



Quality Controls in Auditing

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Care, Pair, and Share

KNOWLEDGE THAT MATTERS. EXPERIENCE THAT COUNTS.

Agenda

Regulators' Perspective

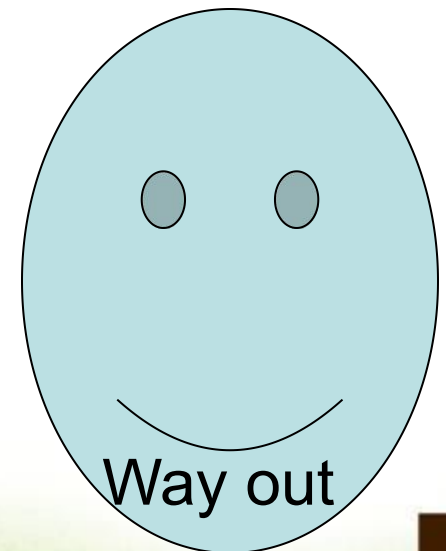
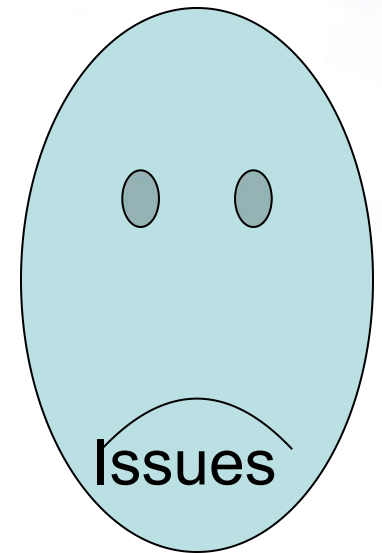
- Peer Review,
 - Quality Review Board,
 - Financial Reporting Review Board,
 - NAFRA, SFIO, etc.
-

Regulators for Chartered Accountants

- The ICAI
 - Quality Review Board (QRB)
 - Financial Reporting Review Board (FRRB)
 - Disciplinary Committee (DC)
 - Peer Review
 - Registrar of Companies
 - Serious Fraud Investigation Office (SFIO)
 - SEBI
 - National Financial Reporting Authority (NAFRA)
 - Economic Offences Wing (EOW)
 - Central Bureau of Investigation (CBI)
 - Enforcement Directorate (ED)
 - Reserve Bank of India
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Scope of Presentation

- Reporting Requirements – Basics.....
- Fundamentals of AS
- Audit Manual
- Important sections concerning audit
- Audit Documentation – General Approach
- Audit Documentation – Way Forward
- Discussion on Regulators



Reporting Requirements

Basics.....



Auditors' Report

The Companies Act 1956	Description	The Companies Act 2013 - Chapter X 139 to 148
Section 227(2)	Deals with B/S., P&L, other Docs.	Section 143 (2)
Section 227(3)	Addnl. Information (a) to (g) vs. (a) to (j)	Section 143 (3)
Section 227(4)	Qualifications, etc. - Reasons	Section 143 (4)
Section 227(1A)	Inquiries	Section 143 (1)
Section 227(4A)	Order – CARO 2003	Section 143 (11)
-	Fraud Reporting	Section 143 (12)
-	Auditing Standards	Section 143 (9)

The Companies Act 2013

- Section 139 – Appointment of auditors.
 - Section 140 - Removal, resignation of auditor and giving of special notice.
 - Section 141 - Eligibility, qualifications, and disqualifications of auditors.
 - Section 142 – Remuneration of auditors.
-

The Companies Act 2013

- Section 143 - Powers and duties of auditors and auditing standards.
 - Section 144 - Auditor not to render certain services.
 - Section 145 - Auditor to sign audit reports, etc.
 - Section 146 - Auditors to attend general meeting.
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The Companies Act 2013

- Section 147 – Punishment for contravention.
- Section 148 – Central Government to specify audit of items of cost in respect of certain companies.

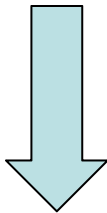
Fundamentals on AS and others

- Standards by ICAI
 - Standards by MCA
 - Guidance Notes of the ICAI
 - Standards on Auditing
-

Fundamentals

- Standards by ICAI
- Standards by MCA
 - AS Rules 2006 – December 7, 2006
 - AS (Amendment) Rules 2016
 - Ins AS Rules 2016

– IND AS



The Income-tax Act 1961
ICDS

Levels

- Level 1
 - Level 2
 - Level 3
-
- 

Level - I

- ✓ **Listed/Proposed to be listed Cos**
- ✓ **Banks, FIs, Insurance Cos**
- ✓ **Enterprises with > 50 crores Turnover in preceding year**
- ✓ **> 10 crores borrowings at any time during the year**
- ✓ **Holding & subsidiary Cos of above.**

Level - II

- ✓ **Enterprises with > One Crore but < 50 crores Turnover.**
- ✓ **> 1 crore but < 10 crores borrowings**
- ✓ **Holding & subsidiary cos of above.**

Level - III

- ✓ **Other than Level - I & Level - II cases**

AS Rules 2006 – December 7, 2006

- Small and Medium Sized Company (SMC) means:
 - whose equity or debt securities are **not listed** or are not in the process of listing on any stock exchange, whether in India or outside India;
 - which is **not a bank, financial institution** or an insurance company;

AS Rules 2006 – December 7, 2006 – AS Rules 2014

- whose turnover (excluding other income) does not exceed **rupees fifty crore** in the immediately preceding accounting year;
- which does not have borrowings (including public deposits) in excess of **rupees ten crore** at any time during the immediately preceding accounting year; and
- which is **not a holding or subsidiary company** of a company which is not a small and medium-sized company.

