report and communicating with those charged with governance about how the auditor plans to address the material misstatement in the auditor's report.**

(b) **Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation.**

- If the **auditor concludes that a material misstatement exists** in other information **obtained after the date of the auditor's report,** the auditor shall:
  - (a) **If the other information is corrected, perform the procedures necessary in the circumstances;** or
  - (b) **If the other information is not corrected** after communicating with those charged with governance, take appropriate action considering the auditor's legal rights and obligations, **to seek to have the uncorrected material misstatement appropriately brought to the attention of users for whom the auditor's report is prepared.**

(CNO--SA720.120) RESPONDING WHEN A MATERIAL MISSTATEMENT IN THE FINANCIAL STATEMENTS EXISTS OR THE AUDITOR'S UNDERSTANDING OF THE ENTITY AND ITS ENVIRONMENT NEEDS TO BE UPDATED.

- If, as a result of performing the procedures in paragraphs to "Reading & Consideration of Other Information", the auditor concludes that a material misstatement in the financial statements exists or the auditor's understanding of the entity and its environment needs to be updated, **the auditor shall respond appropriately in accordance with the other SAs.**

(CNO--SA720.140) REPORTING (MCQ – 720.1, 720.2)

- The auditor's report **shall include a separate section with a heading "Other Information",** or other appropriate heading, when, at the date of the auditor's report:
  - (a) **For an audit of financial statements of a listed entity, the auditor has obtained, or expects to obtain, the other information;** or
  - (b) **For an audit of financial statements of an unlisted corporate entity, the auditor has obtained some or all of the other information.**
- When the auditor's report is required to include an Other Information section in accordance with paragraph above para, this section shall include:
  - (a) A statement that management is responsible for the other information;
  - (b) An identification of:
    - Other information, if any, obtained by the auditor prior to the date of the auditor's report; and
    - For an audit of financial statements of a listed entity, other information, if any, expected to be obtained after the date of the auditor's report;
  - (c) A statement that the auditor's opinion does not cover the other information and, accordingly, that the auditor does not express (or will not express) an audit opinion or any form of assurance conclusion thereon;
  - (d) A description of the auditor's responsibilities relating to reading, considering and reporting on other information as required by this SA; and
  - (e) When other information has been obtained prior to the date of the auditor's report, either:
    - A statement that the auditor has nothing to report; or
    - If the auditor has concluded that there is an uncorrected material misstatement of the other information, a statement that describes the uncorrected material misstatement of the other information.
- When the auditor expresses a qualified or adverse opinion in accordance with SA 705 (Revised), the auditor shall consider the implications of the matter giving rise to the modification of opinion for the statement required in above paragraph Point (e).

(CNO--SA720.140) OBJECTIVE

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

(a) To consider whether there is a **material inconsistency** between the other information and the financial statements;

(b) To consider whether there is a **material inconsistency between the other information and the auditor's knowledge** obtained in the audit;

(c) **To respond appropriately when the auditor identifies that such material inconsistencies appear to exist,** or when the auditor otherwise becomes aware that **other information appears to be materially misstated;** and

(d) To report in accordance with this SA.

(CNO--SA720.160) NOT APPLICABLE

- This SA does not apply to:
  - (a) **Preliminary announcements of financial information;** or (Infosys use to give guidance about next quarter)
  - (b) Securities **offering documents, including prospectuses.** (Red Hearing Prospectus)
  - (c) The auditor's responsibilities under this SA **do not constitute an assurance engagement on other information or impose an obligation on the auditor to obtain assurance about the other information.**
- **Law or regulation may impose additional obligations on the auditor** in relation to other information that are beyond the scope of this SA. (Certificate on Corporate Governance Which involves examining CG report in Annual Report)

ILLUSTRATIONS

Illustration 1 – An auditor's report of a company, whether listed or unlisted, containing an unmodified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.

- **Other Information [or another title if appropriate, such as "Information Other than the Financial Statements and Auditor's Report Thereon"]**

  The Company's **Board of Directors is responsible for the other information.** The other information comprises the [information included in the X report but does not include the financial statements and our auditor's report thereon.]

  Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

  In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider **whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.** If, based on the work we have performed, **we conclude that there is a material misstatement of this other information, we are required to report that fact.**

  We have nothing to report in this regard.

Illustration 2 – An auditor's report of a listed company containing an unmodified opinion when the auditor has obtained part of the other information prior to the date of the auditor's report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor's report.

- **Other Information [or another title if appropriate, such as "Information Other than the Financial Statements and Auditor's Report Thereon"]**

  The Company's Board of Directors is responsible for the other information. The other information

comprises the X report (but does not include the financial statements and our auditor's report thereon), which we obtained prior to the date of this auditor's report, and the Y report, which is expected to be made available to us after that date. Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

[When we read the Y report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance and (describe actions applicable under the applicable laws and regulations)]

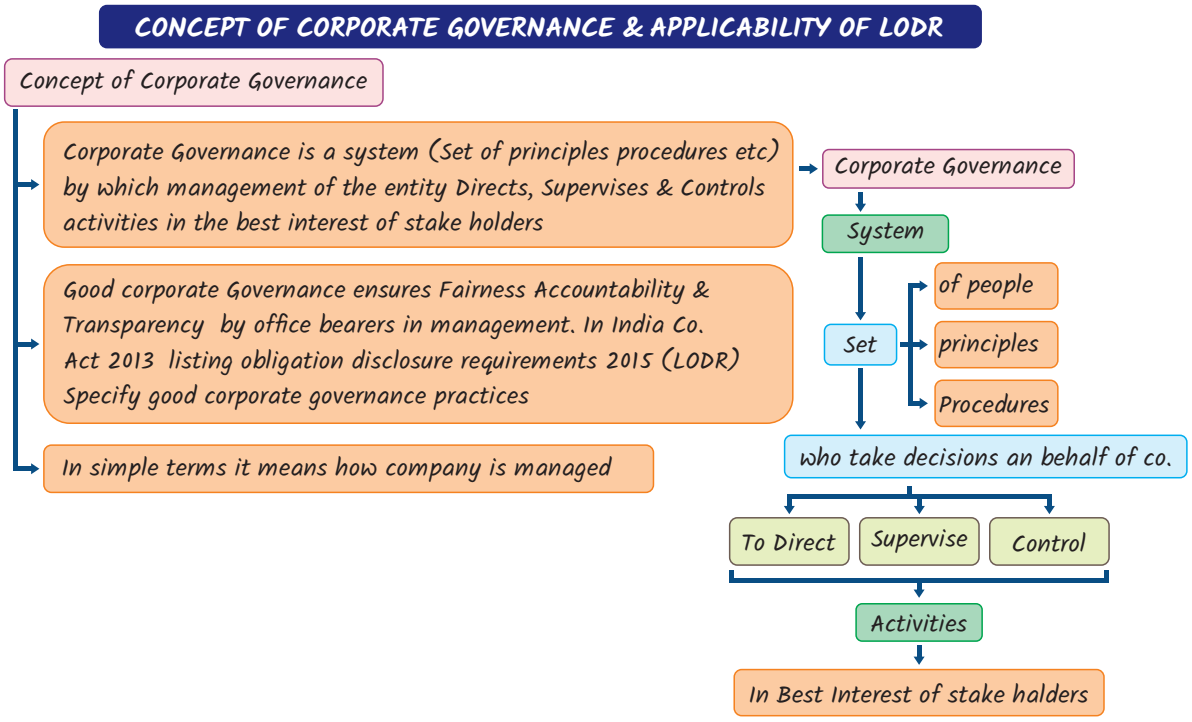
UNIQUE QUESTIONS	
QNO 127.100	*Examples of "Amounts" or "other items" included in the "other information*

Students Notes

07 AUDIT COMMITTEE AND CORPORATE GOVERNANCE

(CNO--ACCG.020) CONCEPT OF CORPORATE GOVERNANCE & LODR

Chart



Concept of Corporate Governance

Corporate Governance means principles, rules, procedures; systems framed to take decisions on behalf of company, so as to direct and control company. (BOD Composition, Meetings, Transactions Approvals & Executions, Information Processing, Accounting & Auditing Etc.)

In India, corporate governance depends on Company Act 2013. Listing Agreement & Disclosure Requirements 2015 (LODR).

(CNO--ACCG.030) APPLICABILITY OF LODR (QNO-422.000)

APPLICABILITY OF LODR

Applicable to all the entities whose designated securities are listed in the recognized stock exchange (RSE)

↓

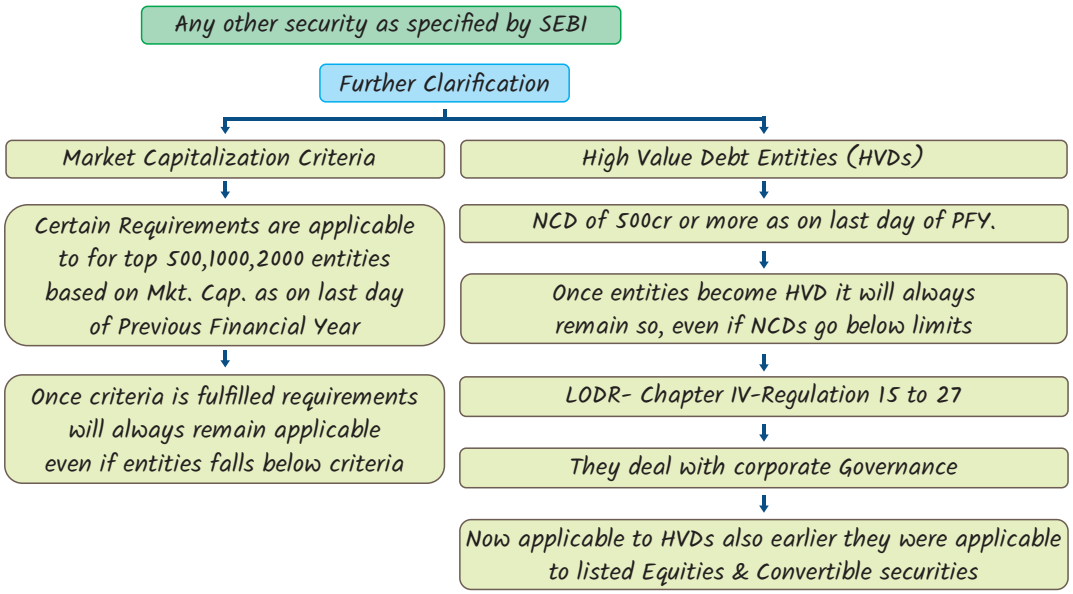
Designated Securities(list)

↓

Shortcut:- **SINUS** Securities

- **S** – Specified securities listed on any platform of RSE i.e., the main board or SME exchange or innovator growth platform
  - ↓
  - Specified securities means equity shares & convertible securities
- **I** – Indian depository Receipts
- **N** – Non-Convertible securities
- **U** – Unit of mutual funds
- **S** – Security Debt instruments (Ownership of good loans)
- **S** – Security Receipts (Ownership of bad loans)

Continue on next Page...



Listed Entities

Unless otherwise provided, these regulations shall apply to the listed entity who has listed any of the following designated securities on recognized stock exchange(s):
(That means Approved by Central Government under SCRA)

Designated Securities

- **Popular Securities**
  - Specified securities listed on
    - Main board (Simply means having Nationwide Trading Terminal) or SME Exchange or
    - Innovators Growth Platform (Also Known as Institutional Trading Platform)

    ('Specified securities' means 'equity shares' and 'convertible securities)

- **Other Securities (NISSU)**
  - Non-convertible securities;
  - Indian depository receipts;
  - Security Receipts (Securities issued by Asset Reconstruction Company giving ownership of Bad Loans as discussed under SARFESI Act)
  - Securitised debt instruments; (Generally gives ownership of good quality Loan Assets)
  - Units issued by mutual funds;

- Any other securities as may be specified by the Board.

Market Capitalisation Based Requirements

The provisions of these regulations which become applicable to listed entities on the basis of market capitalisation criteria shall continue to apply to such entities even if they fall below such thresholds.
(For E.g. There are certain requirements only for Top 500,1000,2000 entities based on market capitalisation as on last day of Previous Financial year)

High Value Debt Based Requirements

The provisions of these regulations which become applicable to listed entities on the basis of the criterion of the value of outstanding listed debt securities shall continue to apply to such entities even if they fall below such thresholds (E.g Entities having NCDs 500 Cr & above as on 31st March of Last Financial Year are called High value Debt Listed Entities)
Note: Chapter IV of LODR covers regulation 15 to regulation 48, out of these regulation 15 to regulation 27 deal with corporate governance matters. Chapter IV was formed for companies whose equity shares and convertible securities were listed, now regulation 15 to 27 is also applicable to HVD listed entities, that means all corporate governance regulations unless specified only for equity are applicable to them also.

(CNO--ACCG.040) ENUMERATE THE ISSUES ADDRESSED IN THE SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015 REGARDING CORPORATE GOVERNANCE (QNO-421.000)

Chart

ISSUES ADDRESSED IN LODR REGARDING CORPORATE GOVERNANCE

Shortcut :- $C^2R^3A^2BS^4$ on MIC get DS^2LR -V



- C – Compliance certificate by CEO & CFO
- C – Compliance certificate regarding compliance of LODR requirements
- R – Report on corporate governance
- R – Risk management committee
- R – Related party transactions disclosures
- A – Audit committee
- A – Accounting Treatment
- B – Board composition
- S – Stakeholders committee
- S – Securities transfer
- S – Statement of Deviation & Variation
- S – Subsidiary Related Requirement
- O – Obligation of director & Senior management
- M – Management discussion & Analysis
- I – Information to shareholders
- C – Code of conduct
- D – Disclosure principles
- S – Secretarial audit
- S – Sexual harassment
- L – Limited review of audit
- R – Nomination & Remuneration committee
- V – Vigil mechanism

Note : Content of Chapter is arranged as per above shortcut.

$C^2R^3A^2BS^4$On MIC get DSLR-V.

- Issues of Corporate Governance: Issues addressed in the LODR, 2015 regarding corporate governance are-
  - **C- Compliance Certificate** by the CEO and CFO
  - **C-Compliance Certificate** from either the auditors or practising company secretaries regarding compliance of conditions on corporate governance
  - **R-Risk management** procedures
  - **R- Report** on Corporate Governance
  - **R- Related party transactions** disclosures,
  - **A-Audit Committee** --> Composition / Meetings / Powers / Role and Responsibilities
  - **A- Accounting Treatment**
  - **B-Board** composition / key function & responsibilities / compensation / disclosures;
  - **S- Subsidiary** company management procedures. 4

- **S- Statement** of Deviation or Variation. 3
- **S- Securities** Transfer. 2
- **S- Stakeholder** Committee. 1

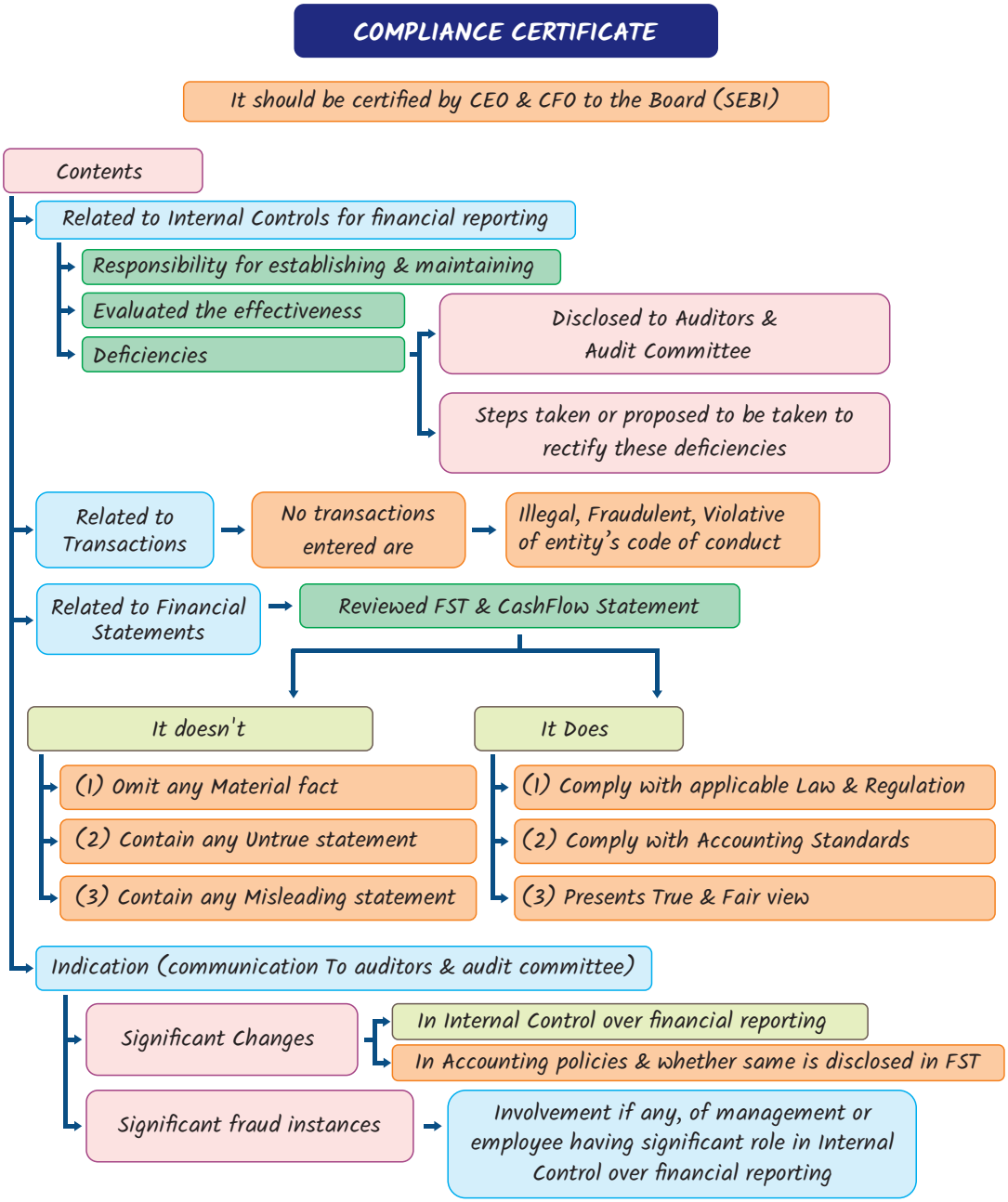
- **O- Obligations** of Director and Senior Management

- **M- Management** Discussion & Analysis Content
- **I- Information** to shareholders; (About Directors)
- **Code of Conduct** and vigil mechanism

- **Disclosure Principles**
- **S**exual Harassment
- **L**imited Review of Audit
- Nomination & **R**emuneration Committee
- **V**igil Mechanism

(CNO--ACCG.060) COMPLIANCE CERTIFICATE (QNO - 421.500) (MCQ - Incs.12.6)

Chart



Continue on next Page...

AUDITORS RESPONSIBILITY

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Simply to check compliance of all above points one by one.

Note :-In exam if there is a question specifically on Auditor's responsibility then explain all above points one by one from the point of view of Auditor's Checking

First comes IFCR

The Chief Executive Officer and the Chief Financial Officer shall certify to the Board that:

(a) They accept **responsibility for establishing and maintaining internal controls for financial reporting** and that they have **evaluated the effectiveness** of the internal control systems of the listed entity pertaining to financial reporting and they have **disclosed to the auditors and the Audit Committee, deficiencies** in the design or operation of internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.

Then comes transactions

(b) There are, to the best of their knowledge and belief, **no transactions entered** into by the listed entity during the year which are **fraudulent, illegal or violative of the listed entity's code of conduct**.

