

CA Final (New Syllabus) Paper 3



ADVANCED AUDITING & PROFESSIONAL ETHICS

VOL 2



INDIGOLEARN.COM



***Prepare for CA EXAMS
LIKE NEVER BEFORE***

1Fin by Indigolearn

#StudentFirst



Experience the world of e-learning



Online classes by faculties
with AIRs



Comprehensive coverage
with cool visual effects



MCQ's with personalised
analytics



Notes and flash cards at one click

Download our APP - 1FIN

9640-11111-0



Our Rankers

AIR 5



Sarthak Aggarwal
CA Inter May-23

AIR 19



Aman Mahajan
CA Inter Dec-21

AIR 33



Sundar B
CA Inter Dec-21

AIR 49



Ria Gupta
CA Inter May-22

What Our Students have to Say....

Aman Mahajan (CA AIR 19)

I really liked your classes, especially the practical linkages explained with amazing graphics. The full subject test series helped a lot in improving my writing speed and presentation skills.

Sundar Sri Renganathan B (AIR 33)

I took Accounting from IndigoLearn and the classes were really good. They emphasized on conceptual clarity over getting things done quickly, which is really vital to score good marks in practical papers. Other resources like Notes, Quizzes and Forum was beneficial too.

Dwarakesh

Thank you IndigoLearn team for the guidance and support throughout the past few months. I had great conceptual clarity in all the subjects and the revision classes by Suraj Sir were very helpful. Study planner and Free resources were very useful. Thank you Team IndigoLearn.

Yug Manoj Kumar Bhattad

I have cleared my CA Foundation examination with the total of 286. And this was not possible without the efforts and support of IndigoLearn. The way of teaching with utmost conceptual clarity is the best thing at IndigoLearn.

Prakash Bhatt

Superb, one stop solution for All CA and Accountancy students they serve real Education at very very reasonable price

Naveen Kumar S

Good experience, unlimited views helped a lot in last one month preparation. Looking forward for

Bhagyasree Chougule

It was only because of IndigoLearn that my concepts became very clear, and I was able to crack the exam. I wasn't 100% prepared I needed more practice but luckily I got through. I'm definitely choosing IndigoLearn for group 2 preparation. A big thanks!

Mohd Thayyab

Theoretical subjects made easier through story based examples and charts. Concept clarity 100%. Fully exam+practical oriented classes will help not only to retain the concepts during exams but for the longer duration.

Lalit Chetan Sanpal

IndigoLearn has been fantastic and brilliant. Helped me a lot in my preparations. I cleared both the groups in first attempt with your brilliant classes and notes. Thanks to all the faculties, coordinators, forum admins and everyone at IndigoLearn. Really grateful. Will go for CA Finals at IndigoLearn For sure. Thank you so much IndigoLearn.

#StudentFirst

Abishek M

I'd like to thank IndigoLearn for all the support they've provided me with. Modules were great. They were time saving and straight to the point. I extensively used the materials provided before exams, they were so helpful. Also I'd appreciate them for providing unlimited views as I kept looking into the maths modules till the end.

Munnur Nandini Sree

Accounting classes I have taken from IndigoLearn. Now I feel that it's a great choice that I have made (after seeing my result) because only in Accounting I got exemption. Thank you IndigoLearn.

Harshita G

Thank u so much IndigoLearn for your guidance. This is only possible because of u people.... For my finals also my journey will continue with IndigoLearn.

Bharathsha PS

I purchased Economics, IT, FM, EIS and Audit from IndigoLearn. All your classes are superb and anyone can easily crack the CA exams. What makes u special is your classes help us to understand the concepts very well. Special thanks to the FM faculty, I studied only 2 chapters in economics, and still managed to score exemption in the 8th paper.

Nayi Mihir kumar

This platform is very helpful in all activity like mcq practise, notes, teaching activities, revisions and the forum interaction with all students which I like the most. If anybody want to clear their exams in first attempt then IndigoLearn is the best platform for them. My all regards to IndigoLearn. Thank you so much.

Rajalaxmi CA Inter

Can't believe I cleared. Sathya Sir, Suraj Sir, Yogita Mam ... thanks to all my faculties. Basically an Eng student with zero accounts knowledge. Thanks IndigoLearn for making me clear in first attempt.

Priyanka Udeshi

All the faculties have excellent knowledge of the subject and deliver it in very crisp & effective manner. Also, quick response at Forums never let any of my doubts go unresolved no matter how small they were. Thank you once again to all the teachers & staff at IndigoLearn!

Naveen Kumar T

It been a great journey with indigo learn team. Thanks to all the facilities and forum friends who support me a lot.

Disclaimer

This book is designed for students pursuing CA Final course, who are appearing for the **Advanced Auditing, Assurance and Professional Ethics** exam in **May-24 or afterwards**. The content in the book is not in the order provided by ICAI to ensure logical and comprehensive learning.

Every effort has been made to avoid errors and omissions. Despite this, errors may still occur. Any mistake, error, or discrepancy may be brought to our attention by emailing us at support@indigolearn.com and we shall fix the same in the next edition of the book.

It is notified that neither the publisher nor the author or seller will be responsible for any damage or loss of action to anyone, of any kind, in any manner, therefrom. No portion of this book may be duplicated or copied in any form or by any means. A violation of this clause provides grounds for legal action.

All disputes are subject to Hyderabad jurisdiction only.

© All Rights Reserved

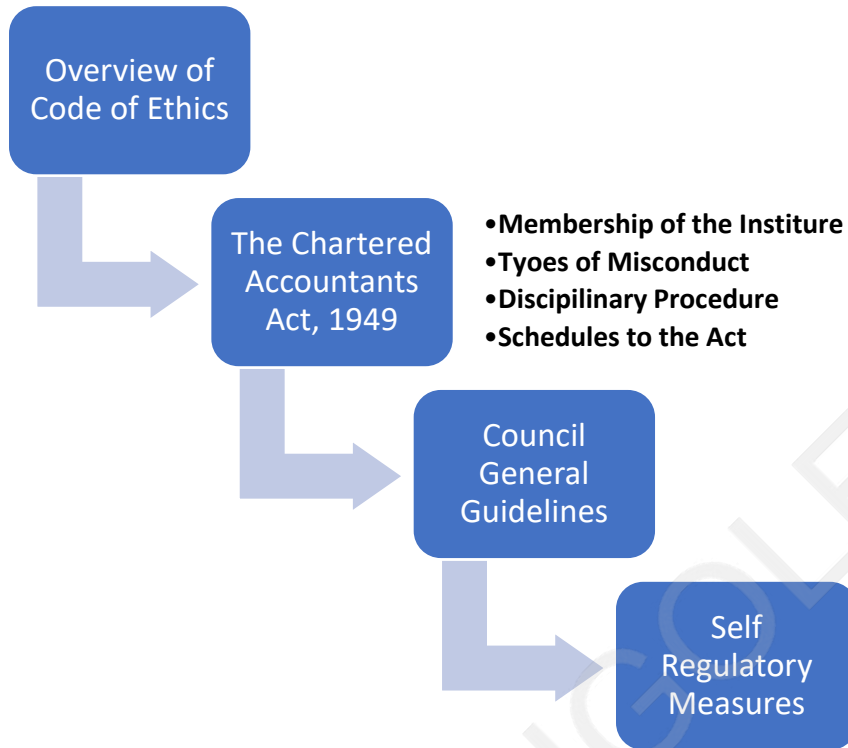
Edition 2 – July 2024

Index

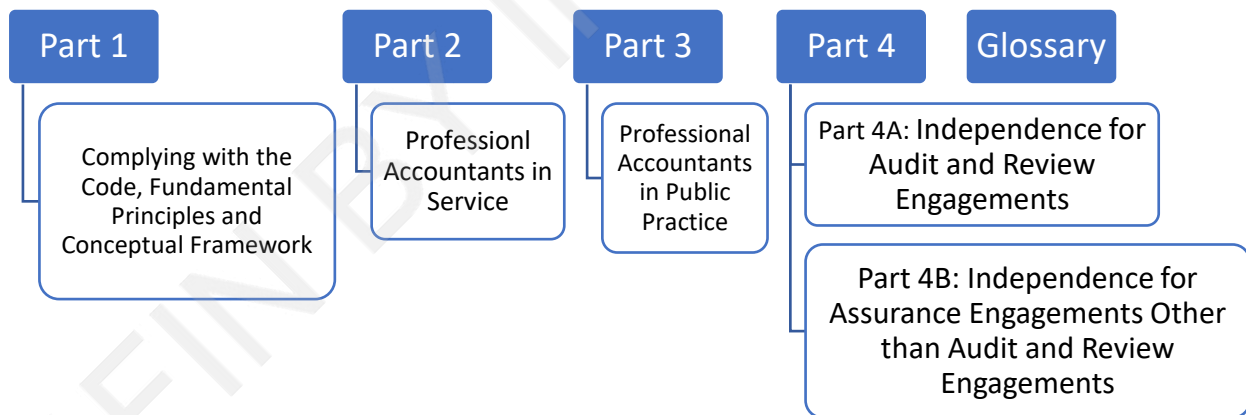
#	Chapter	Page No
1	Professional Ethics	1.1 - 1.68
2	Group Audits	2.1 - 2.18
3	Internal Audit	3.1 - 3.15
4	Audit of PSU	4.1 - 4.16
5	Audit of Banks	5.1 - 5.46
6	Audit of NBFC	6.1 - 6.19
7	Due Diligence	7.1 - 7.7
8	Investigation	8.1 - 8.32
9	Forensic Accounting	9.1 - 9.11
10	Digital Audit	10.1 - 10.27
11	Sustainable Development Goals	11.1 - 11.18

PROFESSIONAL ETHICS

Chapter Overview:



Overview of Code of Ethics:



Part 1: Complying with the Code, Fundamental Principles and Conceptual Framework: includes the fundamental principles and the conceptual framework and is applicable to all professional accountants

Part 2 – Professional Accountants in Service: sets out additional material that applies to professional accountants in service when performing professional activities. Professional accountants in service include professional accountants employed, engaged or contracted in an executive or non-executive capacity in, for example:

- Commerce, industry or service.

- The public sector.
- Education.
- The not-for-profit sector.
- Regulatory or professional bodies.

Part 2 is also applicable to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm as an employee.

Part 3 – Professional Accountants in Public Practice: sets out additional material that applies to professional accountants in public practice when providing professional services, as follows:

- I. Part 4A – Independence for Audit and Review Engagements, which applies when performing audit or review engagements.
- II. Part 4B – Independence for Assurance Engagements Other than Audit and Review Engagements, which applies when performing assurance engagements that are not audit or review engagements.

Glossary: which contains defined terms (together with additional explanations where appropriate) and described terms which have a specific meaning in certain parts of the Code.

Each section of the Code is structured, where appropriate, as follows:

- a. sets out the subject matter addressed within the section, and introduces the requirements and application material in the context of the conceptual framework.
 - b. Introductory material contains information, including an explanation of terms used, which is important to the understanding and application of each Part and its sections.
- Requirements – establish general and specific obligations with respect to the subject matter addressed.
 - Application material – provides context, explanations, suggestions for actions or matters to consider, illustrations and other guidance to assist in complying with the requirements.

Fundamental Principles:



Fundamental principles – sec 100

Integrity

A professional accountant should be straightforward and honest in all professional and business relationships.

Objectivity

A professional accountant should not compromise professional or business judgments because of bias, conflict of interest or undue influence of others.

Professional competence and due care

- A professional accountant has a continuing duty to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation.
- A professional accountant should act diligently and in accordance with applicable technical and professional standards.

Confidentiality

A professional accountant should respect the confidentiality of information acquired as a result of professional and business relationship.

Professional Behavior

A professional accountant should comply with relevant laws and regulations and avoid any conduct that the professional accountant knows or should know might discredit the profession.

Compliance with the Fundamental principles- section 110

- A professional accountant shall comply with each of the fundamental principles.
- The fundamental principles of ethics establish the standard of behavior expected of professional accountant.
- The conceptual framework establishes the approach which an accountant is required to apply assist in complying with those fundamental principles.
- A professional accountant might face a situation in which complying with one fundamental principle conflicts with one or more other fundamental principles. In such a situation, the accountant might consider consulting, with:
 - a. Others within the firm or employing organization,
 - b. Those charged with governance.
 - c. Institute
 - d. Legal counsel.

However, such consultation does not relieve the accountant from the responsibility to exercise professional judgment to resolve the conflict or, if necessary, and unless prohibited by laws or regulation, disassociate from the matter creating the conflict.

- The professional accountant is encouraged to document the substance of the issue, the details of any discussions, the decisions made and the rationale for those decisions.

Integrity: Subsection 111:

- The professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships.
- Integrity implies fair dealing and truthfulness.
- The professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information:
 - a. Contains a materially false or misleading statement;
 - b. Contains statements or information provided negligently; or
 - c. Omits or obscures required information where such omission or obscurity would be misleading.

If a professional accountant provides a modified report in respect of such a report, return, communication or above information, the accountant will not be considered to be in breach of matters referred above.

- When a professional accountant becomes aware of having been associated with information described above, the accountant shall take steps to be disassociated from that information.

Objectivity- sub-section 112

- A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.
- A professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.

Professional competence and due care sub- section 113

- A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:
 - a. Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
 - b. Act diligently and in accordance with applicable technical and professional standards.
- Serving clients and employing organizations with professional competence requires the exercise of sound judgment in applying professional knowledge and skill when undertaking professional activities.
- Maintaining professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments. Continuing professional development enables a professional accountant to develop and maintain the capabilities to perform competently within the professional environment.
- Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.
- In complying with the principle of professional competence due care. a professional accountant shall take reasonable steps to ensure that those working in a professional capacity under the accountant's authority have appropriate training and supervision.

- Where appropriate, a professional accountant shall make clients, the employing organization, or other users of the accountant's professional services or activities, aware of the limitations inherent in the services or activities.

Confidentiality- sub- section 114

A professional accountant shall comply with the principle of confidentiality, which required an accountant to respect the confidentiality of information acquired as a result of professional and employment relationships. An accountant shall:

a. Be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to be a close business associate or an immediate or a close family member;
b. Maintain confidentiality of information within the firm or employing organization;
c. Maintain confidentiality of information disclosed by a prospective client or employing organization;
d. Not disclose confidential information acquired as a result of professional and employment relationships outside the firm or employing organization without proper and specific authority, unless there is a legal or professional duty or right to disclose;
e. Not use confidential information acquired as a result of professional and employment relationships for the personal advantage of the accountant or for the advantage of a third party;
f. Not use or disclose any confidential information, either acquired or received as a result of a professional or employment relationship, after that relationship has ended; and
g. Take reasonable steps to ensure that personnel under the accountant's control, and individuals from whom advice and assistance are obtained, respect the accountant's duty of confidentiality.

Circumstances where disclosure is appropriate

a. Disclosure is required by law, for example:

i. Production of documents or other provision of evidence in the course of legal proceedings; or
ii. Disclosure to the appropriate public authorities of infringements of the law that come to light;

b. Disclosure is permitted by law and is authorized by the client or employing organization; and

c. There is a professional duty or right to disclose, when not prohibited by law:

i. To comply with the requirements of peer review or quality review of the institute.
ii. To respond to an inquiry or investigation by a professional or regulatory body;
iii. To protect the professional interest of a professional accountant in legal proceedings; or
iv. To comply with technical and professional standards, including ethics requirements

Considerations before disclosing information

In deciding whether to disclose confidential information, factors to consider, depending on the circumstances, include:

- i. Whether the interests of any parties, including third parties whose interests might be affected, could be harmed if the client or employing organizations consents to the disclosure of information by the professional accountant.
- ii. Whether all the relevant information is known and substantiated, to the extent practicable.
- iii. The proposed type of communications, and to whom it is addressed.
- iv. Whether the parties to whom the communication is addressed are appropriate recipients.

- A professional accountant shall continue to comply with the principle of confidentiality even after the end of the relationship between the accountant and a client or employing organization.
- When changing employment or acquiring a new client, the accountant is entitled to use prior experience but shall not use or disclosure any confidential information acquired or received as a result of a professional or employment relationship.

Professional Behavior – sub-section 115

- A professional accountant shall comply with the principle of professional behavior, which requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession.
- A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.
- Conduct might discredit the profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession.
- When promoting himself and his work, a professional accountant shall not bring the profession into disrepute. A professional accountant is required to conduct his affairs in a manner that he remains outside the boundaries of profession and other misconduct. A professional accountant shall be honest and truthful and shall not make:
 - a. Exaggerated claims for the services offered by, or the qualifications or experience of, the accountant; or
 - b. Disparaging references or unsubstantiated comparisons to the work of others.
 - c. Any direct or indirect measures to advertise any professional/other facts which are in violation of advertisement guidelines issued by council of the institute from time to time.
- A professional accountant should ensure that the contents of an advertisement are true to the best of his knowledge and belief, and are in conformity with the advertisement Guidelines, and be aware that the institute does not own any responsibility, whatsoever, for such contents or claims by him. However, if a professional accountant is in doubt about whether a form of proposed advertising is appropriate, the accountant is encouraged to consult with the Ethical Standards Board of ICAI.

A professional accountant shall comply with each of the fundamental principles.

The fundamental principles of ethics establish the standard of behaviour expected of a professional accountant.

The conceptual framework establishes the approach which an accountant is required to apply to assist in complying with those fundamental principles

The professional accountant is encouraged to document the substance of the issue, the details of any discussions, the decisions made and the rationale for those decisions.

professional accountant might face a situation in which complying with one fundamental principle conflicts with complying with one or more other fundamental principles. In such a situation, the accountant might consider consulting, with:

- Others within the firm and organization
- Those charged with Governance
- Those charged with Governance
- The Institute
- Legal Counsel

However, such consultation does not relieve the accountant from the responsibility to exercise professional judgment to resolve the conflict or, if necessary, and unless prohibited by law or regulation, disassociate from the matter creating the conflict.

Threats , Evaluation of threats and Safeguards

The conceptual framework specifies an approach for a professional accountant to:

- Identify threats to compliance with the fundamental principles;
- Evaluate the threats identified; and
- Address the threats by eliminating or reducing them to an acceptable level.

Threats to compliance with the fundamental principles fall into one or more of the following categories



Self-interest threats

The threat that a financial or other interest will inappropriately influence a professional accountant's judgment or behavior.

Self- review threats

The threat that a professional accountant will not appropriately evaluate the results of a previous judgment made; or an activity performed by the accountant, or by another individual within the accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of performing a current activity.

Advocacy threats

The threat that a professional accountant will promote a client's or employing organization's position to the point that the Accountant's objectivity is compromised.

Familiarity threats

The threat that due to a long or close relationship with a client, or employing organization's professional accountant's will be too sympathetic to their interest or too accepting of their work.

Intimidations threats

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

Circumstances that may create threats

Self-interest threats

- a. Having a direct financial interest in a client.
- b. Undue dependence on total fees from a client.

- c. Having a close business relationship with a client.
- d. Concern about the possibility of losing a client.
- e. Potential employment with a client.
- f. Having a access to confidential information of the client that might be used for personal gain.
- g. A loan to or from an assurance client or any of its direction or officers.

Self-Review Threat

- a) A loan to or from an assurance client or any of its directors or officers
- b) A professional accountant holding a financial interest in, or receiving a loan or guarantee from, the employing organization.
- c) A professional accountant participating in incentive compensation arrangements offered by the employing organization.
- d) A professional accountant having access to corporate assets for personal use.
- e) A professional accountant being offered a gift or special treatment from a supplier of the employing organization.

Advocacy threats:

- a) Promoting shares in a listed entity when that entity is a financial statement audit client.
- b) Acting as a representative on behalf of an assurance client in litigation or disputes with third parties.
- c) Lobbying in favour of legislation on behalf of a client.

Familiarity threats

- a) A member of the engagement team having a close or immediate family relationship with a director or officer of the client.
- b) A member of the engagement team having a close or immediate family relationship with an employee of the client who is in a position to exert direct and significant influence over the subject matter of the engagement.
- c) A former partner of the firm being a director or officer of the client or an employee in a position to exert direct and significant influence over the subject matter of the engagement.
- d) Long association of an audit team member with the audit client.

Intimidation threats

- a. A professional accountant being threatened with dismissal from a client engagement or the firm because of a disagreement about a professional matter.
- b. A professional accountant feeling pressured to agree with the judgment of a client because the client has more expertise on the matter in question.
- c. A professional accountant being informed that a planned promotion will not occur unless the accountant agrees with an inappropriate accounting treatment.
- d. A professional accountant having accepted a significant gift from a client and being threatened that acceptance of this gift will be made public.

Evaluation of threats

The conditions, policies and procedures described above might impact the evaluation of whether a threat to compliance with the fundamental principles is at an acceptable level.

- (i) Acceptable level: An acceptable level is a level at which a professional accountant using the reasonable and informed third party test would likely conclude that the accountant complies with the fundamental principles.
- (ii) Reasonable and Informed Third Party : The reasonable and informed third party test is a consideration by the professional accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time the conclusions are made. The reasonable and informed third party does not need to be an accountant but would possess the relevant knowledge and experience to understand and evaluate the appropriateness of the accountant's conclusions in an impartial manner.

Addressing Threat

If the professional accountant determines that the identified threats to compliance with the fundamental principles are not an acceptable, the accountant shall address the threats by eliminating them or reducing them to an acceptable levels, the accountant shall do so by:

- a. Eliminating the circumstances, including interest or relationships, that are creating the threats;
- b. Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- c. Declining or ending the specific professional activity

Actions Eliminate Threats

Depending on the facts and circumstances, a threat might be addressed by eliminating the circumstance creating the threat. However, there are some situations in which threats can only be addressed by declining or ending the specific professional activity. This is because the circumstances that created the threats cannot be eliminated and safeguards are not capable of being applied to reduce the threat to an acceptable level.

Safeguards

Safeguards are actions, individually or in combination that the professional accountant takes that effectively reduce threats to compliance with the fundamental principles to an acceptable level.

Examples of safeguards

Safeguards vary depending on the facts and circumstances. Examples of actions that in certain circumstances might be safeguards to address threats include:

- a. Assigning additional time and qualified personnel to required tasks when an engagement has been might address a self- interest threat.
- b. Having an appropriate reviewer who was not a member of the team review the work performed or advise as necessary might address a self-review threat.

- c. Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client might address self-review, advocacy or familiarity threats.
- d. Involving another firm to perform or re-perform part of the engagement might address self-interest, self-review, advocacy, familiarity or intimidation threats.
- e. Separating teams when dealing with matters of a confidential nature might address a self-interest threat.

Responding to Non-Compliance with Laws and Regulations

Introduction & Scope

Introduction - Non-compliance with laws and regulations ("non-compliance") comprises of acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by:

- a client/professional accountant's employing organization;
- TCWG of a client or employing organization;
- management of a client/ employing organization; or
- other individuals working for or under the direction of a client/ employing organization

However, NOCLAR under Revised Code of Ethics address the personal misconduct unrelated to the business activities of the client/ employing organization and non-compliance by parties other than listed out in the definition of NOCLAR.

Scope- As per IESBA, following examples would be covered in NOCLAR:

- Fraud, corruption and bribery
- Money laundering, terrorist financing and proceeds of crime
- Securities markets and trading
- Banking and other financial products and services
- Data protection
- Environmental protection
- Public health and safety
- Tax and pension liabilities and payments

Some important facts about NOCLAR

a) During Course of Providing a Service:

NOCLAR will be applicable if a professional accountant encounters, or is made aware of, non-compliance or suspected non-compliance. He is not required to investigate, nor responsible for ensuring complete compliance.

b) Expertise of Laws not Required:

A professional accountant is expected to apply knowledge and expertise, and exercise professional judgment. However, he is not expected to have a level of knowledge of laws and regulations greater than that which is required to undertake the engagement.

c) Certain Matters Expressly out of Purview:

Matters that are clearly inconsequential, or relating to personal misconduct pertaining to business activities of the client not covered.

d) Disclosure, which is Contrary to Law not Required:

As per IESBA Code, disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation.

Non-Compliance with Laws and Regulations vs SA-250

S. NO.	SA-250	<u>NOCLAR</u>
(a) Applicability	SA 250 is applicable only on Audit, and not on other Assurance engagements.	NOCLAR is applicable on professional accountants in service, and in practice (it applies on Audit as well as other professional services)
(b) Responsibility	SA 250 talks of auditor's responsibilities for laws having direct effect & other laws that do not have a direct effect on the Professional Ethics determination of the amounts and disclosures in the FSs, but compliance with which may be fundamental to the operating aspects of the business.	NOCLAR, while being alike to SA 250 till this point, is further ahead of it in that it takes into account non-compliance that causes substantial harm resulting in serious consequences in financial or non-financial terms.

(c) Stakeholders	SA 250 does not define stakeholders.	NOCLAR is related to effect of non-compliance on investors, creditors, employees as also the general public
(d) Breach of law	This provision is not existent in SA 250	As per NOCLAR, On exceptional circumstances CA might become aware of an imminent breach of a law or regulation that would cause substantial harm to investors etc. Having first considered whether it would be appropriate to discuss the matter with MGT or TCWG & exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted.

Applicability of NOCLAR in India

Where a professional accountant in public practice or senior professional accountant identifies any non-compliance with laws and regulations to comply with the principles of integrity and professional behavior it may have to report such non-compliance by alerting management / TCWG and take further action's as appropriate like reporting to regulatory bodies or withdrawing from engagement

APPLICABILITY

- **Are the professional accountants in public practice required to comply with the provisions of NOCLAR with regard to all professional assignments?**

Provisions of NOCLAR from the standpoint of professional accountants in public practice are applicable to Audit engagements of entities, the shares of which are listed on recognized stock exchanges (s) in India and have a net worth of INR 250 crores or more (earlier all listed entities).

- **"Audit" or "Audit engagement"?**

Shall mean a reasonable assurance engagement in which a professional accountant in public practice expresses an opinion on whether financial statements give a true and fair view by an applicable financial reporting framework (specifically separate definition of Audit added for NOCLAR) Listed entity?

Entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.

- **Whether the provisions of Responding to NOCLAR apply to all professional Accountants in service?**

AS per the revised provisions of Section 260 of Volume -I of the Code of Ethics, provisions of NOCLAR With reference to professional accountants in service apply Only to the senior professional accountants employed with listed entities (earlier all employees of listed entities).

- **Senior professional accountants in service?**

Refers to the Key Managerial Personnel (reference to KMP added). They are directors, officers, or senior employees able to exert significant influence over and make decisions regarding, the acquisition, deployment, and control of the employing organization's human, financial, technological, physical, and intangible resources. There is a greater expectation for such individuals to take whatever action is appropriate in the public interest to respond to non-compliance or suspected non-compliance than other professional accountants within the employing organization. This is because of senior professional accountants' roles, positions, and spheres of influence within the employing organization.

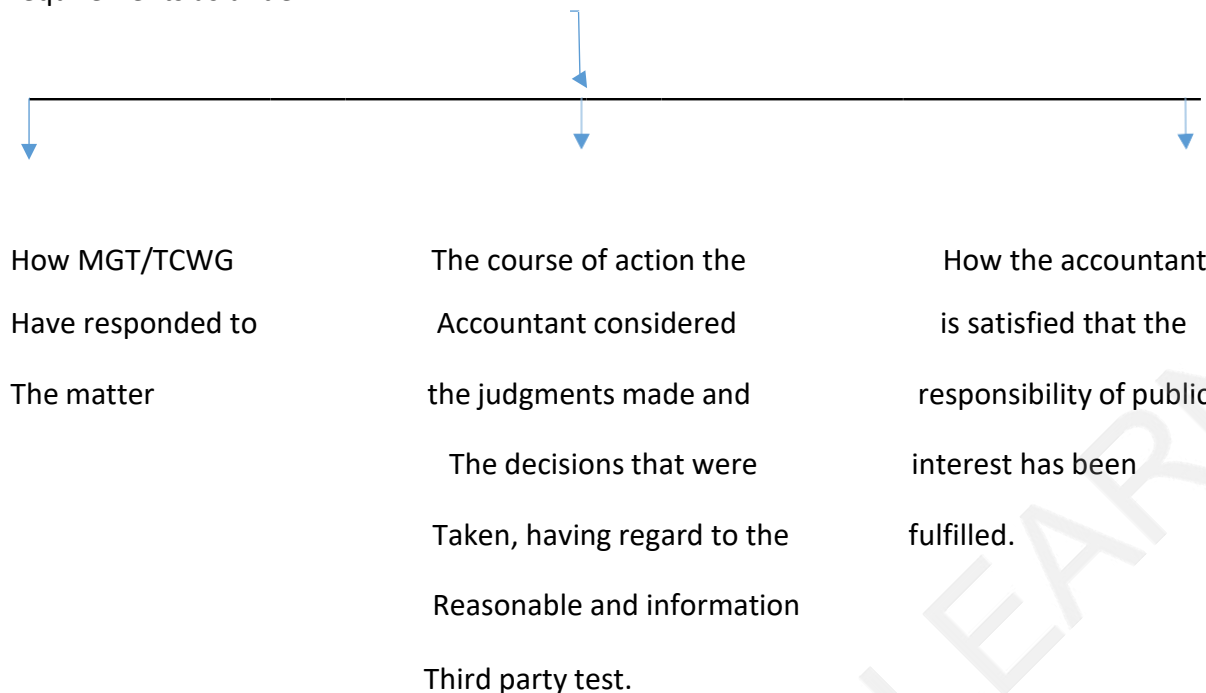
Responding to NOCLAR

In case of Employment	In case of Audit Engagement	Steps to be taken for responding
Responsibilities of Senior professional Accountant in Service	Responsibilities of professional Accountant	<ul style="list-style-type: none">- Obtaining an understanding of the matter- Addressing the matter- seeking Advice- Determining whether- Further action is needed- Determining whether to Disclose the matter to an Appropriate Authority- Imminent Breach- Documentation

Confidentiality under CA Act, 1949 Refer Clause I, Pat I, schedule II for CA inPractice and clause 2, Part II, Schedule II| for CA in Service

Documentation Requirements in NOCLAR

Revised Code over and above require the professional accountant follow the additional documents requirements as under:



Relevant Provisions of Chartered Accountants Act, 1949

Provision	Section
Membership of the institute- Sec 19	19
Disabilities for the Purpose of Membership: Sec 8	8
Types of Members- Sec 5	5
Removal of Member- Sec 20	20
Restoration of Membership- Sec 20	20
Penalty for Falsely Claiming to be a Member- Sec 24	24
Significance of the Certificate of Practice- Sec 6	6
Cancellation and Restoration of Certificate of Practice- Regulation 10	Reg 10
Members deemed to be in Practice- Sec 2(2)	2(2)
Companies not to Engage in Accountancy- Sec 25	25
Member in Practice Prohibited from using a Designation Other Than Chartered Accountant- Sec 7	7
Maintenance of Branch Offices- Sec 27	27

Membership of the institute- Sec 19

On acceptance of application by the Council,

- the applicant's name shall be entered in the Register and
- a certificate of membership in the appropriate Form shall be issued to the applicant.

Particulars of the Register:

Section 19 of the Chartered Accountants Act, 1949 provides the particulars to be included in the Register about every member of the Institute, namely-

Full name,
date of birth, domicile,
residential and professional address;
Date of entry of name in the Register;
Qualifications;
Whether the member holds a COP;
And any other prescribed particulars

Disabilities for the Purpose of Membership

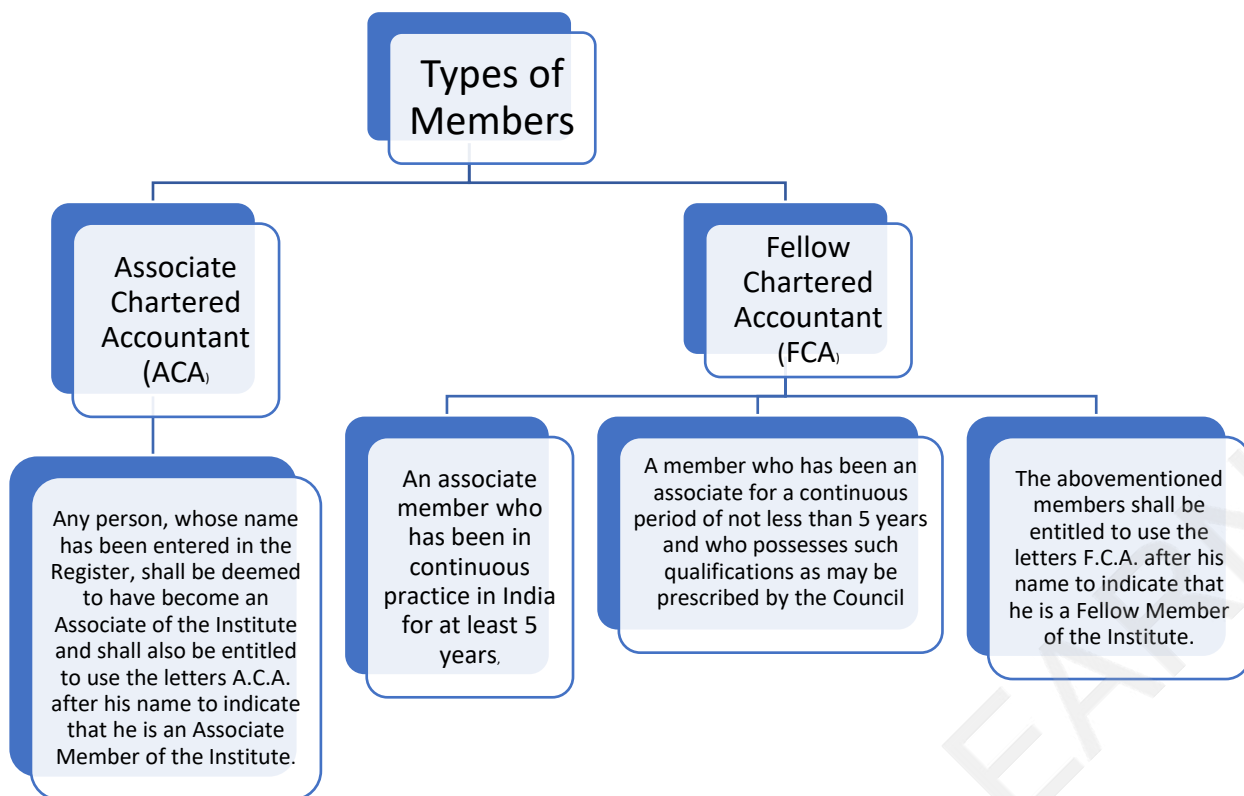
Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, as follows:

<ul style="list-style-type: none">• If he has not attained the age of 21 years at the time of his application for the entry of his name in the Register; or
<ul style="list-style-type: none">• If he is of unsound mind and stands so adjudged by a competent court; or
<ul style="list-style-type: none">• If he is an undischarged insolvent; or
<ul style="list-style-type: none">• If he, being a discharged insolvent, has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part; or
<ul style="list-style-type: none">• If he has been convicted by a competent Court whether within or without India, of an offence involving moral turpitude and punishable with transportation or imprisonment or of an offence, not of a technical nature, committed by him in his professional capacity unless in respect of the offence committed, he has either been granted a pardon or, on an application made by him in this behalf, the Central Government has, by an order in writing, removed the disability; or
<ul style="list-style-type: none">• If he has been removed from membership of the Institute on being found on inquiry to have been guilty of professional or other misconduct;

Points to Remember

- It may be noted that a person who has been removed from membership for a specified period, shall not be entitled to have his name entered in the Register until the expiry of such period.
- In addition, failure on the part of a person to disclose the fact that he suffers from any one of the disabilities aforementioned would constitute professional misconduct.
- The name of the person, who is found to have been subject at any time to any of the disabilities aforementioned, can be removed from the Register of Members by the Council.

Types of Members of the Institute



Removal of Name from the Register- Sec 20

As per section 20 of the Act, the Council may remove, from the Register, the name of any member of the Institute in the following cases-

<ul style="list-style-type: none"> • who is dead; or
<ul style="list-style-type: none"> • from whom a request has been received to that effect; or
<ul style="list-style-type: none"> • who has not paid any prescribed fee required to be paid by him; or
<ul style="list-style-type: none"> • who is found to have been subject at the time when his name was entered in the Register, or who at any time thereafter has become subject, to any of the disabilities mentioned in Section 8, or who for any other reason has ceased to be entitled to have his name borne on the Register

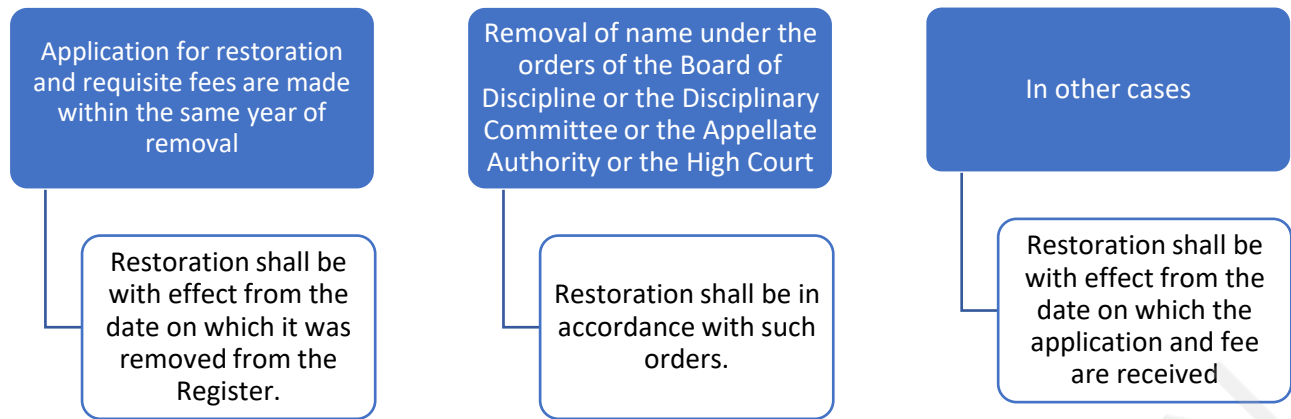
The Council shall remove the name of any member from the Register in respect of whom an order has been passed under this Act removing him from membership of the Institute.

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

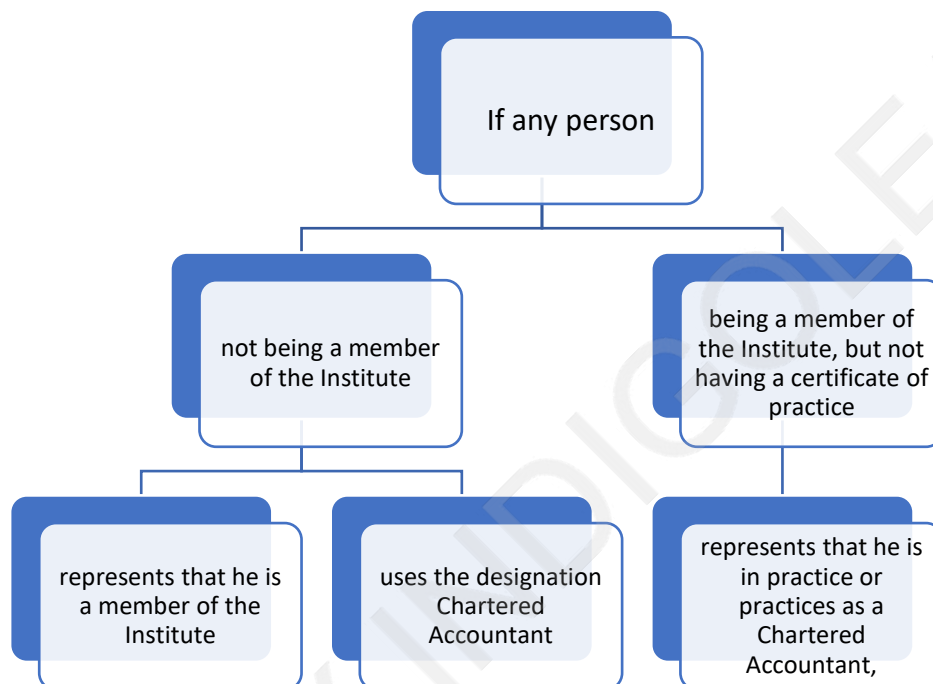
Restoration of Membership

The name of the member may be restored by the Council in the Register on an application, in the appropriate Form, received in this behalf whose name has been removed from the Register for non-payment of prescribed fee as required to be paid by him, if he is otherwise eligible to such membership, on his paying the arrears of annual membership fee, entrance fee and additional fee determined by the Council under the Act.

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



Penalty for Falsely Claiming to be a Member- Sec 24



shall be punishable on

- first conviction with fine which may extend to Rs 1000, and
- on any subsequent conviction with imprisonment which may extend to 6 months or with fine which may extend to Rs 5,000, or with both.

CHARTERED ACCOUNTANTS IN PRACTICE

A practicing Chartered Accountant is a person who is a

- member of the Institute and is holding Certificate of Practice; and
- includes such members of the Institute who are deemed to be in Practice in accordance with the provisions of the Chartered Accountants Act, 1949.

Significance of the Certificate of Practice

Section 6 of the Chartered Accountants Act, 1949 provides that: -

- i. No member of the Institute shall be entitled to practice whether in India or elsewhere unless he has obtained from the Council a certificate of practice:
- ii. Every such member shall pay such annual fee for his certificate as may be determined, by notification, by the Council
- iii. The certificate of practice obtained under sub-section (1) may be cancelled by the Council under such circumstances as may be prescribed.

The Council of the institute is of view that-

- (i) Once the person concerned becomes a member of the Institute, he is bound by the provisions of the Chartered Accountants Act and its Regulations. If and when he appears before the Income-tax Tribunal as an Income-tax representative after having become a member of the Institute, he could so appear only in his capacity as a Chartered Accountant and a member of the Institute.
- (ii) A member of the Institute can have no other capacity in which he can take up such practice, separable from his capacity to practice as a member of the Institute."

Summary:

A Chartered Accountant whose name has been removed from the membership for professional and/or other misconduct, during such period of removal, will not appear before the various tax authorities or other bodies before whom he could have appeared in his capacity as a member of this Institute.

Cancellation and Restoration of Certificate of Practice

Regulation 10 provides that a Certificate of Practice (COP) shall be liable for cancellation, if:

- (i) the name of the holder of the certificate is removed from the Register; or
- (ii) the Council is satisfied, after giving an opportunity of being heard to the person concerned, that such certificate was issued on the basis of incorrect, misleading or false information, or by mistake or inadvertence; or
- (iii) a member has ceased to practice; or
- (iv) a member has not paid annual fee for certificate of practice till 30th day of September of the relevant year.

Where a COP is cancelled, the holder shall surrender the same to the Secretary.

Regulation 11 on restoration of COP states that, on an application made in the approved Form and on payment of such fee, the Council may restore the COP with effect from the date on which it was cancelled, to a member whose certificate has been cancelled due to non-payment of the annual fee for the COP and whose application, complete in all respects, together with the fee, is received by the Secretary before the expiry of the relevant year.

Members deemed to be in Practice – Sec. 2(2)

A member of the Institute shall be deemed “to be in practice” which individually or in partnership with Chartered Accountant in practice, or in partnership with members of such other recognized professions as may be prescribed, he, in consideration of remuneration received or to be received-

i.	Engages himself in the practice of accountancy; or
ii.	Offers to perform or performs service involving the auditing or verification of financial transactions, books, accounts or records, or the preparation, verification or certification of financial accounting and related statements or holds himself out to the public as an accountant; or
iii.	Renders professional services or assistance in or about matters of principle or detail relating to accounting procedure or the recording, presentation or certification of financial facts or data; or
iv.	Renders such other services as, in the opinion of the council, are or may be rendered by Chartered Accountant in practice.

Management Consultancy and other Services

Pursuant to Section 2(2)(iv), the council has passed a resolution permitting a CA in practice to render entire range of “Management Consultancy and other Services”.

Accordingly, “Management Consultancy and other services” shall not include the function of statutory or periodical audit, tax representation or tax advice or acting as liquidator, trustee, executor, administrator, arbitrator or receiver, but shall include the following:

1.	Financial management planning and financial policy determination.
2.	Capital structure planning and advice regarding raising finance
3.	Working capital management.
4.	Preparing project reports and feasibility studies.
5.	Preparing cash budget, cash flow statements, profitability statements, statements of sources and application of funds etc.
6.	Budgeting including capital budgets and revenue budgets.
7.	Inventory management, material handling and storage.
8.	Market research and demand studies.
9.	Price – fixation and other management decision making.
10.	Management accounting systems, cost control and value analysis.
11.	Control methods and management information and reporting.
12.	Personnel recruitment and selection.
13.	Setting up executive incentive plans, wage incentive plans etc.
14.	Management and operational audits.
15.	Valuation of shares and business and advice regarding amalgamation, merger and acquisition; Acting as Registered Valuer under the Companies Act, 2013 read with the Companies (Registered Valuers and valuation) Rules, 2017.
16.	Business Policy, corporate planning, etc.
17.	Organisation structure and behavior.
18.	System analysis and services relating to EDP.
19.	Acting as advisor or consultant to an issue, including such matters as:
a.	Drafting of prospectus and listing agreement and completing formalities with stock exchanges, ROC and SEBI.
b.	Preparation of publicity budget.
c.	Advice regarding selection of various agencies connect with issue.
d.	Advice on post issue activities.

Explanation – for removal of doubts, it is hereby clarified that the activities of broking, underwritings and portfolio management are not permitted.
20. Investment counseling in respect of securities.
21. Acting as registrar to an issue and for transfer of shares/other securities.
22. Quality audit.
23. Environment audit.
24. Energy audit.
25. Acting as recovery consultant in the banking sector.
26. Insurance financial advisory services including insurance brokerage.
27. Acting as insolvency professional in terms of insolvency and Bankruptcy code, 2016.
28. Administrative services.
Administrative services involve assisting clients with their routine or mechanical tasks within the normal course of operations. Such services required little no to professional judgment and are clerical in nature.
Examples of administrative services include:
<ul style="list-style-type: none"> • Word processing services. • Preparing administrative or statutory forms for client approval. • Submitting such forms as instructed by the client. • Monitoring statutory filing dates, and advising an audit client of those dates.
For example, the functions of a GST practitioner as specified under rule 83(8) of central Goods and Services tax rules, 2017:
a. Furnish the details of outward and inward supplies;
b. Furnish monthly, quarterly, annual or final return;
c. Make deposit for credit into the electronic cash ledger;
d. File a claim for refund;
e. File an application for amendment or cancellation of registration;
f. Furnish information for generation of e-way bill;
g. Furnish details of challan in form GST ITC- 04
h. File an application for amendment or cancellation of enrolment under rule 58; and
i. File an intimation to pay tax under the composition scheme or withdraw from the said scheme.

Point to remember

- It is necessary to note that a person is deemed to be in practice not only when he is actually engaged in the practice of accountancy but also when he offers to render accounting services whether or not he in fact does so. In other words, the act of setting up of an establishment offering to perform accounting services would tantamount to being in practice even though no client has been served.
- Services so specified above need to be correlated with the provisions of sec. 144 of the companies Act, 2013 which prohibits an auditor of the company from rendering certain services directly or indirectly to the company or its holding company or its subsidiary company.

Companies not to Engage in Accountancy- Sec 25

Section 25 of the Chartered Accountants Act, 1949 provides that:

- (1) No company, whether incorporated in India or elsewhere, shall practise as chartered accountants.

Here, the term “company” shall include any limited liability partnership which has company as its partner for the purpose of this section.

- (2) If any company contravenes this provision, then, without prejudice to any other proceedings which may be taken against the company, every director, manager, secretary and any other officer thereof who is knowingly a party to such contravention shall be punishable with fine which may extend on first conviction to ` 1,000 and on any subsequent conviction to ` 5,000.

Note:

- In addition, as per section 141(2) of the Companies Act, 2013, where a firm (including a limited liability partnership) is appointed as an auditor of a company, then, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.
- Though the LLPs are allowed to be appointed as an auditor in accordance with the Companies Act, 2013, however, it cannot be engaged into practice, if it has company as its partner, as per the Chartered Accountants Act, 1949.
- Therefore, it can be inferred that the LLP not having any company as its partner, can be engaged into practicing and thus take audit assignments.

Member in Practice Prohibited from using a Designation Other Than Chartered Accountant- Sec 7

- i. Every member of the Institute in practice shall, and any other member may, use the designation of a Chartered Accountant
- ii. No member using such designation shall use any other description, whether in addition thereto or in substitution thereof
- iii. In case a member has more than one COP, (subject to permission of the Council), for matters involving practice as Chartered Accountant, they should use designation “Chartered Accountant”

Points to remember:

Merchant Banker / Advisor to an issue: The members may apply for and obtain registration as category IV Merchant Banker under the SEBI’s rules and regulations and act as Advisor or Consultant to an issue. In client Companies’ offer documents and advertisements regarding capital issue, name and address of the Chartered Accountant or firm of Chartered Accountants acting as Advisor or Consultant to the Issue could be indicated under the caption “Advisor/Consultant to the Issue”. However, the name and address of such Chartered Accountant/firm of Chartered Accountants should not appear prominently.

Directors of Companies, Members of political parties, position in clubs, etc.: The members of the Institute who are also Directors in Companies, members of Political parties or Chartered Accountants Cells in the political parties, holding different positions in clubs or other organizations are not permitted to mention these positions as these would be violative of the provisions of Section 7 of the Act.

Members who are also Cost Accountants: Though a member cannot designate himself as a Cost Accountant, he can use the letters A.C.M.A (Associate) or F.C.M.A (Fellow) after his name, when he is a member of that Institute.

Permission to mention qualifications of certain Institutions: The members are permitted to mention membership of a foreign Institute of Accountancy, which has been recognized by the Council through a Memorandum of Understanding (MoU) / Mutual Recognition Agreement (MRA) with the said Institute.

- It is improper for a Chartered Accountant to state on his professional documents that he is an Income-tax Consultant, Cost Accountant, Company Secretary, Cost Consultant or a Management Consultant.
- Member are allowed to appear before the various authorities including Company Law Board, Income Tax Appellate Tribunal, Sales Tax Tribunal where the law has permitted the same, so far as the designation "Corporate Lawyer" is concerned, the Council was of the view that as per the existing provisions of law, a Chartered Accountant in practice is not entitled to use the designation "Corporate Lawyer".
- Further, the members are not permitted to use the initials 'CPA' (standing for Certified Public Accountant) on their visiting cards.
- Members of the Institute in practice who are otherwise eligible may also practice as Company Secretaries and/or Cost Accountants. Such members shall, however, not use designation/s of the aforesaid Institute/s simultaneously with the designation "Chartered Accountant".

Maintenance of Branch Offices- Sec 27

If a Chartered Accountant in practice or a Firm of Chartered Accountants has

- more than one office in India,
- each one of such offices should be in the separate charge of a member of the Institute.
- Failure on the part of a member or a firm to have a member in charge of its branch and a separate member in case of each of the branches, where there is more than one, would constitute professional misconduct.

However, exemption has been given to members practicing in hill areas subject to certain conditions.

The conditions are:

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

Above conditions apply to any additional office situated at a place beyond 50 kms from the municipal limits in which any office is situated.

It is necessary to mention that the Chartered Accountant in-charge of the branch of another firm should be associated with him or with the firm either as a partner or as a paid assistant. If he is a paid assistant, he must be in whole time employment with him.

A member being in charge of an office of a Chartered Accountant in practice or a firm of such Chartered Accountants shall be satisfied only if the member is actively associated with such office. Such association shall be deemed to exist if the member resides in the place where the office is situated for a period of not less than 182 days in a year or if he attends the said office for a period of not less than

182 days in a year or in such other circumstances as, in the opinion of the Executive Committee, establish such active association.

However, a member can be in-charge of two offices if they are located in one and the same Accommodation. In this context some of the Council's decisions are as follows:

- (1) With regard to the use of the name-board, there will be no bar to the putting up of a name-board in the place of residence of a member with the designation of Chartered Accountant, provided it is a name-plate or a name-board of an individual member and not of the firm
- (2) The exemption may be granted to a member or a firm of Chartered Accountants in practice to have a second office without such second office being under the separate charge of a member of the Institute, provided-
 - the second office is located in the same premises, in which the first office is located or,
 - the second office is located in the same city, in which the first office is located or,
 - the second office is located within a distance of 50 km. from the municipal limits of a city, in which the first office is located

A member having two offices of the type referred to above shall have to declare, which of the two offices is his main office, which would constitute his professional address.

KYC Norms for CA in Practice

The Council of ICAI approved the following KYC Norms which are mandatory in nature and shall apply in all assignments pertaining to attestation functions.

The KYC Norms approved by the Council of ICAI are given below:

1. Where Client is an Individual/ Proprietor

A. General Information

- Name of the Individual
- PAN No. or Aadhar Card No. of the Individual
- Business Description
- Copy of last Audited Financial Statement

B. Engagement Information

- Type of Engagement

2. Where Client is a Corporate Entity

A. General Information

- Name and Address of the Entity
- Business Description
- Name of the Parent Company in case of Subsidiary
- Copy of last Audited Financial Statement

B. Engagement Information

- Type of Engagement

C. Regulatory Information

- Company PAN No.

- Company Identification No.
- Directors' Names & Addresses
- Directors' Identification No.

3. Where Client is a Non-Corporate Entity

A. General Information

- Name and Address of the Entity
- Copy of PAN No.
- Business Description
- Partner's Names & Addresses (with their PAN/Aadhar Card/DIN No.)
- Copy of last Audited Financial Statement

B. Engagement Information

- Type of Engagement

CHARTERED ACCOUNTANTS IN SERVICE

In accordance with the definitions provided under the Code of Ethics,

A Professional Accountant in Service or Chartered Accountant in Service

- means a professional accountant employed or engaged
- in an executive or non-executive capacity
- in areas such as commerce, industry, service, the public sector, education,
- the not-for-profit sector, regulatory bodies or professional bodies, or a professional accountant contracted by such entities.

Disciplinary Procedure

- I. Receipt of complaint along with fee, or Information against member of ICAI of alleged misconduct
- II. Disciplinary Directorate

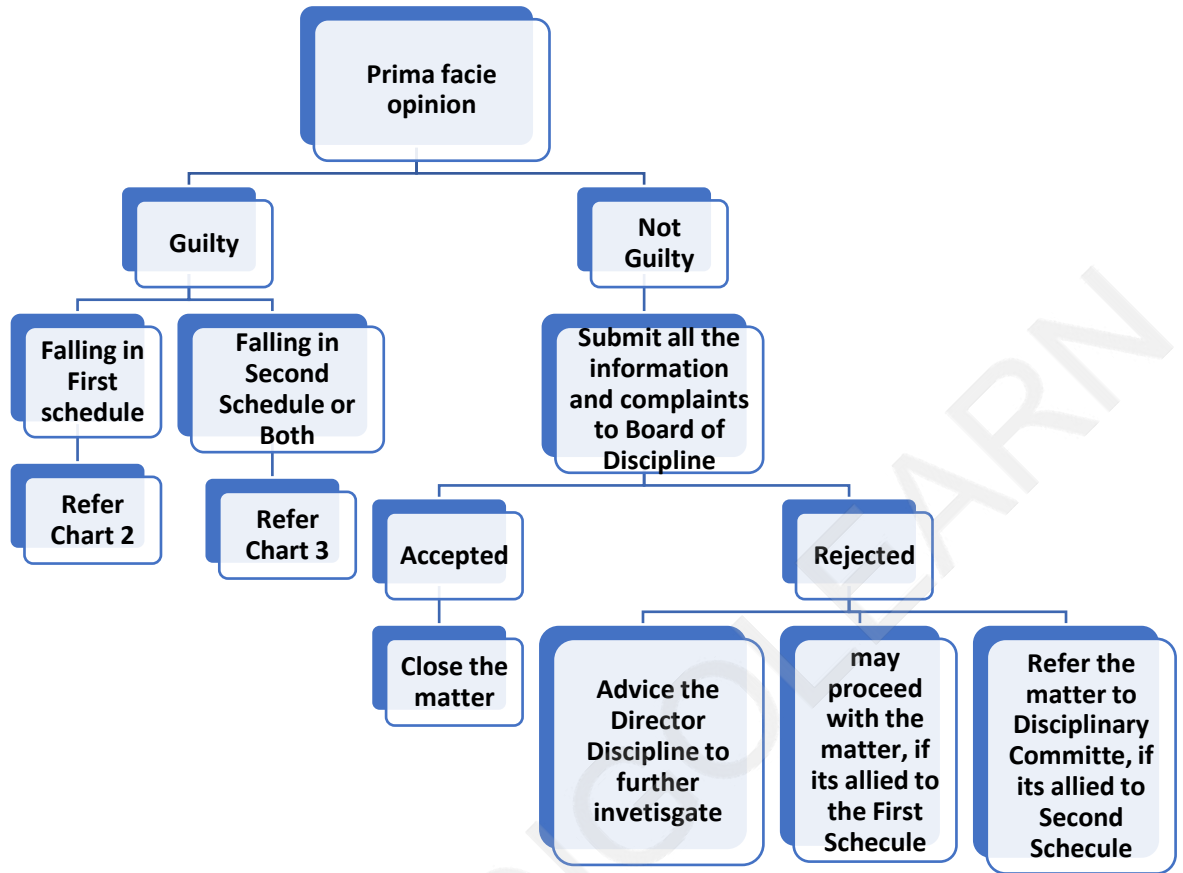
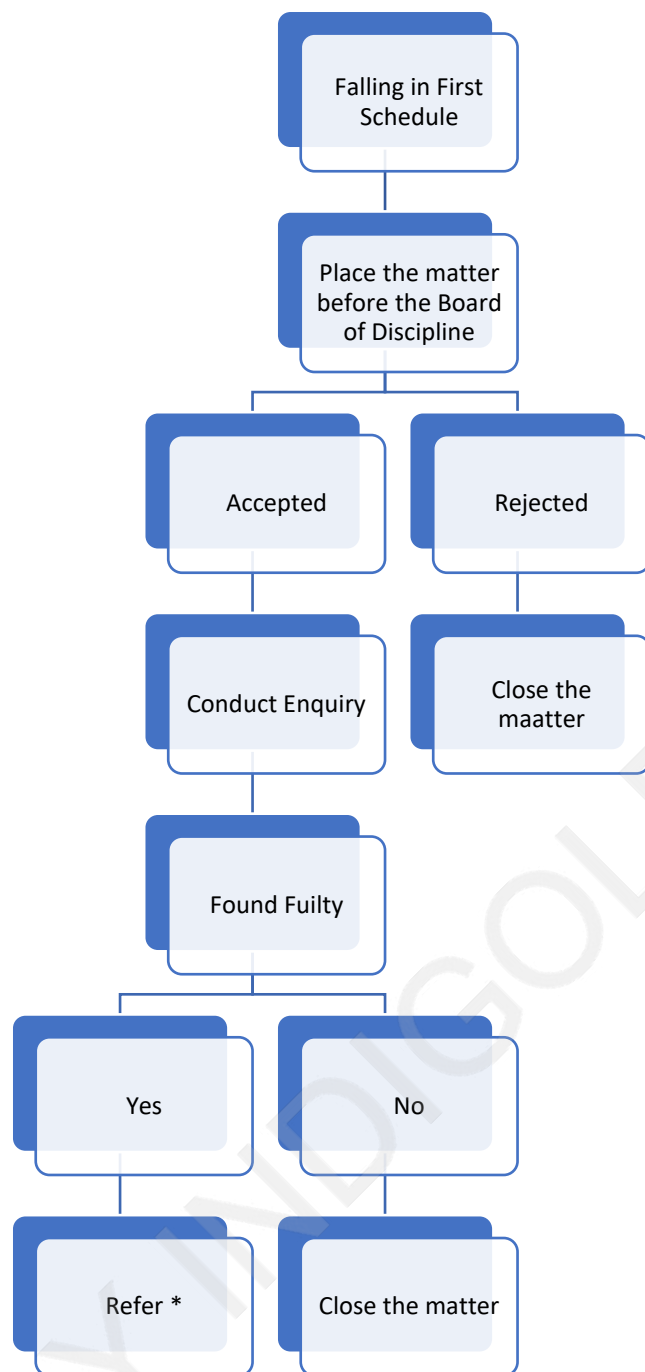


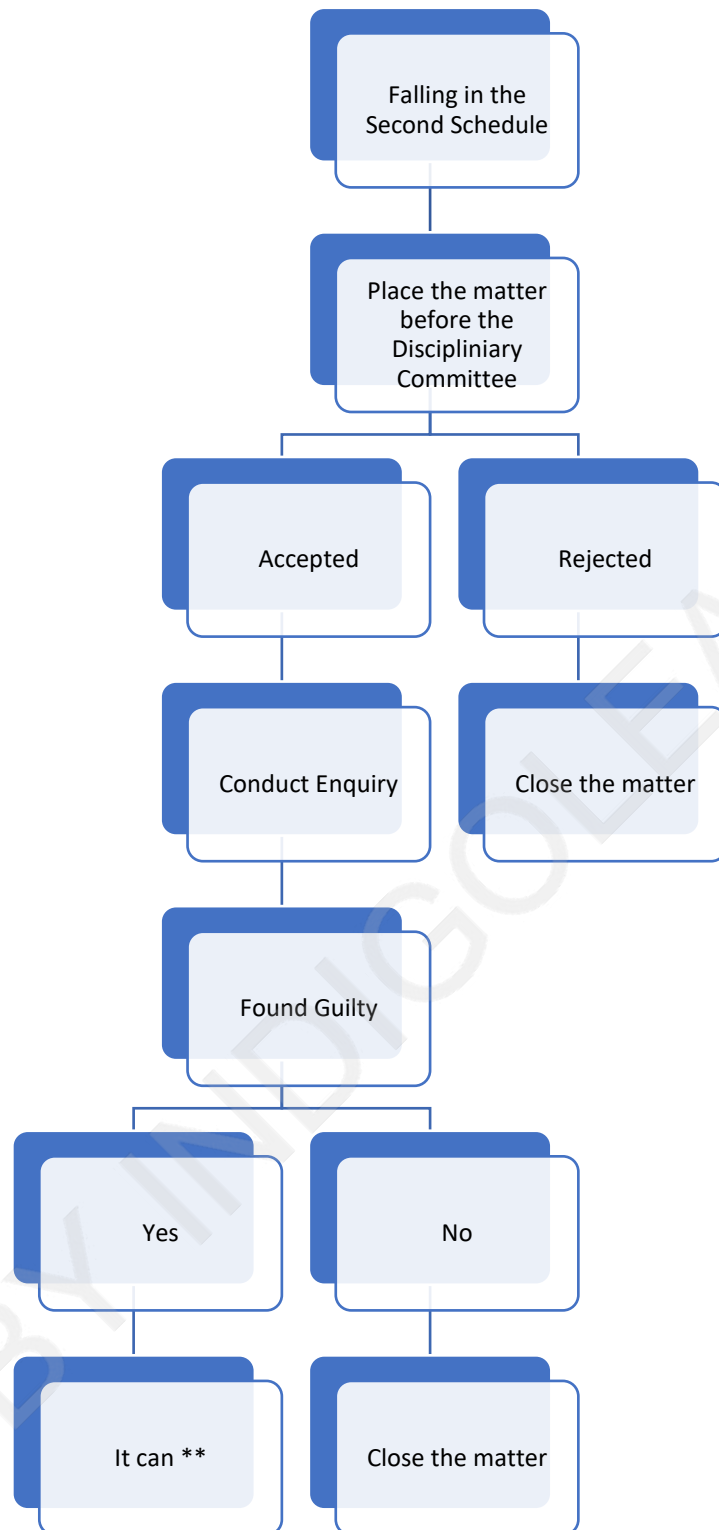
Chart 2



***It can,**

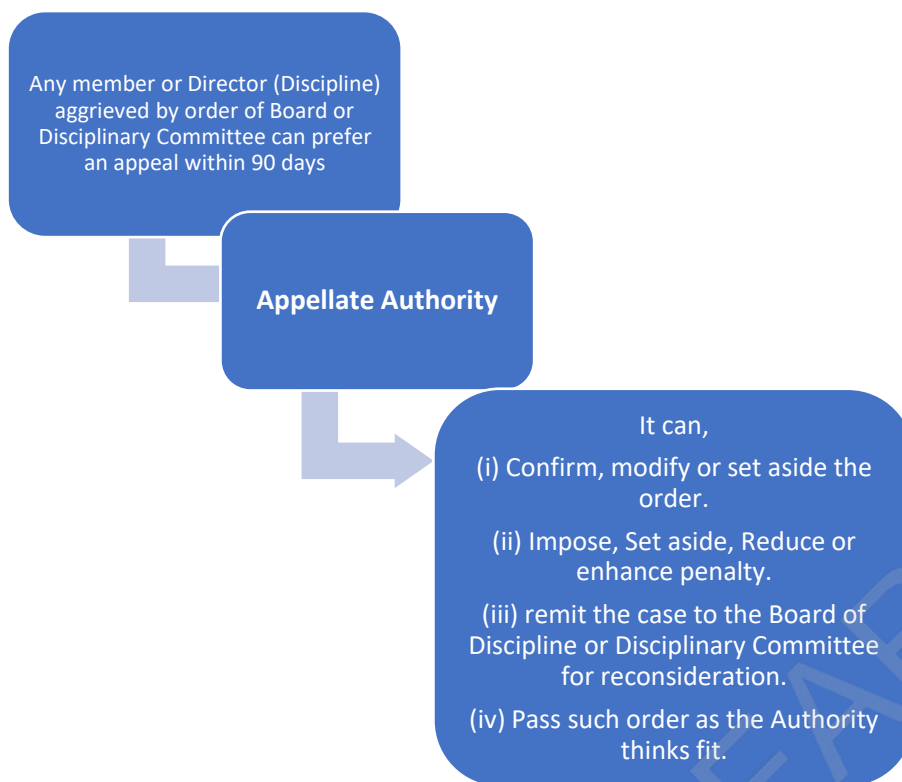
- Reprimand the member
- remove the name of the member up to a period of 3 months
- impose fine upto 100000p

Chart 3



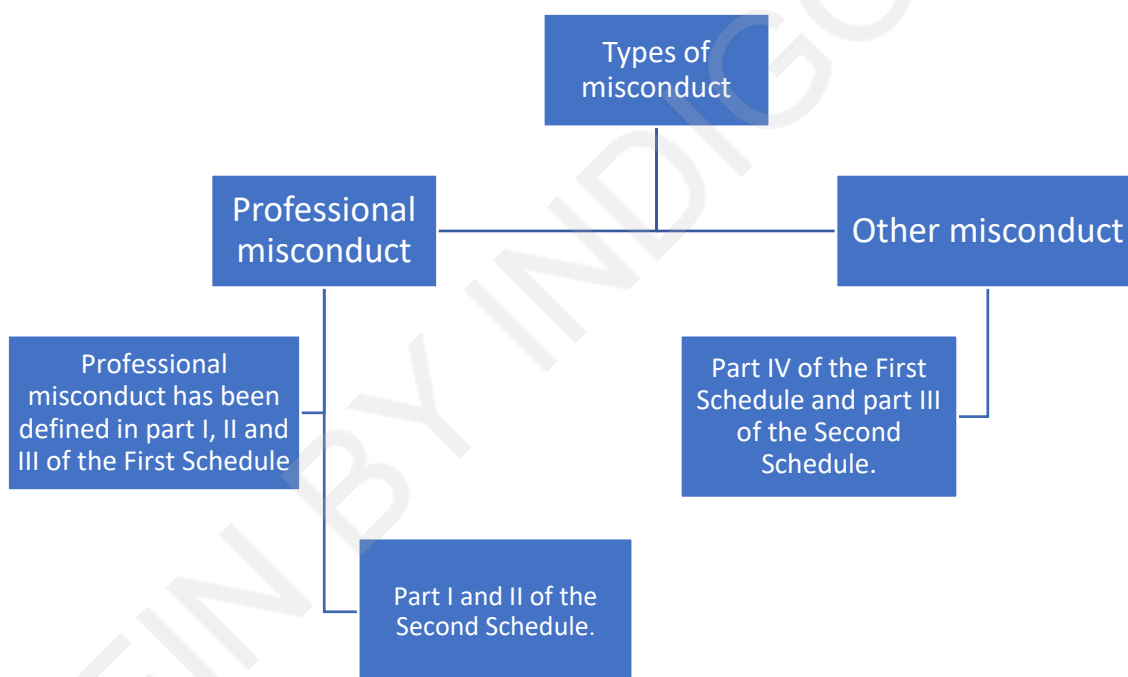
**It can,

- Reprimand the member
- Remove the name of the member permanently or for any duration it thinks fit
- Impose fine up to Rs. 500000



Note:

TYPES OF MISCONDUCT



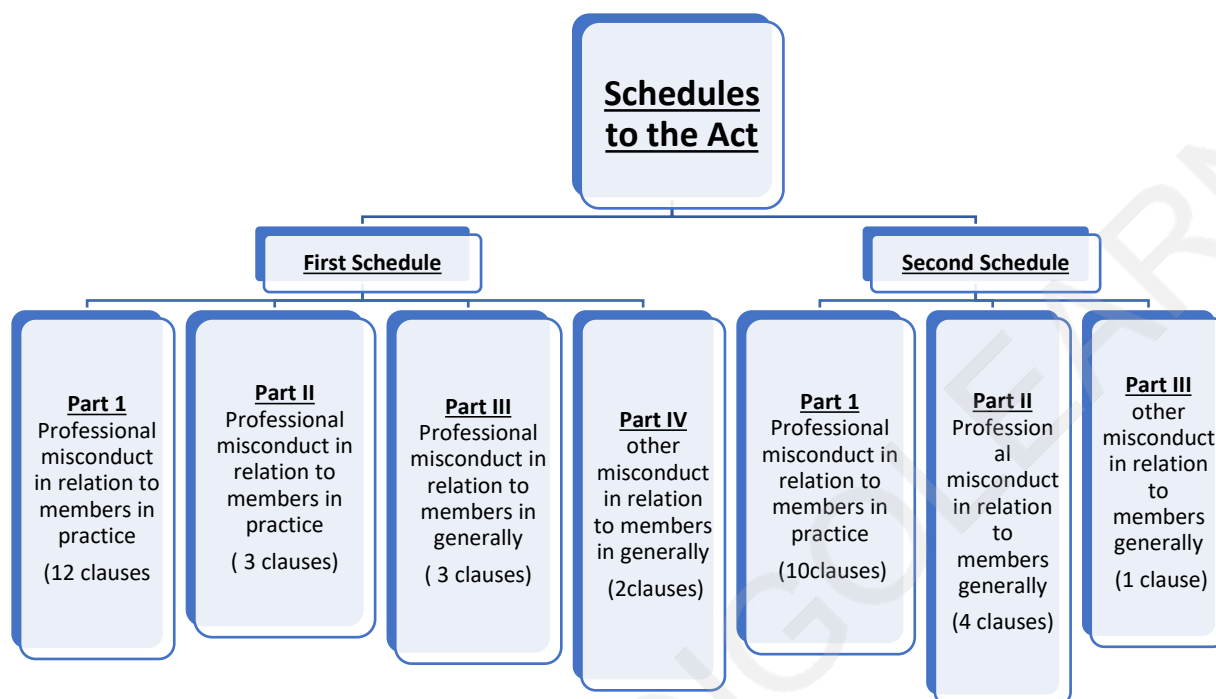
Professional Misconduct

- A member who is engaged in the profession of accountancy whether in practice or in service should conduct/restrict his actions in accordance with the provisions contained in the respective parts of the schedules.
- If the member is found guilty of any of the acts or omissions stated in any of the respective parts of the Schedule, he/she shall be deemed to be guilty of professional misconduct.