General Instructions for SMCs

- SMC which does not disclose certain information pursuant to the exemptions or relaxations given.....disclose
- “The Company is a Small and Medium Sized Company (SMC) as defined in the General Instructions in respect of Accounting Standards notified under the Companies Act, 2013. Accordingly, the Company has complied with the Accounting Standards as applicable to a Small and Medium Sized Company.”

Cessation to be an SMC

- Figures for the corresponding period of the previous accounting period need not be revised
- Disclose the fact

Partial Applicability

- If an SMC opts not to avail of the exemptions or relaxations available for some standards...
- Disclose the standard(s) in respect of which it has availed the exemption or relaxation.

Others

- Law to override AS
- Materiality

Company and other Audits

- I- Pre-Audit Executions
 - II - Audit Execution
 - III - Post-Audit Executions
-

I- Pre-Audit Executions

- 1. Appointment Letter-Corporate from company
 - 2. Communication Letter with previous Auditor
 - 3. Engagement Letter-Corporate Jt. sign of company and auditor
 - 4. Permanent file Contents
-

II - Audit Execution

- 1. Knowledge of Business
 - 2. Daily worksheet
 - 3. Query Sheet
 - 4. Audit Program
-

II - Audit Execution

- 5-A. AS / SA what and when / Documentation
- 5-B. List AS-AAS-GN
- 6. AS checklist and 143 (1) [227(1A)] inquiries -
Memoranda
 - Inquiries
 - CARO Control
 - AS Contol
 - Cash flow Contol
 - IFS Contol
 - Final Checklist



II - Audit Execution

- 7. AS control checklist
- 8. CARO Checklist
- 9. Company law checklist
- Current Working File.....



III - Post-Audit Executions

- 1. Current file Contents
 - 2. Management Representation Letter
 - 3. Draft Annual Report
 - 4. Audit-record to be maintained by firm for ICAI Regulations
-

Inquiries under section 143 (1)

- Are loans and advances made by the Company covered by any security of the parties? If yes, are such loans and advances prejudicial to interest of the Company or its members.
- The Transactions that are represented merely by book entries have in fact taken place and are not prejudicial to the interests of the Company?

Inquiries under section 143 (1)

- If the Company is not an investment company or banking company, whether the investments in shares, debentures, or securities are sold at loss?
- Are loans and advances made by the Company shown as deposits?

Inquiries under section 143 (1)

- Are personal expenses of directors or employees been charged to revenue account, other than that payable under contractual obligations or in accordance with generally accepted business practice and legitimate business needs?
- In respect of shares allotted for cash, has the Company actually received cash? The position as stated in the balance sheet is correct and not misleading?

Small Companies



Exemptions to Small Companies

- 2 (40) – “financial statements”

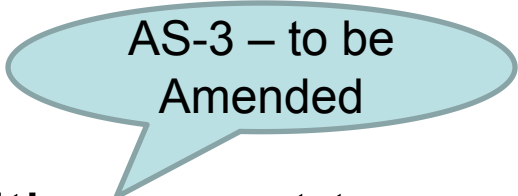
- (i) *a balance sheet;*

- (ii) *a profit and loss account,*

- (iii) *cash flow statement for the financial year;*

- (iv) *a statement of changes in equity, if applicable;*

- (v) *any explanatory note annexed to,*



AS-3 – to be Amended

- Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement

Small Companies

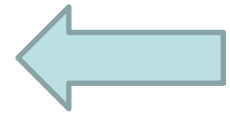
- Section 2 (85) of the Companies Act 2013
- “small company” means a company, other than a public company,—
 - (i) ***paid-up share capital*** of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than **Ten crore rupees**; **and**
 - (ii) ***turnover*** of which **as per profit and loss account for the immediately preceding financial year** does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

Small Companies

- 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;*

Small Companies

- Not a Public Company
- Paid Up Capital RS. 50 Lac – RS. 20 Crore
- Turnover RS. Two Crore – RS. 100 Crore
- Holding – Subsidiary
- Section 8 Company
- Company formed under a Special Act



Turnover – 2 (91) of the Companies Act 2013

Old definition

- “turnover” means the aggregate value of the realisation of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year

New Definition

- “turnover” means the **gross amount of revenue recognised** in the **profit and loss account** from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year

• **Indirect Taxes?**

Revenue

- Total revenue disclosed in Schedule III to the Companies Act 2013.
- Other income
- Revenue from discontinuing operations

Free Reserves [2(43)]

- Such reserves which as per latest audited BS are available for distribution of dividend.

- Provided that:

any amount representing unrealised gains, notional gains or revaluation of assets (whether shown as reserve or otherwise)

Or

Any change in carrying amount of an asset or liability recognised in equity, including surplus in PL on measurement of asset or liability at fair value

Shall not be regarded as free reserves.

Implication of 'unrealised gains'? – adjustment for receivables, AS11 restatement, etc.?