Then comes Financial Statements

(c) They have **reviewed** financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:

(I) These statements do not contain any materially **untrue statement or omit any material fact** or contain statements that might be **misleading;**

(ii) These statements together present a **true and fair view** of the listed entity's affairs and are in compliance with existing **accounting standards, applicable laws and regulations.**

Then indications to Audit Committee

(d) They have **indicated** to the auditors and the Audit committee:

(i) Significant **changes in internal control over financial reporting** during the year;

(ii) Significant **changes in accounting policies** during the year and that the same have been disclosed in the notes to the financial statements; and

(iii) Instances of significant **fraud** of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the listed entity's internal control system over financial reporting."

What should auditor do for IFCR in context of LODR?

- Check whether there is IFCR Framework (Detailed Document for IFCR)
- Whether risks and related documents are mitigated for each significant process
- Whether assessment procedure followed by CEO / CFO is reasonable
- Whether there is processed to identify significant changes in accounting policy / IFCR are communicated to audit committee & auditor
- Whether there is process to which deficiencies identified & steps taken to rectify are communicated to audit committee / auditor
- Whether there is process to issue compliance certificate after considering above & involvement of audit committee (refer to the minutes of the Audit Committee meetings)
- In situations where negative or adverse comments or exclusions/disclaimers are contained in the Compliance Certificate, the auditor should take cognizance of the same in the Audit Report and/or the certificate of compliance of conditions of corporate governance.

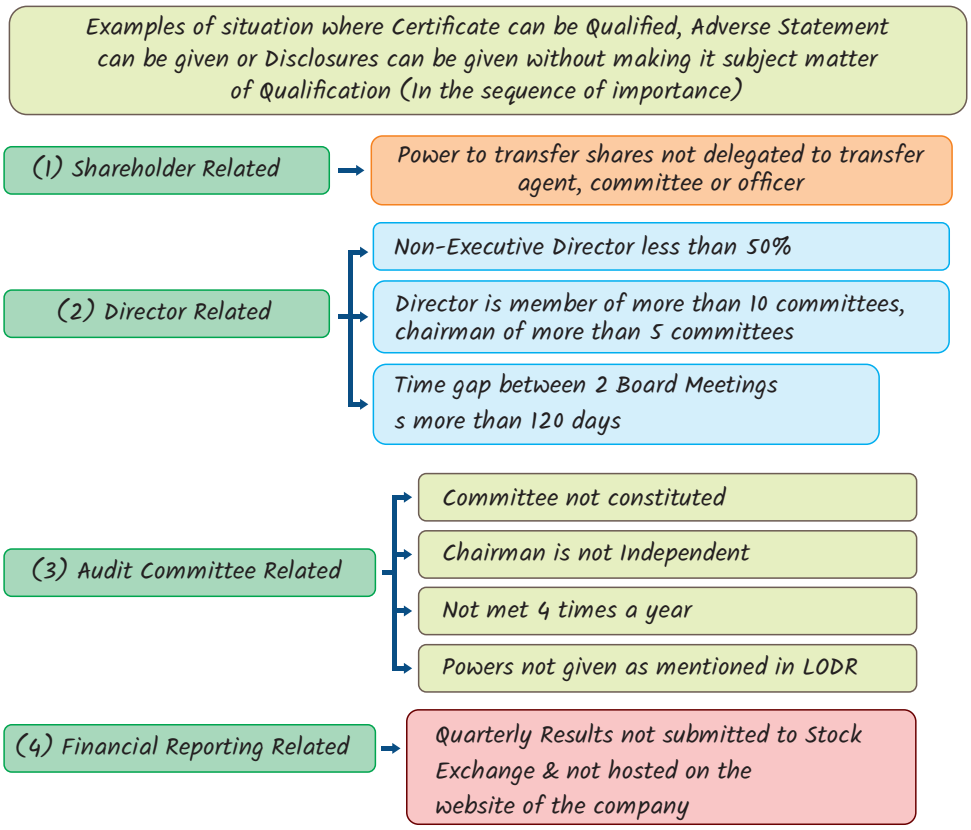
(CNO--ACCG.080) COMPLIANCE CERTIFICATE BY AUDITOR

Chart

COMPLIANCE CERTIFICATE ON CORPORATE GOVERNANCE

Who can give this Certificate → Company is required to obtain compliance certificate either from the Auditors or practicing Company Secretary & it shall be annexed to Director's report

Continue on next Page...



Requirement to Obtain Compliance Certificate

As per Schedule V, a listed entity shall **obtain a compliance certificate from either the auditors or practicing company secretaries** regarding compliance of conditions of corporate governance and **shall annex it to the Directors' Report.**

Adverse or Qualified Statement & Examples (QNO-431.000)

Depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance for e.g., Examples of such circumstances:

- **Shareholder Related**
  - **(Transfer of Shares)**
    The power of share transfer is not delegated to an officer or a committee or to the registrar and share transfer agents.

- **Director Related**
  - **(Number of Non-Executive Directors)**
    The number of non-executive directors is less than 50% of the strength of Board of directors.
  - **(Directorships)**
    A director is a member of more than 10 committees or acts as Chairman of more than 5 committees across all companies in which he is a director.
  - **(Time gap between 2 BOD Meetings)**
    The time gap between two Board meetings is more than one hundred and twenty days.

- **Audit Committed Related**
  - **(Setting up Audit Committee)**
    A qualified and independent audit committee is not set up.
  - **(Chairman of Audit Committee)**
    The Chairman of the audit committee is not an independent director.
  - **(Meetings of AC)**
    The Audit Committee does not meet four times a year.

- **(Powers of Audit Committee)**
  The necessary powers in terms of Part C of Schedule II have not been vested by the Board in the Audit Committee.

- **Financial Reporting Related**
  - **(Quarterly Results)**
    The information of quarterly results is **neither put on the listed entity's website nor sent in a form so as to enable the stock exchange** on which the entity's securities are listed to enable such stock exchange to put it on its own website.

(CNO--ACCG.120) REPORT ON CORPORATE GOVERNANCE [REGULATION 27 AND SCHEDULE II] (MCQ-AC.8)

Chart

AMENDMENT

REPORT ON CORPORATE GOVERNANCE

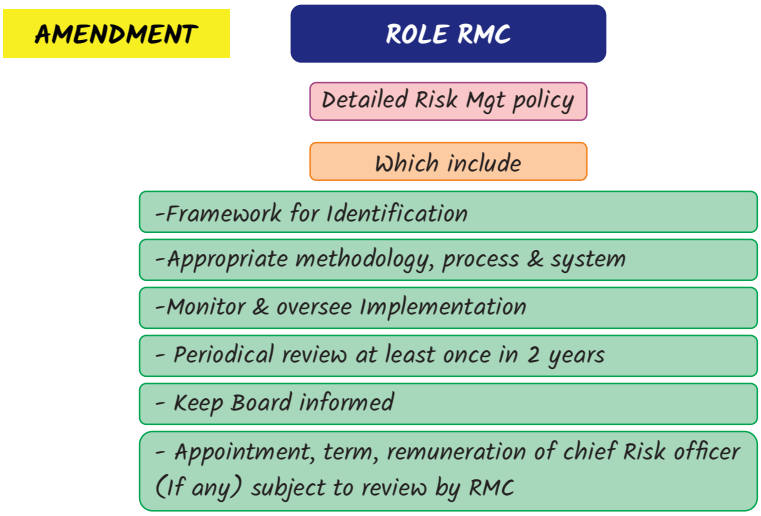
Authorization	Shall be signed either by compliance officer or CEO
Submission	Shall submit Quarterly compliance report to stock exchange within 21 days from end of each quarter
Inclusion in Annual Report	There should be a separate section on corporate governance in Annual Report with detailed compliance report on corporate governance
Auditor should check	No inconsistency of data Between report on Corporate Governance & Financial Statements → If there is inconsistency, apply SA 720

Quarterly compliance report	The listed entity shall submit a quarterly compliance report on corporate governance in the format as specified by the Board from time to time to the recognised stock exchange(s) within 21 days from the end of each quarter.
Authorization	The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the listed entity.
Annual Report	The auditor should ascertain whether the Board of Directors have included in the Annual Report of the listed entity, a separate section on corporate governance with a detailed compliance report on corporate governance.
Inconsistency	Any data in the report on corporate governance should not be inconsistent with that contained in the financial statements.

(CNO--ACCG.100) RISK MANAGEMENT COMMITTEE [REGULATION 21] (QNO - 422.100, 422.150, 434.400)

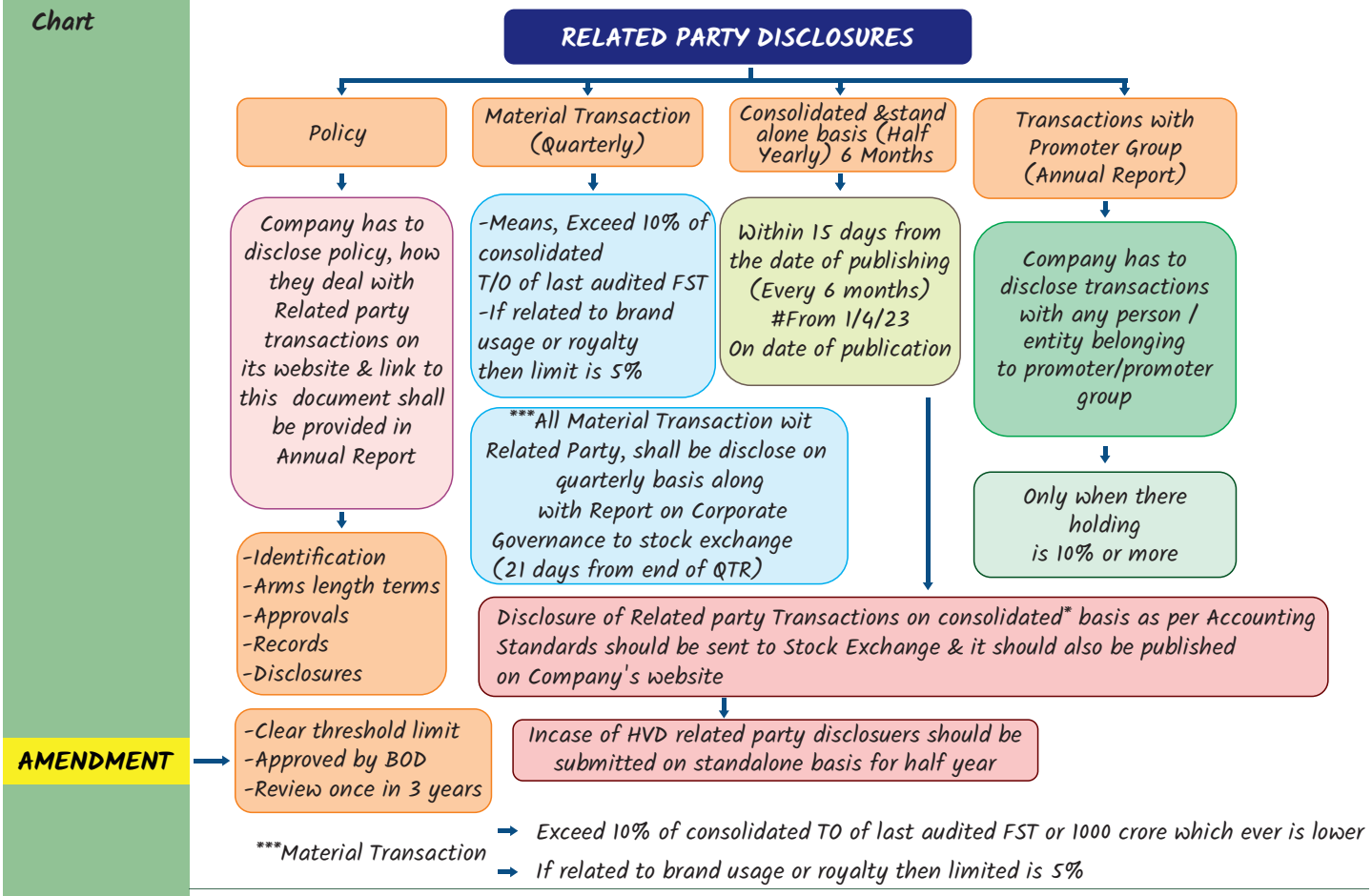
RISK MANAGEMENT COMMITTEE

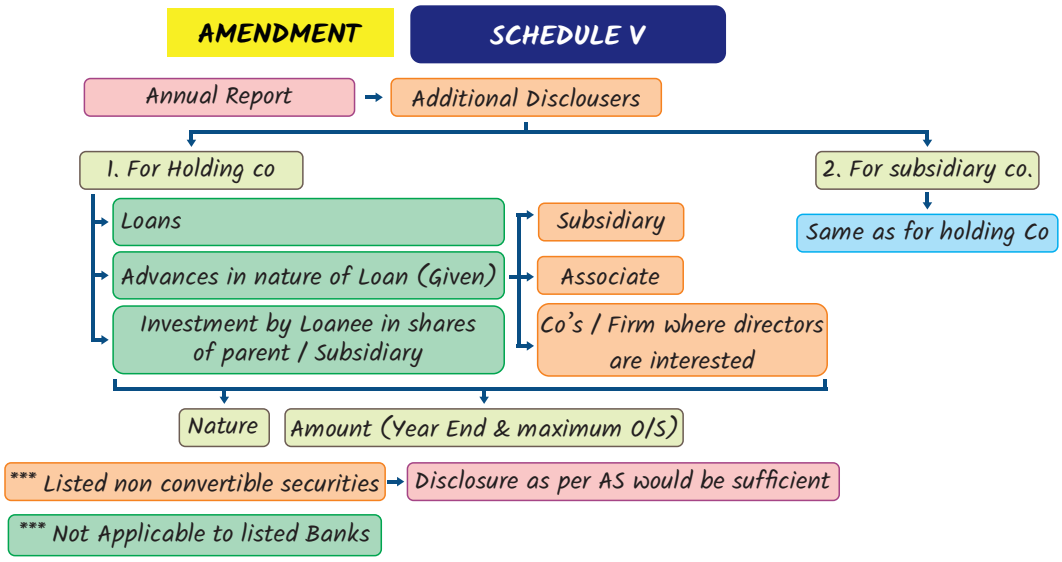
- Roles & responsibility
  - BOD shall define
  - May delegate monitoring & reviewing of risk management plan
  - Specifically covers cyber security
  - Mandatorily include function given in part D of sch II
  - Part D if sch II specifies roles of various committees
- Powers
  - Seek information from employee
  - Obtain outside legal or other professional advice
  - Secure attendance of outside experts
- Rest of the points, Covered in Table of committees given at the end of the Chapter.

Applicability	The provisions of this regulation shall be applicable to top 1000 & HVD listed entities, determined on the basis of market capitalisation, as at the end of the immediate previous financial year.
Constitution	➢ The Board of Directors shall constitute a Risk Management Committee. ➢ **The Risk Management Committee shall have minimum three members with majority of them being members of the board of directors, including at least one independent director and in case of a listed entity having outstanding SR equity shares, at least two thirds of the Risk Management Committee shall comprise independent directors.** ➢ The Chairperson of the Risk Management Committee shall be a member of the Board of Directors and senior executives of the listed entity may be members of the committee.
Meetings	➢ The risk management committee shall meet at least **twice** in a year. ➢ **The meetings of the risk management committee shall be conducted in such a manner that on a continuous basis not more than 180 days shall elapse between any two consecutive meetings.** ➢ **The quorum for a meeting of the Risk Management Committee shall be either two members or one third of the members of the committee, whichever is higher, including at least one member of the board of directors in attendance.**
Roles & Responsibilities	➢ The Board of Directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit and **such function shall specifically cover cyber security.** ➢ **It may be noted that the role and responsibilities of the Risk Management Committee shall mandatorily include the performance of functions specified in Part D of Schedule II.** (Part D specifies roles of various committees , which include roles of risk management committees)
Powers	➢ The Risk Management Committee shall have powers to ▪ seek information from any employee, ▪ obtain outside legal or other professional advice and ▪ Secure attendance of outsiders with relevant expertise, if it considers necessary
Audit Procedures	➢ Risk Management Procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework. ➢ A majority of this Committee will be the members of the Board of Directors. Senior executives of the company may be also be members of the Committee, but the Chairperson of the Committee shall be a member of the Board of Directors
Chart	

(CNO--ACCG.140) Related Party Disclosure [Regulations 23, 27, 46 and Schedule V] (QNO - 422.200)

Chart





Disclosures

- The listed entity shall submit a quarterly compliance report on corporate governance in the format as specified by the Board from time to time to the recognised stock exchange(s) within 21 days from end of quarter.
- Details of all material transactions with related parties shall be disclosed therein. The report shall be signed either by the compliance officer or the chief executive officer of the listed entity.
- The company shall disclose the policy on dealing with related party transactions on its website and a web link thereto shall be provided in the Annual Report.
- The listed entity shall disclose the transactions with any person or entity belonging to the

promoter/ promoter group which hold(s) 10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results.

- The listed entity shall submit within 30 days from the date of publication of its standalone and consolidated financial results for the half year, disclosures of related party transactions on a consolidated basis, in the format specified in the relevant accounting standards for annual results to the stock exchanges and publish the same on its website.

- Provided that a 'high value debt listed entity' shall submit such disclosures along with its standalone financial results for the half year

- Related party transactions and siphoning of funds from the business were the emergent issues in corporate governance of India Inc in 2019, moving beyond board governance and executive compensation that dominated the discussions earlier. From Sun Pharma to Indigo Airlines to Apollo Hospitals, these companies faced scrutiny for their related-party transactions.

