

## 8.1 Auditor's Opinion



Assuming you are an auditor and concluded the audit work, your next step will be issuance of the audit report. An audit report is very important medium of communication i.e. auditor's expert views on the financial statements and it has a significant bearing on the credibility of such statements. By expressing views in the report, the auditor takes upon himself a great responsibility because a large number of people are likely to put reliance on the financial statements. Therefore, the auditor is necessarily to be careful, clear and objective in the matter of preparation of the report. The report should also be as simple as the circumstances permit.

Fig. : Audit Opinion\*

## 8.2 The Auditor's Report on Financial Statements:

*The SA 700 series is purely dedicated to the auditor report to be issued by the auditor. There are following SAs which you need be aware of:*

Particulars	Head	Purpose	Effective Date
SA-700 (Revised)	Forming an Opinion and Reporting on Financial Statements	<ul style="list-style-type: none"> <li>Forming opinion on the financial statements.</li> <li>Form and content of the audit report.</li> </ul>	1 <sup>st</sup> April 2017
SA-701 (newly introduced)	Communicating Key Audit Matters in the Independent Auditor's Report	<ul style="list-style-type: none"> <li>To enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed.</li> <li>To assist the user in</li> </ul>	1 <sup>st</sup> April 2017

\* Source: [www.simplilearn.com](http://www.simplilearn.com)

		<i>understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.</i>	
<b>SA-705 (Revised)</b>	<b>Modifications to the Opinion in the Independent Auditor's Report</b>	<ul style="list-style-type: none"> <li>• To issue an appropriate audit report when the auditor considers the modification in an audit report is necessary.</li> <li>• To deal with the revised form and content when the modification of the opinion take place.</li> </ul>	<b>1<sup>st</sup> April 2017</b>
<b>SA-706 (Revised)</b>	<b>Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report</b>	<p>To draw user's attention Draw users' attention to a matter or matters:-</p> <ul style="list-style-type: none"> <li>• Presented or disclosed in the financial statements and which is fundamental for the understanding of the user, or</li> <li>• Not presented or disclosed in the financial statement and which is relevant for the understanding of the user.</li> </ul>	<b>1<sup>st</sup> April 2017</b>

### **8.2.1 SA-700, "Forming an Opinion and Reporting on the Financial Statements":**

*It deals with the auditor's responsibility to form an opinion on the financial statements. It also deals with the form and content of the auditor's report issued as a result of an audit of financial statements.*

**Objective:** As per SA 700 the objectives of the auditor are:



**Fig.: Audit Report\***

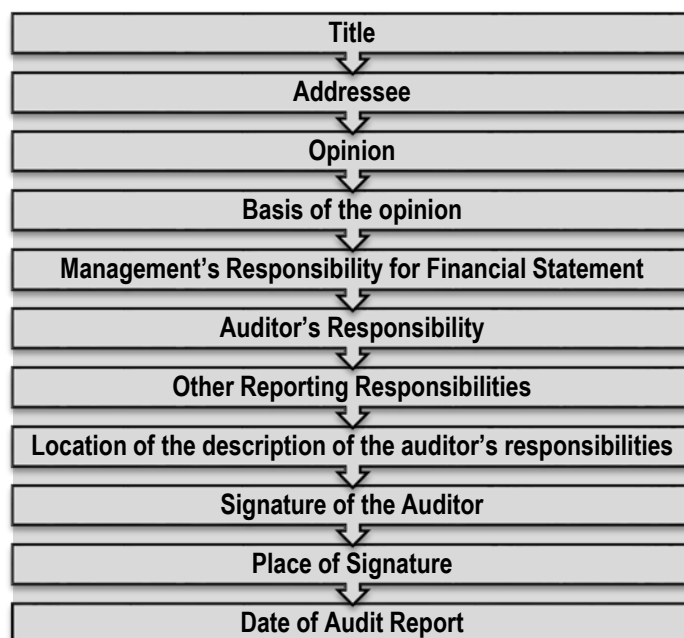
\* Source: hubpages.com

(a) To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and

(b) To express clearly that opinion through a written report.