Associate Company – 2 (6)

- Company in which there is Significant Influence
i.e. control of at least 20% of total share capital or
of business decisions under an agreement
- Subsidiary Company [sec 2(87)]
Controls composition of BoD Exercises or
controls more than $\frac{1}{2}$ of total share capital

Important Sections concerning audit

- Section 73 – Deposits (Loans)

- Section 135 – CSR

June 5, 2015 -
Notification

- Section 185 – Loans to Directors

185 substituted by the
Companies (Amendment)
Act 2017

- Section 186 - Limits for intercompany investments and loans

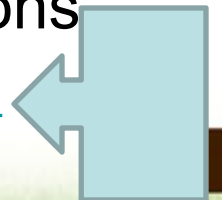
- Sec 192 - Restrictions on non-cash transactions with Directors

Auditor to report under
section 143 - the
Companies (Amendment)
Act 2017

- 197 – Managerial Remuneration

Exemption from section 185

- In case of private company - Section 185 shall not apply to a private company-
- (a) in whose share capital no other body corporate has invested any money;
- (b) if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and
- (c) such a company has no default in repayment of such borrowings subsisting at the time of making transactions under this section. - [Notification dated 5th june, 2015.](#)



Important Sections concerning audit

- Depreciation - Schedule II to the Companies Act 2013 - useful life to compute depreciation Useful life is the period over which an asset is available for use by an entity
- Residual life not to be more than 5 %
- Section 188 - Related Party Transactions
- Section 77 – Registration of Charge
- Section 129 – Financial Statements - CFS

CFS

- Section 129 (3) – CFS of subsidiary
 - Subsidiary includes Associate company / JV
 - Subsidiary – 2 (87)
 - Associate Company - 2 (6)
 - AS – 23 – Consolidation of investments in Associate
 - AS -27 - [Financial Reporting of Interests in Joint Ventures](#)
-

Audit Documentation

General Approach



Why Documentation?

- Auditors increasingly being hauled up before Courts of law.
- *Self-Quality Improvement Process*:
 - Continuous self improvement
 - Self quality control
 - Inbuilt guard against complacency (A feeling of contentment or self-satisfaction, especially when coupled with an unawareness of danger, trouble, or controversy) and taking “anything for granted”.

Why Documentation? SA 230

- Existence of Big gap between the real scope of an audit and the public perception of an audit.
- Self-Defense in a Court of Law
- Evidence of Audit having been planned and performed

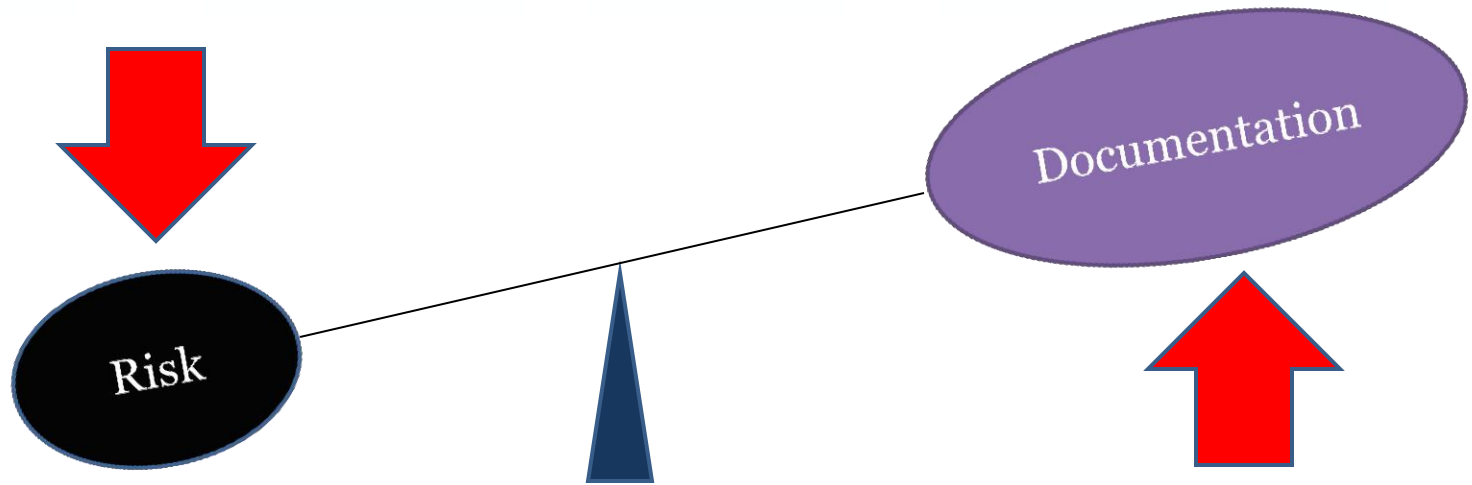
Audit Documentation



Extent of Documentation

- A matter of professional judgment
- Sufficiently complete and detailed for auditor to obtain overall understanding
- Significant matters requiring exercise of audit judgment must be included, along with auditor's conclusions

Changing attitude towards documentation



Some Principles



Specific Principles vis-à-vis - SA 700

- Identification of the financial statements audited together with date and period covered
- Statement as to responsibility of the management and the Auditor
- Performance of audit in accordance with Auditing Standards generally accepted in India

Specific Principles vis-à-vis SA 700

- Description of work performed by Auditor – test nature – reasonable assurance as to absence of material misstatement
- Assessing the accounting estimates
- Evaluating overall financial presentation
- Audit provides reasonable basis for his opinion

Report on the Financial Statements

We have audited the standalone financial statements of AMISH WIRES PRIVATE LIMITED ("the Company"), which comprise the balance sheet as at 31st March 2019, and the statement of Profit and Loss, and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid standalone financial statements give the information required by the Companies Act 2013 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 the Company as at March 31, 2019, and its profit/loss, and its cash flows for the year ended on that date.