Other Misconduct

- These provisions empower the Council to inquire into any misconduct of a member even it does not arise out of his professional work.
- This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.

SCHEDULES TO THE ACT



First Schedule

Where the Director (Discipline) is of the opinion that member is guilty of any professional or other misconduct mentioned in the First Schedule;

he shall place the matter before the Board of Discipline.

PART I - Professional Misconduct in relation to Chartered Accountants in Practice

Clause (1): A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- allows any person
- to practice in his name as a chartered accountant
- unless such person is also a
- chartered accountant in practice and is in partnership with or employed by him.

It ensures that the work of the accountant will be carried out by a Chartered Accountant who may be his partner or his employee and would work under his control and supervision.

Clause (2): A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- pays or allows or agrees to pay or allow,

- directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business,
- to any person
- other than a member of the Institute or
- a partner or
- a retired partner or the legal representative of a deceased partner,
- or a member of any other professional body or
- with such other persons having such qualification as may be prescribed,
- for the purpose of rendering such professional services from time to time in or outside India.

The Council has prescribed [Regulation 53A (1) of the Chartered Accountants Regulations, 1988] the professional bodies, which are as under: -

- (a) The Institute of Company Secretaries of India established under the Company Secretaries Act, 1980.
- (b) The Institute of Cost & Works Accountants of India established under the Cost & Works Accountants Act, 1959.
- (c) Bar Council of India established under the Advocates Act, 1961.
- (d) The Indian Institute of Architects established under the Architects Act, 1972.
- (e) The Institute of Actuaries of India established under the Actuaries Act, 2006.

Further, the Council has also prescribed [Regulation 53A (3) of the Chartered Accountants Regulations, 1988] the persons qualified in India, which are as under:

- (i) Company Secretary within the meaning of the Company Secretaries Act, 1980;
- (ii) Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959;
- (iii) Actuary within the meaning of the Actuaries Act, 2006;
- (iv) Bachelor in Engineering from a University established by law or an Institution recognised by law;
- (v) Bachelor in Technology from a University established by law or an institution recognised by law;
- (vi) Bachelor in Architecture from a University established by law or an institution recognised by law;
- (vii) Bachelor in Law from a University established by law or an institution recognised by law;
- (viii) Master in Business Administration from Universities established by law or technical institutions recognised by All India Council for Technical Education

Share of Profit/ Sale of Goodwill

1. Sole Proprietorship Firm:

Goodwill can be transferred to another Chartered Accountant if:

- Sale is to be completed within 1 year of death
- If dispute of legal heir, inform ICAI within 1 year about the dispute and name shall be preserved for 1 year from SETTLEMENT of dispute.

Note: No sharing of fees between Legal Representative and Purchaser of Goodwill on the death of Sole Proprietor.

Payment shall be in lumpsum, installments allowed if agreement allows.

2. Partnership Firm:

There are two or more partners and one of them dies

Legal Representative of the deceased partner can continue to receive share of partner if partnership deed provides for it

Clause (3): A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- accepts or agrees to accept
- any part of the profits of the professional work of a person
- who is not a member of the Institute

Provided that nothing herein contained shall be construed as prohibiting a member 'from entering into profit sharing or other similar arrangements, including receiving any share commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in item (2) of this part

Referral fees amongst members: It is not prohibited for a member in practice to charge Referral Fees, being the fees obtained by a member in practice from another member in practice in relation to referring a client to him.

Clause (4): A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- enters into partnership,
- in or outside India,
- with any person
- other than Chartered Accountant in practice or
- such other person
- who is a member of any other professional body having such qualifications as may be prescribed,
- including a resident who but for his residence abroad would be entitled to be registered as a member under clause (v) of sub- section (1) of section 4 or
- whose qualifications are recognized by the Central Government or the Council for the purpose of permitting such partnerships.

A Chartered Accountant in practice is not permitted to enter into partnership with any person other than a Chartered Accountant in practice or such other persons as may be prescribed by the Council from time to time. The members may however take note of the fact that they cannot form multi-Disciplinary partnerships till such time that Regulators of such other professionals also permit partnership with chartered accountants, and guidelines in this regard are issued by the Council.

The Regulation 53B prescribes the membership of following professional bodies for entering into partnership:

Company Secretary, member, The Institute of Company Secretaries of India, established under the Company Secretaries Act, 1980;

Cost Accountant, member, The Institute of Cost and Works Accountants of India established under the Cost and Works Accountants Act, 1959;

Advocate, member, Bar Council of India established under the Advocates Act, 1961;

Engineer, member, The Institution of Engineers, or Engineering from a University established by law or an institution recognized by law.

Architect, member, The Indian Institute of Architects established under the Architects Act, 1972;

Actuary, member, The Institute of Actuaries of India, established under the Actuaries Act, 2006.

Clause (5) A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- Secures either through the services of a person
- who is not an employee of such Chartered Accountant or
- who is not his partner or
- by means which are not open to a Chartered Accountant,
- any professional business.

Provided that nothing herein contained shall be construed as prohibiting any agreement permitted in terms of item (2), (3) and (4) of this part.

It may further be noted that the acts of partners and employees of the Firm towards securing professional work are subject to the provisions of Clauses (6) and (7) of Part-I of First Schedule of Chartered Accountants Act, 1949

Clause (6) A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- Solicits clients or professional work
- either directly or indirectly
- by circular, advertisement, personal communication or interview or by any other means.

Provided that nothing herein contained shall be construed as preventing or prohibiting -

- (i) Any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or
- (ii) A member from responding to tenders or enquiries issued by various users of professional services or organizations from time to time and securing professional work as a consequence.

Council Guidelines w.r.t Permitted and Prohibited forms of Solicitation

Advertisement and note in press:

- Members should not advertise for soliciting work or advertise in a manner which could be interpreted as soliciting or offering to undertake professional work.
- They are also not permitted to use the less open method of circulating letters to a small field of possible clients.

- Personal canvassing or canvassing for clients of previous employer through the help of the employees are also not permitted.

The exceptions to the above rule are:

- (i) A member may request another Chartered Accountant in practice for professional work.
- (ii) a member may advertise changes in partnerships or dissolution of a firm, or of any change in address of practice and telephone numbers. Such announcements should be limited to a bare statement of facts and consideration given to the appropriateness of the area of distribution of the newspaper or magazine and number of insertions.
- (iii) a member is also permitted to issue a classified advertisement in the journal/ newsletter of the Institute intended to give information for sharing professional work on assignment basis or for seeking partnership or salaried employment of an accountancy nature, provided it only contains the accountant's name, address or telephone number, fax number, e-mail address and address(es) of social Networking sites of members.

However, mere factual position of experience and area of specialization, relevant to seek response to the advertisement, are permissible.

Empanelment for allotment of audit/ professional work

- Where the existence of such a panel is within the knowledge of a member, he is free to write to the concerned organization with a request to place his name on the panel.
- However, it would not be proper for the Chartered Accountant to make roving enquiries by applying to any such organization for having his name included in any such panel.
- It is permissible to quote fees on enquiries being received from such bodies, which maintain such panel

Responding to Tenders, Advertisements and Circulars: It is not prohibited to the members to respond to tenders and requests made by users of professional work. This is however subject to conditions that may be issued by the Council from time to time.

The Council has issued Guidelines dated 7th April 2016 which stipulate that

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

The "minimum fee" for this purpose should be such that it commensurate with size, value, volume, manpower requirement and nature of work.

EMD/Security Deposit : The Council is of the view that while interference with the practices prevailing for requirement of EMD/Deposit is not required. However, on having received complaint/ instance of exorbitant EMD/Deposit, the Ethical Standards Board may look into the matter on case to case basis.

Publication of Books, Articles or Presentation: It is not permissible for a member to mention in a book or an article published by him, or a presentation made by him, any professional attainment(s), whether of the member or the firm of chartered accountants, with which he is associated. However, he may indicate in a book, article or presentation the designation "Chartered Accountant" as well as the name of the firm.

Issue of Greeting Cards or Invitations :

- The Council does not approve of the issue of greeting cards or personal invitations by members indicating their professional designation, status and qualifications etc.
- However, the Council is of the view that the designation “Chartered Accountant” as well as the name of the firm may be used in greeting cards, invitations for marriages and religious ceremonies and any invitations for opening or inauguration of office of the members, change in office premises and change in telephone numbers, provided that such greeting cards or invitations etc. are sent only to clients, relatives and friends of the members concerned.

Advertisement for Silver, Golden, Platinum or Centenary celebrations : It is not permitted to advertise the events organized by a Firm of Chartered Accountants. However, considering the need of interpersonal socialization/relationship of the members through such get together occasions, the advertisement for Silver, Golden, Diamond, Platinum or Centenary celebrations of the Chartered Accountants Firms may be published in newspaper or newsletter.

Sponsoring Activities

(a) A member in practice or a Firm of Chartered Accountants is not permitted to sponsor an event. However, such member or Firm may sponsor an event conducted by a Programme Organizing Unit (PoU) of the ICAI, provided such event has the prior approval of Continuing Professional Education (CPE) Directorate of the ICAI.

(b) Members sponsoring activities relating to Corporate Social Responsibility may mention their individual name with the prefix “CA”. However, the mention of Firm name or CA Logo is not permitted.

Advertisement of Teaching/Coaching activities by members

- Under the purview of Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, an advertisement of Coaching /teaching activities by a member in practice may amount to indirect solicitation, as well as solicitation by any other means, and may therefore be violative of the provisions of Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949.
- In view of the above, such members are advised to abstain from advertising their association with Coaching /teaching activities through hoardings, posters, banners and by any other means, failing which they may be liable for disciplinary action
- Subject to the above prohibition, such members may put, outside their Coaching/ teaching premises, sign board mentioning the name of Coaching/teaching Institute, contact details and subjects taught therein only.

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

Television or Movie Credits : While sharing name of the member or Firm of Chartered Accountants for inclusion in Television or Movie Credits , it must be taken care of that exhibition of name is not made differently as compared to other entries in the credits.

Soliciting professional work by making roving enquiries: It is not permissible for a member to address letters, emails or circulars specifically to persons who are likely to require services of a Chartered Accountant since it would tantamount to advertisement.

Seeking work from Professional Colleagues: The issue of an advertisement or a circular by a Chartered Accountant, seeking work from professional colleagues on any basis whatsoever except as provided above would be in violation of this clause.

Scope of representation which an auditor is entitled to make under Section 225(3) of the Companies Act, 1956 (Section 140(4) of the Companies Act, 2013) :

- The right to make representation does not mean that an auditor has any prescriptive right or a lien to an audit.
- The wording of his representation should be such that, apart from the opportunity not being abused to secure needless publicity, it does not tantamount directly or indirectly to canvassing or soliciting for his continuance as an auditor.
- The letter should merely set out in a dignified manner how he has been acting independently and conscientiously through the term of office and may, in addition, indicate if he so chooses, his willingness to continue as auditor if reappointed by the shareholders.

Acceptance of original professional work by a member emanating from the client introduced to him by another member:

- The Council has decided that a member should not accept the original professional work emanating from a client introduced to him by another member.
- If any professional work of such client comes to him directly, it should be his duty to ask the client that he should come through the other member dealing generally with his original work.

Giving Public Interviews:

- While giving any interview or otherwise furnishing details about themselves or their firms in public interviews or to the press or at any forum, the members should ensure that, it should not result in publicity.
- Due care should be taken to ensure that such interviews or details about the members or their firms are not given in a manner highlighting their professional attainments.
- Any detail which is given must, in addition to meeting the above requirements, be given only as a response to a specific question, and of factual nature only.

Members and/or firms who publish advertisements under Box numbers: Members/Firms are prohibited from inserting advertisements for soliciting clients or professional work under box numbers in the newspapers. This practice is in violation of this clause.

Educational Videos: While the videos of educational nature may be uploaded on the internet by members, no reference should be made to the Chartered Accountants Firm wherein the member is a partner/ proprietor. Further, it should not contain any contact details or website address.

Website of the CA Firms

The Council has approved the detailed guidelines for posting the particulars on Website by Chartered Accountant(s) in practice and firm(s) of Chartered Accountants in practice: -

1.	The Chartered Accountants and/or Chartered Accountants' Firms would be free to create their own website. The following stipulations will be applicable on such websites: -
2.	The actual format of the Website is not being prescribed nor any standard format of the Website is being given to provide independence to the Members.

3.	The Chartered Accountants and/or Chartered Accountants' Firms would ensure that their websites are run on a "pull" model and not a "push" model of the technology to ensure that any person who wishes to locate the Chartered Accountants or Chartered Accountants' firms would only have access to the information and the information should be provided only on the basis of specific "pull" request.
4.	The Chartered Accountants and/or Chartered Accountants' Firms should ensure that none of the information contained in the Website be circulated on their own or through E-mail or by any other mode or technique except on a specific "pull" request.
5.	The Chartered Accountants would also not issue any circular or any other advertisement or any other material of any kind whatsoever by virtue of which they solicit people to visit their website. The Chartered Accountants would, however, be permitted to mention their website address on their professional stationery and email.
6.	The following information may be allowed to be displayed on the Firms/Members' Websites:
(i)	Member/Trade/Firm name.
(ii)	Year of establishment.
(iii)	Member/Firm's Address (both Head Office and Branches) Tel. No(s), Fax No(s) E-mail ID(s)
(iv)	Nature of services rendered (to be displayable only on specific "pull" request)
(v)	Partners
	<ul style="list-style-type: none"> Partners Name Year of Qualification Other Qualification(s) Tel.. Off. - Direct Res. Mobile E-mail address Area of Experience (to be displayable only on specific "pull" request)
(vi)	Details of Employees - Professional Others Name Designation Area of experience (to be displayable only on specific "pull" request)
(vii)	Job vacancies for the Chartered Accountant/firm of Chartered Accountants (including articleship).
(viii)	No. of articled assistants. (To be displayable only on specific "pull" request).
(ix)	Nature of assignments handled (to be displayable only on specific "pull" request). Names of clients and fee charged cannot be given. While the mention of names of clients is not permissible, members may take note of the following with regard to website of the Firm: -
<p>Note: Disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India, provided that such disclosure is only to the extent of requirement of the regulator and is made only till such period that the member works under the purview of such Regulator/ such requirements of the Regulator are in force. Where such disclosure of names of clients and/or fees charged is made on the website, the member/ firm shall ensure that it is mentioned on the website [in italics], below such disclosure itself, that "This disclosure is in terms of the requirement of [name of the regulator] having jurisdiction in [name of the country/ area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by the Regulator].</p>	
7.	Display of Passport style photograph is permitted.
8.	The members may include articles, professional information, bulletin boards, professional updating and other matters of larger importance or of professional interest on the website. Educational videos on topics of professional relevance are permissible.
9.	The chat rooms can be provided which permit chatting amongst members of the ICAI and between Firms and its clients. The confidentiality protocol would have to be observed. The Firms can provide document management facility with distinct log in and password facility to the clients to access copies of their documents on the Firm website.

10.	The Firm can provide link of its page on Social Networking site. However, the members should not solicit people to visit or like their respective page(s) on such social Networking site.
11.	The members/firms can provide on line advice to their clients who specifically request for the advice whether free of charge or on payment.
12.	The details in the Website should be so designed that it does not amount to soliciting client or professional work. In case any content or technical feature of Website is against the professional Code of Conduct and Ethics as well as the restrictions contained in the schedules to the Chartered Accountants Act, 1949 or against the guidelines or directions issued by ICAI from time to time, appropriate action will be initiated by the ICAI in terms of its disciplinary mechanism either suo moto or on complaint as provided under the Chartered Accountants Act, 1949.
13.	The Website should ensure adequate secrecy of the matters of the clients handled through Website.
14.	No Advertisement in the nature of banner or any other nature will be permitted on the Website.
15.	The Website should be befitting the profession of Chartered Accountants and should not contain any information or material which is unbecoming of a Chartered Accountant.
16.	The Website may provide a link to the Website of ICAI, its Regional Councils and Branches and also the Website of Govt./Govt. Departments/Regulatory authorities/other Professional Bodies.
17.	The Website address should be as near as possible to the individual name/trade name, firm name of the Chartered Accountant in practice or firm of Chartered Accountants in practice. But it should not amount to soliciting clients or professional work or advertisement of professional attainments or services. The Ethical Standards Board (ESB) of ICAI will decide in case there is any difficulty.
18.	The Website should mention the information which is not at material variance from the information as per the ICAI's records.

Clause (7): A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- Advertises his professional attainments or services, or
- uses any designation or expressions other than the Chartered Accountant
- on professional documents, visiting cards, letter heads or sign boards unless
- it be a degree of a University established by law in India or recognized by the Central Government
- or a title indicating membership of the Institute of Chartered Accountants or
- of any other institution that has been recognized by the Central Government or
- may be recognized by the Council.

Provided that a member in practice may advertise through a write up, setting out the service provided by him or his firm and particulars of his firm subject to such guidelines as may be issued by the Council.

Council Guidelines for Advertisement

Advertisement through Write up- Covered in CGG

Other Desination:

- It is improper for a Chartered Accountant in practice to state on his professional documents that he is an Income-tax Consultant, Cost Accountant, Company Secretary, Cost Consultant or a Management Consultant

- A member empanelled as Insolvency Professional or Registered Valuer can mention “Insolvency Professional” or “Registered Valuer” respectively on his visiting card and letter head

Permission to mention qualifications of certain Institutions:

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

Date of setting-up practice: The date of setting up the practice by a member or the date of establishment of the firm on the letter heads and other professional documents etc. should not be mentioned.

Practice as Advocate: Members of the Institute in practice who are otherwise eligible may practise as advocates subject to the permission of the Bar Council but in such case, they should not use designation ‘Chartered Accountant’ in respect of the matters involving the practice as an advocate. In respect of other matters they should use the designation ‘Chartered Accountant’ but they should not use the designation ‘Chartered Accountant’ and ‘Advocate’ simultaneously.

Practice as Company Secretary/Cost Management Accountant: Members of the Institute in practice who are otherwise eligible may also practice as Company Secretaries and/or Cost Management Accountants. Such members shall, however, not use designation/s of the aforesaid Institute/s simultaneously with the designation “Chartered Accountant”.

It is clarified that in the event of the permission being granted to a member in practice to also hold COP of sister Institute(s)/Bar Council, such a member be treated as a member in full-time practice.

Mention of Firm name except on Professional Documents: It is not proper for a Firm of Chartered Accountants to use the designation ‘Chartered Accountant’ except on professional documents, visiting cards, letter heads or sign boards and under the circumstances clarified under Clause (6). However, an individual member may use the prefix “CA” with his name.

Notice in the Press relating to the Success in an Examination: Notice in the press relating to the success in an examination of an individual candidate, should not contain any element of undesirable publicity either in relation to the articled/audit assistant or an employee or the member or the firm with whom he was served.

Reports and Certificates: The reports and certificates issued by a Chartered Accountant bring him to the notice of the public in a greater or lesser degree. It is therefore incumbent upon him to ensure that the extent and manner of publication of certificates are limited to what is necessary to enable the report or certificate to serve its proper purpose. The members may however note that they should use letterhead of their Firm for issuing reports and certificates.

Appearance of Chartered Accountants on Electronic Media (including Internet):

- Members may appear on television, films and Internet and agree to broadcast in the Radio or give lectures at forums and may give their names and describe themselves as Chartered Accountants.
- Special qualifications or specialised knowledge directly relevant to the subject matter of the programme may also be given.

- Firm name may also be mentioned, however, any exaggerated claim or any kind of comparison is not permissible. What he may say or write must not be promotional of him or his firm but must be an objective professional view of the topic under consideration.

Organising Training Courses, Seminars etc. for his staff: A Chartered Accountant in practice holding training courses, seminars etc. for his staff may also invite the staff of other Chartered Accountants and clients to attend the same. However, undue prominence should not be given to the name of the Chartered Accountant in any booklet or document issued in connection therewith.

Writing Articles or Letters to the Press: Members writing articles or letters to the Press on subjects connected with the profession may give their names and use the description Chartered Accountants.

Size of Sign Board: With regard to the size of sign board for his office that a member can put up, it is a matter in which the members should exercise their own discretion and good taste while keeping in mind the appropriate visibility and illumination (limited to the sake of visibility). However, use of glow signs or lights on large-sized boards as is used by traders or shop-keepers is not permissible.

A member can have a name board at the place of his residence with the designation of a Chartered Accountant, provided it is a name plate or name board of an individual member and not of the firm.

Public Announcements with details of Directors:

- The Council's attention has been drawn to the fact that more and more Companies are appointing Chartered Accountants as Directors on their Boards.
- The prospectus or public announcements issued by these Companies often publish descriptions about the Chartered Accountant's expertise, specialisation and knowledge in any particular field or add appellations or adjectives to their names.

It is advisable for a member that as soon as he is appointed as a director on the Board of a Company, he should specifically invite the attention of the management of the Company to the aforesaid provisions and should request that before any such prospectus or public announcements or public communication mentioning the name of the member concerned, is issued, the material pertaining to the member concerned should, as far as practicable be got approved by him

Network Firms and Networking Guidelines : The Council has permitted Network amongst the Firms registered with the Institute. A member of the Network may advertise to the extent permitted by the Advertisement Guidelines issued by Institute.

Use of Logo: The Council decided that the use of logo/monogram of any kind/form/style/design/colour etc. whatsoever on any display material or media e.g. paper stationery, documents, visiting cards, magnetic devices, internet, sign board, by the members in practice and/or the firm of Chartered Accountants, be prohibited. Use/printing of member/firm name in any other manner than amounting to logo/monogram was also prohibited

Common CA Logo : To promote the brand of CA profession and responding to the long felt need to have a symbol of CA Profession in India, ICAI came up with a unique logo which could be used by all members, whether in practice or not.

Clause (8) A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- accepts a position as auditor
- previously held by another chartered accountant or
- a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932
- without first communicating with him in writing.

The professional reasons for not accepting an audit would be:

- (a) Non-compliance of the provisions of Sections 139 and 140 of the Companies Act, 2013 as mentioned in Clause (9) of the Part - I of First Schedule to The Chartered Accountants Act, 1949 ; and
- (b) Non-payment of undisputed Audit Fees by auditees other than in case of Sick Units for carrying out the Statutory Audit under the Companies Act, 2013 or various other statutes; and
- (c) Issuance of a qualified report.

In first two cases. Acceptance of audit amounts to professional misconduct. In (iii) case, member may accept audit if he thinks that attitude of retiring auditor wasn't proper and justified. But if the report was qualified for good and valid reasons, non-acceptance of audit would be healthy practice.

- Where the Previous Auditor is not available for accepting payment of undisputed audit fees, and it is not otherwise possible to transfer the payment to him electronically, the Incoming Auditor may advise the client to purchase Demand Draft of the amount equivalent to undisputed Audit Fees of retiring auditor, and may accept the Audit assignment after verifying the same
- the object of the incoming auditor, in communicating with the retiring auditor is to ascertain from him whether there are any circumstances which warrant him not to accept the appointment.
- Members should therefore communicate with a retiring auditor in such a manner as to retain in their hands positive evidence of the delivery of the communication to the addressee. In the opinion of the Council, the following would in the normal course provide such evidence:-

a. Communication by a letter sent through "Registered Acknowledgement due", or
b. By hand against a written acknowledgement, or
c. Acknowledgement of the communication from retiring auditor's vide email address registered with the Institute or his last known official email address, or
d. Unique Identification Number (UDIN) generated on UDIN portal (subject to separate guidelines to be issued by the Council in this regard)

Premises found Locked : The communication received back by the Incoming Auditor with "Office found Locked" written on the Acknowledgement Due shall be deemed as having been delivered to the retiring auditor.

Firm not found at the given Registered address : If the Communication sent by the Incoming auditor is received back with remarks "No such office exists at this address", and the address of communication is the same as registered with the Institute on the date of dispatch, the letter will be deemed to be delivered, unless the retiring auditor proves that it was not really served and that he was not responsible for such non-service.

As a matter of professional courtesy and professional obligation it is necessary for the new auditor appointed to act jointly with the earlier auditor and to communicate with such earlier auditor.

Special Audit under Income Tax Act, 1961 : It would be a healthy practice if a Tax Auditor appointed for conducting special audit under the Income Tax Act, 1961 communicates with the member who has conducted the Statutory Audit.

Communication required for all kinds of audit : The requirement for communicating with the previous auditor being a Chartered Accountant in practice would apply to all types of Audit viz., Statutory Audit, Tax Audit, GST Audit, Internal Audit, Concurrent Audit or any other kind of audit.

Communication in case of Assignments done by other professionals: A Communication is mandatorily required for all types of Audit/Report where the previous auditor is a Chartered Accountant. In case of assignments done by other professionals not being Chartered Accountants, it would also be a healthy practice to communicate.

Lack of time in acceptance of Government Audits: Although the mandatory requirement of communication with previous auditor being Chartered Accountant applies, in uniform manner, to audits of both government and Non-Government entities, yet in the case of audit of government Companies/ banks or their branches, if the appointment is made well in time to enable the obligation cast under this clause to be fulfilled, such obligation must be complied with before accepting the audit. However, in case the time schedule given for the assignment is such that there is no time to wait for the reply from the outgoing auditor, the incoming auditor may give a conditional acceptance of the appointment and commence the work which needs to be attended to immediately after he has sent the communication to the previous auditor in accordance with this clause. In his acceptance letter, he should make clear to the client that his acceptance of appointment is subject to professional objections, if any, from the previous auditors and that he will decide about his final acceptance after taking into account the information received from the previous auditor.

Clause (9) A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- accepts an appointment as auditor of a Company
- without first ascertaining from it whether the requirements of Sections 139 and 140 of the Companies Act, 2013,
- in respect of such appointment have been duly complied with.

No Chartered Accountant in practice shall charge or offer to charge, accept or offer to accept, in respect of any professional work, fees which are based on a percentage of profits, or which are contingent upon the findings or results of such work, provided that:

(a)	"In the case of a receiver or a liquidator, the fees may be based on a percentage of the realization or disbursement of the assets;
(b)	In the case of an auditor of a co-operative society, the fees may be based on a percentage of the paid-up capital or the working capital or the gross or net income or profits;
(c)	In the case of a valuer for the purposes of direct taxes and duties, the fees may be based on a percentage of the value of property valued;
(d)	in the case of certain management consultancy services as may be decided by the resolution of the Council from time to time, the fees may be based on percentage basis which may be contingent upon the findings, or results of such work;
(e)	in the case of certain fund-raising services, the fees may be based on a percentage of the fund raised;
(f)	in the case of debt recovery services, the fees may be based on a percentage of the debt recovered;

(g) in the case of services related to cost optimisation, the fees may be based on a percentage of the benefit derived; and
(h) any other service or audit as may be decided by the Council. [Following activities have been decided by the Council under “h” above: -
(i) Acting as Insolvency Professional;(ii) Non-Assurance Services to Non-Audit Clients]

Clause (11) A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- Engages in any business or occupation
- other than the profession of chartered accountant
- unless permitted by the Council so to engage.

Provided that nothing contained herein shall disentitle a chartered accountant from being a director of a company (Not being managing director or a whole time director) unless he or any of his partners is interested in such company as an auditor.

Regulation 190A: “A chartered accountant in practice not to engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council”.

General Resolution

Permission granted generally - Members of the Institute in practice be generally permitted to engage in the following categories of occupations, for which no specific permission from the Council would be necessary in individual cases:

- (1) Employment under Chartered Accountants in practice or firms of such chartered accountants.
- (2) Private tutorship.
- (3) Authorship of books and articles.
- (4) Holding of Life Insurance Agency License for the limited purpose of getting renewal commission.
- (5) Attending classes and appearing for any examination.
- (6) Holding of public elective offices such as M.P., M.L.A. and M.L.C.
- (7) Honorary office leadership of charitable-educational or other non-commercial organisations.
- (8) Acting as Notary Public, Justice of the Peace, Special Executive Magistrate and the like.
- (9) Part-time tutorship under the coaching organisation of the Institute.
- (10) Valuation of papers, acting as paper-setter, head-examiner or a moderator, for any examination.
- (11) Editorship of professional journals.
- (12) Acting as Surveyor and Loss Assessor under the Insurance Act, 1938 provided they are otherwise eligible.
- (13) Acting as recovery consultant in the banking sector
- (14) Owning agricultural land and carrying out agricultural activity (w.e.f. August 9th, 2008).

Specific Resolution –

Members of the Institute in practice may engage in the following categories of business or occupations, after obtaining the specific and prior approval of the Council in each case:

- (1) Full-time or part-time employment in business concerns provided that the member and/or his relatives do not hold “substantial interest” in such concerns.
- (2) Full-time or part-time employment in non-business concern.
- (3) Office of managing director or a whole-time director of a body corporate within the meaning of the Companies Act, 1956 (now Companies Act, 2013) provided that the member and/or any of his relatives do not hold substantial interest in such concern.
- (4) Interest in family business concerns (including such interest devolving on the members as a result of inheritance / succession / partition of the family business) or concerns in which interest has been acquired as a result of relationships and in the management of which no active part is taken.
- (5) Interest in an educational institution.
- (6) Part-time or full-time lectureship for courses other than those relating to the Institute’s examinations conducted under the auspices of the Institute or the Regional councils or their branches.
- (7) Part-time or full-time tutorship under any educational institution other than the coaching organization of the Institute.
- (8) Editorship of journals other than professional journals.
- (9) Any other business or occupation for which the Executive Committee considers that permission may be granted.

However, it is open to the Council to refuse permission in individual cases though covered under any of the above categories.

For the purpose of the above resolution:

- (i) the expression “relative”, in relation to a member, means the husband, wife, brother or sister or any lineal ascendant or descendant of that member;
- (ii) a member shall be deemed to have a “substantial interest” in a concern -
 - (i) in a case where the concern is a Company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than twenty per cent of voting power at any time, during the relevant years are owned beneficially by such member or by any one or more of the following persons or partly by such member and partly by one or more of the following persons:
 - (a) One or more relatives of the member;
 - (b) Any concerns in which any of the persons referred to above has a substantial interest;
 - (ii) in the case of any other concern, if such member is entitled or the other persons referred to above or such member and one or more of the other persons referred to above are entitled in the aggregate, at any time during the relevant years to not less than twenty percent of the profits of such concern.

Clause (12) A Chartered Accountant in practice is deemed to be guilty of professional misconduct if he:

- Allows a person not being a member of the institute in practice or
- a member not being his partner
- to sign on his behalf or on behalf of his firm,
- any balance sheet, profit and loss account, report or financial statements.

The financial statements and the reports referred to in this clause obviously means the financial statements and reports as ultimately finalized and submitted to the outside authorities.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated in the following instances and such delegation will not attract provisions of this clause:

- (i) Issue of audit queries during the course of audit.
- (ii) Asking for information or issue of questionnaire.
- (iii) Letter forwarding draft observations/financial statements.
- (iv) Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.
- (v) Acknowledging and carrying on routine correspondence with clients.
- (vi) Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.
- (vii) Issuing acknowledgements for records produced.
- (viii) Raising of bills and issuing acknowledgements for money receipts.
- (ix) Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.
- (x) Any other matter incidental to the office administration and routine work involved in practice of accountancy.

PART II - Professional misconduct in relation to members of the Institute in service

Clause (1) A CA in service is guilty of professional misconduct if he

- pays or allows or agrees to pay
- directly or indirectly to any person
- any share in the emoluments of the employment undertaken by him.

Note: This clause does not restrict such sharing or commitments among relatives, dependents, friends etc., if there is no relationship in procuring or retaining the job and payment is not a consideration for job procurement or retainerhip

Clause (2) A CA in service is guilty of professional misconduct if he

- accepts or agrees to accept
- any part of fees, profits or gains from
- a lawyer, a chartered accountant or broker engaged by such company, firm or person or
- agent or customer of such company, firm or person
- by way of commission or gratification.

The objective is that when a member is in employment, he must maintain high level of ethics and should not accept any other amount from anyone for which he is not entitled from employer under contractual agreement of service.

PART III - Professional misconduct in relation to members of the Institute generally.

Clause (1): A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he -

- not being a fellow of the Institute,
- acts as a fellow of the Institute.

Clause (2) : A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he -

- does not supply the information called for,
- or does not comply with the requirements asked for,
- by the Institute, Council or
- any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority.

Clause (3) A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he –

- while inviting professional work from another chartered accountant or
- while responding to tenders or enquiries or while advertising through a write up,
- or anything as provided for in items (6) and (7) of Part I of this Schedule,
- gives information
- knowing it to be false.

PART IV- Other misconduct in relation to members of the Institute generally

Clause (1) A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he –

- is held guilty by any civil or criminal court for an offence which is punishable with imprisonment
- for a term not exceeding six months.

Clause (2) A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he –

- in the opinion of the Council, brings disrepute to the profession or
- the Institute as a result of his action whether or
- not related to his professional work.

Second Schedule

Part I “Professional Misconduct In Relation To Members in Practice”

Clause (1) A CA in practice shall be deemed to be guilty of professional misconduct if he –

- discloses the information
- acquired in the course of his to any professional engagement
- to any person other than his client so engaging him
- without the consent of his client or
- otherwise than as required by any law for the time being in force.

Matters relating to Audit working papers:

- An auditor is not required to provide the client or other auditors of the same enterprise or its related enterprise such as a parent or a subsidiary, access to his audit working papers.
- The Principal Auditor of an enterprise do not have right of access to the audit working papers of the branch auditors.
- An auditor can rely on the work of another auditor, without having any right of access to the audit working papers of the other audit.
- There is a difference between sharing of working papers and sharing of information. So far as the information is concerned, member can provide the same to the client or to a Regulatory body after obtaining the consent of the client.

Clause (2) A CA in practice shall be deemed to be guilty of professional misconduct if he-

- Certifies or submits in his name or in the name of his firm.
- a report of an examination of financial statements
- unless the examination of such statements and the related records has been made by
 - him or
 - by a partner or
 - an employee in his firm or
 - by another CA in practice.

This Clause ensures that work entrusted to a member has been carried out by the member directly or under his supervision or by another member in practice.

Clause (3) A CA in practice shall be deemed to be guilty of professional misconduct if he –

- Permits his name or the name of his firm.
- to be used in connection with an estimate of earnings
- contingent upon future transactions
- in manner which may lead to the belief that he vouches for the accuracy of the forecast.

Participation in preparation of Prospective forecasts & their review: SAE 3400 "The Examination of Financial Information" allows to a member to review the prospective financial information subject to following conditions:

- He indicates the source of information.
- He indicates the basis of forecasts.
- He gives in his report the major assumptions made in arriving at the forecasts
- He does not vouch for the accuracy of the forecasts.

Clause (4) A CA in practice shall be deemed to be guilty of professional misconduct if he –

- expresses his opinion
- on financial statements of any business or enterprise
- in which he, his firm or a partner in his firm has a substantial interest.

Note:

- The words "financial statements" used in this clause would cover both reports and certificates usually given after an examination of the accounts or the financial statement or any attest function under any statutory enactment or for purposes of income-tax assessments. This would

not, however, apply to cases where such statements are prepared by members in employment purely for the information of their respective employers in the normal course of their duties and not meant to be submitted to any outside authority.

- b. Member must take care to see that they do not land themselves in situations where there could be conflict of interest and duty.
- c. In this connection, the Council has decided not to permit a CA in employment to certify the financial statements of the concern in which he is employed, or of a concern under the same management as the concern in which he is employed, even though he holds COP and that such certification can be done by any CA in practice. This restriction would not however apply where the certification is permitted by any law. The Council has also decided that a Chartered Accountant should not by himself or in his firm name:
 - Accept the Auditor ship of a college, if he is working as a part-time lecturer in the college.
 - Accept the Auditor ship of a Trust where his partner is either an employee or a trustee of the trust.
- d. Requirements of Clause (4) are equally applicable while performing all types of attest functions by the members.
- e. Sec. 141 of Companies Act, 2013 also prohibits a member from auditing the accounts of a company in various situations.
- f. A member of the institute cannot express the opinion in the following cases:
 - Where the member himself is owner/partner of concerned business.
 - Where the partner/relative of the member has substantial interest in concerned business.
 - Where the member himself or his partner or relative is a director or in the employment of an officer or an employee of the company.
- g. Members are not permitted to write books of account of their auditee clients.
- h. A statutory auditor cannot be the internal auditor of the same entity.
- i. An internal auditor cannot be the tax auditor/GST Auditor of the same entity.
- j. A member shall not accept the assignment of audit of a Company for a period of 2 years from the date of completion of his tenure as Director, or resignation as Director of the said company.

Clause (5): A CA 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 not misleading
- where he is concerned with that financial statement in a professional capacity.

Note:

Understanding of Financial Statements:

- Financial statements would cover both reports and certificate usually given after an examination of the accounts or of financial statements under any statutory enactment. Or/for purposes of income tax assessments.
- Statements prepared by members in employment purely for the information of their respective employers in the normal course of their duties and not meant to be submitted to any outside authority are not covered.

Relevant Case laws:

Davar & Sons Ltd. vs M.S. Krishnaswamy: CA had been held guilty for his failure to report the shareholders about the non-creation of a sinking fund in accordance with the Debenture Trust Deed.

Kishori Lal Dutta vs P.K. Mukherjee: CA had been held guilty of professional misconduct of Supreme Court for having not disclosed the fact to the beneficiaries that a large amount of loan have been given out of the funds of an Employees Provident Fund to the Employer Company contravention of the Rules of the Provident Fund.

Clause (6) A CA 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 a financial statement
- with which he is concerned in a professional capacity

Clause (7) A CA 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.

Note:

1. Due Diligence: It implies that work should be performed with skill care and caution.
2. Gross Negligence: It implies negligence of high degree either arising out of reckless of failure to set honestly and reasonably on material matter.

Examples of Gross Negligence

- Failure to check the bank balances with the pass books of the banks and to obtain certificates of balances from the bankers in respect of those balances.
- Issuing clean reports on the balance sheets whereas the reports on the special audit conducted subsequently revealed certain irregularities which amounted to failure to examine the pass book and to verify the cash balance.
- Not completing his work relating to the audit and non-submission of audit report in due time to enable the company to comply with the statutory requirement in this regard.
- Issuing wrong consumption certificate in respect of raw material and components without examination of stock register and other relevant matters.
- Accepting arbitrary valuation of closing stock without any verification.

Clause (8) A CA in practice shall be deemed to be guilty of professional misconduct if he –

- fails to obtain sufficient information
- which is necessary for expression of an opinion or
- its exceptions are sufficiently material to negate the expression of an opinion.

Clause (9) A CA in practice shall be deemed to 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.

- If the auditor fails to perform the audit as per generally accepted procedures and standard his report should draw attention to the material departure from such procedures.
- Failure to perform certain statutory functions and duties is not excused merely by giving qualification or reservation in auditor's report. On failure he should clearly indicate reasonable for failure to perform audit as per generally accepted procedures and standards.
- What constitutes "generally accepted audit procedure would depend upon the facts and circumstances of each case, but guidance is available from the various pronouncements of the institute issued from time to time by way of Engagement and quality control standards, Statements general clarifications, Guidance Notes Technical Guides, Practice Manuals, Studies and Other Papers.

Clause (10) A CA in practice shall be deemed to be guilty of professional misconduct if he –

- Fails to keep moneys of his client
- other than fees or remuneration or money meant to be expended,
- in a separate banking account or
- to use such moneys for purposes for which they are intended within a reasonable time.

Note

In connection with compliance of Clause 10, Council has considered some practical difficulties of the members and the following suggestions have been made to remove these difficulties:

- a) An advance received by a Chartered Accountant against services to be rendered does not fall under Clause (10) of Part I of the Second Schedule.
- b) Moneys received for expenses to be incurred, for example, payment of prescribed statutory fees, purchase of stamp paper etc., which are intended to be spent within a reasonably short time need not be put in a separate bank account. For this purpose, the expression reasonably short time, would depend upon the circumstances of each case.
- c) Moneys received for expenses to be incurred which are not intended to be spent within a reasonably short time as aforesaid, should be put in a separate bank account immediately.
- d) Moneys received by a Chartered Accountant, in his capacity as trustee, executor, liquidator, etc. must be put in a separate bank account immediately.

Part II - Professional Misconduct in Relations to the Members of the Institute Generally

Clause (1) A member of the Institute shall be deemed to be guilty of professional misconduct if he contravenes any of

- the provisions of this Act or
- the Regulations made thereunder or
- the Guidelines issued by the Council.

Note:

The Regulations under which cases of contravention have generally come to the notice of the Council are the following:

Regulation 47	Premium from Articled Clerks prohibited
Regulation 48	Stipend to Articled Clerks -stipend to be paid on monthly basis.
Regulation 190A	Chartered Accountants not to engage in any other business or occupation (Refer Clause 1 1, Part I of First Schedule)

Relevant Judgments:

- Entering into an agreement to pay the articles clerk on annual basis, results into violation of Regulation 48.
- Accepting a loan from an article in case of engagement of the article results into violation of Regulation 47.

Clause (2) A member of the Institute shall be deemed to be guilty of professional misconduct if he

- being an employee of any company, firm or person,
- discloses confidential information acquired in the course of his employment
- except as and when required by any law or except as permitted by the employer

Clause (3) A member of the Institute shall be deemed to be guilty of professional misconduct if he

- includes in any information, statement, return or form to be submitted to
- The Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority.
- any particulars knowing them to be false.

Clause (4) A member of the Institute shall be deemed to be guilty of professional misconduct if he

- Defalcates or embezzles money received in his professional capacity.

Part III : Other Misconduct In Relation To the Members of the Institute Generally

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

COUNCIL GENERAL GUIDELINES, 2008**II Conduct of a Member being an employee**

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

III Appointment of a member as Cost auditor**Omitted****IV Opinion on F.S. in case of substantial interest****Omitted****V Maintenance of books of account**

A member of the institute in practice or the firm of Chartered Accountants of which he is a partner, shall maintain and keep in respect of his/its professional practice, proper books of account including the following:

- I. a Cash Book; and
- II. a Ledger.

VI Tax Audit assignments under Section 44 AB of the Income tax Act, 1961

- A member of the Institute in practice shall not accept, in a financial year, more than the "Specified number of tax audit assignments" u/s 44AB of the income-tax Act, 1961.

- In the case of a firm of CAs in practice, the "specified number of tax audit assignments" shall be construed as the specified number of tax audit assignment for every partner of the firm.
- Where any partner of the firm is also a partner of any other firm or firms of CA in practice the number of tax audit assessment which may not be taken for all the firms together in relation to such partner shall not exceed the "specified number of an audit assignments" in the aggregate.
- Where any partner of a firm of CAs in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which may be accepted by him shall not exceed the "specified number of tax audit assignments" in the aggregate.
- The audits conducted under Sections 44AD, 44ADA and 44AE of the Income –tax Act, 1961 shall not be taken into account for the purpose of reckoning the "specified number of tax audit assignments".
- "The specified number of tax audit assignments" means –
 - a. in the case of a CA in practice or a proprietary firm of CA, 60 tax audit assignments, in a financial year, whether in respect of corporate or non- corporate assesses.
 - b. in the case of firm of CAs in practice, 60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.
- In computing the "specified number of tax audit assignments" each year's audit would be taken as a separate assignment.
- The audit of the head office and branch offices of a concern shall be regarded as one tax audit assignment.
- The audit of one or more branches of the same concern by one CA in practice shall be construed as only one tax audit assignment.
- A Chartered Accountant being a part time practicing partner of a firm shall not be taken into account for the purpose of reckoning the tax audit assignments of the firm.
- A Chartered Accountant in practice shall maintain a record of the tax audit assignments accepted by him in each financial year in the format as may be prescribed by the Council.

Clarification by ICAI w.r.t. signing of Tax Audit Report

- Tax Audit Report accepted by the firm of Chartered Accountants can be signed by any partner on the behalf of the firm.

VII Appointment of an Auditor in case of non-payment of undisputed fees

- A member of the Institute in practice shall not accept the appointment as auditor of entity in case the undisputed audit fee of another Chartered Accountant for carrying out the statutory audit under the Companies Act, 2013 or various other statutes has not been paid:
- In the case of sick unit, the above prohibition of. Acceptance shall not apply.
- For this purpose, the and the provision for audit fee in accounts signed by both -the auditee and the auditor along with other expenses, if any, incurred by the auditor in connection with the audit, shall be considered as "undisputed" audit fee.
- "Sick unit" shall mean a unit registered for not less than 5 years, which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

VIII Specified number of audit assignments

- A member of the Institute in practice shall not hold at any time appointment of more than the "specified number of audit assignments" Companies u/s 141 of the Companies Act, 2013.
- In the case of a firm of CAs in practice, the "specified number of audit assignments shall be construed as the specific number of audit assignments for every partner of the firm.
- Where any partner of the firm of CAs in practice is also a partner of any other firm or firms of CAs in practice, the number of audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the "specified number of audit assignments" in the aggregate.
- Where any partner of a firm or firms of CAs in practice accepts one or more audit of Companies in his individual capacity, or in the name of his proprietary firm, the total number of such assignments which may be accepted by all firms in relation to such CA and by him shall not exceed the "specified number of audit assignments" in the aggregate
- For this purpose, the "specified number of audit assignments" means –
 - a. In the case of a Chartered Accountant in practice or a proprietary firm of Chartered Accountant, 30 audit assignments whether in respect of private Companies or other Companies, with the exception of OPC and dormant companies.
 - b. In the case of Chartered Accountants in practice, 30 audit assignments per partner in the firm, whether in respect of private Companies or other Companies, with the exception of OPC and dormant companies.
- In computing the "specified number of audit assignments" the number of audit of such Companies, which he or any partner of his firm has accepted whether singly or in combination with any other Chartered Accountant in practice or firm of such Chartered Accountants, shall be taken into account.
- The audit of the head office and branch offices of a Company by one CA or firm of such CAs in practice shall be regarded as one audit assignment.
- The audit of one or more branches of the same Company by one CA in practice or by firm of CAs in practice in which he is a partner shall be construed has one audit assignment only.
- The number of partners of a firm on the date of acceptance of audit assignment shall be taken into accounts.
- A CA in practice, whether in full-time or part-time employment elsewhere, shall not be counted for the purpose of determination of "specified number of audit of Companies" by firms of Chartered Accountants
- A CA being a part time practicing partner of a firm shall not be taken into account for the purpose of reckoning the audit assignments of the firm.
- A the 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 buy the firm of Chartered Accountants, or by any of the partners of the firm in his individual name or as a partner of any other firm, as far as possible, in the following format:

S.NO	Name of the company	Registration No.	Date of Appointment	Date of Acceptance
1	2	3	4	5

IX Appointment as Statutory auditor

A member of the institute in practice shall not accept the appointment as statutory auditor of PSU/Government Company and other public companies having turnover of ₹ 50 Crores or more in a year where he accepts any other work or assignment or service in regard to the same undertaking/company on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same undertaking/company.

For the above purpose, the term “other work” or “service” or “assignment” shall include Management Consultancy and all other professional services permitted by the Council pursuant to Section 2(2) (IV) of the Chartered Accountants Act, 1949 but shall not include:

- a. audit under any other statute
- b. Certification work required to be done by the statutory auditors; and
- c. Any representation before an authority

In regard to taking up other work or service or assignment of the undertaken/ company referred to above, it shall be open to such associate concern or corporate body to render such work or service or assignment so long as aggregate remuneration for such other work or service or assignment payable to the statutory auditor/s together with fees payable to its associate concern(s) or corporate body do/does not exceed the aggregate of fee payable for carrying out the statutory audit.

Note:

Applicability of these guidelines seems to be redundant in case of companies as Sec. 144 of Companies Act, 2013 prohibits an auditor of the company from rendering certain services including management services directly or indirectly to the Company or its holding company or its subsidiary company.

X Appointment of an auditor when he is indebted to a concern

A member of the institute in practice or a partner of a firm in practice or a firm or a relative of such member or partner shall not accept appointment as auditor of a concern while indebted to the concern or given any guarantee or provided any security in connection with the indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding ₹ 1, 00,000/-

XI Direction in case of unjustified removal of auditors

A member of the institute in practice shall follow the direction given, by the council or an appropriate committee or on behalf of any of them, to him being the income auditor (S) not to accept the appointment as auditor(s), in case of unjustified removal of the earlier auditors(s).

XII Minimum Fees

Repealed by Council

XIII Guidelines on Tenders

- A member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for CAS, such as audit and attestation services.
- However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the CAs.

XIV Unique Document Identification Number (UDIN) Guidelines

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

- I. For all Certificates w.e.f. 1st February, 2019.
- II. For all GST and Tax Audit Reports w.e.f. 1st April, 2019.
- III. For all other Audit, Assurance and Attestation functions w.e.f. 1st July, 2019.

XVI : Logo Guidelines

- The logo consists of letter 'CA' with a tick mark inside a rounded rectangle with white background.
- The letters CA have been put in blue, the corporate color which not only stands out on the background but also denotes creativity, innovativeness, knowledge, integrity, trust, truth, stability and depth.
- The upside down tick mark typically used by Chartered Accountants, has been used to symbolize the wisdom and value of the professional.
- The green colour in the tick mark signifies growth, prosperity, harmony and freshness.
- Members are encouraged to use the new logo, as published in the guidelines. Do not change the design and colours, including the white background. Refrain from rotating or tilting the logo.

XVII Guidelines for Corporate from of Practice

To empower the members to face the emerging challenges in the service sector as well as to equip them for the opportunities in the non-audit service area, the Council decided to allow members in practice to render Management Consultancy and Other Services in Corporate form, subject to the guidelines to be issued by the Institute in this regard.

The Council decided to allow members in practice to hold the office of Managing Director, Whole-time Director or Manager of a body corporate within the meaning of the Companies Act provided that the body corporate is engaged exclusively in rendering Management Consultancy and Other Services permitted by the Council in pursuant to Section 2(2) (iv) of the Chartered Accountants Act, 1949 and complies with the conditions(s) as specified by the Council from time to time in this regard.

Various conditions as stated in the guidelines are:

Name of the management consultancy company : The Management Consultancy Company shall have a distinct name which shall be approved by the Institute.

Registration : After approval of the name and incorporation under the Companies Act, the Management Consultancy Company is required to be registered with the Institute in a prescribed Form.

Ethical Compliance

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

- a. If the individual practitioner/sole-proprietorship firm/partnership firm is the statutory auditor of an entity then the Management Consultancy Company should not accept the internal audit or book-keeping or such other professional assignments, which are prohibited for the statutory auditor firm.
- b. Ceiling on Non-audit fees is applicable in relation to a Management Consultancy Company.

c. The Management Consultancy Company shall comply with clauses (6) & (7) of Part-I of the First Schedule to the Chartered Accountants Act, 1949 and such other directives as may be issued by the Institute from time to time.

II. The Management Consultancy Company shall give an undertaking that it shall comply with clauses (6) & (7) of Part-I of the First Schedule to the Chartered Accountants Act, 1949 and such other directives as may be issued by the Institute from time to time.

Object of Management Consultancy Company

The Management Consultancy Company shall engage itself only in Management Consultancy & Other Services. The Management Consultancy Company shall give an undertaking that it shall render only Management Consultancy & Other Services prescribed by the Council pursuant to powers u/s 2(2)(iv) of the Chartered Accountants Act, 1949.

Guidelines for Networking

Definitions:

Network:

A larger structure:

- a) That is aimed at co-operation; and
- b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of common brand name, or significant part of professional resources.

Network Firm: means a firm of entity that belongs to a Network.

Concept of Network:

1. To enhance the ability to provide professional services, firms frequently form larger structures with other firms and entities. Whether these larger structures create a network depends on the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct. For example, a larger structure may be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. Alternatively, a larger structure might be such that it is aimed at co-operation and the firms share a common brand name, a common system of quality control, or significant professional resources and consequently is deemed to be a network.
2. The judgement as to whether the larger structure is a network shall be made in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a network exists. This judgement shall be applied consistently throughout the network.
3. Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structures, it is deemed to be a network. However, the sharing of immaterial costs does not in itself create a network. In addition, if the sharing of the costs is limited only to those costs related to the development of audit methodologies, manuals, or training courses, this would not in itself create a network.

Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not in itself create a network.

4. Where the larger structure is aimed at co-operation and the entities within the structure share common ownership, control or management, it is deemed to be a network. This would be achieved by contract or other means.
 5. Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures, it is deemed to be a network. For this purpose, common quality control policies and procedures are those designed, implemented and monitored across the larger structure.
 6. Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is deemed to be a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not deemed to be a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision.
 7. Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is deemed to be a network. A common brand name includes common initials or a common name. A firm is deemed to be using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name, when a partner of the firm signs an audit report.
 8. Even though a firm does not belong to a network and does not use a common brand name as part of its firm name, it may give the appearance that it belongs to a network if it makes reference in its stationery or promotional materials to being a member of an association of firms.
- Accordingly, if care is not taken in how a firm describes such memberships, a perception may be created that the firm belongs to a network.
9. Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources, it is deemed to be a network.

Professional resources include:

•	Common system that enable firms to exchange information such as client data, billing and time records;
•	Partners and staff;
•	Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements;
•	Audit methodology and audit manuals; and
•	Training courses and facilities.

10. The determination of whether the professional resources shared are significant, and therefore the firms are the network firms, shall be made based on the relevant facts and circumstances. Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources should be significant. The same applies to a common training endeavour. Where, however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool, or a common technical department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

Forms of the Network:

The different forms of network can be as under:

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

Approval of Name of Network amongst firms registered with institute:

- The network may have distinct name which should be approved by the institute. To distinguish a “Network” from a ‘firm’ of Chartered Accountants, the words “& Affiliates” shall be used after the name of the network and the words “& Co.”/ “& Associates” shall not be used. The prescribed format of application for approval of Name for Network id at Form ‘A’.
- Provisions of Regulation 190 of the Chartered Accountants Regulations, 1988 shall be applicable to the name of Network. However, even if a name is approved and subsequently it is found that the same is undesirable then, the said name may be withdrawn at any time by the institute. The institute shall reject 3 any undesirable name and the provisions in respect of names of companies as prescribed in the companies Act, 1956 (Now Companies Act, 2013) shall be applicable in spirit.
- The institute shall approve or reject the name of the network and intimate the same to the network at its address mentioned in Form ‘A’ within a period which shall not be later than 30 days from the date of receipt of the said form.
- Mere approval of the name of the network shall not entitle the network to carry on practice in its own name.

Registration of network with entities in India:

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

Listing of Network with entities outside India:

- The duly authorized representative(s) of the Indian Member firm(s)/ Member constituting the Network with entities outside India shall file a declaration with the institute in Form 'D' for Listing of such Network within 30 days from the date of entering into the Network arrangement.
- Proprietary/ individual members, partnership firm as well as members in LLP or any such other entity of members as may be permitted by the Act, shall be permitted to join such network with entities outside India provided that the proprietary/ individual members, partnership firms as well as members in LLP or any such entity of members are allowed to join only one network and firms having common partners shall join only one such network.

Change in constitution of registered Network:

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

Ethical compliance:

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

1. If one firm of the network is the statutory auditor of an entity then the associate [including the networked firm (s)] or the said firm directly/ indirectly shall not accept the internal audit or book-keeping or such other professional assignments which are prohibited for the statutory auditor firm.
2. The guidelines of ceiling on non-audit fees is applicable in relation to a network as follows:
 - For a network firm who is doing statutory audit [including its associate concern and /or firm(s)m having common partnership], it shall be the same as mentioned in the said notification; and
 - For other firms of the same network collectively, it shall be 3 times of the fee payable for carrying out the statutory audit of the same undertaking/company.
3. In those cases where rotation of firms is prescribed by any regulatory authority, no member firm of the network can accept appointment as an auditor in place of any member firm of the network which is retiring.
4. The network may advertise the network to the extent permitted by the advertisement guidelines issued by institute. The firms constituting the network are permitted to use the words "network firms" on their professional stationery.
5. The constituent member firms of a network and the network shall comply with all the ethical standards prescribed by the council from time to time.

Consent of client:

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

Framework of Internal Byelaws of Network:

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

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

Council Guidelines for Advertisement, 2008

Guidelines for write up

Meaning of write up:

“Write up” means the writing of particulars according to the information given in the guidelines setting out services rendered by the members or firms and any writing or display of the particulars of the Members in practice or of firms issued, circulated or published by way of print or electronic mode or otherwise including in newspapers, journals, magazines and websites, which include social Networking Websites (in push as well as in pull mode) in accordance with the Guidelines.

Conditions to be complied with:

The write up shall comply with the following conditions:

A.	It shall be honest and truthful.
B.	There shall be no exaggerated claims for the services offered by the member or the Firm, or the qualifications or experience of the member or any of the partners or any other person associated with the Firm.
C.	It must not make any disparaging references or unsubstantiated comparisons to the work of others.
D.	It should not be of a nature that may bring the profession into disrepute.
E.	It should not contain testimonials or endorsements concerning members or names of clients (both the past and present) or the fees charged.
F.	It should not contain any information about achievements/awards (except the awards given by the central or state Governments or Regulatory bodies) or any other position held, or accreditations granted by any organization.
G.	Monogram of any kind or use of any kind to catch words is not permissible.

H.	The membership No./ FRN (as may be applicable) is mandatory to the mentioned in the write up.
I.	It should not be of font size exceeding 14.
J.	It must not be violative of any provisions of Chartered Accountant Act, 1949, Chartered Accountant Regulations, 1988, code of ethics, 2020 or any Guideline of the Council.

Information to be contained in write ups

For members

- i. CA..... Name
- ii. Membership No. with Institute
- iii. Age
- iv. Date of becoming ACA
- v. Date of becoming FCA
- vi. Date from which COP held
- vii. Recognized qualifications
- viii. Languages known
- ix. Telephone/Mobile/Fax No.
- x. Professional Address
- xi. Website
- xii. E-mail
- xiii. CA Logo
- xiv. Passport style photograph
- xv. Details of Employees (Nos:)
 - a. Chartered Accountants-
 - b. Other professionals
 - c. Articles/Audit Assistants
 - d. Other employees
- xvi. Name of the employees and their particulars on the lines allowed for a member as stated above.
- xvii. Services provided
 - a.
 - b.
 - c.
- xviii. Position held as Director or Managing Director in a Management Consultancy Company registered with the Institute.

For Firms

- i. Name of the Firm Chartered Accountants
- ii. Firm registration No. with Institute
- iii. Year of establishment
- iv. Professional Address registered with the Institute (both head office and branches)
- v. Working hours (vi) Tel. No. (s)/ Mobile No./ Fax No. (s)
- vi. E-mail
- vii. No. of partners
- viii. Name of the proprietor/ partners and their particulars on the lines allowed for a member as stated above including passport style photograph.
- ix. CA Logo
- x. Details of Employees (Nos:)
 - a. Chartered Accountants-
 - b. Other professionals
 - c. Articles/Audit Assistants
 - d. Other employees
- xi. Name of the employees and their particulars on the lines allowed for a member as stated above.
- xii. Services provided
 - a.
 - b.
 - c.
- xiii. Affiliation with a Network registered with the Institute

Points to remember:

The write up may have the signature, Name of the Member/Name of the partner signing on behalf of the firm, place and Date.

Online Third party platforms:

A member of non- Chartered Accountants firms, corporates including banks, finance companies and newspapers have set up their own websites providing advisory services on taxation and other areas where Chartered Accountants are rendering professional service, some of such websites may request Chartered Accountants or Chartered Accountants' firms to provide consultation and advice through their websites. No other services, besides consultancy and advice can be rendered through such websites.

This would be permitted subject to the condition that on the website, contact address of the Chartered Accountant concerned is not provided nor such website will contain any material which advertises professional achievements or status of such Chartered Accountant except making a statement that they are Chartered Accountants. The name of Chartered Accountants' firm with suffix "Chartered Accountants" would not be permitted.

Publication of Name or Firm Name in the Telephone or other Directories:

The Chartered Accountants and Chartered Accountants Firms may have entries made in a Telephone Directory (in printed and electronic form) either by making a special request or by means of an additional payment.

The council has also considered the question of permitting entries in respect of Chartered Accountants and their firms under specified groups in telephone/ trade directories subject to the following additional restrictions:

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

Application based Service provider Aggregators:

It is not permissible for the members to list themselves with online Application based service provider Aggregators, wherein other categories like businessman, technicians, maintenance workers, event organizers etc. are also listed.

Specialized Directories for limited circulation:

•	The name, description and address of the member (or firm) may appear in any directory or list of members of a particular body in which the names are listed alphabetically.
•	For a specialized directory or publication such as a "Who's Who" (including those compiled on purely local basis), a member should use his discretion in supplying information, bearing in mind the nature and purpose of the publications.
•	In addition to his name, description and address and those of his firm, a member may give where appropriate, directorships, held and reasonable personal details and may state his outside interests. He should not, however, give the names of any of his clients.

Exemptions:

A special exemption has been made as regards publication of the name and address of a member or that of his firm, with the description Chartered Accountant(s), in an advertisement appearing in the press in the following circumstances, provided that the advertisement is not displayed more prominently than is usual for such circumstances or the name of the member or that of his firm with the designation. Chartered Accountants appears in type not bolder than the substance of the advertisement:

a.	Advertisement for recruiting staff in the members own office.
b.	Advertisement inserted on behalf of clients requiring staff or wishing to acquire or dispose of business or property.
c.	Advertisement for the sale of a business or property by a member acting in a professional capacity as trustee, liquidator or receiver.

When advertising for staff, it is desirable that members should avoid the expression such as “a well-known firm”, since this would savor of advertisement. Similar considerations apply to advertisements for article assistants. The advertisements should not contain any promotional element nor should there be any suggestion that the services offered by the Chartered Accountant or his firm are superior to those offered by other accountants.

Recent Decisions of Ethical Standard Board

1. A Chartered Accountant in practice may be an equity research adviser, but he cannot publish retail report, as it would amount to other business or occupation.
2. A Chartered Accountant, who is a member of a Trust, cannot be the auditor of the said trust.
3. A Chartered Accountant in practice may engage himself as Registration Authority (RA) for obtaining digital signatures for clients.
4. A Chartered Accountant can hold the credit card of the bank when he is also auditor of the bank, provided the outstanding balance on the said card does not exceed rupees 100000 beyond the prescribed credit period limit on credit card given to him.
5. A Chartered Accountant in practice can act as mediator in court, since acting as a “mediator” would be deemed to be covered within the meaning of “arbitrator”; which is inter alia permitted to the members in practice as per Regulation 191 of the Chartered Accountants Regulations, 1988.
6. A Chartered Accountant in practice is not permitted to accept audit assignment of a bank in case he has taken loan against a Fixed Deposit held by him in that bank.
7. The ethical standards Board in 2013 generally apply the stipulations contained in the then amended Rule 11U of the Income Tax generally, wherein statutory auditor/tax auditor cannot be valuer of unquoted equity shares of the same entity.