**Purpose:** The requirements of this SA are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally and the need to increase the value of auditor reporting by making the information provided in the auditor's report more relevant to users. This SA promotes consistency in the auditor's report, but recognizes the need for flexibility to accommodate particular circumstances of individual jurisdictions. Consistency in the auditor's report, when the audit has been conducted in accordance with SAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. It also helps to promote the user's understanding and to identify unusual circumstances when they occur.

**Basic Elements of the Auditor's Report:** As per SA 700 "Forming an opinion and reporting on financial statements", the auditor's report includes the following basic elements, which ordinarily includes in case of Auditors's Report for Audits Conducted in Accordance with Standards on Auditing:



1. **Title:** The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor.

**Example,** "Independent Auditor's Report," distinguishes the independent auditor's report from reports issued by others.

2. **Addressee:** *The auditor's report shall be addressed as required by the circumstances of the engagement.*

3. **Auditor's Opinion :** *The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."*

*The Opinion section of the auditor's report shall also:*

- (a) Identify the entity whose financial statements have been audited;*
- (b) State that the financial statements have been audited;*
- (c) Identify the title of each statement comprising the financial statements;*
- (d) Refer to the notes, including the summary of significant accounting policies; and*
- (e) Specify the date of, or period covered by, each financial statement comprising the financial statements.*

*When expressing an unmodified opinion on financial statements prepared in accordance with a fair presentation framework, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:*

- (i) In our opinion, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [the applicable financial reporting framework]; or*
- (ii) In our opinion, the accompanying financial statements give a true and fair view of [...] in accordance with [the applicable financial reporting framework].*

*When expressing an unmodified opinion on financial statements prepared in accordance with a compliance framework, the auditor's opinion shall be that the accompanying financial statements are prepared, in all material respects, in accordance with [the applicable financial reporting framework].*

*If the reference to the applicable financial reporting framework in the auditor's opinion is not to Accounting Standards, the auditor's opinion shall identify the origin of such other framework.*

4. **Basis for Opinion :** *The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:*

- (a) States that the audit was conducted in accordance with Standards on Auditing;*
- (b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;*
- (c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall refer to the Code of Ethics issued by ICAI*
- (d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.*

**5. Going Concern:** Where applicable, the auditor shall report in accordance with SA 570 (Revised).<sup>1</sup>

**6. Key Audit Matters:** For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701.

*When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.*

**7. Responsibilities for the Financial Statements:** The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." The auditor's report shall use the term that is appropriate in the context of the legal framework applicable to the entity and need not refer specifically to "management". In some entities, the appropriate reference may be to those charged with governance.

*This section of the auditor's report shall describe management's responsibility for:*

- (a) Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and*
- (b) Assessing the entity's ability to continue as a going concern<sup>2</sup> and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.*

*This section of the auditor's report shall also identify those responsible for the oversight of the financial reporting process, when those responsible for such oversight are different from those who fulfill the responsibilities described in next paragraph. In this case, the heading of this section shall also refer to "Those Charged with Governance" or such term that is appropriate in the context of the legal framework applicable to entity.*

*When the financial statements are prepared in accordance with a fair presentation framework, the description of responsibilities for the financial statements in the auditor's report shall refer to "the preparation and fair presentation of these financial statements" or "the preparation of financial statements that give a true and fair view," as appropriate in the circumstances.*

**8. Auditor's Responsibilities for the Audit of the Financial Statements :** The auditor's report shall include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."