(CNO--ACCG.160) AUDIT COMMITTEE QNO-422.000 / 426.500) (MCQ-AC.3 / Incs.12.2 / Incs.12.3/ Incs.55.4)

Audit Committee under LODR Vs Company Act 2013

Particulars	LODR	Companies Act
Applicability	Same as applicability of LODR	As per Section 177 all listed public companies, Public companies having paid up capital 10 crores or more, turnover 100 crores or more, Loan/ Debenture/ Deposit exceeding 50 crores are supposed to have AUDIT COMMITTEE. The following classes of unlisted public company shall not be covered under sub-rule (1), namely:— (a)a joint venture; (b)a wholly owned subsidiary; and (c)a dormant company as defined under section 455 of the Act. *Figures as on last audited balance sheet
Composition	Minimum 3 Directors (Atleast 2/3rd IDs) However, in case of a listed entity having outstanding SR (Superior Rights) equity shares, the audit committee shall only comprise of independent directors.	Minimum 3 Directors (Majority IDs)
Qualifications	All members should be "Financially Literate" At least one Expert	Majority including Chairman should be able to "able to understand FST"
Chairman	Should be ID	Silent
Secretary	Company Secretary of Company.	Silent
Number of meetings (QNO-426.000/ 426.500)	Audit Committee shall meet at least 4 times in a year, Gap between 2 meetings should not be more 120 days	Silent
Quorum	2 Members or 1/3rd of members whichever is higher. (At least 2 IDs)	Silent

Invitees to committee Meetings	Finance Head / Head of Internal Audit / Representative of Statutory Auditor /	Auditor / Key Managerial Person can attend and have right to be heard with respect to audit report but cannot vote
Presence at AGM	Chairman of Audit Committee should be present at AGM	Silent

(CNO--ACCG.180) SEC 177 AUDIT COMMITTEE (QNO – 422.000 / 422.050/429.010)

Chart

SEC 177 – AUDIT COMMITTEE (AC)

Note: For provisions related to applicability, constitution of Audit Committee refer table of committee at the end of Chapter

Sub-section 4 Functions of Audit Committee

Every Audit committee shall act in accordance with Terms of Reference, specified in writing by Board which includes following

- Auditor Related Points
  - Recommendation for Appointment, * Remuneration & terms of appointment of Auditors
  - Review & Monitor Auditors Independence & performance
  - Examination of FST & Auditor's Report

*NOTE: In case of Govt. Company, it is limited to recommendation of remuneration

- Related Party Transactions Points

All related party transactions need approval of Audit Committee (including modification)

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If approved by AC, no further Approval, if rejected send recommendation to BOD

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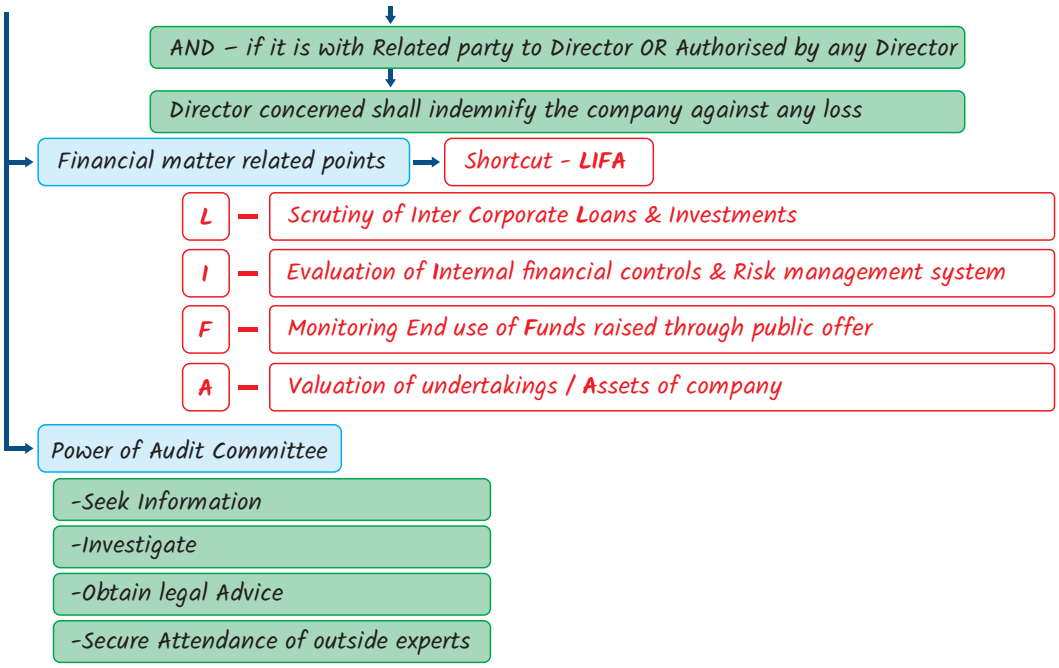
BOD will decide. If BOD goes against AC, write reasons & disclose in annual report

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However in following special circumstances the procedure to be followed will be as follows

Repetitive	Small	Abnormal	Family
Repetitive Transactions	Transactions Not Exceeding Rs. 1 Cr.	Specified Transactions (Sec 188)	Other than Sec 188 Transactions
Instead of approval of Audit Committee for every transaction	Entered by director/ officer without Approval of Audit Committee	i.e., Not in ordinary course of business or Not at arm's length	If between Holding & wholly Owned Subsidiary
Omnibus Approval can be obtained (one time approval with conditions)	AND Not Ratified by AC within 3 months	BOD approval is required	Provisions of Clause not applicable
	Such Transaction shall be voidable at option of AC	If limits are crossed	That means AC approval not required
	If Voided	Ordinary Resolution is to be passed	

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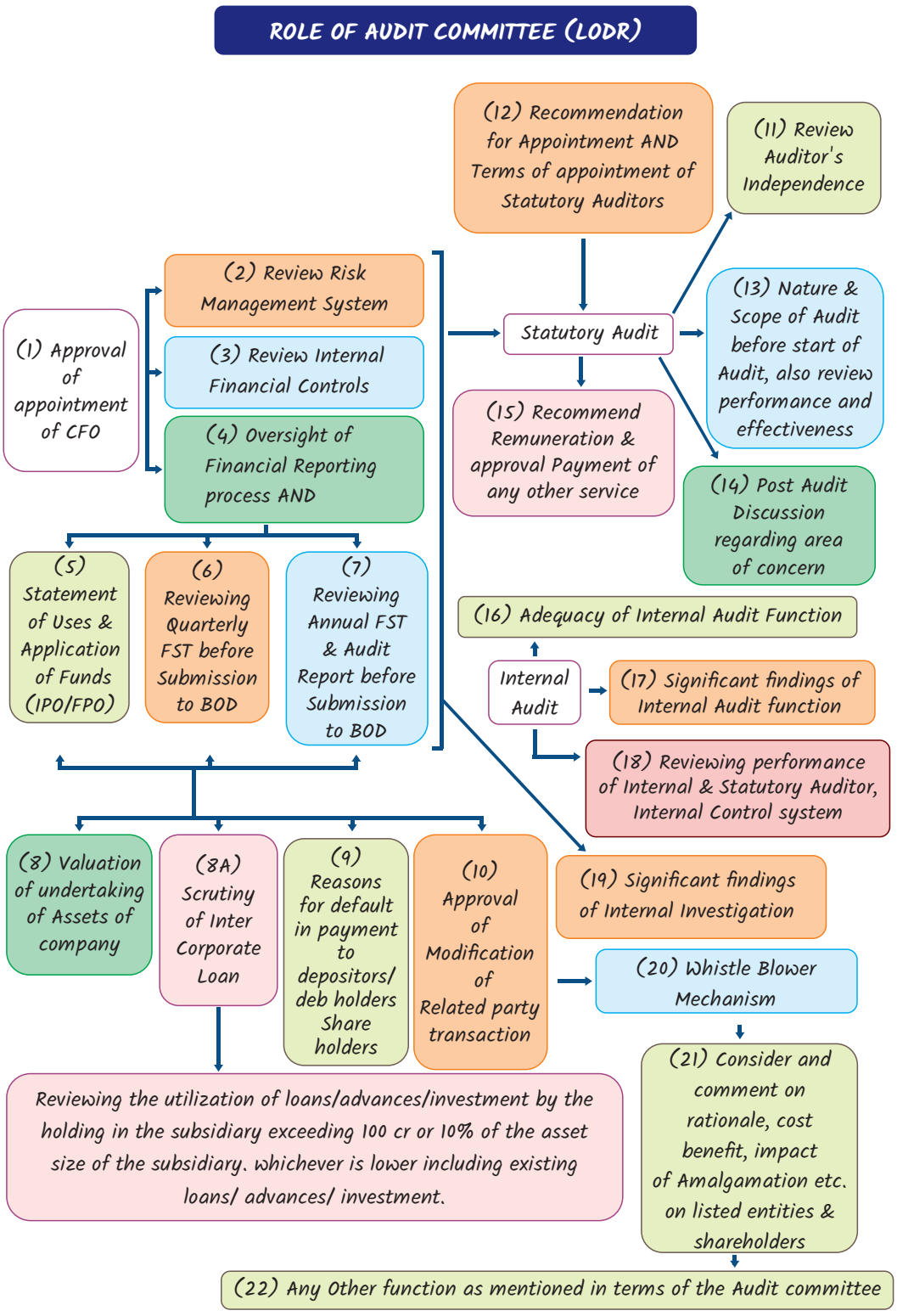


Section 1 (Applicability)	The Board of Directors of every listed public company and such other class or classes of companies, as may be prescribed (See Table Above), shall constitute an Audit Committee.
Section 2 (Constitution)	The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority: Provided that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.
Section 3 (Transitional Provision -Time Limit)	Every Audit Committee of a company existing immediately before the commencement of this Act shall, within one year of such commencement, be reconstituted in accordance with sub-section (2).
Section 4 (Functions of Audit Committee) (QNO-422.050)	Every Audit Committee shall act in accordance with the **terms of reference specified in writing** by the Board which shall inter alia, include,— ***Auditor Related Points*** (i)the recommendation for appointment, remuneration and terms of appointment of **auditors** of the company; (ii)review and monitor the **auditor's independence and performance**, and effectiveness of audit process; (iii)examination of the **financial statement and the auditors' report** thereon; ***Related Party Connected Points*** (iv)approval or any subsequent modification of transactions of the company with **related parties:** Provided that the Audit Committee may make **omnibus approval** for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed:1 Provided further that in case of transaction, **other than transactions referred to in section 188, and where Audit Committee does not approve the transaction,** it shall make its recommendations to the Board:2 Provided also that in case any transaction involving any amount **not exceeding one crore rupees** is entered into by a director or officer of the company **without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction** shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it:4 Provided also that the provisions of this clause shall not apply to a transaction, other than a transaction referred to in section 188, between a holding company and its wholly owned subsidiary company;3

	Financial Matter Connected Points (v) scrutiny of **inter-corporate loans and investments** 2 (vi) **valuation of undertakings or assets** of the company, wherever it is necessary 3 (vii) evaluation of **internal financial controls and risk management systems;** 4 (viii) monitoring the **end use of funds raised through public offers and related matters.** 1
Section 5 (Calling Comments from Auditors)	The Audit Committee may call for the **comments of the auditors** about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.
Section 6 (Authority to Investigate) (QNO-427.000)	The Audit Committee shall have **authority to investigate** into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have **power to obtain professional advice from external sources and have full access to information contained in the records of the company.**
Section 7 (Right to be Heard) (QNO-427.000)	The **auditors of a company and the key managerial personnel** shall have a **right to be heard** in the meetings of the Audit Committee when it considers the auditor's report **but shall not have the right to vote.**
Section 8 (Disclosure in BOD Report)	The **Board's report** under sub-section (3) of section 134 shall **disclose** the composition of an Audit Committee and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in such report along with the reasons therefore.
Section 9 (Vigil Mechanism)	Every listed company or such class or classes of companies, as may be prescribed, shall establish a **vigil mechanism** for directors and employees to report genuine concerns in such manner as may be prescribed
Section 10 (Safeguards & Disclosure)	The vigil mechanism under sub-section (9) shall provide for adequate **safeguards against victimisation** of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases: Provided that the details of establishment of such mechanism shall be **disclosed by the company on its website**, if any, and in the Board's report.

ROLE OF AUDIT COMMITTEE (QNO - 429.010)

Chart



(CNO--ACCG.190) MANDATORY REVIEW BY AUDIT COMMITTEE (QNO - 425.000 / 425.500)

Discussion

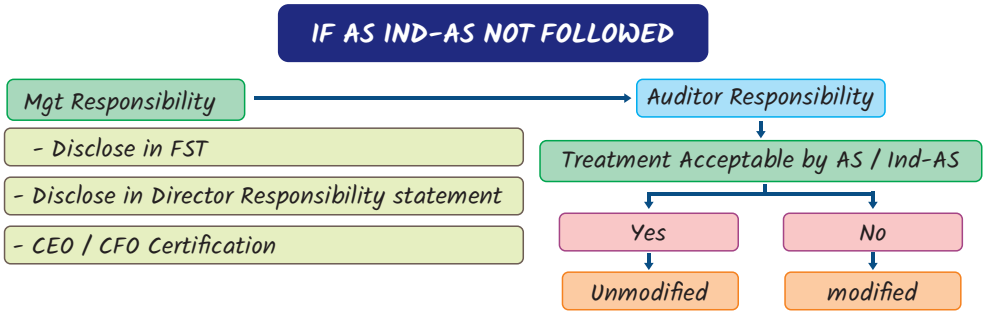
AMENDMENT

The Audit Committee shall mandatorily review the following information as per Part C(B) of Schedule II: "SIM OF CMD"

1. Management discussion and analysis of financial condition and results of operations;
2. Management letters / letters of internal control weaknesses issued by the statutory auditors;
3. Internal audit reports relating to internal control weaknesses;
4. The appointment, removal and terms of remuneration of the Chief Internal Auditor shall be subject to review by the Audit Committee; and
5. Statement of deviations: (a) quarterly statement of deviations including report of monitoring agency if applicable and (b) annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

(CNO--ACCG.195) Disclosure of Accounting Treatment [Schedule V]

Chart



Discussion

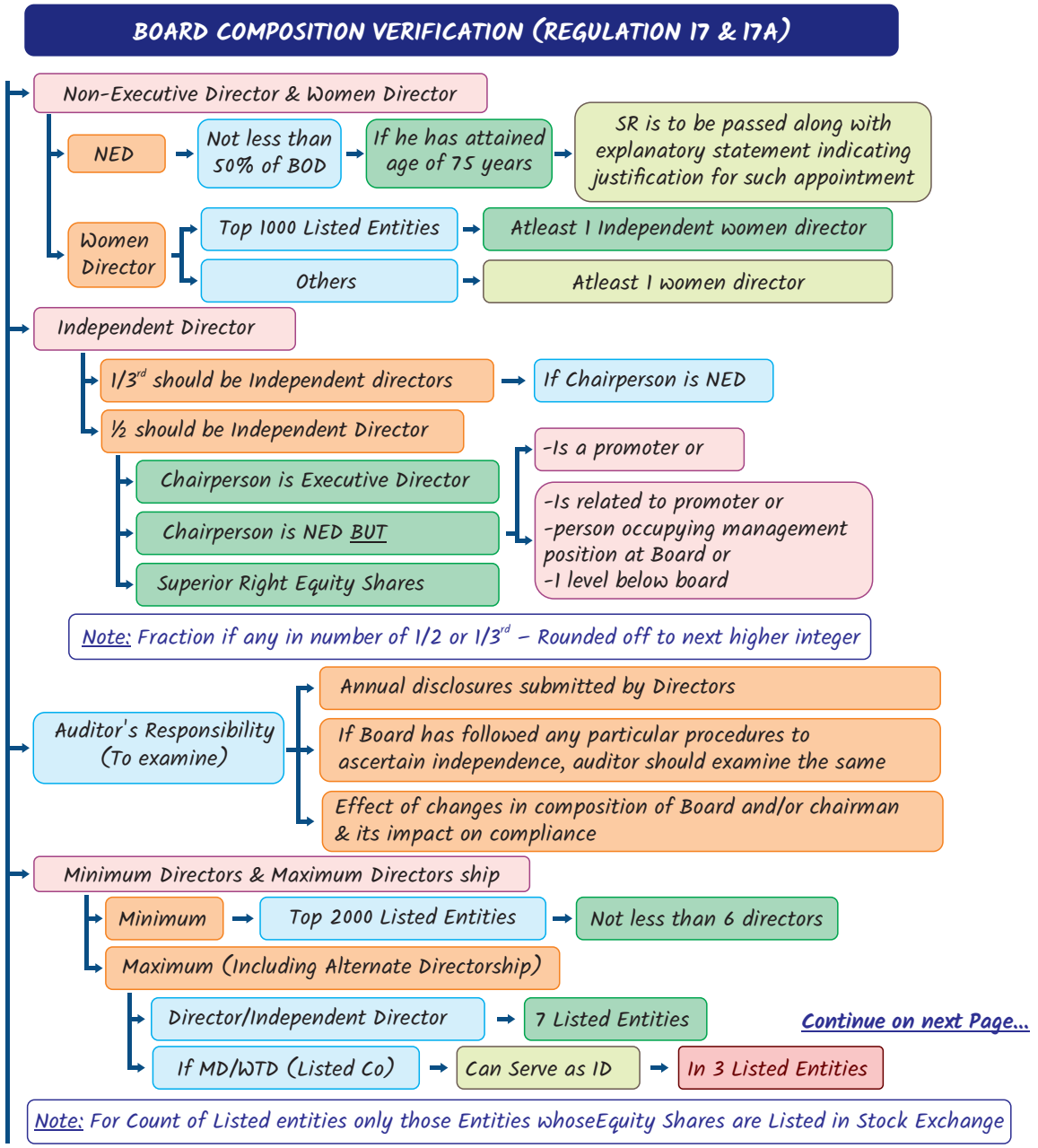
- Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction.

- In this regard, the auditor should refer to Sections 133, 134 and 143 of the Companies Act, 2013. Also, the auditor should refer to the Compliance Certificate issued in accordance with Regulation 17(8).

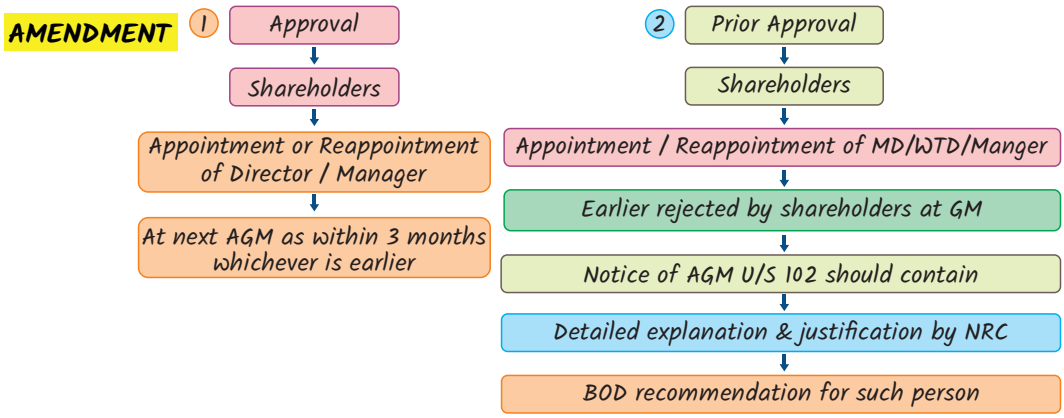
(CNO--ACCG.200) BOARD COMPOSITION VERIFICATION - Regulation 17 and 17A (QNO – 430.500 /434.020/ 434.200)

(MCQ-AC.1/ AC.6 / Incs.09.2 / Incs.15.2/ Incs.27.6 / Incs.27.7 / Incs.33.4/ Incs.56.2)

Chart



Continue on next Page...



(a) Requirement of Non-Executive Director and Woman Director

BOD Composition Throughout the reporting period	➢ The auditor should ascertain whether, throughout the reporting period, the Board of Directors comprises an optimum combination of executive and non-executive directors, ▪ With at least one-woman director and 1 ▪ Not less than 50% of the Board of Directors comprising non-executive directors.2
In case of Top 500 -1000 listed entities	It may be noted that the Board of directors of the **top 500 listed entities** shall have **at least one independent woman director** (and the Board of directors of the **top 1000 listed entities** shall have **at least one independent woman director by April 1, 2020).**1A The top 500 and 1000 entities shall be **determined on the basis of market capitalisation,** as at the end of the **immediate previous financial year.**
Non-executive Directorship -Age Requirement	The auditor should also ensure that **no listed entity shall appoint** a person or continue the directorship of any person as a **non-executive director** who has **attained the age of seventy-five years.**2A **Unless a special resolution** is passed to that effect, in which case **the explanatory statement annexed to the notice for such motion shall indicate the justification** for appointing such a person.
How to verify the type of Directorship	The **minutes of the Board of Directors'** meetings should be **verified to ascertain** whether a director is an **executive director or a non-executive director.** 2B

(b) Requirement of Independent Directors

No. of Independent director depends on Chairperson	The auditor should also verify that **where the Chairperson** of the Board is a **non-executive director, at least one-third** of the Board should **comprise of independent directors** and in case the listed entity **does not have a regular non-executive Chairperson, at least half of the** Board of Directors **should comprise independent directors.**
Chairperson Connected	Further, if the regular **non-executive Chairperson is a promoter** of the listed entity or **is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board** of the listed entity shall consist of **independent directors**

Rounding off to the next integer	In determining the number of requisite independent directors and/or non-executive directors, the fraction, if any, **in the number of one-half or one-third as the case may be, should be rounded off.** Since the terms in this clause refer to **'not less than'** and **'at least'**, it would be appropriate to compute the number by **rounding off any fraction to the next integer.** For example, in a Board headed by a non-executive Chairman and comprising of six other directors (i.e.,seven directors), the independent directors should be three or more.
Independent directors if outstanding SR equity shares	In case of listed **company having outstanding SR equity shares,** the auditor shall check that at **least half of the board of directors comprises of independent directors**
Auditor's Responsibility to check Independence of directors and Changes in Composition	**Annual disclosure submitted by the directors** to the Board of Directors **may be examined** for this purpose. **If the Board of Directors has followed any particular procedure(s) to ascertain the independence of directors, the auditor should examine the same.** **Effect of changes in the composition of the Board and/or its Chairman and its impact on compliance throughout the reporting period should also be examined.**

(c) Minimum Directors & Maximum Directorships

Minimum Directors in case of Top 1000 and 2000 entities (MCQ-AC.4, AC.7)	The auditor should ensure that the **board of directors of the top 1000 listed entities** (and the **top 2000 listed entities** with effect from **April 1, 2020**) shall comprise of **not less than six directors.**
➢ **Explanation**	The top 1000 and 2000 entities shall be determined on the basis of **market capitalisation as at the end of the immediate previous financial year**
Listed entities -Maximum number of Directorships	The directors of listed entities shall comply with the following conditions with respect to the maximum number of directorships, including any alternate directorships that can be held by them at any point of time – 1) A person shall **not be a director in more than eight listed entities** (and in **not more than seven listed entities** with effect from **April 1, 2020**). It may be noted that a person shall **not serve as an independent director in more than seven listed entities.** 2) Notwithstanding the above, **any person** who is **serving as a whole-time director / managing director** in any **listed entity** shall serve as an **independent director in not more than three listed entities**
➢ **How to calculate the number of Directorship**	For the purpose of above-mentioned provision, the **count for the number of listed entities** on which a person is a director / independent director shall be only **those whose equity shares are listed on a stock exchange.**

(d) Requirement of Chairperson of BOD (MCQ – Incs.15.2)

	➢ **Requirement** **With effect from April 1, 2020,** the audit shall ensure that the **Chairperson of the board** of the **top 500 listed entities** is – a) a non-executive director. b) not related to the Managing Director or the Chief Executive Officer as per the definition of the term "relative" defined under the Companies Act, 2013.