The Board has at its recent meeting (January, 2017) has reviewed the above, and decided that where law prohibits for instance in the Income Tax Act and the rules framed thereunder, such prohibition on statutory auditor/tax auditor to be the valuer will continue, but where there is no restriction under any law, the said eventuality will be permissible, subject to compliance with the provisions, as contained in the code of Ethics relating to independence.

8. The ethical standards Board in 2011 decided that it is not permissible for a member who has been Director of a Company, upon resignation from the company to be appointed as an auditor of the said company, and the cooling period for the same may be 2 years.

The Board has at its recent meeting (January, 2017) has reviewed the above, and noted that the Section 141 of Companies Act, 2013 on disqualification of auditors does not mention such prohibition; though threats pertaining to the said eventuality have been mentioned in the code of ethics.

Further, the Board was of the view that a member may take decision in such situation based on the provisions of the Companies Act, 2013 and provisions of code of ethics.

9. A Chartered Accountant in practice cannot become financial advisors and receive fees/commission from the Financial Institutes such as Mutual Funds, Insurance Companies, NBFCs etc.
10. A Chartered Accountant cannot exercise lien over the client documents/records for non-payment of his fees.

11. It is not permissible for CA Firm to print its vision and values behind the visiting cards, as it would result in solicitation and therefore would be violative of provisions of clause (6) of part 1 of First Schedule to the Chartered Accountants Act, 1949.
12. It is not permissible for Chartered Accountants in practice to take agencies of UTI, GIC or NSDL.
13. It is not permissible for a member in practice to be settlor of a trust.
14. A member in practice cannot hold Customs Broker License .
15. A Chartered Accountant in service may appear as tax representative before tax authorities on behalf of his employer, but not on behalf of other employees of the employer.
16. A Chartered Accountant who is Statutory auditor of a bank cannot for the financial year accept stock audit of the same branch of the bank or any of the branches of the same bank or sister concern of the bank, for the same financial year.
17. A CA Firm which has been appointed as the internal auditor of a PF Trust by a Government Company cannot be appointed as its statutory auditor.
18. A concurrent auditor of the bank 'X' cannot be appointed as statutory auditor of bank 'Y', which is sponsored by 'X'.
19. A CA/CA Firm can act as internal auditor of the company & Statutory auditor of its employees PF Fund under the new Companies Act (2013).
20. The ethical standards board while noting that there is requirement for a Director u/s 149(3) of the companies Act, 2013 to reside in India for minimum period of 182 days in the previous calendar year, decided that such a Director would be within the scope of Director Simplicitor (Which is generally permitted as per ICAI norms), if he is non-executive director, required in the Board Meetings only, and not paid any remuneration except for attending such Board Meetings.
21. It is permissible for a practicing Chartered Accountant holding Certificate of Practice to become a member of the 'Board of Management' in Primary (Urban) Co-operative Banks. The Ethical Standards Board noted that the position of a member of 'Board of Management' in Primary (Urban) Co-operative banks (UCBs) and the role attached to that position is similar to that of a Director-Simplicitor; where there is no involvement of a member in the day-to-day functioning/operations and not signatory etc. and only sitting fees for the services rendered are provided.
22. Member in practice cannot act as Trademark or Patent Attorney. However, Professional advice in relation to Intellectual Property Rights (IPR) is a routine professional work for a Chartered Accountants in practice and same is permissible under the provisions of the Chartered Accountants Act, 1949.
23. It is not permissible for a member in practice to accept the appointment of statutory audit of the society wherein immediate family member i.e., spouse or dependent, of member hold honorary position of one of the managing committees of the institutes governed by the society.
24. The Council decided that for the purpose of Appointment of an auditor when he is indebted to a concern, as dealt with under Chapter X of the Council General Guidelines, 2008, the term "auditor" shall not include internal auditor, concurrent auditor or an auditor giving report to the Management. In other words, the provision relating to criteria/limit of indebtedness shall apply only to statutory audits.
25. A CA Firm may register itself on Udyog Aadhar, a web portal of Ministry Micro, Small and Medium Enterprises.

26. There is no prohibition for internal auditor of a company to acquire/purchase shares of the said Company.
27. It is not permissible for a member to use Messaging Applications to send messages to make people aware about his practice, and mention the services provided therein.
28. A Chartered Accountant in practice being Director Simplicitor in a Company cannot sign ROC Forms of the Company as it is a direct conflict of role.
29. A Chartered Accountant in practice can act as Authorized Representative of a Foreign Company, provided he is not the auditor of the said Company.
30. It is permissible for two or more Chartered Accountants in practice collectively to have joint training session for their clients on GST, and share the fees collected from the clients thereof.
31. A chartered accountant in practice can provide services through kiosk only if the services provided are professional activities of a practicing-chartered accountant, permitted under the Act.
32. A Chartered Accountant in service is allowed to take e-return registration if it does not conflict with employment obligation. However, he cannot certify the return.
33. In case where Chartered Accountant in practice is a non-executive director in a company, he or a Firm in which he is a partner, should not accept the appointment as a statutory auditor of a Company which is a joint venture of the original Company, as it would impact independence.
34. There is no conflict of interest in a Chartered Accountant, who is a member of a Trust, being the auditor of the said trust. It is subject to the exception where a particular statute governing a Trust prescribes prohibition on the member of the Trust to be its Auditor or otherwise where there is conflict of interest as per the provisions of Code of Ethics.
35. The Ethical Standards Board in 2013 generally apply the stipulations contained in the then amended Rule 11U of Income Tax generally, wherein statutory auditor /tax auditor cannot be the valuer of unquoted equity shares of the same entity. The Board has at its recent Meeting
36. (January, 2017) has reviewed the above, and decided that where law prohibits for instance in the Income Tax Act and the rules framed thereunder, such prohibition on statutory auditor/tax auditor to be the valuer will continue, but where there is no specific restriction under any law, the said eventuality will be permissible, subject to compliance with the provisions, as contained in the Code of Ethics relating to independence.
37. It is not permissible for CA Firm to print its vision and values behind the visiting cards, as it would result in solicitation and therefore would be violative of the provisions of Clause (6) of Part-I of First Schedule to the Chartered Accountants Act, 1949.
38. A chartered accountant who is the statutory auditor of a bank cannot for the same financial year accept stock audit/inspection Audit of the same branch of the bank or any of the branches of the same bank or sister concern of the bank, for the same financial year.
39. A CA Firm which has been appointed as the internal auditor of a PF Trust by a Government Company cannot be appointed as its Statutory Auditor.
40. A CA/CA Firm can act as the internal auditor of a company & statutory auditor of its employees PF Fund under the new Companies Act (2013).

Chapter-13 GROUP AUDITS

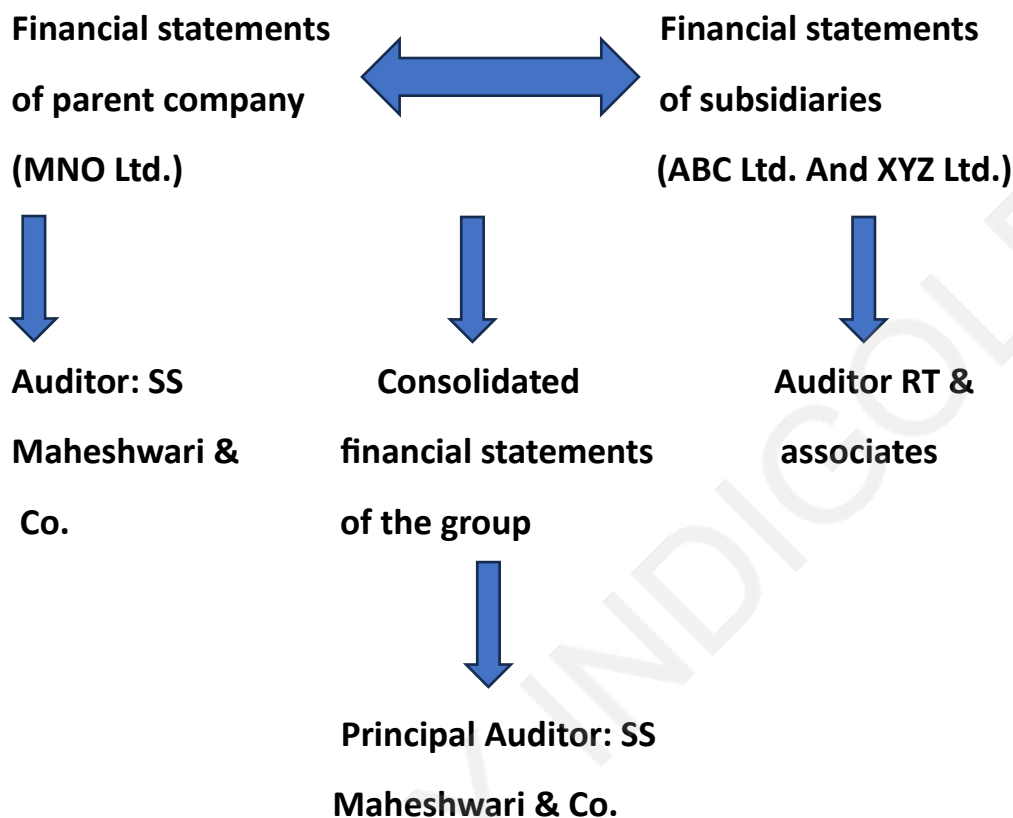
INTRODUCTION

Meaning

Consolidated Financial Statements (CFS)

It refers to the FS of a group in which the assets, liabilities, equity, income, expenses and cash flow of the parent and its subsidiaries are presented as those of a single economic entity.

Example



Activities involved in above example:

- Management of MNO Ltd., ABC Ltd. & XYZ Ltd. will prepare their respective standalone FS.
- Standalone FS will be audited by respective auditors.
- Thereafter, Parent Co. i.e. MNO Ltd. will prepare CFS for the group.
- CFS will be audited by the principal auditor i.e. SS Maheshwari & Co.

Definition

Principal Auditor

Auditor with reporting responsibilities w.r.t consolidated FS of the group.

Investment Entity

It is an entity that:

- A. obtain funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- B. commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- C. measures and evaluates the performance of substantially all of its investments on a fair value basis.

Features of CFSs

- It presents the financial position of an entire group including the parent and its group companies.
- It provides a complete overview of the operations and profitability of the entire group which is controlled by the parent.
- It is presented in the same format as adopted by the parent for its separate FS.
- The formats for preparation of B/S, statement of P &L and a statement of change in equity (if applicable) are prescribed under the Schedule III of the Companies Act, 2013.

Format: Similar as Standalone Financial Statements as given under Schedule III to Companies Act, 2013

Consolidate financial Statements includes

- Consolidated balance sheet
- Consolidated statement of profit and loss,
- Consolidated cash flow statement,
- Consolidated statement of change in equity (if applicable) and
- Any explanatory notes annexed to, or forming part thereof

Audit

An entity which prepares CFS, either under any law or regulation governing the entity or Suo moto, required to engage the auditor for conducting the audit of CFS. Auditor follows principles as given in Guidance Notes on Audit of Consolidates Financial Statements.

Applicable Financial Reporting Framework: AS- 21/ Ind AS- 110 Consolidated Financial Statements.

Legal Provisions

Sec. 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 FS prepare a CFS of the company and of all the subsidiaries in the **same form and manner as that of its on.**

Sec. 129(4) of the Companies Act, 2013:

It provides that the provisions applicable to the preparation, adoption and audit of the Financial Statements of a holding company shall, mutatis mutandis, also apply to its CFS.

Approval:

The CFS shall also be **approved by the BOD** before they are signed on behalf of the Board, along with its standalone FS and shall also be **laid before the AGM** of the company along with the laying of its standalone FS.

Separate Statement:

The company shall also attach along with its FS, a separate statement containing salient features of the FS of its subsidiary (ies) in Form **AOC-I**.

Compliance with Schedule-III & AS:

According to the Companies (Accounts) Rules, 2014, the consolidation of FS of the Company shall be made in accordance with the **provisions of Schedule III** to the Act and the applicable AS. (As refers to AS or Ind AS as applicable).

However, a company which is **not required to prepare CFS** under AS, it shall be sufficient if the company complies with provisions of CFS provided in Schedule III of the Act.

Non-applicability

The requirement related to **preparation of CFS shall not apply to a company if it meets the following conditions:**

- a. It is a **wholly-owned subsidiary**, or is a **partially-owned subsidiary** of another company and **all its other members**, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, **do not object** to the company not presenting CFS;
 - b. It is a company whose securities are **not listed** or are not in the process of listing on any stock exchange, whether in India or outside India, and
 - c. Its ultimate or any intermediate holding company files CFS with the Registrar which are in compliance with the applicable AS. (This exemption is provided under Ind AS IIO and CA, 2013 as well).
- **Exemption by CG:** As per sub-section 6 of the section 129 of the Companies Act, 2013, the **CG may**, on its Own or on an application by a class or classes of companies, by notification, **exempt any class or classes of companies** from complying with any of the requirements of section 129 or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest.

- **An investment entity need not present CFS** 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.
- As per paragraph 33 of Ind AS 110, the **parent of an investment entity (Definition discussed earlier) shall consolidate** all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

RESPONSIBILITY OF THE PARENT

Management of the parent is responsible for **preparation & presentation** of CFS.

This includes:

a) Identifying components , and including the financial information of the components to be included in the CFS;
b) where appropriate, identifying reportable segments for segmental reporting;
c) Identifying related parties and related party transactions for reporting;
d) Obtaining accurate and complete financial information from components ;
e) Making appropriate consolidation adjustments ;
f) Harmonisation of accounting policies and accounting framework; and
g) GAAP conversion , where applicable.

Additionally issue instructions to the management of the component specifying the requirements relating to **financial information** of the components **to be included** in the CFS.

Instructions ordinarily cover:

- **Accounting policies** to be applied,
- **Statutory and other disclosure** requirements applicable to the parent,

including **identification of and reporting on:**

• Reportable segments
• Related parties
• Related party transactions
• Reporting timetable

RESPONSIBILITY OF THE AUDITOR OF THE CFS

Auditor's Objective in Audit of CFS

Principal Auditor of the CFS is responsible for expressing an opinion on whether the CFS are prepared in accordance with the financial reporting framework in addition to reporting on the matters as required under the Companies Act, 2013 and any other statute to the extent applicable.

Therefore, the **auditor's objectives** in an audit of CFS are:

- a) To satisfy himself that the CFS have been prepared in accordance with the requirements of **Applicable Financial Reporting Framework**;
- b) To enable himself to **express an opinion on the true and fair view** presented by the CFS;
- c) To enquire into the matters as specified in **section 143(1)** of the Companies Act, 2013; and
- d) To report on the matters given in clauses (a) to (i) of **section 143(3)** of the Companies Act, 2013, for other matters rules 143 (3) (j) read with Rule II of the Companies (Audit and Auditors) Rules, 2014 to comment on the matters specified in sub-rule (a) to (i) to the extent applicable
- e) Auditor should also validate the requirement of preparation of CFS for the company as per APPLICABLE FINANCIAL REPORTING FRAMEWORK.

Standards on Auditing, Statements and Guidance Notes on auditing matters

Applies in the same manner to audit of CFS as they apply to audit of standalone FS. It means that the auditors, while conducting the audit of CFS are, inter alia, expected to:

- a) **Plan their work** to enable them to conduct an effective audit in an efficient and timely manner;
- b) Obtain an **understanding of the accounting and IC systems including IT system** like consolidation tool, sufficient to plan the audit and determine the **nature, timing and extent of his audit procedures**;
- c) Use professional judgement to **assess audit risk and to design audit procedures** to ensure that the risk is reduced to an acceptable level; etc.

AUDIT CONSIDERATIONS

The following features of CFS have an impact on the related audit procedures:

- a) **The CFS are prepared on the basis of separate FS** of the parent and its components, using the consolidation procedures prescribed by Accounting Standards under APPLICABLE FINANCIAL REPORTING FRAMEWORK; and
- b) The auditor of the CFS **may use the work of other auditors** as per the requirement of Standards on Auditing unless the auditor of CFS is also the auditor of the other components of the group (SA 600).
- c) The CFS (including the intermediate CFS prepared internally) are **prepared using**:
 - Separate FS of the parent and its components; and
 - other financial information, which might not be covered by the separate FS of these entities.

The 'other financial information would include disclosures to be made in the CFs about the components, proportion of items included in the CFs to which different accounting policies have been applied where permitted, adjustments made for the effects of significant transactions or other events that occur between the FS parent and its components, as the case may be, etc.

Consolidation Example

- Group consists of entity A and its, subsidiaries B and C
- B has a loan with A of 100

	A	B	C	Total	Eliminations	Group
PPE	100	50	30	180		180
Shares in subsidiaries	500	-	-	500	-500	-
Intercompany receivables	100	-	-	100	-100	-
Receivables	-	400	300	700	-	700
Intercompany debt	-	-100	-	-100	100	-
Debt	-100	-50	-130	-280		-280
Equity	-600	-300	-200	-1,100	500	-600

USING THE WORK OF OTHER AUDITORS-SA 600

- When an auditor accepts the audit of CFS, the auditor should assess whether based on his work alone he would be able to express an opinion on the true and fair view presented by the CFS. If the auditor is of the view that his on participation may not be enough or sufficient, he should **consider using the work of 'other auditors'**.
- Such other auditors' might be the:
 - Statutory auditors of the separate FSs of one or more of the components; or
 - Auditors appointed specifically for assisting the auditor of the CFS.
- Where the **statutory auditors of one or more of the components** of the parent are also **requested to assist the principal auditor**, the work to be performed by such statutory auditors for use by the principal auditor would constitute an **assignment separate from the assignment** to conduct the statutory audit of the respective component.

The principal auditor, if **he decides to use the work of another auditor** in relation to the audit of CES, should comply with the requirements of SA 600.

MATERIALITY CONSIDERATIONS

In carrying out the audit of the standalone FS. the **computation of materiality** for the purpose of issuing an opinion on **standalone** FS of each component would be done component-wise on a **standalone basis**.

However, with regard to **determination of materiality during the audit of 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) 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 FS 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 the materiality for each component and communicates to the component auditor, if he believes is required for a true and fair view on CFS.
➤ The principal auditor also obtains certain confirmations from component auditors like independence, code of ethics, certain information required for consolidation and disclosure requirements, etc.
➤ Materiality also considered, as per SA 600, while considering modifications or observations component auditor's report and do not regard such observations material irrespective of materiality level for group/CFS as a whole.

AUDITING THE CONSOLIDATION

Before commencing an audit of CFS, the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner.

The auditor should make plans, among other things, for the following:

- 1) Understanding of the **group structure and group- wide controls** including assessment of I1 system and related general and applications IT related controls (manual and automated) for consolidation process;
- 2) Understanding of **accounting policies** of the parent and its components as well as of the consolidation process including the process of translation of FS of foreign components;
- 3) Determining and programming the **nature, timing, and extent of the audit** procedures to be performed based on the assessment of the risk of material misstatement in the consolidation process;
- 4) Determining the **extent of use of other auditor's work** in the audit; and
- 5) **Coordinating** the work to be performed.

Completeness of components

- The auditor should obtain a **listing of all the components** included in the CFS and verify that all the components have been included in the CFS unless these components meet criterion for exclusion.
- **In respect of completeness** of this information, the auditor should perform the following procedures:

<ul style="list-style-type: none">• Review his working papers for the prior years for the known components;
<ul style="list-style-type: none">• Review the parent's procedures for identification of various components;
<ul style="list-style-type: none">• Make inquiries of management to identify any new components or any component which goes out of CFS;
<ul style="list-style-type: none">• Review investments of parent and its components to determine shareholding in other entities;
<ul style="list-style-type: none">• Review the joint ventures and joint arrangements as applicable;
<ul style="list-style-type: none">• Review other arrangements entered into by parent that have not been included in CFS of the group;
<ul style="list-style-type: none">• Review the statutory records maintained by the parent, for example, Registers u/s 186, 190 of the Companies Act, 2013.
<ul style="list-style-type: none">• identify the changes in the shareholding that might have taken place during the reporting period.

Auditor should document procedures performed for assessing completeness of the components to be consolidated.

Means by which control, joint control or significant influence can be obtained can be many

- **Auditor to establish may verify:**
 - Board's minutes.
 - Shareholder agreements entered into by the parent,
 - Agreements with the entities to which the parent might have provided any technology or know how,
 - Enforcement of statute, etc.
- Auditor may also review the **minutes of the meetings** of the BOD **subsequent to the year-end** to understand any liquidation of investments or any further investments which have been made.

Components excluded from Consolidated financial statements

Auditor should examine the reasons for exclusion and whether it is in conformity with:

A. Applicable financial reporting framework

Under the Companies (Accounting Standards) Rules, 2006: Exclusion of a subsidiary, associate or jointly controlled entity could be due to one, that the relationship of parent with the subsidiary, associate or jointly controlled entity is:

<ul style="list-style-type: none"> • intended to be temporary; or
<ul style="list-style-type: none"> • It operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.

Under Ind AS 110: There are no exceptions from consolidation except Ind AS 10 prescribes certain criteria where CFS are not required

- It also prescribes certain criteria where CFS are not required (discussed earlier).
- **Auditor should satisfy himself that** the exclusion made by the management falls within prescribed categories, **example** in case an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary, associate or joint venture is temporary, **auditor should verify that the intention of the parent**, to dispose off the subsidiary, investment in associate or interest in jointly controlled entity, in the near future, existed at the time of acquisition of the subsidiary, making investment in associate or jointly controlled entity.
- verify that the reasons for exclusion are given in the CFS.
- If an entity is excluded from the CFS for reasons other than those allowed by the A-FREW, auditor should consider its effect on the auditor's report to be issued.

COMPANIES ACT, 2013

Intermediate subsidiary in India is not required to present CFS, as discussed earlier. (compliance with conditions u/s 129)

Changes in Ownership status & categorisation of group entities

- The auditor should also examine whether there is any change in the status of a component (e.g., subsidiary to associate, V to associates or vice-versa).
- The auditor, in such cases, should examine whether these changes have been appropriately accounted for in the CFS.

CFS under Companies (Accounting Standards) Rules, 2006

FS of the parent and its subsidiaries are combined on a line-by-line basis by adding together like items of assets, liabilities, income, expenses and cash flows and then certain calculations like determination of goodwill or capital reserve, minorities interest and adjustments like elimination of intra group transactions, balances and unrealised profits etc. are made in accordance with the requirements of

➤ AS 21, "CFS",
➤ AS 23 - "Accounting for investments in Associates in CFS"
➤ AS 27- "Financial Reporting of interests in Joint Ventures"

CFS under Companies (Indian Accounting Standards) Rules, 2015

- FS of the parent and its subsidiaries are combined as per Ind AS 110, CFS" on a line-by-line basis by adding together like items of assets, liabilities, income, expenses and cash flows:
- Related goodwill/ capital reserve (or gain on bargain purchase) and non-controlling interest is determined as per **Ind AS 103**;
- Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method in accordance with Ind AS 103;
- Adjustments like elimination of intra group transactions, balances, unrealised profits and deferred tax etc. are made in accordance with the requirements of **Ind AS 10**.
- Investments in associates and joint ventures are accounted for using the equity Method as prescribed in **Ind AS-28**, "Investments in Associates and Joint Ventures" Interests in assets, liabilities, revenues and expenses in a joint operation are accounted for as part of separate FS of the entity in accordance with Ind AS-III, "Joint Arrangements".
- In a **business combination achieved in stages**, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate in accordance with Ind AS 103.
- Auditor should verify that the **adjustments warranted** by the relevant AS under A-FREW have been made wherever required and have been properly approved by the management of the parent.
- Auditor should also pay attention to **off B/S entities** which sometimes do not qualify for the definition of subsidiary; however, parent might have transferred risks of various business ventures to these entities.
- De-facto control should also be considered.
De facto control means an investor with less than the majority of the voting rights has the practical ability to direct the relevant activities unilaterally.

Special Considerations

1 Permanent Consolidation Adjustments

- It refers to 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 AS.
 - Determination of amount of equity attributable to minority/ non-controlling interests.
- **Auditor's procedures on Permanent Consolidation Adjustments**
 - 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.
- Examine whether the **pre-acquisition reserves have been allocated appropriately** between the parent and the minority interests/ non-controlling interests of the subsidiary.
- 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.
- Auditor should verify that the gross amounts of **goodwill and capital reserves** arising on acquisition of various subsidiaries have been disclosed in the notes to the CFS to reflect the excess/shortage over the parents' portion of the subsidiary's equity.

Example

XVZ Ltd. is a company engaged in the manufacture of tyres for four wheelers and two wheelers through its subsidiaries ABC Ltd. and MNO Ltd. The company has invested 70% in ABC Ltd. During the FY 2021-22, the company reduced the control over ABC Ltd. from 70% to 55%. Consequently, certain adjustments were made to the accounts for the change in share of equity held in Xy2 Ltd, whose financials are being consolidated. Such kind of adjustments are known as permanent consolidation adjustments.

Current period Consolidation Adjustments

- It refers to adjustments that are made in the **accounting period for which the CFS is done.**
- Current period consolidation adjustments primarily relate to elimination of intra-group transactions and account balances including:
 - Intra-group interest** paid and received, or management fees, etc.,
 - Unrealised intra-group profits** on assets acquired/ transferred from/ to other subsidiaries;
 - Record deferred taxes on unrealised intercompany profits** elimination in accordance with Ind AS 12,
 - Intro-group** indebtedness;
 - Adjustments related to harmonising the different accounting policies being followed by the parent and its components;
 - Adjustments to the FS (of the parent and the components being consolidated) for recognised **subsequent events or transactions** that occur between the B/S date and the date of the auditor's report on the CFS of the group including (SA S60 defines subsequent events)
 - Adjustments for the effects of significant transactions or other events that occur between the **date of the components B/S and not already recognised in its FS** and **date of the auditor's report** on the group's CFS when the FS of the **component to be used for consolidation are not drawn up to the same B/S date as that of the parent**

- h. In case of a **foreign component, adjustments to convert** a component's audited FS prepared under the component's local GAAP to the GAAP under which the CFS are prepared
- i. Determination of **movement in equity attributable** to the minorities interest/noncontrolling interest since the date of acquisition of the subsidiary.
- j. 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 CFS prepared under Ind AS. Adjustments are made in memorandum records of parent. Auditor should review such records.

Auditor's Procedures on Current Consolidation Adjustments

Review

Auditor should review the **memorandum records** to verify the adjustment entries made in the preparation of CFS.

- 1) Verify that the **intra group transactions and account balances** have been eliminated.
- 2) Verify that the CFS have been prepared using **uniform accounting policies** for like transactions and other events in similar circumstances;
- 3) Verify that **adequate disclosures** have been made in the CES of application of **different accounting policies** in case, it was impracticable to harmonise them.
- 4) While preparing CFS Under Ind AS, auditors should ensure that appropriate adjustments are made to that group member's FS in preparing the CFS to ensure conformity with the group's accounting policies in accordance with Ind AS 110;
- 5) Verify the **adjustments made to harmonise the different accounting policies** including adjustments made by management to convert a component's FS prepared under the component's GAAP to the GAAP under which the CFS are prepared
- 6) Verify the **calculation of minorities/non-controlling interest**;
- 7) 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);
- 8) Verify that **income and expenses** of the subsidiary are included in CFS **from the date it gains control** until the date when the entity ceases to control the subsidiary and further such income and expenses are based on the amounts of the assets and liabilities recognised in CFS at the acquisition date.

Management Procedures

Auditor should gain an understanding of the procedures adopted by the management to assist auditor in reducing the audit risk to an acceptably low level.

Impairment Loss

- Impairment loss might exist for goodwill arising on consolidation.

- Goodwill arising on consolidation is carried at the value determined at the date of acquisition of the component, and the same is to be tested for impairment loss at every B/s date.

Auditor should examine whether any impairment loss has been determined by the parent,
If Yes

- Examine the procedure followed for determination of impairment loss.
- Satisfy that the amount of impairment loss determined is fair.
- In case the impairment loss in goodwill of a component has been determined in foreign currency, auditor should verify if any amount of loss in local currency need to be adjusted from currency translation reserve on account of movement in the exchange rate from the date when the goodwill was first accounted for in the CFS of parent, to the date of determination of impairment loss.
- Auditor should also perform audit procedures to understand and verify whether intragroup losses are indicating loss that requires recognition in the consolidated financial statements.

Minority interest

- Auditor shall, determine in cases where minority interests' share of the losses exceed the minority/non-controlling interests' share of the equity, the excess, and any further losses applicable to the minority interest, have been accounted for in accordance with the relevant AS.

Reporting date

- The FS of the components should be drawn up to the same reporting date as that of parent.
- If it is not practicable, FS are drawn up to different reporting dates; adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's FS. Maximum difference can be:
 - 6 months as per AS
 - 3 months as per Ind AS

Event after B/S date

Auditor of CFS should review other components results between its financial reporting date and that of the parent for significant transactions on other events that have taken place during the period, having material effect on the financial position, operations or cash flows and needs to be reflected in the CFS by way of disclosure or otherwise.

Different Accounting period

The fundamental accounting assumption of "consistency" requires the auditor of the CFS to consider whether the length of the reporting periods and any difference in financial year-ends are the same from period to period. If there have been any changes in the respective reporting periods of the components included in the CFS that have a material effect on the

FS, auditor should ensure that the entity discloses such changes and the manner of treatment in the FS.

Notes and other explanatory material of CFS

AS 21 lays down certain principles that should be observed while giving information which is part of the separate FS of the Components but that need not be reported in the notes and other explanatory material of the CFS.

The auditor should:

- 1) examine that the **notes required by the applicable standards** necessary for true and fair view of the CFS have been included in CFS; and
 - examine that **additional statutory information disclosed** in the separate FS of the subsidiary and/or a parent having bearing on the true and fair view of the CFS have been disclosed in the CFS
 - In addition, **the information required pursuant to schedule III** to the Companies Act, 2013 (general instructions for the preparation of CFS) should be disclosed.

Example, following information is also required to be disclosed in the CFS separately for the parent and each of its components (including foreign component) which has been consolidated:

- *amount of net assets and net assets as a **percentage of consolidated net assets**;*
- *amount of share in profit or loss and the percentage share in profit or loss as a **percentage of consolidated profit or loss**;*
- *amount in other comprehensive income (OCI) and the percentage of OCI as a **percentage of Consolidated OCI**.*

Consolidation adjustments (including elimination of intra group transactions)

Should be either disclosed as a single line item separately or adjusted in the information (e.g. net assets) disclosed for the parent and its each component.

Exclusions from CFS

- In case of companies, the **information such as the following given in the notes to the separate FS** of the parent and/or the subsidiary, **need not be included in the CFS**.
 - I. Source from which bonus shares are issued, e.g., capitalisation of profits or reserves or from securities premium account.
 - II. Disclosure of all unutilised monies out of the issue indicating the form in which such unutilised funds have been invested.
 - III. Disclosure required under Micro, Small and Medium Enterprises Development Act, 2006

- IV. A statement of investments (whether shown under "financial assets or non-financial assets as stock-in-trade) separately classifying trade investments and other investments, showing the names of the bodies corporate (indicating separately the names of the bodies corporate under the same management) in whose shares or debentures, investments have been made (including all investments, whether existing or not, made subsequent to the date as at which the previous balance sheet was made out) and the nature and extent of the investment so made in each such body corporate.
- V. Value of imports calculated on C.I.F. basis by the company during the F. Y in respect of:
 - Raw materials;
 - Components and spare parts;
 - Capital goods.
- VI. Expenditure in foreign currency during the F. Y on account of royalty, know-how professional and consultation fees, interest, and other matters.
- VII. Value of all imported raw materials, spare parts and components consumed during the F. y and the value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption.
- VIII. The amount remitted during the year in foreign currencies on account of dividends, With a specific mention of the number of non-residents
- IX. Shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related.
- X. Earnings in foreign exchange classified under the following heads, namely:
 - Export of goods calculated on F.O.B. basis;
 - Royalty, Know-how, Professional and Consultation fees;
 - Interest and Dividend;
 - Other income, indicating the nature thereof.
- XI. Disclosure of AS/Ind AS and other laws on CFS additionally required.

MANAGEMENT REPRESENTATIONS

- The auditor of the CFS should obtain evidence that the management of the parent **acknowledges its responsibility** for a true and fair presentation of the CFS in accordance with the **financial reporting framework** applicable to the parent and that parent management has approved the CFS.
- in addition, the auditor of the CFS obtains written representations **from parent management on matters material to the CFS.**
- Examples of such representations include:

a) Completeness of components included in the CFS;
b) Identification of reportable segments for segmental reporting;

c) identification of related parties and related party transactions for reporting;
d) Appropriateness and completeness of permanent and current period consolidation adjustments, including the elimination of intra-group transactions.

REPORTING

- The auditor should, while preparing the report, consider the requirements of **SA 700, 705 and 706**.
- Where, the auditor uses the work of other auditors in the audit of CES, the requirements of **SA 600** should also be considered.

Reporting

- **when the Parent's Auditor is also the Auditor of all its Components.**
- **when the Parent's Auditor is not the Auditor of its Components.**
- **when the Component (s) Auditor Reports on FS under an Accounting Framework different than that of the parent.**
- **When the Component (S) Auditor Reports under an Auditing Framework different than that of the parent.**
- **Components Not Audited.**

1 When the Parent's Auditor is also the auditor of all its Components

While drafting the audit report, the auditor should report:

- Whether **principles and procedures** for preparation and presentation of CFS as laid down in the relevant AS have been followed.

In case of any departure or deviation, auditor should consider the requirements given in SA 705, Modifications to the Opinion in the independent Auditor's reports in the audit report so that users of the CFS are aware of such deviation.

- Auditor should issue an audit report **expressing opinion whether the CFS give a true and fair view** of the state of affairs of the Group as on B/S date and as to **whether consolidated profit and loss statement gives true and fair view** of the results of consolidated profit or losses of the Group for the period under audit.
- Where the **CFS also include a cash flow statement**, auditor should also give his opinion on the true and fair view of the cash flows presented by the consolidated cash flow statements.

2 When the Parent's Auditor is not the Auditor of all its Components

- Additionally consider the requirement of SA 600.
- As prescribed in SA 706, if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the CFS should **disclose clearly the magnitude of the portion of the FS audited by the other auditor(s)** in

terms of amounts or percentages of total assets, revenues and cash flows of components included in CES not audited by the parent's auditor. This is construed as an indication of the divided responsibility between the auditors of the parent and its subsidiaries. If component is a N/A (Equity method) then magnitude in this clause is presented in terms of **net profits** of N/A audited by component auditors

3 When the Component(s) Auditor Reports on FS under an Accounting Framework Different than that of the Parent

- local component auditors may be unable to report on FS prepared using the parent's GAAP because of their unfamiliarity with such GAAP.
- When a component's FS are prepared under different accounting framework, the parent's **management perform a conversion of the components' audited FS.**
- **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 FS on the basis of the parent's accounting policies, to facilitate the preparation of the group's CFS.**
 - The **group accounting manual** would be used which normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework of the group.
 - **The local component auditor can then audit and issue an audit report on the components FS prepared in accordance with "group accounting policies"**
 - Principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's FS.
 - This would **eliminate the need for auditing the differences between** the basis used for the component's FS and that of the CFS.
 - 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 CFS.

4 When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent

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' FS should also be audited under a framework that corresponds to auditing standards generally accepted in India (Indian GAAS).

5 Components Not Audited

Auditor should consider unaudited components in **evaluating a possible modification to his report** on the CFS. The evaluation is necessary because the auditor **has not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances**. In such cases, the auditor should evaluate both **qualitative and quantitative factors** on the possible effect of such amounts remaining unaudited, when reporting on the CFS On accordance with SA 705.

INTERNAL AUDIT

NEED FOR INTERNAL AUDIT

- To obtain report on the deficiency in IC system and underlying transaction.
- Better governance of organization.
- To take timely remedial actions wherever needed.

INTERNAL AUDIT STANDARDS BOARD (IASB)

- The ICAI constituted the Internal Audit Standards Board (ASB) as a non-standing technical board of February S, 2004.
- The IASB is constituted with the object of
- Formulating:
 - Standards on Internal Audit (SIAs),
 - Guidance notes on internal Audit,
- Continuously review the Standards and Guidance Notes,
- Formulate and Review:
 - Implementation Guides,
 - Technical Guides,
 - Practice Manuals
 - Studies and other papers,

which may be issued under its own authority for guidance of the members.

- Besides, the IASB also undertakes research and promote knowledge dissemination in the field of internal audit.

Definition of internal Audit

As defined in Framework Governing internal Audits, "Internal Audit provides independent assurance on the effectiveness of ICs and risk management processes to enhance governance and achieve organizational objectives."

Role of internal Audit

The nature of internal audit services may go beyond assurance to include an advisory (consulting) role to help an organization achieve its objectives, provided this does not compromise the independence of the internal auditor.

Providing advisory inputs on governance activities such as:

- Risk management,
- Framework of monitoring statutory compliances,
- Automation of activities,
- Avenues of process re-engineering with increase operational efficiency,
- Code of ethics.

Scope of Internal Audit

The internal auditing is not confined to financial transactions only and include review of operational activities, underlying ICs, compliance to applicable laws and regulations.

The objectives and scope of internal Audit Function as per SA 610, "Using the Work of an internal Auditor may include:

Indicative Objectives & Scope of Internal Audit

Monitoring of ICs

Example: Performing three-way matching of purchase invoices order, receipt of material before approving vendor payment.

Examination of financial and operating information

Example: Internal Audit of sales records, delivery records, sales commission for identifying correctness of revenue recorded.

Review of operating activities

Example: Reviewing Inventory Management activities and appropriate handling to prevent damages.

Review of compliance with laws and regulations

Example: Review of compliance with newly applicable tax Regime.

Risk management

Example: Evaluation and management of Risk Exposure for complex financial instruments transactions.

Governance

Example: Assessment of Governance Process in the accomplishment of objectives on ethics and values.

LEGAL FRAMEWORK/ APPLICABILITY OF PROVISIONS OF INTERNAL AUDIT

Sec. 138 of the Companies Act, 2013

As per section 13 of the Companies Act, 2013, following class of companies (pre-scribed in Rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate, namely:

- a. Every listed company;
- b. Every unlisted public company having:

i.	Paid up share capital of ₹50 Cr. or more during the preceding F.Y; or
ii.	Turnover of 200 Cr. or more during the preceding F.Y; or
iii.	Outstanding loans or borrowings from Banks or Public Financial institutions exceeding ₹100 Cr. or more at any time during the preceding F.Y; or
iv.	outstanding deposits of ₹25 Cr. or more at any time during the preceding F. Y; and

- c. Every private company having:

i.	Turnover of ₹200 Cr. or more during the preceding F.Y; or
ii.	Outstanding loans or borrowings from Banks or Public Financial Institutions exceeding ₹100 Cr. or more at any point of time during the preceding F.Y.

Transition Provision

An existing company if covered under any of the above criteria shall comply with the requirements within six months of commencement of such applicability.

Eligibility for appointment of Internal auditor

As per section 138, the internal auditor shall either be

- A Chartered Accountant
- A Cost Accountant
- **Other professional**, as may be decided by the Board
- He can also be an employee of the company.

AUTHORITY OF INTERNAL AUDITOR

The internal auditor must be regarded as:

- A part of the management and not merely as an assistant thereto.
- Must have the authority to investigate every organizational activity to meet the objectives and scope of the internal audit.

RESPONSIBILITIES OF INTERNAL AUDITOR

W.r.t Internal Audit function

The internal Audit function performs a number of activities to achieve its objectives as out lined in its Terms of Engagement (SIA 210-Managing the Internal Audit Function). A few of the critical activities are as follows:

a) Define the overall plan, scope and methodology of the internal Audit Function on a periodic basis.
b) Oversee and monitor various audit assignments, their proper planning, execution, reporting of findings and subsequent closure of reported observations.
c) Plan, acquire, engage and review the performance, training and development of professional staff, talent and other resources to achieve its objectives.
d) Identify, source, engage and manage external experts and technical solutions, if required.
e) Communicate and engage with all key stakeholders regarding progress and achievement of objectives.
f) Develop and maintain a quality evaluation and improvement program.

W.r.t Accounting function & Financial records

With respect to the accounting function and financial records of the organization, the responsibilities of an internal Auditor include:

a) To ascertain adequacy of system of IC by a continuous examination of accounting procedures, receipts and disbursements, and to provide adequate safe guards against misappropriation of assets.
b) To operate independently of the accounting staff and must not in any way divest with any of the responsibilities placed upon him.

c) Not to involve in the performance of executive functions in order that the objective outlook does not get obscured by the creation of the vested interest.
d) To observe facts and situations and bring them to notice of authorities who would otherwise never know them.
e) Critically appraise various policies of the management and draw its attention to any deficiencies, wherever these require to be corrected.
f) To associate closely with management and keep knowledge up to date by being informed about all important occurrences and events affecting the business, as well as the changes that are made in business policies.
g) At all times, the internal auditor must enjoy an independent status.

MANAGEMENT FUNCTIONS AND SCOPE OF INTERNAL AUDITING

Management Function

- Management is a process by which the affairs of an enterprise are conducted in such a manner that its goals and objectives are attained through optimum utilization of all available resources, within the legal, social, economic and environmental constraints.
- To achieve optimum utilization of resources management should determine the goals and objectives of the concern, quantify them to the extent possible, develop major policies and plans, implement them and exercise control over such implementation

Objectives of internal audit

- For companies required to comply with sec. 138 of the companies Act, 2013, Rule 13(2) of companies (Accounts) rules 2014, states:
“The Audit Committee of the company or the Board shall, in consultation with the internal Auditor, formulate the scope, functioning, periodicity, and methodology for conducting the internal audit.”
- Other Organizations (not covered under Rule 13)
Those who appoint the internal Auditor (e.g., owners, promoters, Board of Trustees, etc.) would generally define the objectives of internal audit.
- Internal auditor should, in consultation with TCWG, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner.

Scope of Internal auditing

- Internal audit plan should be developed in such a manner that all the business processes covering both financial as well as operational activities are reviewed by internal audit function within a defined time cycle.
- Ensuring that appropriate consideration is made and adequate balance is ensured to the following:

➤ Risk underlying the business process.
➤ Value that the internal audit can provide to the organization.
➤ Effort involved in conducting the internal audit for a particular business process.
➤ Risk Appetite of the organization.

- Coverage of all auditable areas within the defined time range.

- Each of the managerial functions should be reviewed by the internal auditor.
- The scope of internal auditor's work should also include a review of:

a. Review of internal Control Systems and Procedures

- It involves assessing the design and operational efficiency and effectiveness of IC system to strengthen the overall IC environment of the entity.
- The objective to review is to minimize the overall residual risk by suggesting the appropriate controls to reduce the inherent risk.

b. Review of Custodian and safeguarding of Assets

- It involves verifying the existence of the assets.
- Review the segregation of duties is in place.
- Review the control systems to ensure that all assets are accounted for fully.
- Review the means used for safeguarding assets against losses e.g. fire, improper or negligent activity, theft and illegal acts, etc.
- Review the control systems for intangible assets e.g. the procedures relating to credit control.

c. Review of compliance with policies, plans, procedures and regulations

- It is essential that the various functional segments of an enterprise comply with the relevant policies, plan, procedures, laws and regulations so that the operations are carried out in a coordinated manner.
- Examine the system of periodical review of existing policies, particularly when there is a change in the method and nature of operations of the enterprise.
- By combining the results of his review of the adequacy of the systems with the result of his compliance tests, the internal auditor should be able to evaluate the effectiveness of the former.
- He should point out specific weakness and suggest remedial action

d. Review of Relevance and Reliability of information

- Review the information systems to evaluate the reliability and integrity of financial and operating information given to management and to external agencies such as governmental bodies, investors, trade organizations, labor unions, etc.
- Examine the accuracy and reliability of financial and operational records.
- The usefulness of the reports as well as of the records should be evaluate with reference to their costs.
- Examine whether the reporting is by exception i.e. the reports highlight the significant and distinctive features.
- In case of automated management information system, the adequacy of the controls build in the system should be reviewed to ensure data integrity and reliability of such information.

e. Review of the organization structure

The internal auditor should conduct an appraisal of the organization structure to ascertain whether it is in harmony with the objectives of the enterprise and whether the assignment of responsibilities is in consonance therewith.

For this purpose, auditor should:

- Review the manner in which the enterprise activities are grouped for managerial control. Review whether responsibility and authority are in harmony with the grouping pattern.
- Examine the organization chart to find out whether the structure is simple and economical and that no function enjoys an undue dominance over the others.
- See that the responsibilities of managerial staff at headquarters do not overlap with those of chief executives at operating units.
- Examine whether there is a satisfactory balance between the authority and responsibility of important executives.
- Examine the reasonableness of the span of control of each executive (the number of subordinates that an executive controls).
- Examine whether there is a unity of command i.e., whether each person reports only to one superior.
- Where dual responsibilities cannot be avoided, the primary one should be specified and the specific responsibility to each senior fixed. This must be made known to all concerned.
- Review adequate segregation of duties is considered while defining the organization structure.
- Evaluate the process of managerial development in the enterprise.

f. Review of Utilization of Resources

- Check whether proper operating standards and norms have been established for measuring the economical and efficient use of resources.
- They should be detailed enough to be identifiable with specific operating responsibilities and should be capable of being used by operating personnel for monitoring and evaluating their performance.
- Review the methods of establishing operating standards and norms.
- Carefully examine the assumptions made while setting the standards to ensure that they are appropriate and necessary.
- Where there is a wide divergence between actual performance and the corresponding standards, reasons may be considered.
- Evaluate resources utilization, and identifying the facilities which are under-utilized.

g. Review of Accomplishment of Goals and Objectives

- Review the overall objectives of the enterprise to evaluate whether they are clearly stated and are attainable.
- Examine whether, to the extent possible, objectives are expressed in precise quantifiable terms (both monetary and non-monetary) to facilitate detailed planning to be made for achieving them. Budgeting forms an important part of such planning.
- There should also be sufficient flexibility in the plans to permit improvements in their implementation, as would benefit the enterprises as a whole.

INTEGRITY, OBJECTIVITY AND INDEPENDENCE OF INTERNAL AUDITOR

There is a set of core principles fundamental to the internal audit function and activities, these basic principles of internal audit are critical to achieving the desired objectives as set out in the Definition of internal Audit.

<ul style="list-style-type: none"> • The Internal Auditor shall be free from any undue influences which force him to deviate from the truth. This independence shall be not only in mind but also in appearance.
<ul style="list-style-type: none"> • He shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives.
<ul style="list-style-type: none"> • He shall be honest, truthful and be a person of high integrity.

<ul style="list-style-type: none"> • He shall operate in a highly professional manner and seen to be fair in all his dealings.
<ul style="list-style-type: none"> • He shall avoid all conflicts of interest and not seek to derive any undue personal benefit or advantage from his position.
<ul style="list-style-type: none"> • He shall conduct his work in a highly objective manner, especially in gathering and evaluation of facts and evidence.
<ul style="list-style-type: none"> • He shall not allow prejudice or bias to override his objectivity, especially in arriving at conclusions or reporting his opinion.

QUALITIES OF INTERNAL AUDITOR

In order to perform his duties effectively, Internal Auditor is required to possess go0u knowledge of the subject matter, underlying information system and good soft skills. Some of the specialized knowledge and expertise that Internal Auditor should obtain are:

<ul style="list-style-type: none"> • Accounting and financial expertise to be able to discharge his duties.
<ul style="list-style-type: none"> • Expected to evaluate both financial and operational controls. This requires a good knowledge of the operations of the organization, technology and commercial practices of the enterprise.
<ul style="list-style-type: none"> • A good knowledge of commerce, laws, taxation, cost accounting, economics, quantitative methods and EDP systems.
<ul style="list-style-type: none"> • An understanding of the accounting software, ERP system and other applications being used by the organization along with the knowledge of the basic controls related to Information Technology.
<ul style="list-style-type: none"> • An understanding of management principles and techniques is another essential qualification of an internal auditor as also the ability to deal with people.
<ul style="list-style-type: none"> • By his conduct the internal auditor should provide an assurance to the management that the confidentiality of such information would be maintained.

PERFORMING INTERNAL AUDIT ENGAGEMENT

Internal audit engagement comprises of following five steps:

Step 1	Obtain knowledge of the Business and its Environment
Step 2	Perform Audit Planning
Step 3	Gather required information
Step 4	Perform audit checks
Step 5	Reporting of internal Audit Issues

Step 1 Obtain knowledge of the Business and its Environment

- Conduct meetings with key stakeholders, Board of Directors and Key management personnel to obtain understanding of the organization's business environment, its operations, organization's vision, mission and top management s expectations from the audit functions.
- Obtain understanding of various business documents - standard operating Procedures and Financial Statement, etc.
- Obtain understanding of the underling information Technology landscape, various applications and ERP systems of the organization and Management information system of the organization.
- Obtain understanding of the regulatory landscape and various laws and regulations that are applicable to the organization.

Step 2 Perform Audit Planning

- Internal Auditor must plan the audit engagement as per the Standard on Internal Audit (SIA) 310, planning the internal Audit Assignment.
- Once audit scope is approved by the Audit Committee and BOD, Internal Auditor must share detailed Audit Plan with the key managerial personnel's and plan in advance the detailed schedule of the internal Audit to be conducted.
- Internal Auditor must conduct the opening meeting with key stakeholders before start of audit engagement and share details of information and system Access required to perform the audit.
- Detailed work plan must be prepared by the audit managers and approved with Head of Internal Audit / Chief Internal Auditor.
- The work plan must be prepared after performing the evaluation of all major underlying risks in the process being reviewed and the audit checks to be performed to assess the adequacy of the control environment to mitigate such risks.

Step 3 Gather required information

- Internal Auditor must obtain the required information and perform checks to ensure correctness and integrity of information received.
- Internal Auditor must obtain the information directly from the source, to the extent possible.
- Adequate planning should be done and advance intimation should be made for any interim information needed for performing audit checks.

Step 4 Perform audit checks

- Internal Auditor should collate all data and perform analytical procedures to identify key trends and outliers.
- Analytical procedures should be performed in accordance with the Standard on Internal Audit (SIA) 6, Analytical Procedures.
- Relevant analytical tools may be used to perform review of the complete data for the audit period, to the extent possible.
- Wherever needed, Internal Auditor must select the sample in accordance with Standard on Internal Audit (SIA) 5, Sampling.
- Detailed audit testing must be performed as per the audit work plan.
- Internal Auditor must ensure adequate evidences must be collected and stores in accordance to Standard on internal Audit (SIA) 320, Internal Audit Evidence. Internal Auditor must prepare detailed list of the identified audit issues and controls gaps.
- Interim reports may be issued after proper review of the work performed as per the Standard on internal Audit (SIA) 350, Review and Supervision of Audit Assignments.
- Adequate document of the internal audit work papers needs to be ensured as per Standard on Internal Audit (SIA) 330, Internal Audit Documentation.

Step 5 Reporting of Internal Audit Issues

- Internal Auditor must prepare a draft report of Internal Audit issues comprising of the business process/ function reviewed as per scope, detailed audit coverage and exclusions, if any, audit period covered during the audit, summary along with detailed issues over the gaps noted along with implication of the business and recommendation to mitigate the identified gaps.
- Internal Auditor must also review the status of actions taken by the management against the actions agreed during previous audits and report the status of such follow up in the audit report.

- Internal Auditor should, thereafter, circulate Final Report and present his findings to the Audit Committee.
- Internal auditor must adhere to Standard on Internal Audit (SIA) 360, Communication with Management and Standard on internal Audit (SIA) 370, Reporting Results while sharing the result of internal audit with the stakeholders.

INTERNAL AUDIT REPORT

As per Standard on internal Audit (SIA) 370 Reporting Results, reporting of internal audit results is generally undertaken in two stages:

Stage 1

- At the end of a particular audit assignment, an "Internal Audit Report" covering a specific area, function or part of the entity is prepared by the internal Auditor highlighting key observations arising from those assignments.
- This report is generally issued with details of the manner in which the assignment was conducted and the key findings from the audit procedures undertaken.
- This report is issued to the auditee, with copies shared with local and executive management, as agreed during the planning phase.

Stage 2

- On a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor. (or the Engagement partner, in case of external service provider).
- Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee.
- Some part of the aforementioned Internal Audit Reports may form part of the periodic (e.g. Quarterly) report shared with the Audit Committee.

This SIA deals with the internal auditor's responsibility to issue only the first type of reports, the Internal Audit Report pertaining to specific audit assignments and not to the periodic (e.g. Quarterly) reporting for the whole entity as per the Annual/Quarterly audit plan.

On the basis of the internal audit work completed, the internal Auditor shall issue a clear, well documented internal Audit Report which includes the following key elements:

• An overview of the objectives, scope and approach of the audit assignments;
• The fact that an internal audit has been conducted in accordance with the SIA;
• An executive summary of key observations covering all important aspects, and specific to the scope of the assignment;
• A summary of the corrective actions required (or agreed by management) for each observation; and
• Nature of assurance, if any, which can be derived from the observations.

The internal audit report shall be issued within a reasonable time frame from the completion of the internal audit work.

Basis of Internal Audit Report

- Each internal audit report is prepared on the basis of the audit procedures conducted and the analysis of the audit evidence gathered.
- Conclusions reached shall be based on all the findings rather than on a few deviations or issues noted.
- Controls operating effectively have their own importance and should be acknowledged, while the risk and significance of observations noted have a role to play in prioritizing the matters to be reported.

Conducted in Accordance with SIAs

Where the internal audit is conducted in compliance with the SIA, and the internal auditor can substantiate the same with supporting evidence and documentation, the internal audit report shall include a statement confirming that "the internal audit was conducted in accordance with the SIA issued by ICAI."

Content and Format of Internal Audit Report

- The manner in which the internal audit report is drafted and presented is a matter of professional judgment and choice and could be influenced by the preferences of the recipients.
- The SIA does not mandate any particular format or list of contents since the Internal Auditor is expected to exercise his best professional judgement on matters regarding how and what to report. Where some level of assurance is being provided, the form and content of the report shall be as per SIA 380, "Issuing Assurance Reports".
- A typical internal audit report should include the following:
 - Audit scope performed.
 - Audit period covered.
 - Executive Summary.
 - Summary of the critical findings.
 - Detailed audit findings with elaboration on business impact and root cause of such issues.
 - Rating of the highlighted issues (e.g. High / Medium / Low) in accordance to the rating criteria approved by Audit Committee.
 - Audit recommendation to improve control environment and address the highlighted finding.
 - Response received from the responsible functional authority containing action plan and target timelines for action.

Documentation

To confirm compliance of audit procedures with this SIA, the list of documents required is as follows;

- Copies of draft and final internal audit reports to be maintained, appropriately cross referenced to specific observations.
- If appropriate, management action plans may be counter signed by respective management personnel.

Follow up

As per SIA 390 Monitoring and Reporting of Prior Audit Issues:

"Monitoring and reporting" refer to the periodic tracking of issues raised during prior audits and evaluation of the corrective actions undertaken by the auditee to resolve them and to report any open and pending matters to the management and TCWG (e.g. the Audit Committee).

<ul style="list-style-type: none"> • The Chief internal Auditor is responsible for continuously monitoring the closure of prior audit issues through timely implementation of action plans included in past audits.
<ul style="list-style-type: none"> • This shall be done with a formal monitoring process, elements of which are pre agreed with management and TCWG.
<ul style="list-style-type: none"> • The responsibility to implement the action plans remains with the management. In monitoring and reporting of prior audit issues, the responsibility of the Internal Auditor is usually in the form of an "Action Taken Report (ATR) of previous audits".
<ul style="list-style-type: none"> • The internal auditor should review whether follow-up action is taken by the management on the basis of his report.
<ul style="list-style-type: none"> • If no action is taken within a reasonable time he should draw the management's attention to it.
<ul style="list-style-type: none"> • Where the management has not acted upon his suggestions or not implemented his recommendations, the internal auditor should ascertain the reasons thereof.
<ul style="list-style-type: none"> • Where the management has accepted his recommendations and initiated the necessary action, the internal auditor should periodically review the manner and the extent of implementation of the recommendations and report to the management highlighting the recommendations which have not been implemented fully or partly.

RELATIONSHIP BETWEEN INTERNAL AND EXTERNAL AUDITORS

- The scope and objective of internal audit are dependent upon the size and structure of the entity and the requirements of its management. Internal auditor operates in Various areas, such as:

➤ Review of the accounting system and IC;
➤ Examination of financial and operating information for the benefit of management;
➤ The examination of the economy, efficiency and effectiveness of operations including non-financial controls of various tangible assets of the entity.

- Evaluation done by the internal auditor in respect of ICs, reliability of financial information, verification of assets, etc. has important bearing on statutory auditor.
- Audit Committee of the company or the Board shall, in consultation with the internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit (as per Sec. 138 of the companies Act, 2013).
- It is obligatory for a statutory auditor to examine the scope and effectiveness of the work carried out by the internal auditor. He should examine the Internal Audit Department of the organization, the strength of the internal audit staff, their qualification and their powers.
- Extent of independence exhibited by the internal auditor in the discharge of his duties and his status in the organization are important for determining the effectiveness of his audit.
- External auditor should, evaluate the internal audit function to the extent he considers that it will be relevant in determining the nature, timing and extent of his compliance and substantive procedures. Depending upon such evaluation, the external auditor may be able to adopt less extensive procedures than would otherwise be required.

Difference between Internal & External Audit

Basis for comparison	Internal Audit	External Audit
----------------------	----------------	----------------

1. Performed by	Internal audit is performed by an independent internal auditing function within the organization or by external body.	It is an audit function performed by the independent body which is not a part of the organization
2. Examination	The Internal auditor examines the adequacy of operational controls of the organization	The External auditor examines the Accuracy and Validity of FS.
3. Appointment	The internal auditor is appointed by the Audit Committee or Board of Directors.	The External auditor is appointed by the Members.
4. User of Report	Generally, internal audit report is used by top Management and referred by statutory auditor.	The user of external audit report is Stakeholders.
6. Reporting	Internal Audit Report provides weakness in IC and effectiveness of the operational activities.	The opinion is provided on the truthfulness and fairness of the FS of the company.
7. Status of Auditor	The Internal auditor could be an employee of the company	The External auditor is mandatorily not an employee of the company

SA-610 "Using the work of an Internal Auditor" deals with the relationship between internal & external auditors.

RELATIONSHIP BETWEEN INTERNAL & EXTERNAL AUDIT

1. Determining whether, in which areas, and to what extent the work of the Internal Audit function can be used.
2. Determining the Nature and Extent of work of the Internal Audit function that can be used.
3. Determining whether, in which areas, and to what extent Internal Auditors can be used to provide Direct Assistance.

Determining whether, in which areas, and to what extent the work of the Internal Audit Function can be used

Evaluating the Internal Audit (A) Function:

Evaluation of IA Function includes:

- Appraisal activity
- Examining / Evaluating adequacy and effectiveness of ICs.

Scope of IA Function

- Review of ICs.
- Examination of Financial and Operational records and transactions.
- Review of Operating Activities

- Review of Regulatory Laws & Compliances.

Objective of Evaluation of IA Function

- Evaluate & improve the effectiveness of ICs.

Determining whether, in which areas, and to what extent the work of the Internal Audit Function can be used

The external auditor shall not use the work of the internal audit function if he determines that:

- The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors.
- Lacks sufficient competence.
- Does not apply a systematic and disciplined approach, including quality control.

Determining whether, in which areas, and to what extent Internal Auditors can be used to provide Direct Assistance

Nature & Extent of work that can be assigned to internal auditors providing Direct Assistance

1. The External Auditor shall consider:
2. The External Auditor shall not use internal auditors to provide direct assistance to perform procedures:

The External Auditor shall consider

Amount of judgement w.r.t:

- a. Planning & performing relevant audit procedures
- b. Evaluation of the audit evidence gathered.

Assessed risk of material misstatement.

Evaluation of existence & significance of threats.

The External Auditor shall not use internal auditors to provide direct assistance to perform procedures:

- Making significant judgements in the audit.
- Related to higher assessed risks of material misstatement where the judgement required is more than limited.
- Related to work which is reported to management or TCWG by Internal audit function.
- Related to decisions the External Auditor makes in accordance with SA 610.

The external auditor has the sole responsibility for the audit opinion expressed, even if he uses the work/direct assistance of internal auditor.

If the External Auditor uses Internal Auditors to provide Direct Assistance on the audit, the External Auditor shall include in the Audit Documentation

- The evaluation of the existence and significance of threats to the objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance;
- The basis for the decision regarding the nature and extent of the work performed by the internal auditors;

- Who reviewed the work performed and the date and extent of that review in accordance with SA 230 Audit Documentation;
- The written agreements obtained from an authorized representative of the entity and the internal auditors; and
- The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.

Refer SA 610 for the above.

INTERNAL AUDIT AS A MANAGEMENT FUNCTION

- Management is a process by which the affairs of an enterprise are conducted in such a manner that its goals and objectives are attained through optimum utilization of all available resources, within the legal, social, economic and environmental constraints.
- Management functioning is a set of five general functions: planning, organizing, staffing, directing and controlling.
- As per the revised definition of the term Internal Audit' as per para 3 of the ICAI's Framework Governing Internal Audits, "internal audit provides independent assurance on the effectiveness of ICs and risk management processes to enhance governance and achieve organizational objectives"
- Thus, internal auditor critically evaluates the management activities and advise them on the areas of improving ICs and manage business and operational risks effectively by recommending appropriate mitigating controls.
- Internal Auditor is expected to report on the identified gaps and areas of weak IC.
- Internal Auditor should identify the root cause of the problems and suggest appropriate mitigating steps and strengthen the ICs environment of the organization.
- Accordingly, Internal Audit is seen as an important function that helps management to achieve organization goals and perform its function in on orderly manner.

AUDIT TRAIL

- Audit Trail (or Edit Log) is a visible trail of evidence enabling one to trace information contained in statements or reports back to the original input source.
- Audit trails are a chronological record of the changes that have been made to the data. Any change to data including creating new data, updating or deleting data must be recorded.
- Records maintained as audit trail may include the following information:
 - When changes were made i.e., date and time (timestamp)
 - Who made the change i.e., User id.
 - What data was changed i.e., data/ transaction reference; success/failure.
- Audit trails may be enabled at the accounting software level depending on the features available in such software or same may be captured directly in the database underlying such accounting software.
- Auditor shall evaluate whether necessary IT controls have been established to demonstrate that audit trail feature was functional, operated & was not disabled.
- List of ICs which may be required to be implemented and operated are given below:
 - Controls to ensure that the audit trail feature has not been disabled or deactivated.
 - Controls to ensure that User IDs are assigned to each individual and that User IDs are not shared,
 - Controls to ensure that changes to the configurations of the audit trail are authorized and logs of such changes are maintained.

- Controls to ensure that access to the audit trail (and backups) is disabled or restricted and access logs, whenever the audit trails have been accessed, are maintained.
- Controls to ensure that periodic backups of the audit trails are taken and archived as per the statutory period specified under the provisions of the Act.

Audit of Public Sector Undertaking

Introduction

- Public sector undertakings in India are fundamentally owned or controlled by central government, or any state government or governments, or partly by the central government and one or more state governments
- These enterprises are industries supplying basic inputs to industry and agriculture, such as coal, oil, steel, minerals and metals, cement, chemicals and fertilizers and heavy equipment.
- Public utilities like the railways, postal and telecom services, electricity generation and supply, road transport, etc. constitute another class of public enterprises.

Categories for Organisation of PSU

- Departmentally managed undertakings which form part and parcel of government activities. Eg: Indian Railways, Postal Services
- Government companies and deemed government companies set up under the Companies Act, 2013
- Corporations set up under the specific Acts of the legislature. Eg: LIC, UTI etc

FRAMEWORK FOR GOVERNMENT AUDIT

- In India, the Government audit is performed by an independent constitutional authority, i.e., Comptroller and Auditor General of India (C&AG), through the Indian Audit and Accounts Department
- Article 148 to 151 of the Constitution prescribes the role of C&AG as follows:

<u>Article 148</u>	<ul style="list-style-type: none">• Appointment of C&AG by the President.• Special procedure for removal of C&AG, only on the ground of proven misbehaviours or incapacity.• Salary and other conditions of service to be determined by the Parliament.
<u>Article 149</u>	<ul style="list-style-type: none">• Perform such duties and exercise such powers in relation to the accounts of the Union and States and of any other authority or body as may be pre- scribed by or under any law made by the Parliament.• The C&AG's (Duties, Powers and Conditions of Service) Act, 1971 defines these functions and powers in detail.
<u>Article 150</u>	<ul style="list-style-type: none">• On the advice of the C&AG, President to prescribe such form in which accounts of the Union and States shall be kept.
<u>Article 151</u>	<ul style="list-style-type: none">• Audit reports of the C&AG relating to the accounts of the Central/ State Government should be submitted to the President/Governor of the State who shall cause them to be laid before Parliament/State Legislative Assemblies.

Legal Framework of CAG

Appointment: CAG shall be appointed by the President of India

Term: CAG shall hold office for six years or up to age of 65 years whichever is earlier.

Remuneration: CAG should be paid remuneration equivalent to that of a SC judge

Removal:

- CAG can be removed only when each house of parliament decides to do so by a majority of not less than 2/3rd of the members present and voting.
- CAG shall not be removed from the office except on the ground of proven misbehaviour or incapacity.

Resignation: He can resign at any time through a resignation letter addressed to the President.

The number of organisations subject to the audit of the Comptroller and Auditor General of India is very large. This includes

All the Union and State Government departments and offices including the Indian Railways and Posts and Telecommunications

Non-commercial autonomous bodies and authorities owned or controlled by the Union or the States.

Authorities and bodies substantially financed* from Union or State revenues (NGO)
(Amount not less than 25 lakhs, and amount is not less than 75% of total expenditure)

Public commercial enterprises controlled by the Union and State governments, i.e. government companies and corporations.

Audit of Government Companies (Commercial Audit) –

- There is a special arrangement for the audit of companies where the equity participation by Government is 51 percent or more.
- The auditors of these companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them.
- He is also empowered to comment upon the audit reports of the auditors.
- In addition, he has a right to conduct a supplementary audit of such companies and cause test audit if considered necessary, by an order.

Audit Board Setup in Commercial Audit –

- A unique feature of the audit conducted by the Indian Audit and Accounts Department is the constitution of Audit Boards for conducting comprehensive audit appraisals of the working of Public Sector Enterprises engaged in diverse sectors of the economy.
- These Audit Boards associate with them experts in disciplines relevant to the appraisals. They discuss their findings and conclusions with the managements of the enterprises and their controlling ministries and departments of government to ascertain their view points before finalisation.

- The results of such comprehensive appraisals are incorporated by the Comptroller and Auditor General in his reports.
- These Audit Boards have no separate legal entity and work under the supervision and control of the Comptroller and Auditor General.