*This section of the auditor's report shall:*

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<sup>1</sup> SA 570 (Revised), *Going Concern*, paragraphs 21–23

<sup>14</sup> SA 570 (Revised), paragraph 2

- (a) *State that the objectives of the auditor are to:*
  - (i) *Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and*
  - (ii) *Issue an auditor's report that includes the auditor's opinion.*
- (b) *State that reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and*
- (c) *State that misstatements can arise from fraud or error, and either:*
  - (i) *Describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements; or<sup>3</sup>*
  - (ii) *Provide a definition or description of materiality in accordance with the applicable financial reporting framework.*

*The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report shall further:*

- (a) *State that, as part of an audit in accordance with SAs, the auditor exercises professional judgment and maintains professional skepticism throughout the audit; and*
- (b) *Describe an audit by stating that the auditor's responsibilities are:*
  - (i) *To identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error; to design and perform audit procedures responsive to those risks; and to obtain audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.*
  - (ii) *To obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor shall omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.*

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<sup>15</sup> SA 320, Materiality in Planning and Performing an Audit, paragraph 2

- (iii) *To evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.*
  - (iv) *To conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If the auditor concludes that a material uncertainty exists, the auditor is required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify the opinion. The auditor's conclusions are based on the audit evidence obtained up to the date of the auditor's report. However, future events or conditions may cause an entity to cease to continue as a going concern.*
  - (v) *When the financial statements are prepared in accordance with a fair presentation framework, to evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.*
- (c) *When SA 600, "Using the Work of Another Auditor", applies, further describe the auditor's responsibilities in a group audit engagement by stating:*

*The division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components is audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors*

*The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report also shall:*

- (a) *State that the auditor communicates with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that the auditor identifies during the audit;*
- (b) *State that the auditor provides those charged with governance with a statement that the auditor has complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters that may reasonably be thought to bear on the auditor's independence, and where applicable, related safeguards; and*
- (c) *For audits of financial statements of all such entities for which key audit matters are communicated in accordance with SA 701, state that, from the matters communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit of the financial statements of the current period and are*

*therefore the key audit matters. In accordance with the requirements of SA 701, the auditor describes these matters in the auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, the auditor determines that a matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.*

**9. Location of the description of the auditor's responsibilities for the audit of the financial statements:** *The description of the auditor's responsibilities for the audit of the financial statements required by this SA shall be included:*

- (a) Within the body of the auditor's report;*
- (b) Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix; or*
- (c) By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or the auditing standards expressly permit the auditor to do so.*

*When the auditor refers to a description of the auditor's responsibilities on a website of an appropriate authority, the auditor shall determine that such description addresses, and is not inconsistent with, the requirements of this SA.*

**10. Other Reporting Responsibilities:**

- (a) If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled "Report on Other Legal and Regulatory Requirements" or otherwise as appropriate to the content of the section, unless these other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the SAs in which case the other reporting responsibilities may be presented in the same section as the related report elements required by the SAs.*
- (b) If other reporting responsibilities are presented in the same section as the related report elements required by the SAs, the auditor's report shall clearly differentiate the other reporting responsibilities from the reporting that is required by the SAs.*
- (c) If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements of this SA shall be included under a section with a heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" shall follow the "Report on the Audit of the Financial Statements."*

**11. Signature of the Auditor:** *The auditor's report shall be signed. The report is signed by the auditor (i.e. the engagement partner) in his personal name. Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm. The partner/proprietor signing the audit report also needs to mention the*



## 8.9 Advanced Auditing and Professional Ethics

***membership number assigned by the Institute of Chartered Accountants of India. They also include the registration number of the firm, wherever applicable, as allotted by ICAI, in the audit reports signed by them.***

The report is to be signed by the maker of the report. Normally, a chartered accountant in practice signs the report in the name he is registered as a practitioner. If he is an individual, it may be his individual name or the firm name of which he is the sole proprietor. For those who practise as a partnership, it is usual for them to sign in the firm name. Under Section 145 read with Section 141(2) of the Companies Act, 2013, only the person appointed as an auditor of the company or, where a firm is so appointed, only the partner in the firm who is a chartered accountant, may sign the auditor's report or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.

It is obvious that the person appointed makes the report; otherwise the very essence of the appointment of a particular man or firm will be lost. In a profession, the particular skill and reputation of the practitioner counts considerably and if anybody else is allowed to make the report on behalf of the person appointed, then this confidence in the person will cease to be a factor. This has other implications also from the point of view of professional responsibility; it will create an unusual legal situation. It has also implications from the standpoint of the practitioner. If in respect of appointments held by him, the reports are made by others, gradually the goodwill of the practitioner will end and the clients may shift to the person actually making the report.