- **Non applicability of above**
  It may be noted that this provision **shall not be applicable** to the listed entities **which do not have any identifiable promoters** as per the shareholding pattern filed with stock exchanges.

- **How to determine Top 500 entities**
  It may also be noted that **the top 500 entities shall be determined on the basis of market capitalisation,** as at the end of the immediate previous financial year.

Independent Director / BOD Meetings

Please see law notes and follow same. So that we can avoid duplication and it is core part of law.
Question was asked on % share holding for independent directors & relatives

(CNO--ACCG.280) STAKEHOLDERS RELATIONSHIP COMMITTEE (QNO - 434,400) (MCQ-AC.9 / Incs.15.3)

Discussion

FUNCTIONS OF STAKEHOLDER RELATIONSHIP COMMITTEE (SHARE HOLDERS / DEBENTURE HOLDERS & OTHER SECURITY HOLDERS)

Note: For provisions related to applicability, constitution of Stakeholder Committee refer table of committee at the end of Chapter

In the sequence of importance

REVIEW OF

- (Ownership Related) → Services given by Registrar & Share Transfer Agent
- (Voting) → Measures taken for effective exercise of voting rights
- (Receipt of dividend & important docs) → Measures taken to ensure timely receipt of dividend warrant/ annual report
- Grievances → Resolving the Grievances of Security holders & statutory notices & also reducing Quantum of unclaimed dividend

Auditor is supposed to check all above points using following 3 things

- Minutes of BOD Meeting
- Minutes of Committee Meetings
- Certificate / report from SEBI/Stock Exchange on pending grievances of stakeholders (If any)

Non-executive Directorship -Age Requirement

- **Constitution**
  The listed entity **shall constitute** a Stakeholders Relationship Committee to specifically look into various aspects of interest of **shareholders, debenture holders and other security holders**

- **Chairman**
  - The chairperson of this Committee shall be a **non-executive director**
  - The Chairperson of the Stakeholders Relationship Committee **shall be present at the annual general meetings to answer queries of the security holders.**

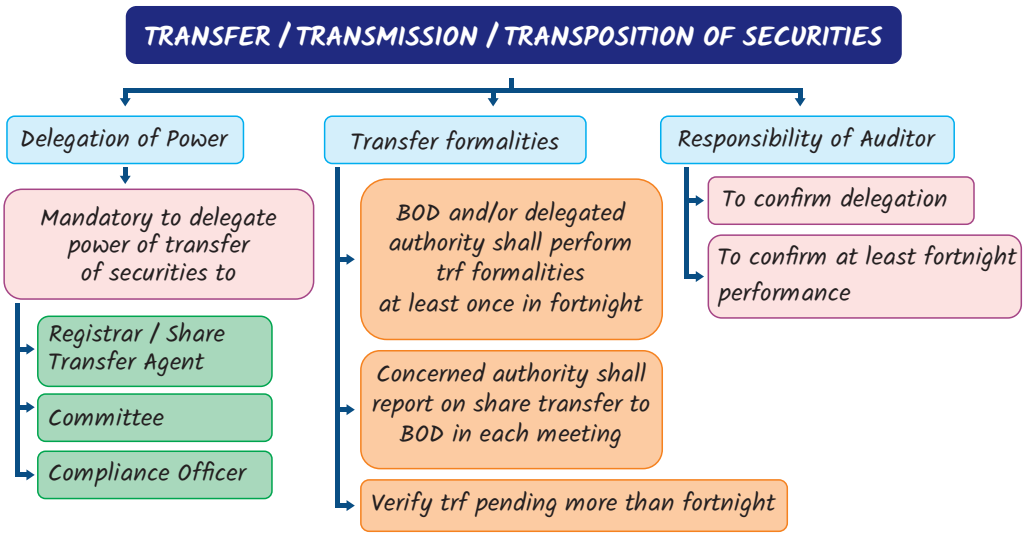
- **Other Members&Meeting**
  - At **least three directors, with at least one being an independent director,** shall be members of the Committee. However, in case of a listed entity having **outstanding SR equity shares, at least two thirds of the Committee shall comprise of independent directors.**
    The Stakeholders Relationship Committee shall **meet at least once in a year.**

- **Function**
  - The role of the committee shall inter-alia include the following-
    Resolving the grievances of the security holders of the listed entity including complaints related to transfer/transmission of shares, non-receipt of annual report, non-receipt of declared dividends, issue of new/duplicate certificates, general meetings etc.4
  - Review of measures taken for effective exercise of **voting rights by shareholders.2**
  - Review of **adherence to the service standards** adopted by the listed entity in respect of various services being rendered by the Registrar & Share Transfer Agent.1
  - Review of the various measures and initiatives taken by the listed entity for **reducing the quantum of unclaimed dividends and ensuring timely receipt of dividend warrants/annual reports/statutory notices by the shareholders of the company.3**

- **Auditor Responsibility**
  The auditor should ascertain from the minutes book of the Board meetings whether a Board committee, namely a Stakeholders Relationship Committee has been set up under the chairmanship of a non-executive director to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of annual report, non-receipt of declared dividends, etc. Further, the auditor should also ascertain from the minutes book of the Committee meetings whether such committee is prima facie functioning.
  The auditor should also verify from the records of the Committee as well as from the certificate obtained by the listed entity from SEBI and stock exchange(s), if any, as regards the investors 'grievances pending up to the date of certificate of compliance of conditions of corporate governance.

(CNO--ACCG.260) TRANSFER OR TRANSMISSION OR TRANSPOSITION OF SECURITIES

Chart



***(1).Transfer - Buy / sell shares
(2). Transmission - Transfer by operation of law (2). Transposition - change in order of joint holder

Delegation of Powers

The Board of Directors of a listed entity shall delegate the power of transfer of securities;

- to a committee or
- to the compliance officer or
- to the registrar to an issue and/or share transfer agent.

Responsibility of Auditor

- **Confirm Delegation**
  The auditor should ascertain from the minutes book of the Board meetings whether the listed entity has delegated the power of share transfer to an officer or a committee or to the registrar and share transfer agents.

- ***Confirm once in fortnight requirement***

The auditor should also verify from the records maintained to ascertain whether the delegated authority has attended to share transfer formalities at least once in a fortnight. The auditor may verify whether any transfer request is pending for more than a fortnight and are not attended to in terms of this Regulation.

(CNO--ACCG.240) STATEMENT OF DEVIATIONS OR VARIATIONS (MCQ-Incs.47.1/ Incs.47.2)

Chart

STATEMENT OF DEVIATION / VARIATION

- Applicability → Applicable for Money raised through
  - Public Issue
  - Right Issue
  - Preferential Issue

01 Meaning of Statement of Deviation

- When Money raised is not used for the object,
- As specified in the offer document / explanatory statement to notice of GM

Meaning of Statement of Variation

- Offer documents / Explanatory statement explains,
- Category wise (internal allocation) utilization of funds Internal Breakup (Cap Exp, Sales & Marketing, Working Capital etc.)
- If there is difference in utilization of funds as against category wise projections
- It is explained in Statement of Variation

02 Reporting

- Quarterly Reporting
  - Statement of deviation / variation, should be submitted to stock exchange on quarterly basis (even if there is no miss utilization)
  - Such statement should be submitted till the time money is fully utilized or the purpose for which proceeds were raised is achieved (whichever earlier)
- Annual Reporting*
  - Statement of Deviations & Variations (only if used for other purpose) → Certified by Statutory Auditor + also give explanation in directors report
  - Statement of Total fund utilization → Statement explaining utilization of funds raised from preferential allotment / Qualified institutional placement should be disclosed in Annual Report

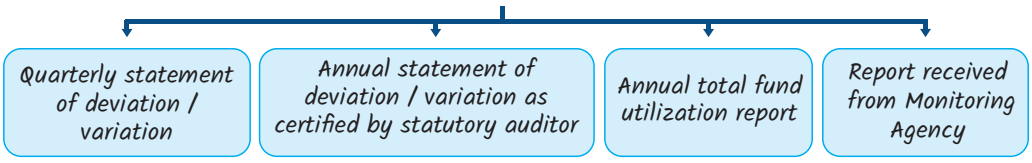
*This point was missed by module but we included it from LODR for better clarity

03 MONITORING AGENCY REPORT

- If issue size is of 500 crore or more, then company has to appoint Monitoring Agency &
- Any comment / report received from monitoring agency should be submitted to stock exchange

04 AUDIT COMMITTEE REVIEW (Basically all the statement as explained above)

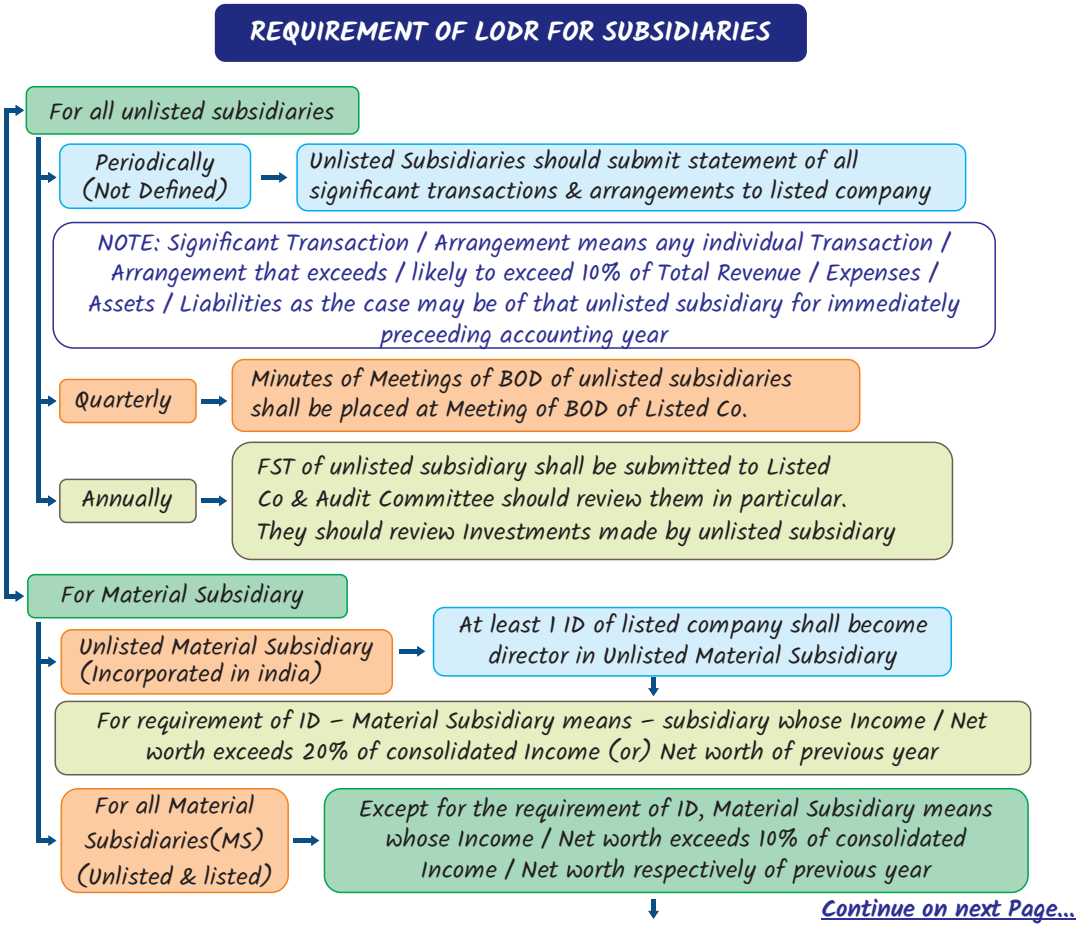
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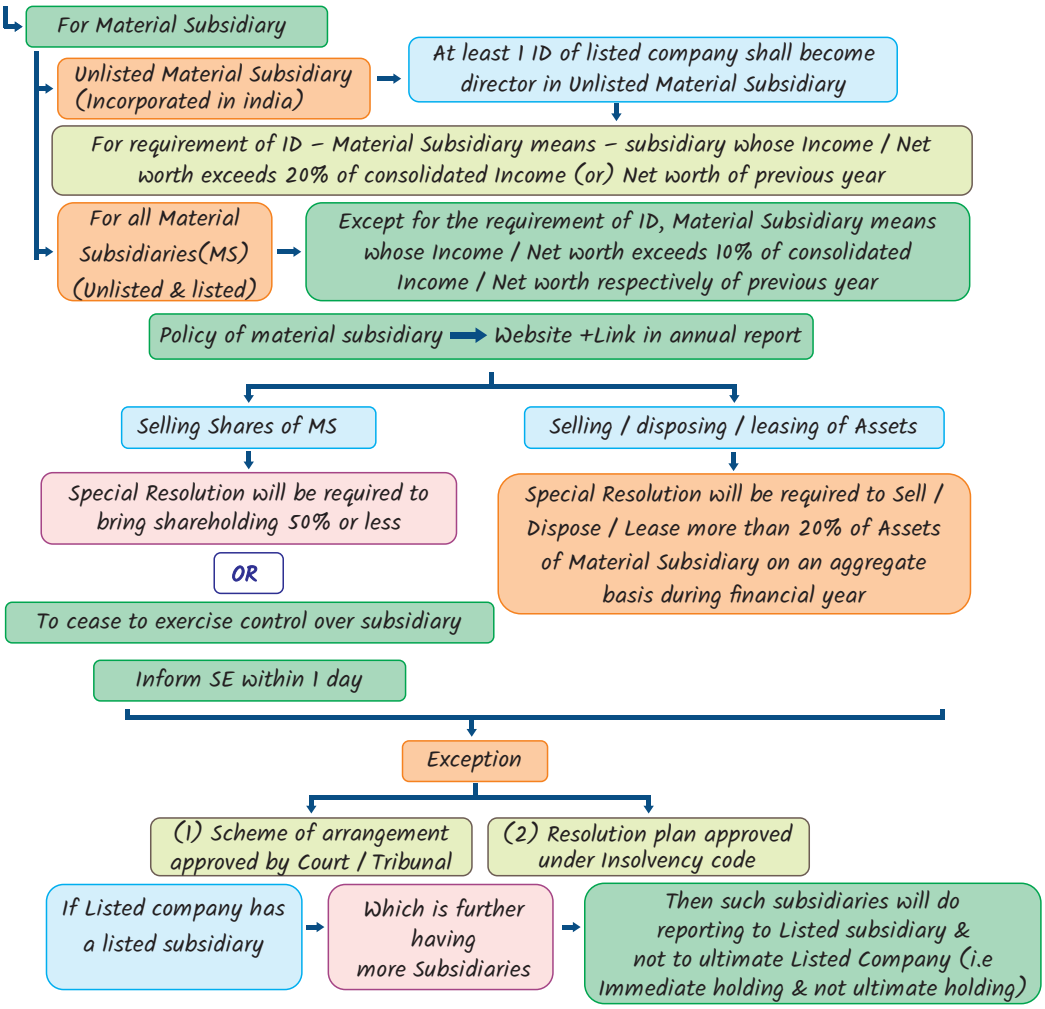
Quarterly Submission to Stock Exchange	The **listed entity shall** submit to the **stock exchange** the following statement(s) on a **quarterly basis** for public issue, rights issue, preferential issue etc.
Deviation	**Indicating deviations,** if any, in the use of proceeds from the objects stated in the offer document or explanatory statement to the notice for the general meeting, as applicable;
Variation	Indicating **category-wise variation** (capital expenditure, sales and marketing, working capital etc.) between projected utilisation of funds made by it in its offer document or explanatory statement to the notice for the general meeting, as applicable and the actual utilisation of funds.
Number of Quarters	The statement(s) shall be continued to be given **till such time the issue proceeds have been fully utilised** or the purpose for which these proceeds were raised has been achieved.
Preferential Allotment	Where an entity has raised funds through **preferential allotment or qualified institutions placement,** the listed entity shall disclose every year, the utilization of such funds during that **year in its Annual Report** until such funds are fully utilized.
Audit Committee Involvement	The audit committee shall mandatorily review: ➢ Quarterly statement of deviation(s) including report of monitoring agency, if applicable, submitted to stock exchange(s) in terms of Regulation 32(1). ➢ Annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

(CNO--ACCG.220) SUBSIDIARY (QNO - 434.250 / 434.260)

Chart



Continue on next Page...



Non-executive Directorship -Age Requirement

Corporate governance requirements with respect to subsidiary of listed entity:

- **At least one independent director** on the board of directors of the listed entity shall be a director on the board of directors of an **unlisted material subsidiary,** incorporated in India.

  ("Material subsidiary" shall mean a subsidiary, whose income or net worth exceeds 20 percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

- **Explanation** -The listed entity shall formulate a policy for determining 'material' subsidiary.)

- The audit committee of the listed entity shall also **review the financial statements, in particular, the investments made by the unlisted subsidiary.**

- The **minutes of the meetings** of the board of directors of the unlisted subsidiary shall be placed at the meeting of the board of directors of the listed entity.

- The management of the unlisted subsidiary shall periodically bring to the notice of the board of directors of the listed entity, a statement of **all significant transactions and arrangements entered into by the unlisted subsidiary.**

  Explanation-For the purpose of this regulation, the term "significant transaction or arrangement" shall mean any individual transaction or arrangement that exceeds or is likely to **exceed ten percent of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the unlisted material subsidiary for the immediately preceding accounting year.**

- A listed entity shall not dispose of shares in its material subsidiary resulting in reduction of its shareholding (either on its own or together with other subsidiaries) to less than or equal to 50% or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting except in cases where such divestment is made under a scheme of arrangement arrangement duly approved by a Court/Tribunal.

duly approved by a Court/Tribunal, or under a resolution plan duly approved under section 31 of the Insolvency Code and such an event has been disclosed to the recognized stock exchanges within one day of the resolution plan being approved.

- Selling, disposing and leasing of assets amounting to more than **twenty percent of the assets of the material subsidiary on an aggregate basis during a financial year shall require prior approval of shareholders by way of special resolution,** unless the sale/disposal/lease is made under a scheme of arrangement duly approved by a Court/Tribunal.
- Where a **listed entity has a listed subsidiary,** which is itself a holding company, the provisions of this regulation shall apply to the listed subsidiary in so far as its subsidiaries are concerned.
- The company shall **formulate a policy for determining 'material' subsidiaries** and such policy shall be disclosed on the company's website and a web link thereto shall be provided in the Annual Report.