Action on Audit Reports –

- The Parliament and the State Legislatures have, constituted specialized Committees like the Public Accounts Committee (PAC), Estimates Committee and the Committee on Public Undertakings (COPU), to which the audit Reports and Annual reports are referred to.

Public Accounts Committee (PAC):

1. Examine that the moneys (shown in the accounts) were disbursed for the purpose to which they were applied.
2. Examine that the expenditure was authorised.
3. Examine that re-appropriation has been made in accordance with the provisions made (i.e., distribution of funds).
4. Examine the statement of accounts of autonomous and semi-autonomous bodies, the audit of which is conducted by the Comptroller Auditor General either under the directions of the President or by a Statue of Parliament.

Estimates Committee

The functions of the Estimates Committee are:

- a. to report what economies, improvements in organization, efficiency or administrative reform, consistent with the policy underlying the estimates may be affected;
- b. to suggest alternative policies in order to bring about efficiency and economy in administration;
- c. to examine whether the money is well laid out within the limits of the policy implied in the estimates; and
- d. to suggest the form in which the estimates shall be Parliament. presented to Parliament

Committee on Public Undertakings

The functions of the committee are:

1. To examine the reports and accounts of public undertakings.
2. To examine the reports of the CAG on public undertakings.
3. To examine the efficiency of public undertakings and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.
4. To exercise such other functions as may be allotted by the Speaker from time to time.

The examination of public enterprises by the Committee takes the form of Comprehensive appraisal or evaluation of performance of the undertaking. It involves a thorough examination, including evaluation of the policies, programmes and financial working of the undertaking

C&AG's Role – The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committees.

- I. His Reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his Reports;
- II. He scrutinises the notes which the Ministries submit to the Committees and helps the Committees to check the correctness of submissions to the Committees and facts and figures in their draft reports;
- III. The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations.
- IV. The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature;
- V. In respect of those Audit Reports, which could not be discussed in detail by the Committee's, written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature.

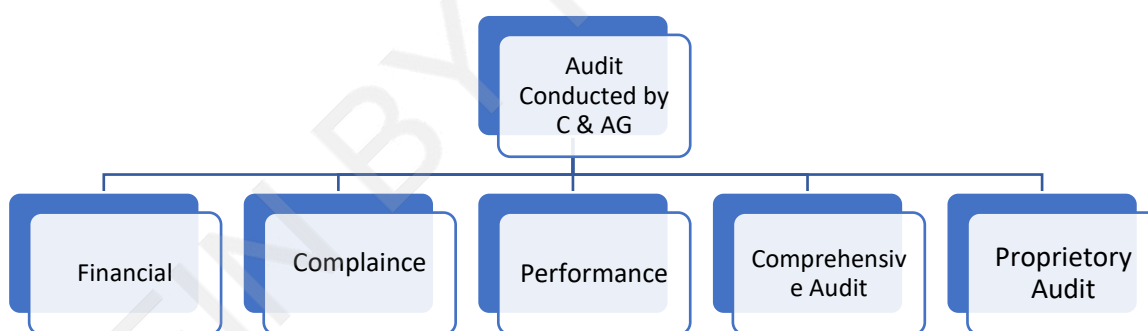
OBJECTIVE AND SCOPE OF PUBLIC ENTERPRISES AUDIT

Objectives of Audit

Objectives of Audit of PSU, in broader context, covers two main elements:

- a. **Fiscal Accountability:** It includes audit of provision of funds, sanctions, compliances and propriety.
- b. **Managerial accountability:** It includes audit of efficiency, economy and effectiveness.

Another equally important objective of audit of PSU is to help the government and the enterprise management to **improve their efficiency and effectiveness**. This is achieved by bringing out financial and operational deficiencies, inadequacies or ineffectiveness of systems, shortfalls in performance etc. and by analysing the causes of shortfall from acceptable standards of performance.



1. Audit of PSUs not constrained to Financial and Compliance Audit:

- Audit of public enterprises in India is not restricted to financial and compliance audit;
- it extends also to performance (efficiency, economy and effectiveness with which these operate and fulfil their objectives and goals).

2. Propriety Audit:

- Another aspect of audit relates to questions of propriety.
- This audit is directed towards an examination of management decisions in sales, purchases, contracts, etc. to see whether these have been taken in the best interests of the undertaking and conform to accepted principles of financial propriety.

3. **Comprehensive Audit:**

- Under comprehensive audit, the C&AG do not really cover again the field which has already been covered.
- He conducts an appraisal or an efficiency-cum- performance audit. He sees whether the undertakings have fulfilled the objectives for which they have been established, whether value-for-money spent has been obtained, whether the targets have been achieved, etc.
- He locates the areas of weakness including review of the decisions taken by the management and a comprehensive appraisal of the performance of the undertaking.

4. **Organisation's Decision to be taken by Competent Authority:**

- In examining the decisions of a management, the auditor examines that these were taken by the competent authority after examination of all aspects (economic, technological, public interest)
- on the basis of all the relevant information available at that time and taking into consideration the different alternatives available to management and that the decisions were consistent with the aims and objectives of the enterprise.

5. **Helping Government:**

- Audit is an instrument of accountability. But an equally important purpose of audit of public enterprises in India is to help the Government and the enterprise managements improve their efficiency and effectiveness.
- This is achieved by bringing out financial and operational deficiencies, inadequacies or ineffectiveness of systems, shortfalls in performance, etc. and by analysing the causes of shortfall from acceptable standards of performance.

6. **Highlighting Issues of Efficient and Economic Operations:**

- Financial performance is linked with physical performance and issues of efficient and economic operations and management of resources are highlighted. There is an increasing emphasis on audit being an instrument of improvement.

7. **Fiscal and Managerial Accountability:**

- In the broader context, Government audit encompasses two main elements, viz.,
 - (a) Fiscal Accountability: It includes audit of provisions of funds, sanctions, compliances and propriety; and
 - (b) Managerial Accountability: It includes audit of efficiency, economy and effectiveness
- Efficiency- cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater efficiency, economy, and effectiveness.

Elements of PSU Audits

Parties involved

Auditor

Responsible party

Intended Users

- **The auditor:** In public sector auditing the role of auditor is fulfilled by Supreme Audit Institution, India and by its personnel delegated with the task of conducting audits.
- **The responsible party:** In public sector auditing, the relevant responsibilities are determined by constitutional or legislative arrangement. The responsible parties may be responsible for the

subject matter information, for managing the subject matter or for addressing recommendations and may be individuals organizations. Generally, auditable entities and those charged with governance of the auditable entities would be the responsible parties.

- **Intended users:** The intended users are the individuals, organizations or classes thereof for whom the auditor prepares the audit report. The intended users may be legislative or oversight bodies, TCWG or the general public. The intended user is primarily the Parliament or the Legislature which represents the citizens by determining the priorities of public finance, purpose and content of public spending and income.

Subject Matter, Criteria and Subject Matter Information

- **Subject matter** refers to the information, condition or activity that is measured or evaluated against certain criteria
- **The criteria** are the benchmarks used to evaluate the subject matter. Each audit shall have criteria suitable to the circumstances of that audit.

In determining the suitability of criteria, the auditor considers their relevance, reliability and objectivity completeness, reliability and objectivity (neutrality, general acceptance and comparability with criteria used in similar audits)

- **Subject matter information** refers to the outcome of evaluating or measuring the subject against the criteria

Types of Engagement

There are two types of engagement:

Attestation Engagements and

Direct Reporting Engagements.

- **In attestation engagements**, the responsible party measures the subject matter against the criteria and presents the subject matter information, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for expressing a conclusion.
- **In direct reporting engagements**, it is the auditor who measures or evaluates the subject matter against the criteria.

Principles of PSU Auditing

General Principles

- i. Ethics & Independence
- ii. Professional Judgment, due care and skepticism
- iii. Quality Control
- iv. Audit Team Management & Skill
- v. Audit Risk
- vi. Materiality
- vii. Documentation
- viii. Communication

Principles relating to Auditing Process



Planning an Audit

1. Auditors shall obtain an understanding of the nature of the entity/programme to be audited.

2. Auditors shall conduct a risk assessment or problem analysis and revise this as necessary in response to the audit findings.
3. Auditors shall identify and assess the risks of fraud relevant to the audit objectives.
4. Auditors shall plan their work to ensure that the audit is conducted in an effective and efficient manner.

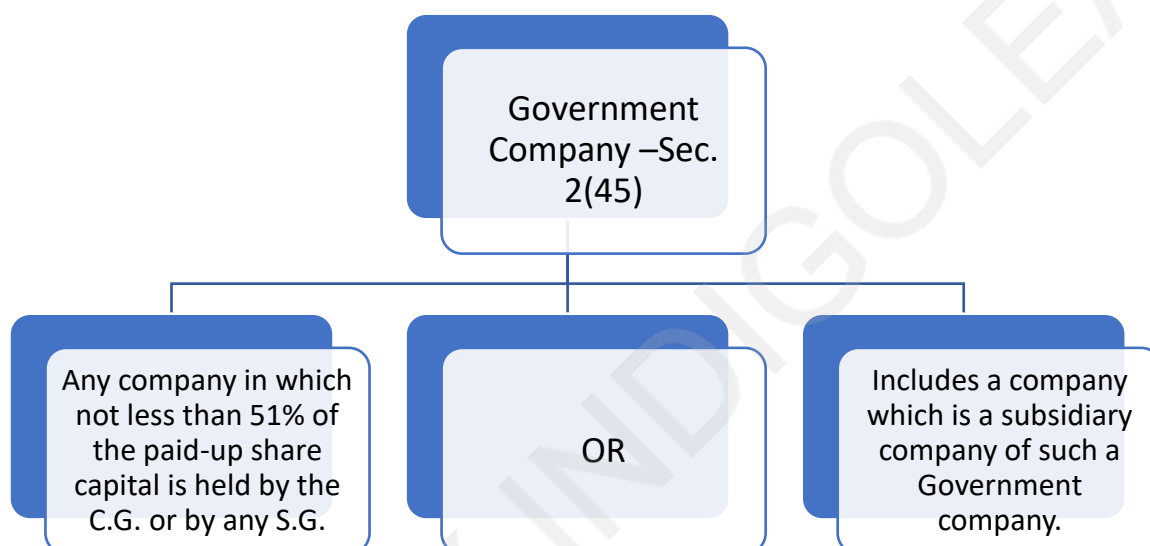
Conducting an Audit

1. Auditors shall perform audit procedures that provide sufficient and appropriate audit evidence to support the audit report
2. Auditors shall evaluate the audit evidence and draw conclusions

Reporting & Follow up

1. Auditors shall prepare a report based on the conclusions reached
2. Follow up on reported matter as relevant

AUDIT OF GOVERNEMENT COMPANIES



Appointment of Auditor

Subsequent Auditor Sec 139(5)

Appointment by CAG

In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government (CG), or by any State Government (SG) or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor General (CAG) of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor.

Time limit for appointment

The appointment shall be made within a period of 180 days from the commencement of the financial year.

Tenure of Auditor

The auditor so appointed shall hold office till the conclusion of the AGM.

First Auditor Sec 139(7)

Appointment of CAG

In the case of a Government company or any other company owned or controlled, directly or indirectly, by the CG, or by any SG, or SGs, or partly by the CG and partly by one or more SGs, the first auditor shall be appointed by the CAG of India.

Time limit for appointment

The auditor shall be appointed within 60 days from the date of registration of the company.

Consequences of failure of CAG

- In case the CAG of India does not appoint such auditor within the said period, the BOD of the company shall appoint such auditor within next 30 days;
- In the case of failure of the Board to appoint such auditor within the next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an EGM

Duties of auditor of Govt. Companies – Sec. 143(5)

- In the case Government company, the CAG shall appoint the auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited.
- The auditor so appointed shall submit a copy of the audit report to the CAG which, among other things, include the following:
 1. Directions, if any, issued by CAG
 2. The action taken thereon and
 3. Its impact on the accounts and financial statement of the company

Right of CAG supplementary Audit Sec. 143(6)

- The CAG shall within 60 days from the date of receipt of the audit report have a right to, conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorise in this behalf.
- For the purposes of such audit, CAG may
 - a. 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 CAG may direct; and
 - b. Comment upon or supplement such audit report.
- Any comments given by the CAG upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements u/s 136(1) and also be placed before the AGM of the company at the same time and in the same manner as the audit report.

Test audit – sec. 143 (7)

The CAG may, in case of Government Company and government owned or controlled companies, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19 A of the CAG (Duties, powers and condition of service) Act, 1971, shall apply to the report of such test audit.

AUDITS CONDUCTED BY CAG



Financial Audit:

Financial audit is primarily conducted to:

- express an audit opinion on the financial statements; and
- enhance the degree of confidence of intended users in the financial statements.

The C&AG shall express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In the case of financial statements prepared in accordance with a fair presentation financial reporting framework, whether the financial statements are presented fairly, in all material respects, or give a true and fair view, in accordance with that framework.

COMPLIANCE AUDIT

- Compliance audit is the independent assessment of whether a given subject matter is in compliance with applicable authorities identified as criteria.
- Compliance audits are carried out by assessing whether activities, financial transactions and information comply in all material respects, with the authorities which govern the audited entity.
- Compliance auditing may be concerned with
 1. **Regularity** - adherence of the subject matter to the formal criteria emanating from relevant laws, regulations and agreements applicable to the entity
 2. **Propriety** - observance of the general principles governing sound financial management and the ethical conduct of public officials

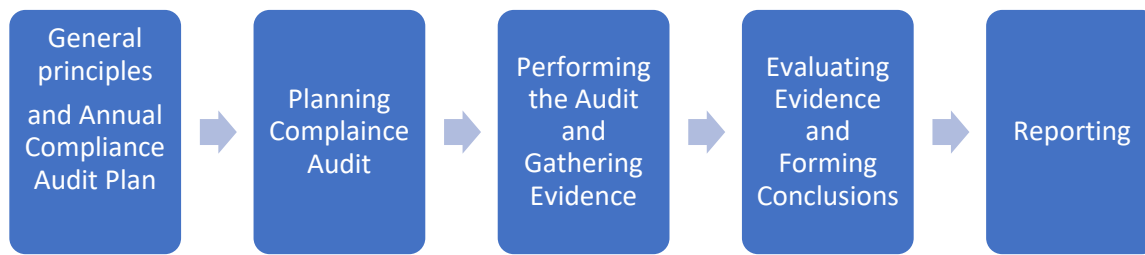
While regularity is the main focus of compliance auditing, propriety is equally pertinent in the public-sector context, in which there are certain expectations concerning financial management and the conduct of officials.

Perspective of Compliance Audit

Compliance audit can be part of a combined audit that may also include other aspects. Though other possibilities exist, compliance auditing is generally conducted either:

- in relation with the audit of financial statements, or
- separately as individual compliance audits, or
- in combination with performance auditing

COMPLIANCE AUDIT PROCESS



PERFORMANCE AUDIT

Meaning

A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

Elements of Performance Audit

Performance audits include evaluation of economy, efficiency and effectiveness.

Economy

- Economy stands for minimising the cost of resources used for an activity, having regard to appropriate quantity, quality and at the best price.
- Evaluating economy implies forming an opinion whether resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.

Efficiency- It is the input-output ratio. In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output. When the audit objective of efficiency considers outputs, focus is usually on processes by which an organisation transforms inputs into outputs.

Auditing efficiency embraces aspects such as whether:

- (a) sound procurement practices are followed;
- (b) resources are properly protected and maintained;
- (c) human, financial and other resources are efficiently used;
- (d) optimum number of resources (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner;
- (e) public sector programmes, entities and activities are efficiently managed, regulated, organised and executed;
- (f) efficient operating procedures are used; and
- (g) the objectives of public sector programmes are met cost-effectively

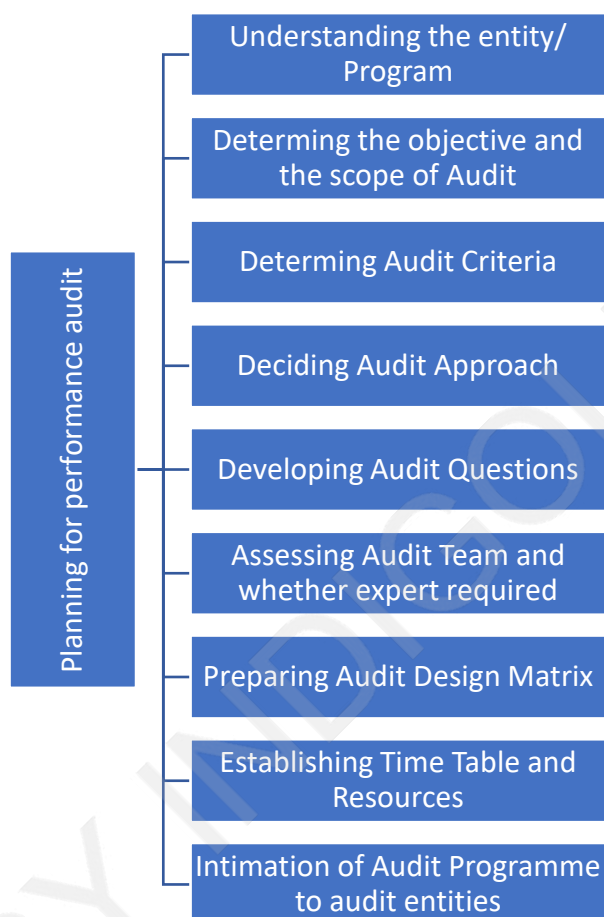
Effectiveness- It is the extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity.

In auditing effectiveness, performance audit may, for instance:

- (a) assess whether the objectives of and the means provided (legal, financial, etc.) for a new or ongoing public sector programme are proper, consistent, suitable or relevant to the policy;
- (b) determine the extent to which a program achieves a desired level of program results;
- (c) assess and establish with evidence whether the observed direct or indirect social and economic impacts of a policy are due to implementation of the policy or to other causes;
- (d) identify factors inhibiting satisfactory performance or goal-fulfilment;

- (e) assess whether the programme complements, duplicates, overlaps or counteracts other related programmes;
- (f) assess the effectiveness of the program and/or of individual program components;
- (g) determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost;
- (h) assess the adequacy of the management control system for measuring, monitoring and reporting a programme's effectiveness;
- (i) assess compliance with laws and regulations applicable to the program; and
- (j) identify ways of making programmes work more effectively

STEPS IN PLANNING PERFORMANCE AUDIT



Planning for Performance Audit

Understanding the entity /programme

- Auditors should obtain an understanding of the programme to be audited to help assess, among other matters, the significance of possible audit objectives and the feasibility of achieving them.
- The auditors' understanding may be obtained from documents of the entity, legislative documents, policy documents, past audits, media coverage special focus groups etc.

Defining Audit Objective and Scope

- These are the basic audit questions that performance auditors seek answers to.
- These are usually expressed in terms of questions about performance i.e., achievement of economy, efficiency and effectiveness of an entity, programme or activity under audit.
- The audit objectives should be defined in a concise manner, as they will Impact the nature of the audit, govern its conduct and affect audit conclusions.
- Defining scope focuses the extent, timing and nature of the audit.

Determining the audit Criteria

- Criteria are the standards used to determine whether a program meets or exceeds expectations.
- In selecting criteria, auditors have a responsibility to use criteria that are reasonable, attainable, and relevant to the matters being audited.
- The audit criteria may be sought to be obtained from the following Sources:
 - I. Procedure manuals of the entity.
 - II. Policies, standards, directives and guidelines.
 - III. Criteria used by the same entity or other entities in similar activities or programmes.
 - IV. Independent expert opinion and know how.
 - V. New or established scientific knowledge and other reliable information.
 - VI. General management and subject matter literature and research papers.

Deciding Audit Approach

No uniform audit approach can be prescribed that is applicable to all types of subjects of performance audits. Selection of approach also determine methods and means used for conducting the audit. Some of the methods which could be used in conducting performance audits include:

- (A) **Analysis of Procedures:** review of systems in place for planning, conducting, checking and monitoring the activity.
- (B) **Case Studies:** Analysis of a particular issue within the context of the whole area under review.
- (C) **Use of Existing Data:** investigate the data held by the entity management and other relevant sources.
- (D) **Surveys:** It is a method of collecting information from members of a population to assess the incidence, distribution and interrelation of events and conditions.
- (E) **Analysis of results:** Analysis of input-output to determine the efficiency of programme.
- (F) **Quantitative analysis:** Examination of available data relating to financials like earnings, revenue, or data relating to programme implementation like details of beneficiaries etc.

Developing audit Questions

- Audit team should prepare a list of questions to which they would seek answers.
- There could be many ways to develop and frame audit questions. The performance auditors should frame a comprehensive and detailed list of questions.

Assess audit team skills and requirement of outside expertise

- The performance auditor must possess the range of skills and experience necessary for effective discharge of audit mandate.
- The Audit team needs to decide at the planning stage on which aspect expertise is required.

Audit design Matrix

- Audit Design matrix is a rigorous, structured and highly focused approach to designing a performance audit study, based around the audit objectives, associated sub-objectives and lower level detailed questions.

- ***Specimen of Audit Design matrix is:***

Audit Objective	Audit Questions	Audit Criteria	Evidence	Data Collection and analysis method
(1)	(2)	(3)	(4)	(5)

Establish the timetable and resources

- It is important to determine the timetable and the resources needed.
- Selection of appropriate audit team is the most important component in planning an audit.
- Considerations for selection of a particular team should be recorded in the planning documents along with the proposed timelines for various activities to be undertaken as part of the audit process.

Intimation of Audit

- Audited entities must be informed about the intention of taking up the planned performance audit with scope and extent of audit well before the commencement of Audit.

Comprehensive Audit of Public Enterprises

Concept of comprehensive Audit

- Comprehensive Audit involves assessing overall efficiency and effectiveness of Public Enterprises. This is done by reference to certain pre-determined standards, objectives and criteria.
- The starting point of a comprehensive audit of a public enterprise, which covers aspects of economy, efficiency and effectiveness, is the preparation of an audit programme based on the study of decisions relating to the setting up of the enterprise, its objectives, the areas of operation, organization, financial and operational details, capital and operational budgets and other relevant available papers
- These audit programs (or guidelines) identify the areas/aspects which require further detailed audit analysis

Areas to be covered:

The areas covered in comprehensive audit will vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. Some of the broad areas are listed below:

1. Comparison of overall capital cost of the project with the approved planned costs.
2. Production or operational outputs vis-a-vis underutilization of the installed capacity
3. Soundness of systems of project formulation and implementation.
4. Achievement of Planned rate of return
5. Adequacies of Cost control measures.
6. Existence and performance of Research and development programs.
7. Existence of adequate system of repairs and maintenance.
8. Effective and economical procedures
9. Inefficiency or insufficiency of Project planning
10. Undue waste, unproductive time for men and machines, wasteful utilization or even non-utilization of resources

PROPRIETY AUDIT

Meaning

Propriety Audit stands for verification of transactions on the tests of

- public interest,
- commonly accepted customs and
- Standards of conduct.

Emphasis/ Scope

Instead of too much dependence on documents, vouchers and evidence, it shifts the emphasis to the substance of the transactions and looks into the appropriateness thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure.

Thus, propriety audit is concerned with scrutiny of executive actions and decisions bearing on financial and profit and loss situation of the company with special regard to public interest and commonly accepted customs, and standards of conduct.

Principles

- i. Expenditure is not prima facie more than the occasion demands and that every official exercise the same degree of vigilance in respect of expenditure as a person of ordinary prudence would exercise in respect of his own money.
- ii. The authority exercises its power of sanctioning expenditure to pass an order which will not directly or indirectly accrue to its own advantage.
- iii. Funds are not utilized for the benefit of a particular person or group of persons.
- iv. Apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others.

Propriety elements in Companies Act, 2013

- Section 143(1) requiring enquiry into certain specified matters.
- Section 143(6) and 143(7) requiring a supplementary audit and test audit respectively in respect of the Government companies on matters specified.
- Section 148 relating to Cost Records and Audit.
- Additional information in Part II of Schedule III.

Propriety elements in CARO, 2020

Clause (iii)

- 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.
- 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.
- 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.
- 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.

Para 3(iv)

In respect of loans, investments, guarantees, and security whether provisions of Sections 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide details thereof.

Para 3(viii)

- 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,
- If so, whether the previously unrecorded income has been properly recorded in the books of account during the year.

Para 3(ix)

- Whether the company is a declared wilful 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 utilized 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.

Para 3(x)

- a. Whether moneys 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;
- b. 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 Sec. 42 and Sec. 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.

Para 3(xi)

- a. 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;
- b. Whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;
- c. Whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;

Para 3(xiii)

Whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act where applicable and the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards.

Para 3(xv)

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 have been complied with.

Para 3(xviii)

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.

Problems in Propriety Audit

- The expression "propriety" is a moral term and can be understood by reference to the concept of morality accepted by the society at a given time.
- Propriety audit has an inherent element of subjectivity because it is very difficult to establish standards of public interest, commonly accepted customs, standards for conduct which are not firm basis for audit evaluation.
- The element of of subjectivity has caused proper discharge of duty very delicate and demands discretion, but wisdom of taking commercial decisions under dynamic environment (the economic, social and political) must be evaluated with reference to the circumstances in which these were taken and therefore, the auditor in his field must reconstruct such circumstances.
- The judgment of the auditor must be objective as otherwise it would dampen the initiative of management and others in taking commercial decisions and propriety audit would prove itself to be counterproductive.
- To take care of this situation, the C&AG has developed the norms of propriety for expenditure of public funds in our country, By laying down the standards of propriety for Government expenditure the C&AG has really tried to tackle in a practical way the complex problem of subjectivity inherent in a situation calling for propriety consideration.

Audit Report of CAG

Reports of the CAG on the PSUs of C.G. are presented to the parliament in the following parts:

- a. Introduction containing a general review of the working results of Government companies, Coverage deemed Government companies and corporations.
- b. Results of comprehensive appraisals of selected undertakings conducted by the Audit Board.
- c. Resume of the company auditor's reports submitted by them under the directions issued by the CAG and that of comments on the accounts of the Government companies.
- d. Significant results of audit of the undertakings not taken up for appraisal by the Audit Board

Audit of Banks

Characteristics of Banks different from most commercial enterprises

a) Custody of large volumes of monetary items, including cash and negotiable instruments, whose physical security has to be ensured.
b) Engagement in a large volume and variety of transactions in terms of number and value which necessarily require complex accounting and internal control systems and widespread use of Information Technology (IT).
c) Operation through a wide network of geographically dispersed branches and departments necessitating a greater decentralization of authority and dispersal of accounting and control functions, with consequent difficulties in maintaining uniform operating practices and accounting systems, particularly when the branch network transcends national boundaries.
d) Assumption of significant commitments without any transfer of funds. These items, called 'off-balance sheet' items, may at times not involve accounting entries and the failure to record such items may be difficult to detect.
e) Engagement in transactions that are initiated at one location, recorded at a different location and managed at yet another location.
f) Direct Initiation and completion of transactions by the customer without any intervention by the bank's employees. For example, over the Internet or mobile or through automatic teller machines (ATMs).
g) Integration and linkages of national and international settlement systems could pose a systemic risk to the countries in which they operate.
h) Regulatory requirements by governmental authorities often influence accounting and auditing practices in the banking sector

Special Audit Consideration

Special audit considerations arise in the audit of bank because of

•	the particular nature of risks associated with the transactions undertaken;
•	the scale of banking operations and the resultant significant exposures which can arise within short period of time;
•	the extensive dependence on IT to process transactions;
•	the effect of the statutory and regulatory requirements;
•	the continuing development of new products and services and banking practices which may not be matched by the concurrent development of accounting principles and auditing practices.
•	Evolution of technology and providing services through Net Banking and Mobiles has exposed banks to huge operational and financial risk.
•	The banks use different applications to carry out different transactions which may include data flow from one application to other application; the auditor while designing his plans should also understand interface controls between the various applications.

Legal framework: Acts governing Banking Operations

- Banking Regulation Act, 1949;
- Reserve Bank of India Act, 1934;
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970; and 1980.
- State Bank of India Act, 1955;
- Regional Rural Banks Act, 1976;
- Companies Act, 2013;
- Cooperative Societies Act, 1912 or the relevant State Cooperative Societies Acts;
- Information Technology Act, 2000;
- Prevention of Money Laundering Act, 2002;
- Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- Credit Information Companies Regulation Act, 2005; and
- Payment and Settlement systems Act, 2007

Form and Content of Financial Statements

Every banking company is required to prepare a Balance Sheet and a Profit and Loss Account in the forms set out in the Third Schedule to the Act or as near thereto as the circumstances admit.

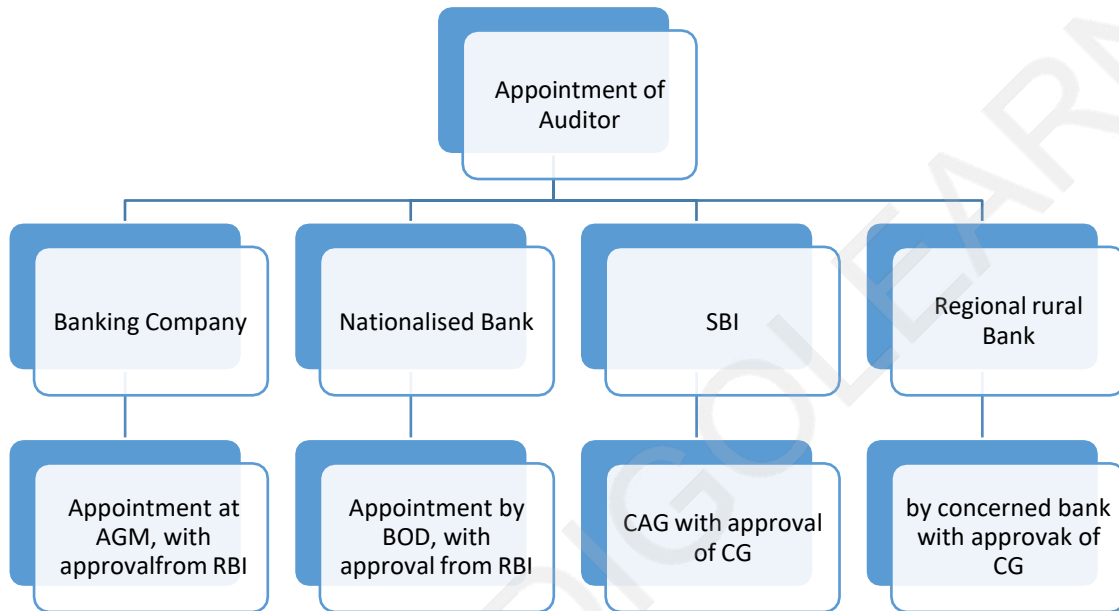
- Form A of the Third Schedule to the Banking Regulation Act, 1949, contains the form of Balance Sheet and Form B contains the form of Profit and Loss Account.
- Every banking company needs to comply with the disclosure requirements under the various Accounting Standards, as specified under section 133 of the Companies Act, 2013.
- The preparation of balance sheet of a bank usually involves preparation of standalone financial statements and consolidated financial statements.
- Preparation of Standalone financial statements involve consolidation of branch accounts and incorporation of various verticals/departments of bank in case of a nationalized bank/public sector bank.
- The detailed procedures in this regard may vary from bank to bank.
- In case of private banks, the processes of accounting are centralized and there is no concept of mandatory branch audit in accordance with RBI guidelines.
- Public sector banks and private banks are listed on recognized stock exchange and are required to comply with SEBI regulations including LODR.

Audit of Accounts & Appointment of Auditor

As per Sec. 30(1) of the Banking Regulation Act, the Balance sheet and Profit and loss account of a banking company should be audited by a person duly qualified under any law for the time being in force to be an auditor of companies.

Authority appointing the Auditors

- Auditor of a banking company is to be appointed at the AGM of the shareholders.
- Auditor of a nationalized bank is to be appointed by the concerned bank acting through its Board of Directors.
- In either case, approval of the RBI is required before the appointment is made.
- Auditors of the SBI are to be appointed by the CAG in consultation with the C.G. Subsidiaries of SBI will be appointed by SBI
- Auditors of regional rural banks are to be appointed by the concerned bank with the approval of the C.G.



Conducting An Audit

Stages in conducting Bank Audit



Stage 1

Initial Considerations

Initial Considerations include considerations of:

1. Acceptance & Continuance: consider the engagement risk before acceptance of audit engagement
2. Declaration of Indebtedness: Written confirmation that the auditors/partners/family members are not declared as Willful defaulters. Declaration regarding absence of disqualification stipulated u/s 141 of companies Act, 2013.
3. Internal Assignments in Banks by Statutory Auditors – not allowed in same year
4. Terms of Audit Engagements- SA 210, to be written by the auditor and acknowledged by the bank.
5. Communication with Previous Auditor-Clause (8) of Part 1 of First Schedule
6. Planning: NTE of audit procedures
7. Establish Engagement Team- depend on size, nature and complexity of the bank's operation.

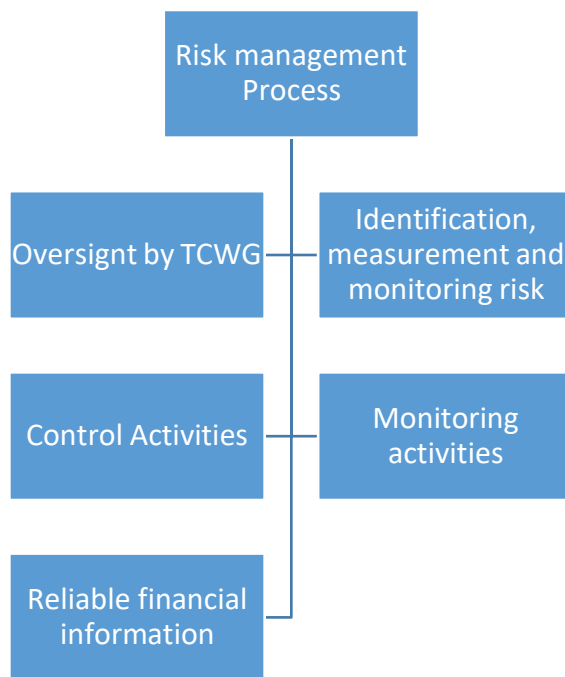
Stage II

Understanding the business operations

Auditor is required to obtain understating of:

- Bank and its Environment including Internal Control
- Bank's Accounting Process
- Risk Management Process

Requirements of Risk Management System in a Bank



Involvement of TCWG

- Risk Management policies should be approved by TCWG (BOD/ CEO)
- While approving the policies, TCWG should ensure that the policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it Considers as acceptable.

Identification, measurement & monitoring by risks.

Risks that may significantly affect the achievement of bank's goals and objectives should be identified, measured and monitored against pre-approved limits and criteria.

Control activities

Banks must have appropriate controls to manage its risks, including the following:

- effective segregation of duties,
- Accurate measurement and reporting of positions
- verification and approval of transactions,
- Reconciliation of positions and results
- setting of limits, and
- reporting and approval of exception
- Physical security and contingency planning

Monitoring activities

Independent risk management unit should be set up which regularly assess the riskmanagement models, methodologies and assumptions used to measure and manage risk.

Reliable information systems

Banks must have a reliable information system that provide adequate financial, operational and compliance information on a timely and consistent basis to management and TCWG.

TCWG and management require risk management information that is easily understood and enables them to assess the changing nature of the bank's risk profile

Stage III

Risk Assessment

Auditor is required to identify and assess following risk:

- **Risks of Material Misstatements** - SA 315 requires the auditor to identify and assess the risks of material misstatement at the financial statement level and the assertion level for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures.
- **Risk of Fraud including Money Laundering**- As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor's objective is to identify and assess the risks of material misstatement in the financial statements due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately. The attitude of professional skepticism should be maintained by the auditor to recognize the possibility of misstatements due to fraud.
The RBI has framed specific guidelines that deal with prevention of money laundering and "Know Your Customer (KYC)" norms.
- **Specific Risks**- The auditors should identify and assess specific risks of material misstatement at the financial statement level which refers to risks that relate to the banking industry and the use of IT therein.
- **Associated with Outsourcing of activities**: The modern-day banks make extensive use of outsourcing as a means of both reducing costs as well as making use of services of an expert not available internally. There are, however, certain risks associated with outsourcing of activities by banks and therefore, it is quintessential for the banks to effectively manage those risks

Stage IV

Execution stage

Execution stage considers the following:

- **Engagement Team Discussions**: The engagement team should hold discussions to gain better understanding of bank and its environment, including internal control, and to assess the potential for material misstatements of the financial statements.
- **Response to the Assessed Risks** – SA 330 requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. The auditor should design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.

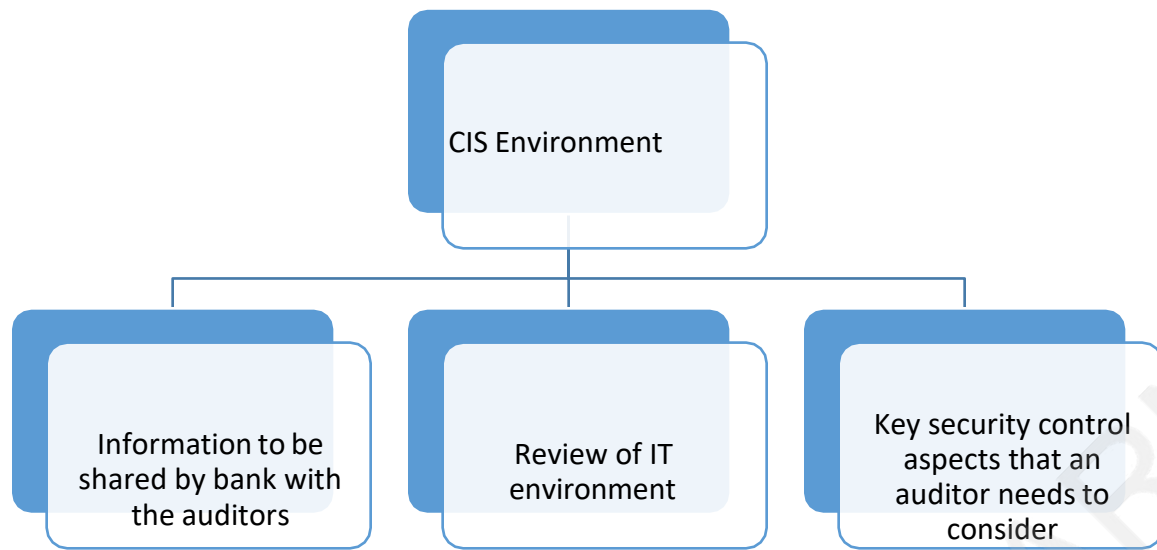
- **Establish the Overall Audit Strategy:** SA 300 states that the objective of the auditor is to plan the audit so that it will be performed in an effective manner. For this purpose, the audit engagement partner should:
 - i. establish the overall audit strategy, prior to the commencement of an audit; and
 - ii. involve key engagement team members and other appropriate specialists while establishing the overall audit strategy, which depends on the characteristics of the audit engagement.
- **Audit Planning Memorandum:** The auditor should summarize the team's audit plan by preparing an audit planning memorandum in order to:
 - i. Describe the expected scope and extent of the audit procedures to be performed by the auditor.
 - ii. Highlight all significant issues and risks identified during their planning and risk assessment activities, as well as the decisions concerning reliance on controls.
 - iii. Provide evidence that they have planned the audit engagement appropriately and have responded to engagement risk, pervasive risks, specific risks, and other matters affecting the audit engagement.
- **Determining Audit Materiality:**
 - The auditor should consider the relationship between the audit materiality and audit risk when conducting an audit.
 - The determination of audit materiality is a matter of professional judgment and depends upon the knowledge of the bank, assessment of engagement risk, and the reporting requirements for the financial statements.
 - Judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement, or combination of both.
- **Appropriateness of Going Concern:** In obtaining an understanding of the bank, the auditor should consider whether there are events and conditions which may cast significant doubt on the bank's ability to continue as a going concern.

Stage V

Reporting

- Independent auditors report (SA 700)
- Long form audit report (discussed above)
- Report on any other matters to Bank, Regulator or Government.

Special Audit Considerations in CIS environment



Special consideration in IT environment:

Information to be shared by Banks with Auditors

Considering the importance of IT systems in preparation and presentation of financial statements. It is imperative that bank should share detailed information with auditors like

1. Overall IT policy, structure and environment of Bank's IT system
2. Data processing and data interface under various systems
3. Data integrity and data security
4. Business Continuity plans and disaster control plans
5. Accounting manual and critical accounting entries, their processes and involvement of IT systems
6. Controls over key aspects, use of various account heads, expense booking, overdue identification etc.
7. Controls on recording of various e-banking and internet banking products and channels
8. MIS reports being generated and their periodicity
9. Major exception reports and process of generation including embedded logic
10. Process of generating various information related to disclosures in financial statements and involvement of IT systems

Review of IT Environment

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

Key security control aspects that an auditor needs to consider

The key security control aspects that an auditor needs to consider when undertaking audit in a computerised environment include the following:

1. Ensure that authorised, accurate and complete data is made available for processing.
2. Ensure that in case of interruption due to power, mechanical or processing failures, the system restarts without distorting the completion of the entries and records.
3. Ensure that the system prevents unauthorized amendments to the programmes.
4. Verify whether "access controls" assigned to the staff-working match with the responsibilities as per manual. It is important for the auditor to ensure that access and authorization rights given to employees are appropriate.
5. Verify that segregation of duties is ensured while granting system access to users and that the user activities are monitored by performing activities log review.

6. Verify that changes made in the parameters or user levels are authenticated. Verify that charges calculated manually for accounts when function is not regulated through parameters are properly accounted for and authorized.
7. Verify that exceptional transaction reports are being authorized and verified on a daily basis by the concerned officials. It is important for auditor to understand the nature of exception and its impact on financials.
8. Verify that the account master and balance cannot be modified/amended/alterd except by the authorized personnel.
9. Verify that all the general ledger accounts codes authorized by Head Office are in existence in the system.

Internal Audit and Inspection

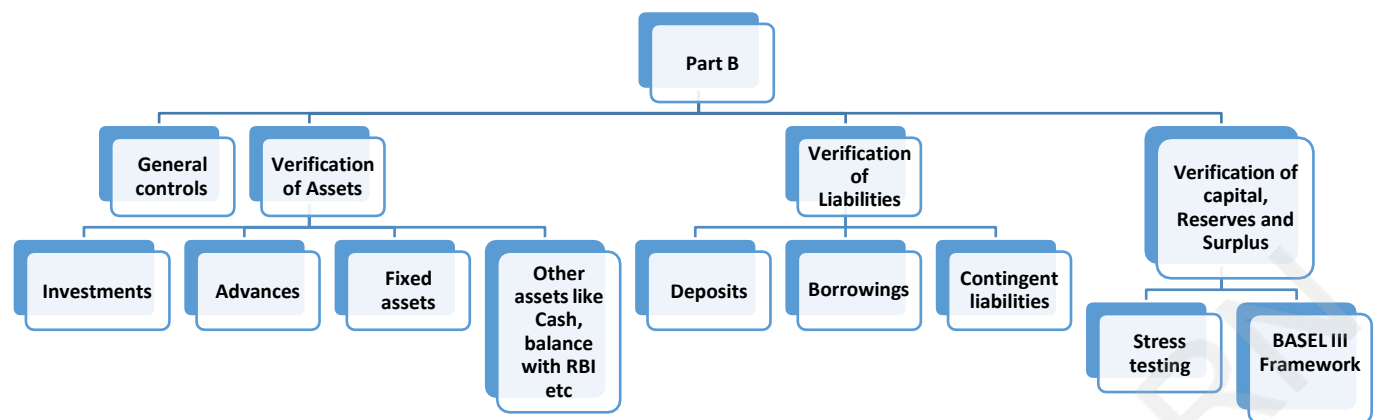
<ul style="list-style-type: none"> Central audit and inspection department in Banks is a combination of centralized function with some level of decentralization which is usually headed by a Chief Audit Executive.
<ul style="list-style-type: none"> It is responsible for undertaking risk-Based Internal Audit (RBIA) as per the framework as stipulated by RBI.
<ul style="list-style-type: none"> It is also responsible for identification of branches for revenue audit, appointment of concurrent auditors, deciding their scope, meeting the concurrent auditors, discussing their issues, conducting trainings if needed, and review of work of concurrent auditors.
<ul style="list-style-type: none"> The primary function is to ensure that the audit function is handled smoothly, effectively & efficiently.

Risk based Internal Audit

Risk-based internal audit is conducted based upon the risk assessment of business and control risks of branches. The risk assessment process includes

a) Identification of inherent business risks in various activities undertaken by branches (Business risk).
b) Assessment of effectiveness of control systems for monitoring inherent risks of business activities of branch (Control risk). cannot be
c) Making an assessment of level and direction of various risk areas and assess level and direction of overall business risk and control risk.
d) Drawing up of risk matrix taking into account factors viz. Risk of branch

Verification of Assets and Liabilities



INTERNAL CONTROL PROCEDURES IN BANK

General controls

1. The staff and officers of the bank should be shifted from one position to another frequently and without prior notice.
2. The work of one person should be checked by another person.
3. A responsible officer should be given possession of demand drafts, chequebooks etc.
4. The signature book should be kept with a responsible officer.
5. The management structure should be clearly drawn and rights and duties should be properly understood.
6. The bank should take out insurance policies against loss due to all the risks such as fire, natural calamities, theft and employees' infidelity.
7. The financial powers of officers of different grades should be clearly defined.
8. There should be surprise inspection of head office and branches at periodic interval by the internal audit department. The irregularities pointed out in the inspection reports should be promptly rectified.

Cash

1. Cash should be kept in joint custody of at least two responsible officers.
2. Surprise checking should be conducted.
3. The cashier should not have access to customer's ledger accounts and the day book.
4. Payments should be made only after the vouchers have been passed by a proper officer.
5. Receipt and payment scrolls or their totals should be compared with the cash column of the Day-Book by independent persons.
6. High value cash receipts and payments should be verified by a higher officer/ branch manager and the excess cash balance should be remitted to currency chest according to branch's retention limit on daily basis
7. Receipt and payment scrolls (memoranda books maintained by the cashier) should be compared

with the cash column of the day book by an independent person.

8. The limits on the payment powers of the teller should be laid out.

Clearings

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

Bills of collection

1. All documents accompanying the bill should be received and entered in the register by a proper officer.
2. The accounts of the principals should be credited only after realisation of the bill.
3. It should be ensured that bills sent by one branch to another branch for collection are not included twice in the amalgamated balance sheet.

Bills Purchased

1. At the time of purchase of the bills, an officer should verify that all documents of title are properly assigned to the bank
2. Sufficient margin should be kept while purchasing or discounting of a bill.
3. All irregular outstanding accounts should be periodically reported to the head office.
4. In case of purchase or discounting of a bill, proportionate income should be recognized between the periods.

Loans and advances

1. Advances should be made only after evaluating creditworthiness of the borrowers and obtaining sanction from the proper authorities of the bank.
2. All the loan documents like promissory notes, letters of hypothecation, guarantee letter, etc. should be executed by the parties before advances are made.
3. While determining the loan amount to be sanctioned, sufficient margin should be kept against securities taken so as to cover any decline in the value thereof and also to comply with RBI directives
4. Securities should be received and returned by responsible officer and should be kept in the

joint custody of at least two responsible officers.
5. Securities requiring registration should be registered in the name of the bank.
6. In the case of physical possession of goods as security, the goods should be test checked at the time of receipts. In respect of hypothecated goods not in possession of the bank, surprise checks should be made.
7. Personal inquiries should be made so as to determine market value of goods.
8. For any increase/decrease in the value of securities, drawing power should be adjusted. All the accounts should be kept within both the drawing power and the sanctioned limit at all times.
9. All irregular accounts should be brought to the notice of the H.O. regularly 10. The operation in each advance should be reviewed at least once every year 11. There should exist a proper system for post disbursement supervision and
follow-up
12. Classification of advances should be made as per RBI Guidelines.
13. Ensure that the funds disbursed should be utilized only for the purpose for which advances have been granted.

Demand Drafts

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

Inter Branch Accounts

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

Credit Card Operations

1. There should be effective screening of applications with reasonably good credit assessments.
2. There should be strict control over storage and issue of cards.
3. There should be a system whereby a merchant confirms the status of unutilized limit of a credit card holder from the bank before accepting the settlement in case the amount to be settled exceeds a specified percentage of the total limit of the card holder
4. There should be system of prompt reporting by the merchants of all settlements accepted by them through credit cards
5. Reimbursement to merchants should be made only after verification of the validity of merchant's

acceptance of cards.
6. All the reimbursements should be immediately charged to the customer's account.
7. There should be a system to ensure that statements are sent regularly and promptly to the customer.
8. There should be a system of monitor and follow-up of customers' payments.
9. Items overdue beyond a reasonable period should be identified and attended to carefully. Credit should be stopped as early as possible, to avoid increased losses.
10. There should be a system of periodic review of credit card holders' accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.

Compliance with CRR and SLR Requirements

Cash Reserve Ratio (CRR) :

- It is a specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserves either in cash or as deposits with the central bank.
- One of the important determinants of cash balances to be maintained by banking companies and other scheduled banks is the requirement for maintenance of a certain minimum cash reserve.
- While the requirement for maintenance of cash reserve by banking companies is contained in the Banking Regulation Act, 1949, corresponding requirement for scheduled banks is contained in the Reserve Bank of India Act, 1934.
- The RBI, from time to time, reviews the evolving liquidity situation and accordingly decides the rate of CRR required to be maintained by scheduled commercial banks. Therefore, the auditor needs to refer to the master circular issued from time to time in this regard to ensure the compliance of CRR requirements.

Statutory Liquidity Ratio (SLR)

Central statutory of the banks are required to verify the compliance of SLR on 12 odd dates in different months of a financial year not being Fridays.

The resultant report is to be sent to the management of the bank and to the RBI. To verify compliance with SLR requirements, the statutory auditor has to examine two aspects.

- a) Correctness of figure of the Demand and Time liabilities (DTL) and
- b) Maintenance of prescribed percentage of liquid assets.

Audit Approach and Procedure

1. Obtain an understanding of the relevant circulars of the RBI so as to ascertain the items to be included in composition of DTL.
2. Request the branch auditors to verify the correctness of the trial balances and examine the cash balance at the branch on the selected dates.
3. Examine, on a test basis, the consolidations regarding DTL position prepared by the head office with reference to the related returns received from branches. Ensure that the consolidations prepared by the bank include the relevant information in respect of all the branches.

4. Examine the composition of items of DTL as per circulars/instructions of RBI.
6. Specify number of unaudited branches and a statement that auditor has relied on the returns received from the unaudited branches in forming his opinion.
7. While examining the computation of DTL, specifically examine that items have been excluded from liabilities as per RBI guidelines. Some of these items are:-

i.	Paid up capital, reserve, any credit balance in profit & loss account of bank, amount of loan taken from RBI and amount of refinance taken from EXIM bank, NHB, SIDBI and NABARD
ii.	Part amounts of recoveries from the borrowers in respect of debts considered bad and doubtful of recovery.
iii.	Amounts received in Indian currency against import bills and held in sundry deposits pending receipts of final rates.
iv.	Un-adjusted deposits/balances lying in link branches for agency business like dividend warrants, interest warrants, refund of application money, etc., in respect of shares/debentures to the extent of payment made by other branches but not adjusted by the link branches.
v.	Margins held and kept in sundry deposits for funded facilities

9. Similarly, specifically examine that the items have been included in liabilities as per RBI guidelines. Some of these items are:-

i.	Net credit balance in branch adjustment accounts.
ii.	Borrowings from abroad by banks in India needs to be considered as 'liabilities to other' and thus, needs to be considered at gross level unlike 'liabilities towards banking system in India', which are permitted to be netted off against 'assets towards banking system in India'. Thus, the adverse balances in Nostro Mirror Account needs to be considered as 'Liabilities to other'.
iii.	The reconciliation of Nostro accounts (with Nostro Mirror Accounts) needs to be scrutinized carefully to analyze and ascertain if any inwards remittances are received on behalf of the customers / constituents of the bank and have remained unaccounted and / or any other debit (inward) entries have remained unaccounted and are pertaining to any liabilities for the bank.

9. Examine whether the consolidations prepared by the bank include the relevant information in respect of all the branches.
10. It may be noted that, even though interest accrues daily, it is recorded in the books only at periodic intervals. Thus, examine whether such interest accrued but not accounted for in books is included in the computation of DTL.
11. The auditor at the central level should apply the audit procedures listed above to the overall consolidation prepared for the bank as a whole. Where such procedure is followed, the central auditor should adequately describe the same in the report.
12. While reporting on compliance with SLR requirements, the auditor should specify the number of unaudited branches and state that he/she has relied on the returns received from the unaudited branches in forming an opinion.
13. Recently, there has been introduction of Automated Data Flow (ADF) for CRR & SLR reporting and the auditors should develop necessary audit procedures around this

Audit of Assets

I. Cash, Bank balances and Money at call and Short Notice

- Cash
- Balance with RBI
- Balance with other Banks
- Money at call and short notice

Audit approach:

- The auditor's basic objective in verification of these items is their existence and completeness as on date of balance sheet and audit procedures have to be tailored to meet these.
- Cash would be appearing in balance sheet of almost all branches. However, in most of the branches of a bank, there will be no bank account requiring reporting except in branches with treasury operations.
- Activity pertaining to money at call and short notice is handled by treasury department of the bank at head office level.
- Banks have a robust system of internal controls pertaining to cash like joint custody of two responsible officers, checking of cash at periodic intervals etc due to higher risk of misappropriation.
- The balance with other banks (in case of applicable branches) are reconciled periodically.
- The auditor has to be satisfied about effective operation and implementation of internal controls in this area.

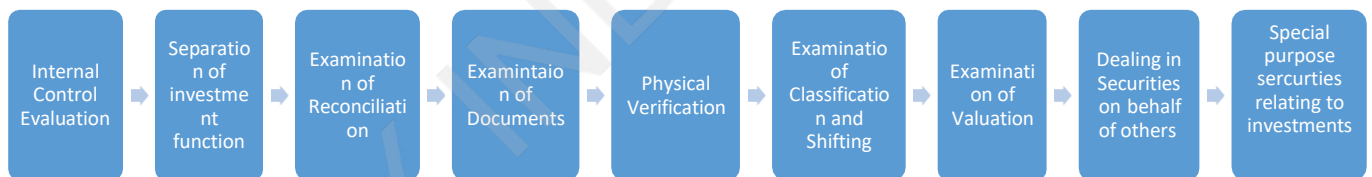
Audit Procedure

<u>Area of Focus</u>	<u>Suggested Audit Procedure</u>
<u>Cash</u>	<ul style="list-style-type: none">• Carry out the physical verification of cash (including foreign currency, if any, cash at ATM and cash at cash deposit machines) as close to the balance sheet date as possible.• The cash balance as physically verified should be agreed with the balance shown in the cash register/balance in CBS.
<u>Balance with Reserve Bank of India</u>	<ul style="list-style-type: none">• Verify the ledger balances in each account with reference to the bank confirmation certificates and reconciliation statements as at the year-end.<ul style="list-style-type: none">a) Review the reconciliation statements, paying special attention to the following items appearing in the reconciliation statements:b) Cash transactions remaining unresponded;c) Revenue items requiring adjustments/write-offs; andd) Other credit and debit entries originated in the statement provided by RBI remaining unresponded for more than 15 days.
<u>Balance with Other Banks (Other than Reserve Bank of India)</u>	<p>Apart from the procedures described above in examining the balances with Reserve Bank of India, while reviewing the reconciliation statements, the auditor should pay particular attention to the following.</p> <ul style="list-style-type: none">• Examine that no debit for charges or credit for interest is outstanding and all the items which ought to have been taken to revenue for the year have been so taken.• Examine that no cheque sent or received in clearing is outstanding.• Examine that all bills or outstation cheques sent for collection and outstanding as on the closing date have been credited subsequently.• Examine large transactions in inter-bank accounts to ensure that no

	<p>transactions have been put through for window-dressing particularly towards the close of year.</p> <p>The balances with banks outside India should also be verified in the manner described above. These balances should be converted into the Indian currency at the exchange rates prevailing on the balance sheet date</p>
<u>Money at Call and Short Notice</u>	<ul style="list-style-type: none"> • Examine whether there is a proper system of authorization, general or specific, for lending of the money at call or short notice. Compliance with the instructions or guidelines laid down in this behalf by the head office or controlling office of the branch, including the limits on lending's in inter-bank call money market should also be examined. • Call loans should be verified with the certificates of the borrowers and the call loan receipts held by the bank. • Examine whether the aggregate balances comprising this item as shown in the relevant register tally with the control accounts as per the general ledger. • Examine subsequent repayments received from borrowing banks to verify the amounts shown under this head as at the year-end. It may be noted that call loans made by a bank cannot be netted-off against call loans received. • Verify that the interest has been properly accrued and accounted for on year-end outstanding balances of call/ short notice money.

II. VERIFICATION OF INVESTMENTS

Audit procedure for Verification of Investments



Internal Control Evaluation and Review of Investment Policy

- Examine the internal controls over investments so as to ensure whether the same are in consonance with the guidelines of the RBI.
- Review the investment policy of the bank to ascertain that the policy conforms, in all material respects, to the RBI's guidelines as well as to any statutory provisions applicable to the bank
- It should clearly outline the broad investment objectives separately for the investments on its own account and investments on behalf of customers.

Separation of Investment Functions

- Check the segregation of duties within the bank staff in terms of executing trades, settlement and monitoring of such trades and accounting of the same (generally termed as front office, middle office and back-office functions' segregation).

Examination of Reconciliation

- Examine the reconciliation of the investment account, physically verify the securities on hand, obtain confirmations from counter-party banks for Bank Receipts (BRs) issued by such banks and on hand, obtain confirmation of Subsidiary General Ledger (SGL) balances with the Public Debt Office (PDO), and examine the control and reconciliation of BRs issued by the bank.

Examination of Documents

- Ascertain whether the investments made by the bank are within its authority.
- Ensure that any other covenants or conditions which restrict qualify or abridge the right of ownership and/or disposal of investments, have been complied with by the bank.
- The acquisition/disposal of investments should be verified with reference to the broker's contract note, bill of costs, receipts and other similar evidence.

Physical Verification

- Verify the of investment scrips physically at the close of business on the date the balance sheet
- Verify investments held with public debt office of RBI, custodians and depository with the statement of holdings as on date of balance sheet. Independent balance confirmation requests can be made in accordance with SA-505. In case independent confirmations are not received back, alternative audit procedures like getting bank personnel to download investment statement from E-Kuber for government securities (E-Kuber is CBS platform of RBI) in auditor's presence can be designed.
- In respect of BRs issued by other banks and on hand with the bank at the year-end, the auditor should examine confirmations of counterparty banks about such BRs. Where any BRs have been outstanding for an unduly extended period, the auditor should obtain written explanation from the management for the reasons thereof.
- If certain securities are held in the names of nominees, the auditor should examine whether there are proper transfer deeds signed by the holders and an undertaking from them that they hold the securities on behalf of the bank.

Examination of classification and shifting

• Examine that entire investment portfolio of bank is classified under three categories i.e. HTM, HFT and AFS and shifting of securities is as per regulatory norms and laid down policy.

• Examine whether the shifting of the investments from 'available for sale' to 'held to maturity' is duly approved by the Board of Directors of the bank.

Examination of Valuation

1. Examine whether the method of accounting followed by the bank in respect of investments, including their year-end valuation, is appropriate.
2. Examine whether the investments have been properly classified into the three categories at the time of acquisition based on such intention as evidenced by the decision of the competent authority such as Board of directors, Asset Liability Committee (ALCO) or Investment Committee
3. Examine compliance by the bank with the guidelines of the RBI relating to valuation of

investments.

4. Verify that investments are classified as non-performing investments (NPI) as per applicable RBI guidelines. (Non-performing investments are those where interest/principal is in arrears and remains unpaid for more than 90 days). In such cases, banks have not to reckon income on securities and are required to make provisions for depreciation in value of investment.
5. Examine whether income from investments is properly accounted for. This aspect assumes special importance in cases where the bank has opted for receipt of income through the electronic/on line medium
6. Verify whether adequate disclosure of any change in method of valuation of investment is made.
7. Examine whether the profit or loss on sale of investments has been computed and accounted for properly.
8. Verify that there is a proper system for recording and maintenance of TDS certificates received by the bank.

Dealings in Securities on Behalf of Others

- Examine whether prior approvals for carrying out such dealings have been obtained
- Examine whether bank's income from such activities has been recorded and is fairly stated in the bank's financial statements.
- Consider whether the bank has any material undisclosed liability from a breach of its fiduciary duties, including the safekeeping of assets.

Special purpose Certificates Relating to Investments

Pursuant to RBI's circulars, issued from time to time, banks require their central auditors to issue the following certificates regarding investments of the bank (in addition to their main audit report and the LFAR).

1. Certificate on reconciliation of securities by the bank (both on its own Investment Account as well as PMS client's account). The reconciliation is to be presented in a given format.
2. Certificate on compliance by the bank in key areas of prudential and other guidelines relating to such transactions issued by the RBI.
3. Examine whether the bank is maintaining separate accounts for
• the investments made by it on their own Investment Account,
• on PMS clients' account, and
• on behalf of other constituents (including brokers).
4. As per the RBI guidelines, banks are required to get their investments under PMS separately audited by external auditors.

Audit, Review and Reporting

- Banks should undertake half-yearly reviews (as of 30th September and 31st March) of their investment portfolio.

- These half yearly reviews should not only cover the operational aspects of the investment portfolio but also clearly indicate amendments made to the investment policy and certify the adherence to laid down internal investment policy and procedures and RBI guidelines.
- The internal auditors are required to separately conduct the concurrent audit of treasury transactions and the results of their report should be placed before the CMD once every month. Banks need not forward copies of the internal audit report to RBI.
- Major irregularities observed in these reports and position of compliance thereto may be incorporated in the half yearly review of the investment portfolio.

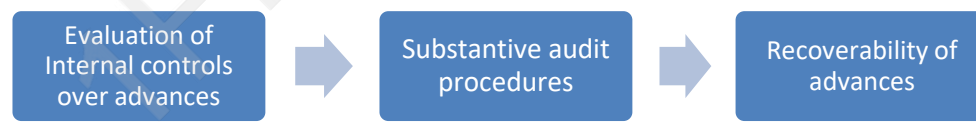
III. ADVANCES

Advances generally constitute the major part of the assets of the bank. There are substantial number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors. The auditor is primarily concerned with obtaining evidence about the following while carrying out audit of advances:

1	Amounts included in the balance sheet in respect of advances are outstanding at the date of balance sheet.
2	Advances represent amounts due to the bank.
3	Amounts due to the bank are appropriately supported by loan documents.
4	There are no unrecorded advances.
5	The stated basis of valuation of advances is appropriate and properly applied and recoverability of advances is recognized in their valuation.
6	Advances are disclosed, classified and described in accordance with recognized accounting policies and practices and relevant statutory and regulatory requirements.
7	Appropriate provisions towards advances are made as per RBI norms, accounting standards and generally accepted accounting practices.

There exists elaborate and detailed control system & procedure in banks pertaining to appraisal, sanctioning, documentation, disbursal, review, monitoring and supervision of advances. Audit approach of advances should encompass designing appropriate audit procedures to obtain audit evidence in all these areas.

Audit Procedures - In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:



Evaluation of Internal Control

- Examine area of credit appraisal and verify whether laid down procedures regarding credit appraisals including loan applications, preparation of proposals, obtaining satisfaction about creditworthiness of borrowers are being followed;
- Examine advances are sanctioned according to delegated authority:

- c) Examine all necessary loan documents have been executed after sanction but before disbursements are made to borrowers;
- d) Examine compliance with stipulated terms of sanction and end use of funds more particularly in case of term loans;
- e) Examine existence, enforceability and valuation of securities. In respect of securities requiring registration, examine this area also;
- f) Examine the validity of the recorded amounts;
- g) Review operations of the accounts and look for adverse features like unauthorised over drawings beyond limits;
- h) Examine whether system laid down in bank for review/renewals of advances is being followed;
- i) Review whether drawing power is being calculated properly on basis of stock/book debt statements received from borrowers as stipulated in respective sanction letters;
- j) Ensure compliance with Loan Policy of Bank as well as prudential norms of RBI including appropriate asset classification and provisioning.

Substantive Audit Procedure

1. Verify correctness of master data of loan accounts updated in CBS. Check parameters like instalments, EMI, rate of interest, tenure of loans etc.
2. Verify that each customer of bank is tagged under single customer id in respect of all its accounts including those in which credit facilities are granted.
3. Examine all large advances while other advances may be examined on a sample basis.
4. Examine accounts identified to be problem accounts but which have not yet slipped into NPA category.
5. Examine those accounts which have been adversely commented upon by concurrent auditors/bank's internal inspection/RBI inspection team.
6. Examine list of restructured accounts to ensure that restructure is as per RBI guidelines. Remember restructured account portfolio requires additional provisioning.
7. Examine quick/early mortality accounts. Any advance slippage to NPA within 12 months of its sanction is called as quick/early mortality case.
8. Verify completeness and accuracy of interest being charged.
9. Carry out appropriate analytical procedures.

Examination of recoverability

- I. Review periodic statements submitted by the borrowers indicating the extent of compliance with terms and conditions.
- II. Review latest financial statements of borrowers.
- III. Review reports on inspection of security
- IV. Review Auditors' reports in the case of borrowers enjoying aggregate credit facilities beyond a cut off limit fixed by BODs of bank

Verification of asset classification, income recognition and Provision for Non-performing assets:

An important aspect of audit of advances relates to their asset classification and provisioning.

This implies that advances are classified in accordance with prudential norms on asset classification, income is recognized on actual record of recovery and a proper provision should be made in respect of advances where the recovery is doubtful.

Audit approach

- The Reserve Bank has prescribed objective norms for determining the quantum of provisions

required in respect of advances.

- The auditors must take / download the latest Master Circular of RBI to familiarise himself fully with the norms prescribed by RBI in this regard.
- The circulars issued by RBI after the date of issue of Master Circular and till the date of audit should also be taken / downloaded and reviewed by the auditors for its adherence.
- These norms should be construed as laying down the minimum provisioning requirements and wherever a higher provision is warranted in the context of the threats to recovery, such higher provision should be made.
- The provisions of section 15 of the Banking Regulation Act, 1949 may be noted. This section, which applies to banking companies, nationalized banks, State Bank of India and regional rural banks, requires the bank concerned to make adequate provision for bad debts to the satisfaction of its auditor before paying any dividends on its shares.
- It may be noted that verification of applicable prudential norms on asset classification, income recognition and provisioning is an important responsibility of statutory branch auditor as well as statutory central auditor.