Example:

If A, B and C were in practice as ABC & Co. Chartered Accountants, any of A or B or C could sign as "ABC & Co." in his own hand. But now in view of the objection raised by the Department of Company Affairs to this practice, the Council of the Institute in the SA 700 "The Auditor's Report on Financial Statements" has recommended to the members who are in practice in partnership that signature on or authentication of the auditor's report or any other document required to be signed or authenticated by the auditor should be made in the following manner.

For ABC and Co.  
Chartered Accountants  
Firm Registration Number  
Signature  
(Name of the Member Signing the Audit Report)  
(Designation)<sup>4</sup>

In addition to the provisions of the Companies Act, 2013 referred to above, Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949 provides that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he allows a person, not being a member of the Institute or a member not being his partner, to sign on his

<sup>4</sup> Partner or Proprietor, as the case may be.

behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements. The provision is intended to safeguard the professional purity by excluding non-chartered accountants from signing the aforesaid documents. By excluding chartered accountants who are not partners, it seeks to keep the line of professional responsibility clear. Partners are mutual agents and therefore, allowing a partner to sign does not interfere with the clarity of responsibility.

**12. Place of Signature :** *The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.*

**13. Date of the Auditor's Report:** *The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that:*

- (a) *All the statements that comprise the financial statements, including the related notes, have been prepared; and*
- (b) *Those with the recognized authority have asserted that they have taken responsibility for those financial statements.*

**Auditor's Report Prescribed by Law or Regulation:** *If the auditor is required by law or regulation applicable to the entity to use a specific layout, or wording of the auditor's report, the auditor's report shall refer to Standards on Auditing only if the auditor's report includes, at a minimum, each of the following elements:*

- (1) *A title.*
- (2) *An addressee, as required by the circumstances of the engagement.*
- (3) *An Opinion section containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements.*
- (4) *An identification of the entity's financial statements that have been audited.*
- (5) *A statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall refer to the Code of Ethics issued by ICAI.*
- (6) *Where applicable, a section that addresses, and is not inconsistent with, the reporting requirements of SA 570 (Revised).*
- (7) *Where applicable, a Basis for Qualified (or Adverse) Opinion section that addresses, and is not inconsistent with, the reporting requirements of SA 570 (Revised).*
- (8) *Where applicable, a section that includes the information required by SA 701, or additional information about the audit that is prescribed by law or regulation and*

*that addresses, and is not inconsistent with, the reporting requirements in that SA.<sup>5</sup>*

- (9) A description of management's responsibilities for the preparation of the financial statements and an identification of those responsible for the oversight of the financial reporting process that addresses, and is not inconsistent with, the requirements.*
- (10) A reference to Standards on Auditing and the law or regulation, and a description of the auditor's responsibilities for an audit of the financial statements that addresses, and is not inconsistent with, the requirements.*
- (11) The auditor's signature.*
- (12) The Place of signature*
- (13) The date of the auditor's report.*

***Auditor's Report for Audits Conducted in Accordance with Both Standards on Auditing Issued by ICAI and International Standards on Auditing or Auditing Standards of Any Other Jurisdiction:***

***An auditor may be required to conduct an audit in accordance with, in addition to the Standards on Auditing issued by ICAI, the International Standards on Auditing or auditing standards of any other jurisdiction. If this is the case, the auditor's report may refer to Standards on Auditing in addition to the International Standards on Auditing or auditing standards of such other jurisdiction, but the auditor shall do so only if:***

- (a) There is no conflict between the requirements in the ISAs or such auditing standards of other jurisdiction and those in SAs that would lead the auditor:***
  - (i) to form a different opinion, or***
  - (ii) not to include an Emphasis of Matter paragraph or Other Matter paragraph that, in the particular circumstances, is required by SAs; and***
- (b) The auditor's report includes, at a minimum, each of the elements set out in Auditor's Report Prescribed by Law or Regulation discussed above when the auditor uses the layout or wording specified by the Standards on Auditing. However, reference to "law or regulation" in above paragraph shall be read as reference to the Standards on Auditing. The auditor's report shall thereby identify such Standards on Auditing.***