Basis for Opinion

We conducted our audit in accordance with the Standards on Auditing (SAs) specified under section 143(10) of the Companies Act, 2013. Our responsibilities under those Standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the Code of Ethics issued by the Institute of Chartered Accountants of India together with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act 2013 and the Rules thereunder, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of Management and Those Charged with Governance for the Standalone Financial Statements

The Company's Board of Directors is responsible for the matters stated in section 134 (5) of the Companies Act 2013 ("the Act") with respect to the preparation of these standalone financial statements that give a true and fair view of the financial position, financial performance, and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the accounting Standards specified under section 133 of the Act. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding of the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Board of Directors is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those Board of Directors are also responsible for overseeing the company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report

Specific Principles – Cash System

- “It is the policy of the Assessee to prepare his financial statements on the cash receipts and disbursements basis. On this basis, revenue and the related assets are recognized when received rather than when earned, and expenses are recognized when paid rather than when the obligation is incurred. In our opinion.....”

SQC1 and Peer Review



Points

- Peer review
- What are quality controls in the context of peer review?
- Review of general controls
- Review of specific controls
 - additional procedures
- Documentation

Objectives

- To understand the quality of assurance work done by PUs
- To point out instances of weakness for the PU to remediate
- PUs in India with longstanding practices
- Several generations old – culture and traditions that are no longer in tune with the changing risk scenario in which we operate

**The Only thing Constant
in this World is.....**

Change



Change

- They must often change, who would be constant in happiness or wisdom. ~ Confucius
- When we are no longer able to change a situation, we are challenged to change ourselves. ~ Victor Frankl
- It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change. ~ Charles Darwin

...Peer review

- Help Peers to Grow vertically
- Unlearn the old and relearn the new: at any age, a CA is always a student
- You need to know before you can challenge!

Quality controls in the context of peer review

Role of controls testing in peer review

- What are controls? - preventive, detective
- Controls testing (compliance approach) v substantive testing (substantive approach)
- Controls testing methods in peer review
 - Inquiry, corroborated by inspection of documents

Types of controls in peer review

- **General controls (SQC)**
 - Quality controls at the firm level, designed to provide reasonable assurance as to the firm and its personnel comply with professional standards and regulatory and legal requirements and reports issued by the firm or engagement partner appropriate in the circumstances

- **Specific controls (SAs)**
 - Controls at the engagement level, designed to ensure that the ET plans and performs an assurance engagement in compliance with the standards on auditing or review and other regulatory and legal requirements

Review of general controls – SQC1

Change in concept of general controls

- Earlier - Five general controls –
 - Independence,
 - Maintenance of professional skills and standards,
 - Outside consultation,
 - Staff supervision and Development, and
 - office administration

Change in concept of general controls

- SQC 1 codifies all these aspects into one Quality Control Standard – mandatory w.e.f. 1st April 2009 with Six elements –
 - Leadership responsibilities for quality within the firm
 - Ethical requirements,
 - Acceptance and continuance of client relationships and specific engagements,
 - Human resources,
 - Engagement performance,
 - Monitoring

Implementation Guide on Standard on Quality Control 1

What is SQC 1?

- Q: Do SQC 1 requirements apply to all firms?
 - A: Yes

 - Q: Are there any exemptions for small firms?
 - A: No, but the nature of policies and procedures that a small firm is expected to follow may depend upon factors like its size, operating characteristics, and whether it is part of a network

 - Q: What is the peer reviewer's responsibility for this?
 - A: A peer reviewer is expected to test if the PU has complied with SQC 1 and, if not, to determine that the PU has failed in complying with general controls
-

What does SQC 1 require a firm to do?

- To establish and communicate QC policies and procedures – based on guidance provided
- To implement those standards in its day to day practice
- To monitor the implementation and effectiveness of the QC policies and procedures that it has adopted
- The peer reviewer to evaluate and report if the PU has done all of the above

Documentation and communication of QC

- QC policies and procedures must be:
 - (a) documented,
 - (b) communicated to the firm's personnel
- Such communication
 - Describes the policies and their objectives
 - Emphasizes that each individual has personal responsibility for quality and is expected to comply with the policies
 - Explains that the firm encourages its personnel to communicate their views / concerns on QC matters

1st element – Leadership responsibilities

- Tone at the top to be set for quality and its message to percolate down the line
- QC to tie in to partner / staff appraisals
- Commercial considerations must not override quality of work and reporting
- Sufficient resources devoted to develop, document and support quality control policies and procedures
- Firm's quality controller to have sufficient and appropriate experience, ability, and authority

2nd element – Ethical requirements

- Code of Ethics
 - Integrity, objectivity, professional competence and due care, confidentiality, and professional behavior
- Independence
 - **Independence Policy** to be made based on the “threats and safeguards” approach

What are “threats” to independence?