<u>Area of focus</u>	<u>Suggested Audit Procedure</u>
<u>Classification and Provision</u>	<ul style="list-style-type: none"> • Verify whether bank has a system of ongoing identification and classification of advances through CBS without manual intervention and its accuracy in crystallizing date of NPA. • Examine whether the classification made by the branch is appropriate. Particularly, examine the classification of advances where there are threats to recovery. • Examine whether the secured and the unsecured portions of advances have been segregated correctly and provisions have been calculated properly. • Review and compare the date of NPA of loan accounts mentioned in current year statements with that of previous year. Reasons for any change should be ascertained.
Accounts regularized near Balance sheet date	<ul style="list-style-type: none"> • As per the Reserve Bank guidelines, if an account has been regularised before the balance sheet date by payment of overdue amount through genuine sources, the account need not be treated as NPA. • Where, subsequent to repayment by the borrower (which makes the account regular), the branch has provided further funds to the borrower (including by way of subscription to its debentures or in other accounts of the borrower), the auditor should carefully assess whether the repayment was out of genuine sources or not. • Where the account indicates inherent weakness based on the data available, the account should be deemed as NPA. • In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors about the manner of regularization of the account to eliminate doubts on their performing status. • It is to be ensured that the classification is made as per the position as on date and hence classification of all standard accounts be reviewed as on balance sheet date. • The date of NPA is significant to determine the classification and hence specific care be taken in this regard. • NPA should be recognized only based on concept of Past Due/ Overdue concept, and not based on the Balance Sheet date.

Drawing Power Calculation	<ul style="list-style-type: none"> • Ensure that the drawing power is calculated as per the extant guidelines (i.e. the Credit Policy of the Bank) formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors reflected from respective sanction letters • Special consideration should be given to proper reporting of sundry creditors and stocks covered under LCs/guarantees for the purposes of calculating drawing power. • It is to be ensured that declared stocks shall not cover borrower's liability outstanding in form of sundry creditors for goods or covered by LCs/guarantees availed for procurement of material. • In case bank has provided credit facility against primary security of book debts, net value of debtors (i.e. eligible trade debtors as per terms of sanction less bills discounted with banks) is to be arrived at • It is to be ensured that drawing power is calculated net of stipulated margin. Further, in case of consortium accounts, drawing power calculation and allocation made by lead bank is binding on member banks. • The drawing power needs to be calculated carefully in case of working capital advances to companies engaged in construction business. The valuation of work in progress should be ensured in consistent and proper manner. It also needs to be ensured that mobilization advance being received by the contractors is reduced while calculating drawing power. • The stock audit including audit of book debts should be carried out by the bank for all accounts having funded exposure of more than stipulated limit. • The report submitted by the stock auditors should be reviewed during the course of the audit and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of drawing power.
Accounts with temporary deficiencies	<ul style="list-style-type: none"> • Banks should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as <ul style="list-style-type: none"> a) non-availability of drawing power based on latest available stock statement, b) balance outstanding exceeding the limit temporarily and c) non-renewal of limits on the due date. • stock statements relied upon by the banks for determining drawing power should not be older than 3 months. • The outstanding in the account based on drawing power calculated from stock statements older than 3 months are considered as irregular. Ensure adherence to these guidelines.
Limits not reviewed	<ul style="list-style-type: none"> • Accounts where regular/ad hoc limits are not reviewed within 180 days from the due date/date of ad hoc sanction, should be considered as NPA. Auditors should also ensure that the ad hoc/short reviews are not done on repetitive basis. In such cases, auditor can consider the classification of account based on other parameters and functioning of the account.
Asset classification to be borrower wise and not facility wise	<ul style="list-style-type: none"> • Ensure that asset classification is borrower wise and not facility wise. Therefore, it is to be ensured that all the facilities granted by a bank to borrower will have to be treated as NPA and not particular facility which has become irregular. • If debits arising out of devolvement of LC or invoked guarantees are kept in separate account, the outstanding balance should be treated as part of

	<p>borrower's principal account for purpose of application of prudential norms on asset classification, income recognition and provisioning.</p>
Government Guaranteed Advances	<ul style="list-style-type: none"> • If government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. • However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked. • This exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days. • • In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.
Agricultural Advances	<ul style="list-style-type: none"> • Ensure that NPA norms have been applied in accordance with the crop season determined by the State Level Bankers' Committee in each State. Depending upon the duration of crops • short term/ long term - raised by an agriculturist, the NPA norms would also be made applicable to agricultural term loans availed of by them. Also ensure that these norms are made applicable to all direct agricultural advances listed in Master Circular on lending to priority sector. • In respect of agricultural loans, other than those specified in the circular, ensure that identification of NPAs has been done on the same basis as non-agricultural advances.
Provisioning Towards Standard Assets	<ul style="list-style-type: none"> • The auditor should check the latest RBI Circulars in this regard. • It is be understood that provision for standard assets is also required to be made at variable rates in respect of different sectors for the funded outstanding in accordance with RBI norms as a matter of prudence. • The provisions need to be checked in detail with the statement of advances. The bifurcation of standard advances under relevant category for proper calculation of provision should be checked and certified at branches level.
Restructured Advances	<ul style="list-style-type: none"> • Restructuring is an act in which a lender, for economic or legal reasons relating to borrower's financial difficulty, grants concessions to the borrower. • It may involve modification of terms of advances including alteration of amount of instalments/alteration of repayment period/rate of interest/sanction of additional credit facilities etc. to help in curing of default. • RBI has given revised guidelines for treatment of restructured accounts by its circular. • The auditor should verify compliance with the requirements of the circular issued in this regard. • Banks may restructure the accounts classified under standard, substandard or doubtful categories. Banks cannot restructure accounts with retrospective effect. • Once the bank receives an application/proposal in respect of an account for restructuring, it implies that the account is intrinsically weak. • Accordingly, during the time the account remains pending for restructuring,

	<p>the auditors need to take a view whether provision needs to be made in respect of such accounts, pending approval for restructuring.</p> <ul style="list-style-type: none"> On restructuring, the account will be downgraded from Standard to substandard. NPAs will remain in the same category
Upgradation of Account	<ul style="list-style-type: none"> Examine all the accounts upgraded from NPA to standard category during the year, to ensure that the upgrading of each account is strictly in terms of RBI guidelines. There can be a possibility of incorrect upgradation of account on the basis of partial recoveries made in the account and overdue portion might not have wiped out completely. There can also be a possibility of recoveries being made in the account after cut-off date and account being upgraded as on date of balance sheet.
Sale/Purchase of NPAs	<p>Examine</p> <ul style="list-style-type: none"> the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers including non-performing financial assets that may be purchased/sold, norms or such purchase/sale, valuation procedure and accounting policy. only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years. the assets have been sold/ purchased “without recourse’ only i.e the entire credit risk associated with the non-performing asset should be transferred to the purchasing bank. subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs. the NPA has been sold at cash basis only. Under no circumstances, NPA can be sold to another bank at a contingent price. The entire sale consideration has to be received on upfront basis. the bank has not purchased an NPA which it had originally sold. the auditor should also ensure that: <ul style="list-style-type: none"> -on the sale of the NPA, the same has been removed from the books of the account of selling bank on transfer; -If the sale is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year. -If the sale is for a value higher than the NBV, the excess provision shall not be reversed but will be utilized to meet the shortfall/ loss on account of sale of other non-performing financial assets. <p>Similarly, in case of purchase of NPAs, the auditor should verify that:</p> <ul style="list-style-type: none"> the NPA purchased has been subjected to the provisioning requirements appropriate to the classification status in the books of the purchasing bank. any recovery in respect of an NPA purchased from other banks is first adjusted against its acquisition cost and only the recovered amount in excess of the acquisition cost has been recognized as profit. <ul style="list-style-type: none"> for the purpose of capital adequacy, banks have assigned 100% risk weights to the NPAs purchased from other banks.

V. Fixed Assets

- The Third Schedule to the Banking Regulation Act, 1949 requires fixed assets to be classified into two categories in the balance sheet, viz., Premises and Other Fixed Assets.
- Premises wholly or partly owned by the banking company for the purpose of business including residential premises used by employees of bank are shown under the head "Premises".
- Other fixed assets include furniture & fixture, motor vehicles, computers, office equipment etc.
- Though not specifically mentioned under the Banking Regulation Act, 1949, the assets taken on lease and intangible assets should be shown separately for proper classification and disclosure and also to comply with the requirements of the Accounting Standards (ASs).
- Section 9 of the Banking Regulation Act, 1949, prohibits a banking company from holding any immovable property, howsoever acquired (i.e., whether acquired by way of satisfaction of claims or otherwise), for a period exceeding seven years from the date of acquisition, except such as is required for its own use.

Audit Approach :

In most of the banks,

- fixed assets are generally purchased by the head office or regional/zonal offices.
- Statutory branch auditor has to ascertain the procedure followed and plan accordingly.
- maintenance of records is centralized at head office level.
- information relating to purchase, sale of fixed assets is accounted for with help of Fixed asset management software. The audit procedures have to be designed accordingly

Audit Procedure:

Internal Controls

Examine the system of internal controls broadly covering the following:

• Control over expenditures incurred on fixed assets acquired or self- constructed.
• Accountability and utilization controls.
• Information controls for ensuring availability of reliable information about fixed assets.
• Ascertain whether the accounts in respect of fixed assets are maintained at the branch or centrally.
• Ascertain the location of documents of title or other documents evidencing ownership of various items of fixed assets.
• Examine whether acquisitions, disposals, etc. effected at the branch during the year have been properly communicated to the head office

Premises

• Verify the opening balance of premises with reference to schedule of fixed assets, ledger or fixed assets register.
• Acquisition of new premises should be verified with reference to authorization, title deeds, record of payment, etc.
• Self-constructed fixed assets should be verified with reference to authorization and documents such as, contractors' bills, work order records and record of payments.
• Examine whether the balances as per the fixed assets register reconcile with those as per the ledger

and the final statements.
<ul style="list-style-type: none"> In the case of leasehold premises, capitalisation and amortisation of lease premium, if any, should be examined. Any improvements to leasehold premises should be amortized over their balance useful life.
<ul style="list-style-type: none"> In case the title deeds are held at the head office or some other location, the branch auditor should obtain a written representation to this effect from the branch management and should bring this fact to the notice of the central statutory auditor through a suitable mention in the report. This fact should also be brought in the Long Form Audit Report (LFAR).
<ul style="list-style-type: none"> Where premises are under construction, it should be seen that they are shown under a separate heading, e.g., 'premises under construction'.
<ul style="list-style-type: none"> Advances/ payments to contractors for such assets should be shown under a separate item under the head "fixed assets".
<ul style="list-style-type: none"> Where the premises (or any other fixed assets) are re-valued, the auditor should examine the appropriateness of the basis of revaluation. The auditor should also examine whether the treatment of resultant revaluation surplus or deficit is in accordance with relevant Accounting Standard. The auditor should also check the impairment, if any, by applying the principles laid down in relevant Accounting Standard.
<ul style="list-style-type: none"> Examine that no immovable properties other than those required for the own use of the bank have been included in fixed assets (own use would cover use by employees of the bank, e.g., residential premises provided to employees). The branch auditor should also obtain a written representation to the above effect from the branch management.

Other Fixed Assets

<ul style="list-style-type: none"> The procedures discussed above regarding premises also apply, to the extent relevant, to verification of other fixed assets. In respect of moveable fixed assets, the auditor should pay particular attention to the system of recording the movements as well as other controls over such fixed assets, e.g., their physical verification at periodic intervals by the branch management and/or by inspection/internal/concurrent audit team. The auditor should also examine whether discrepancies have been properly dealt with in the books of account and adequate provision in respect of any damaged assets has been made with appropriate approvals.
<ul style="list-style-type: none"> In case of transfer of fixed assets, like furniture, office equipment, etc. from one branch to another; the auditor should examine whether accumulated depreciation in respect of such assets is also transferred.
<ul style="list-style-type: none"> In case of intangible assets, verify whether the relevant guidelines given by RBI by way of Circulars and the requirements of AS 26 have been followed.
<ul style="list-style-type: none"> Examine whether fixed assets have been properly classified. Fixed assets of similar nature only should be grouped together.
<ul style="list-style-type: none"> Examine whether any expenditure incurred on a fixed asset after it has been brought to its working condition for its intended use, has been dealt with properly.
<ul style="list-style-type: none"> The auditor at head office level should examine if the consolidated fixed assets schedule matches in all respect and all the transfers in/out, are tallied. A broad check on the depreciation amount vis-a-vis the gross block of assets be reviewed with special emphasis on the computer hardware/software.

Sale of Fixed Assets

Verify the copy of sale deed and receipt of the sale value, in respect of fixed assets sold during the year. Ensure that the profit/ loss on sale of assets has been properly accounted for.

Leased Assets

Verify accounting and provisioning norms to be followed by banks undertaking leasing activity in

accordance with RBI circulars and guidelines. The auditor, in respect of leased assets, should also have regard to the requirements of AS 19, "Leases".

Impairment of Assets

Verify whether the guidelines given by RBI's circular on compliance with Accounting Standards, and the requirements of AS 28 have been followed.

VI. Other Assets

The auditor may carry out the audit of various items appearing under the head 'other assets' in the following manner

Audit Procedure

Inter-Office Adjustments

<ul style="list-style-type: none">• Examine whether Inter-branch accounts are normally reconciled at the central level.
<ul style="list-style-type: none">• The auditor should report on the year-end status of inter-branch accounts indicating the dates up to which all or any segments of the accounts have been reconciled.
<ul style="list-style-type: none">• The auditor should also indicate the number and amount of outstanding entries in the inter branch accounts, giving the relevant information separately for debit and credit entries.
<ul style="list-style-type: none">• The auditor should ensure that any discrepancies found in inter-branch accounts have been properly dealt with in the books. The auditor can obtain the relevant information primarily from branch audit reports.

Interest Accrued

<ul style="list-style-type: none">• Examine whether the interest has been accrued on the entire loans and advances portfolio of the bank. Special consideration should be given to the overdue bills purchased/discounted.
<ul style="list-style-type: none">• Ensure that only such interest as can be realized in the ordinary course of business should be shown under this head. This is based on the principle, recognised in AS 9, that revenue cannot be recognised if there is a significant uncertainty about its collectability.

Tax Paid in Advance/Tax Deducted at Source

<ul style="list-style-type: none">• Ensure that the certificates for such tax deducted at source is collected by the branch and the original copy is sent to the Head Office along with the transfer of such Tax Deducted at Source (TDS) amount to Head Office on periodic basis as defined.
<ul style="list-style-type: none">• TDS Certificates / credits in the form 26AS, and claim of the same in Income Tax returns filed should be checked to ensure the justification of the claim towards such certificates.
<ul style="list-style-type: none">• At Head Office level, the availability of all the TDS Certificates / credits in the form 26 AS, and claim of the same in Income Tax returns filed should be checked to ensure the justification of the claim towards such certificates.

Stationery and Stamps

<ul style="list-style-type: none">• Ensure that the item "Stationery and Stamps" includes only exceptional items of expenditure on stationery like bulk purchase of security paper which is to be written off over a period of time.
--

<ul style="list-style-type: none"> Such items should be valued at cost. Normal expenditure on stationery is charged to profit & loss account. Therefore, this item may not appear at branch level as considerable part of stationery is supplied to branches by head office.
<ul style="list-style-type: none"> Evaluate the existence, effectiveness and continuity of internal controls over these items in the normal course of audit.
<ul style="list-style-type: none"> branch auditor is required to specifically comment on the adequacy of the relevant internal controls in the LFAR.
<ul style="list-style-type: none"> Physically verify the stationery and stamps on hand as at the year-end, especially stationery of security items. Any shortage should be inquired into as it could expose the bank to a potential loss from misuse.
<ul style="list-style-type: none"> Examine whether the cost of stationery and stamps consumed during the year has been properly charged to the profit and loss account for the year in the context of the accounting policy/instructions from the head office regarding treatment of cost of stationery and stamps.

Non-Banking Assets Acquired in Satisfaction of Claims

<ul style="list-style-type: none"> Ensure that the heading includes those immovable properties/tangible assets which the bank has acquired in satisfaction of debts due or its other claims and these are being held with intention of being disposed off.
<ul style="list-style-type: none"> Verify such assets with reference to the relevant documentary evidence, e.g., terms of settlement with the party, order of the Court or the award of arbitration, etc.
<ul style="list-style-type: none"> Check that the ownership of the property is legally vested with the bank. If there is any dispute or other claim about the property, the auditor should examine whether the recording of the asset is appropriate or not. In case the dispute arises subsequently, the auditor should examine whether a provision for liability or disclosure of a contingent liability is appropriate, keeping in view the requirements of AS 29 "Provisions, Contingent Liabilities and Contingent Assets".
<ul style="list-style-type: none"> Ensure compliance with Section 9 of Banking Regulation Act, on holding period of such assets.
<ul style="list-style-type: none"> Ensure that as at date of acquisition, the assets should be recorded at lower of net book value of advance or net realizable value of asset acquired.

Others

This is the residual heading, which will include items not specifically covered under other sub-heads, e.g., claims which have not been received, debit items representing additions to assets or reductions in liabilities which have not been adjusted for technical reasons or want of particulars, etc., receivables on account of government business, prepaid expenses, accrued income other than interest (e.g., dividend declared but not received) may also be included under this head.

The audit procedures relating to some of the major items included under this head are discussed below:

Non-Interest- Bearing Staff Advances

<ul style="list-style-type: none"> Examine non-interest-bearing staff advances with reference to the relevant documentation and the policy in this regard which is framed by the bank. The availability, enforceability and valuation of security, if any, should also be examined.
--

•	Ensure that the same relates to employees on the rolls of the bank on the date of the preparation of financial statements.
---	--

Loans and Advances to Officials and Relatives

•	The auditor should verify that loans have been ordinarily sanctioned by the next higher sanctioning authority as compared to the recipient of loan.
•	Loans to senior officers or of higher amount should have been reported to the Board.

Security Deposits

•	Examine security deposits with various authorities (e.g., on account of telephone, electricity, etc.,) and with others (e.g., deposits in respect of premises taken on rent) with reference to documents containing relevant terms and conditions, and receipts obtained from the parties concerned.
•	Ensure that the deposit amount has not become due as per the terms and conditions. If it is so, then the recoverability of the same needs to be considered in detail and appropriate provision be made against the amount which is doubtful to recover.

Suspense Account

•	Obtain from the management details of old outstanding entries in suspense account along with reasons for delay in adjusting the entries. Where the outstanding balances comprised in suspense account require a provision/write-off, the auditor should examine whether the necessary provision has been made/write-off.
---	---

Prepaid Expenses

•	Examine whether the basis of allocation of expenditure to different periods is reasonable.
•	Examine whether the allocation of discounting and rediscounting charges paid by the bank to different accounting periods is in consonance with the accounting policy followed for the bank as a whole

Miscellaneous Debit Balances on Government Account

•	Review the ageing statements pertaining to these items.
•	Examine the recoverability of old outstanding items
•	Examine whether claims for reimbursement have been lodged by the branch in accordance with the relevant terms and conditions. The net balances of the amount recoverable at the Head Office level should also be taken along with the age-wise analysis of the same. In case of old outstanding balances without any confirmation or proper justification of the same, should be provided for in the accounts.
•	For major variance as compared to the previous year figures, verify whether reasons for the same have been recorded and reviewed.

Verification of Capital and Liabilities

I. Capital

The auditor may carry out the audit of various items under 'Share Capital' in the following manner:

Audit Approach and Procedures

- The auditor should verify the opening balance of capital with reference to the audited balance sheet of the previous year.
- In case there has been an increase in capital during the year, the auditor should examine the relevant documents supporting the increase.
 - For example, in case of an increase in the authorised capital of a banking company, the auditor should examine the special resolution of shareholders and the Memorandum of Association.
 - An increase in subscribed and paid-up capital of a banking company, on the other hand, should be verified with reference to prospectus/other offer document, reports received from Registrars to the issue, bank statement, returns filed with the Registrar of Companies etc.

Stress Testing

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

BASEL III framework

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

Capital Adequacy:

- The term 'capital adequacy' is used to describe the adequacy of capital resources of a bank in relation to the risks associated with its operations.
- The basic approach of capital adequacy framework is that a bank should have sufficient capital to provide a stable resource to absorb any losses arising from the risks in its business.
- Capital is divided into tiers according to the characteristics/qualities of each qualifying instrument.
- For supervisory purposes capital is split into two categories:

Tier I and Tier II, representing different instruments' quality as capital.

•	<u>Tier I capital</u> consists mainly of share capital and disclosed reserves and it is a bank's highest quality capital because it is fully available to cover losses
•	<u>Tier II capital</u> consists of certain reserves and certain types of subordinated debt. The loss absorption capacity of Tier II capital is lower than that of Tier I capital.

Components of Capital:

The Master Circular on Capital Adequacy discusses the Capital Funds in two categories – capital funds for Indian banks and capital funds of foreign banks operating in India.

In case of foreign banks operating in India, RBI's Master Circular on Capital Adequacy also lays down certain additional provisions in respect of capital to be followed by such banks.

$$\text{CRAR} = \frac{\text{Eligible total capital funds}}{\text{Risk Weighted Assets and off balance sheet items}} \times 100$$

The RBI requires banks to maintain a minimum CRAR of 9 per cent on an ongoing basis. The Master Circular on Capital Adequacy contains detailed guidelines on calculation of risk weighted assets and off-balance sheet items for CRAR.

Example: For secured housing loans up to ₹ 75 lakh, the risk weight, subject to some conditions is 50%. for those above ₹ 75 lakhs, it is 75%, for loans to commercial real estate, it is 100%.

Thus for a housing loan of ₹ 60 lakh given by the bank, the risk weighted asset will be taken at $60 \times 50\% = ₹ 30$ lakhs for the purpose of the denominator in the above formula.

II. RESERVES AND SURPLUS

The following are required to be disclosed in the balance sheet under the head 'Reserves and Surplus'

- Statutory reserves
- Capital reserve
- Share Premium
- Revenue and other Reserves including Investment fluctuation reserve
- Balance in Profit and Loss Account

Reconciliation to be shown for each reserve separately

Audit Approach and Procedures

- i. The auditor should verify the opening balances of various reserves with reference to the audited balance sheet of the previous year.
- ii. Additions to or deductions from reserves should also be verified in the usual manner, e.g., with reference to board resolution.
- iii. In the case of statutory reserves and share premium, compliance with legal requirements should also be examined.
- iv. Thus, the auditor should specifically examine whether the requirements of the governing legislation regarding transfer of the prescribed percentage of profits to reserve fund have been complied with.
- v. In case the bank has been granted exemption from such transfer, the auditor should examine the relevant documents granting such exemption.
- vi. Similarly, it should be examined whether the appropriations from share premium account conform to the relevant legal requirements.
- vii. Compliance with foreign laws in respect of overseas branches, need to be verified by the auditor.

Deposits

Audit Approach

- Deposits represent the important source of funds for banks.

- In carrying out audit of deposits and liabilities, the auditor is primarily concerned with obtaining reasonable assurance that all known liabilities are recorded and stated at appropriate amounts.

The following areas should be considered when auditing Deposits:

i.	Current account and Savings Account
ii.	Term deposits
iii.	Deposits designated in foreign currency

- There are some accounts like NRE [Non-Resident (External) Rupee account scheme] and NRO [Non-Resident Ordinary Rupee account scheme].
- NRE accounts may be opened by Non- Resident Indians and persons of Indian origin. NRO accounts may be opened by all non-residents.
- These accounts may be maintained in form of savings, current, recurring or fixed deposit and are denominated in Indian Rupees.
- Deposits would be appearing in balance sheet of most of the branches. Hence, these are of concern to auditors at branch and central/head office level.

Current and saving accounts

1.	Verify on a sample basis current account and saving accounts opened during the year for adherence to KYC norms.
2.	Verify the balances in individual accounts on a sample basis.
3.	Check the calculations of interest on a test check basis. Remember that no interest is paid generally on current accounts by banks.
4.	Examine whether the procedure for obtaining balance confirmation periodically has been followed consistently.
5.	Ensure that debit balances in current accounts are not netted out on the liabilities side but are appropriately included under the head advances.
6.	Inoperative accounts (both current and saving) are a high-risk area of frauds in banks. As per RBI guidelines, a savings/current account should be treated as inoperative/dormant if there are no transactions in the account for over a period of two years. Verify on a sample basis some of inoperative accounts revived/closed during the year. Ensure that inoperative accounts are revived only with proper authority.

Term deposits

1.	Examine whether the deposit receipts and cash certificates are issued serially and all of them are accounted for in the registers.
2.	Verify in case of bulk deposits (₹ 2 crore and above for scheduled commercial banks presently), correct rate of interest has been offered.
3.	In case of closure of term deposit, test check whether required foreclosure penalty has been deducted from applicable rate of interest payable.
4.	Verify on sample basis some of recurring deposit accounts opened during the year.
5.	Verify correctness of rate of interest on term deposits on sample basis.

Deposits designated in foreign currencies

1.	Verify some of FCNR accounts opened during the year on sample basis and ensure these conform to RBI directions.
2.	Verify on sample basis permissible credits and debits in FCNR accounts as per RBI directions.
3.	In case of FCNR accounts, examine whether these have been converted into Indian Rupees at rate notified in this behalf by head office.
4.	Examine whether any resultant increase or decrease has been taken to the profit and loss account.
5.	Verify that interest on deposits has been paid on the basis of 360 days in a year. Income on NPI should be recognized on realization.

Others

In case of NRE and NRO accounts, verify on a sample basis credits and debits as per RBI guidelines. Also check repatriability. NRE accounts are repatriable whereas NRO accounts are not repatriable except for all current income subject to certain conditions

General

- Verify that deposits of a bank are not inflated for purpose of balance sheet presentation. For example, some customers might be given overdrafts near date of balance sheet and the resultant overdrawn amounts may be placed as deposits with banks and further advances may be given on strength and security of these deposits. It would lead to inflated deposits as well as advances. The transactions may be reversed after close of the year.
- Examine that interest accrued but not due on deposits is not included under the relevant deposits but is shown under the head 'other liabilities and provisions.
- Ensure that framework relating to 'Know Your Customer' and Anti- Money Laundering measures is formulated and put in place by the bank.

BORROWING

Audit Procedures:

Borrowings

<ul style="list-style-type: none">• Obtain and verify confirmation certificates and other supporting documents such as, agreements, correspondence, etc.
<ul style="list-style-type: none">• External confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence that the auditor requires to respond to significant risks of material misstatement. The auditor is required to comply with the requirements of SA 505 "External Confirmations" which contains guidance on designing and performing external confirmation procedures to obtain relevant and reliable audit evidence.
<ul style="list-style-type: none">• Examine whether a clear distinction has been made between 'rediscount' and 'refinance' for disclosure of the amount under the above head since rediscount does not figure under this head.
<ul style="list-style-type: none">• Examine whether borrowings of money at call and short notice are properly authorised. The

rate of interest paid/payable on, as well as duration of such borrowings should also be examined by the auditor.
<ul style="list-style-type: none"> Examine the relevant correspondence or other documents to ensure that the branch has been authorised by the Head Office to borrow/retain other borrowings and that the terms on which borrowings have been made are in accordance with the authorisation.
<ul style="list-style-type: none"> Examine whether the amount shown in the branch accounts is properly classified based on security or otherwise.

OTHER LIABILITIES AND PROVISIONS

The Third Schedule to the Banking Regulation Act, 1949, requires disclosure of the following items under the head 'Other Liabilities and Provisions'.

- Bills Payable
- Inter office Adjustments
- Interest Accrued
- Others (including provisions)

Audit Procedures:

The auditor may verify the various items under the head 'other liabilities and provisions' in the following manner.

Bills Payable

Evaluate the existence, effectiveness and continuity of internal controls over bills payable. Such controls should usually include the following-

<ul style="list-style-type: none"> Drafts, mail transfers, traveller's cheques, etc. should be made out in standard printed forms.
<ul style="list-style-type: none"> Unused forms relating to drafts, traveller's cheques, etc. should be kept under the custody of a responsible officer.
<ul style="list-style-type: none"> The bank should have a reliable private code known only to the responsible officers of its branches, coding and decoding of the telegrams should be done only by such officers.
<ul style="list-style-type: none"> The signatures on a demand draft should be checked by an officer with the specimen signature book.
<ul style="list-style-type: none"> All the telegraphic transfers and demand drafts issued by a branch should be immediately confirmed by advices to the branches concerned. On payment of these instruments, the paying branch should send a debit advice to the originating branch.
<ul style="list-style-type: none"> Examine an appropriate sample of outstanding items comprised in bills payable accounts with the relevant registers. Reasons for old outstanding debits in respect of drafts or other similar instruments paid without advice should be ascertained.
<ul style="list-style-type: none"> Correspondence with other branches after the year-end (e.g., responding advices received from other branches, advices received from other branches in respect of drafts issued by the branch and

paid by the other branches without advice) should be examined specially in so far as large value items outstanding on the balance sheet date are concerned.

Inter-office Adjustments

The balance in inter-office adjustments account, if in credit, is to be shown under this head.

Interest Accrued

Examine interest accrued with reference to terms of the various types of deposits and borrowings. It should be specifically examined that such interest has not been clubbed with the figures of deposits and borrowings shown under the head 'Deposits and Borrowings'

Others (Including Provisions)

It may be noted that the figure of advances and investments in the balance sheet of a bank excludes provisions in respect thereof made to the satisfaction of auditors. The auditor should examine other provisions and other items of liabilities in the same manner as in the case of other entities.

In such cases which indicate the possibility of window-dressing, the auditor should consider making a suitable qualification in main audit report besides other applicable reporting

Contingent Liabilities

Audit Approach

In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. The auditor should obtain representation from management that:

1. all off-balance sheet transactions have been accounted in the books of account as and when such transaction has taken place;
2. all off balance sheet transactions have been entered into after following due procedure laid down;
3. all off balance sheet transactions are supported by the underlying documents;
4. all year end contingent liabilities have been disclosed;
5. the disclosed contingent liabilities do not include any crystallised liabilities which are of the nature of loss/expense and which, therefore, require creation of a provision/adjustment in the financial statements;
6. the estimated amounts of financial effect of the contingent liabilities are based on the best estimates in terms of AS 29, including consideration of the possibility of any reimbursement;
7. In case of guarantees issued on behalf of the bank's directors, the bank has taken appropriate steps to ensure that adequate and effective arrangements have been made so that the commitments would be met out of the party's own resources and that the bank will not be called upon to grant any loan or advances to meet the liability. Consequent upon the invocation of the said guarantee(s) and that no violation of sec. 20 of the Banking

Regulation Act, 1949 has arisen on account of such guarantee; and

8. Such contingent liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote include the management's justification for reaching such a decision in respect of those contingent liabilities.

Audit Procedure

Contingent Liabilities

- Ensure that there exists a system whereby the non-fund-based facilities or additional/ad hoc credit facilities to parties are extended only to their regular constituents, etc.
- Ascertain whether there are adequate internal controls to ensure that transactions giving rise to contingent liabilities are executed only by persons authorized to do so and in accordance with the laid down procedures.
- Verify in case of LCs for import of goods, the payment to the overseas suppliers is made based on shipping documents and after ensuring that the said documents are in strict conformity with the terms of LCs.
- Ascertain whether the accounting system of the bank provides for maintenance of adequate records in respect of such obligations and whether the internal controls ensure that contingent liabilities are properly identified and recorded.
- Test the completeness of the recorded obligations.
- Review the reasonableness of the year-end amount of contingent liabilities in the light of previous experience and knowledge of the current year's activities.
- Review whether comfort letters issued by the bank has been considered for disclosure of contingent liabilities.
- Examine whether the bank has given any guarantees in respect of any trade credit (buyer's credit or seller's credit) and the period of guarantees is co-terminus with the period of credit reckoned from the date of shipment.
- Verify whether bank has extended any non-fund facility or additional/ad hoc credit facilities to other than its regular customers. In such cases, auditor should ensure concurrence of existing bankers of such borrowers and enquire regarding financial position of those customers.

Claims against the Bank not acknowledged as debts

- a) The auditor should examine the relevant evidence, for example correspondence with lawyers, claimants, workers/officers and workmen's/officer's unions.
- b) The auditor should also review the minutes of the meeting of the Board of directors/committees of the Board, contracts, agreements and arrangements, list of pending legal cases and correspondence relating to taxes, duties etc., to identify claims against the bank.
- c) The auditor should ascertain from the management the status of claims outstanding as at the end of previous year.

- d) A review of subsequent events would also provide evidence about completeness and valuation of claims.

Liability on account of outstanding Forward Exchange contracts

- a) Verify the outstanding forward exchange Contracts with the statement of outstanding forward exchange contracts generated from the bank's computerized accounting system or manual register maintained by the branch.
- b) The auditor may physically verify the underlying documents including confirmations from merchants to test the existence of such outstanding contracts.
- c) The auditor may verify outstanding derivative contracts like options, interest rate swaps etc. with reports generated in this regard.

Guarantees given on behalf of constituents

- a) Examine the adequacy of internal controls exercised over issuance of guarantees, for example, whether guarantees are sanctioned by appropriate authority, whether adequate margins are taken from customers before issuance of guarantees, etc.
- b) Examine the adequacy of controls exercised over unused guarantee forms, for example whether unused forms are kept under the custody of a responsible official, whether a proper record of forms issued is being kept, whether stock of forms is periodically verified and reconciled with the book records, etc.
- c) Examine whether the prescribed procedure of marking off the expired guarantees is being followed or not.
- d) Examine the relevant guarantee registers with the list of outstanding guarantees to ensure that all outstanding guarantees are included in the amount disclosed.
- e) Examine that expired guarantees are not included in this head.
- f) Verify guarantees with the copies of the letters of guarantee issued by the bank and with the counter-guarantees received from the customers.
- g) Verify the securities held as margin.
- h) Ensure whether a provision is required in terms of the requirements of AS 29, "Provisions, Contingent Liabilities and Contingent Assets", in case any claim arises under these guarantees

Acceptances, Endorsements and Other Obligations

- Evaluate the adequacy of internal controls over issuance of letters of credit and over custody of unused LC forms in the same manner as in the case of guarantees.
- Verify the balance of letters of credit from the register maintained by the bank. The register indicates the amount of the letters of credits and payments made under them. The auditor may examine the guarantees of the customers and copies of the letters of credit issued. The security obtained for issuing letters of credit should also be verified.
- Examine whether the bank has incurred a potential financial obligation in respect of letters of comfort and if such obligation has been cast, ensure the amount to be disclosed under contingent liability.

Other Items for which the Bank is Contingently Liable

- Determine and verify any other items under this head as required. For example, outstanding underwriting contracts, bills rediscounting, disputed tax demands

Bills for Collection

- Ensure that the bills drawn on other branches of the bank are not included in bills for collection.
- Verify outward bills for collection with reference to the corresponding register maintained.
- Examine collections made subsequent to the date of the balance sheet to obtain further evidence about the existence and completeness of bills for collection as on the date of Balance Sheet.
- Examine the procedure for crediting the party on whose behalf a bill has been collected. Confirm that this procedure is in consonance with the nature of obligations of the bank in respect of bills for collection.
- Examine that adequate internal controls exist that debits the customer's account with the amount of bank's commission as soon as a bill collected is credited to the customer's account. The auditor should also examine that no income has been accrued in the accounts in respect of bills outstanding on the balance sheet date.

Auditor's Report

In the case of a nationalized bank, the auditor is required to make a report to the Central Government in which the auditor should state the following:

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

Report of auditors of SBI also to be made to CG and is identical to nationalised bank's audit report.

Format of Audit Report

The auditors, central as well as branch, should also ensure that the audit report issued by them complies with the requirements of

- SA 700, "Forming an Opinion and Reporting on Financial Statements",
- SA 705, "Modifications to the Opinion in the Independent Auditor's Report",
- SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report",
- SA 710, "Comparative Information-Corresponding Figures and Comparative Financial Statements"

and

- SA 720, The Auditor's Responsibility Relating to Other Information in Documents Containing Audited Financial Statements.

As per reporting requirements cast through Rule 11 of the Companies (Audit and Auditors) Rules, 2014 the auditor's report shall also include their views and comments on the following matters, namely:

- (1) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
- (2) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
- (3) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.
- (4) (i) Whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;

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

(iii) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and (ii) contain any material mis-statement.
- (5) Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.
- (6) Whether the company, has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.]

Long Form Audit Report (LFAR)

- Besides the audit report as per the statutory requirements discussed above, the terms of appointment of auditors of public sector banks, private sector banks and foreign banks (as well as their branches), require the auditors to also furnish a long form audit report (LFAR).
- The long form audit report is to be given by statutory branch auditors as well as statutory central

auditors.

- The LFAR for branch auditors is in form of questionnaire where observations/comments have to be provided on range of matters including cash, balance with banks, investments. Advances, deposits etc. These are submitted by the statutory branch auditors to statutory central auditors.

- The consolidation is done at head office level and LFAR for bank is submitted by statutory central auditors to management. The LFAR, on the bank, after due examination, should be Placed before the ACB of the bank indicating the action taken/proposed to be taken for rectification of the irregularities, if any, mentioned therein; and a copy of the LFAR and the relative agenda note, together with the Board's views or directions, is submitted to RBI within 60 days of submission of LFAR by statutory auditors.

Other Reporting Requirements

- The RBI issued a Circular relating to implementation of recommendations of Committee on Legal Aspects of Bank Frauds applicable to all scheduled commercial banks (excluding Regional Rural Banks).
- The said circular provides details regarding liability of accounting and auditing profession including the professional conduct, non-disclosure of client information and need to report fraud.
- SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", explains that the duty of confidentiality is over-ridden by statute, law or by courts.
- Whereas an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error according to SA 240.
- If an auditor of a company, in the course of the performance of duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.(Sec 143(12) of Companies Act,2013)
- It must be noted that auditor is not expected to consider each and every transaction but to evaluate the system as a whole. Therefore, if the auditor while performing normal duties comes across any instance, he/she should report the matter to the RBI in addition to Chairman/Managing Director/Chief Executive of the concerned bank.

Reports and Certificates

In addition to main audit report, SCAs are required to issue the following reports/certificates:

1.	Report on adequacy and operating effectiveness of Internal Controls over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3) (i) of the Companies Act, 2013.
2.	Long Form Audit Report (LFAR).
3.	Report on compliance with SLR requirements.
4.	Report on whether the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time.

5.	Certificate on reconciliation of securities by the bank (both on its own investment account as well as PMS Banks' account).
6.	Certificate on compliance by the bank in key areas of prudential and other guidelines relating to such transactions issued by the RBI.
7.	Report On whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI.
8.	Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention.
9.	Certificate in respect of custody of unused Bank Receipt forms and their utilization.
10.	Authentication of capital adequacy ratio, including disclosure requirements and other ratios reported in the notes on accounts.
11.	Certificate in respect of DICGC claims.
12.	Report on status of the compliance by the bank with regard to the implementation of recommendations of the Ghosh Committee relating to frauds and malpractices and of the recommendations of Jilani Committee on internal control and inspection/credit system.
13.	Report on instances of adverse credit-deposit ratio in the rural areas.
14.	Asset liability management.
15.	Certificate on Corporate Governance in case of banks listed on Stock Exchange. In some banks this certification may not be got done by the central auditors.
16.	Certification on claim of various interest subsidies and interest subvention.

CONCURRENT AUDIT SYSTEM

Meaning and Nature

- It is an examination which is contemporaneous with the occurrence of transactions.
- It attempts to shorten the interval between a transaction and its examination by an independent person not involved in its documentation.
- There is an emphasis in favour of substantive checking in key areas rather than test checking.
- It is considered as part of bank's early -warning system to ensure timely detection of irregularities.

Coverage of Business

- The scope of work to be entrusted to concurrent auditors, coverage of business/branches. Etc. is left to the discretion of the head of internal audit of banks with the due prior approval of the Audit Committee of the Board of Directors (ACB).
- Banks may, however, ensure that risk sensitive areas identified by them as per their specific business models are covered under concurrent audit. The detailed scope of the concurrent audit may be determined and approved by the ACB.
- The broad areas of coverage under concurrent audit shall be based on the identified risk of the unit and must include random transaction testing of sufficiently large sample of such transactions wherever required.

Types of Activities to be covered

1. Daily cash transactions with particular reference to any abnormal/ high value receipts and payments.
2. Proper accounting of inward and outward cash remittances.
3. Proper accounting of currency chest transactions, its prompt reporting to the RBI.
4. Expenses incurred by cash payment involving sizeable amount.

Investments

1. Ensure that in respect of purchase or sale of securities the branch has acted within its delegated power having regard to its Head Officer instructions.
2. Ensure that the securities held in the books of the branch are physically held by it.
3. Ensure that the branch is complying with the RBI/head Of the guidelines regarding BRs, SGL forms, delivery of scrips documentation and accounting. Ensure that the sale or purchase transactions are at rates beneficial to the bank.

Deposits

1. Check the transactions about deposits received and repaid.
2. Percentage check of interest paid on deposits may be made including calculation of interest on large deposits.
3. Check new accounts opened particularly current accounts. Operations in new current/SB accounts may be verified in the initial periods to see whether there are any unusual

operations.

Advances

1. Ensure that loans and advances have been sanctioned properly in accordance with delegated authority.
2. Ensure that securities and documents have been received and properly charged/registered.
3. Ensure that post disbursement supervision and follow-up is proper, Such as receipt of stock statements, instalments, recovery/renewal of sanction limits, etc.
4. Verify whether there is any misutilization of the loans and whether there are instances indicative of diversion of funds.
5. Check whether the letters of credit issued by the branch are within the delegated power and ensure that they are for genuine trade transactions.
6. Check the bank guarantees issued, whether they have been properly worded and recorded in the register of the bank. Whether they have been promptly renewed on the due dates.
7. Ensure proper follow-up of overdue bills of exchange.
8. Verify whether the classification of advances has been done as per RBI guidelines.
9. Verify whether the claims to DICGC and ECGC is submitted in time.
10. Verify that instances of exceeding delegated powers have been promptly reported to controlling/Head Office by the branch and have been confirmed or ratified at the required level.

Foreign Exchange

1. Check foreign bills negotiated under letters of credit.
2. Check FCNR and other non-resident accounts whether the debits and credits are permissible under rules.
3. Check whether inward/outward remittance have been properly accounted for.
4. Examine extension and cancellation of forward contracts for purchase and sale of foreign currency. Ensure that they are duly authorised and necessary charges have been recovered.
5. Ensure that balances in Nostro accounts in different foreign currencies are within the limit as prescribed by the bank.
6. Ensure that the overbought/oversold position maintained in different currencies is reasonable, considering the foreign exchange operations
7. Ensure adherence to the guidelines issued by RBI/HO of the bank about dealing room operations.
8. Ensure verification/reconciliation of Nostro and Vostro account transactions/Balances.

House Keeping

1. Ensure that the maintenance and balancing of accounts, ledgers and registers including clean cash is proper.
2. Early reconciliation of entries outstanding in the inter-branch and inter-bank accounts, Suspense Account, Sundry Deposits Account, DDDR Account, Drafts Account, etc.

3. Ensure timely adjustment of large value entries.
4. Carry out a percentage check of calculations of interest, discount, commission and exchange.
5. Check whether debits in income account have been permitted by the competent authorities.
6. Check the transactions of staff accounts.
7. Examine the day book to verify as to how the differences in clearing have been adjusted.
8. Detection & prevention of revenue leakages through close examination of income and expenditure accounts.
9. Verify cheques returned/bills returned register and look into reasons for return of those instruments.
10. Checking of inward and outward remittances (DDs, MTs & TTS)

Appointment of Concurrent Auditors and Accountability

- It is the discretion of individual banks to consider whether concurrent audit should be done by bank's own staff or external auditors.
- If bank has engaged its own officials, they should be experienced, well trained and sufficiently senior. The staff engaged on concurrent audit must be independent of the branch where concurrent audit is to be conducted.
- Appointment of an external audit firm may be initially for one year and can be extended up to three years, after which an auditor could be shifted to another branch subject to satisfactory performance.
- If external firms are appointed and any serious acts of omissions or commissions are noticed in their working their appointments may be cancelled and the fact may be reported to RBI & ICAI.

Remuneration of Concurrent Auditor

- Terms of appointment of the external firms of Chartered Accountants for the concurrent audit and their remuneration may be fixed by banks at their discretion.
- Broad guidelines should be framed by Audit committee of the Board for these purposes. Suitable packages should be fixed by each bank's management in consultation with its Audit Committee, keeping in view various factors such as coverage of areas, quality of work expected, number of people required for the job, number of hours to be spent on the job, etc.

Reporting System

- There should be proper reporting of the findings of the concurrent auditors. For this purpose each bank should prepare a structured format. The major deficiencies noticed during audit should be highlighted in a special note and given immediately to the bank's branch/controlling offices. A quarterly review containing key features brought out during the concurrent audits should be placed before the Audit Committee of Board of Directors (ACB).

- There should be zone-wise reporting of the findings of the concurrent audit to ACB and an annual appraisal/report of the audit system should be placed before the ACB.
- Before submission of the report the auditor should discuss the important issues on which he/she wishes to report with the branch manager and concerned officers. This will enable the auditor to take into consideration the opposite view point and clarify any doubts.
- Minor irregularities pointed out by the concurrent auditors are to be rectified in a timely manner. Serious irregularities should be reported to the controlling offices/ Head Offices for immediate action.
- Whenever fraudulent transactions are detected. They should immediately be reported to inspection & Audit Department (Head Office) as also the Chief Vigilance Officer as well as Branch Managers concerned (unless the branch manager is involved).
- Follow-up action on the concurrent audit reports should be given high priority by the Controlling office/Inspection and Audit Department and rectification of the features done without any loss of time.

AUDIT COMMITTEE

- Banks are required to constitute an Audit Committee of their Board in pursuance of RBI guidelines.
- One of the functions of this committee is to provide direction and also oversee the operations of the total audit function in the bank.
- The committee also has to review the internal inspection/audit function in the bank, with special emphasis on the system, its quality and effectiveness in terms of follow up.
- The committee has to review the system of appointment and remuneration of concurrent auditors.
- The Audit Committee is, therefore, connected with the functioning of the system of concurrent audit.
- The method of appointment of auditors, their remuneration and the quality of their work is to be reviewed by the Audit Committee.
- It is in this context that periodical meetings by the members of the audit committee with the concurrent auditors and statutory auditors help the audit committee to oversee the operations of the total audit function in the bank.

Audit of Non-Banking Financial Companies

Meaning and Types of NBFC

Meaning of NBFC

Sec. 45 I(f) of the RBI (Amendment) Act, 1997 defines a NBFC, as:

- a) A financial institution which is a company;
- b) A non-banking institution which is a company with principal business of receiving of deposits or lending in any manner;
- c) Such other non-banking institution or class of such institutions, as the RBI, with approval of the CG. may specify by notification in the official Gazette.

Points to be remember

- a) In order to identify whether a particular company is an NBFC, it is to be determined whether the financial activity is the principal business of the company.
- b) Financial activity will be considered as principal business if the company's financial assets constitute more than 50% of the total assets (netted off by intangible assets) and income from financial assets constitute more than 50% of the gross income.
- c) A company which fulfills both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI.

Registration and regulation of NBFC

- Sec. 45-1A of RBI (Amendment) Act, 1997 provides that no NBFC is allowed to commence or carry on the business of a NBFC without.
 - a) Obtaining a certificate of registration issued by the RBI; and
 - b) Having the net owned fund of ₹ 25 lakh or such other amount, not exceeding ₹ 100 crore, as the bank may, by notification in the official Gazette, specify. **(2 crores since April 1999)**

Note: Net owned funds as prescribed for registration purpose is ₹ 200 lakhs.

- The registration is required where the financing activity is a principal business of the company.
- However, to obviate dual regulation, certain categories of NBFC which are regulated by other regulators are exempted from requirement of registration with the RBI, for example: companies registered with SEBI or IRDA.

- The RBI has issued directions to NBFC on acceptance of public deposits, prudential norms, risk exposure norm & other measures to monitor financial solvency and reporting by NBFC.
- RBI also issued directions to auditors to report to the RBI, BOD and shareholders, any non-compliance with the RBI Act and regulations made by the RBI.

Types of NBFC

- Company engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.
- A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

Companies exempted from registration under RBI

1)	Housing finance institutions (regulated by National Housing Bank);
2)	Merchant Banking Companies (regulated by SEBI);
3)	Stock Exchanges (regulated by SEBI);
4)	Companies engaged in the business of stock-broking/sub-broking (regulated by SEBI);
5)	Venture capital fund companies (regulated by SEBI);
6)	Nidhi companies (regulated by MCA, Government of India);
7)	Insurance companies (regulated by IRDA);
8)	Chit companies (as defined in clause (b) of section 2 of the chit funds Act, 1982);
9)	Micro finance companies;
10)	Asset reconstruction companies;
11)	Mutual Benefit companies;
12)	Core investment companies; and
13)	Alternative investment fund (AIF) companies

Note: Core investment companies with asset size of less than ₹ 100 crore, and those with asset size of ₹ 100 crore and above but not accessing public funds are exempted from registration with the RBI.

Classification of NBFC's registered with RBI

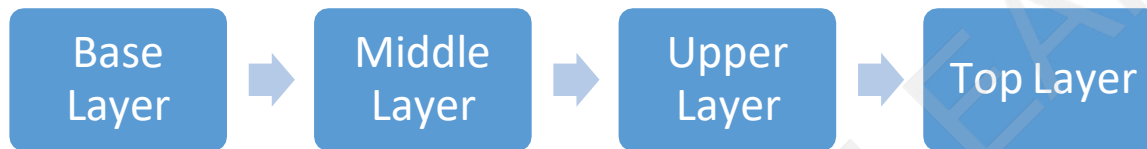
NBFCs registered with RBI are categorized as follows:

- in terms deposit acceptance or otherwise into Deposit and Non-Deposit accepting NBFCs;
- non deposit taking NBFCs by their size into systemically important and non-systemically important (NBFC-NDSI and NBFC-ND); and
- by the kind of activities, they conduct.

Within the categorization mentioned in (c) above, (i.e. by the kind of activity they conduct) the different types of NBFCs are as follows:

• Investment and Credit Company (ICC)
• Infrastructure Finance Company (IFC)
• Systematically important core investment company (CIC-ND-SI)
• Infrastructure Debt-fund Non banking financial company (IDF-NBFC)
• NBFC- Micro finance institution
• NBFC-Factors (NBFC Factors)
• NBFC-Non-operative Financial holding company (NOFHC)
• Asset Finance company, investment company, loan company, mortgage guarantee companies etc.

Layers of NBFC



The four layers are NBFC – Base Layer (NBFC-BL), then NBFC- Middle Layer (NBFC-ML), NBFC Upper Layer (NBFC-UL) and lastly NBFC – Top Layer (NBFC-TL). The Toplayer is ideally expected to be empty and will be filled by RBI based on required need.

Details of NBFCs populating the various layers is mentioned below:

Base Layer

The Base Layer shall comprise of

- (a) non-deposit taking NBFCs below the asset size of `1000 crore and
- (b) NBFCs undertaking the following activities-
 - (i) NBFC-Peer to Peer Lending Platform (NBFC-P2P),
 - (ii) NBFC-Account Aggregator (NBFC-AA),
 - (iii) Non-Operative Financial Holding Company (NOFHC) and
 - (iv) NBFCs not availing public funds and not having any customer interface.

Middle Layer

The Middle Layer shall consist of

- (a) all deposit taking NBFCs (NBFC-Ds), irrespective of asset size,
- (b) non-deposit taking NBFCs with asset size of `1000 crore and above and
- (c) NBFCs undertaking the following activities
 - (i) Standalone Primary Dealers (SPDs),

- (ii) Infrastructure Debt Fund - Non-Banking Financial Companies (IDF-NBFCs),
- (iii) Core Investment Companies (CICs),
- (iv) Housing Finance Companies (HFCs) and
- (v) Infrastructure Finance Companies (NBFC-IFCs).

Upper Layer

The top ten eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor.

Top Layer

The Top Layer will ideally remain empty. This layer can get populated if the Reserve Bank is of the opinion that there is a substantial increase in the potential systemic risk from specific NBFCs in the Upper Layer. Such NBFCs shall move to the Top Layer from the Upper Layer.

Categorisation of NBFCs carrying out specific activity

As the regulatory structure envisages scale based as well as activity-based regulation, the following prescriptions shall apply in respect of the NBFCs

- a) NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface will always remain in the Base Layer of the regulatory structure.
- b) NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be.

SPD and IDF-NBFC will always remain in the Middle Layer.

- c) The remaining NBFCs, viz., Investment and Credit Companies (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC) could lie in any of the layers of the regulatory structure depending on the parameters of the scale based regulatory framework.
- d) Government owned NBFCs shall be placed in the Base Layer or Middle Layer, as the case may be. They will not be placed in the Upper Layer till further notice.

References to NBFC-ND, NBFC-ND-SI & NBFC-D - From October 01, 2022:

All references to NBFC-ND shall mean NBFC-BL and all references to NBFC-D and NBFC-NDSI shall mean NBFC-ML or NBFC-UL, as the case may be.

Difference between Bank and NBFC

i.	NBFC cannot accept demand deposits, however some NBFCs can accept Term Deposits;
ii.	NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;
iii.	deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation (DICGC) is not available to depositors of NBFCs, unlike in case of banks.

iv.	No Minimum Exposure to Priority Sector required by NBFCs.
-----	---

PRUDENTIAL NORMS

Capital Requirements

- Every NBFC shall maintain a capital ratio consisting of Tier 1 and Tier II capital of its aggregate risk weighted assets on-balance sheet and of its riskadjusted value of off-balance sheet items, which shall not be less than 15%.
- The Tier I capital in respect of applicable NBFCs (other than NBFC-MFI andIDF-NBFC) at any point of time, shall not be less than 10%.
- NBFCs primarily engaged in lending against gold jewellery shall maintain aminimum Tier 1 capital of 12%.
 - However, in the case of Non-Systemically Important Non-Deposit Taking Company (Reserve Bank) Directions, 2016, Net Owned Fund requirements have to be complied
 - In these Directions, degrees of credit risk expressed as percentage weightages have been assigned to balance sheet assets
For example, percentage weights assigned to Fixed Assets is 100, Cash & Bank Balances is 0, etc. Hence, the value of each asset / item requires to be multiplied by the relevant risk weights to arrive at risk adjusted value of assets. The aggregate shall be taken into account for reckoning the minimum capital ratio. The risk weighted asset shall be calculated as the weighted aggregate of funded items as detailed hereunder:

<u>S.No</u>	<u>Weighted Risk asset-On Balance Sheet items</u>	<u>Percentage weight</u>
1	Cash and bank balances including fixed deposits and certificates of deposits with banks	0
2	Investments: (a) Approved securities [Except at (c) below] (b) Bonds of public sector banks (c) Fixed deposits/certificates of deposits/bonds of public financial institutions (d) Shares of all companies and debentures / bonds/ commercial papers of all companies and units of all mutual funds (e) All assets covering PPP and post commercial operations date (COD) infrastructure projects in existence over a year of commercial operation	0 20 100 100 50
3	Current assets: (a) Stock on hire (net book value) (b) Intercompany loans/deposits (c) Loans and advances fully secured	100 100 0

	against deposits held	
	(d) Loans to staff	0
	(e) Other secured loans and advances considered good [Except at (vi) below]	100
	(f) Bills purchased/discounted	100
	(g) Others (To be specified)	100
4	Fixed Assets (net of depreciation):	
	(a) Assets leased out (net book value)	100
	(b) Premises	100
	(c) Furniture & Fixture	100
5	Other assets:	
	(a) Income tax deducted at source (net of provision)	0
	(b) Advance tax paid (net of provision)	0
	(c) Interest due on Government securities	0
	(d) Others (to be specified)	100
6	Domestic Sovereign:	
	(a) Fund based claims on the Central Government	0
	(b) Direct loan / credit / overdraft exposure and investment in State Government securities	0
	(c) Central Government guaranteed claims	20
	(d) State Government guaranteed claims, which have not remained in default / which are in default for a period not more than 90 days	100
	(e) State Government guaranteed claims, which have remained in default for a period of more than 90 days	20

Income Recognition

- The income recognition shall be based on recognized accounting principles.
- In case of NPA, income including interest/discount/hire charged/leaserentals etc. shall be recognized only when it is actually realized.
- In case of NPA, any income recognized before the asset became NPA and remaining unrealized shall be reversed.

Asset classification

Every NBFC shall, after taking into account the degree of well-defined credit weakness and extent of dependence of collateral security for realization, classify its lease/ hire purchase assets, loans and

advances and any other forms of credit into the following classes, namely:

- a) Standard assets;
- b) Sub- Standard assets;
- c) Doubtful assets; and
- d) Loss assets.

Standard assets

The asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem or carry more than normal risk attached to the business.

Sub- Standard assets

- An asset which has been classified as NPA for a period not exceeding 12 months .
- An asset where the terms of the agreement regarding interest and/or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or reschedule or reconstructed terms;

Doubtful assets

- An asset which remains a sub-standard asset for a period not exceeding 12 months.

Loss Assets

- An asset identified as loss asset by the applicable NBFC or its internal or external auditor or by the bank during the inspection of the applicable NBFC, to the extent it is not written off by the applicable NBFC; and
- An asset which is adversely affected by a potential threat of non- recoverability due to either erosion in the value of security or non- availability of security or due to any fraudulent act or omission on the part of the borrower.

Note: For NSI-ND taking NBFC, 12 months shall be substituted by 18 months. NSI- ND- asset size less than 500 crores.

Non-performing Assets

- a) An asset, in respect of which, interest has remained **overdue for a period of 3 months or more.**
- b) A term loan inclusive of unpaid interest, when the instalment is overdue for a period **of 3 months or more** or on which interest amount remained overdue for a period of 6 months or more.
- c) A demand or call loan, which remained overdue for a period of **3 months or more from the date of demand or call or on which interest amount** remained overdue for a period of 3 months or more.
- d) A bill which remains overdue for a period of 3 months or more.
- e) The interest in respect of a debt or the income on receivables under the head 'other Current assets' in the nature of short-term loans/advances, which facility remained overdue for a period of 3 months or more;
- f) Any dues on account of sale of assets or services rendered or reimbursement of expenses

incurred, which remained overdue for a period of 3 months or more;

- g) The least rental and hire purchase instalment, which has become overdue for a period of 3 months or more;
- h) In the respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/beneficiary when any of the above credit facilities becomes non-performing asset.

Note: For NSI-ND NBFC, substitute 3 months by 6 months.

Provisioning Requirements

Standards Assets

Every applicable NBFC, shall make provision for standard assets at 0.40% by the end of March, 2018 and thereafter, of the outstanding, which shall not be reckoned for arriving at net NPAs.

The provision towards standard assets need not be netted from gross advances but shall be shown separately as 'contingent provision against Standard Assets' in the balance sheet.

Sub Standards Assets

A general provision of 10% of total outstanding shall be made.

Doubtful Assets

Unsecured Portion

100% to the extent to which the advance is not covered by the realizable value of the security.

Secured Portion

Period for which the asset has been considered as doubtful	% of provision
Up to one year	20
One to three years	30
More than three years	50

Loss Assets

The entire asset shall be written off. If the assets are permitted to remain in the books for any reason, 100% of the outstanding shall be provided for.

Audit Procedure

Ascertaining the Business

To ascertain the business of the company, auditor is required to study the following:

- a) Memorandum and Article of Association of the company.
- b) Business policies of the company.
- c) Minutes of the Board/committee meetings.
- d) Based on the classification of a company, it will be required to comply with the provisions relating to limits on acceptance of public deposits as contained in the NBFC Public Deposit Directions

Evaluation of internal control system

- Auditor is required to evaluate internal control system prevailing in the NBFC to ensure that the internal controls put in place by the NBFC are adequate and are being effectively followed.
- Auditor is required, in particular, to review the effectiveness of system of recovery and periodical review of advances because any deficiency in these systems may result in high level of NPAs.

Registration with the RBI

Auditor should obtain a copy of the certificate of registration granted by the RBI or in case the registration has not been granted, a copy of the application form filed with the RBI needs to be obtained.

Section 45-IA inserted in the RBI Act, 1934, w.e.f. 9th January, 1997, has made it incumbent on the part of all NBFCs to comply with registration requirements and have minimum net owned funds (NOF) of ₹ 10 crore (Although the requirement of minimum NOF at present stands at ₹ 200 lakh

Investments in Liquid Assets

- Every NBFC holding public deposits is required to invest a specified percentage (as the RBI may specify from time to time).
- The RBI has also prescribed a format for reporting to ensure compliance with the requirement of maintenance of liquid assets on a quarterly basis.
- This quarterly return (duly signed by an officer of the NBFC) is required to be submitted within prescribed time limit from the end of the relevant quarter and with reference to investments held in approved securities during the relevant quarter.
- The auditor should ascertain whether investment in prescribed liquid assets have been made and whether quarterly returns as mentioned above have been regularly filed with the RBI by the concerned NBFC.

Compliance of Public Deposit Directions

- ❖ The auditors must ascertain whether the company properly classified as per the requirements of various regulations. In case, the NBFC has not been classified by the RBI, the classification of a company will have to be determined after a careful consideration of various factors such as particulars of earlier registration granted, if any, particulars furnished in the application form for registration, company's Memorandum of Association and its financial results.
- ❖ Thereafter, it must be ascertained whether the company has complied with the following

aspects in relation to the activity of mobilisation of public deposits:

- (i) The ceiling on quantum of public deposits has been linked to its credit rating as given by an approved credit rating agency.
- (ii) Obtain a copy of the credit rating assigned to NBFC and check whether the public deposits accepted/held by it are in accordance with the level of credit rating assigned to it.
- (iii) In the event of a upgrading/downgrading of credit rating, the auditor should bear in mind that the NBFC will have to increase/reduce its public deposits in accordance with the revised credit rating assigned to it within a specified time frame and should ensure that the NBFC has informed about the same to the RBI in writing.
- (iv) In the event of downgrading of credit rating below the minimum specified investment grade, a non-banking financial company, being an investment and credit company or a factor, shall regularise the excess deposit as provided hereunder:

(a)	with immediate effect, stop accepting fresh public deposits and renewing existing deposits;
(b)	all existing deposits shall run off to maturity; and
(c)	report the position within 15 working days, to the concerned Regional Office of the RBI where the NBFC is registered.
(d)	Provided no matured public deposit shall be renewed without the express and voluntary consent of the depositor.

(v) Test check the interest calculations in respect of public deposits mobilised by a NBFC to ascertain that the NBFC has not paid interest in excess as per specification.

(vi) Test check the brokerage/ commission/ incentive calculations with the bills and vouchers for reimbursement of out of pocket expenses submitted by the parties to ascertain that the NBFC has not paid brokerage/ commission/ incentive/ reimbursement of expenses in excess as per specification.

(vii) Ascertain whether the NBFC has accepted or renewed any public deposit only after a written application form the depositor in the form to be supplied by the company, and shall contain all particulars specified in the Non-Banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977.

(viii) Verify the deposit register maintained by a NBFC and test check the particulars that have been entered therein in respect of each depositor with supporting receipts issued to the depositors. Also check whether the NBFC is regularly paying its deposits on due dates and in the case of a delay/default, the reasons for the delay/default and the actual date of payment.

(ix) Check whether the investments made in approved liquid assets by a NBFC holding public deposits have been lodged in safe custody with a designated scheduled commercial bank as required by the NBFC Acceptance of Public Deposits Directions and also whether. certificate was obtained from the RBI to that effect.

(x) Check whether the NBFC has filed its prescribed returns in a timely manner.

(xi) In the case of NBFCs not accepting/holding public deposits, check whether a board resolution has been passed by the NBFC to the effect that it has neither accepted any public deposits nor would it accept any public deposits during the year.

(xii) In the case of Group Holding Investment Companies, check whether the NBFC has passed a board

resolution to the effect that the company has invested or would invest/hold its investments in share and securities of group companies specifying the names of the companies. In addition to the above, group holding investment companies are required to give a further undertaking that it would not trade in such shares/securities and that it has neither accepted nor would it accept any public deposits during the year.

Compliance of Prudential Norms by NBFC

1. **Prudential Norms:** The auditor has to verify the compliance of prudential norms relating to (1) income recognition; (2) Income from investments; (3) Asset classification; (4) Provision for bad & doubtful debts; (5) Capital adequacy norm; (6) Prohibition of granting loans against its own shares; (7) Prohibition on loans & investments for failure to repay public deposits & (8) Norms for concentration of credit etc.
2. **Policy for demand Loans:** The auditor shall ensure that Board of the NBFC shall frame a policy for granting demand/call loans and implement the same.
3. **Classification of Advances:** The auditor should verify the classification of advances and loans as standard/sub-standard/doubtful/loss and that proper provision has been made in accordance with the directions.
4. **Income from NPA:** Auditor should ensure that unrealised income from non-performing assets has not been taken to profit and Loss Account.
5. **Recovery in NPA Accounts:** The auditor should check all NPAs of the previous year to verify whether during the current year any payments have been received or still they continue to be NPA during the current year also.

MASTER DIRECTION –

MONITORING OF FRAUDS IN NBFC (RESERVE BANK) DIRECTIONS, 2016

Classification of Frauds

In order to have uniformity in reporting frauds have been classified as under mainly based on the provisions of the Indian Penal Code:

- a. Misappropriation and criminal breach of trust
- b. Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
- c. Unauthorized credit facilities extended for reward or for illegal gratification.
- d. Negligence and cash shortages
- e. Cheating and forgery
- f. Irregularities in foreign exchange transactions
- g. Any other type of fraud not coming under the specific heads as above. Points to remember *Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (d) and (f) above are to be reported as fraud if the intention to cheat/defraud is suspected/proved.*

However, the following cases where fraudulent intention is not suspected/proved, at the time of detection, will be treated as fraud and reported accordingly:

- a. **Cases of cash shortages more than ₹ 10,000; and**
- b. **Cases of cash shortages more than ₹ 5000 if detected by management/auditor/ inspecting officer and not reported on the occurrence by the persons handling cash.**

AUDIT CHECK LIST

Investment and Credit Company

- i. Physically verify *all the shares and securities* held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
- ii. Verify whether the NBFC has not advanced any loans against the security of its own shares.
- iii. Verify that dividend income wherever declared by a company, has been duly received by an NBFC and interest wherever due [except in case of NPAs] has been duly accounted for. NBFC Prudential Norms require dividend income on shares of companies and units of mutual funds to be recognized on cash basis. However, the NBFC has an option to account for dividend income on accrual basis, if the same has been declared by the body corporate in its Annual General Meeting and its right to receive the payment has been established. Income from bonds/debentures of corporate bodies is to be accounted on accrual basis only if the interest rate on these instruments is predetermined and interest is serviced regularly and not in arrears.
- iv. Test check bills/contract notes received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates.
- v. Verify the *Board Minutes* for purchase and sale of investments. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long-Term Investments.
- vi. Check whether the investments have been valued in accordance with the NBFC Prudential Norms and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.
- vii. Obtain a list of subsidiary/group companies from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares and whether the Valuation is as per Prudential norms.
- viii. Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
- ix. An auditor will have to ascertain whether the requirements of AS 13 "Accounting for Investments" or other accounting standard, as applicable, (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
- x. In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.
- xi. Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon).
- xii. Verify charges received or paid in respect of securities lend/borrowed.
- xiii. Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.
- xiv. An auditor should examine whether each loan or advance has been properly sanctioned. He should verify the conditions attached to the sanction of each loan or advance i.e. limit on borrowings, nature of security, interest, terms of repayment, etc.
- xv. An auditor should verify the security obtained and the agreements entered into, if any, with the concerned parties in respect of the advances given. He must ascertain the nature and value of security and the net worth of the borrower/guarantor to determine the extent to which

an advance could be considered realizable.
xvi. Obtain balance confirmations from the concerned parties.
xvii. As regards bill discounting, verify that proper records/documents have been maintained for every bill discounted/rediscouted by the NBFC. Test check some transactions with reference to the documents maintained and ascertain whether the discounting charges, wherever, due, have been duly accounted for by the NBFC.
xviii. Check whether the NBFC has not lent/invested in excess of the specified limits to any single borrower or group of borrowers as per NBFC Prudential Norms.
xix. An auditor should verify whether the NBFC has an adequate system of proper appraisal and follow up of loans and advances. In addition, he may analyze the trend of its recovery performance to ascertain that the NBFC does not have an unduly high level of NPAs.
xx. Check the classification of loans and advances (including bills purchased and discounted) made by a NBFC into Standard Assets, Sub-Standard Assets, Doubtful Assets and Loss Assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms.