CLARIFICATION ON % CONTRIBUTION OF MATERIAL UNLISTED SUBSIDIARY

Regulation 16 Clause (c)(which deals with definition) says it is exceeding 10%

Below is the text

(c) "material subsidiary" shall mean a subsidiary, whose income or net worth exceeds [ten] percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

But Regulation 24 (1) which talks about Corporate Governance of Subsidiary says that for this regulation it will be exceeding 20%

Please see text below

Corporate governance requirements with respect to subsidiary of listed entity.

24. [(1) At least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, whether incorporated in India or not.

Explanation – For the purposes of this provision, notwithstanding anything to the contrary contained in regulation 16, the term "material subsidiary" shall mean a subsidiary, whose income or net worth exceeds twenty percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.]

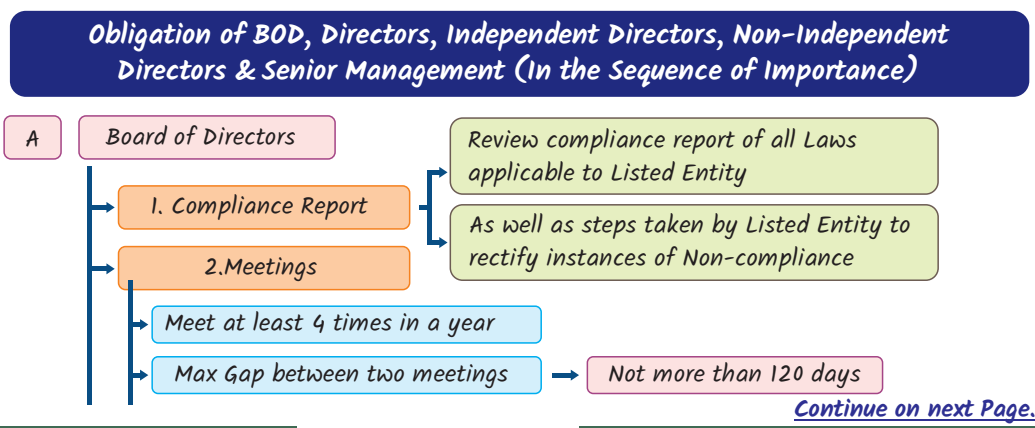
Final Conclusion

It will 10% for all regulations of LODR except in case 24(1) it will be considered 20%.

So, for appointment of independent director at material subsidiary it will be 20% and for other points it will be 10%.

(CNO--ACCG.300) OBLIGATIONS WITH RESPECT TO EMPLOYEES INCLUDING SENIOR MANAGEMENT, KEY MANAGERIAL PERSONS, DIRECTORS AND PROMOTERS (QNO-434.100)

Chart



Continue on next Page...

- Meet at least 4 times in a year
- Max Gap between two meetings → Not more than 120 days
- Quorum for Top 2000 Listed Entities → 1/3rd of Total strength or 3 Directors w.e. higher (Including at least .1 Independent director)
  - Participation by video conferencing / other audio visual means → Shall also be Counted for Quorum
- 3. Succession Plan → Ensure that plans are in place for orderly succession of Board & Senior Management

B Independent Directors

- Meeting
  - Atleast one meeting in FY without presence of non-independent Director and member of management.
  - All ID's should try to attend
- Liable for acts of Omissions / Commissions by Co. if
  - Occurred with his knowledge, Attributable through Board process & with his Consent / Connivance (Security allow illegal acts)
  - Not acted diligently with respect to LODR Regulations
- Director & Officer Insurance (DOI)
  - It is insurance to cover Personal liability arising due to wrong act of director or officer while managing company
  - Applicable to top 1000 Cos.by Mkt. Cap. and HVD's
  - For all independent director, quantum and risk will be determined by BOD
- Time to replace Independent Director → If ID has resigned / removed
  - Shall be replaced within 3 months

AMENDMENT

Note: If even after resignation, Company is fulfilling the requirement of Independent director then Above Provision for replacement of new ID will not be applicable

C → Directors → Max limit on Membership & Chairmanship of Committees

- A Director can be
  - Member — Max 10 committees
  - Chairperson — Max 5 committees

*NOTE: Committees for this subclause includes only "Audit Committee" and Stake holder relationship committee

: For purpose of Calculation of Limit

Included	Excluded
All Public Limited Companies (Whether Listed or Not)	Foreign Co's.
	HVDs
	Pvt Limited Co's.
	Sec 8 Co's.

D Senior Management → Shall disclose to the Board all Material Financial & Commercial Transactions

- Where there is a conflict of Interest with company

Senior Manager Disclosure	Senior management shall make disclosures to the board relating to **all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large** (for E.g. dealing in company shares / commercial dealings with bodies, which have shareholding of management and their relatives etc.)
Limit on memberships & Chairmanships of committees (Can also cover maximum directorship requirement)	A director shall not be a member in more than ten committees or act as chairperson of more than five committees across all listed entities in which he /she is a director which shall be determined as follows: (a) the limit of the committees on which a director may serve in all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies, **high value debt listed entities** and companies under Section 8 of the Companies Act, 2013 shall be excluded; (b) for the purpose of determination of limit, chairpersonship and membership of the audit committee and the Stakeholders' Relationship Committee alone shall be considered
BOD Meetings (MCQ-AC.5)	➢ The Board **shall meet at least four times a year,** with a maximum time gap of one hundred and twenty days between any two meetings. ➢ The **quorum** for every meeting of the board of directors of the top 1,000 listed entities and of the top 2,000 listed entities with effect from April 1, 2020 shall be **one-third of its total strength or three directors, whichever is higher, including at least one independent director.** ➢ The participation of the directors by **video conferencing** or by other audio-visual means shall also be counted for the purposes of such quorum.
Review Compliance Reports	The Board shall periodically review compliance reports of all laws applicable to the listed entity, prepared by the listed entity as well as steps taken by the listed entity to rectify instances of non-compliances.
Liability of Independent Director	An independent director shall be held liable, only in respect of such acts of omission or commission by the listed entity which had **occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently** with respect of the provisions contained in the LODR Regulations.
Time to replace independent director	An independent director who resigns or is removed from the Board of Directors of the listed entity shall be replaced by a new independent director at the earliest but not later than the **three months from the date of such vacancy.** Provided that where the listed entity fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.
Meeting of ONLY Independent Directors	The independent directors of the listed entity shall hold at least one meeting in a financial year, without the presence of non-independent directors and members of the management and all the independent directors shall strive to be present at such meeting
Succession of BOD / Senior Management	The Board of Directors of the listed entity shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management.
D & O Insurance Requirement	➢ Top 1000 listed entities by market capitalization calculated as on March 31 of the preceding financial year, shall undertake Directors and Officers insurance (D and O insurance) for all their independent directors of such quantum and for such risks as may be determined by its board of directors. ➢ A 'high value debt listed entity' shall undertake Directors and Officers insurance (D and O insurance) for all its independent directors for such sum assured and for such risks as may be determined by its board of directors

(CNO--ACCG.320) MANAGEMENT DISCUSSION AND ANALYSIS (QNO-433.000) (MCQ - Incs.12.5)

Chart

MANAGEMENT DISCUSSION & ANALYSIS (MDA)

Part of BOD Report → Co should incorporate MDA as part of Directors Report / as an addition to Director's Report

↓

Which is ultimately included in Annual Report

MATTERS WHICH ARE COVERED IN MDA

Shortcut – **SOFT** discussion with **RISHI** for Management Discussion & Analysis

- **S** – **S**egment wise or product wise performance
- **O** – **O**utlook (Future of Economy & Industry)
- **F** – **F**inancial performance with respect to operational performance
- **T** – Opportunities & **T**hreats [For business Units in Economy]
- **R** – **R**isks & Concerns [for Entities & its departments] specific & quantified
- **I** – **I**ndustry structure & development (past year)
- **S** – **S**ignificant changes in key financial ratios along with detailed explanation [change of 25% or more will be considered as significant]
  - (1) Assets in Numerator → Current Ratio
  - (2) Liability in Numerator → Debt-Equity Ratio
  - (3) Profit in Numerator
    - Operating Profit Margin (%)
    - Net Profit Margin (%)
    - Return on Networth (Any change needs explanation)
    - Interest Coverage Ratio
  - (4) Sales in Numerator
    - Inventory Turnover Ratio
    - Debtor Turnover Ratio
- **H** – Major Development in **H**uman Resources / Industrial relation front
- **I** – **I**nternal Control system & their adequacy

DISCLOSURE OF ACCOUNTING TREATMENT

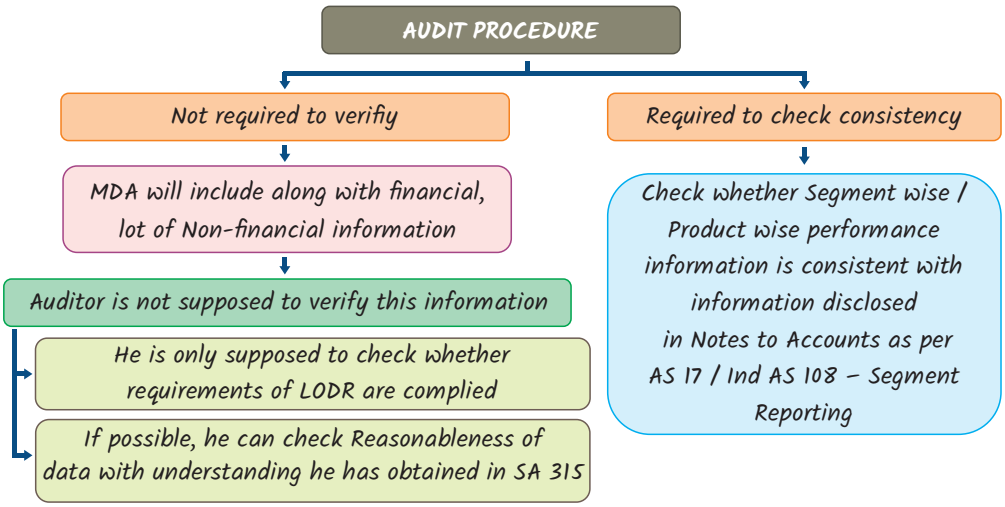
If there is a Non-Compliance of Accounting Standards

↓

Details should be explained in FST along with explanation

↓

Also same should be incorporated in MDA



Addition to BOD Report

As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion &Analysis should include discussion on the following matters within the limits set by the company's competitive position:

Matters to be Covered

SOFT Discussion with **RISHI**^{2} in Management Discussion & Analysis

- **S**egment-wise or product-wise performance
- **O**utlook (Future of economy & industry)
- Discussion on **F**inancial performance with respect to operational performance
- Opportunities and **T**hreats (At Macro Level)

- **R**isks and concerns (At Micro Level)
- **I**ndustry structure and developments (Past Year)
- details of **S**ignificant changes (i.e change of 25% or more as compared to the immediately previous financial year) in key financial ratios, along with detailed explanations there for, including:
  - Details of any change in Return on Net Worth as compared to the immediately previous financial year along with a detailed explanation thereof
  - Current Ratio
  - Debtors Turnover
  - Inventory Turnover
  - Debt Equity Ratio
  - Operating Profit Margin (%)
  - Net Profit Margin (%) or sector-specific equivalent ratios, as applicable.
- Material developments in **H**uman Resources / Industrial Relations front, including number of people employed. (HR Function in company)
- **I**nternal control systems and their adequacy (ICS in Company)
- **I**nterest Coverage Ratio

Disclosure of Accounting Treatment:

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the **fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction.**

Don't verify just check compliance, Useful for understanding Entity

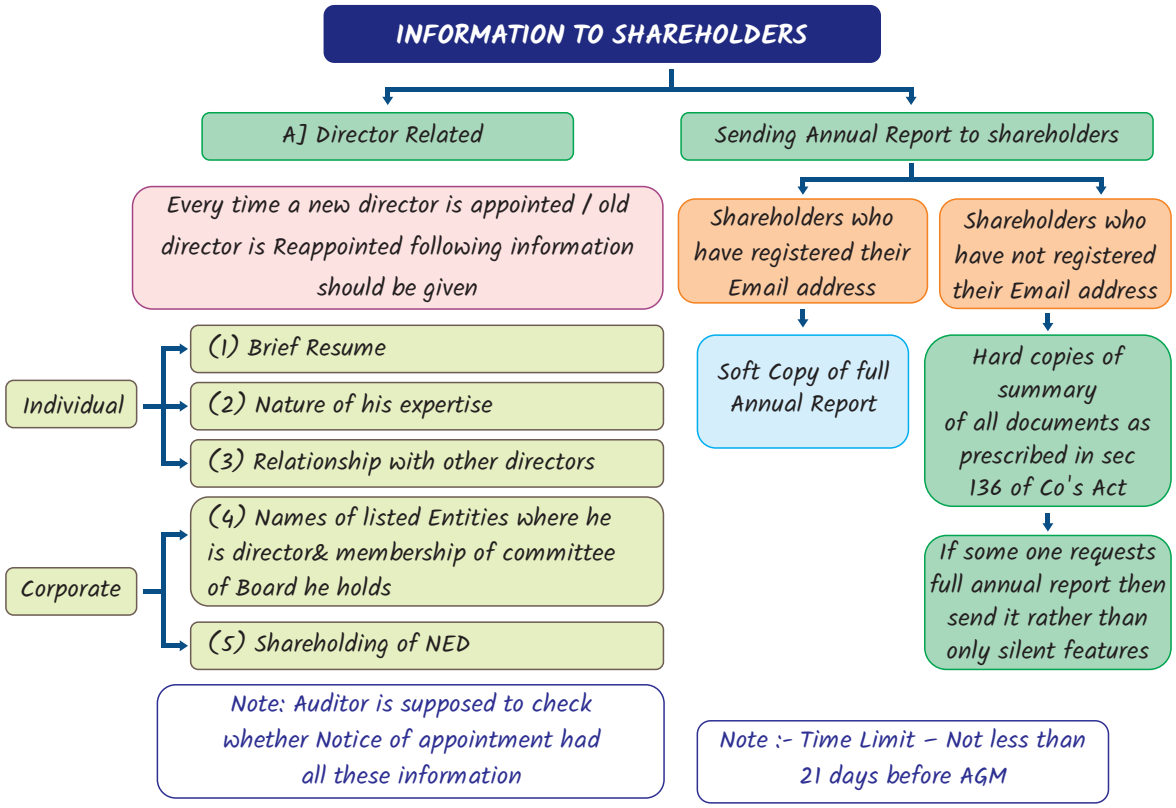
The above information presented by the management is likely to include non-financial information, which may be outside the auditor's area of expertise. In such situations, the auditor may keep in mind SA 315 relating to "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment" and the **fact that he is only required reviewing the compliance with disclosure requirements and not verifying the particular facts as disclosed by the management.**

Consistent with reporting in Financial Statements

The auditor should ascertain that the segment-wise or product-wise performance (sub-clause (c) as stated above) is **consistent with what is reported in financial statements** complying with AS 17(Segment Reporting)/ Indian Accounting Standard 108 (Operating Segments) and also as per provisions of Section 133, 134 and 143 of the Companies Act, 2013.

(CNO--ACCG.340) INFORMATION TO SHAREHOLDERS (QNO-433.010)

Chart



AMENDMENT

1. Also give details of listed entities from person resigned in past 3 year
2. In case of NED also include beneficial holding
3. In case of ID how skills & capabilities meet requirement of role

In case of the **appointment of a new director or re-appointment of a director** the shareholders must be provided with the following information:

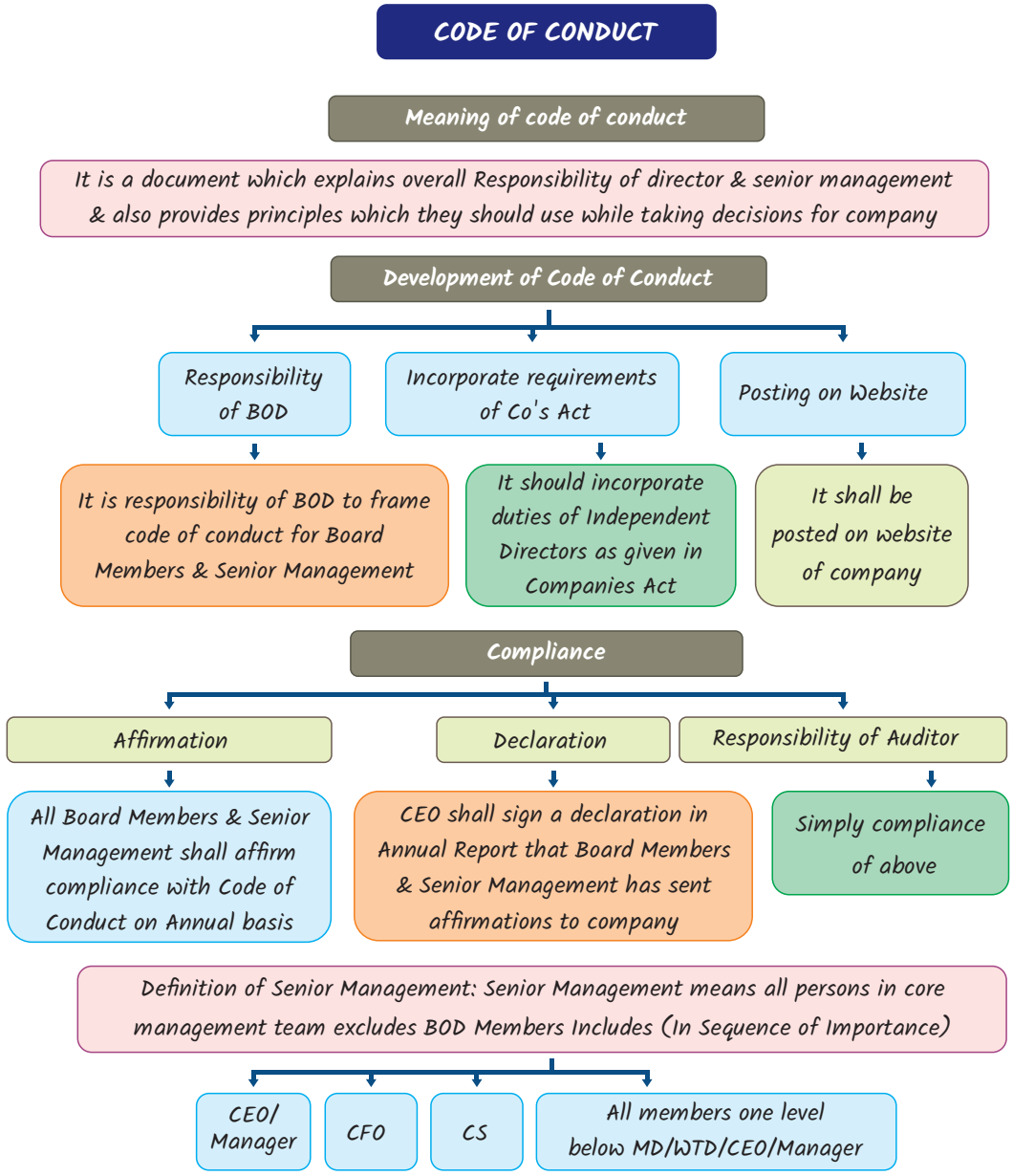
- A **brief resume** of the director;
- Nature of his **expertise** in specific functional areas;
- Disclosure of **relationships between directors inter-se;**
- Names of **listed entities in which the person also holds the directorship and the membership of Committees of the Board;** and
- **Shareholding of non-executive directors.**

The **auditor should ascertain** from the communications sent, whether in the case of appointment of a new director or re-appointment of a director, the shareholders have been provided with the information stipulated above.