- Self-interest threat
 - Auditor could benefit from an interest
- Self-review threat
 - Auditor audits his own work
- Advocacy threat
 - Auditor promotes client’s position / opinion
- Familiarity threat
 - Relationship buys auditor’s sympathy
- Intimidation threat
 - Auditor succumbs to client’s threats

Illustrative “safeguards”

- Involving an additional advisory or reviewing partner or manager
- Rotation of partner / manager
- Discussion of independence matters with audit committee or board
- Independence confirmations from engagement team
- Removing individuals who might cause a threat; e.g. those with financial / business interests or having employment relationships

What independence policies should a PU have?

- Financial interests
 - Investments in debt / equity, making borrowings except commercially, taking insurance, giving loans, being executor/ trustee, etc.
- Employment relationships
 - Serving as officer / director, relatives in accounting / financial reporting oversight role, taking employment or being in employment negotiations
- Business relationships
 - Having business relationship or joint investment (partnership interest)

...What independence policies should a PU have?

- Long association
 - Using same partner / staff: rotation policy, cooling off period
- Gifts and hospitality
 - Accepting gifts/ hospitality unless clearly insignificant
- Fees
 - Total fees from auditee are large proportion of firm's fees, long unpaid fees (=loan), contingent fee arrangements

...What independence policies should a PU have?

- Scope of services
- Service proscribed by law (internal audit), behaving / having authority in management role, taking decisions for management, custody of auditee assets, supervising auditee's employees, preparing source documents for auditee

- Non-audit services – Illustrative SOX:
 - bookkeeping or other services related to the accounting records or financial statements of the audit client;
 - financial information systems design and implementation;
 - appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

...What independence policies should a PU have?

- Non-audit services – Illustrative SOX:

- actuarial services;
- internal audit outsourcing services;
- management functions or human resources;
- broker or dealer, investment adviser, or investment banking services;
- legal services and expert services unrelated to the audit;

...What independence policies should a PU have?

- Complying with the policies
 - Partners / staff responsible for understanding policies, provide details for independence control, systems to help compliance, consultation process, learning
- Confirming compliance
 - Annual confirmation, engagement confirmation
- Understanding consequences of non-compliance
 - Firm's disciplinary process / actions, ignorance no excuse

3rd element – Acceptance and continuance of client relationships and specific engagements

- Considerations for client acceptance / continuance
 - Evaluating client for reputation of integrity – internet media and industry searches, reputation of promoters / KMPs, related parties, any criminal antecedents
 - Background checks
 - Conflicts of interest – other clients
 - Nature of operations, business practices, industry, aggressive accounting, low fees, time pressures
 - Does firm have resources to handle work?
 - Communication with predecessor auditor
 - Does firm want to associate its name with client?

Considerations for engagement acceptance/ continuance

- o Understanding of services to be performed, knowledge and expertise, industry knowledge, quality and quantity of personnel and specialists, ability to perform within time- line, changes in client personnel, reporting requirements, scope of work, delinquency in paying fee, intimidation of team, weak internal controls, going concern

- Processes for controlling acceptance / continuance, conflict resolution and withdrawal

- o Formal approval process – client and engagement acceptance and continuance form

4th element – Human resources

- Resources possess desired characteristics
- Firm determines required capabilities / competencies – partners and personnel, assigns responsibility
- Right person on right job, right partner, effective supervision - Training
- Continuing professional education, upgradation of industry and accounting / auditing skills (including IT skills), ability to exercise professional skepticism
- Promotion criteria – technical competency and professional maturity, rather than mere seniority

5th element – Engagement performance

- Practice aids and performs engagement planning
- Selection of team, responsibilities, developing / updating background information, risk assessment and responses to risks including fraud considerations, tailored detailed audit programs, time budget, engagement planning memorandum
- Engagement performance, supervision, review, documentation, reporting, file archival
- Consistency in engagement quality (manuals), written audit programs, managing new risks, compliance with standards (checklists), documentation, consultation and resolving difference of opinion, supervision, review, engagement summary memorandum, report issuance, file assembly, back-up / archival, file retention

6th element - Monitoring

- Quality controller
- Updating policies, procedures, manuals, checklists
- Monitoring compliance with firm manuals and ethical policies, review, observations
- Annual inspection (practice review)
- Covering all general and specific controls – Firm QC inspection checklist
- Complaints and allegations
- Documentation of all elements of firm's QC system

Review of general controls – bearing on Peer Review

- A review of general controls under SQC 1 also encompasses the ‘compliance procedures’ under Review of Records
- Review of general controls -at least or more than half of the time allowed for peer review if the PU has documented policies and procedures
- Having completed this review, the peer reviewer to move directly to ‘substantive procedures’ – which essentially means ‘file review’

Duties of Peer Reviewer

- To consider if he requires to increase the sample size for selection of engagements to be reviewed substantively
- If general controls satisfactory - may reduce the sample size for file review – otherwise not to provide a “clean report” to the PU
- Peer reviewer to report general quality controls where the PU has ‘failed’ and provide his recommendations

Review of specific controls – additional procedures

What are specific controls?

- Ensure that the engagement teams uphold compliance with Laws and regulations; e.g. the Companies Act 1956, Income Tax Act, 1961, Banking Regulation Act, 1949
- Accounting standards – either of the ICAI or those prescribed under Sec 211(3C) of the Companies Act
- Standards on auditing of the ICAI
- Any other applicable standards of the ICAI; e.g. standards on review engagements

How far does review of general controls also cover specific controls?