AUDITOR'S DUTY

The following are the important duties of an auditor –

Compliance with NBFC Auditor's Report - RBI Directions

The auditors under section 143 of Companies Act 2013 will report to members and the auditor shall also make a separate report to the Board of directors of the company and to RBI on exception basis. Section 45MA of the Reserve Bank of India Act, 1934 requires the auditor of a deposit taking NBFC to inquire whether returns of deposits are submitted to RBI. If not furnished to RBI, the aggregate amount deposits held should also be included in the report u/s 143 of Companies Act 2013.

Material to be included in the Auditor's report to the Board of Directors

A. In case of all NBFC's

<ul style="list-style-type: none"> Whether the company is engaged in the business of non-banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria. Whether the company has obtained a Certificate of Registration (CoR) from the RBI
<ul style="list-style-type: none"> In case of a company holding CoR issued by the RBI, whether that company is entitled to continue to hold such CoR in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year
<ul style="list-style-type: none"> Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in Master Direction of RBI

Note:

- Every NBFC shall submit a Certificate from its Statutory Auditor that it is engaged in the business of non-banking financial institution requiring it to hold a Certificate of Registration under Section 45-IA of the RBI Act and is eligible to hold it.
- A certificate from the Statutory Auditor in this regard with reference to the position of the company as at end of the financial year ended March 31 may be submitted to the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the non-banking

financial company is registered, within one month from the date of finalization of the balance sheet and in any case not later than December 30th of that year.

In the case of a non-banking financial companies accepting/holding public deposits

Apart from the matters enumerated in (A) above, the auditor shall include a statement on the following matters, namely-

(i)	Whether the public deposits accepted by the company together with other borrowings indicated below viz.
(a)	from public by issue of unsecured non-convertible debentures/bonds;
(b)	from its shareholders (if it is a public limited company); and
(c)	from entities which are not excluded from the definition of 'public deposit

(ii)	Whether the public deposits held by the company in excess of the quantum of such deposits permissible to it under the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 are regularized in the manner provided in the said Directions;
------	--

(iii)	Whether the non-banking financial company is accepting "public deposit" without minimum investment grade credit rating from an approved credit rating agency as per the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016
-------	---

(iv)	Whether the capital adequacy ratio as disclosed in the return submitted to the Bank in terms of the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 has been correctly determined and whether such ratio is in compliance with the minimum CRAR prescribed therein
------	---

(v)	In respect of non-banking financial companies referred to in clause (iii) above,
(a)	whether the credit rating, for each of the fixed deposits schemes that has been assigned by one of the Credit Rating Agencies listed in Non- Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 is in force; and
(b)	whether the aggregate amount of deposits outstanding as at any point during the year has exceeded the limit specified by the such Credit Rating Agency;

(vi)	Whether the company has violated any restriction on acceptance of public deposit as provided in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;
(vii)	Whether the company has defaulted in paying to its depositors the interest and/or principal amount of the deposits after such interest and/or principal became due;
(viii)	Whether the company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, and concentration of credit/investments as specified in the Directions issued by the Bank in terms of the Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016;

(ix)	Whether the company has complied with the liquid assets requirement as prescribed by the Bank in exercise of powers under section 45-IB of the RBI Act and whether the details of the designated bank in which the approved securities are held is communicated to the office concerned of the RBI in terms of NBS 3; Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;
(x)	Whether the company has furnished to the RBI within the stipulated period the return on deposits as specified in the NBS 1 to – Non- Banking Financial Company Returns (Reserve Bank) Directions, 2016;
(xi)	Whether the company has furnished to the RBI within the stipulated period the quarterly return on prudential norms as specified in the Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;
(xii)	Whether, in the case of opening of new branches or offices to collect deposits or in the case of closure of existing branches/offices or in the case of appointment of agent, the company has complied with the requirements contained in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

In the case of a non-banking financial company not accepting public deposits

Apart from the aspects enumerated in (A) above, the auditor shall include a statement on the following matters, namely: -

(i)	Whether the Board of Directors has passed a resolution for non- acceptance of any public deposits;
(ii)	Whether the company has accepted any public deposits during the relevant period/year;
(iii)	Whether the company has complied with the prudential
(iv)	In respect of Systemically Important Non-deposit taking NBFCs as defined in Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016:
	(a) Whether the capital adequacy ratio as disclosed in the return submitted to the RBI in form NBS - 7, has been correctly arrived at and whether such ratio is in compliance with the minimum CRAR prescribed by the RBI;
	(b) Whether the company has furnished to the RBI the annual statement of capital funds, risk assets/exposures and risk asset ratio (NBS-7) within the stipulated period.
(v)	whether the non-banking financial company has been correctly classified as NBFC Micro Finance Institutions (MFI)

In the case of a company engaged in the business of non-banking financial institution not required to hold CoR subject to certain conditions

Apart from the matters enumerated in (A)(I) above where a company has obtained a specific advice from the RBI that it is not required to hold CoR from the RBI, the auditor shall include a statement that the company is complying with the conditions stipulated as

Reasons to be stated for unfavourable or qualified statements:

Where, in the auditor's report, the statement regarding any of the items referred to in paragraph 3 above is unfavorable or qualified, the auditor's report shall also state the reasons for such unfavorable or qualified statement, as the case may be. Where the auditor is unable to express any opinion on any of the items referred to in paragraph 3 above, his report shall indicate such fact together with reasons therefor.

COMPLIANCE WITH CARO, 2020

Para 3 Clause (iii)

Clause (iii) of Paragraph 3 of CARO, 2020 requires the company auditor to report 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 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;
- b) 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;
- c) 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;
- d) 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 Sec. 2(76) of the Companies Act, 2013.

Para 3 Clause (xii)- a) Net owned funds to deposit ratio- 1:20

b) unencumbered term deposits of 10%

c) Default in repayment of principle and interest

Para 3(xvi)

Reporting Requirement

Clause (xvi) of Paragraph 3 of CARO, 2020 requires the company auditor to report:

- a) whether the company is required to be registered under Section 45-1A of the RBI Act, 1934 and if so, whether the registration has been obtained;
- b) whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934:

c) 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;

d) 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;

Related Provisions

- Sec. 45-IA of RBI (Amendment) Act, 1997 provides that no NBFC is allowed to Commence or carry on the business of a NBFC without obtaining a certificate of registration from RBI.
- The registration is required where the financing activity is a principal business of the company.
- Financial activity will be considered as principal business if the company's financial assets constitute more than 50% of the total assets and income from financial assets constitute more than 50% of the gross income, a company which fulfils both these criteria is required to get itself registered as NBFC with RBI.
- This test is popularly known as 50-50 test and is applied to determine whether or not a company is into financial business.

Audit Procedure and Reporting

- I. Examine the transactions of the company with relation to the activities covered under the RBI Act and directions to determine whether company is engaged in financial activity.
- II. Auditor should examine the financial statements to ascertain whether. Company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.
- III. Ascertain whether the net owned funds of the company exceed such amount so as to require the company to get itself registered as NBFC with RBI.
- IV. Ascertain whether the company has obtained the registration as NBFC. If not, the reasons should be sought from the management and documented.
- V. Auditor's Report under CARO, 2020 shall incorporate the following:
 - 1) Whether the registration is required under section 45-IA of the RBI Act, 1934.
 - 2) If so, whether it has obtained the registration.
 - 3) If the registration not obtained, reasons thereof.

IND AS AND SCHEDULE III

Applicability of IND AS on NBFCs

- As per Rule 4(1)(iv) of the Companies (Indian Accounting Standards) Rules, 2015 and as amended by Companies (Indian Accounting Standards) (Amendment) Rules, 2016, NBFCs are required to comply with Indian Accounting Standards (Ind AS) as under.
 - I. **Accounting periods beginning 1 April 2018:** Listed and unlisted NBFCs having a net worth of ₹ 500 crore or more and holding, subsidiary, joint venture or associate Companies of such NBFCs;

II. Accounting periods beginning 1 April 2019: All other listed NBFCs, unlisted NBFCs having a net worth of ₹ 250 crore or more but less than ₹ 500 crore and holding, subsidiary, joint venture or associate companies of such NBFCs.

- The net worth shall be calculated in accordance with the standalone financial statements of the NBFCs as on 31st March 2016 or the first audited financial statements for accounting period which ends after that date.

Schedule III

- The schedule III to the Companies Act, 2013 has been divided into three divisions vide notification dated 11.10.2018.
- Division I deals with F.S. for a company whose F.S. are required to comply with the Companies (AS) Rules, 2006.
- Division II deals with F.S. for a company whose FS. Are drawn up in compliance of the Companies (Ind AS) Rules, 2015.
- Division III deals with F.S. for a Non-Banking Financial Company (NBFC) whose F.S. are drawn up in compliance of the Companies (Ind AS) Rules, 2015.

Parts of Division III

Division III has been divided as follows:

- Part I contains the form in which the Balance Sheet of a company required to comply with Ind AS and states the general instructions as regard to preparation of Balance Sheet
- Part II contains the form and states the general instructions as regard to preparation of Statement of Profit and Loss.
- Part III contains general instructions for preparation of Consolidated F.S.

Differences between Division II and Division III

The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

- a) NBFCs have been allowed to present the items of the balance sheet in order of their liquidity which is not allowed to companies required to follow Division II. Additionally, NBFCs are required to classify items of the balance sheet into financial and non-financial whereas other companies are required to classify the items into current and non-current.
- b) An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1% of the total income. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1% of the revenue from operations or ₹ 10 lakhs. Whichever is higher.
- c) NBFCs are required to separately disclose under receivables, the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member.
- d) NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of showing those only as part of the notes.
- e) Separate disclosure of trade receivable which have significant increase in credit risk & credit

impaired.

- f)** The conditions or restrictions for distribution attached to statutory reserves have to be separately disclose in the notes as stipulated by the relevant statute.

1FIN BY INDIGO LEARN

Due Diligence

Introduction:

- Due Diligence is used to investigate and evaluate a business opportunity.
- It implies a general duty to exercise care in any transaction.
- Most legal definition of due diligence describe it as a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measure by any absolute standard but depends on the relative facts of the special case.

Meaning and Nature of Due Diligence

- Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the verification of material facts.
- It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction
- Due Diligence is required to be performed in cases of corporate restructuring, venture capital financing, lending, leveraged buyouts, public offerings, disinvestment, corporatisation, etc
- Corporate restructuring shall include merger. Acquisition, internal reconstruction etc.
- Emerging area is around mandatory human rights and environmental due diligence. The OECD Due Diligence Guidance for Responsible Business Conduct (RBC) set out the expectation that how an enterprises can carry out risk-based due diligence. Under OECD RBC due diligence standards, enterprises are expected to carry out risk-based due diligence to identify, prevent, mitigate and account for how they address actual and potential adverse impacts to people, society and the planet.

Difference between Due Diligence and Audit

<u>Audit</u>	<u>Due Diligence</u>
Audit is an independent examination and evaluation of the financial statements on an organization with a view to express an opinion thereon	due diligence refers to an examination of a potential investment to confirms all material facts of the prospective business opportunity
It involves review of financial records	It involves review of financial and non-financial records as deemed relevant and material. Due diligence aims to take the care that a reasonable person should take before entering into an agreement or a transaction with another party

Importance of Due Diligence

There are many reasons for carrying out due diligence including:
a. To confirm that the business is what it appears to be
b. To identify potential 'deal killer' defects in the target company and avoid a bad business transaction

c. To gain information that will be useful for valuing assets, defining representations and warranties, and/or negotiating price concessions and
d. To verify that the transaction complies with investment or acquisition criteria.

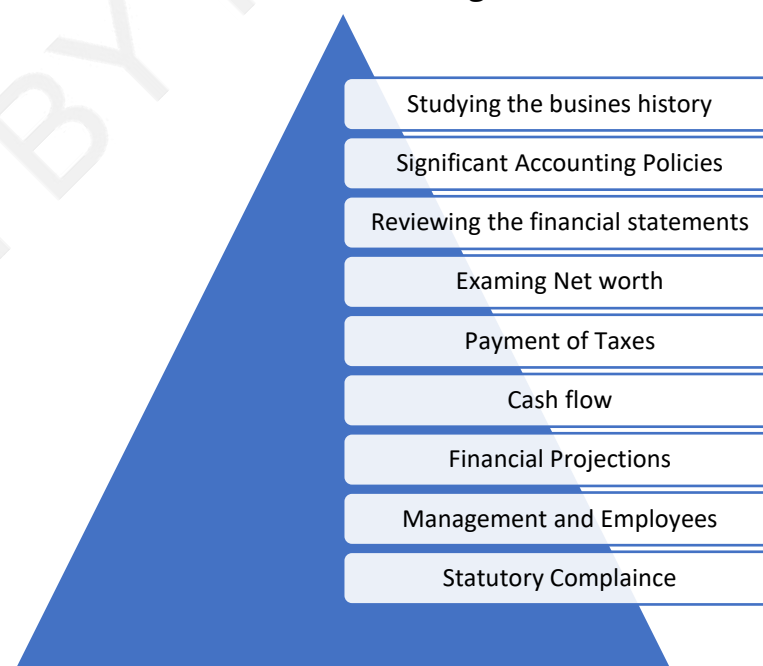
Classification of Due Diligence

Due Diligence can be sub-classified into discipline-wise exercises in following manner:

- (i) **Commercial/Operational Due Diligence:** It is generally performed by the concerned acquire enterprise involving an evaluation from commercial, strategic and operational perspectives. For example, whether proposed merger would create operational synergies.
- (ii) **Financial Due Diligence:** It involves analysis of the books of accounts and other information pertaining to financial matters of the entity. It should be performed after completion of commercial due diligence.
- (iii) **Tax Due Diligence:** It is a separate due diligence exercise but since it is an integral component of the financial status of a company, it is generally included in the financial due diligence. The accountant has to look at the tax effect of the merger or acquisition.
- (iv) **Information Systems Due Diligence:** It pertains to all computer systems and related matter of the entity.
- (v) **Legal Due Diligence:** This may be required where legal aspects of functioning of the entity are reviewed
- (vi) **Environmental Due Diligence:** It is carried out in order to study the entity's environment, its flexibility and adaptiveness to the acquirer entity.
- (vii) **Personnel Due Diligence:** It is carried out to ascertain that the entity's personnel policies are in line or can be changed to suit the requirements of the restructuring.

Financial Due Diligence

Aspects to be covered under Financial due diligence



I. Studying the business history

- The details of how the company was set up
- Who were the original promoters
- An eye into the history of the target company may reveal its turning points, survival strategies adopted by the target company from time to time, the market share enjoyed by the target company and changes therein, product life cycle and adequacy of resources
- the accountant should make relevant enquiries about the history of target's business products, markets, suppliers, expenses, operations. Eg: nature of business, location of warehouse, production facilities etc.

II. Accounting Policies:

- ascertain whether any accounting policy is inappropriate.
- The accountant should also see the effects of the recent changes in the accounting policies.
- The target company might have changed its accounting policies in the recent past keeping in view its intention of offering itself for sale.
- The accountant has to look at any material effect of accounting policies on the overall profitability and their correctness.
- The accountant's report should include a summary of significant accounting policies used by the target company, that changes that have been made to the accounting policies in the recent past, the areas in which accounting policies followed by the target company are different from those adopted by the acquiring enterprise, the effect of such differences.

III. Review of Financial statements:

- The accountant should examine whether the financial statements of the target company have been prepared in accordance with the Statute governing the target company, Framework for Preparation and Presentation of the Financial Statements and the relevant Accounting Standards. If not, the accountant should record the deviations from the above and consider whether it warrant an inclusion in the final report on due diligence.
- It is important to make an evaluation of the profit reported by the target company. The reason being that the price of the target company would be largely based upon its operating results.
- The accountant should consider the presence of an extraordinary item of income or expense that might have affected the operating results of the target company.
- It is advisable to compare the actual figures with the budgeted figures for the period under review and those of the previous accounting period.
- It is important that the trading results for the past four to five years are compared and the trend of normal operating profit arrived at.
- The normal operating profits should further be benchmarked against other similar companies.

- Based on the trend of operating results, the accountant has to advise the acquiring enterprise, through due diligence report, on the indicative valuation of the business.

IV. Examining Net worth:

- Evaluate the basis upon which assets have been valued and liabilities have been recognised
- The net worth of the business has to be arrived at by taking into account the impact of under/over valuation of assets and liabilities.

V. Payment of Taxes:

- It is important to check if the company is regular in paying various taxes to the Government.
- The accountant has to also look at the tax effects of the merger or acquisition.

VI. Cash Flow:

- A review of historical cash flows and their pattern would reflect the cash generating abilities of the target company and should highlight the major trends

<i>It is necessary to check that:</i>
Is the company able to honour its commitments to its trade payables, to the banks, to government and other stakeholders?
How well is the company able to turn its trade receivables and inventories?
How well does it deploy its funds?
Are there any funds lying idle or is the company able to reap maximum benefits out of the available funds?
What is the investment pattern of the company and are they easily realisable?

VII. Financial projections:

- The accountant should obtain from the target company the projections for the next five years with detailed assumptions and workings.
- The accountant evaluates the appropriateness of assumption used in the preparation and presentation of financial projections. If, the accountant is of the opinion that as assumption used by the target company is unrealistic, the accountant should consider its impact on the overall valuation of the company

VIII. Management and Employees:

- Examine the status of work force, staff and employees and their retention.
- It is also important to judge the job profile of the administrative and managerial staff to gauge which of these matches the requirements of the new incumbents
- It is important to see if all employee benefits like Provident Fund (P.F.), Employees State Insurance (E.S.I.), Gratuity, leave and Superannuation have

been properly paid/ provided for/funded. In case of un-funded Gratuity, an actuarial valuation of the liability has to be obtained from a reputed actuary

- It is very important to consider the pay packages of the key employees as this can be a crucial factor in future costs.

IX. Statutory Compliance:

- make a list of laws/ statues that are applicable to the entity as well as make a checklist of compliance required from the company under those laws.
- If the company has not been regular in its legal compliance it could lead to punitive charges under the law.
- These may have to be quantified and factored into the financial results of the company.

Work Approach to due diligence:

Process of due diligence is exercised so as to analyse the numerous variables like age of the company, market geography, price levels etc.

The purchase of business in many instances is the largest and most expensive assets purchased in life time and therefore some caution should be exercised through the due diligence process. Therefore, assessing the businesses fair value passes through

- Reviewing and reporting on the financials submitted by the target company.
- Assessing the business first hand by a site visit (if applicable).
- Working through the due diligence process with the acquisitioning company or investor by defining the key areas.
- Helping prepare an offer based on completion of due diligence.

Hidden Liabilities

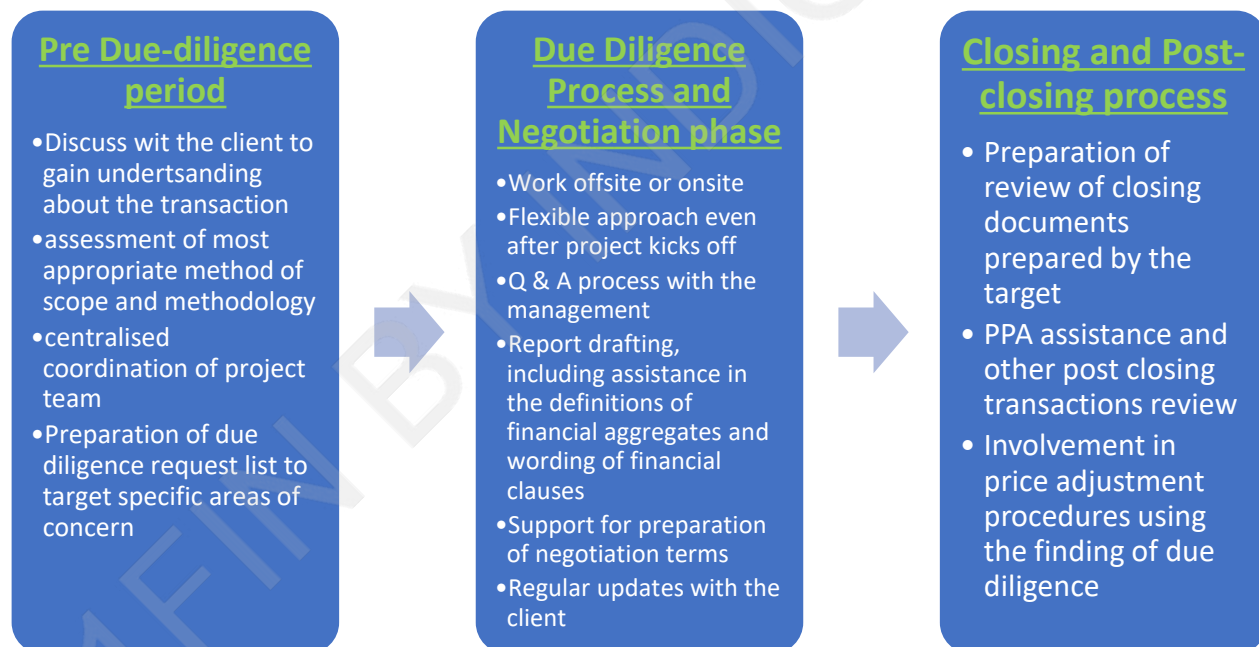
<ul style="list-style-type: none"> • The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.
<ul style="list-style-type: none"> • The company may have given "Letters of Comfort" to banks and Financial Institutions. Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.
<ul style="list-style-type: none"> • The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
<ul style="list-style-type: none"> • Product and other liability claims; warranty liabilities; product returns/discounts; liquidated damages for late deliveries etc. and all litigation.
<ul style="list-style-type: none"> • Tax liabilities under direct and indirect taxes. Long pending sales tax assessments.
<ul style="list-style-type: none"> • Pending final assessments of customs duty where provisional assessment only has been completed.
<ul style="list-style-type: none"> • Agreement to buy back shares sold at a stated price. Future lease liabilities.
<ul style="list-style-type: none"> • Environmental problems/claims/third party claims.
<ul style="list-style-type: none"> • Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.

- | |
|--|
| <ul style="list-style-type: none"> • Huge labour claims under negotiation when the labour wage agreement has already expired. |
| <ul style="list-style-type: none"> • Unresolved labour litigation |

Over-Valued Assets:

<ul style="list-style-type: none"> • Uncollected/uncollectable receivables.
<ul style="list-style-type: none"> • Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.
<ul style="list-style-type: none"> • Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
<ul style="list-style-type: none"> • Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
<ul style="list-style-type: none"> • Litigated assets and property.
<ul style="list-style-type: none"> • Investments carried at cost though realizable value is much lower. Investments carrying a very low rate of income / return.
<ul style="list-style-type: none"> • Infertuous project expenditure/deferred revenue expenditure etc.
<ul style="list-style-type: none"> • Group Company balances under reconciliation etc.
<ul style="list-style-type: none"> • Intangible assets of no value.

How to Conduct Due diligence?



1. Start with an open mind. Do not assume that anything wrong will be found and look for it. What needs to be done is to identify trouble spots and ask for explanations.
2. Get the best team of people. If you do not have a group of people inside your firm that can do the task (e.g., lack of staff, lack of people who know the new business because you are

acquiring a business in an unrelated area, etc.), there are due diligence experts that you can hire. When hiring such professionals, look for their experience record in the industry.

3. Get help in all areas like finance, tax accounting, legal, marketing, technology, and any others relevant to the assignment so that you get a 360-degree view of the acquisition candidate.
4. Talk to customers, suppliers, business partners, and employees are great resources.
5. Take a risk management approach. So, while you want to do your research, you also want to make sure that you do not antagonise the team of people of the target company by bogging them down with loads of questions.
6. Prepare a comprehensive report detailing the compliances and substantive risks/issues.

CONTENTS OF A DUE DILIGENCE REPORT

The contents of a due diligence report will always vary with individual circumstances. Following headings are illustrative:

Example of Headings of a Due Diligence Report	
•	Executive Summary
•	Introduction
•	Background of Target company
•	Objective of due diligence
•	Terms of reference and scope of verification
•	Brief history of the company
•	Share holding pattern
•	Observations on the review
•	Assessment of management structure
•	Assessment of financial liabilities
•	Assessment of valuation of assets
•	Comments on properties, terms of leases, lien and encumbrances.
•	Assessment of operating results
•	Assessment of taxation and statutory liabilities
•	Assessment of possible liabilities on account of litigation and legal proceedings against the company
•	Assessment of net worth
•	Interlocking investments and financial obligations with group / associates' companies, amounts receivables subject to litigation, any other likely liability which is not provided for in the books of account
•	SWOT Analysis
•	Comments on future projections
•	Status of charges, liens, mortgages, assets and properties of the company
•	Suggestion on ways and means including affidavits, indemnities, to be executed to cover unforeseen and undetected contingent liabilities
•	Suggestions on various aspects to be taken care of before and after the proposed merger/acquisition.

INVESTIGATION

Introduction

- The term investigation implies a systematic and in-depth examination or inquiry to establish a fact or to evaluate a specific situation
- Investigation means inquiry into facts.
- The term investigation may be defined as an examination of books and records preliminary to financing or for any other specified purpose, sometimes differing in scope from the ordinary audit.
- Investigation covers areas of financing decisions, investment decisions, fraud or profitability determination or cost determination etc.

Audit v/s Investigation

- Investigation differs substantially from an audit assignment.
- Audit aims at collection of sufficient appropriate audit evidence to enable the auditor to form a judgement and express an opinion on the financial statements or other data under examination.
- An investigation, on the other hand, requires special in-depth examination of the particular records or transaction with the objective of establishing a part or happening or assessing a particular situation.

<u>Basis</u>	<u>Audit</u>	<u>Investigation</u>
Objective	The main objective of an audit is to verify whether the financial statements display a true and fair view of the state of affairs and the working results of an entity.	An investigation aims at establishing a fact or a happening or at assessing a particular situation
Scope	The scope of audit is wide and in case of statutory audit the scope of work is determined by the provisions of relevant law	The scope of investigation may be governed by statute or it may be non-statutory.
Periodicity	The audit is carried on either quarterly, half-yearly or yearly	The work is not limited by rigid time frame. It may cover several years, as the outcome of the same is not certain.
Nature	Involves tests checking or sample technique to draw evidences for forming a judgement and expression of opinion. It is mandatory for companies.	Requires a detailed study and examination of facts and figures. Investigation is voluntary in nature
Inherent Limitation	Audit suffers from inherent limitation.	No inherent limitation owing to its nature of engagement.
Evidence	It seeks persuasive evidence	It seeks conclusive evidence.

Observation of Accounting Principles	Is governed by compliance with generally accepted accounting principles, audit procedures and disclosure requirements	It is analytical in nature and requires a thorough mind, capable of observing, collecting and evaluating facts.
Reporting	The outcome is reported to the owners of the business entity	The outcome is reported to the person(s) on whose behalf investigation is carried out.

Steps in Investigation



I. Step 1: Determination of Objective and Establishing Scope

- The investigator should be absolutely clear about what is sought to be achieved by the investigation.
- If instructions from the client leave matters vague and non-specific, it would be proper for the investigator to have the matters discussed and obtain clearly written instructions covering the object, the scope and purpose of investigations and the issues incidental thereto.
- The period to be covered under investigation should be clearly specified

II. Step 2: Investigation Programme

- It is not possible to draw up one programme to serve different types of investigations
- The investigation programme should be drawn up having regard to:

The nature of the business
The structure of business organization
The instructions from the client embodying the objectives and scope of work
The consequent scope and depth of investigation
The necessity to extend the investigation into books and records belonging to others.
The investigator should concentrate on areas considered relevant rather than to undertake a wide-ranging verification.

- The programme should also be flexible so that knowledge gained with the progress of work can be used to extend, reduce or modify the extent and areas of checking.

III. Stage 3: Collection of Evidence:

- The investigator would be gathering relevant evidence connected with the matters to be investigated.
- The investigator should look for the most convincing evidence; he should seek and examine all the available evidence and by a process of elimination and corroboration, should endeavour to reach at the truth of the matter.
- He, unlike the auditor, is not to restrict himself to prima facie evidence ordinarily available.
- He should examine it and if circumstances demand should try to obtain evidence that may have to be specifically procured.
- The investigating accountant can take help of external experts/ persons like, related parties outside the organization, valuation experts etc. to obtain specific evidence.
- The work of investigating accountant should ensure that the process of obtaining evidence does not interfere with the regular work of client.

IV. **Stage 4: Analysis and Interpretation of Findings**

- Careful analysis and correlation of facts and figures will be necessary before the investigator can reach his conclusion.
- The conclusion should be well reasoned, backed by established facts and evidenced by proper records/ data.
- He must analyse the data objectively on the basis of evidence gathered by him and should not draw conclusions according to pre-conceived notions
- While interpreting the figures, the investigator must keep in mind various factors e.g., the political and economic considerations, competition faced by the business, historical pattern of the data, nature of the business, etc.
- The interpretation should be brief, clear and free from doubts.

V. **Stage 5: Reporting of Findings**

- Like all other work of an accountant, an investigation results in a report.
- It is submitted and addressed to the party at whose instance the investigation has been carried out.
- The nature of the report is governed mainly by two factors –
 - ✚ The instructions given by the client as regards the special aspects of the business which are required to be investigated;
 - ✚ The findings of the investigating accountant/ investigator.
- The important issues to be kept in mind by the investigator while preparing his report are as follows:

(i)	The report should not contain anything which is not relevant.
(ii)	Every word or expression used should be properly considered so that the possibility of arriving at a different meaning or interpretation other than the one intended by the investigator can be minimized.
(iii)	Relevant facts and conclusions should be properly linked with evidence.
(iv)	Bases and assumptions made should be explicitly stated.
(v)	The report should clearly spell out the nature and objective of the assignment accepted its scope and limitations, if any.

(vi)	The report should be made in paragraph form with headings for the paragraphs. Any detailed data and figures supporting any finding may be given in Annexures.
(vii)	The report should also state restrictions or limitations, if any, imposed on the instructions given by the client. Preferably the reasons for placing such restrictions and their impact on the final result should also be stated.
(viii)	The opinion of the investigator should appear in the final paragraph of the report.

Special Issues in Investigation

I. Whether an investigator is required to undertake 100% verification approach or whether he can adopt selective verification:

- depends on the circumstances of the case under investigation
- Example: If the investigator has to establish the amount of cash defalcated by the cashier, he has probably no option but to carefully examine all the cash vouchers and related records.
- On the other hand, if he is to arrive at the profitability of a concern, he may verify constituent transactions on a selective basis taking extreme care to see that no material transaction that affects profit.
- In investigation, it is always safer to go by statistically recognised sampling methods

II. Whether the investigator can put reliance on the already audited statement of account –

- Again, depends on circumstances of each case
- If the investigation has been launched because of some doubt in the audited statement of account, no question of reliance on the audited statement of account arises.
- However, if the investigator has been requested to establish value of a business or a share or the amount of goodwill payable by an incoming partner, ordinarily the investigator would be entitled to put reliance on audited materials
- It was held in the case of *Short & Compton v. Brackert* (1904) that an accountant, when making an investigation for an incoming partner, was entitled to assume that the figures appearing in the books were correct
- It is, therefore, desirable for the investigator to ascertain from the client, in advance, in writing, whether the audited statements of account produced to him should be taken as correct.
- If the statements of account produced before the investigator were not audited by a qualified accountant, then of course there arises a natural duty to get the figures in the accounts properly checked and verified
- However, when the accounts produced to the investigator have been specially prepared by a professional accountant, who knows or ought to have known that these were prepared for purposes of the investigation, he could accept them as correct relying on the principle of liability to third parties
- Nevertheless, it would be prudent to see first that such accounts were prepared with objectivity and that no bias has crept in to give advantage to the person on whose behalf these were prepared.

III. Assistance of Expert:

- An investigator may feel the necessity of obtaining views and opinions of experts in various fields to properly conduct the investigation.
- It would be therefore, proper for the investigator to get the written general consent of his client, to refer special matters for views of different experts at the beginning of investigation.

IV. Investigation out of disputes and conflicting claims

- The investigator should remain above disputes or conflicting claims and be alert to the possibilities of the information or documents made available to him to be prejudiced.
- The investigator should keep him scrupulously professional and should keep the interest of all the involved parties in view.
- This work requires not only the best of skill but of a high degree of maturity and experience.

V. Basis of opinion of an investor:

- The investigator should refrain from issuing speculative opinion.
- He should confine his opinion to the established facts and nothing more.
- If the facts, as conveyed through the books, records, papers and other evidence, are not capable of being properly established, he should not express an opinion or, if at all he expresses any opinion,
- he should qualify the opinion by clearly stating the reasons therefor.

VI. Whether an investigator can make futuristic statements:

- The investigator should refuse to be futuristic.
- He may assume that the established trend in the business will continue in the near future, in the absence of any contrary evidence, in arriving at the present value of a business.
- He, however, should not project the trend into any future years to establish a value.

VII. Retention of Working Papers:

- Investigating accountant should retain in his files full notes of the work carried out, copies of schedules and all working papers, annexures, facts, figures, record of conversations and the like.
- the working papers should link up the figures as shown by the books of business with the final figures produced by the investigating accountant. This will also be of immense help to the investigator in correlating facts and events and later in drafting the report.

Special Aspects in connection with business investigation



- **Studying the overall picture:** Figures are only symbols; and it is impossible to interpret them intelligently without knowledge of the background in which they have emerged.
- **Political and Economic factors:**
 - a) Adequacy of fixed and working capital
 - b) Trends of sales and profit in future
 - c) Whether the profit which the business could be expected to maintain in the future would yield an adequate return on the capital employed?
 - d) Whether the business is operating at its 100 percent capacity or improvements can be made to reach at full productivity?
- **Studying the Statement of Profit and Loss-** Prepare a columnar P & L Account to compare with previous years, for a period of 5 to 7 years.
 - a) Turnover
 - b) Wage structure
 - c) Depreciation and Maintenance
 - d) Managerial Remuneration
 - e) Exceptional and non-recurring items
 - f) Repairs and Maintenance
 - g) Unusual year
- **Balance Sheet:**
 - a) Fixed Assets
 - b) Investments
 - c) Inventories
 - d) Trade Receivables
 - e) Other Liquid Assets
 - f) Liabilities
 - g) Taxation
 - h) Capital
- **Studying over all picture:**
 - i. It is of utmost importance first to have an overall picture of the position of the business which is being investigated before the details are gone into.
 - ii. This is because figures are only symbols; and it is impossible to interpret them intelligently without knowledge of the background in which they have emerged.
 - iii. For studying the economic and financial position of the business, the following should be considered:
 - a. The adequacy or otherwise of fixed and working capital. Are these sufficient for the growth of the business?
 - b. What will be the trend of the sales and profits in the future? Establishing the trend of sales, product-wise and area-wise will ordinarily help in drawing a conclusion on whether the trend will be maintained in the future.
 - c. Whether the profit which the business could be expected to maintain in the future would yield an adequate return on the capital employed?
 - d. Whether the business is operating at its 100 percent capacity or improvements can be made to reach at full productivity?
- **Statement of Profit and Loss**
 - Turnover** –
 - The figures of sales should be broken down between the various products sold to show variations in turnover of individual products from year to year.

- In this way, it would be possible to find out the products the sales of which have been increasing and those the sales of which have been falling.
- By reference to the list of customers, in the Order Books, it should be ascertained whether the business has a very large turnover with a few customers or a small turnover with several customers.
- The Order Books should also be examined to find out if fictitious sales have been entered in any year to boost up profits. If so, the figures of sales of the year or years should be adjusted.
- If the business consists of activities which are dissimilar in operation, like manufacturing and agency, then apart from splitting the income between the two sources, expenses should also be apportioned between them to separately arrive at the figures of profit from each of the activities.

Wage structure -

- The method of computing wages and the rates of wages should be examined.
- On occasions a business may have to pay higher wages than those prevailing in other business in the same neighbourhood in pursuance of an industrial award.
- consider the relationship of the business with its workers/ labour unions.
- A business which has suffered several industrial disputes, strikes, etc. and has had its working interrupted by them frequently cannot be expected to prosper unless a proper settlement is reached with workers' unions.

Depreciation and Maintenance -

- The charge on account of depreciation and maintenance of machinery and other assets included in the accounts of different years should be compared to verify that depreciation has been provided from year to year on a consistent basis and that it is adequate.
- Also, the necessary adjustment in the depreciation charge should be made if it is the practice of the company to write off the assets on a renewal basis.
- If assets have been revalued, it should be confirmed that depreciation on the increased valuation has been adjusted. Generally, with age, the cost of maintenance of assets should increase. If it has not, the reason thereof should be ascertained.
- In case of leasehold property, it should be ascertained whether an adequate provision has been made for the dilapidation charge which may be payable at the end of the lease.

Managerial Remuneration

- It should be verified that the remuneration payable to various members of managerial personnel is not excessive in relation to the profits of the business after taking into account the time devoted by each of them.
- However, it could also be that no or only a nominal remuneration has been charged in the accounts.
- In either case, an adjustment should be made to arrive at true profitability of the concern.
- In case of company, requirement of relevant section of Companies Act, 2013 is to be seen. It has to be assured that calculation of profit for arriving at the remuneration is correct.

Exceptional and non-recurring items -

- It is customary to adjust exceptional items in the summary of Statement of Profit and Loss in order that they may not obscure the trend of the profits.
- In the matter of non-recurring items, it is necessary to remember that adjustments are to be made in respect of exceptional items which do not recur from year to year or can be considered exceptional having regard to their materiality or periodicity.
- It is worthwhile to examine the income tax assessment orders of the business to find out the items which have been treated as revenue but have been considered inadmissible by the taxing authority.
- Where the effect of these has been abnormal on the tax paid by the company from year to year, suitable adjustments should be made in the figures of taxes paid, as well as in the assets amounts.
- Adjustments should be made in respect of exceptional profits and losses like, profit or loss on sale of obsolete asset.

Repairs and maintenance –

- Generally, companies, as a matter of routine undertake major repairs, overhauls and maintenance programme at an interval of 3 or 4 years while running repairs and maintenance continue in the usual manner which gives rise to fluctuating charges in the accounts unless periodic major expenses are treated as deferred expenditure.
- Due to wrong allocation of expenses between capital and revenue, repair charges may appear to be heavy or low. If fluctuating and abnormal charges for repairs is noticed, it would be the duty of the investigating accountant to scrutinise this head thoroughly to establish correct and normal charge for repairs.

Unusual year –

- A company's record of profitability may show a trend of increasing or decreasing profit or loss or it may be highly erratic and fluctuating.
- Where a definite trend is discernible, the job of the investigating accountant is somewhat simplified.
- He can adopt recent years' record of profitability as the basis for estimating future maintainable profit having regard to the inflationary state in the economy. But if the same is fluctuating, there would be more demand on judgement of the accountant in selecting the period to be covered for estimation of profitability.
- In such cases it may even be necessary to take into consideration results of past 9 to 10 years with a view to iron out the fluctuation.
- If, however, it is noticed that results of one or more years under scrutiny were materially vitiated by exceptional factors like a long-term industrial dispute, natural calamities, pandemic, fire, war, ravage etc., the investigating accountant should eliminate such year / years from consideration altogether since they do not reflect the results obtained through normal business.

• **Balance Sheet**

Fixed Assets –

- Fixed assets, usually, are shown in accounts at cost less depreciation but the accounts do not show the ages of different assets.
- It is desirable, therefore, to obtain age analysis of various items of fixed assets. Assets which are old or are obsolete would naturally have to be replaced. It should be seen that their values

are not in excess of the value of service that they could be expected to render to the business during the balance period of their active life and the amount they would fetch on sale as scrap.

- Title deeds should be verified to ascertain the extent of enterprise's ownership in such assets, like land and building jointly owned by two or more companies or their subsidiaries.
- it should be seen that if assets have been revalued, the increased depreciation charge has been adjusted against profit.
- Further, investigator has to assure whether assets whose recoverable amount is less than carrying amount are impaired and requirement of AS 28, "Impairment of Asset", has been complied.

Investments -

- Investments should be broadly classified into long term investments and current investments.
- Current investment is by its nature readily realisable and is intended to be held for not more than one year.
- All other investments are long term investments.
- Current investments are valued on the basis of lower of cost and fair value determined either on an individual investment basis or by category of investment but not on an overall basis.
- Long-term investments are usually carried at cost.
- However, when there is a permanent decline in the value of long-term investments, the carrying amount should be reduced to recognise the decline.
- The carrying amount of long-term investments is determined on an individual investment basis.
- Interest, dividends and rentals receivable in connection with investment are generally regarded as income. However, in some cases, such receipts represent recovery of cost and should therefore be reduced from, the cost of investment (e.g. dividend out of pre-acquisition profits).

Inventories -

- It should be seen that inventories have been valued consistently and that the basis of valuation was such that the value placed on inventories did not include any element of profit.
- Also, there should be due allowance for damaged, obsolete and slow-moving inventories. In some cases, physical verification of inventories is necessary where the inventories belonging to the entity are held by other parties.
- Examine the appropriateness of valuation of work in progress as disclosed in the books.

Trade Receivables -

In assessing their value, the following should be taken into account:

(i)	Whether provision for bad debts have been made in the years in which the relevant sales took place instead of in the year in which they have been written off, except when debts have had to be written off on account of a slump or a fall in international prices, during a period subsequent to the period in which sales had taken place.
(ii)	The length of the credit period allowed or any excessive discounts allowed throughout the period under investigation, to determine whether it has been necessary to increase continually the credit period in order to affect the sales. If it has been so, it would indicate that the demand for the goods manufactured by the concern in the market has been diminishing gradually.
(iii)	Debts should be classified according to their age. This would disclose the character of the parties with whom the company trades and the amount of working capital that will

	be necessarily blocked on this account in the course of business. Determine Debtors to Sales Ratio.
--	---

Other liquid assets –

- It should be ascertained that the assets so described are readily realisable.
- Money with a bank in liquidation should be taken only to the extent guaranteed by Deposit Insurance Scheme.

Idle assets –

- On a scrutiny, it may appear that certain assets are remaining idle and are not being properly applied in the business.
- These may come from all sections of assets.
- For example, certain plant and machinery may have been put to use after a considerable period of time after acquisition. Some of the fixed assets may be awaiting installation even at the valuation time.
- The company may hold large cash and bank balances, not warranted by the need of the business. Then again, there may be instances of obsolete and slow-moving inventories of large value in the accounts of the company.
- It would be the duty of the investigating accountant to eliminate these idle assets, if any, after proper identification from the net worth of the business.
- However, proper value of these assets may be separately added to the value of the business.

Liabilities –

- whether those are stated fully or understated or overstated
- whether the profits of the business have been inflated by suppression of liabilities or there are any free reserves included in the liabilities.
- In either case, an adjustment would be necessary. Secondly, it should be ascertained that liabilities are not unduly large or are not outstanding for a long time, in such cases, it would be necessary to pay off some of them which would cause a drain on the liquid resources of the concern. The fact should be stated in the report.

Taxation –

- Orders in respect of assessments completed should be studied and it should be verified that an adequate provision has been made in respect of liabilities for taxes which have not been assessed.
- It should be seen that in the past there has been no reopening of assessments. If so, the company may be liable for an undisclosed sum of taxes plus penalties.
- Any temporary tax benefit should also be disregarded.

Capital - In this regard, it is necessary to ascertain:

(i)	Whether the capital is well balanced. This would not be the case if the number of debentures and preference share capital are disproportionately large as compared to the equity capital. Low equity capital would handicap the company in raising further equity capital, on favourable terms for financing the business or to pay off capital commitment. Further, when the capital is highly geared, it would affect the value of the equity capital;
(ii)	That the amount of capital is reasonable compared to the value of fixed assets and the amount of working capital required. The terms associated with the issue of the capital should also be studied; restriction on transferability of shares usually depresses the value of share and of the business.

(d)	Interpretation of figures - Fixed Assets - The amount of capital expenditure which would be necessary in the future for the continuation of the business, in its existing stage, should be assessed having regard to the under-mentioned factors:
(i)	the amount required for the replacement of assets when these would become worn out or obsolete;

Turnover - In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:

(i)	Trend: Whether in the past sales have been increasing consistently or they have been fluctuating. A proper study of this phenomenon should be made.
(ii)	Marketability: Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.
(iii)	Political and economic considerations: Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?
(iv)	Competition: What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

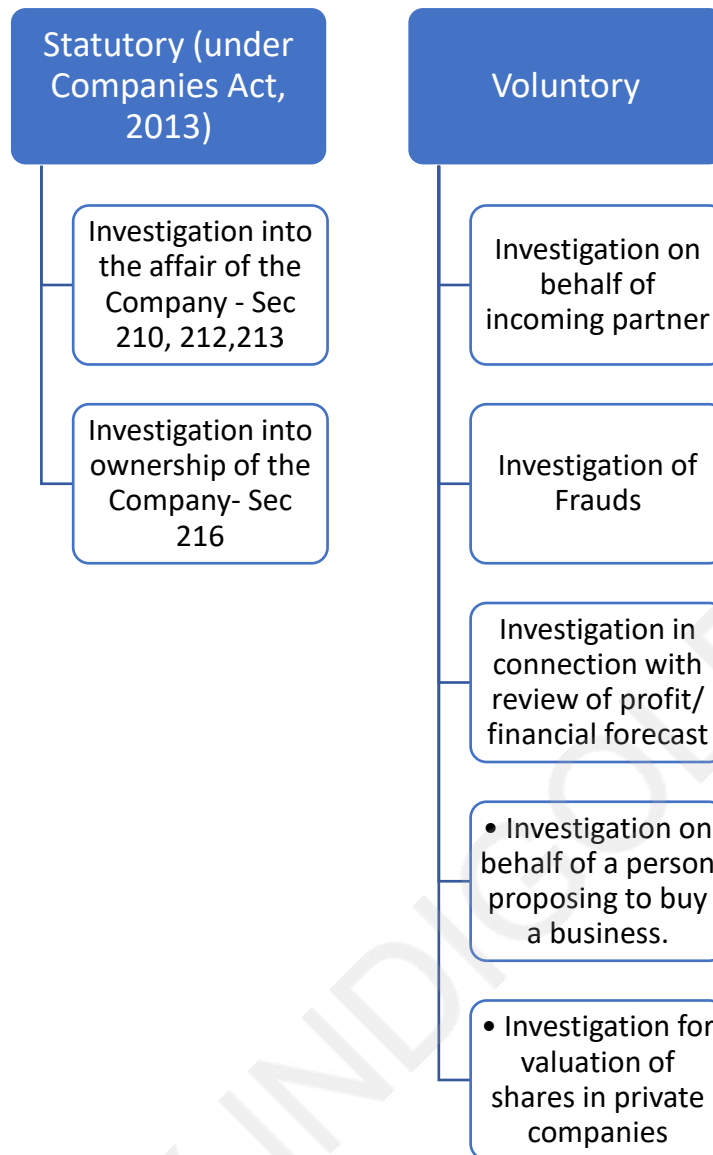
Working Capital - In making assessment of the working capital requirements in the future, the following matters should be taken into account:

(i)	Has the ratio of inventory to turnover been increasing and if so, is it a continuing or only a temporary trend?
(ii)	Are the trade payables being paid promptly or is there a backlog which will have to be dealt with?
(iii)	What will be the effect on inventory, trade receivables and trade payables, if the turnover is increased or if new products are introduced?

Estimating Future Maintainable Profits -

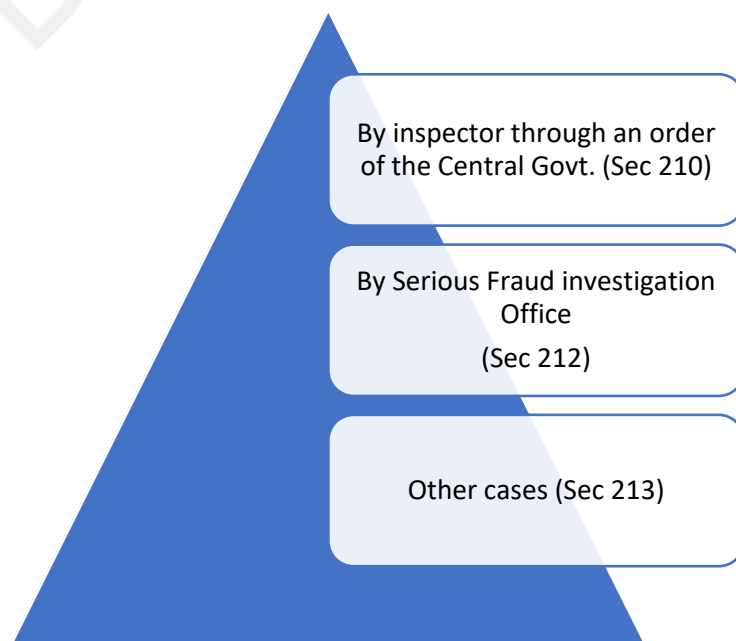
- Fluctuations in profits during the years under review should be examined after adjusting the profits for extraneous factors, if any, that had given rise to fluctuations to determine whether the factors responsible for the fluctuations were temporary or was likely to recur in future.
- A statement should be prepared showing separately the profits after depreciation earned in each of the years during the period under review, after making adjustments therein, if considered necessary, as regards factors which have been responsible for any extraordinary increase in profits.
- If the percentage of profits before taxation to capital has been stable or has been increasing, it would indicate that the business would continue to earn the same rate of profit as it has done in the past.
- If, on the other hand, the percentage has been falling, and there is no evidence that the factors responsible therefore have ceased to operate, investment of further capital in the business would not be commercially advisable.

Types of investigation



Investigation under Companies Act 2013

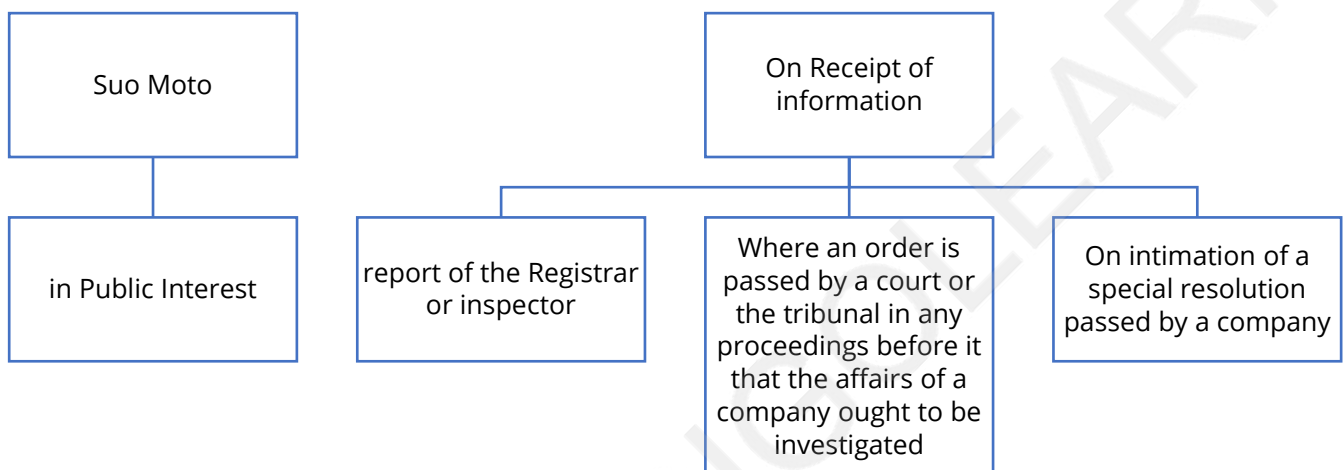
Investigation into the Affairs of the company- Sec: 210, 212 & 213 of Companies Act, 2013



Investigation into the affairs of a company as envisaged under Sec 210:

Situation under which it can order Investigation

- a) On the receipt of a report of the Registrar or inspector u/s 208 of companies Act 2013:
- b) On intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
- c) In public interest,
- d) Where an order is passed by a court or the tribunal in any proceedings before it that the affairs of a company ought to be investigated.



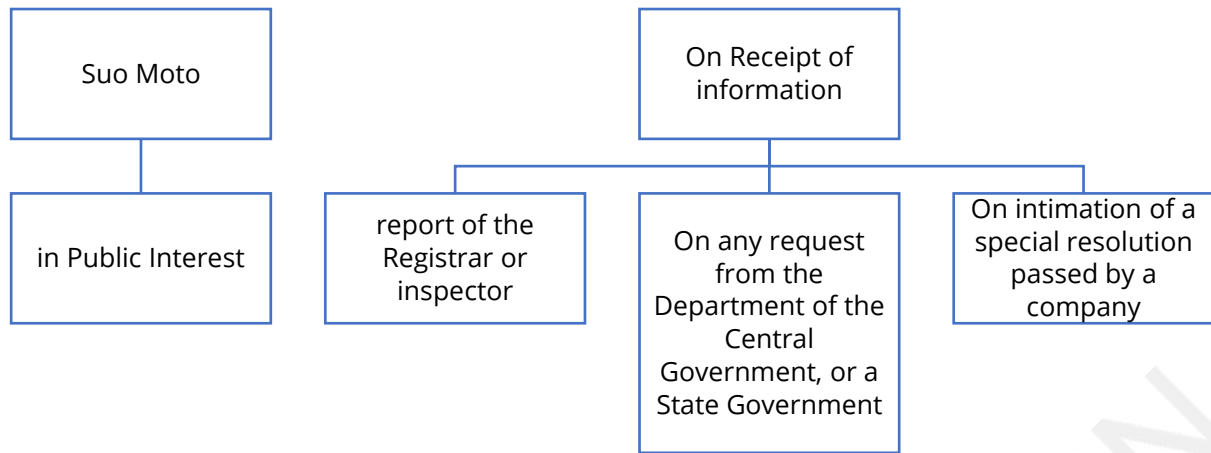
Investigation by SFIO- SEC 212

C.G. may, by an order, assign the Investigation, into the affairs of the company, to the serious fraud Investigation office (SFIO) in the following cases

1. On receipt of a report of the Registrar or inspector u/s 208; or
2. On intimation of a special resolution passed by a company; or
3. In public interest.
4. Or any request from the Department of the Central Government, or a State Government

Note:

- Where any case has been assigned to SFIO, no other Investigating agency of C.G. or any S.G. shall proceed with Investigation in such case.
- The SFIO shall follow the manner and procedure as provided and submit its report to the C.G.
- The Central Government may also direct to submit an interim report.



Investigation in other cases- sec.213

The Tribunal may,

a) On an application made by-

1. Not less than 100 members or members holding not less than 10% of the total voting power, ***in the case of a company having a share capital***; or
2. Not less than 1/5th of the persons on the company's register of members, in the case of a company having no share capital,

And

supported by necessary evidence;

OR

b) On an application made to it by any other person, if it is satisfied that there are circumstances suggesting that:

1. the business of the company is being conducted with intend to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose, or that the company was formed for any fraudulent or unlawful purpose;
2. persons concerned in the formation of a company or the management of its affairs have been guilty of fraud, misfeasance or other misconduct; or
3. the members of the company have not been given all the information w.r.t. its affairs which they might reasonably expect,

order, after giving a reasonable opportunity of being heard to the parties concerned, that the affairs of the company ought to be investigated by an inspector or inspectors appointed by the CG and where such an order is passed, the Central Government shall appoint one or more competent persons as inspectors to investigate into the affairs of a company in respect of such matters and to report thereupon to it in such manner as the Central Government may direct.

Investigation of ownership of the company – sec 216 of Companies Act, 2013

1. Where it appears to the C.G. that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons:

- a) who are or have been financially interested in the success or failure, of the company; or
 - b) who are or have been able to control or to materially influence the policy of the company, or
 - c) Who have or had beneficial interest in shares of a company or who are or have been beneficial owners or significant beneficial owners of a company.
2. While appointing an inspectors, the C.G. may define the scope of the investigation, whether as respects the matters or the period to which it is to extend or otherwise, and in particular, any limit the investigation to matters connected with particular shares or debentures.
3. Subject to terms of appointment of any inspector, his powers shall extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which, though not legally binding, is or was observed or is likely to be observed in practice and which is relevant for the purpose of his investigation.

Scope and Extent of Investigation Under Companies Act, 2013- for Sec 216

- When a CA is appointed to carry out an investigation under section 210, 213 or 216 of Companies Act, 2013, the scope and extent of enquiry, the objective of the investigation and other matters asked for investigation are specified in the order of investigation issued by the appointing authority.
- On the basis of terms of investigation, the investigating accountant should determine the areas of accounts to be investigated and the extent to which enquiry is to be made.
- In case of company having subsidiaries or where one or more directors are interested in one or more entities, all the dealings with these entities should be examined.
- Any breach of duty for purpose of investigation would be material only if it has resulted in a loss to the company. In such a case, the factors responsible for the losses, besides the amount thereof, shall have to be investigated.
- Negligence would be culpable only if it was in relation to duty cast by the act, Articles of Association or by a resolution of the shareholders or that of the Board of Directors.
- Any negligence in the discharge of duty of a director or any other managerial personnel must be construed very broadly. As such, it is their duty to safeguard the property of company and protect the interest of shareholders.
- An investigator may interrogate directors, officers, agents, and others concerned with matters under his enquiry, if appears necessary.
- If the investigating accountant is required to report on the efficiency of the management, he should be discreet in expressing his opinion.
- The inspector must ensure that the persons who figure in the investigation get the fullest opportunity to explain their action and conduct.

Procedures, power & Report of inspectors – Section 217, 219 & 223 of Companies Act 2013

Production of documents & evidence. Sec 217

- Officers, employees and agents of a company which is under investigation should:
 - Preserve & produce all books & papers necessary, and
 - Provide necessary assistance which they are reasonably able to give.
- With the previous approval of CG, the inspector may require any other body corporate to furnish such information, books etc. as he may deem necessary.
- Books could be detained only for a period of 180 days. Thereafter, they should be returned. Whenever required, books could be called back.

Examine on Oath Sec 217

Inspector may examine officers, employees and agents of company under investigation or related companies on oath.

However, to examine any other person, he requires prior approval of Central Government

Powers of Civil Court. Sec 217

The inspector, being an officer of the Central Government, making an investigation shall have all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit in respect of the following matters, namely: -

- a. The discovery and the production of books of account and other document, at such place and time as may be specified by such person;
- b. Summoning and enforcing the attendance of persons and examining them on oath; and
- c. Inspection of any books, registers and other documents of the company at any place.

Note: For any non-compliance of the order of Inspector, the director or the officer will be punishable with imprisonment and with fine.

Power of inspector to carry investigation into affairs of related companies & persons - Sec. 219

If an inspector appointed under section 210 or 212 or section 213 to investigate into the affairs of a company considers it necessary for the purposes of the investigation, to investigate also the affairs of-

- Any other body corporate which is, or has at any relevant time been the company's subsidiary company or holding company, or a subsidiary company of its holding company.
- Any other body corporate which is, or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time, the managing director or the manager of the company;
- Any other body corporate whose board of Directors comprises nominees of the company or is accustomed to act in accordance with the directors or instructions of the company or any of its directors; or
- Any person who is or has at any relevant time been the company's managing director or manager or employee,

He shall, subject to the prior approval of the central government, investigate into and report on the affairs of the other body corporate or of the managing director or manager, in so far as he considers that the results of his investigation are relevant to the investigation of the affairs of the company for which he is appointed.

Inspector's Report- sec. 223

- a) An inspector appointed by C.G. may, and if so directed by the C.G. shall, submit interim reports to that government, and on the conclusion of the investigation, shall submit a final report to the Central Government.
- b) Every report shall be in writing or printed as the Central Government may direct.
- c) A copy of the report made may be obtained by members, creditors or any other person whose interest is likely to be affected by making an application in this regard to the C.G.
- d) The report of any inspector appointed under this chapter shall be authenticated either;

- i. by the seal of the company whose affairs have been investigated; or
 - ii. by a certificate of a public officer having the custody of the report; as provided under section 76 of the Indian Evidence Act, 1872,
- and such report shall be admissible in any legal proceeding as evidence in relation to any matter contained in the report.

General Approach for investigation

The general approach for investigation u/ss 210 and 213 of companies Act, 2013 is conditioned by the legal requirements in these regards. Investigation under sections 210 and 213 do not call for any special approach. The general approach for investigations should, therefore, be formulated having regard to the terms to reference, scope, period, programme and procedure of the investigation and the attending legal requirements as explained below:

Clarity of terms of reference

- The inspector should ensure that the terms of reference are clear, unambiguous and in writing.
- If he has any doubt about any terms, he should obtain clarification in writing.
- He should also take into consideration the possible effect of limitations, if any, put in terms of reference and should keep the C.G. informed in writing about their effect on the investigation.

Scope of investigation

- Inspector should determine scope of the investigation on the basis of the terms of reference. At this stage, it may be useful for the inspector to go into the history of the company and its affiliated or associates.
- He should evaluate the terms of reference in sketching the scope of investigation; this will enable him to locate the limitations, if any, in terms of reference, not clearly mentioned.

Period of investigation

Inspector should also have regard to the period over which the investigation should stretch. The evaluation of terms of reference and the consequential determination of the scope of investigation are the twin props on which the entire investigation would rest.

Framing of Programme

- The next step is the investigator/inspector should frame his programme for investigation in a systematic manner.
- He should keep adequate working notes and papers with references and cross references in a proper and methodical way to aid him in the preparation of the report.
- The actual process of investigation would be essentially an evidence gathering procedure and, at every step, he should have regard to the procedures laid down in these sections regarding production of documents and evidence, examination on oath and seizure of documents.
- He should also keep his mind open to revelations he comes across in the process of evidence collection and should assess whether the programme of investigation needs amendment or modification.

Using the work of Experts

He should also consider whether assistance of other experts like engineers, lawyers, etc., is necessary in the interest of a comprehensive and full proof examination of the documents and information.

Legal requirements & investigation Report

- After completion of steps in the investigation programme and collection of all the information that he needed, report should be prepared. However, an interim report may be made if required.
- The findings should be completed and exhaustive. Before he makes his final report should obtain keep on record the evidences relied upon by him. By the nature of things, such evidence should be as conclusive as possible depending on circumstances of the case. He should make his report in accordance with the provision of the companies Act, 2013.

Voluntary Investigation

Investigation on behalf of incoming Partner

Purpose

- To know whether the terms offered to him are reasonable having regard to the nature of the business, profits records, capital distribution, personal capability of existing partners, etc.
- To ascertain whether the capital to be contributed by him would be safe and applied usefully.

Areas to be covered

a) Ascertaining the history of the firm since inception and growth of the firm.
b) Studies of the provisions of the Deed of partnership, particularly for composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, etc.
c) Scrutiny of the record of profitability of the firm's business over a suitable number of years
d) Examination of the asset and liability position to determine the tangible asset, investment, appraisal of the value of intangibles like goodwill, know-how, patents, etc including contingent liabilities and those for pending tax assessment.
e) Assess position of order at hand and the range and quality of clientele should be thoroughly examined under which the firm is presently operating.
f) Scrutinize terms of loan finance to assess its usefulness and the implication for the overall financial position.
g) Study important contractual and legal obligations. It may be the case that the firm has standing agreement with the employees as regards salary and wages, bonus, gratuity and other incidental benefits.
h) Study the composition and quality of key personnel employed by the firms and any likelihood of their leaving the organization.
i) Ascertain reasons for the offer of admission to a new partner and it should be determined whether the same synchronizes with the retirement of any senior partner whose association may have had considerable impact having on the firm's successes.
j) Appraisal of the record of capital employed and the rate of returns. It is necessary to have a comparison with alternative business avenues for investments.
k) Ascertain manner of computation of goodwill on admission as also on retirement, if any.
l) Examine whether any special clause exist in the deed of Partnership to allow admission in future a new partner.

On the basis of the broad frame of considerations as given above, the investigating accountant should devise his own considerations in each case which may be quite diverse. Additional considerations may come up in the case of service-rendering firms where profit and business record, goodwill of the firm and of individual partners would assume greater significance.

Again, in the case of industrial firms, the network of customers, their scatter, size, etc., would be relevant for consideration.

Investigation for Valuation of Shares in Private Companies

The necessity for valuation of shares of a private company arises, for under the Companies Act, a private company must restrict the transfer of its shares. In consequence, the shares of a private company do not have a free market in which their prices could be determined by interaction of the forces of supply and demand.

There are two main methods for valuation:

- Net worth basis and
- Yield basis

Net worth basis

(a) Each asset should be revalued on taking into account its utility to the business as a going concern. The value of different assets, on a revaluation, may be either more or less in comparison to their book values.

Example: The book value of safes and furniture in the case of a bank is usually much less as compared to their utility. On the other hand, the book value of intangible assets, e.g., leasehold rights, patents, goodwill, etc., in case of an industrial concern may be higher in comparison with the advantage which accrues to it from these assets. In both the cases, the assets should be revalued at their replacement cost i.e., the cost of similar assets at the prevailing market price, reduced by the amount of depreciation which they would have suffered, if they were in use during the period that the corresponding assets have been in use. But the cost adopted, in cash, should be the cost of the assets as were originally purchased or that of their substitutes considered more suitable in the circumstances of the case.

(b) The value of goodwill of a business is primarily dependent on its capacity to earn super-profit and the period over which these are expected to arise. The super profits that the business would earn in the future are estimated on the basis of profits earned in the past, after making an allowance therein for the continuation or otherwise of favourable factors, which in the past had enabled the business to earn super-profits.

This is usually a difficult matter since, for the purpose, it is necessary to analyse the trend of economic, social and political forces which have an impact on the profitability of the business.

Example: The installed capacity must be viewed against future national requirements on taking into account the government's licensing policy. Again, government policies like controls over selling price or advantages of marketing through its own organisations will have to be considered since any change therein might seriously affect the profit structure. Therefore, to determine the impact of these factors, the accountant must have knowledge of the company's working and experience of the business in general.