***When the auditor's report refers to both the ISAs or the auditing standards of a specific jurisdiction and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.***

***Supplementary Information Presented with the Financial Statements: If supplementary information that is not required by the applicable financial reporting framework is presented***

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<sup>5</sup> SA 701, paragraphs 11–16

*with the audited financial statements, the auditor shall evaluate:*

- *whether, in the auditor's professional judgment, supplementary information is nevertheless an integral part of the financial statements due to its nature or how it is presented. When it is an integral part of the financial statements, the supplementary information shall be covered by the auditor's opinion.*
- *whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements. If this is not the case, then the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall identify the unaudited supplementary information and explain in the auditor's report that such supplementary information has not been audited.*

#### **8.2.2 SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report":**

*This SA 701 provide guidance regarding communication of Key Audit Matters. Key Audit matter are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.*

*Purpose: The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.*

*Scope: Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not:*

- (a) A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;*
- (b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);*
- (c) A substitute for reporting in accordance with SA 570 (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or*
- (d) A separate opinion on individual matters.*

*This SA applies to audits of complete sets of general purpose financial statements of listed entities and circumstances when the auditor otherwise decides to communicate*

*key audit matters in the auditor's report. This SA also applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report. However, SA 705 (Revised) prohibits the auditor from communicating key audit matters when the auditor disclaims an opinion on the financial statements, unless such reporting is required by law or regulation.*

**Determining Key Audit Matters:** *The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:*

- (a) *Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315*
- (b) *Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.*
- (c) *The effect on the audit of significant events or transactions that occurred during the period.*

**Communicating Key Audit Matters:** *The introductory language in this section of the auditor's report shall state that:*

- (a) *Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and.*
- (b) *These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.*

**Illustration**

*The following illustrates the presentation in the auditor's report if the auditor has determined there are no key audit matters to communicate:*

**Key Audit Matters**

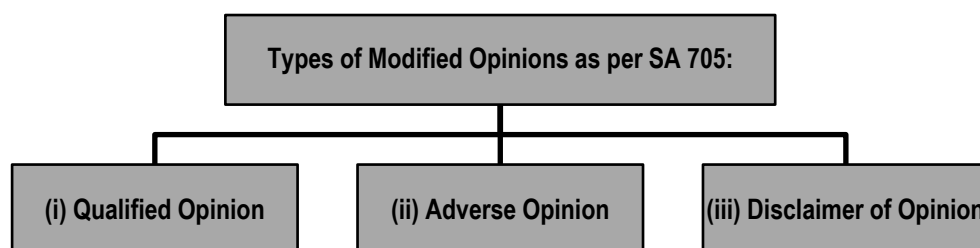
*[Except for the matter described in the Basis for Qualified (Adverse) Opinion section or Material Uncertainty Related to Going Concern section,] We have determined that there are no [other] key audit matters to communicate in our report.]*

**8.2.3 SA 705, "Modifications to the Opinion in the Independent Auditor's Report":**

**Modified Opinions:** SA 705 deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

The succinct requirements of this SA 705 are given below-

### Types of Modified Opinions:



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

- (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- (b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

**Objective:** The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:

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

### Circumstances When a Modification to the Auditor's Opinion is Required:

The auditor shall modify the opinion in the auditor's report when:

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

### Determining the Type of Modification to the Auditor's Opinion:

**Qualified Opinion:** The auditor shall express a qualified opinion when:

- (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

**CASE STUDY**

“The Company’s financing arrangements expire and amounts outstanding are payable on May 19, 20X1. The Company has been unable to re-negotiate or obtain replacement financing. This situation indicates the existence of a material uncertainty that may cast significant doubt on the Company’s ability to continue as a going concern and therefore the Company may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not fully disclose this fact.” You are required to identify the type of opinion and draft the same.