- When testing QC for the 5th element – Engagement Performance, a reviewer may call for checklists used by PU for compliance with standards
 - Test of design = To see if the checklists, as designed, have the level of detail and accuracy to meet the objective
 - Test of implementation = To see if the firm actually uses those checklists when performing its audits in all cases
 - Test of operating effectiveness = To see if by using the checklists, the desired compliance is indeed achieved

Reporting

- If matters that should be qualified are in fact qualified, and if not, whether the audit documentation contains justification for that
- If matters that are significant to a user's understanding of the financial statements are reported as matters of emphasis
- Pervasive misstatements where audit evidence was available...
- Pervasive possible misstatements where audit evidence was not available or denied...
- Multiple uncertainties whose aggregate possible effect could be pervasive...
-Disclaimer of opinion or an adverse opinion instead of Qualified Report

The Golden Rule

The Golden Rule

What is not
documented is
not done !!!
done !!!

-
- Any change, even a change for the better, is always accompanied by drawbacks and discomforts.
 - Time is the best Remedy



SAs. In General



An Overview of Engagement Standards

– Standards on Auditing - 100 - 999

- 100 – 199: Introductory Matters
- 200 - 299: General Principles & Responsibilities (9)
- 300 – 499: Risk Assessment & Response to Assessed Risks (5)
- 500 – 599: Audit Evidence (11)
- 600 – 699: Using Work of Others (3)
- 700 – 799: Audit Conclusions & Reporting (2)
- 800 – 899: Specialized Areas
- 2000 – 2699- Standards on Review Engagements (SREs) (1)
- 3000 – 3699- Standards on Assurance Engagements (SAEs) (1)
- 4400 – 4699- Standards on Related Services (SRSs) (2)

200 - 299: General Principles and Responsibilities

- SA 200 – Basic Principles Governing an Audit
- SA 200A – Objective and Scope of the Audit of Financial Statements
- SA 220 – Quality Control for Audit Work
- Revised SA 230 - Audit Documentation*
- Revised SA 240 - The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements **
- Revised SA 250 - The Auditor's Responsibilities Relating to Laws and Regulation in an Audit of Financial Statements***
- SA 210 - Terms of Audit Engagement
- Revised SA 260 - Communication with Those Charged with Governance****
- SA 299 - Responsibility of Joint Auditors

**Hitherto known as SA 230, "Documentation"*

***Hitherto known as SA 240, "The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements"*

****Hitherto known as SA 250, "Consideration of the Laws and Regulations in an Audit of Financial Statements"*

*****Hitherto known as SA 260, "Communications of Audit Matters to Those Charged with Governance"*

300 – 499: Risk Assessment & Response to Assessed Risks

- Revised SA 300-Planning an Audit of Financial Statements*
- **SA 315-Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment****
- SA 320 – Audit Materiality
- SA 300 - The Auditor's Responses to Assessed Risks**
- SA 402 – Audit Considerations Relating to Entities Using Service Organisations

**Hitherto known as SA 300, "Audit Planning"*

***Due to issuance of this Standard (along with SA 330) , the existing Standard on Auditing (SA) 310, "Knowledge of the Business", SA 400, "Risk Assessments and Internal Control", and SA 401, "Auditing in a Computer Information Systems Environment", issued in June 2002, April 2000 and January 2003, respectively, stands withdrawn.*

500 – 599: Audit Evidence

- Revised SA 500-Audit Evidence*
- SA 501– Audit Evidence – Additional Considerations for Specific Items
- SA 505 – External Confirmations
- SA 510-Initial Engagements—Opening Balances
- SA 520 – Analytical Procedures
- Revised SA 530-Audit Sampling**
- Revised SA 540-Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures***
- SA 550 -Related Parties
- Revised SA 560-Subsequent Events****
- Revised SA 570-Going Concern*****
- Revised SA 580-Written Representations*****

**Hitherto known as SA 500, "Audit Evidence"*

***Hitherto known as SA 530, "Audit Sampling"*

****Hitherto known as SA 540, "Auditing of Accounting Estimates"*

*****Hitherto known as SA 560, "Subsequent Events"*

******Hitherto known as SA 570, "Going Concern"*

******Hitherto known as SA 580, "Representations by Management"*

600-699 Using Work of Others

- SA 600, Using the Work of Another Auditor
- Revised SA 610, Using the Work of Internal Auditors
- SA 620, Using the Work of an Auditor's Expert

700-799 Audit Conclusions and Reporting

- Revised SA 700, Forming an Opinion and Reporting on Financial Statements
- SA 701, Communicating Key Audit Matters in the Independent Auditor's Report
- Revised SA 705, Modifications to the Opinion in the Independent Auditor's Report
- Revised SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
- SA 710, Comparative Information—Corresponding Figures and Comparative Financial Statements
- Revised SA 720, The Auditor's Responsibilities Relating to Other Information

800-899 Specialized Areas

- SA 800, Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
- SA 805, Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
- SA 810 , Engagements to Report on Summary Financial Statements

2000-2699 Standards on Review Engagements (SREs)

- SRE 2400 (Revised), Engagements to Review Historical Financial Statements
- SRE 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity”