The listed entity shall send the soft copy of the full annual report to the shareholders who have registered their email address(es) or hard copies of the salient features of all the documents, as prescribed in section 136 of the Companies Act, 2013 or rules made thereunder (unless the full annual has been specifically requested) where the email address has not been registered, not less than twenty-one days before the annual general meeting.

(CNO--ACCG.360) CODE OF CONDUCT (QNO-432.000 /433.020)

Chart



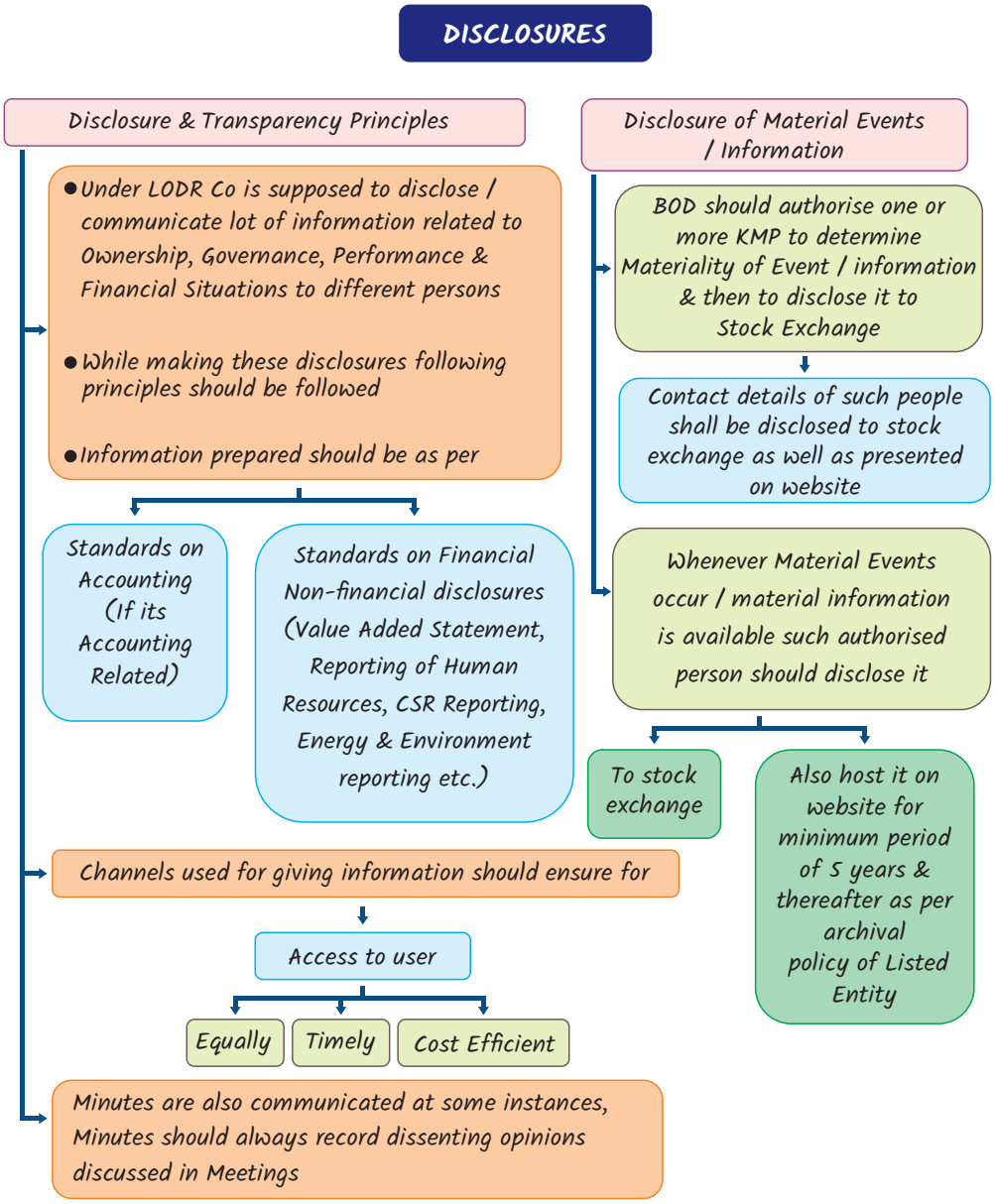
Responsibility of BOD & SM	The Board shall lay down a code of conduct for all Board members and senior management of the listed entity.
Incorporate Companies Act	The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013. *
Posting on Website	The code of conduct shall be posted on the website of the company.
Compliance	All Board members and senior management personnel shall affirm compliance with the code on an annual basis.
Declaration by CEO	The Annual Report of the company shall contain a declaration to this effect signed by the CEO.
Senior Management	For this purpose, the term "senior management" shall mean personnel of the listed entity who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below chief executive officer/managing director/whole time director/manager (including chief executive officer/manager, in case they are not part of the board) and shall specifically include company secretary and chief financial officer.

Responsibility of Auditor

The auditor should ascertain whether the Board of Directors of the company has laid down a Code of Conduct for all Board members and senior personnel of the company and obtain a copy of the same. He should also verify whether all Board members and senior management personnel have affirmed compliance with the code on an annual basis and whether the code has been posted on company's website.

(CNO--ACCG.440) MANNER OF DISCLOSURES

Chart



Principles to be followed

The listed entity shall **ensure timely and accurate disclosure** on all material matters including the financial situation, performance, ownership, and governance of the Listed entity, in the following manner:

(a) Information shall be prepared and disclosed in accordance with the **prescribed standards of accounting, financial and non-financial disclosure.**

(b) Channels for disseminating information should provide for **equal, timely and cost efficient access to relevant information by users.**

© Minutes of the meeting shall be maintained **explicitly recording dissenting opinions,** if any

Disclosure of events or information [Regulation 30(1), (5) (8)]

- **Disclosure of Material Events or Information**
  Every listed entity shall make disclosures of any events or information which, in the opinion of the board of directors of the listed company, is material.
- **Authorising KMP**
  Board of directors of the listed entity shall authorize one or more Key Managerial Personnel for the purpose of determining materiality of an event or information and for the purpose of making disclosures to stock exchange(s) under this regulation and the contact details of such personnel shall be also disclosed to the stock exchange(s) and as well as on the listed entity's website.

- **Website Hosting of Material Events or Information**

  Such disclosures shall be hosted on the website of the listed entity for a minimum period of five years and thereafter as per the archival policy of the listed entity, as disclosed on its website.

(CNO--ACCG.420) SECRETARIAL AUDIT AND SECRETARIAL COMPLIANCE REPORT OF LISTED ENTITY AND ITS MATERIAL UNLISTED SUBSIDIARIES

Chart

	SECRETARIAL AUDIT	SECRETARIAL COMPLIANCE REPORT
Applicability	To Listed Entity & its Material unlisted subsidiary incorporated in India	Only to listed entity
Who will conduct	Company Secretary in Practice	Same
Where to disclose	Annex it with Annual Report & send to shareholder	With in 60 days from the end of FY, send it to stock exchange
Coverage	Examines compliance of all the laws, rules, regulations applicable to company	Examines compliance of SEBI Act, Regulation & Guidelines, etc.

Secretarial Audit (MCQ-AC.10)

Every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex a secretarial audit report given by a company secretary in practice, in such form as specified, with the annual report of the listed entity. (Covers all the Laws applicable to Company, gets more time & it is sent to Shareholders along with annual report.)

Secretarial compliance report

Every listed entity shall submit a secretarial compliance report in such form as specified, to stock exchanges, within sixty days from end of each financial year. (Covers only SEBI Act, Regulations etc gets only 60 Days & it is sent to Stock Exchange)

(CNO--ACCG.460) SEXUAL HARASSMENT (QNO - 433.030)

Chart

SEXUAL HARASSMENT

Disclosure in Annual Report

- Complaints filed
- Complaints disposed
- Complaints pending

Disclosure in Annual Report

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

a. number of **complaints filed** during the financial year

b. number of **complaints disposed** of during the financial year

c. number of **complaints pending** as on end of the financial year

(CNO--ACCG.400) LIMITED REVIEW OF THE AUDIT OF ALL THE ENTITIES WHOSE ACCOUNTS ARE TO BE CONSOLIDATED WITH THE LISTED ENTITY

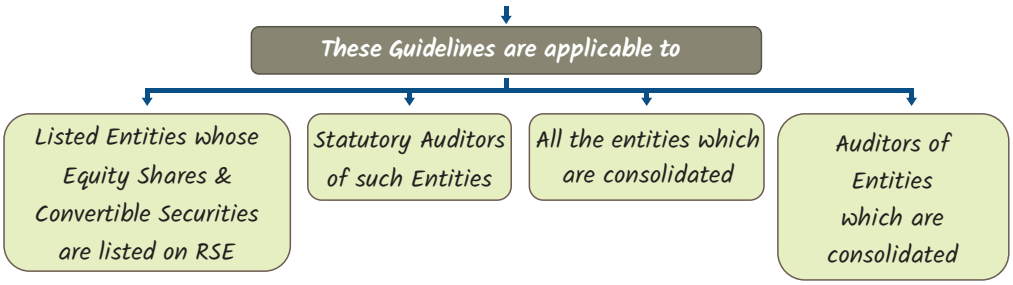
Chart

LIMITED REVIEW OF AUDIT REQUIREMENT

Statutory Auditor of listed entity should perform limited review of Audits of all the Entities which are consolidated with the Listed Entity as per AS / Ind AS

SEBI has issued Guidelines on how to Conduct such Limited Review of Audits

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Responsibility of Statutory Auditor

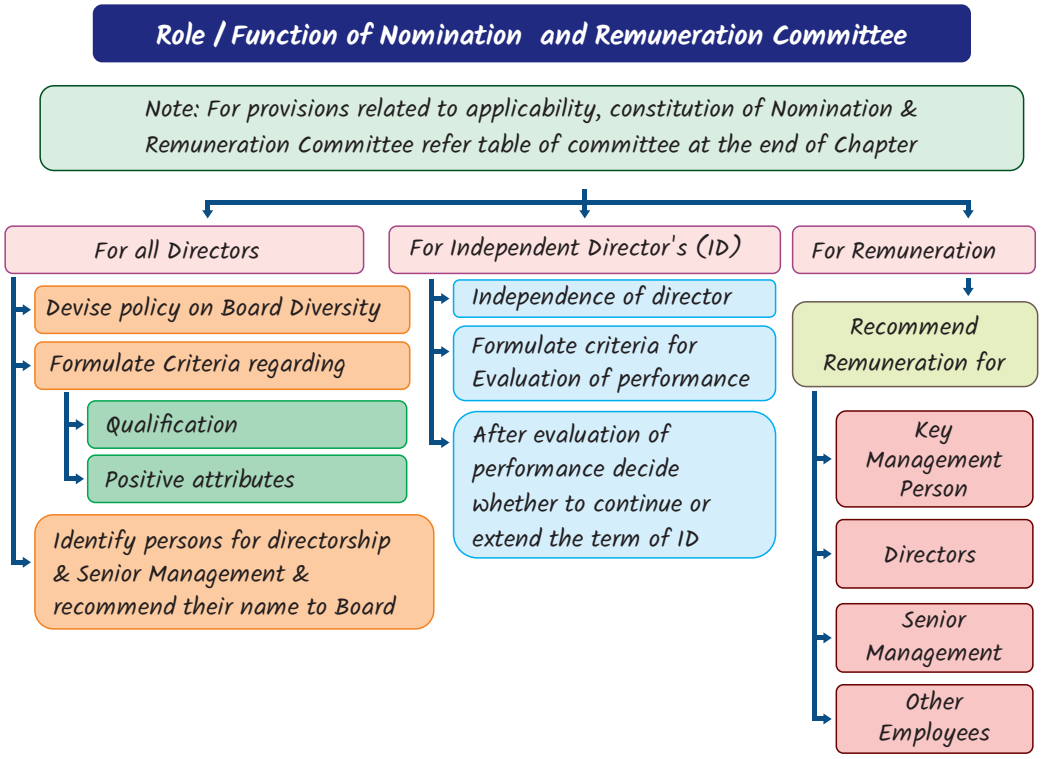
The **statutory auditor** of a listed entity shall undertake a **limited review of the audit** of all the entities/companies whose accounts are **to be consolidated** with the listed entity as per AS / IndAS in accordance with guidelines issued by SEBI on this matter

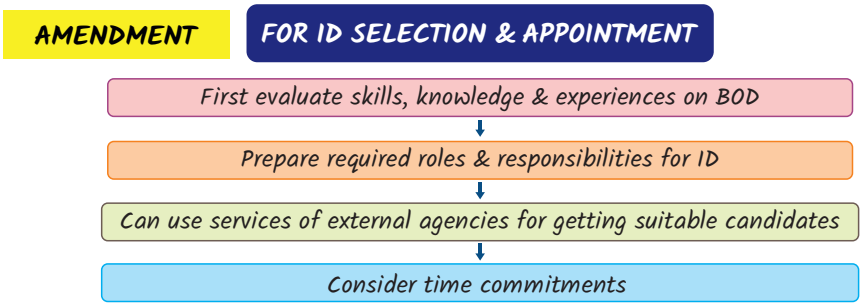
Applicability of guidelines by SEBI

- all **listed entities** whose equity shares and convertible securities are listed on a recognised stock exchange,
- the **statutory auditors** of such entities,
- all entities whose accounts are **to be consolidated** with the listed entity and the **statutory auditors of entities** whose accounts are to be consolidated with the listed entity

(CNO--ACCG.480) NOMINATION AND REMUNERATION COMMITTEE (QNO - 434.400/434.150)

Chart





(I) Constitution, Composition& Meetings

Mandatory for	The Board of Directors of **every listed public** company shall constitute the Nomination and Remuneration Committee
Compositions of Committee	It shall comprise of **at least three directors, all of whom shall be non-executive directors and at least 2/3 shall be independent directors.** Chairperson of the committee shall be an independent director.
Who can & who cannot become chairperson?	**Chairperson** of the committee **shall be an independent director** and it may be noted that the **Chairperson of the company (whether executive or nonexecutive)** may be appointed as a **member** of the Nomination and Remuneration Committee **but shall not chair such committee.**
Chairperson of the NRC to answer shareholders queries	The **Chairperson of the Nomination and Remuneration Committee may be present** at the **Annual General Meeting**, to **answer the shareholders' queries.** However, it would be up to the **Chairperson to decide who shall answer the queries**.
Minimum number of meetings	The nomination and remuneration committee **shall meet at least once in a year.**
Quorum	The **quorum** for a meeting of the nomination and remuneration committee **shall be either two members or one third of the members of the committee, whichever is greater, including at least one independent director in attendance.**

(II) Role of Committee

The role of such committee shall, inter-alia, include the following:

- Nomination Related
  - Devising a policy on **Board diversity;**
  - Formulation of the **criteria** for determining qualifications, positive attributes and independence of a director and
  - **Identifying persons** who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal;
  - Formulation of criteria for **evaluation of performance** of independent directors and the Board of Directors;
  - whether to **extend or continue** the term of appointment of the independent director, on the basis of the report of performance evaluation of independent directors.

- **Remuneration Related**
  - **recommend** to the Board of Directors a policy, relating to the remuneration of the **directors, key managerial personnel and other employees;**
  - **recommend to** the board, all remuneration, in whatever form, payable to **senior management.**

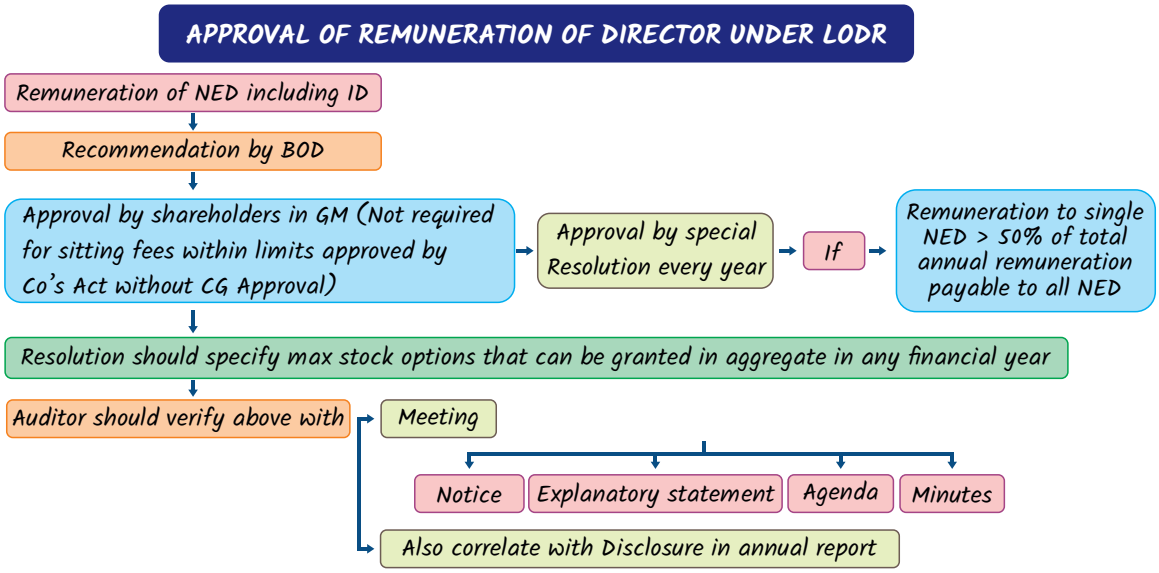
(CNO--ACCG.490) REMUNERATION OF DIRECTORS [PART C OF SCHEDULE V] (QNO - 434.160)

Disclosure to be given in annual report

Disclosure requirements regarding directors' remuneration are stated below:

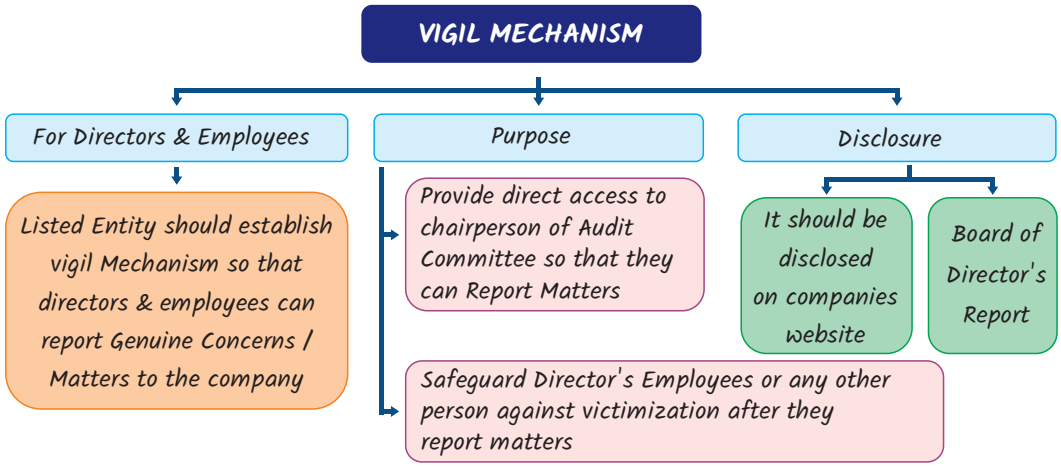
- All pecuniary relationship or transactions of the non-executive directors vis-à-vis the listed entity shall be disclosed in the Annual Report.
- Criteria of making payments to non-executive directors. Alternatively, this may be disseminated on the listed entity's website and reference drawn thereto in the annual report.
- In addition to the disclosures require
- d under the Companies Act, 2013, the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report:
  - All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc.
  - Details of fixed component and performance linked incentives, along with the performance criteria.
  - Service contracts, notice period, severance fees.
  - Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable

Chart



(CNO--ACCG.500) VIGIL MECHANISM [REG 22, 46 & PART C OF SCHEDULE V] (QNO- 434.300)(MCQ – Incs.15.1)