Yield Basis

- (a) The value of shares on yield basis is arrived at on the basis of present value of the right to receive dividends in the future.
- (b) Since dividends can be paid only out of profits, in this case also, it is necessary to determine the amounts of profits which the company would be earning in future as well as the amounts thereof which would be distributed as dividend from year to year.
- (c) The rate at which the amount of dividends should be capitalised is decided on taking into account the

1. risk that shareholders are taking in the matter of declaration of dividends being continued in future,
 2. assessed in the background of past history of the company,
 3. the amount of reserves the company possesses, both secret and those disclosed in its books,
 4. future prospects of the line of manufacture or trade in which the company is engaged and
 5. the impact of various social and political factors that are likely to emerge on the company's profitability.
- (d) Since the effect of these factors is reflected in the prices at which the shares of companies engaged in similar trades and businesses are quoted on the Stock Exchange, the investigating accountant should consider them.
- (e) This would help him to know the rate at which their dividends were being capitalised.
- (f) He should adopt the average rate of return expected by investors in the shares of such companies but it should be applied only after making due allowance for the factors peculiar to the case, such as restrictions on transfer of shares, majority holding, etc.
- (g) In any valuation of shares, with the transfer of shares control is also to pass, a separate value should be ascertained for the control and added to the value otherwise obtained either on net worth basis or yield basis.

Investigation on behalf of Bank for Advances

Purpose

- Reasons for obtaining the loan
- Determination of sources of repayment
- Availability of security, if borrowed fails to repay.

Collection of information

Investigator is required to collect the information w.r.t.

- Purpose for which the loan is required.
- Manner in which the borrower proposed to invest the amount of the loan.
- Schedule of repayment of loan submitted by the borrower, particularly, the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case.
- Financial standing and reputation for business integrity enjoyed by the directors and officers of the company.
- Authorisation under memorandum or the articles of Association to borrow money for the purpose for which the loan will be used.
- History of growth and development of the company and its performance during the past five years.
- How the economic position of the company would be affected by economic, political and social changes that are likely to take place during the period of loan.

- Whether any loan application to any other Bank or Financial Institution was made, and if so, the reasons for rejection thereof.

Examination of Financial Statements.

- (i) Preparation of a condensed income statement
 - From P & L Account for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years.
 - Purpose is to ascertain strengths of profitability.
- (ii) Computation of Relevant Ratios
 - Sales to Average Stocks held.
 - Sales to Fixed Assets.
 - Equity to fixed Assets.
 - Current Assets to Current liabilities.
 - Quick Assets to Quick liabilities.
 - Equity to long Term Loans.
 - Sales to book Debts.
 - Return on Capital Employed.
- (iii) Break- up annual sales
 - Product – wise to show their trend

Schedule of assets and liabilities

- (i) Assets
 - To ensure their existence, ownership and proper valuation.
 - To examine whether assets have been adequately insured.
- (ii) Liabilities
 - To determine present and future obligations.
 - To ensure completeness of recording.

Steps involved in the verification assets and liabilities included to Balance sheet

Fixed assets

- The investigating accountant should prepare schedules of full description of each term, its gross value the rate at which depreciation has been charged and the total depreciation written off.
- In case the rate which depreciation has been adjusted is inadequate, the fact should be stated.
- In case any asset is encumbered, the amount of the charge and its nature should be disclosed.
- In case the asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation.

Inventory

- The investigating accountant should prepare schedules of the value of different types of inventories held (raw materials, work in progress and finished goods) and the basis on which these have been valued.
- Details as regards the nature and composition of finished goods should be disclosed.
- Slow-moving or obsolete items should be separately stated along with the amounts of allowances, if any made in their valuation. For assessing redundancy. The changes that have occurred in important items of inventory subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered.
- If any inventory has been pledged as a security for a loan the amount of loan should be disclosed.

Trade Receivables, including bills receivable

Composition of trade receivable should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts are considered bad or doubtful and the provision if any, that has been made against them.

Further, the total amount outstanding at the close of the period should be segregated as follows:

(i) debts due in respect of which the period of credit has not expired;
(ii) debts due within six months; and
(iii) debts due but not recovered for over six months.

If any debts are due from

- directors or other officers or employees of the company,
- the particulars thereof should be stated.
- Amounts due from subsidiary and affiliated concerns, as well as those considered abnormal should be disclosed.
- The recoveries out of various debts subsequent to the date of the Balance sheet should be stated.

Investments

Investigating accountant should prepare schedule of investments which disclose the date of purchase, cost and the nominal and market value of each investment. If any investment pledged as security for a loan, full particulars of the loan should be given.

Secured Loans and unsecured loans

- Investigating accountant is required to included debentures and other loans together in a separate schedule.
- Against the debentures and each secured loan, the amounts outstanding for any payment along with debentures of payment should be shown.
- In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for re-payment of a liability should be disclosed.
- In case any unsecured loan is to be repaid prior to repayment of Bank loan, its terms and conditions should be verified.

Provision of Taxation

- Investigation accountant should ascertain the period up to which taxes have been assessed.
- If provision for taxes not assessed appears in be inadequate, the fact should be stated along with the extent of the shortfall.

Other liabilities

- It should be stated whether all the liabilities, actual and contingent, are correctly disclosed.
- Also, an analysis according to ages of trade payables should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements

Insurance

- Investigating accountant should prepare schedule of insurance policies giving details of risks covered, the date of payment of last premiums and the sum assured.
- He should also make a report as to whether or not the insurance- cover appears to be adequate, having regard to the value of assets.

Contingent Liabilities

- Investigation accountant should ascertain particulars of any contingent liabilities which have not been disclosed.
- For this purpose, he may conduct direct enquires from the borrower company and members of its staff.
- The investigating accountant should ascertain particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report.

Investigation of Frauds

Types of Frauds –

- **Fraudulent financial reporting and**
- **Misappropriation of Assets**
- **Corruption**

Fraudulent Financial Reporting

- Alteration or falsification of records & documents
- Misrepresentation in or intentional omission of events, transactions or information
- Intentional misapplication of accounting principles
- Fictitious Journal Entries
- Adjusting assumptions and changing judgments
- Omitting, advancing or delaying the recognition of events or transactions.
- Abnormal Year End Transactions.
- Improper Asset Valuation
- Overstatement of Revenue or Understatement of Liabilities

Misappropriation of Assets

Embezzlement of receipts in respect of written-off accounts – Skimming or Cash

Larceny

- Stealing physical assets or intellectual properties
- Introduction of fictitious vendors
- Payroll Schemes – Ghost Employees, Falsified Wages, & Commission Schemes
- Reimbursement Schemes – Mischaracterised Expenses, Multiple Reimbursement, & Fictitious Expenses
- Using entities assets for personal use

Corruption

- Conflict Interest
- Bribery
- Illegal Gratuities
- Money Laundering

Fraudulent Entries –

- Late entry
- No entry
- Part entry
- Inserting wrong entries to divert attention

Sales Fraud

- Price enhancement
- Omission to make receipt of sale of scrap.
- Billing and sales reversals in amusement parks.
- Food production yield ratio in hotels and suppression of Revenue.
- Using or hiring assets of the company in lean period
- Omission in preparation of dispatch note for sale
- Sale of Assets recorded as Income
- Cash sale adjusted as credit sale.
- Writing off a good debt as bad & irrecoverable

Collection Fraud

- Defalcation of contributions to charity funds
- Crediting donation to loan accounts.
- Rental collected in cash but not recorded.

Expenses Frauds

- Overcharging expenses
- Falsification of documents
- Untimely payment
- Introduction of fictitious vendor.
- Unnecessary/ huge provisioning of expenses

Payroll Frauds

- Extra number of employees
- Extra hours
- Calculation of net pay by transferring rounding off amount to personal account.
- Not deactivating the retired employees' IDs
- Fictitious employees/ workers paid salary.

Data Frauds

- Change in computer data
- Destroy, suppress or insert records
- Using open fields in computerized accounting system

Technology related Frauds

- Employing hostile Software Programs or malware attacks
- Phishing mails

- Vishing – Voice Mail
- Smishing - Text messages
- Whaling – Targeted phishing on high network individuals
- Card duplications
- Stealing confidential data

Banking related Frauds

- Forged Signatures
- Cheque Frauds - Alteration in amounts, Alteration in accounts titles, Kite flying
- Cash lending during working hours
- Missing notes in bundles
- Use of same notes bundles by two branches
- Wrong posting in other accounts
- Misuse of sensitive stationery
- ATM transaction misuse
- Using PINs of debit card/credit card holder
- Advances - inflated stock statements, inflated projections, forged/duplicate land documents, L/CS

Others –

- Teaming and Lading
- Process houses mixing inferior quality material to sale good quality material
- Pilferage and theft in super markets
- Selling classified information,
- Withholding information from customer about free product schemes, discount and concession.
- Enhancement of performance
- Taking advantage of disaster or natural calamity.
- Trust FDs
- Fictitious journal entries to inflate expenses or income.

I. Fraud for personal Gain

Bribery

- These are related to contract fraud or procurement fraud and are, generally, out of books transactions.
- For identifying such frauds, auditor normally conducts a property audit over the veracity of the transactions.

II. Corporate Frauds/Irregularities

a. Advance Billing

- A situation where fictitious sales are booked in anticipation of actual sales, resulting in misrepresentation of revenue so as to mislead financiers and stakeholders.

b. Shell/Dummy Company Schemes

- Fictitious companies are being formed to transfer profits or funds from the main company.
- This could also involve fictitious bills which are used in the name of dummy companies diverting the funds taken from banks and financial institutions.

c. Money Laundering Activities

- Companies with extensive cash handling and inadequate identification process or source of money or about the remitter are susceptible to money laundering activities.

III. Fraud at operational Level Employees

(a). Tampering of Cheques/Drafts/On-line payments/receipts

- Tampering of cheques, payee name being altered, or preparation of cheques without issue of the cheques to payee etc., are methods that may also lead to falsification of accounts.
- On-line payments generally are considered a transparent mechanism to prevent the above frauds.

(b) Off Book Frauds

- Misappropriation of the cash before these are recorded in the books or before the sale is recorded in the books.
- These frauds are difficult to unearth as the cash or collection is taken off before the accounting entries are made in the books.

(c) Cash Misappropriation

- Cash is Misappropriation after the accounting entries are already passed in the books.
- These occur when there are delays in accounting of cash collections and there are no laid down cash flow control.

(d) Teeming and lading

- This is achieved through cash deposits or cheques collected from customers being overlapped with the collections from subsequent customers and the amount collected is diverted to personal account.

(e) Fraudulent Disbursements

- It is take place either by issuing or submission of false bills, or personal expense bills being converted into official expense bills.

(f) Expense Reimbursement Schemes

These schemes involve employees resorting to treating their personal expenses as incurred for business purpose and claiming reimbursement.

(g) Payroll Fraud

It involves payment to non-existent employees or showing higher pay than actual disbursement to employees/ workers, etc.

(h) Commission Schemes

Exaggerating the sales through fictitious billings to earn higher commission or alter the sales prices of the product sold from those stipulated by the company or share the sale volumes achieved with other employees to share higher commission.

(B) Procedure for Investigation of frauds

- Before proceeding of investigate any type of fraud, the investigating accountant should ascertain the exact duties of the person concerned who is suspected to have committed a fraud; his relationship to the general routine of the office, and the circumstances in which any known instances of defalcation have comes to light. Such an enquiry would give a clue to promising avenues of investigation.
- Greater the authority of the individual suspected of a fraud, wider would be the field which would have to be covered by the investigation.
- At times, an accountant is called upon to investigate a suspected fraud, the details or the nature whereof is not known. In such case, for localizing the source of the fraud, the investigating accountant will have to study the financial and accounting structure of the organization.
- As a first step, he should examine the line of responsibility between the various members of the staff. He should have a look at the system of internal control in operation for spotting out the weakness, if any, that may exist in it.
- Relying on the above study, he should direct his enquiry towards those aspects of the business where there has been excessive control in hands of single persons/ employee, without any supervision by any other person/ employee or, any other inherent weakness that may be in existence in the system.

Ways of committing Fraud

Cash receipts

- Issuing a receipt for full amount collected, entering lesser amount on the counterfoil.
- Showing a larger cash discount than actually allowed.
- Adjusting a fictitious credit in the account of customer for goods returned.
- Writing off a good debt as bad & irrecoverable to cover up misappropriation of amount collected.
- Short- debiting customer's ledger account and withdrawing the difference on collection of full amount.
- Under- casting the receipts side of cash book.
- Over- casting the payment side of the cash book.
- Cash Payment
- Making a double payment of an invoice or paying a false invoice.
- Paying personal expenses out of the business by falsifying details.
- Withdrawing unclaimed credit balances of customers.
- Falsely adjusting a refund in the account of a customer and withdrawing the credit balance.
- Wrong totalling of the wage sheets and misappropriating the excess amount withdrawn from the bank for payment of wages.

(a)Verification of Cash Receipts

- i. On the assumption that some of these may have been diverted before being entered in the books, evidence as regards income received from different sources should be scrutinised, e.g., inventory, sales summaries, rental registers, correspondence with customers, advices of travelling salesmen and counterfoils or receipts.
- ii. Carbon copies of receipts marked 'duplicate', should be scrutinised to confirm that they are in fact copies of receipts issued earlier. In addition, by recalling paying-in-slips from the bank the details of cash deposited on each day should be compared with those shown in the Cash Book.
- iii. The record of sales of scrap of waste paper, that of collection of rents from labourers temporarily accommodated in the company's quarters, that of refunds of amounts deposited with the electric supply co., or any other Government authorities should be examined for finding out if any of these amounts have been misappropriated.
- iv. Cash sales should be vouched in detail.
- v. Recoveries from customers and sundry parties should be checked with the copies of receipts issued to them; deductions made on account of cash discounts should be reviewed.
- vi. All withdrawals from the bank should be checked by reference to corresponding entries in the bank pass book.

(b) Inflating cash payment – Cash payment frauds may be in the form of:

- (i) Making double payment of an invoice or paying a false invoice.
- (ii) Paying personal expenses out of the business by falsifying details. e.g., showing betting losses as advertisement charges.
- (iii) Withdrawing unclaimed credit balances of customers or amounts falsely credited in the accounts of parties.
- (iv) Falsely adjusting a refund in the account of a customer and withdrawing the credit balance.
- (iv) Wrong totalling of the wage sheets and misappropriating the excess amount withdrawn from the bank for payment of wages.

(c) Verification of Cash Payments:

- i. All the evidence as regards cash payments made, including acknowledgement by parties for payments shown to have been made to them, should be carefully scrutinised.
- ii. In the case where a figure appears to have been erased or altered on the receipts issued by the party, on reference to the party concerned, the actual amount paid to him should be confirmed.
- iii. The same procedure should be adopted in respect of amounts acknowledged on blank papers.
- iv. All payments by bearer cheques should be examined. The system of recording of wages should be reviewed, especially as regards possible over-totalling of wage sheets, and entries in them of dummy workmen.
- v. The system of ordering and receiving goods should be reviewed so as to confirm that no payment has been made in respect of supplies which have not been received.
- vi. Confirmations should be obtained from partners or Directors in respect of amounts shown to have been paid to them.
- vii. The Petty Cash Book should be vouched and totaled. Special attention should be paid to payments made on account of salaries and wages; confirmation should be obtained from the

management that all payments of such salaries and wages were made to persons who were actually in the service of the company.

- viii. All the withdrawals from the bank should be checked by reference to entries in the bank's pass book.
- ix. All the bills receivable or payable should be checked by reference to the Bills Books.

Suppliers Ledger

- Adjusting fictitious or duplicate invoices as purchases in the accounts of suppliers and subsequently misappropriating the amount when payments are made to the suppliers in respect of these invoices.
- Suppressing the Credit Notes Issued by suppliers and withdrawing the corresponding amounts not claimed by them.
- Withdrawing the amounts unclaimed by suppliers, for one reason or another by showing that the same have been paid them.
- Accepting purchase invoices at prices considerably higher than their market prices and collecting the excess amount, paid in cash, from the suppliers.

Verification of Supplier Ledger

- The Purchase Journal should be vouched by reference to entries in the Goods Inward Book and the suppliers' invoices to confirm that amounts credited to the accounts of suppliers were in respect of goods, which were duly received and the suppliers' accounts had been credited correctly.
- All the suppliers should be requested to furnish statements of their accounts to see whether or not any balance is outstanding or due so as to confirm that allowances and rebates given by them have been correctly adjusted and were duly authorized by the authorized person/ officer.
- Examine the system of internal control in relation to purchase orders issued and identify possibilities of collusion with suppliers.

Customer's Ledger

- By the 'teeming and lading' method, i.e., misappropriating the amount collected from a customer and crediting his account by the amount paid by him only when an amount is subsequently collected from another customer; repeating this practice with several items collected and depositing back the amount or amounts so misappropriated before the close of the year.
- Misappropriating the amount collected from a customer and subsequently adjusting his account by crediting the amount on account of allowance or a rebate for excess price charged.
- Crediting the amount received from a customer to the account of another customer and subsequently withdrawing the amount wrongly credited.

Verification of balances in customers' ledger:

- i. Special attention should be paid to allowances adjusted on account of goods returned or difference in price or on any other account as well as to amounts written off as bad debts.
- ii. To confirm that the accounts of customers have been debited in respect of goods supplied to them, entries in the Order Book should be cross-checked with those in the Sales Day Book where the same is kept.

- iii. The investigating accountant should obtain confirmation of customers in respect of the amounts standing in their accounts.
- iv. Those of them who have no balance in their accounts should be requested to confirm the statement of their account (which should be sent to them) for ascertaining that the entries shown therein were genuine.

Inventory Frauds

Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.

- (i) Employees may simply remove goods from the premises.
- (ii) Theft of goods may be concealed by writing them off as damaged goods, etc.
- (iii) Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.
- (iv) Inflating the quantities issued for production is another way of defalcating raw materials and store items.
- (v) Stocks actually dispatched but not entered in sales/ debtor's account.

Verification Procedure for Defalcation of inventory –

- i. It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash.
- ii. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and dispatch of all goods, etc. should be reviewed to localise the weakness in the system.
- iii. The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of:
 - a. a system of inventory control, and existence of detailed record of the movement of inventory, or
 - b. availability of sufficient data from which such a record can be constructed.

Indicators of Fraud

Several Indicators of fraud

- i. Discrepancies in Accounting Records including non-recording or partial recording or incorrect recording or delayed recording of amounts, misclassifications, etc.
- ii. Conflicting or missing evidence including missing documents, altered documents, significant unexplained items in reconciliations, discrepancies between entity's records and confirmations received etc.
- iii. Unacceptable management responses such as – denial of access to records/facilities/employees, undue time pressure to resolve complex issues, unusual delays in providing requested information, denial for use of Computer Assisted Audit Techniques, unwillingness to address identified deficiencies in internal control etc.
- iv. Other indications such as – Accounting Policies in variance with Industry Norms, Frequent changes in accounting estimates etc.

Fraud Diamond

Considering the Four Elements of Fraud:

Many frauds, especially some of the multibillion-dollar ones, would not have occurred without the right person with the right capabilities in place. Opportunity opens the doorway to fraud, and incentive and rationalization can draw the person toward it. But the person must have the capability to recognize the open doorway as an opportunity and to take advantage of it by walking through, not just once, but time and time again. This gives rise to the fourth element of fraud.

Fraud Diamond i.e. four elements of fraud is a theory which was established by David T. Wolfe and Dana R. Hermanson.

Under this Wolfe and Hermanson classified the indicators of fraud into 4 categories

Incentive: I want to, or have a need to, commit fraud.
Opportunity: There is a weakness in the system that the right person could exploit. Fraud is possible.
Rationalization: I have convinced myself that this fraudulent behaviour is worth the risks.
Capability: I have the necessary traits and abilities to be the right person to pull it off. I have recognized this particular fraud opportunity and can turn it into reality.

Responses to Frauds

- SA 330 states the auditor's response to assessed risks. It requires auditor to assign and supervise personnel taking into account of knowledge, skill and ability of the individuals, evaluating of selection and application of accounting policies by the entity and incorporate of an element of unpredictability in the selection of the nature, timing and extent of audit procedure.
- Response to the risks related to management override of controls includes testing the appropriateness of journal entries and other adjustments made in preparation of the F.S., review of accounting estimates for biases and also review the significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.
- Auditor need to assessed fraud risk factors for material misstatement or misappropriation of assets due to fraud, such as incentive/ pressures, opportunities and attitudes/ rationalizations.
- The responses to fraud will include communications to management and with TCWG, communication to regulatory and enforcement authorities and appropriate documentation on his assessment of the RMM.
- Detection of fraud depends upon effectiveness of Audit Procedure. Detection risk, however, can only be reduced, not eliminated.

Investigation of behalf of an individual or firm proposing to buy a Business

Scope of investigation

Objective of such an investigation is to collect such information as would enable the purchaser to decide whether it is worthwhile to buy the business and if so, for what amount.

Matters to be considered

In case of proprietary concerns or partnership

1. Reasons for the sale of the business and the effect on turnover and profits that there would be on retirement of the present proprietor (or partners)
2. The length of lease under which the premises are held, the prospects of its renewal or extension.

3. The unexpired period of any patents owned by the vendors.
4. The age of the present managerial staff and the prospects of continuing in service under the new proprietorship and the possible liability, not already provided for that would arise as regards payment of pensions or gratuities in case of old and aged employees/ retrenched employees.
5. If the bulk sales are made to the customers whose number is small, the profitability of the business would be greatly shaken on withdrawing their support. This would be an element of weakness which should be investigated as it might affect future profitability.
6. The valuation that could be placed on goodwill to determine whether the appearing in the book is less or more; if none is included to determine the amount that should be included, if at all.

If the business belongs to a limited company

The vendor's interest in this case will be purchased by the acquisition shares. On that account, the following additional matters require consideration

1. Authorised and issued capital of the company.
2. Uncalled liability, if any, on the shares.
3. Rights attached to each class of shares, if the capital is divided into different classes of shares.
4. Particulars of dividends paid in the past and the amounts thereof which are in arrear (on cumulative preference shares)
5. If there are any mortgages/ charge created on the assets appearing in the company's books, a search should be made in the register of charges in the office of the registrar of companies.
6. Price at which the shares are being offered. If the company is public company, the price will be usually be in excess of market price quoted on the stock exchange, but in the case of unquoted shares particularly when the company, a valuation will have to be placed on the shares for the purpose of purchase.

Investigation for valuation of shares in Private Company

- The shares of Private company do not have a free market in which their prices could be determined.
- In respect of equity share valuation, there are two methods
 - Net worth basis- amount of net worth /number of equity shares
 - Yield basis- on the basis of Present value of the right to receive dividends in future (P.V of FMP/no. of shares)

Investigation in connection with review of Profit/ Financial Forecasts

There are many investigations which involve an examination of future profits like,

- (1) Profit reports can be required as part of a general investigation into the purchase of a business or,
- (2) By banks and financial institutions with regard to project cash flow and profitability statements for appraisal of loan applications submitted by the intending borrowers.

All forecasts depend, to a large extent, on the nature of the business with its numerous and substantial uncertainties. Therefore, such forecasts are not capable of verification by the reporting accountants in the same way as financial statements which present the results of a completed accounting period. Normally, such situations involve special review as these depart from the auditor's traditional role of expressing an opinion in relation to past events.

1. Introduction

- **“Forensic”** means “suitable for use in the court of law” and it is to that standard and potential outcome that forensic accountants generally have to work.
Bologna said that it is the application of financial skills and investigative mentality to unresolved issues, conducted within the context of the rules of evidence. As an emerging discipline, it encompasses financial expertise, fraud knowledge and a sound knowledge and understanding of business reality and the working of legal system.
- **Forensic:** The word forensic comes from the Latin word forensis, meaning "of or before the forum. It is -
 - Relating to, used in, or appropriate for courts of law or for public discussion or argumentation.
 - Relating to the use of science or technology in the investigation and establishment of facts or evidence in a court of law.
- **Forensic Accounting:**
 - i. The integration of accounting, auditing and investigative skills yields the specialty known as Forensic Accounting.
 - ii. It is the study and interpretation of accounting evidence.
 - iii. It is the application of accounting methods to the tracking and collection of forensic evidence, usually for investigation and prosecution of criminal acts such as embezzlement or fraud.
 - iv. Forensic Accounting can sometimes be referred to as Forensic Auditing.
- **Forensic Accounting by Hopwood, Leiner, and Young**
 - Forensic accounting is the application of investigative and analytical skills for the purpose of resolving financial issues in a manner that meets standards required by courts of law.
 - Forensic accountants apply special skills in accounting, auditing, finance, quantitative methods, certain areas of the law, research and investigative skills to collect, analyse and evaluate evidential matter and to interpret and communicate findings
- **Red Flag:** Red flags are indicators or warning of any impending danger or inappropriate behavior. Red flag does not necessarily indicate the existence of fraud however are indicators that caution needs to be exercised while investigating the situations.
Red flags are classified in categories such as
 - financial performance red flag,
 - accounting system red flags,
 - operational red flags and
 - behavioural red flags.
 -

Forensic Accounting has established itself as dynamic and strategic tool in combating corruption, financial crimes and frauds through investigations and resolving allegations of fraud and embezzlement. Thus, a new area, known as Forensic Accounting, was needed to detect the frauds in companies that suspected fraudulent transactions.

2. Audit v/s Forensic Accounting

Statutory Audit is a legal mandate and designed to provide an overall assurance to the shareholders of true and fair nature of the annual financial statements primarily from a materiality perspective. Individual transactions and balances do not play a major role except in so far as they have a material impact on the overall financial statements. The Auditor has the overall responsibility to issue his independent opinion without any influence from anyone.

Forensic Accounting is a separate mandate altogether and designed primarily to provide support to legal cases. The Forensic professional does not conduct an audit using sample selection methodologies to perform substantive or compliance tests. The professional undertakes a scrutiny and detailed examination of all transactions and balances relevant to the mandate so that the evidence discovered is suitable for a court of law (i.e., in compliance with legal requirements) where it can be challenged through cross examination by the defending party.

No audit report with any opinion is issued by the professional as his mandate is limited to present his findings to a superior authority (e.g., a judge) who will examine these from a legal point of view to establish whether the law has been violated or not.

Sr. No.	Particulars	Other Audits	Forensic Accounting
1.	Objectives	Express an opinion as to 'True & Fair' presentation	Whether fraud has actually taken place in books
2.	Focus	Very General- An overall review of books of account	Narrow- Validate transactions and n
3.	Period	Normally for a particulars accounting period.	No such limitations
4.	Verification of stock, Estimation realisable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation	Independent/verification of suspected/selected items where misappropriation in suspected
5.	Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
6.	Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.

Forensic Accounting v/s Statutory Audit

Basis	Statutory Audit	Forensic Accounting
Objective	TRUE AND FAIR PICTURE	DISCOVER FACTS AND EVIDENCE
Focus	VERY GENERAL – AN OVERALL REVIEW OF THE BOOKS OF ACCOUNT	NARROW – VALIDATE TRANSACTIONS AND BALANCES

<u>Approach</u>	CONTROL TESTS OF TRANSACTIONS AND SUBSTANTIVE TESTS OF BALANCES	FOCUSED TESTING TO CONFIRM SUSPICION / ALLEGATION
<u>Target</u>	IDENTIFYH MATERIAL MIS – STATEMENTS IN FINANCIAL STATEMENTS	IDENTIFY / CONFIRM NATURE OF VIOLATION
<u>Skills</u>	TESTING & CHECKING, ANALYSIS, INQUIRY & OBSERVATION	SCRUTINY & ANALYSIS, FACT – FINDING, INTERVIEWS
<u>Presumption</u>	PROFESSIONAL SKEPTICISM, DUE PROFESSIONAL CARE	NEUTRALITY
<u>Outcome</u>	AUDIT REPORT OPINION (QUALIFICATION – SUBJECT TO/EXCEPT FOR)	PRESENT EVIDENCE TO A COURT OF LAW – THEY SHALL JUDGE)!
<u>Nature</u>	IT'S A LEGAL MANDATE	Separate mandate altogether and designed primarily to provide support to legal cases
<u>Conducted by</u>	ONLY BY A CHARTERED ACCOUNTANT	NON-CAs PERMITTED
<u>Expression</u>	EXPRESSION OF AN INDEPENDENT OPINION	REPORT FINDINGS OF EVIDENCE DISCOVERED
<u>Conducted on</u>	ON FINANCIAL STATEMENTS AS PER ICAI AUDITING STANDARDS	PRIMARLY FINANCIALS
<u>Conducted as per</u>	AS PER ICAI AUDITING STANDARDS	ICAI STANDARDS
<u>Examination of transaction and balances</u>	<u>Individual transactions and balances do not play a major role except in so far as they have a material impact on the overall financial statements.</u>	The professional undertakes a scrutiny and detailed examination of all transactions and balances relevant to the mandate so that the evidence discovered is suitable for a court of law.
<u>Opinion</u>	<u>issue his independent opinion without any influence from anyone.</u>	No audit report with any opinion is issued by the professional as his mandate is limited to present his findings to a superior authority

3. Forensic Accountant Professional

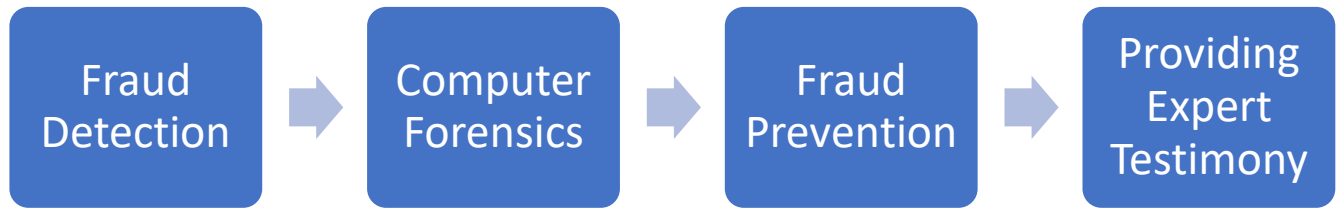
- A Forensic Professional is often retained to analyse, interpret, summarize and present complex financial and business-related issues in a manner which is both understandable and properly supported.
- Forensic Accountants are trained to look beyond the numbers and deal with the business reality of the situation.
- A Forensic Professional must initially consider whether his/her firm has the necessary skills and experience to accept the work. Forensic audits are highly specialized, and the work requires detailed knowledge of fraud investigation techniques and the legal framework.
- Forensic professional needs to have an understanding on various frauds that can be carried off and how evidence need to be collected.

4. Areas of Forensic Accounting Professional

An indicative list of services that can be provided by the Professional in this area are as follows:

• Financial Statement manipulations
• Fund diversions/Asset tracing
• Anti-Money laundering
• Licence Fees/Dues/Tax Evasion

<ul style="list-style-type: none"> • Related party transactions/valuations
<ul style="list-style-type: none"> • Valuations/Estimations of loss/damage
<ul style="list-style-type: none"> • Suspicious transactions under IBC (Insolvency and Bankruptcy Code)



Fraud Detection

- Investigating and analysing financial evidence.
- Detecting financial frauds
- Tracing misappropriated funds.

Computer Forensics

Area of Computer forensics comprises of developing computerized applications to assist in the recovery, analysis and presentation of financial evidence.

Fraud prevention

Area of fraud prevention comprises of

- Reviewing internal controls to verify their adequacy
- Providing consultation in the development and implementation of an internal control framework aligned to an organization's risk profile

Expert Testimony

Area of Expert testimony comprises of

- "Assisting in legal proceedings,
- Testifying in court as an expert witness
- Preparing visual aids to support trial evidence

Note: In order to properly perform these services a Forensic Professional must be familiar with legal concepts and procedures and have expertise in the use of IT tools and techniques that facilitate data recovery and analysis. In addition, a Forensic Auditor must be able to identify substance over form when dealing with an issue.

Forensic Professional are engaged by:

Forensic Auditors can be engaged in public practice or employed by

<ul style="list-style-type: none"> • Insurance companies,
<ul style="list-style-type: none"> • Banks,
<ul style="list-style-type: none"> • Police forces,
<ul style="list-style-type: none"> • Lawyers
<ul style="list-style-type: none"> • Government agencies and

- Other organizations.

Forensic Professional : shall have the following qualities (Characteristics)

• Out of the Box Thinking
• Strong Visualization and Imagination
• Curiosity
• Persistence
• Detail-oriented
• Inquisitiveness
• Creativity
• Discretion
• Scepticism
• Confidence
• Sound professional judgement
• Objectivity and credibility

Forensic Professional shall possess the following skills relating to:

• Auditing standards, procedures and related methodologies
• Accounting & Business reporting systems
• Information Technology Data Analytics Criminology
• Legal Framework
• Litigation processes & procedures Investigative Techniques Evidence gathering
• Network of professional contacts in related fields' viz. enforcement, regulatory bodies, law, industry, peers etc.

Note:A forensic accountant should possess not only the broad knowledge of accounting principles, practice and standards but also the knowledge of insurance, banking civil and criminal law and human psychology.

Importance of Forensic Professionals:

Forensic Professionals can resolve the matters by combining accounting knowledge & experience with respect to:

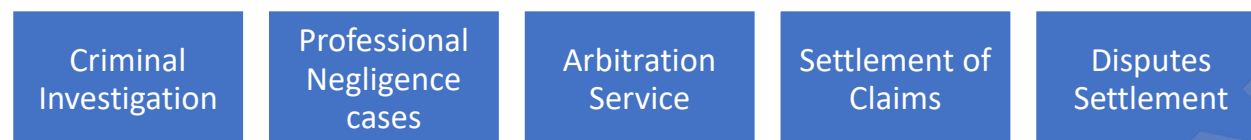
- Fraud Prevention
- Fraud Detection
- Risk Management

5. Services rendered by forensic Professionals

- Crafting questions to be posed
- Responding to questions posed
- Identifying documents to be requested and/or submitted
- Identifying individuals to be most knowledgeable of facts
- Conducting research relevant to facts of the case
- Identifying and preserving key evidence

- Evaluating produced documentation and information for completeness Analysing produced records and other information for facts
- Identifying alternative means to obtain key facts and information
- Providing questions for deposition and cross examination of fact and expert witnesses

The services rendered by the forensic accountants are in great demand in the following areas:



1. Criminal Investigation:

Matters relating to financial implications the services of the forensic accountants are availed of. The report of the accountants is considered in preparing and presentation as evidence.

2. Professional Negligence Cases

Professional negligence cases are taken up by the forensic accountants. Non- conformation to Generally Accepted Accounting Standards (GAAS) or non- compliance to auditing practices or ethical codes of any profession

3. Arbitration service

Forensic accountants render arbitration and mediation services for the business community. Their expertise in data collection and evidence presentation makes them sought after in this specialized practice area

4. Fraud Investigation and Risk/Control Reviews :

Forensic accountants render such services both when called upon to investigate specific cases as well for a review of or for implementation of Internal Controls. Another area of significance is Risk Assessment and Risk Mitigation.

5. Settlement of insurance claims:

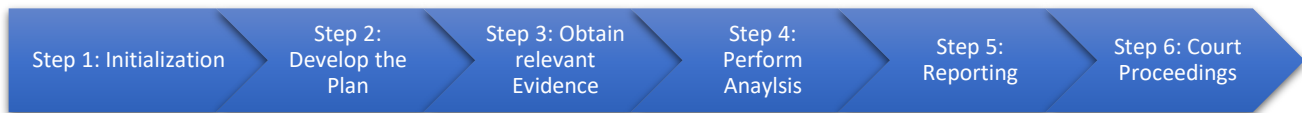
Insurance companies engage forensic accountants to have an accurate assessment of claims to be settled.

In case of policyholders seek the help of a forensic accountant when they need to challenge the claim settlement as worked out by the insurance companies

6. Dispute settlement:

Business firms engage forensic accountants to handle contract disputes, construction claims, product liability claims, infringement of patent and trade marks cases, liability arising from breach of contracts and so on

6. Process of Forensic Accounting



Step 1: Initialisation

It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment.

- It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment.
- It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand.
- A conflict check should be carried out as soon as the relevant parties are established.
- It is often useful to carry out a preliminary investigation prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issue.

Step 2: Develop Plan

- This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and
- will set out the objectives to be achieved and the methodology to be utilized to accomplish them.

Step 3: Obtain Relevant Evidence:

- It involves obtaining relevant documents, economic information tracing different assets/persons/unaccounted records, meeting with other experts, statutory and internal auditors of the client.
- The evidences gathered should be sufficient to ultimately identify and prove the fraudster(s) and the mechanism adopted for such frauds
- It is important that the investigating team is skilled in collecting evidence that can be used in a court case within the stipulated time period, and in keeping a clear chain of custody until the evidence is presented in court.

Step 4: Perform the Analysis:

The actual analysis to be performed will solely depend upon the nature of the assignment. This may include:

i.	Summarisation of a large number of transactions.
ii.	Calculating the economic damages and if required, the loss of goodwill.
iii.	Estimating the present value of the financial losses or frauds involved in case such irregularities or frauds took place for a long period of time.
iv.	Performing the statistical regression or sensitivity analysis of the frauds etc.
v.	Using various computerized application softwares and graphs etc. to explain and analyses the frauds.
vi.	Utilizing charts and graphics to explain the analysis

Step 5: Reporting:

- Issuing an audit report is the final step of a fraud audit. Auditors will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence, a conclusion as to the amount of loss suffered as a result of the fraud and to identify those involved in fraud.
- The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.
- The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.
- The forensic auditor should have active listening skills which will enable him to summarize the facts in the report. It should be kept in mind that the report should be based on the facts assimilated during the process and not on the opinion of the person writing the report.

Step 6- Court proceedings

- The investigation is likely to lead to legal proceedings against the suspect.
- The evidence gathered during the investigation will need to be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified

7. Forensic Accounting & Investigation Report

Forensic Accounting and Investigation Standard, known as FAIS or "Standard" 510, outlines the responsibility of professionals to issue written reports to stakeholders upon completing an assignment. Reporting the results of completed work procedures and findings is the concluding phase of the assignment. Since one engagement may encompass multiple assignments, multiple reports may need to be issued, with each assignment warranting its own report.

- **Written Report:** Professionals are required to issue a written report that clearly and accurately conveys the results of the assignment. Findings must be based on reliable and relevant evidence, resulting in a precise and unambiguous report.
- **Report Addressee and Distribution:** Reports are addressed to primary stakeholders and may be shared with other stakeholders if required or permissible.
- **Format or Content of Report:** While this Standard does not mandate a fixed format or content, certain key elements must be included to ensure the recipient understands the assignment's purpose, scope, and limitations. If stakeholders or regulatory requirements specify the format and content, professionals must adhere to those requirements while incorporating key elements.

Key Elements of the Report may include:

• Title, addressee, and distribution list
• Scope and objectives of the assignment
• Approach and work procedures undertaken
• Executive summary of results and findings
• Use of experts, if applicable
• Compliance with FAIS or any deviations

<ul style="list-style-type: none"> Findings supported by evidence
<ul style="list-style-type: none"> Assumptions, limitations, and disclaimers
<ul style="list-style-type: none"> Conclusions (if any) drawn from the assessment

- Discussion of Draft Report:** If engagement mandates discussion of findings with the subject party, a summary of their responses must be included in the report, adhering to principles of natural justice. Discussions may occur through internal processes of primary stakeholders or interviews with the subject. At times, the Professional is requested to incorporate the discussion of draft findings as part of the interview process with the subject.
- Assumptions and Limitations:**
 - The Professional shall list any relevant assumptions made during the assignment having a significant bearing on the subject matter.
 - In addition, the Professional may encounter limitations that restrict the methodologies or procedures applied in carrying out the assignment.
 - Such limitations can be in the form of lack of (or limited) management support, restricted (or denied) access to required records, information or people, due to any reason such as court orders, short timelines, etc.
 - These disclaimers would be covered in the report as a key element of the report.
 - The report shall not express an opinion or pass any judgement on the guilt or innocence.
 - Determination of culpability is either a disciplinary process internal to the organization under review, or a judicial process depending on the specific situation under review.
 - The report can, at best, highlight the circumstances and facts that may aid a stakeholder decision or further a civil or criminal investigation.
- Reporting Timelines:** Reports must be issued within a reasonable timeframe as per engagement terms. Interim reports may be required without compromising investigation progress, also subject to this Standard. An Audit report is a medium through which an auditor expresses his opinion under audit. It is an important part of the audit as it provides the results of the audit conducted by the auditor.

8. OVERVIEW OF FORENSIC ACCOUNTING AND INVESTIGATION STANDARDS (FAIS)

- The Institute of Chartered Accountants of India (ICAI) has established with various mandates, one of which is to ensure the standards of performance of its members. In line with this commitment, the ICAI recently released a comprehensive set of standards in the field of forensic science known as the "Forensic Accounting and Investigation Standards" (FAIS). These standards are designed to uphold the delivery of high-quality output by ICAI members in the realm of forensic accounting and investigations.
- The Framework Governing Forensic Accounting and Investigations sets forth the fundamental principles and parameters for conducting such services.
- It is intended to uphold and enhance the quality of practice among ICAI members engaged in forensic accounting and investigation services.
- This framework should be read alongside the Preface to the Forensic Accounting and Investigation Standards (FAIS).

The primary objectives of the Framework are as follows:

<ul style="list-style-type: none"> • Provide a comprehensive understanding of Forensic Accounting and Investigations and their essential components.
<ul style="list-style-type: none"> • Outline the cohesive manner in which these components interact when delivering such services.
<ul style="list-style-type: none"> • Sustain and elevate the quality of forensic accounting and investigation services.

- The Framework establishes the structural foundation governing the professions of Forensic Accounting and Investigations.
- It is built upon the “Definition of forensic accounting and investigation” and is underpinned by the Code of Ethics. The Framework consists of four components inherent to the forensic accounting and investigation process.
- While these components may not be explicitly mentioned in individual Standards, they are implicitly part of the FAIS and are therefore mandatory, except for Guidance, which is recommended.

Key Components (Forming pillars) of framework

1. Basic principles of Forensic Accounting & Investigations
2. Key Concepts
3. Standards on Forensic Accounting & Investigations
4. Guidance

The Forensic Accounting and Investigation Standards (referred to as “FAIS” or the “Standards”) at a broad level seek to provide:

- The Professionals with the minimum standards for undertaking forensic accounting and investigation (FAI) assignments;
- The Users of FAI services with an indication of the quality of service that can be expected from such engagements;
- The Regulators and Governmental agencies with an appreciation of what can be expected from FAI services; and
- To everyone, guidance on matters of implementation and related practical issues.

The Standards are designed to be principle-based rather than rule-based, allowing for professional judgment to be exercised in unique situations and specific circumstances. Given the distinct nature of forensic assignments, the application of forensic accounting and investigative skills, along with the use of digital forensic tools, may vary depending on the specifics of each engagement.

In cases where a member is unable to adhere to any of the requirements outlined in the FAIS, or if there is a conflict between the Standards and other mandates such as statutory or regulatory requirements, the FAI report (or similar communication) should highlight any significant deviations along with a suitable explanation.

Forensic Accounting and Investigation Standards (FAIS)

100 Series:: Standards on Key Concepts

FAIS 110 : Nature of Engagement FAIS 120 : Fraud Risk

FAIS 130 : Laws and Regulations

FAIS 140 : Applying Hypotheses

200 Series: Standards on Engagement Management

FAIS 210 : Engagement Objectives

FAIS 220 : Engagement Acceptance and Appointment FAIS 230 : Using the Work of An Expert

FAIS 240 : Engaging with Agencies

FAIS 250 : Communication with Stakeholders

300 Series: Standards on Executing Assignments

FAIS 310 : Planning the Assignment FAIS 320 : Evidence and Documentation FAIS 330 : Conducting Work Procedures FAIS 340 : Conducting Interviews

FAIS 350 : Review and Supervision

FAIS 360 : Testifying Before a Competent Authority

400 Series: Standards on Specialised Areas

FAIS 410 : Applying Data Analysis

FAIS 420 : Evidence Gathering in Digital Domain FAIS 430 : Loans Or Borrowings

500 Series: Standards on Reporting

FAIS 510 : Reporting Results

600 Series: Standards on Quality Control

FAIS 610 : Quality Control

1.1 Introduction

Technology is integral part of day to day business operations. It is essential that organizations review their technology-related controls to identify gaps and risks for continuous improvement and to ensure regulatory compliance. A strong controls and security position will allow organizations to build trust with their stakeholders.

Digital Audit is placing assurance on the effectiveness of the IT systems implemented in an organization

1.2 Key Features of a Digital Audit

- Digital audits encourage embracing technological advancements and provide confidence in staying updated.
- They enhance the quality of opinion, resulting in more reliable audit reports.
- Digital audits save time, costs, and human effort, redirecting resources to more productive tasks. Automated processes can operate 24/7, facilitating real-time transactions.
- They standardize processes and implement controls to mitigate risks.
- Digital audits provide a comprehensive overview of end-to-end processes and optimize technology usage against set standards.
- They contribute to creating a digital strategy for the future, facilitating the adoption of new technologies like AI, robotics, analytics, and automation.
- Digital audits enable informed decision-making for the auditee.

1.3 Advantages of Digital Audit

a. Enhanced Efficiency and Effectiveness:

Increased efficiency is a major advantage of digital audits. By utilizing tools and automation, processes can be standardized, and routine tasks can be automated. For example, reconciliation processes that used to take hours can now be automated, saving time and costs.

b. Higher Audit Quality:

Technology enables the quick evaluation of massive volumes of data. This helps auditors pinpoint areas needing more testing, reducing the risk of serious errors going unnoticed.

c. Cost Reduction:

Automation of previously manual processes cuts down auditing costs. This can shorten audit duration, ultimately reducing overall expenses.

d. Improved Analytics:

Enhanced analytics capabilities allow management and auditors to identify trends and patterns that might be difficult to detect manually. For instance, AI can analyze large financial datasets to uncover potential fraud, a task that's challenging for human auditors.

e. Enhanced Risk Assessment:

Implementing various automations and streamlining testing enhances the risk assessment process. This allows management and auditors to focus testing efforts on areas with higher risks of material misstatement, leading to informed decision-making.

1.4 Considerations and Challenges of Digital Audit

Considerations that organisations should keep in mind while using digital techniques and automation

Know what business benefits the organization wants to achieve with automation

Think people first and do not underestimate the fact that change is difficult

Target the right processes which is the key for successful automation

Automation is not a stand alone solution and should be a part of broader digitalisation strategy

Ensure the process works and it is standardised before automating.

Automation introduces new challenges for organisation

Consider Governance and data security in the risk framework.

As auditors understand management's implementation and oversight of new technologies, they'll also examine how these changes affect the company's business & operations, particularly its IT setup.

This involves understanding:

- a. New activities or alterations to existing processes resulting from new technology, such as new revenue streams, shifts in personnel roles and responsibilities, task automation, and changes in staffing levels impacting internal controls
- b. Changes in how the company develops and maintains its systems, assessing whether these changes introduce new risks necessitating additional controls
- c. The influence of new technology on the organization's ability to acquire, generate, and utilize relevant, high-quality information to support internal control functions.

2. Auditing Digitally

Auditing Digitally involves using technology advancements to conduct audits effectively and efficiently, especially in today's rapidly evolving IT landscape.

Embracing automation and innovation is crucial for modernizing audit practices. New technologies aid in data capture, procedure automation, information analysis, and focusing on client risks. The key is understanding how technology can assist and integrating it into auditing processes.

Some use cases -

Automation in Data Capture: Instead of manually inputting data from various sources into audit software, auditors can utilize technologies like optical character recognition (OCR) to automatically extract information from documents and spreadsheets. This not only saves time but also reduces the risk of human error in data entry.

Utilizing AI for Risk Assessment: Auditors can employ artificial intelligence (AI) algorithms to analyze large datasets and identify patterns indicative of potential risks or anomalies in financial

transactions. AI can quickly sift through vast amounts of data to pinpoint areas requiring further investigation, enhancing the effectiveness of risk assessment procedures.

Expectations from An Auditor

Audit teams must engage experts in various software applications and technologies. Proficiency in new technologies like RPA (Robotic Process Automation), AI, and blockchain enables auditors to deliver high-quality audits. Investing in digital upskilling is essential for ensuring top-notch technology audits.

While current technology focus is on automating processes and enhancing tools like data analytics, opportunities exist for more advanced technologies like AI and drones to make a larger impact. These technologies may also expand audit scopes, such as using data analytics and machine learning to detect fraud.

The use of bots has reduced manual intervention, leading to more accurate results and saving auditors time. Highlighted exceptions can be promptly reviewed, further streamlining the audit process.

2.1 Key Features & Advantages of Auditing Digitally

Improved Audit Quality:

By leveraging automation and data analytics, auditors can transition from sampling to reviewing or re-performing the entire population of transactions. For example, instead of analyzing a small sample of invoices, auditors can now examine every invoice in detail, enhancing audit accuracy and thoroughness.

This ultimately free up time for audit teams to analyses the information and better understand the business they audit.

Decreased Human Dependency:

Technology minimizes manual intervention, reducing the risk of errors caused by human judgment. For instance, automated testing processes streamline auditing procedures, mitigating errors arising from individual interpretations.

Automation and Ease:

Automation of tasks such as data extraction and sampling improves audit quality and reduces manual errors. For instance, utilizing reporting dashboards like Power BI facilitates data analysis, aiding auditors in forming well-informed opinions.

Improved Efficiency:

Technology that previously required extensive training is now accessible to auditors through digital upskilling. This leads to increased efficiency and reduced errors. For example, after simple training, auditors can utilize advanced tools and techniques, boosting talent retention and confidence.

Better Risk Assessment:

Automation and technology enable auditors to focus on significant challenges and assess risks more accurately. This allows auditors to concentrate on strategic aspects rather than repetitive tasks. For

instance, dashboards and visual presentations help identify areas needing more attention, facilitating precise risk assessment.

2.2 Considerations in Auditing Digitally

As new technologies continue to reshape various industries, it's crucial to acknowledge that the needs of auditors are distinct. Throughout the technological journey, it's essential to ask and answer key questions:

- **Identifying the Problems to Solve / What problems are you trying to solve?**

Continuously assess emerging technologies and tools to determine their potential benefits for auditing. Consider what improvements could enhance your audit processes and how to measure the return on investment.

Example: Assessing how machine learning algorithms can automate data analysis, thus reducing the time required for auditing tasks.

- **Selecting Suitable Technology / Which technology can help you?**

Explore various tools and solutions offered by vendors and startups, particularly those focused on data acquisition, manipulation, and visualization. Evaluate how seamlessly these solutions can integrate into existing processes and address any potential implementation challenges early on.

Example: Considering the adoption of cloud-based platforms for data storage and collaboration, ensuring accessibility and scalability for audit teams.

- **Upskilling Your Team / How will you upskill your people to make best use of the technology available?**

Recognize that the effectiveness of technology depends on the skills of the individuals using it. Prioritize training and development initiatives to ensure that audit teams understand how and why they are leveraging technology. Overcoming resistance to change requires ongoing training to improve competency and confidence.

Example: Providing training sessions on using advanced analytics software to identify patterns and anomalies in financial data, empowering auditors to make more informed decisions.

- **Range of Automated Solutions:**

Explore a spectrum of automation solutions, ranging from basic to sophisticated, to standardize repetitive tasks and optimize audit efforts. Utilize techniques such as robotics for data gathering, data analytics for planning and budgeting, and reporting through interactive dashboards to enhance audit efficiency.

Example: Implementing robotic process automation (RPA) for automating data extraction from multiple sources, reducing manual effort and minimizing errors in audit procedures.

Solutions	Description
Macros & Scripts	Rules based automation within a specific application
Business Process Automation (BPA)	Reengineering existing business processes
Robotic Process Automation (RPA)	Automating labour intensive repetitive activities across multiple systems and interfaces

Intelligent Process Automation (IPA)	Combining RPA with AI technologies to identify patterns, learn over time and optimise workflows.
--------------------------------------	--

3. Understanding the IT Environment (Automated / Digital Environment)

As required by SA 315, auditor is required to obtain an understanding of the entity and its environment as a part of Risk Assessment procedure to identify and assess Risk of material misstatement. In an automated environment, auditor is required to obtain an understanding of the following:

1. Applications being used by the entity;
2. IT infrastructure components for each of the application;
3. Organization structure and governance;
4. Policies, procedures and processes followed;
5. Extent of IT integration & Use of service organisations.
6. IT risks and controls.

3.1 Documenting the understanding

As required by SA 230, auditor is required to document the understanding of a company automated environment.

Illustration to show how auditor documents details of automated environment

<u>Application</u>	<u>Used for</u>	<u>Database</u>	<u>Operating System</u>	<u>Network</u>	<u>Server and Storage</u>
REVS	Front desk, guest reservation	MS-SQL Server	Windows 2016	In-house developed	HP Server Internal HDD
BILLSYS	Billing	Oracle 12c	Windows 2016	Packaged Software	HP Server Internal HDD

3.2 Considerations of automated environment in different stages of Audit



In a controls-based audit in an automated environment, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. In this approach, the considerations of automated environment will be relevant at every phase as given below:

- during risk assessment, the auditor should consider risk arising from the use of IT systems at the company;

<ul style="list-style-type: none"> • when obtaining an understanding of the business process and performing walkthroughs the use of IT systems and applications should be considered;
<ul style="list-style-type: none"> • while assessing the entity level controls the aspects related to IT governance need to be understood and reviewed;
<ul style="list-style-type: none"> • pervasive controls including segregation of duties, general IT controls and applications should be considered and reviewed;
<ul style="list-style-type: none"> • during testing phase, the results of general IT controls would impact the nature, timing and extent of testing;
<ul style="list-style-type: none"> • when testing of reports and information produced by the entity (IPE) generated through IT systems and applications;
<ul style="list-style-type: none"> • at completion stage, evaluation of control deficiencies may require using data analytics and CAATs.

3.3 Key Areas for an Auditor to understand IT Environment

Understanding Transaction Flow:

Auditors need to grasp how transactions move through the IT systems. This means knowing how information is processed in specific applications and databases. For instance, changes in transaction flow could happen because of updates to software or alterations in stored data.

Identifying Significant Systems:

Auditors must pinpoint the important IT applications and the supporting infrastructure. This involves understanding how data related to key transactions and financial information moves within the entity's IT systems.

Recognizing Manual and Automated Controls:

Auditors need to recognize both manual and automated elements within the entity's internal control system. This mix of manual and automated controls varies depending on how the entity uses IT. Knowing the characteristics of each type helps auditors assess the risks of errors in financial reporting.

Identifying Used Technologies:

Auditors must understand the new technologies being used and their impact on financial reporting. They need to assess the risks associated with these technologies. Examples of such technologies include blockchain, robotics, artificial intelligence, etc.

Examples of Emerging Technologies:

- Blockchain: Used in cryptocurrency businesses like token issuers and exchanges.

Robotics: Used in automated processes in manufacturing or logistics.

- Artificial Intelligence: Used for data analysis and decision-making in various industries.
- Internet of Things: Used in smart home devices and industrial automation.
- Biometrics: Used for security purposes like fingerprint or facial recognition.
- Drones: Used for surveillance, delivery, and monitoring in various sectors.

Assessing IT Complexity:

Not all IT applications are equally complex. Complexity depends on factors like automation levels, reliance on system-generated reports, customization in IT systems, business models, changes made during the year, and the use of emerging technologies. Auditors evaluate the overall complexity of the IT environment by considering these factors for each application.

- 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.

4. Identifying the risks arising from usage of IT

4.1 How to Identify IT Risks?

To identify risks associated with the use of IT, auditors consider the nature of the IT applications in place. They also assess cybersecurity risks that may apply.

The likelihood of IT-related risks increases when there's a higher volume or complexity of automated application controls. This is especially true if management heavily relies on these controls for transaction processing or maintaining data integrity.

4.2 Risk Arising from Use of IT

Unauthorized Data Access: Unauthorized users may access data, leading to its destruction or improper alteration. For example, multiple users accessing a shared database may pose particular risks.

Unauthorized Access Privileges: IT personnel gaining access beyond their duties can compromise segregation of duties. This may result in unauthorized changes to master file data.

Unauthorized Changes to IT Systems: Changes made without proper authorization may disrupt IT systems or compromise data integrity.

Inappropriate manual intervention Inappropriate manual intervention refers to instances where human involvement in IT processes deviates from established procedures or standards, leading to errors, inefficiencies, or security risks. For example, unauthorized personnel manually altering data in a system without proper authorization or oversight can introduce inaccuracies or compromise data integrity.

Failure to Update IT Systems: Neglecting necessary updates to IT applications or infrastructure can leave systems vulnerable to security breaches or malfunctions.

Data Loss or Corruption: Inadequate cybersecurity measures can lead to data loss or corruption, potentially due to hacking or system failures. This can result in fraud or breaches of sensitive information.

System Downtime: Hardware failures, cyberattacks, or power outages can cause IT systems to be offline, disrupting business operations.

System Integration Risks: Integrating multiple IT systems can lead to compatibility issues, system failures, or incorrect data if not done properly. This includes risks related to software versions, patches, and compatibility.

Regulatory Compliance Risks: Changes in laws or regulations can impact business operations and compliance requirements. Different industries face varying regulatory demands, necessitating careful management of compliance risks.

Performance Issues: Heavy data loads or network usage can affect IT system performance. Scaling resources or hardware may address performance issues, but this can be costly and requires informed decision-making.

4.3 Identifying IT Dependencies Impacting Audit

It's crucial to identify and document an entity's IT dependencies clearly and consistently. This helps in understanding the entity's reliance on IT, how IT is integrated into its business model, identifying potential IT-related risks, recognizing related IT General Controls, and developing an effective audit approach.

How do IT dependencies arise?

Causes of IT Dependencies

IT dependencies emerge when IT is utilized to initiate, authorize, record, process, or report transactions or financial data for inclusion in financial statements.

- **Initiation:** When IT systems are used to start or begin transactions.
- **Authorization:** IT systems involved in approving or authorizing transactions.
- **Recording:** Systems responsible for recording transactional data accurately.
- **Processing:** IT systems that carry out processing tasks related to transactions or financial data.
- **Reporting:** Systems used for generating reports or financial statements based on processed data.

Automated Controls Automated controls in IT ensure that business rules are followed. For instance:

Purchase orders are approved using workflow systems, which may include checks for specific date formats.

Existence checks prevent the creation of duplicate customer numbers.

Reasonableness checks limit transaction amounts to ensure accuracy.

Reports	System-generated reports are data produced by IT systems. These reports are frequently employed in manual controls within an entity, such as business performance assessments. They also serve as the basis for information used by auditors when choosing items for testing, conducting substantive tests, or performing analytical procedures. Examples include vendor master reports and customer aging reports.
Calculations	Calculations are accounting tasks carried out by an IT system rather than a person. For instance, the system might use the 'straight-line' depreciation formula to figure out the depreciation of an asset. This involves subtracting the asset's residual value from its initial cost, then dividing by its useful life. Similarly, the system could determine

Security

the total amount invoiced to a customer by multiplying the item price by the quantity shipped.

The IT environment facilitates security measures, including segregation of duties, to limit access to information and define roles and responsibilities. This helps prevent employees from both committing and concealing errors or fraud, as well as processing unnoticed mistakes.

Interfaces

Interfaces are programmed to move data between different IT systems. For instance, an interface might be set up to transfer data from a payroll sub-ledger to the general ledger.

4.4 Understanding and responding to risk arising from IT dependencies

When auditors pinpoint IT dependencies crucial to the entity's transaction flow and financial data processing, it's essential to grasp how management handles the risks linked to them. Management might use Information Technology General Controls (ITGCs) to mitigate these risks.

The illustration below is an overview of the Control Objectives and controls for each area of general IT controls

Controls	Objective
Access Security	To ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives
Description <ul style="list-style-type: none"> - Access requests to the application are properly reviewed and authorized by management - Access of terminated user is removed on a timely basis - Access rights to applications are periodically monitored for appropriateness - Transactions of administrative and sensitive generic IDs are monitored - Security policies and procedures are maintained - Access to operating system and database is restricted. 	
Program Change	To ensure modified systems continue to meet financial reporting objectives
Description <ul style="list-style-type: none"> - Change Management policy and procedures are maintained. - Development, testing and production environments are segregated for changes to application configurations - Changes are adequately tracked and recorded. - Changes to application configurations are adequately tested and approved before being migrated into production - Emergency changes are approved. - Segregation of duties is maintained between developer and implementor. 	
Data Centre and network operations Objective	To ensure production systems are appropriately backed up to meet financial reporting objectives
Description	

- **Policies and procedures for data back and recovery is maintained.**
- **Data is appropriately backed up and recoverable**
- **Restoration testing is performed**
- **Monitoring and compliance of service level agreements.**
- **Batch job scheduled are monitored for failures and access is restricted.**

IT dependencies can impact how the entity's controls are designed and executed. As a result, auditors assess IT dependencies pertinent to the audit and evaluate associated risks. When IT dependencies are identified, auditors should include tests of Information Technology General Controls (ITGCs). If the controls for the IT environment are not properly implemented or functioning, reliance on ITGCs may be compromised, making the IT dependencies unreliable.

5. Assessing Cyber Risks (Including Remote Audit)

Cyber risk refers to attempts to gain unauthorized access to computer systems or networks with the intention of causing harm, stealing, exposing, altering, disabling, or destroying data. Regulators worldwide are increasingly focusing on cyber risk management, mandating financial institutions to assess their cybersecurity programs, manage cyber risks, and enhance resilience against cyber-attacks.

Common types of cyber-attacks include:

- Malware:** Malware, or malicious software, is any program or code designed to harm computers, networks, or servers. It encompasses various subsets such as ransomware, fileless malware, trojans, and viruses.
 - **Ransomware:** In a ransomware attack, attackers encrypt a victim's data and demand payment for the decryption key. These attacks often occur through phishing emails containing malicious links.
 - **Fileless Malware:** Fileless malware utilizes legitimate system tools to execute attacks without leaving traditional traces of malware. This makes detection challenging.
 - **Trojan:** Trojans masquerade as legitimate software but contain malicious code. They are often installed through deceptive methods like phishing.
 - **Mobile Malware:** This type of malware targets mobile devices and can be delivered through various means such as malicious downloads and operating system vulnerabilities.
- Denial-of-Service (DoS) Attacks:** A Denial-of-Service (DoS) attack is a malicious, targeted attack that floods a network with false requests in order to disrupt business operations. In a DoS attack, users are unable to perform routine and necessary tasks, such as accessing email, websites, online accounts or other resources that are operated by a compromised computer or network. While most DoS attacks do not result in lost data and are typically resolved without paying a ransom, they cost the organization time, money and other resources in order to restore critical business operations.
- Phishing:** Phishing is a type of cyberattack that uses email, SMS, phone, social media, and social engineering techniques to entice a victim to share sensitive information - such as passwords or account numbers - or to download a malicious file that will install viruses on their computer or phone.

- Spear Phishing - Spear-phishing is a type of phishing attack that targets specific individuals or organizations typically through malicious emails. The goal of spear phishing is to steal sensitive information such as login credentials or infect the targets' device with malware.
 - Whaling - A whaling attack is a type of social engineering attack specifically targeting senior or C-level executive employees with the purpose of stealing money or information or gaining access to the person's computer in order to execute further cyberattacks.
 - Smishing - Smishing is a type of fraudulent practice of sending text messages purporting to be from reputable companies in order to induce individuals to reveal personal information, such as passwords or credit card numbers.
 - Vishing- Vishing, a voice phishing attack, is the fraudulent use of phone calls and voice messages pretending to be from a reputable organization to convince individuals to reveal private information such as bank details and passwords.
- d. **Spoofing:** Spoofing is a technique through which a cybercriminal disguises themselves as a known or trusted source. In so doing, the adversary is able to engage with the target and access their systems or devices with the ultimate goal of stealing information, extorting money or installing malware or other harmful software on the device.
- Domain Spoofing : Domain spoofing is a form of phishing where an attacker impersonates a known business or person with fake website or email domain to fool people into the trusting them. Typically, the domain appears to be legitimate at first glance, but a closer look will reveal subtle differences.
- Example – www.IndigoLearn.com vs www.IndigoLearn.com [The first has capital “I” and the second has small “L”]
- Email Spoofing Email spoofing is a type of cyberattack that targets the businesses by using emails with forged sender addresses. Because the recipient trusts the alleged sender, they are more likely to open the email and interact with its contents, such as a malicious link or attachment.
- e. **Identity-Based Attacks:** When a valid user's credentials have been compromised and an adversary is pretend to be that user. For e.g., people often use the same user ID and password across multiple accounts. Therefore, possessing the credentials for one account may be able to grant access to other, unrelated account.
- f. **Insider Threats:** When current or former employees that pose danger to an organization because they have direct access to the company network, sensitive data, and intellectual property (IP), as well as knowledge of business processes, company policies or other information that would help carry out such an attack.
- g. **DNS Tunneling :** DNS Tunneling is a type of cyberattack that leverages domain name system (DNS) queries and responses to bypass traditional security measures and transmit data and code within the network. This tunnel gives the hacker a route to unleash malware and/or to extract data, IP or other sensitive information by encoding it bit by bit in a series of DNS responses.
- h. **IoT-Based Attacks:** An IoT attack is any cyberattack that targets an Internet of Things (IoT)

device or network. Once compromised, the hacker can assume control of the device, steal data, or join a group of infected devices

5.1 Stages of Cyber Risk

Stage 1 - Assessing the cyber risk : No organization is completely immune to a cyber risk. Different clients will have different levels of risks, even with the same industry. Every organization should consider at least the common threats-

- Ransomware disabling their organization (including their plants and manufacturing facilities)
- Common criminals using email phishing and hacks for fraud and theft.
- Insiders committing malicious activities or accidental activities resulting in unintended disclosure of information theft and frauds.

Stage 2 - Impact of cyber risk : Cyber-attack can impact one, two or more types of risks. The impact of the attack would vary from organization to organization and most importantly from an attack to attack. Some of the indicative areas can be –

- Regulatory costs
- Business interruptions causing an operational challenge for an organization.
- Data loss, reputational loss and litigation.
- Ransomware - more common these days where entire systems are encrypted
- Intellectual property theft which may not only take the competitive advantage, but we may also result in any impairment/impediment charge because of the loss of IP.
- Incident response cost which could be for investigations & remediations
- Breach of Privacy, if personal data of a consumer is hacked it could have a significant impact on the organization.
- Fines and penalties

Stage 3- Managing the cyber risk: A strategic approach to cyber risk management can help an organization to:

- Gain a holistic understanding of the cyber risks, threats facing their organization and other financial institutions
- Assess existing IT and cybersecurity program and capabilities against the relevant regulatory requirements
- Align cybersecurity and IT transformation initiatives with strategic objectives and critical risks
- Understand accepted risks & documented compensating controls

5.2 Cyber Security Framework

The cybersecurity framework involves identifying, protecting, detecting, responding to, and recovering from risks to the organization's assets, including electronic ones.

Identify the risk:

- Determine if the entity's risk assessment considers cybersecurity risks.

- Conduct periodic risk assessments to identify potential cybersecurity risks, such as IT system failures, loss of data, or unauthorized access.
- Maintain an inventory of information assets and classify them based on sensitivity and business value.
- Review how cybersecurity risks affect internal controls over financial reporting.
- Consider leveraging established risk-based cybersecurity programs like NIST or ISO.
- Establish roles and responsibilities for cybersecurity, such as CISO and CIO, and involve those charged with governance.