Assurance Engagements Other Than Audits or Reviews of Historical Financial Information

- 3000-3699 Standards on Assurance Engagements (SAEs)
- 3000-3399 Applicable to All Assurance Engagements
- 3400-3699 Subject Specific Standards
 - SAE 3400 “The Examination of Prospective Financial Information”
 - SAE 3402, “Assurance Reports on Controls At a Service Organisation”
 - SAE 3420, Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

Related Services

- 4000-4699 Standards on Related Services (SRSs)
 - SRS 4400 “Engagements to Perform Agreed-upon Procedures Regarding Financial Information”
 - SRS 4410 (Revised), Compilation Engagements

Formation of the Financial Reporting Review Board

- Review the general purpose financial statements of certain enterprises and auditor's report thereon with a view to determine, to the extent possible:
 - Compliance with the generally accepted accounting principles in the preparation and presentation of financial statements;
 - Compliance with the disclosure requirements prescribed by regulatory bodies, statutes and rules and regulations relevant to the enterprise; and
 - Compliance with the reporting obligations of the auditor.

FRRB

- Suo motto
 - On a reference made to it by any regulatory body like, Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, Ministry of Corporate Affairs, Election Commission of India, etc.
-

FRRB

- Material / serious non-compliance - refer the case to the Director (Discipline) of the Institute of Chartered Accountants of India (now NAFRA)
 - Not material non-compliances and which do not affect the true and fair view of financial statements, - appropriately bring the non-compliance to the attention of the auditor
-

Certain Non Compliances observed by FRRB

- ***AS 1, Disclosure of Accounting Policies***

- Accounting policy relating to revenue recognition that the revenue has been recognized on the basis as stipulated under the AS 9
 - Going Concern – Continuous Losses
 - Often omit to disclose accounting policies with regard to the borrowing costs, valuation of inventories, accounting for investments, impairment of assets, provisions, contingent liabilities and contingent assets, Revenue Recognition
-

Certain Non Compliances observed by FRRB

- ***AS 2, Valuation of Inventories***

- Not creating provision for excise duty payable on finished goods lying in the stock.
 - Do not consider net realizable value in the valuation of raw materials, packing materials and consumables & store.
 - do not disclose the method of valuation of inventories i.e. whether FIFO / Weighted Average
-

Schedule VI to the Companies Act, 1956

- Do not disclose Secured and Unsecured loans separately
- Disclosed only total amounts of (a) Current assets, loans and advances, and (b) Current liabilities and provisions, on the face of balance sheet.



AS 1, *Disclosure of Accounting Policies*



- Failure to disclose significant accounting policies adopted in the preparation and presentation of financial statements such as revenue recognition, borrowing costs, inventories, impairment of assets, goodwill and subsidies granted by the government.
- Gain on outstanding derivative contract has been recognised in the statement of profit and loss which is against the principle of prudence as given in AS 1 (i.e. in view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily cash). In this case, the company did not state whether it has adopted AS 30, *Financial Instruments: Recognition and Measurement*, AS 31, *Financial Instruments: Presentation* and AS 32, *Financial Instruments: Disclosures*.

AS 2, Valuation of Inventories



- Failure to disclose the cost formula adopted for determining the cost of inventories. In certain cases where the company has various classes of inventories, the formula for valuation of each class has not been identified and in certain cases, the cost formula has not been correctly applied (e.g. use of average cost instead of weighted average cost).

AS 3, Cash Flow Statements



- A cash flow statement has not been prepared by a certain subsidiary of a listed company and also a certain company which is in the process of listing (on the ground of being a small and medium sized company), when such companies are not exempt from preparation of cash flow statement under AS 3⁴.

AS 12, Accounting for Government Grants



- Capital investment subsidy which is in the nature of promoter's contribution has been credited to statement of profit and loss instead of capital reserve.

AS 16, *Borrowing Costs*



- In certain cases, cost of derivative transactions has been added to the cost of borrowings. Such cost does not qualify to be a borrowing cost as it is neither an ancillary cost incurred in connection with the arrangement of borrowings nor it is an exchange difference arising on the amount of principal of the foreign currency borrowings.

AS 17, *Segment Reporting*



- In certain cases, disclosure of the fact that there is only one business or geographical segment has not been made. Merely reporting that 'segment reporting as per AS 17 is not applicable' is not a sufficient disclosure as per AS 17.
- In certain cases, amount of segment assets and segment liabilities do not match with the aggregate assets and liabilities as given in the balance sheet. A reconciliation has not been given to explain the difference in figures.

⁴AS 3 is not mandatory for small and medium sized companies. A small and medium sized company means a company:



AS 18, Related Party Disclosures

- In certain cases, there is a failure to disclose corporate guarantees given to banks/financial institutions for credit facilities extended to the subsidiaries and/or personal guarantees given by the directors for loans taken from banks/financial institutions as related party transactions.



AS 20, Earnings Per Share (EPS)

- Failure to disclose negative basic and diluted EPS (i.e. loss per share) on the face of the statement of profit and loss.



AS 21, Consolidated Financial Statements (CFS)

- Fact that different policies have been adopted for subsidiaries (vis-à-vis parent) have been mentioned. However, companies have not mentioned proportion of the items in the CFS to which these different accounting policies have been applied. Additionally, such companies did not disclose the fact that it is not practicable to follow uniform accounting policies.