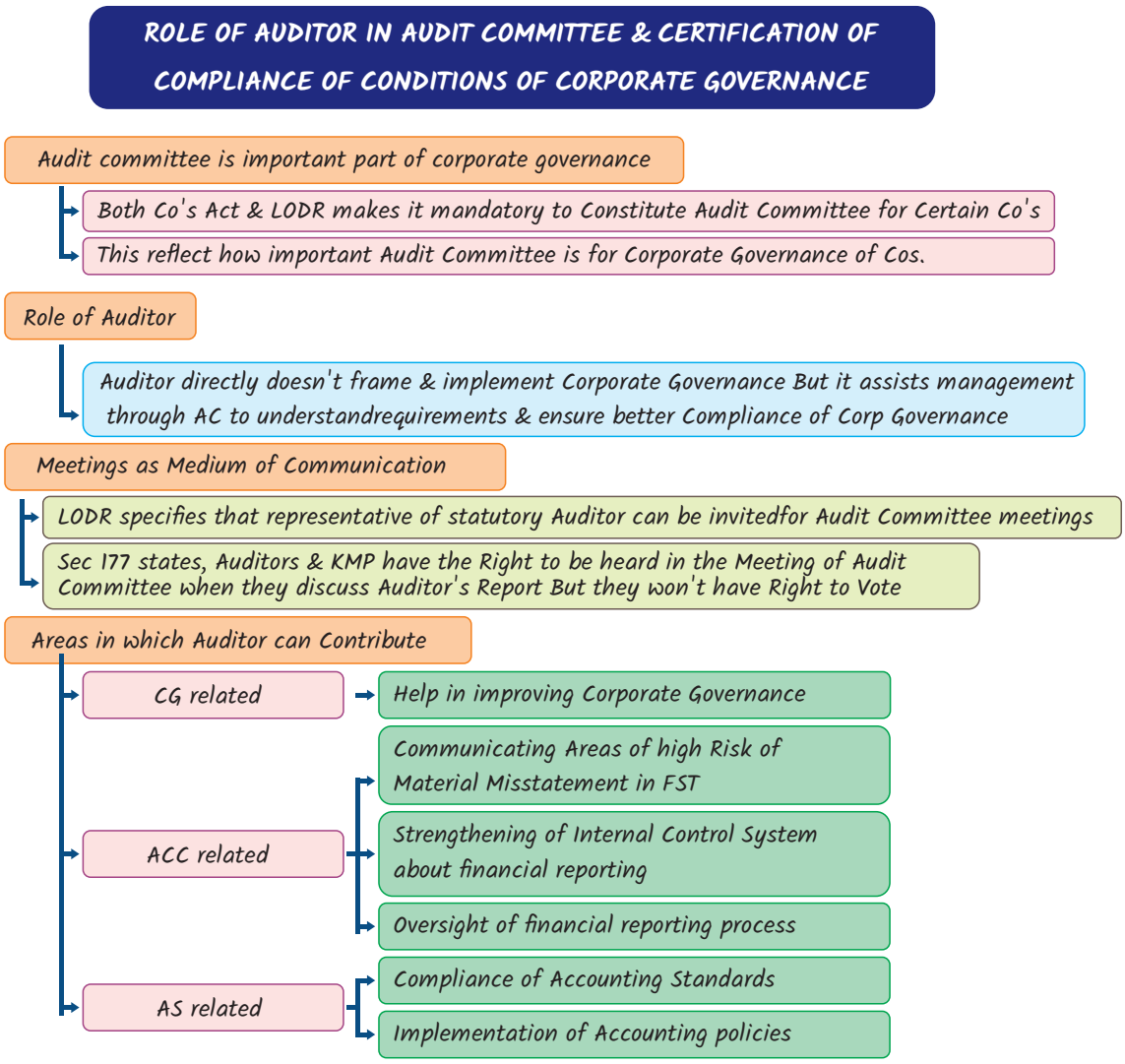
Chart



- The **listed entity** shall **establish a vigil mechanism** for directors and employees to report genuine concerns.
- This mechanism should also provide for **adequate safeguards against victimization** of director(s) / employee(s) or any other person **who avail the mechanism** and also **provide for direct access to the chairperson** of the Audit Committee in appropriate or exceptional cases.
- The details of establishment of such mechanism shall **be disclosed by the company on its website** and in the Board's report.

(CNO--ACCG.380) ROLE OF AUDITOR IN AUDIT COMMITTEE AND CERTIFICATION OF COMPLIANCE OF CONDITIONS OF CORPORATE GOVERNANCE (QNO-429.000)

Chart



Importance of Audit Process

The LODR Regulations as well as the Companies Act, 2013 in respect of the constitution of Audit Committee underline the importance of audit process and its contribution to the corporate governance process.

Attending AC Meetings

Regulation 18 (1) (f) stipulates that a representative of the statutory auditor, when required, shall be invited to the meetings of the Audit Committee. Similarly, Section 177 of the Companies Act, 2013 provides the auditors of a company and the key managerial personnel the right to be heard in the meetings of the Audit Committee when it considers the auditor's report, but they shall not have the right to vote

Communic-ation with AC

The auditor must ensure that he communicates frequently and openly with the Audit Committee on key accounting or auditing issues that, in the auditor's judgment, give rise to a greater risk of material misstatement of the financial statements, and ensure that he addresses any questions or concerns voiced by the Audit Committee. He can contribute significantly in assisting and advising the Audit Committee on improving corporate governance, oversight of financial reporting process, implementation of accounting policies and practices, compliance with accounting standards, strengthening of the internal control systems about financial reporting and reporting processes.

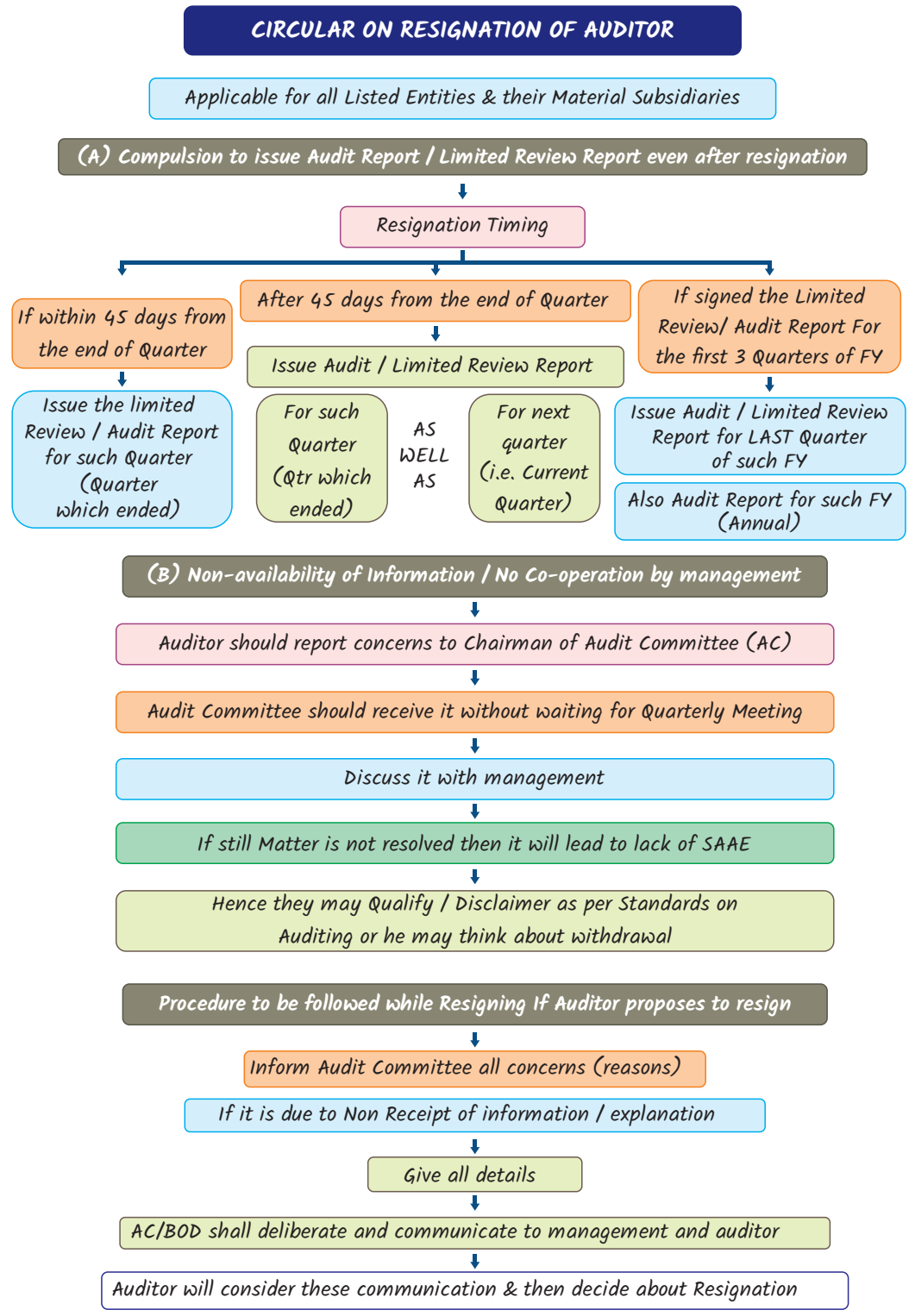
Assisting Management & AC

The auditor must devote substantial professional time in assisting the management and the Audit Committee to enable them to discharge their functions effectively and in certification of the requirements of corporate governance.

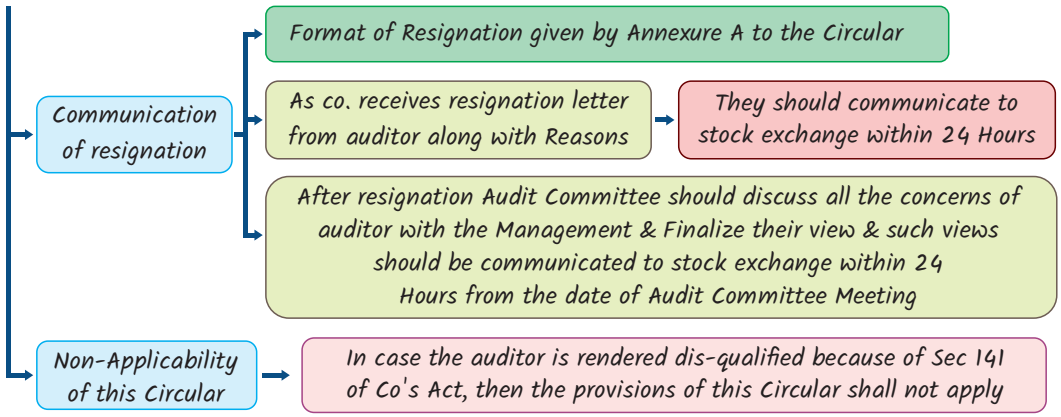
The auditor has to keep in mind that his role is not to drive corporate governance directly. Rather, it is the management's responsibility to do so and, in the process, he should play a significant role in assisting management to ensure better standards of corporate governance.

(CNO--ACCG.520) SEBI CIRCULAR ON RESIGNATION OF AUDITOR (MCQ – Incs.23.1)

Chart



Continue on next Page...



Existing LODR Requirements

- **Disclosure to stock exchange, resignation of auditor within 24 hours**
  As per LODR detailed reasons to be disclosed by the listed entities to the stock exchanges in case of resignation of the auditor of a listed entity as soon as possible but not later than 24 hours of receipt of such reasons from the auditor.

(CNO--ACCG.540) Conditions on Resignation (Content of Circular)

In light of the above, the conditions to be complied with upon resignation of the statutory auditor of a **listed entity / material subsidiary** w.r.t. limited review / audit report as per SEBI LODR Regulations, are as under:

PART A (Compulsion to issue audit / review report) (QNO-434.500/ 434.600)

- **All listed entities/material subsidiaries shall ensure compliance with the following conditions while appointing/re-appointing an auditor:**
  - If the auditor resigns **within 45 days from the end of a quarter** of a financial year, then the auditor shall, before such resignation, **issue the limited review/ audit report for such quarter.**
  - If the auditor resigns **after 45 days from the end of a quarter** of a financial year, then the auditor shall, before such resignation, **issue the limited review/ audit report for such quarter as well as the next quarter.**
  - Notwithstanding the above, if the auditor has **signed the limited review/ audit report for the first three quarters of a financial year,** then the auditor shall, before such resignation, **issue the limited review/audit report for the last quarter of such financial year as well as the audit report for such financial year.**

PART B (Resignation if there is non-receipt of information)

- Other conditions relating to resignation shall include:
  - **Reporting of concerns** with respect to the listed entity/its material subsidiary to the Audit Committee:
    - In case of any concern with the management of the listed entity/material subsidiary such as **non-availability of information /non-cooperation by the management** which may hamper the audit process, the auditor shall approach the **Chairman of the Audit Committee** of the listed entity and the Audit Committee shall receive such concern directly and immediately **without specifically waiting for the quarterly Audit Committee meetings.**
  - **Disclaimer in case of non-receipt of information:** In case the listed entity/ its material subsidiary does not provide information required by the auditor, to that extent, **the auditor shall provide an appropriate disclaimer in the audit report, which may be in accordance with the Standards of Auditing as specified by ICAI/NFRA.**
  - In case the **auditor proposes to resign,**
    - all concerns with respect to the proposed resignation, along with relevant documents shall be brought to the **notice of the Audit Committee.** In cases where the proposed resignation is **due to non-receipt of information I explanation** from the company, the auditor shall inform the Audit Committee of the details of information I explanation

sought and not provided by the management, as applicable.

- On receipt of such information from the auditor relating to the **proposal to resign** as mentioned above, the **Audit Committee I board of directors,** as the case may be, shall **deliberate on the matter and communicate its views to the management and the auditor.**

- **Inclusion in Engagement Letter**
  The listed entity/ material subsidiary shall ensure that the conditions as mentioned in Part A and Part B above are **included in the terms of appointment of the statutory auditor at the time of appointing/re-appointing the auditor.** In case the auditor has already been appointed, the terms of appointment shall be **suitably modified to give effect to Part A and Part B above.**

- **Certification by Company Secretary**
  The **practicing company secretary shall certify** compliance by a listed entity with Part A and Part B above in the annual secretarial compliance report.

Part C (Format / Audit Committee's Views / Co-Operation)

(MCQ – Incs.38.3)

- Obligations of the listed entity and its material subsidiary:

  - **Format of information to be obtained from the statutory auditor upon resignation:**
    Upon resignation, the listed entity/its material subsidiary shall obtain information from the Auditor in the format as specified in **Annexure A to this Circular. The listed entity shall ensure disclosure of the same** to stock exchange within 24 hours.

  - **Disclosure of Audit Committee's views to the Stock Exchanges:**
    Upon resignation of the auditor, the **Audit Committee shall deliberate** upon all the concerns raised by the auditor with respect to its resignation as soon as possible, but not later than the date of the next Audit Committee meeting and communicate its views to the management. **The listed entity shall ensure the disclosure of the Audit Committee's views to the stock exchanges as soon as possible but not later than 24hours after the date of such Audit Committee meeting.**

  - **Co-operation by listed entity and its material subsidiary:**
    During the period from when the auditor proposes to resign till the auditor submits the report for such quarter /financial year as specified above, the listed entity and its material subsidiaries shall continue to provide all such documents/information as may be necessary for the audit I limited review.

Miscellaneous (QNO-434,700) (MCQ – Incs.23.2)

- **Power of SEBI to Issue Circular**
  The Circular is issued in exercise of the powers of the SEBI Act, 1992 read with regulations of the SEBI LODR Regulations and shall be in addition to the provisions of Companies Act, 2013.
- **Responsibility of Stock Exchange**
  The **Stock Exchanges are advised to bring the provisions of this circular** to the notice of all listed entities and their material subsidiaries and also disseminate it on their websites.
- **If No AC then BOD**
  In case an **entity is not mandated to have an Audit Committee, then the board of directors** of the entity shall ensure compliance of this circular.

- **Non-Applicability of this Circular**
  In case the auditor is rendered disqualified due to operation of any condition mentioned in Section141oftheCompaniesAct,2013,then the provisions of this Circular shall not apply.

TABLE ON COMMITTEES

	Committee Name	RISK MANAGEMENT COMMITTEE	AUDIT COMMITTEE		STAKEHOLDERS RELATIONSHIP COMMITTEE	NOMINATION & REMUNERATION COMMITTEE (NRC)
			Co's Act Sec 177	LODR		
	Applicability	Top 1000 & HVDs Listed Entity	Sec 177	LODR	LODR	Listed Public Company
Members	Chairman	Member of BOD	——	Independent Director Present at AGM	NED Present at AGM	ID be present at AGM Chairman of Co cannot chair this Committee He may become member of NRC
	Minimum directors	Minimum 3	Min 3	Min 3	Min 3	Min 3
	ID/ Majority	- Majority from BOD - At least 1 ID	Majority ID	2/3rd – ID	At least 1 ID	All NED
	Other Points	Senior Executive can become member	Majority be able to read FST (Incl Chairman)	All financially literate 1 Expert CS-Secretary	——	2/3 Independent
	Effect of Superior Right Equity Shares	2/3rd Members should be Independent Directors	——	All ID	2/3rd ID	——
	Meetings	- At least twice in a year - Gap not more than 180 days	—— ——	Min 4 times Gap not be more than 120 Days	At least once in a year	At least once in a year
	Quorum	-1/3 or 2 member whichever is higher -At least 1 member of BOD	——	1/3rd or 2 whichever higher 2 ID's	——	1/3rd or 2 whichever higher At least 1 ID
	Important Functions	-Risk mgt plan -Cyber security -Seek info	Ref chart on functions of Audit Committee u/s 177	Ref chart on role of Audit Committee as per LODR	Ref chart on Stake holder relationship committee	Ref chart on NRC
	Power	-Obtain legal advice -Secure attendance of outside expert -Investigate matters in Ac's domain				

Note :-(1) Top 1000
-Risk mgt commitee
-1 independent Women Director
-D&O Insurance (HUDs)

Note :-(2) Top 2000
-Minimum 6 Directors
-Quorum requirement for BOD meeting 1/3rd as 3 Director (1 ID)

UNIQUE QUESTION	
QNO-430.600	Independent Director - Case Study on Share Holding
QNO-434.010	Independent Director (Case Study)

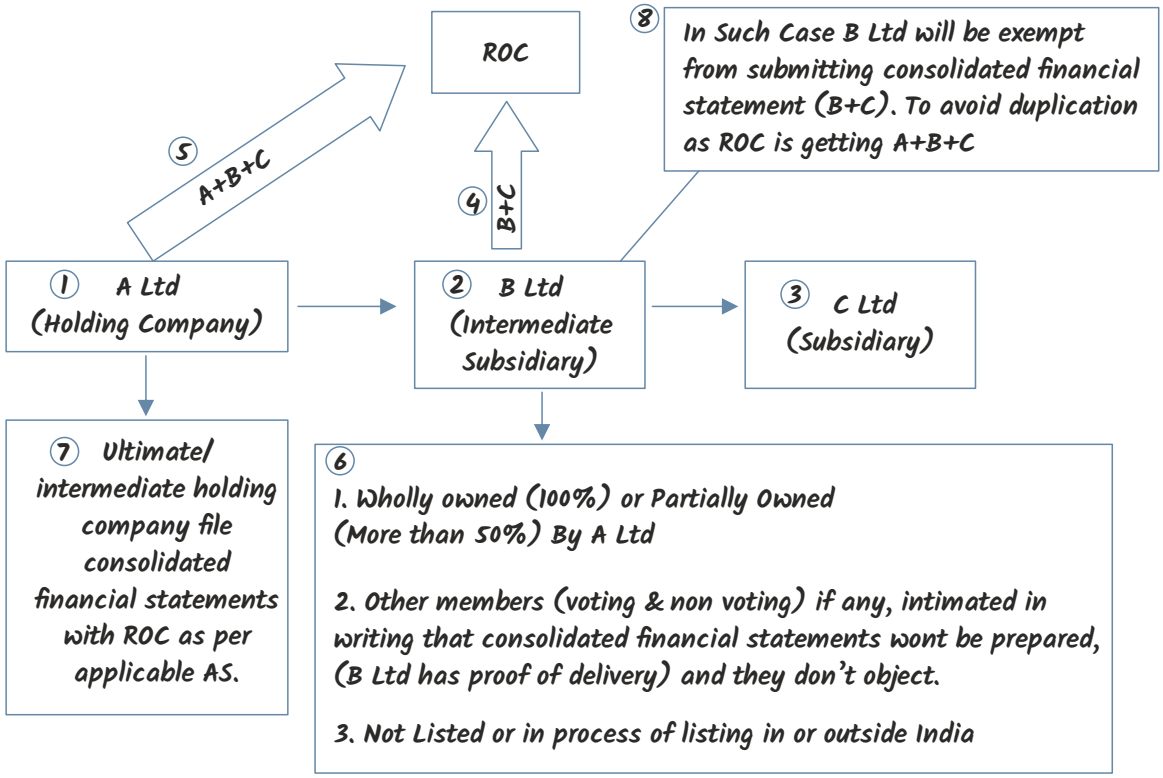
UNIQUE MCQ	
MCQ	AC.11

08 AUDIT OF CONSOLIDATED FINANCIAL STATEMENTS

(CNO--CFS.020) CONSOLIDATION UNDER COMPANY ACT 2013 (QNO-435.000 / 436.400/437.000)

(MCQ-CFS.13 ,Incs.03.4 / Incs.16.4 / Incs.29.1)

Compulsory Consolidation	According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.
Mutatis Mutandis	Further, section 129(4) of the said Act, provides that the provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to the consolidated financial statements.
Approval	The Consolidated financial statements shall also be approved by the board of directors before they are signed on behalf of the board, along with its own financial statements and shall also be laid before the annual general meeting of the company along with the laying of its own financial statement.
Exemption Under Company's Act	But following exemptions were granted as per Rule 6 Company (Accounts) Rule 2014. Consolidation is not applicable Amended exemption regarding wholly owned / partially owned subsidiary



Exemption Under AS (QNO-436.000 QNO-436.100 QNO-436.200 QNO-436.300)

- AS-21, gives two exemption from consolidation.
  - Temporary Holding
  - Restriction on repartrition of funds

  But IND-AS 110, does not gives above two exemptions.So consolidation will be required as per IND-AS 110, even in above two points are applicable.
- IND-AS 110 gives exemptions in folowing cases
  - Investment entities
  - Intermediary Subsidiaries(provided all conditions are satisfied)
  - Employee benefit plans covered under IND-AS 19

If the question is silent about whether the answer should be as per AS or IND AS ,it is advisable that answer should be provided per both .