Protect the risk:

- Understand the entity's processes for safeguarding electronic assets.
- Conduct formal training to raise awareness of cyberattack risks.
- Implement effective controls for data security.
- Identify material digital assets subject to cybersecurity risks and prioritize their protection.

Detect the risk:

- Have controls and procedures to identify and assess cybersecurity risks and incidents.
- Review processes to monitor and detect security breaches or incidents.
- Monitor antivirus systems and firewall logs for signs of attacks.
- Establish a process for reviewing and updating systems to address vulnerabilities.

Respond to the risk:

- Capture details of cybersecurity incidents and how they were identified.
- Have a response plan in place and communicate it to relevant stakeholders.
- Assess costs associated with the incident, such as litigation and regulatory investigation costs.
- Develop future action plans to improve cybersecurity measures.

Recover from the risk:

- Take appropriate actions to recover from the attack and ensure business continuity.
- Implement a recovery plan after evaluating the impact and communicating with regulators.
- Make necessary improvements, such as patch upgrades and enhanced technology, to prevent future attacks.

5.3 Control Considerations for Cyber Risks

In addition to having cybersecurity policies, procedures, frameworks, and regular assessments in place, management should establish strong and updated internal controls to mitigate cyber risks:

Controls around vendor setup and modifications:

Cyber schemes involve changes to vendor information through email phishing scams, leading to inappropriate fund disbursements and impacting financial statements. Key considerations include:

- Who is responsible for vendor data changes, and is the process centralized or

decentralized?

- Are secure communication channels used for requests, and is multi-factor authentication enabled for emails?
- What systems and technologies handle vendor data changes, and are authentication protocols defined?

Controls around electronic transfer of funds:

Similar to vendor changes, fraudulent wire transfer requests pose risks. Relevant controls involve:

- Educating personnel on phishing scams related to wire transfers.
- Defining authentication protocols for verifying wire transfer requests.
- Identifying systems and technologies used for initiating, authorizing, and releasing wire transfers.

Controls around patch management:

Cyber and ransomware attacks exploit known vulnerabilities, often due to unapplied patches. Essential measures include:

- Implementing a patch management program.
- Conducting periodic vulnerability scans to identify missing patches.
- Establishing procedures for receiving notifications about patches from external vendors like Microsoft.

5.4 Remote Audit

Remote audit, also known as virtual audit, occurs when auditors utilize online or electronic means to conduct auditing activities. This can be either partially or completely virtual, where auditors interact with the auditee using technology to gather audit evidence or review documentation.

Audit planning and scoping are vital in every audit process. This involves discussing the scope, schedule, and methods for conducting the audit. With the onset of the COVID-19 pandemic, businesses have adapted to new norms, with remote audits being embraced by clients.

Auditors must develop customized strategies to ensure that remote audits meet the necessary requirements and produce results comparable to traditional onsite audits.

Feasibility and Planning:

Planning should include agreeing on audit timelines, selecting meeting platforms (such as Zoom, Microsoft Teams, or Google Meet), establishing data exchange methods, and handling access authorization requests. It's essential to ensure feasibility by assessing the technology available, the competencies of auditors and auditees, and resource availability.

During the execution phases of a remote audit, video or teleconferencing with auditees is conducted, and audit evidence documentation is shared through a document sharing platform.

Confidentiality, Security, and Data Protection:

To maintain data security and confidentiality, access to the document sharing platform should be restricted and secured by encrypting transmitted data. Once reviewed and documented by

auditors, information is removed from the platform and stored according to relevant archiving standards and data protection requirements.

Auditors must consider legislation and regulations that may necessitate additional agreements from both parties, such as agreements regarding the recording of sound and images. Screenshots should not be taken as audit evidence without prior authorization from the audited organization. If access to the auditee's IT system is required, auditors should use a VPN (Virtual Private Network) to create a secure and encrypted online connection, preventing unauthorized access and enabling remote work.

Risk Assessment:

Clear and consistent communication between auditors and auditees is crucial during remote audits. Risks related to achieving audit objectives are identified, assessed, and managed. An evaluation of whether a remote audit is sufficient to achieve the audit objectives should be conducted and documented for each audit, involving all members of the audit team and representatives from the audited organization.

ADVANTAGES	DISADVANTAGES
Cost and time effective: No travel time and travel costs involved.	Due to network issues, interviews and meetings can be interrupted.
Comfort and flexibility to the audit team as they would be working from home environment,	Limited or no ability to visualize facility culture of the organization, and the body language of the auditees. Time zone issues could also affect the efficiency of remote audit session
Time required to gather evidence can spread over several weeks, instead of concentrated into a small period that takes personnel from their daily activities.	The opportunity to present doctored documents and to omit relevant information is increased. This may call for additional planning, some additional/different audit procedures, Security and confidentiality violation.
Auditor can get first-hand evidence directly from the IT system as direct access may be provided.	Remote access to sensitive IT systems may not be allowed. Security aspects related to remote access and privacy needs to be assessed
Widens the selection of auditors from global network of experts.	Cultural challenges for the auditor. Lack of knowledge for local laws and regulations could impact audit. Audit procedures like physical verification of assets and stock taking cannot be performed.

Remote auditing is increasingly important, particularly during unprecedented events like the COVID-19 pandemic. It offers organizations and auditors the opportunity to utilize communication technology tools effectively. Moreover, there is a shifting perception among management regarding remote audits, as they offer flexibility in terms of scheduling without disrupting daily business operations, along with cost savings.

Auditors must ensure proper access to systems and networks is granted with appropriate approvals, both for employees working remotely and for auditors conducting remote audits. Data transfer should occur through encrypted means to maintain data privacy. Management should maintain and regularly review a list of employees working remotely, ensuring they access systems and networks only through a VPN (Virtual Private Network) and that such access is authorized. Additionally, VPN access should be promptly terminated once an employee leaves the organization or when the audit is completed. Auditors can verify the effectiveness of these controls during remote audits.

5.5 Emerging Technologies in Audit

The financial reporting landscape is rapidly changing due to emerging technologies like data analytics, artificial intelligence (AI), robotic process automation, and blockchain. Auditors are adapting by transforming their own processes to keep pace with these changes.

As the use of emerging technologies in financial reporting increases, it's crucial for auditors and their clients to become familiar with them. Auditors need to assess how these technologies impact businesses and evaluate whether management is properly addressing their impact on internal controls over financial reporting.

Data analytics involves generating valuable insights from raw system data. Audit analytics, a subset of data analytics, allows auditors to analyze large datasets to identify patterns, anomalies, and other useful information. This enhances audit efficiency and accuracy, enabling businesses to make informed decisions based on verifiable data.

Audit analytics helps auditors in various ways, including discovering patterns, identifying anomalies, and extracting useful information from data. These techniques, known as Computer Assisted Auditing Techniques (CAATs), utilize multiple data analytical and visualization tools to delve deep into audit issues and minimize the risk of overlooking critical attributes.

Auditors can leverage various applications and tools to analyze large datasets and improve audit quality. Some popular CAATs tools include:

ACL (Audit Command Language) Analytics: Used for fraud detection, prevention, and risk management by sampling large datasets to uncover irregularities or patterns indicating control weaknesses or fraud.

Alteryx: Consolidates financial or operational data to assess controls, automate analytics, and perform machine learning to detect fraud or irregularities. It also streamlines processes and eliminates routine tasks.

Power BI: Provides non-technical users with tools for aggregating, analyzing, visualizing, and sharing data. Auditors can use visualization tools to identify outliers and create interactive dashboards for reporting to higher management.

CaseWare: A data analysis software that helps in conducting audit and assurance engagements quickly, accurately, and consistently. It shares analytical insights to support better decision-making and integrates everything needed to conduct assurance and reporting engagements.

6. Automated Tools in Audit

- Businesses are swiftly embracing new technologies to enhance efficiency and leverage the latest innovations.
- Robotic process automation (RPA), blockchain, machine learning, Internet of Things (IoT), and artificial intelligence (AI) are among the key examples of automation technologies.
- As automation becomes more prevalent, auditors are faced with the task of understanding and conducting procedures across a broader range of systems that generate data essential for financial reporting.
- In response to both management and auditors' independent risk assessments, the audit scope may need to encompass peripheral systems. This includes testing general IT and application controls related to these systems due to the increased reliance on technology for financial reporting.
- As an example, a manufacturing company might use RPA to automate inventory management processes, while a financial institution could implement blockchain technology to enhance the security and transparency of transactions. Machine learning algorithms might be employed by an e-commerce platform to analyze customer data and personalize recommendations, and IoT devices could be utilized by a logistics company to track shipments in real-time. AI-powered chatbots could be integrated into customer service systems to provide immediate assistance to users.

6.1 Internet of Things (IoT)

The Internet of Things (IoT) revolutionizes how everyday devices like cell phones, coffee makers, and washing machines connect to the internet. Through data collection, analytics, connectivity, and coordinated processes, IoT transforms not only business models but also organizational strategies. However, this shift exposes entities to new legal and regulatory challenges.

For example, consider a smart airconditioner in a household that connects to the internet to regulate temperature remotely. This device collects data on usage patterns, energy consumption, and user preferences, enabling homeowners to optimize energy efficiency. However, it also raises privacy concerns regarding the security of personal data stored in the cloud.

In auditing, the widespread adoption of IoT means auditors can't rely solely on manual controls. They must adapt to include new systems in their audits and enhance their skills to evaluate automated controls effectively. For instance, consider mobile payment systems allowing customers to pay via credit card using their smartphones at retail stores. This introduces new transaction flows and risks, such as dependency on external service providers for accurate data handling and routing.

These changes could create alternative pathways for incoming payments, relying in part on third-party service providers for information accuracy. Auditors must assess transaction volumes and associated processes and controls to ensure accuracy and security.

Common IoT risks include device hijacking, data siphoning, denial-of-service attacks, data breaches, and device theft. For example, a smart home security system may be vulnerable to hacking, leading to unauthorized access to personal data or property.

6.2 Artificial Intelligence (AI)

Artificial intelligence (AI) refers to systems or machines capable of learning and making decisions. These systems use data analysis and algorithms to predict outcomes based on patterns and behaviours learned over time. From asking Siri to locate Air Pods or instructing Amazon Alexa to dim the lights, to quickly accessing phone features or predicting the best time to book travel, AI is becoming an integral part of daily life.

- Auditing in AI environment requires a focus on understanding the logic behind algorithms and ensuring they remain unbiased.
- Auditor should verify the effectiveness of algorithms and confirm that their outputs are properly reviewed and approved.
- Auditors must also address cybersecurity concerns and identify potential vulnerabilities that could impact AI functionality.
- Understanding how AI influences transaction flows and decision-making processes within an organization is crucial for auditors.

If management increasingly relies on AI for oversight, auditors must comprehend the implications of this shift and assess how new risks are managed. Additionally, they should consider whether existing risks receive adequate attention in light of these changes, which may necessitate adjustments to the audit approach.

Common risks associated with AI include security vulnerabilities due to increased data usage, improper configuration leading to potential harm, and data privacy concerns requiring explicit consent from data providers. 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 proposed wording of the modification.

6.3 Blockchain

- Blockchain operates on a decentralized ledger secured by encryption, where each transaction is validated by participants and added to a chain of information replicated across all users.
- Any attempt to modify or delete a block is detected and rejected, ensuring data integrity.
- For auditors, understanding the governance and security of blockchain transactions is crucial.
- While blockchain relies on cryptography for security, risks remain, especially as it interfaces with legacy systems and external partners. Concerns such as insecure APIs and data privacy cannot be overlooked.
- Weaknesses in blockchain application development and compliance with data privacy laws pose additional challenges for auditors.
- Auditors must assess whether blockchain implementation complies with regulations and doesn't expose the organization to legal liabilities.
- The strengths of blockchain, such as irreversible transactions and data security, can also be its weaknesses.
- Organizations need robust protocols and contingency plans to avoid being locked out of their own data.
- Operating through network nodes increases exposure to cyber-attacks, emphasizing the importance of security measures.

Auditors must ensure that organizations have effective data management processes and stay updated on evolving regulatory requirements. Compliance managers should continuously monitor regulatory developments and adapt processes accordingly to mitigate risks associated with blockchain technology.

Case Study on Block Chain

XY Bank, headquartered in New York, offers a broad range of financial services including asset management, commercial banking, investment banking, and treasury and securities services.

The Five Indian banks in partnership with XY bank, provide a comprehensive range of banking services and products encompassing retail banking, corporate banking, international banking, and other financial services. All these banks have been significant contributors to the digitalization of banking services in India.

Under the pilot programme, the Indian banks will open on-chain Nostro accounts with XY Bank branch in Gift City. The blockchain-based system is expected to facilitate instant, 24×7 settlement between the accounts held at the US bank. Essentially, it will create a private intra-correspondent banking network, redefining the traditional banking hours and enabling seamless money transfer.

Following are the illustrative steps for performing audit of above said block chain:

- (a) Obtain a comprehensive understanding of the blockchain-based pilot program, including its objectives, scope, and key processes involved.
- (b) Review the partnership agreements, contracts, and legal documentation governing the relationship between the Indian banks and XY Bank.
- (c) Identify the specific blockchain technology used, its functionalities, and the underlying smart contracts.

(d) Assess Internal Controls:

Review policies and procedures related to the on-chain Nostro accounts, settlement processes, and money transfer mechanisms.

Assess the governance framework, risk management practices, and compliance procedures established by the Indian banks and XY Bank.

(e) Review Security Measures:

Assess encryption methods, cryptographic key management, and secure transmission protocols used for data protection.

Review measures taken to prevent unauthorized access, cyber threats, and potential vulnerabilities in the blockchain network.

(f) Test Transaction Validity and Accuracy:

Validate that transactions are recorded and settled accurately on the blockchain, ensuring adherence to relevant regulations and contractual obligations.

Perform reconciliations between on-chain Nostro accounts and the corresponding accounts held at XY Bank to confirm the accuracy of balances and transactions.

(g) Evaluate Compliance and Regulatory Requirements:

Review documentation and procedures related to customer due diligence, transaction monitoring, and reporting obligations.

Ensure that the pilot program adheres to industry-specific standards and best practices.

(h) Assess Business Continuity and Disaster Recovery:

Evaluate the adequacy of backup and recovery procedures, redundancy measures, and failover mechanisms to ensure uninterrupted operations.

Test the effectiveness of these plans by conducting simulations or examining historical incidents and response procedures.

(i) Report Findings and Recommendations:

Provide recommendations for improving internal controls, security measures, compliance procedures, and overall efficiency and effectiveness of the pilot program.

Communicate the audit results to the relevant stakeholders, highlighting areas of concern and suggesting remedial actions.

6.4 NFT (Non-Fungible Token)

NFT means something is unique and cannot be replaced. Unlike physical money and cryptocurrencies are fungible (means they can be traded or exchanged for one another) NFTs are non-fungible tokens. NFTs contains the digital signature which make them unique. NFTs are digital assets, e.g., photos, videos, artwork, sports collectibles etc.

NFTs are tokens used to represent ownership of unique items. NFTs allow their creators to tokenize things like art, collectibles, or even real estate. They are secured by the blockchain and can only have one official owner at a time. No one can change the record of ownership or copy/paste a new NFT into existence.

Key Features of NFT-

- Digital Asset - NFT is a digital asset that represents Internet collectibles like art, music, and games with an authentic certificate created by blockchain technology that underlies Cryptocurrency.
- Unique - It cannot be forged or otherwise manipulated.
- Exchange - NFT exchanges take place with cryptocurrencies such as Bitcoin on specialist sites.

Challenges of NFT-

NFTs has its own challenges like ownership and copyright concerns, security risks, market is not that wide, online frauds etc. NFT audit considerations includes comprehensive code review for verifying the safety of a token, valid contract, data privacy and potential cyber threat.

6.5 Robotic Process Automation

RPA is the automation of the repetitive processes performed by users. It is a software technology that emulate humans' actions interacting with digital systems and software. Process efficiency, customer experience and control effectiveness contributed to RPA. Robotic Process Automation software bots can interact with any application or system the same way people do—except that RPA bots can operate around the clock, nonstop, much faster and with 100% reliability and precision

Case Study

A large passenger carrier is having an AI bot for passenger ticket booking with following processes:

User Interaction: The bot interacts with passengers through various channels such as a website, mobile app, or messaging platforms. Passengers can initiate a conversation with the bot by providing their travel details, preferences, and other required information.

Natural Language Processing (NLPT):he bot utilizes natural language processing techniques to understand and interpret the passenger's queries and requests. It can process text or voice inputs and extract relevant information to facilitate ticket booking.

Query Handling:The bot responds to passenger queries related to ticket availability, fares, train schedules, seat preferences, and other relevant information. It can provide real-time updates and answers to common passenger questions.

Booking Process: Upon receiving a booking request, the bot collects the necessary details from the passenger, including travel dates, destinations, class preferences, and passenger information. It validates the inputs, checks seat availability, and calculates fares based on the carrier's pricing structure.

Integration with Booking Systems :The bot interfaces with the carrier's booking systems to check seat availability, reserve seats, and process payment transactions. It securely communicates with the backend systems to initiate the booking process.

Payment Processing : The bot facilitates secure payment transactions, allowing passengers to provide payment details and complete the booking. It may integrate with various payment gateways or services to process credit card payments, net banking, or other payment methods.

Confirmation and Ticket Generation : Once the booking is successfully processed, the bot generates a booking confirmation along with a unique ticket number. It provides the passenger with the necessary information, including the ticket details, train information, and any other relevant instructions.

Ancillary Services: The bot may offer additional services such as seat upgrades, meal selection, travel insurance, or other ancillary offerings. It can provide information and assist passengers in availing these services during the booking process.

Post-Booking Support: The bot can assist passengers with post-booking support, including itinerary changes, cancellations, or ticket modifications. It handles these requests, checks the carrier's policies, and processes the necessary changes as per the passenger's requirements.

Integration with Customer Support : the bot may be integrated with customer support systems to escalate complex queries or issues to human agents when necessary. It can provide a seamless transition from automated assistance to human interaction, ensuring a high level of customer service.

Following are the illustrative steps to audit ticket booking bot system:

- Identify the objectives and goals of auditing the ticket booking bot
- Determine the scope of the audit, including the specific aspects of the bot's functionality and operations to be evaluated.
- Review relevant regulatory and compliance standards applicable to the ticket booking process, such as data protection and privacy regulations, payment card industry standards, and any specific industry guidelines.
- Identify and assess potential risks associated with the ticket booking bot, such as unauthorized access to customer data, system failures, or inaccurate booking information.
- Develop a comprehensive set of audit procedures to assess the effectiveness, efficiency, and compliance of the ticket booking bot. This may include:
 - Reviewing the system architecture, design, and documentation.
 - Evaluating the security measures in place, including authentication, access controls, and encryption.
- Testing the bot's functionality by simulating booking scenarios and verifying the accuracy of

the results.

- Assessing the performance of the bot, such as response times and scalability.
 - Analyzing logs and audit trails to detect any unusual or suspicious activities.
 - Examining the data handling processes, ensuring proper encryption, storage, and protection of customer data.
 - Verifying compliance with relevant regulations, policies, and procedures.
 - Conducting penetration testing or vulnerability assessments to identify potential weaknesses in the bot's security.
 - Decide on the appropriate sampling methodology to evaluate the bot's performance and compliance. This may involve selecting a representative sample of booking transactions or data for analysis.
 - Conduct the audit based on the defined procedures, following best practices and professional audit standards.
 - Document your findings, including any issues or areas of improvement identified during the audit.
 - Compile the audit findings into a comprehensive report, detailing the audit objectives, scope, procedures performed, and results.
 - Provide recommendations for addressing any identified weaknesses, risks, or non-compliance issues.
 - Present the report to relevant stakeholders, such as management, IT teams, and compliance officers.
 - Track the implementation of recommended actions and ensure appropriate measures are taken to address any identified weaknesses.
 - Periodically review and monitor the bot's performance, security, and compliance to ensure ongoing effectiveness.
-

Audit Implications:

Auditors must understand the RPA processes, including data extraction, aggregation, and cleansing. Without this understanding, initiating an audit becomes challenging. Comprehensive assurance requires reviewing the source code, necessitating auditors' familiarity with RPA development tools. This knowledge aids in reviewing logs, configuration controls, and access privileges. Additionally, standard IT controls remain relevant.

Common Risks of RPA:

Operational and execution risks arise when bots are deployed without a proper operating model, leading to incorrect tool selection, flawed assumptions, and compromised security. Properly assigning responsibilities, providing training, and clarifying role changes can mitigate operational risks significantly.

Change management risks emerge from inadequate adherence to the change management lifecycle and incomplete testing, resulting in inaccurate outcomes.

RPA strategy risks stem from setting unrealistic expectations and KPIs, which can lead to uncertainty. Management should thoroughly analyze RPA's capabilities, limitations, and potential before formulating a strategy.

7. CONTROL CONSIDERATIONS OR OBJECTIVES OF AUDITING DIGITALLY

Emerging technologies can bring great benefits, but they also come with a varied set of substantial risks.

The strength of the auditing profession is the assessment of risks and controls. As they address the challenge of assessing technology risk, auditors can and should focus on the following control considerations:

1. Auditors should gain a holistic understanding of change in the industry and the information technology environment to effectively evaluate management's process for initiating, processing, and recording transactions and then design appropriate auditing procedures.
2. Auditors, as appropriate, should consider risks resulting from the implementation of new technologies and how those risks may differ from those that arise from more traditional, legacy systems.
3. Auditors should consider whether digital upskilling or specialists are necessary to determine the impact of new technologies and to assist in the risk assessment and understanding of the design, implementation, and operating effectiveness of controls. E.g., cybersecurity control experts, IT specialists in the team etc.

Examples of Technology Risks where auditors should test the appropriate controls for relying on the digital systems

- Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both
- Unauthorized access to data that might result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions or inaccurate recording of transactions (specific risks might arise when multiple users access a common database)
- The possibility of information technology personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby leading to insufficient segregation of duties
- Unauthorized or erroneous changes to data in master files
- Unauthorized changes to systems or programs
- Failure to make necessary or appropriate changes to systems or programs
- Inappropriate manual intervention
- Potential loss of data or inability to access data as required
- Risks introduced when using third-party service providers
- Cybersecurity risks

8. Key Steps for Auditors in a Changing Technology Environment

As auditors obtain an understanding of the impact of technology on a company's business, its systems of internal control, and its financial reporting, some important reminders include the following:

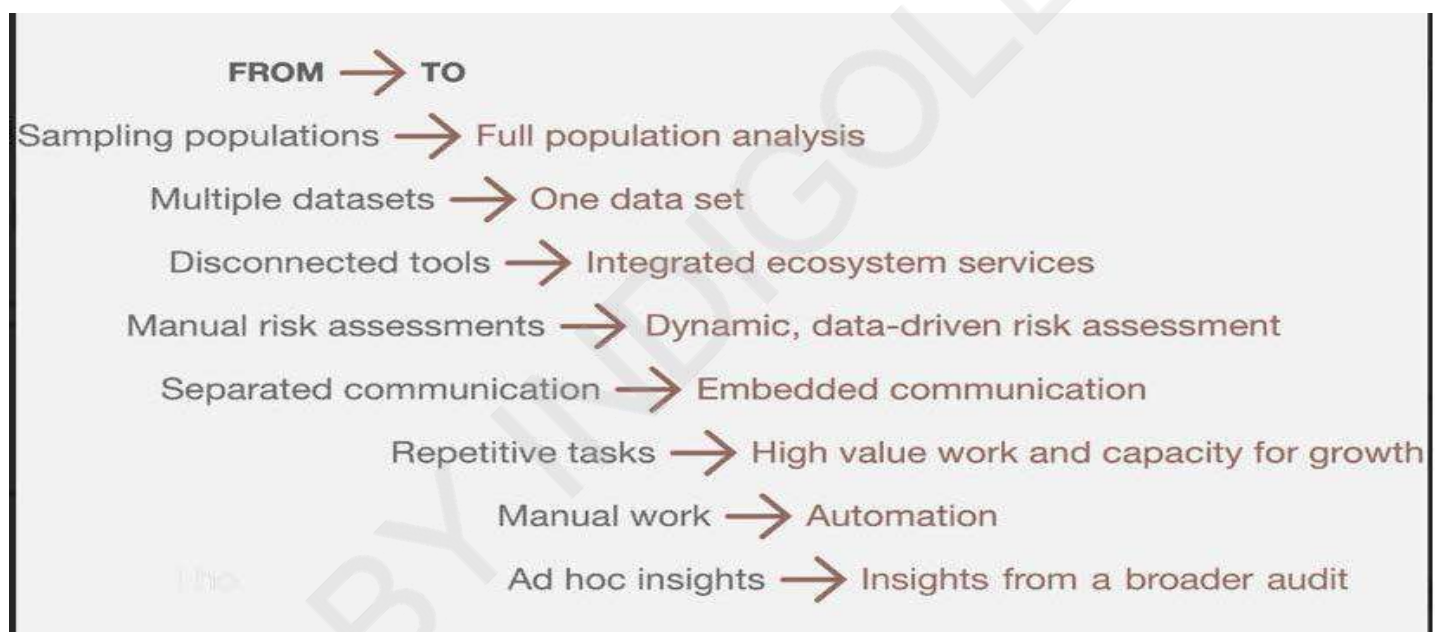
- Maintain sufficient professional skepticism when reviewing management's risk assessment for new systems.

- Understand the direct and indirect effects of new technology and determine how its use by the entity impacts the auditor's overall risk assessment.
- Understand how the technologies impact the flow of transactions, assess the completeness of the in-scope ICFR systems, and design a sufficient and appropriate audit response.
- Assess the appropriateness of management's processes to select, develop, operate, and maintain controls related to the organization's technology based on the extent the technology is used.

9. Next Generation Audit

The Next Generation Audit is human-led, tech-powered and data-driven. It is based on combining emerging technologies to redefine how audits are performed.

Next Generation audit aims at



Drone Technology:

Drones are revolutionizing inventory management, especially in remote areas. For instance, in forestry, drones can efficiently count and monitor trees over vast expanses of land. Additionally, they can carry sensors and cameras, making them ideal for inspecting hard-to-reach places like oil rigs or wind turbines.

By integrating drone-captured data with other sources like QR code readers or manual counts, auditors can enhance the accuracy and efficiency of their audits. For example, in agriculture, drones can be used to assess crop health and yield, providing valuable insights for financial audits.

Augmented Reality (AR):

AR overlays digital information onto the real world, offering exciting possibilities across various industries. One notable application is in retail, where AR allows customers to visualize products in their own space before making a purchase. Another example is in education, where AR can bring textbooks to life with interactive 3D models.

Virtual Reality (VR):

VR immerses users in simulated environments, creating endless opportunities for training, entertainment, and beyond. In the automotive industry, VR is used for virtual vehicle prototyping, allowing designers and engineers to collaborate on new models before physical prototypes are built. Similarly, in real estate, VR enables virtual property tours, saving time and resources for both buyers and sellers.

Examples of AR & VR

In architecture and engineering, AR and VR technologies empower professionals to visualize building designs in a tangible way, enhancing the planning and design process. For example, architects can use AR to overlay digital models onto physical spaces, allowing them to assess scale and spatial relationships more effectively. Similarly, engineers can leverage VR to immerse themselves in virtual prototypes, identifying potential design flaws before construction begins.

In the business sector, AR and VR offer innovative ways to showcase products and streamline customization processes. For instance, companies can use AR apps to allow customers to virtually try out different furniture arrangements in their homes before making a purchase. Additionally, VR simulations can enable employees to undergo virtual training sessions, improving their skills and knowledge retention.

In healthcare, AR technology provides valuable support to surgeons during procedures. Surgeons can use AR overlays to visualize patient anatomy in real time, helping them navigate complex surgical pathways with greater precision. For example, AR headsets like Vision Pro can display vital signs and medical imaging data directly within the surgeon's field of view, enhancing situational awareness and decision-making during operations.

Metaverse:

The Metaverse represents the next frontier of digital interaction, combining elements of virtual reality, augmented reality, and blockchain technology. In gaming, the Metaverse allows players to create and own digital assets, fostering vibrant virtual economies. Moreover, in healthcare, the Metaverse could facilitate remote consultations and medical training in lifelike virtual environments.

Looking ahead, key considerations for the Metaverse include the development of digital economies, governance frameworks, identity management, and the infrastructure needed to support real-time interactions. As the Metaverse evolves, it promises to reshape how we work, play, and connect in the digital age.

Some considerations for future –

- Beyond cryptocurrencies, coins, and exchanges, players in the Metaverse will need to consider how to build digital monetary systems and apply economic principles to things like digital land.
- Governance models will become ever more difficult to balance openness and user contribution with strategic direction and innovation.
- Identity in the digital world has historically been different based on the platform utilized. The practical challenge of identity will also have to be considered in the Metaverse (e.g., KYC)
- Synchronicity is the ability for aspects of the Metaverse to be multiplayer, simultaneous,

and real-time. This includes transactions and actions happening in the Metaverse and are dependent on the infrastructure of digital economies, networking and computing power required to operate a digital world.

Case Scenarios

Virtual Banking and Transactions

A forward-thinking financial institution, establishes a presence in the metaverse to offer virtual banking services. Users can create virtual bank accounts, access personalized financial dashboards, and perform transactions using virtual currencies. Customers can seamlessly transfer funds, make virtual purchases, and engage in virtual commerce, all within the immersive environment of the metaverse. XYZ Bank leverages the metaverse to provide a convenient and interactive banking experience, attracting tech-savvy customers who value digital innovation.

Digital Asset Management

At digital asset management company, recognizes the growing popularity of virtual assets in the metaverse. They launch a virtual asset trading platform within the metaverse, allowing users to buy, sell, and trade NFTs and other digital assets. Investors can diversify their portfolios, participate in virtual auctions, and even showcase their virtual art collections in virtual galleries. Crypto Investments Ltd. leverages the metaverse's decentralized and secure infrastructure to facilitate transparent and efficient transactions of virtual assets.

Virtual Financial Education and Training:

A Financial Learning Academy aims to enhance financial literacy using the metaverse. They create a virtual classroom environment where participants can attend interactive financial education sessions. Students can engage in simulated investment activities, learn about budgeting and financial planning, and gain hands-on experience through virtual trading simulations. Financial Learning Academy leverages the immersive nature of the metaverse to provide an engaging and practical financial education platform, preparing individuals for real-world financial challenges.

Virtual Meetings and Conference

For a leading industry even an organisation hosts a virtual conference within the metaverse. Participants from around the world can access the conference through their virtual avatars. They can attend keynote speeches, panel discussions, and networking events in virtual conference halls. Attendees can interact with industry experts, explore virtual exhibition booths, and establish valuable connections in the financial sector. Global Finance Summit leverages the metaverse to create a global and inclusive conference experience, fostering collaboration and knowledge sharing.

Data Visualization and Analytics:

A company utilizes the metaverse to offer advanced data visualization and analytics tools to financial professionals. Their virtual analytics platform allows users to visualize complex financial data in interactive and immersive 3D environments. Users can explore data trends, conduct simulations, and analyze financial performance through intuitive interfaces within the metaverse. Analytics Solutions Inc. leverages the metaverse's immersive capabilities to enhance data-driven decision-making, enabling financial professionals to gain deeper insights into market trends and make informed investment decisions.

SUSTAINABLE DEVELOPMENT GOALS (SDG) ENVIRONMENT, SOCIAL AND GOVERNANCE (ESG) ASSURANCE

INTRODUCTION

Sustainability is a concept related to the **development of products, goods and services that involves meeting our present needs without compromising the ability of future generations** to fulfil their own needs.

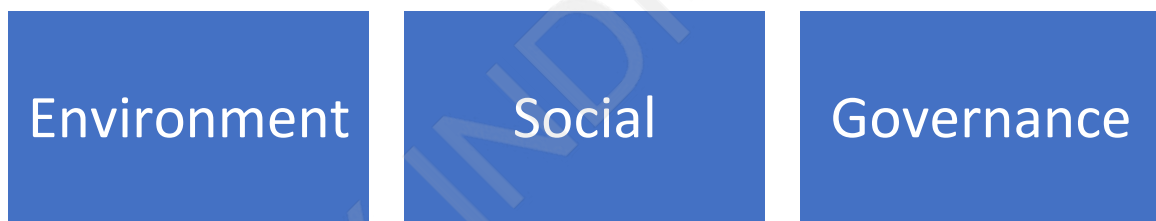
Sustainability recognises that the environment is an exhaustible resource. Therefore, it is important to **use the environment and its resources rationally and protect** it for the good of the Earth, our environment, humanity, and all living things.

The concept of sustainable development is named after the Brundtland report, which reports sustainable consumption in developed countries

In this report Sustainable Development is defined as:

"Sustainable development is development that strives to meet the needs of developing countries seeking to achieve a more sustainable world. Sustainable development addresses the needs of the present moment without compromising current and future generations to meet their own sustainable lifestyles."

Sustainable development can be applied to business corporate policy as it encompasses the following three pillars of sustainability



These three pillars constitute the term ESG

Environment (E)

- It stands for **corporate climate policies**, energy use, waste, pollutions, natural resource conservation, and treatment of animals.
- It includes **natural resources** that every entity absorbs for its functioning like coal, electricity, water, etc. Processing this energy into products / services which will leave behind certain wastes like carbon emissions, water discharges, e-wastes, discharges, etc. Thus, one is dependent on the environment for carrying out its operations.

Social (s)

- It addresses the **relationships the entity has and the reputation it fosters with people and institutions** in the communities where business is conducted and the value chain is involved.
- It further includes **labour relations, diversity, and inclusions**.
- Every company operates within a broader and diverse society.

Governance (G)

- It is the internal system of practices, controls, and procedures entity adopts in order to govern itself, make effective investment decisions, comply with the law, and meet the needs of all stakeholders.
- Every entity, which is itself a legal creation, requires governance

The above pillars include the following elements as under:

Environment

Climate Change:

• Carbon Emissions - Product Carbon Foot Prints
• Financing Environmental Impact
• climate Change Vulnerability

Natural Resources:

• Water Stress -
• Bio-diversity & land use
• Raw Material sourcing

Pollution & Waste:

- Toxic emission and waste
- Packing Material and Waste
- E-Waste

Environment Opportunity:

• Clean Tech
• Green Building
• Renewable Energy

SOCIAL

Human Capital

• Labour Management
• Health & Safety
• Human Capital Development
• Supply Chain Labour Standards

Product Liability

• Product Safety & Quality
• Chemical Safety
• - Financial Product Safety
• Privacy & Data Security
• Responsible Investment

Stakeholders

- Opposition: -Controversial Sourcing

Social opportunity:

● Access to communication
● Access to Finance
● Access to Health Care
● Opportunities in Nutrition and Health

GOVERNANCE

● Broad Diversity
● Executive Pay
● Ownership
● Accounting

Corporate behaviour

- Business Ethics

● Anti-Competitive Practices
● Corruption & instability
● Financial system & stability
● Tax transparency

ESG Reporting:

- ESG reporting is all about disclosure of information, data, metrics that explain the added value in these three areas.
- **Types of ESG reports:**
 - **Qualitative Report:** tend to describe a company's strategy or policy around the relevant topics.
 - **Quantitative Report:** includes metrics, and Key Performance Indicators (KPIs) linked to each area in order to measure progress against goals and report on achievements.
- A mixed approach that makes use of both qualitative and quantitative information tends to add the maximum value to the quality of disclosures.

2. SUSTAINABLE DEVELOPMENT GOALS

- **Adoption:** In 2015, sustainable development was adopted by all **United Nations Members States to provide blueprint, which mentioned the Sustainable development Goals (SDGs)**
- There were **17 SDGs which are considered as an urgent** call for action by all countries, whether developed or developing countries.
- **Purpose:** They recognised that **ending of poverty** and other deprivations must go hand in hand with strategies that **improve health and education, reduce inequality, and spur economic growth** -all while tackling climate change and working to preserve our oceans and forests.

- Today, the Division for Sustainable Development Goals (DSDG) in the United Nations

Department of Economic and Social Affairs (UNDESA) provides substantive support and capacity building for the SDGs and their related thematic (connected) issues including water, energy, climate, oceans, urbanization, transport, science and technology, the Global Sustainable Development Report (GSDR), partnerships and Small Island Developing States.

- SDG plays a key role in the evaluation of UN system wide implementation of the 2030 Agenda and on advocacy and outreach activities relating to the SDGs.

Following are the 17 SDGs:	
1. No Poverty	10. Reduced inequalities
2. Zero Hunger	11. Sustainable Cities & Communities
3. Good Health & Well Being	12. Responsible Consumption & Production
4. Quality Education	13. climate Action
5. Gender Equality	14. Life Below Water
6. Clean Water & Sanitization	15. Life on Land
7. Affordable & Clean Energy	16. Peace, Justice & Strong institutions
8. Decent Work & Economic Growth	17. Partnership for the Goals
9. Industry innovation & infrastructure	

3. GLOBAL TRENDS IN SUSTAINABLE REPORTING

- ❖ **Mandatory for:** public sector or government-run companies, large corporations, multinational business conglomerates, and listed companies in stock exchanges.
- ❖ **Reporting provisions:** sector-specific, and thematic reporting provisions.
- ❖ **Framework used:** Global Reporting initiative (GRI) Sustainability Reporting Standards, having 93% of the world's largest 250 corporations report on their sustainability performance through GR.
- ❖ **GRI Sustainability Reporting Standards** are developed with true multi-stakeholder contributions and rooted in the public interest.

Global Reporting Initiative [GRI]

- Helps the organisations to **report on economic, environmental, and social impacts**
- General disclosures which are required to be reported are **Economic, Environment and Social**.
- This report is **addressed to all the stakeholders of the entity**.

Carbon Disclosure Project [CDP]

- **Captures the environmental performance** data which is related to GHG emissions, water, forests, and supply chain.

- Major details required to be reported are climate **change, Forest**, and Water security.
- This report is **addressed to** all the **investors**, buyers, and other stakeholders of the entity.

International Integrated Reporting Framework (IRC)

- Established guiding principles and content elements in order to allow the companies to produce integrated reports.
- This **report consists of Organisational overview, Governance structure, Business model, risks and opportunities, strategy, performance, outlook etc.**

Comprehensive Corporate Reporting System

In September 2020, these frameworks & standard setting institutions came together to show a commitment to working towards a comprehensive corporate reporting system.

The intent of the collaboration was:

- **Joint market** guidance on how the frameworks & standards can be applied in a complementary and additive way.
- **Joint vision** of how these elements could complement Financial GAAP and serve as a natural starting point for progress towards a more coherent, comprehensive corporate reporting system. **Joint commitment** to drive towards this goal, through an ongoing programme of deeper collaboration between the institutions and stated willingness to engage closely with other interested stakeholders.
- In November 2002, the IFRS Foundation Trustees published a revised Constitution and a Feedback statement that responds to the feedback from Exposure Draft Proposed Targeted Amendments to the IFRS Foundation Constitution to accommodate an international Sustainability Standards Board to Set IFRS Sustainability Standards.
- International investors with global investment portfolios are increasingly calling for high quality, transparent, reliable, and comparable reporting

by companies on climate and other Environmental, Social and Governance (ESG) matters.

- **On 3 November 2021**, the IFRS Foundation Trustees announced the creation of a new standard-setting board-the **International Sustainability Standards Board (ISSB)** to help meet this demand.
- The intention is for the ISSB to deliver a **comprehensive global baseline of sustainability-related disclosure standards** that provide investors and other capital market participants with information about companies sustainability related risks and opportunities to help them make informed decisions.
- Further, the ISSB has taken the technical guidance for developing IFRS Sustainability Disclosure Standards.

Task Force on Climate-Related Financial Disclosures (TCFD)

- It was created in 2015 by the Financial Stability Board (FSB)
- The goal is to help companies to create consistent climate-related disclosures.
- Unlike GRI, which works on a wide range of organizations, TCFD is targeted at companies that predominantly handle financial-related interests, such as banks and insurance firms.

Climate Disclosure Standards Board (CDSB)

- An international group of business which is committed to making climate-related disclosures in the mainstream global corporate reporting.
- CDSB framework was formed to help organizations to disclose climate related risks and opportunities. The CDSB framework has also set out an approach for reporting environmental information.

Value Reporting Foundation (VRF)

VRF IS a non-profit organisation which was a result of the merger between SASB Foundation and the international integrated Reporting Council IRC). The international Accounting Standards Board (IASB) and the ISSB has agreed to worktogether in order to build an Integrated Reporting Framework.

International Sustainability Standards Board (ISSB) in March 2022 launched a consultation on its first **two proposed standards-one on climate- related disclosures and one on general sustainability-related disclosure**

The proposed standards, when finalised, would form a comprehensive global baseline of sustainability-related disclosures designed to meet the information needs of investors in assessing enterprise value.

IERS SI: The proposed requirements in the Exposure Draft IFRS S2 Climate- related Disclosures (climate Exposure Draft) build upon the recommendations ofthe Task Force on Climate-Related Financial Disclosures (TCFD) and incorporateindustry-based disclosure requirements derived from the Sustainability Accounting Standards Board (SASB) Standards.

4 INTEGRATED REPORTING

Integrated Reporting

1. **Manufactured Capital**
2. **Financial Capital**
3. **Intellectual capital**
4. **Social capital**
5. **Human capital**
6. **Natural Capital**

There are 6Cs of integrated Reporting-also known as 6 capitals:

Financial Capital

- **Pool of funds that is available to the organization** for use in theproduction of goods or provision of services.
- **Obtained through financing**, such as debt, equity, or grants, orgenerated through operations or investments.

Manufactured Capital

- Seen as human-created, production-oriented equipment and tools.
- Available to the organisation for use in the production of goods or the provision of services, including buildings, equipment, infrastructure (suchas roads, ports, bridges & waste, and water

treatment plants).

Natural Capital

- Is an **input to the production of goods or the provision of services**.
- An organisation's activities also impact, positively or negatively, on natural capital.
- Includes **water, land, minerals and forests, biodiversity, and ecosystem health**.

Human Capital

- **People's skills and experience, their capacity, and motivations to innovate**, including their
- **Alignment with and support of the organisation's governance framework & ethical values** such as its recognition of human rights.
- Ability to **understand and implement an organisation's strategy**.
- **Loyalties and motivations** for improving processes, goods, and services, including their ability to lead and to collaborate.

Social Capital

- **Institutions and relationships established within and between each community, group of stakeholders and other networks** to enhance individual and collective well-being.
- **Includes:**
 - **Common values and behaviour**.
 - **Key relationships, the trust and loyalty** that an organization has developed and strives to build and protect with customers, suppliers, and business partners.
 - An organization's **social license** to operate.

Intellectual Capital

- **Key element in an organization's future earning potential**, with a tight link and contingency between investment in R&D, innovation, human resources, and external relationships, which can determine the organisation's competitive advantage.

5 GLOBAL SCENARIOS IN VARIOUS COUNTRIES

United States

In March 2022, the US Securities and Exchange Commission (SEC) proposed climate-risk disclosure requirements, which would expand the annual reporting requirements of publicly traded companies.

In their SEC filings, companies would be required to discuss financially material, climate-related risks guided by the TCFD recommendations.

Reporting would include:

- company's climate risk management processes.
- How the risks identified would impact financial performance
- How these risks are managed and mitigated

- Any scenario analysis, transition plans, and publicly announced climate goals.

United Kingdom

In 2019, UK passed a law targeting net zero greenhouse gas (GHG) emissions by 2050.

A key regulation for UK ESG disclosures is the Companies Act of 2006, which includes requirements for annual reporting.

Applicable to large companies that are either listed, exceed £500 million in annual turnover, or have more than 500 employees.

Non-financial information has always been required in annual reports, but in 2022, the Act was expanded to include sustainability matters.

The new requirements align with the recommendations from the Task Force on climate-Related Financial Disclosure (TCFD).

Companies are required to discuss the strategy, processes, and due diligence regarding matters of:

- Environment (including the company's impact on the environment)
- Company's employees
- Social matters
- Respect for human rights
- Anti-corruption and anti-bribery

Specifically for the environment, climate-related disclosures **must include:**

- climate change-related risks and opportunities
- How these risks and opportunities are managed through targets and KPIs
- How climate change is addressed in corporate governance
- How climate risk impacts strategy

Additionally, large UK companies are required to report on their VK energy use and carbon emissions within their annual reports through the Streamlined Energy and Carbon Reporting.

In 2023, ESG reporting in the UK will be further formalised through the Sustainability Disclosure Requirements (SDRS). The SDRS will provide a framework for corporates to manage sustainability-related risks, opportunities, and impacts, as well as set relevant metrics and targets.

Following table showcases the evolution of sustainable development reporting in the recent past:

March 21
Sustainable Finance Disclosures Regulations (SFRI) comes into effect for asset managers and financial advisors operating in EU
April 21
European commission adopts the CSRD proposal which will require large companies to report on the social and environment impacts starting in 2024
October 21
GRI Standards updated
November 21
IFRS foundation announces the formation of its global reporting standardization initiative through the ISSB. UK financial conduct authority releases sustainability requirements disclosure papers.
December 21
The European commission published the first delegated act on sustainable activities for the

first two environmental objective of the EU Territory
February 2022
The EU adopts a proposal for a directive on corporate sustainability due diligence with rules for companies to respect human rights and the environment in the global value chains.
March 2022
US Sec announces climate change disclosure proposals. ISSB exposure draft for public commentary
April 2022
European financial reporting advisory board issues exposure draft of the European Sustainability Reporting standards (ESRS) for public commentary
June 2022
China's voluntary guidance for Enterprise ESG Disclosures take effect.

EVOLUTION OF ESG IN INDIA

Voluntary Guidelines on Corporate Social Responsibility

Announced by MCA in 2009.

Ultimate goal was to integrate sustainability into business practices and into decision making process

National Voluntary Guidelines (NVGs)

- Issued by MCA as additional guidelines on Social, Environmental, and Economic Responsibilities of Business, 2011 (NVGs)
- Emphasizing the importance of corporate entities' environmental, social, and economic responsibilities, as well as the need to integrate them into business practices and investment decision making processes.

2009

Corporate Social Responsibility Voluntary Guidelines 2009

- " MCA issued CSR voluntary guidelines for the businesses to add value to the operations and contribute towards long-term sustainability of the business.
- These guidelines were issued to encourage the corporates to focus on Ethical functioning, Rights and welfare of workers, Human Rights, Environmental development and taking social development activities.

2012

SEBI Mandates top 100 listed companies to file Business Responsibility Report (BRR)

- Top 100 listed companies by market capitalization were required to file BRR.
- BRR 10 as in line with the ESG principles.

2017

National Guidelines on Responsible Business Conduct (NGRBC) 2018

- MCA revised the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 (NVGs) and formulated NGRBC.

2011

National voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business

- Issued in July 2011
- Contained comprehensive principles to be adopted by Companies as part of their business practice.

2015

- BRR became part of SEBI (Listing obligations and Disclosure Requirements) Regulations, 2015
- SEBI vide Circular no. CIR/CFD/CMD/10/2015 dated November 04, 2015, had prescribed the format for the Business Responsibility Report (BRR) in respect of reporting on ESG (Environment, Social and Governance) parameters by listed entities in line with clause (f) of sub regulation (2) of regulation 34 of SEBI (LODR) Regulations 2015.
- Top 500 listed companies by market capitalisation were required to file BRR.

2019

National Guidelines on Responsible Business Conduct (NGRBC) 2018

MCA revised the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 (NVGs) and formulated the National Guidelines on Responsible Business Conduct (NGRBC)

BRR became mandatory for top 1,000 listed companies

- As per SEBI (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2019, with effect from December 26, 2019, the annual report of the top 1,000 listed entities based on market capitalisation shall contain a BRR as per clause (i) of sub regulation (2) of regulation 34 of Listing Regulations.

2022

Mandatory reporting of top 1000 listed Companies to file BRSR along with the annual reports.

2017

SEBI recommended Integrated Reporting for top 500 listed companies

- On 6 February 2017, SEBI issued a circular advising top 500 listed companies which are required to prepare BRR to adopt IR on a voluntary basis from the financial year 2017-18.

2021

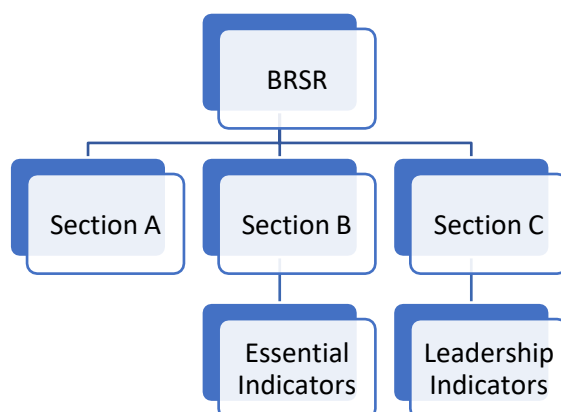
New reporting requirements on ESG parameters called the Business Responsibility and Sustainability Report (BRSR)

- Under notification no. SEBI/AD-NRO/GN/2021/22 dated May 05, 2021, SEBI introduced new reporting requirements on ESG parameters called the Business Responsibility and Sustainability Report (BRSR).
- BRSR seeks disclosures from Listed entities on their performance against the nine principles of the 'National Guidelines on Responsible Business Conduct (NGRBCS) and reporting under each principle is divided into essential and leadership indicators.
- Reporting
 - Essential indicators: mandatory in nature
 - Leadership indicators: voluntary in nature
- Listed entities should endeavour to report the leadership indicators also.
- BRSR is intended towards having quantitative and standardised disclosures on ESG parameters to enable comparability across companies, sectors, and time.

- In Feb 2020, ICAI constituted Sustainability Reporting Standards Board (SRSB).
- Mission of the SRSB is to take appropriate measures to increase awareness and implement measures towards responsible business **conduct, developing audit** guidance for integrated Reporting.
- Encouraged by SEBI, ICAI Introduced India's first award to celebrate the business practice of integrated Reporting, internationally acknowledged as the emerging best practice in corporate reporting.
- Started a **Certificate Course** on Sustainable Development Goals (SDGs), Business **Responsibility Reports (BRR), Integrated Reporting (IR)**.
- Proposed an ICAI Executive Development Program on **Business Responsibility Reporting (BRR)**.
- In last 2 years, ICAI has issued following publications:
 - Standard on Assurance Engagements **(SAE 3410): Assurance Engagements on Greenhouse Gas Statement.**
 - Background Material on BRSR **(revised 2021)**
 - Sustainable Development Goals: Accountants creating sustainableWorld - **Part I covering SDGs 1 to 5**
 - Sustainable Development Goals: Accountants creating sustainableWorld - **Part 2 covering SDGs 6 to 11**
 - Sustainable Development Goals: Accountants creating sustainableWorld - **Parts 3 covering SDG 12 to 17**
 - FAQs On Sustainability Reporting: Heart of Good Governance.
 - Sustainability Reporting Maturity Model (SRMM): **Version 1.0**

Business Responsibility and Sustainability Report (BRSR)

Reporting under BRSR is mandatory from F. Y 2022-23. However, disclosure was voluntary in F.Y 2021-22.



The reporting questionnaire is divided into three sections:

- **Section A: General Disclosures**

This section contains the details of the listed companies, its products, services, operations, employee related details, its holding, subsidiary, associate companies etc.

➤ **Section B: Management Process and Disclosures**

It contains questions related to policy and management processes, governance, leadership, and oversight.

➤ **Section C: Principle-wise Performance Disclosures**

companies are required to report upon Key Performance Indicators (KPIs) in alignment with the nine principles of the NGRBC. The section classifies KPIs into two categories that companies are required to report upon:

- **Essential indicators (Mandatory Disclosures)**

This would include data on training programs conducted, environmental data on energy, emissions, water, waste management, etc.

- **Leadership indicators (optional Disclosures)**

This would include life cycle assessments, details of conflict management policy, additional data, on biodiversity, energy consumptions, supply chain managements etc.

Nine Principles of BRSR

The nine principles in BRSR are categorised into the ESG components of Environment, Social and Governance with

- 2 in environment,
- 3 in social; and
- 4 in governance

Even though they are separate, they are interlinked to each other in some way. For example, the environmental protection is closely linked to the stakeholder engagement and inclusive growth.

Principle 1

Ethics, Transparency and Accountability

Principle 2

Safe and Sustainable Goals and service

Principle 3

Promote well-being of all employees including those in the value chain

Principle 4

Respect for stakeholders interests and responsiveness

Principle 5

Respect and Promote human rights.

Principle 6

Protection and Restoration of environment

Principle 7:

Influence on Public and Regulatory policy

Principle 8:

Promote inclusive Growth and Equitable development.

Principle 9:

Provide value to the consumers in a responsible manner

Principle 1: Ethics, Transparency and Accountability

The first principle emphasizes that the **business decisions** in an organisation should be **open to disclosure** and accessible to the relevant interested parties.

The essence of **core elements** associated with the first principle are:

- I. The entities' governing structure should develop policies, SDG & ES procedures, practices for their offices, factories, and work areas, ensuring that **ethics is not compromised**.
- II. The information relating to the policies, procedures, and practices along with the performance should be **made available to the stakeholders**.
- III. In case of adverse effects, **more care has to be taken for transparent disclosures**.
- IV. The **entities in the value chain** should be **encouraged to adopt these principles** by the governance structure.
- V. The entities should **proactively respond to the outside entities that violate** the nine principles of the BRSRs. This includes their suppliers, distributors, sub-contractors, or regulatory officers that may engage with the business concern.

Principle 2: Safe and Sustainable Goals and Service

Entities should make sure that their goods, services, and the operations result in **better life for the consumers and end-users**.

The essence of the **core elements associated with the second principle is:**

- When a product is designed by the entity, production methods and technologies have to be devised in such a way so as to **minimise the resource usage to make it sustainable**.
- Entities are also responsible to educate and make aware their consumers **and clients about their rights**.
- Entities should take measures that reduce the over exploitation of the nature's resources by consuming sustainably and encourage methods for reduce, reuse and recycling of the resources.

Principle 3: Promote well-being of all employees including those in the value Chain

The third principle relates to all the initiatives an entity has to take for the **benefit of its employees from the point** of view of their

The essence of the core elements associated with the principle is: Entity should:

- Ensure **compliance with all regulatory requirements** as far as employees are concerned.
- Respect the **dignity of employee** as a human being and should not restrict their freedom of associations, unions, and other participatory mechanism for collective bargaining of their rights and redressal of issues they face at the workplace.
- Prevent all kinds of **child labour, bonded labour**, and any other forms of **involuntary labour**.
- Have a system in which the **work-life balance** of the employees is not compromised.
- Be responsible:
 - To create a workplace and work environment that is **safe, hygienic, and comfortable** for people to work for long durations.
 - To create a workplace which is **free of harassment and violence**,
 - For **skill development, career development and training** of the workforce employed.
- Businesses have to ensure timely payment of the worker's wages and compensation.
- Payment of the wages has to be **as per the living wages**, which can take care of the basic needs

and provide economic security to the employees.

Principle 4: Respect for stakeholders' interests and responsiveness

The concept of interested party or stakeholders to a business has been a point of discussion in all the regulatory and voluntary systems that relate to the management system of any organisation, be it related to the quality, environment or the occupational health and safety of the workers.

The essence of the core elements associated with the principle is:

- The entities have to be **transparent and communicate** with the stakeholders about the impacts of their operations and business decisions on the people and the nature.
- The **policies, decisions, and the impact of the** operations of the organisation to the stakeholders have to be disclosed transparently with no ambiguity on the extent of the issues.
- The entities have to systematically **determine the context of their operation** and **identify their interested parties**.
- The entities should **fairly share the benefits to the stakeholders** or give an opportunity to them to benefit from the operations in an equitable manner.

Principle 5: Respect and Promote human rights

The concept of human rights covers a wide variety of violence and threatening abusive issues faced by people.

It refers to the **human rights issues** that happen directly or indirectly **due to the operation of the business**.

The essence of the core elements associated with the principle are:

- Entities should have a **clear understanding** of the human rights and various ways by which human rights can be violated from the perspective of the **Constitution of India, national laws and policies** and the content of **international Bill of Human Right**.
- Entities when developing their management systems, should **integrate the human rights element into their policies, procedures, and practices**.
- Businesses should **recognise and respect the human rights** of all relevant stakeholders and groups **within and beyond the workplace, including** that of communities, consumers, and vulnerable and marginalised groups.

Principle 6: Protection and Restoration of Environment

The **sixth principle** looks at the environmental responsibility as a basic requirement for the economic prosperity and sustainability.

The **core elements** associated with this principle are: Entities should:

- **have policies, procedures, and practices** in place to assess and rectify impacts to the environment. This should cover the whole life cycle of the product.
- **Utilize natural** and manmade resources in an optimum manner to ensure their sustainability by taking feedback from the stakeholders.
- measure their performance relating to the prevention of **pollution, destruction of forests**, waste generation, energy use, land use, etc.
- **Contribute towards climate change** resilience in line with India's commitment to various international mechanisms **such as. Paris Agreement and National Action Plans for Climate Change**.
- **compare its activities with industry best practices** to reduce, reuse and recycle/ recover materials, resources.

- look out for **avenues by which they can improve their performance** towards various environmental responsibilities.

Principle 7: Influence on Public and Regulatory Policy

The seventh principle of influencing the policy formulation positively recognises that the businesses **operate within the framework of statutory and legislative policies** of the governing authority.

The principle further highlights that:

- **Core elements of BRSR have to met** holistically when the organisations go ahead with their contributions to policy formulation and policy advocacy.
- **Collective associations** such as, the trade groups and industry chambers have to be utilised when moving ahead with the policy advocacy and formulation.
- Role in policy advocacy by the organisation should be in such a way that it encourages fair **competition and prevents** human rights abuses.

Principle 8: Promote Inclusive Growth and Equitable Development

This can work only with close participation and collaboration amongst the entities, authorities, the civil associations contributing to one another for a better livelihood, and assistance to the marginalised communities.

The core elements of the eighth principle are:

- Entities should:
 - have systems in place to identify and address impacts of their activities on the social, cultural, and e business created issues like, land acquisition and use and construction economic aspects of the people. This includes activities for new facilities.
 - review, measure, and track the adverse impacts of their activities on the society and environment and make action plans to mitigate them adequately.
 - make efforts to bring up creative products, technologies, and business concerns that help the marginalised communities to have well-being and a better quality of life.
 - when designing their CSR activities, review local and regional development priorities to help the marginalised groups and communities.
 - take care to ensure that business induced displacement or relocation of communities does not happen, and in unavoidable cases, should make sure to have mutually agreed, participative, and informed negotiations to provide fair compensation to the affected people.
- All forms of intellectual property and traditional knowledge should get the deserved respect from the organisation, and efforts should be made to ensure that benefits derived from their knowledge are shared equitably.

Principle 9: Provide value to the consumers in a responsible manner

The primary purpose of any business is to create or provide useful products and services to the customer in exchange of reasonable profits.

The core elements associated with the principle are:

- Entities should:
 - put in their efforts to **reduce the negative impacts of their products and services** on consumers, natural environment, and society at large.
 - transparently and accurately **disclose all kinds of adverse impacts** to the user, planet, society, on the biodiversity from their products.
 - inform the customers on the safe and responsible ways of usage, **reuse, recycling, and disposal of their products, and ways to eliminate** over-consumption.

- **when in the business of providing essential goods and services** (e.g., Utilities), enable **universal access**, including to those whose services have been discontinued for any reason, in a non-discriminatory and responsible manner.
- When conceptualising, designing, and marketing their products, the organisation **should not in any manner prevent the freedom of choice and fair competition**.
- When handling customer data, the right to privacy of the customer needs to be maintained.
- When **advertising about their products**, the organisations should ensure that **misleading and confusing information is not exposed to the customers** about their products or its usage.
- Business enterprises should **make available transparent and accessible grievance redressal and feedback management system** for their customers to raise their voices or to seek clarifications.

Alignment of BRSR Principles with SDGs

Principles/ SDGS	P1	P2	P3	P4	P5	P6	P7	P8	P9
SDG 1			<input type="checkbox"/>	<input type="checkbox"/>				<input type="checkbox"/>	
SDG 2		<input type="checkbox"/>				<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
SDG 3			<input type="checkbox"/>					<input type="checkbox"/>	
SDG 4			<input type="checkbox"/>					<input type="checkbox"/>	<input type="checkbox"/>
SDG 5			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
SDG 6		<input type="checkbox"/>				<input type="checkbox"/>		<input type="checkbox"/>	
SDG 7		<input type="checkbox"/>				<input type="checkbox"/>	<input type="checkbox"/>		
SDG 8		<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>			<input type="checkbox"/>	
SDG 9		<input type="checkbox"/>					<input type="checkbox"/>		
SDG 10		<input type="checkbox"/>					<input type="checkbox"/>		
SDG 11			<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	<input type="checkbox"/>	
SDG 12						<input type="checkbox"/>			<input type="checkbox"/>
SDG 13		<input type="checkbox"/>				<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
SDG 14		<input type="checkbox"/>				<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
SDG 15		<input type="checkbox"/>				<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
SDG 16	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
SDG 17	<input type="checkbox"/>						<input type="checkbox"/>	<input type="checkbox"/>	

Assurance in BRSR

Applicability: SEBI has currently started with the top 1,000 listed companies. But very soon, remaining listed companies would also need to comply with the provisions of BRSR.

BRSR is expected to be used as a single means for disclosing sustainability related information in India. This would be the main document which the stakeholders, investors would review and do industry analysis.

Hence, assurance in this reporting becomes more critical.

ESG Audit:

- ESG Audit would be a process that would help the **companies to evaluate the environmental and social risks for the company's products, services, operations, etc.**
- Conducting an ESG audit also helps **businesses look at their supply-chain risks, risk management**

capabilities and transparency with shareholders.

SSAE: 3000 Assurance Engagements on Sustainability information

ICAI has recently issued Standard on Sustainability Assurance Engagements (SSAE) 3000 Assurance Engagements on Sustainability Information.

This standard deals with assurance engagements on an entity's sustainability information.

This is an umbrella standard applicable to all assurance engagements on Sustainability information.

The intended users of this Standard include:

- Assurance providers providing assurance on sustainability information.
- Entities seeking to engage a professional auditor.
- Regulators, investors, and other users of Sustainability Reporting data.

Assurance: This standard provides reasonable or limited assurance on sustainability information

Effective date of application:

- For assurance reports covering periods ending on 31st March 2023 – Voluntary basis.
- For assurance reports covering periods ending on or after 31st March 2024 -Mandatory basis
- ICAI has also issued SSAE 3410, Assurance Engagements on Greenhouse Gas Statements which deal with assurance engagements on an entity's sustainability information including assurance of BRSR.

Methodology to provide assurance on BRSR

Preliminary

Review of ESG reports, parameters

On-Site

• Assessment/ verification of ESG report
• Issuance of Assessment report and assessment statement
• Review of the responses & clarifications on the findings
• Submission of findings of the onsite assessment and document review
• Preparation of Assessment/ verification report including final results of Assessment/ Recommendation

Social Audit Standards

- The Sustainability Reporting Standards Board (SRSB) of the ICAI has recently issued **Social Audit Standards (SAS 100 to I600)**.
- **Aim:** To provide the Social Auditor with the necessary guidance in relation to independent impact assessment engagement of Social Enterprises engaged in various areas and the audit steps and procedures that should be applied while conducting the social impact assessment
- The **Standard sets out the minimum requirements to be followed** while conducting impact assessment.
- However, laws or regulations may establish additional requirements which should be followed, as applicable.

ROLE OF AUDITOR: CONSIDERATION OF CLIMATE RELATED RISKS IN AN AUDIT OF FINANCIAL STATEMENTS

Auditor's Objective:

The role of the auditor is to obtain reasonable assurance about whether the FS as a whole are free from material misstatement, whether due to fraud or error, to enable auditor to report whether the FS are prepared and presented fairly, in all material respects, in accordance with the A-FRFW.

Obtain understanding of the entity:

In developing the understanding of an entity, **the auditor should include the consideration of climate related risks and how these risks may be relevant to the audits.** The climate-related risks could be more relevant in certain sectors or industries, e.g., banks and insurance, energy, transportation, materials and buildings, agriculture, food, and forestry products.

Usage:

Investors and stakeholders are seeking information from auditor's reports about **how climate-related risks were addressed in the audit.** With this increased user focus on climate change, auditor need to be aware of, and may face, increasing pressure for transparency about climate matters in his audit reports.

Audit Report:

- Must follow the requirements of **applicable auditing standards.**
- A key mechanism of communication to users about the audit that was performed.
- In addition to the audit opinion, it provides information about **auditor's responsibilities** and, when required, an understanding of the matters of most significance in the audit and how they were addressed.
- It may, also, warrant inclusion of an **Emphasis of Matter (EOM)** paragraph to draw attention to disclosures that are of fundamental importance to users understanding of the Fs.

Auditor's Responsibilities:

- Determine whether the entity has **appropriately disclosed relevant climate-related information in the FS** in accordance with the A-FRFW e.g., Indian Accounting Standards or Accounting Standards, when relevant before considering climate-related matters in the auditor's report.
- **Read the other information** for consistency with information disclosed in the FS and information that may be publicly communicated to stakeholders outside the FS, such as management report narratives in the annual report, press releases, or investor updates (As per ISA 720 and SA 720)

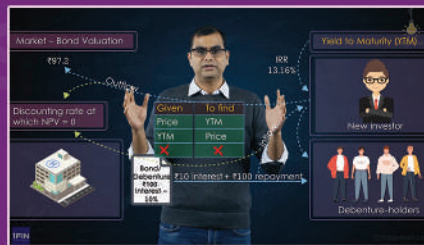
Conclusion

- The overarching importance of sustainability reporting **continues to gain momentum globally** with demand from various stakeholders and substantial research and developments towards uniform set of sustainability standards.
- The uniformity is not achieved yet due to lack of a common language for sustainability reporting.
- As reporting of sustainability information becomes the trend being observed globally, the demand for independent assurance of sustainability information is anticipated to grow as entities around the globe look to enhance the integrity of their sustainability reporting.
- Hence, it is imperative that **auditors and assurance providers understand** the current landscape and continue to monitor ongoing developments.
- The demand and for assurance on "sustainability branded" reporting continues to grow and therefore there is an **urgent need for globally accepted sustainability/ ESG assurance standards** that can be used by all assurance professional

Our Approach

We go to great lengths to ensure that we deliver a quality learning experience to our students. Right from pedagogy design to faculty selection, video recording and animation, at every stage our goal is to ensure that the final output is the BEST and it meets the requirements of the learners. It is our laser sharp focus on maintaining HIGH QUALITY and setting new benchmarks in the CA education domain, that make our efforts stand out and help our students to succeed in their examinations.

A Glimpse of our e-learning modules

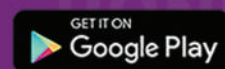


START LEARNING TODAY

1. Go to <https://www.indigolearn.com> and click on Sign Up
2. Choose your courses & pay online
3. Start Learning Instantly



@IndigoLearn



Download our APP 1FIN

1FIN
BY INDIGOLEARN