AS 24, Discontinuing Operations

- Failure to disclose the information relating to net cash flows attributable to the operating, financing and investing activities of the discontinuing operations during the reported period.



AS 26, Intangible Assets

- Failure to classify research and development expenditures between research and development phase.



AS 28, Impairment of Assets

- Net selling price for the purpose of impairment loss has been determined on the basis of expected salvage value (i.e. estimated value that an asset will realise upon its sale at the end of its useful life) rather than on the basis of value obtained as on the balance sheet date (which cannot be considered to be an end of the useful life of an asset, unless the assets would not be in use after the reporting date).

III to the 2013 Act

With respect to compliance with Schedule II and III to the 2013 Act, some of the discrepancies highlighted by FRRB are as follows:

Statement	FRRB observations
Balance sheet and related notes	<ul style="list-style-type: none"><li data-bbox="465 639 1850 882">• Expenses on acquisition of intellectual property rights and licences for projects under development have been classified as capital work-in-progress instead of intangible assets under development.<li data-bbox="465 948 1889 1105">• Operating cycle of assets and liabilities has been determined on the basis of duration of each contract instead of determining it for the company as a whole.<li data-bbox="465 1156 1860 1396">• Advances given to government authorities classified on the basis of amount held with different authorities instead of disclosing them as per their nature such as income tax, etc.

been classified as interest expenses. This is not in line with the requirements of Schedule VI to the 1956 Act.

- Exchange differences on foreign currency transactions and translation have been included in the cost of raw material consumed instead of presenting them separately.
- Profit on slump sale (being an exceptional item) has been adjusted before charging of depreciation cost and finance cost. This presentation is not in line with the requirements of Schedule VI to the 1956 Act.

Others

- Balance of securities premium account has been utilised for writing off exchange differences on share/debenture issue expenses and premium payable on their redemption in contravention of provisions of Section 52 of the 2013 Act/Section 78(2) the 1956 Act.



Banks (including NBFCs)

- Failure to disclose the following particulars by a NBFC classified as non-deposit taking asset financing company:
 - a) Capital to risk asset ratio
 - b) Exposure to real estate sector, both direct and indirect and
 - c) Maturity pattern of assets and liabilities.
- Failure to disclose the provisioning coverage ratio (ratio of provisioning to gross non-performing assets) in the notes to accounts to the balance sheet.
- In certain cases, banks have not classified borrowings into following categories:
 - a) Borrowings in India
 - b) Borrowings outside India.

Further, borrowings should be sub-classified depending on their source e.g. perpetual tier-I bonds, subordinated debts, etc.



Insurance companies

- Failure to separately disclose amount of investments held in money market instruments such as government securities or bonds including treasury bills as investing activities in the cash flow statement.

Quality Review Board

- Government of India
- Section 28A of the Chartered Accountants Act, 1949,
- Consequent to the Chartered Accountants (Amendment) Act, 2006 by Notification GSR. 448 (E) dated 28th June, 2007.

QRB - Objectives

- (a) make recommendations to the Council with regard to the quality of services provided by the members of the Institute;
 - (b) review the quality of services provided by the members of the Institute including audit services; and
 - (c) guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.
-

QRB - Powers

- The Board may:
- (a) on its own or through any specialized arrangement set up under the Institute, evaluate and review the quality of work and services provided by the members of the Institute in such manner as it may decide;
- (b) lay down the procedure of evaluation criteria to evaluate various services being provided by the members of the Institute and to select, in such manner and form as it may decide, the individuals and firms⁴ rendering such services for review;

QRB - Powers

- (c) call for information from the Institute, the Council or its Committees, Members, clients of members or other persons or organizations, in such form and manner as it may decide, and may also give a hearing to them;
- (d) invite experts to provide expert / technical advice or opinion or analysis on any matter or issue which the Board may feel relevant for the purpose of assessing the quality of work and services offered by the members of the Institute

QRB - Powers

- (e) make recommendations to the Council to guide the members of the Institute to improve their professional competence and qualifications, quality of work and services offered and adherence to various statutory and other regulatory requirements and other matters related thereto.
- Call for information from the members direct or through Institute.
- Call for information from companies direct or through Government / Regulators

Selection of Audit Firms for Quality Review

- (a) Criteria based on companies whose accounts have been Audited
 - (b) Criteria based on Audit Firms auditing the accounts
 - Appointment of Technical Reviewers**
-

Other Regulators

- Registrar of Companies
 - Serious Fraud Investigation Office (SFIO)
 - SEBI
 - National Financial Reporting Authority (NAFRA)
 - Economic Offences Wing (EOW)
 - Central Bureau of Investigation (CBI)
 - Enforcement Directorate (ED)
 - Reserve Bank of India (RBI)
-

Audit Documentation

Way Forward



Documentation Essentials

- Adopt a policy on documentation procedures that is supported by management and routinely followed by all staff.
 - Preprinted form or computerized system for capturing all documentation and make it accessible to all firm members.
 - Document all client interactions, except those that are strictly confidential.
 - Make documentation notes with client interactions.
 - Retain all documentation for about ten years.
-

Documentation – Raising Practice Level

- Tangible reflection of caliber of high quality services
 - A reminder to clients of what has been done for them
 - More opportunities to offer new services
 - Improves writing / communication skills of staff
 - A Billable service
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