Investment Entity

- An investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.
- An investment entity is an entity that:
  - obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
  - commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
  - measures and evaluates the performance of substantially all of its investments on a fair value basis.
- However, as per paragraph 33 of Ind AS 110, parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

What if no consolidation?

Requirement of Schedule III if no consolidation is done is as follows

An entity shall disclose the list of subsidiaries or associates or joint ventures which have not been consolidated in the consolidated financial statements along with the reasons of not consolidating.

Even if no consolidation is done following should be done for all subsidiaries

- As per Sec 129 Attach along with its financial statement, a separate statement containing the **salient features of the financial statement of its subsidiary** or subsidiaries in such form as may be prescribed **(FORM AOC 1)**
- As per Sec 136 provided also that every company having a subsidiary or subsidiaries shall, — (Here subsidiary means only subsidiary not associate & JVs)
  - Place **separate audited accounts in respect of each of its subsidiary on its website,** if any;
  - Provide **a copy of separate audited financial statements in respect of each of its subsidiary, to any shareholder** of the company who asks for it.

De facto control

De facto control means an investor with less than majority of the voting rights has the practical ability to direct the relevant activities unilaterally.

Consolidation is required in case of de facto control also.

(CNO--CFS.040) RESPONSIBILITY OF PARENT (QNO-440.000)

Responsibility

The responsibility for the preparation and presentation of consolidated financial statements, among other things, is that of the management of the parent. This includes:

- identifying components, and
- obtaining accurate and complete financial information from components; and

- GAAP conversion, where applicable.
- harmonization of accounting policies and accounting framework; and.
- including the financial information of the components to be included in the consolidated financial statements;
- making appropriate consolidation adjustments.
- where appropriate, identifying reportable segments for segmental reporting;
- identifying related parties and related party transactions for reporting;

Instructions to Component

Apart from the above, the parent ordinarily issues instructions to the management of the component specifying the parent's requirements relating to financial information of the components to be included in the consolidated financial statements. The instructions ordinarily cover the accounting policies to be applied, statutory and other disclosure requirements applicable to the parent, including the identification of and reporting on reportable segments, and related parties and related party transactions, and a reporting timetable.

(CNO--CFS.060) RESPONSIBILITY OF AUDITOR

Responsibilities under Companies Act is Same

Section 129(4) of the Companies Act, 2013 requires that the provisions of this Act applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, apply to the consolidated financial statements.

Besides other matters, the principal auditor of the consolidated financial statements is responsible for expressing an opinion on whether the consolidated financial statements are prepared, in all material respects, in accordance with the financial reporting framework under which the parent prepares the consolidated financial statements in addition to reporting on the additional matters as required under the Companies Act, 2013 and any other statute to the extent applicable. (For example, reporting on Sec 143 / IFCR)

Objectives of Auditor (QNO-440.050)

Therefore, the auditor's objectives in an audit of consolidated financial statements are:

(a) Express Opinion

to enable himself to **express an opinion** on the true and fair view presented by the consolidated financial statements.

(b) Compliance of FRF

to satisfy himself that the consolidated financial statements have been prepared in accordance with the **requirements of applicable financial reporting framework;**

(c) Sec 143(1)

to enquire into the matters as specified in **section 143(1)** of the Companies Act, 2013; and.

(d) Sec 143(3)

to report on the matters given in the **clauses (a) to (i) of section 143(3)** of the Companies Act, 2013; for other matters under **section 143(3)(j) read with rule 11 of the Companies (Audit and Auditors) Rules, 2014,** to comment on the matters specified in sub-rule (a),(b) and (c)2 to the extent applicable.

Follow SA / GN

Standards on Auditing, Statements and Guidance Notes on auditing matters issued by the Institute of Chartered Accountants of India apply in the same manner to audit of consolidated financial statements as they apply to audit of separate financial statements. It means that the auditors, while conducting the audit of consolidated financial statements are, inter alia, expected to:

- **plan their work** to enable them to conduct an effective audit in an efficient and timely manner;
- obtain an **understanding of the accounting and internal control systems** including IT system like consolidation tool, sufficient to plan the audit and determine the nature, timing and extent of his audit procedures. Such an understanding would help the auditors to develop an effective audit

approach;

- use **professional judgement to assess audit risk and to design audit procedures** to ensure that the risk is reduced to an acceptable level; etc.

(CNO--CFS.080) PERMANENT CONSOLIDATION ADJUSTMENTS (QNO-438.000) (MCQ – CFS.15/ Incs.09.1/ Incs.57.4)

Definition

Permanent consolidation adjustments are those adjustments that are made **only on the first occasion or subsequent occasions in which there is a change in the shareholding of a particular entity** which is consolidated. Permanent consolidation adjustments are:

- Determination of **goodwill or capital reserve** as per applicable accounting standards.
- Determination of amount of **equity attributable to minority/ no controlling interests**

Preacquisition Reserves

The auditor should verify that the above calculations have been made appropriately. The auditor should pay particular attention to the determination of **pre-acquisition reserves of the components. Date(s) of investment** in components assumes importance in this regard. The auditor should also examine whether the pre-acquisition reserves have been **allocated appropriately between the parent and the minority interests/ non-controlling interests** of the subsidiary. The auditor should also verify the changes that might have taken place in these permanent consolidation adjustments on account of **subsequent acquisition of shares in the components, disposal of the components in the subsequent years.**

(CNO--CFS.100) CURRENT PERIOD CONSOLIDATION ADJUSTMENTS (QNO-439.000) (MCQ-CFS.2/CFS.3/CFS.5/CFS.6/CFS.10/CFS.11)

Current period adjustments are those adjustments that are made in the accounting period for which the consolidation of financial statements is done. Current period consolidation adjustments primarily relate to elimination of intra-group transactions and account balances including:

- **Foreign Component**
  In case of a foreign component, adjustments to convert a component's audited financial statements prepared under the component's local GAAP to the GAAP under which the consolidated financial statements are prepared.
- **GAAP Adjustment**
- **Harmonising accounting policy**
  adjustments related to harmonising the different accounting policies being followed by the parent and its components;

- **Intra group income / expense**
  intra-group interest paid and received, or management fees, etc.;

- **Stock Reserve**
  unrealised intra-group profits on assets acquired/ transferred from/ to other subsidiaries;

- **Deferred Tax**
  adjustments of deferred tax on account of temporary differences arising out of elimination of profit and losses resulting from intra group transactions and undistributed profits of the component in case of consolidated financial statements prepared under Ind AS.

- **Intra group balances**
  intra-group indebtedness;

- **Subsequent Events**
  adjustments to the financial statements (of the parent and the components being consolidated) for recognized subsequent events or transactions that occur between the balance sheet date and the date of the auditor's report on the consolidated financial statements of the group.

There are two types of subsequent events:

- ***Adjusting Events***
  The first type of subsequent events consists of events or transactions that provide additional evidence about conditions that existed at the date of the financial statements, including the estimates inherent in the process of preparing financial statements (i.e. adjusting events).
- ***Non-Adjusting Events***
  The second type of subsequent events consists of events that provide evidence about conditions that did not exist at the date of the financial statements but arose subsequent to that date (i.e. non-adjusting events).

Events occurring after balance sheet date which do not require adjustments would not normally require disclosure, although they may be of such significance that they may require a disclosure in the report of approving authority in the case of accounting standards and in the financial statements in case of Ind AS. For such events, the following shall be disclosed:

- *The nature of the event; and*
- *An estimate of its financial effect or a statement that such an estimate cannot be made.*
- *adjustments for the effects of significant transactions or other events that occur between the date of the components balance sheet and not already recognised in its financial statements and the date of the auditor's report on the group's consolidated financial statements when the financial statements of the component to be used for consolidation are not drawn up to the same balance sheet date as that of the parent;*

- ***Minority Interest***
  determination of movement in equity attributable to the minority's interest/non-controlling interest since the date of acquisition of the subsidiary.

(CNO--CFS.110) REVIEWING THE MEMORANDUM RECORDS

Discussion

- *The adjustments required for preparation of consolidated financial statements are made in memorandum records kept for the purpose by the parent. The auditor should review the memorandum records to verify the adjustment entries made in the preparation of consolidated financial statements.*
- ***Apart from reviewing the memorandum records, the auditor should inter alia:***
  - *verify that the intra group transactions and account balances have been eliminated;*
  - *verify that the consolidated financial statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances;*
  - *verify that adequate disclosures have been made in accordance with AS 21 in the consolidated financial statements of application of different accounting policies in case, it was impracticable to harmonize them. Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so4 but while preparing CFS under Ind AS, auditors should ensure that appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies in accordance with Ind AS 110;*
  - *verify the adjustments made to harmonise the different accounting policies including adjustments made by management to convert a component's financial statements prepared under the component's GAAP to the GAAP under which the consolidated financial statements are prepared;*
  - *verify the calculation of minorities/non-controlling interest;*
  - *verify adjustments relating to deferred tax on account of temporary differences arising out of elimination of profit and losses resulting from intergroup transactions (where the parent's accounts are maintained in Ind AS);*

- verify that income and expenses of the subsidiary are included in consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary and further such income and expenses are based on the amounts of the assets and liabilities recognised in consolidated financial statements at the acquisition date.

(CNO--CFS.115) MANAGEMENT REPRESENTATIONS

Discussion

- SA 580, "Written Representations" requires the auditor to obtain written representations from management and, where appropriate, those charged with governance. The auditor of the consolidated financial statements should obtain evidence that the management of the parent acknowledges its responsibility for a true and fair presentation of the consolidated financial statements in accordance with the financial reporting framework applicable to the parent and that parent management has approved the consolidated financial statements. In addition, the auditor of the consolidated financial statements obtains written representations from parent management on matters material to the consolidated financial statements.
- **Examples of such representations include:**
  - Completeness of components included in the CFS;
  - Identification of reportable segments for segmental reporting;
  - Identification of related parties and related party transactions for reporting;
  - Appropriateness and completeness of permanent and current period consolidation adjustments, including the elimination of intra-group transactions.

(CNO--CFS.120) REPORTING (QNO-443.000) (MCQ-CFS.4 / CFS.14/ Incs.07.6)

(a)Parents Auditor = Auditor of all Components

While drafting the audit report, the auditor should report whether Principles / procedures for preparation / presentation is as per accounting standard.

In case of any departure or deviation, the auditor should make adequate disclosure in the audit report so that users of the consolidated financial statements are aware of such deviation.
Auditor should issue an audit report expressing opinion whether the -consolidated financial statements, (at b/s date)

-consolidated profit and loss statement (during the year)
-cash flow (if prepared)
give a true and fair view of the state of affairs of the Group.

(b)Parents Auditor not Same as component auditor

The auditor of the CFS should consider the requirement of SA 600.
As per SA 706-
if the auditor considers it necessary to make reference to the audit of the other auditors i.e. considers it material, the auditor's report on the CFS should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s).

This may be done by stating in aggregate:
Rs or % of total assets, revenues and cash flows of components included in the CFS not audited by the parent's auditor.

Above should be presented before giving effect to permanent and current period consolidation adjustments.
Reference in audit report of CFS that part of the audit of the group was made by other auditor(s) is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors of the parent and its components.

c)FRF of component is different from FRF of Parent (QNO-439.010)

The parent may have components located outside India applying an accounting framework (GAAP) that is different than that of the parent in preparing its FST.

When a component's FST are prepared under an accounting framework that is different than that of the framework used by the parent in preparing group's CFS , the parent's management perform a conversion of the components' audited FST from the framework used by the component to the framework under which the CFS are prepared.

The conversion adjustments are audited by the principal auditor to ensure that the financial information of the component(s) is suitable and appropriate for the purposes of consolidation.
A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual.

Group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. The local component auditor can then audit and issue an audit report on the components financial statements prepared in accordance with "group accounting policies".

When applying this approach of, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's financial statements.
This ensures that the information will be directly usable and relevant for the preparation of CFS by the parent entity, eliminating the need for auditing by the auditor, the differences between the basis used for the component's financial statements and that of the consolidated financial statements.
The Principal auditor can then decide whether or not to rely on the components' audit report and make reference to it in the auditor's report on the consolidated financial statements.

d)Auditing Framework used by component auditor is different from parent's auditor

Audits of FST, including CFS, are performed under auditing standards generally accepted in India ("Indian GAAS"). In order to maintain consistency of the auditing framework and to enable the parent auditor to rely and refer to the other auditor's audit report in their audit report on the CFS, the components' FST should also be audited under a framework that corresponds to Indian GAAS.

e)Financial Statements of component not audited.

Where the FST of one or more components continue to remain unaudited, the auditor reporting on the CFS should consider unaudited components in evaluating a possible modification to his report on the CFS.
The auditor should evaluate both qualitative and quantitative factors on the possible effect of such amounts remaining unaudited when reporting on the consolidated financial statements using the guidance provided in SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

(CNO--CFS.140) CHECKING COMPLETENESS OF THE COMPONENTS IN CONSOLIDATION (QNO 443.050)

Audit Procedures

- The auditor should obtain a listing of all the components included in the consolidated financial statements and review the information provided by the management of the parent identifying the components. The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion
  - In respect of completeness of this information, the auditor should perform the following procedures:
    - review his working papers for the prior years for the known components.
    - review the parent's procedures for identification of various components.
    - make inquiries of the management to identify any new components or any component which goes out of consolidated financial statements.
    - review the investments of parent as well as its components to determine the

shareholding in other entities.

- review the joint ventures and joint arrangements as applicable.
- review the other arrangements entered into by the parent that have not been included in the consolidated financial statements of the group.
- review the statutory records maintained by the parent, for example registers under section 186, 190 of the Companies Act, 2013.
- Identify the changes in the shareholding that might have taken place during the reporting period.

(CNO--CFS.160) RELEVANCE OF SA 600 IN AUDIT OF CONSOLIDATION (QNO - 442.000, 442.500)

Discussion

- Standard on Auditing SA 600, 'Using the Work of Another Auditor' establishes standards when an auditor, reporting on the financial statements of an entity (the group—in the case of consolidated financial statements), uses the work of another auditor on the financial information of one or more components included in the financial statements of the entity (Paragraph 2 of SA 600). The principal auditor, if he decides to use the work of another auditor in relation to the audit of consolidated financial statements, should comply with the requirements of SA 600.

- In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis. However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following:
  - The auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS.
  - The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components, and consider using the work of other auditors as applicable.
  - The principal auditor also computes materiality for each component and communicates to the component auditor, if he believes is required for true and fair view on CFS.
  - The principal auditor also obtains certain confirmations from component auditor like independence, code of ethics, certain information required for consolidation and disclosure requirements etc.

- However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the principles of SA 600 needs to be considered. ICAI issued an announcement dated May 25, 2017 which amended paragraph 17 of Guidance Note and states that while considering the observations (for instance modification and /or emphasis of matter/other matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the parent auditor should comply with the requirements of SA 600, "Using the Work of Another Auditor". Therefore, the concept of materiality would be considered while considering the observations of the component auditor.

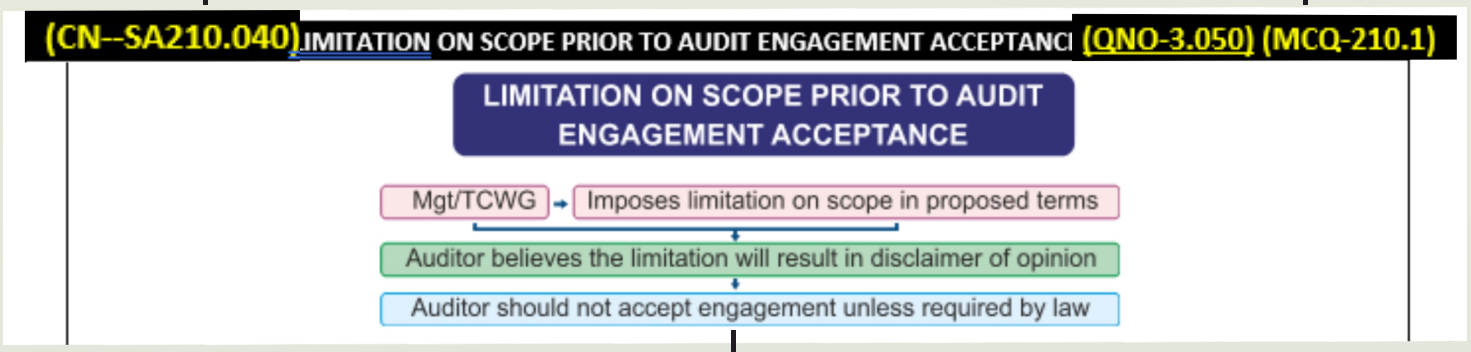
UNIQUE QUESTIONS	
QNO-437.000	Control Over Composition of Board
QNO-437.500	Planning Audit of Consolidated Financial Statements
QNO-443.060	Including only relevant Notes to accounts of Standalone FST in consolidated FST
QNO-444.000	AS 21 (Losses in Subsidiary)

UNIQUE MCQS	
MCQ No	CFS.1
MCQ No	CFS.7
MCQ No	CFS.8
MCQ No	CFS.12
MCQ No	Incs.16.2 / Incs.16.3 / Incs.36.2 / Incs.36.3

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