In view of circumstances mentioned in SA 705, the auditor should give **Qualified Opinion** in above case. Draft qualified opinion is given as under;

**Qualified Opinion**

In our opinion, except for the incomplete disclosure of the information referred to in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Companies Act, 2013, in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the company as at March 31, 20X1;
- (b) in the case of the Profit and Loss Account, of the profit/ loss for the year ended on that date; and
- (c) in the case of the cash flow statement, of the cash flows for the year ended on that date.

**Adverse Opinion:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

**CASE STUDY**

“The Company’s financing arrangements expired and the amount outstanding was payable on March 31, 20X0. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company’s ability to continue as a going concern and therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact.” You are required to identify the type of opinion and draft the same.

In view of circumstances mentioned in SA 705, the auditor should give **Adverse Opinion** in above case. Draft qualified opinion is given as under;

**Adverse Opinion**

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion paragraph, the financial statements do not give the information required by the Companies Act, 2013, in the manner so required and also do not give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the company as at March 31, 20X0; and
- (b) in the case of the Profit and Loss Account, of the profit/loss for the year ended on that date; and
- (c) in the case of the cash flow statement, of the cash flows for the year ended on that date.

**Disclaimer of Opinion:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

***Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement***

If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

If management refuses to remove the limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity, and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (a) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (b) ***If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:***
  - (i) ***Withdraw from the audit, where practicable and possible under applicable law or regulation; or***
  - (ii) ***If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.***



***If the auditor withdraws, before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.***

***Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion:*** When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement. To include such an unmodified opinion in the same report in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole.

#### **Form and Content of the Auditor's Report When the Opinion is Modified**

When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section.

##### **What special consideration needed for expressing Qualified Opinion?**

***When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion section:***

- (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or***
- (b) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework].***

***When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion.***

##### **What special consideration needed for expressing Adverse Opinion?**

***When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section:***

- (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or***
- (b) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].***

**What special consideration needed for expressing Disclaimer of Opinion?**

***When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:***

- (a) State that the auditor does not express an opinion on the accompanying financial statements;***
- (b) State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and***
- (c) Amend the statement required in SA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.***

***Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.***

**What is the Basis for Modification of Opinion (Qualified/Disclaimer /Adverse)?**

When the auditor modifies (Qualification/Disclaimer/Adverse) the opinion as above on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

- (a)** Amend the heading "Basis for Opinion" to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and
- (b)** Within this section, include a description of the matter giving rise to the modification.

If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures in the notes to the financial statements), the auditor shall include in the Basis for Opinion section a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor shall so state in this section.

If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the Basis for Opinion section an explanation of how the disclosures are misstated.

If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed, the auditor shall:

- (a)** Discuss the non-disclosure with those charged with governance;
- (b)** Describe in the Basis for Opinion section the nature of the omitted information; and
- (c)** Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information.

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If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the Basis for Opinion section the reasons for that inability.

When the auditor expresses a qualified or adverse opinion, the auditor shall amend the statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion to include the word "qualified" or "adverse", as appropriate.

When the auditor disclaims an opinion on the financial statements, the auditor's report shall not include following elements required under SA 700

- (a) A reference to the section of the auditor's report where the auditor's responsibilities are described; and
- (b) A statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the Basis for Opinion section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof.

### **How Auditor will give description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements?**

When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

- (a) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;
- (b) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- (c) The statement about auditor independence and other ethical responsibilities required in SA 700 (Revised).

### **Communication with Those Charged with Governance**

When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification.

### **8.2.4 SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report":**

***Objective: The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:***

- (a) *A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or*
- (b) *As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.*

**Emphasis of Matter paragraph** – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

**Other Matter paragraph** – A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

**When to give emphasis of Matter Paragraphs in the Auditor's Report?**

*If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:*

- (a) *The auditor would not be required to modify the opinion in accordance with SA 705 (Revised)<sup>3</sup> as a result of the matter; and*
- (b) *When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.*

*These circumstances may include:*

- *When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.*
- *To alert users that the financial statements are prepared in accordance with a special purpose framework.*
- *When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events).*

*When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:*

- (a) *Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";*
- (b) *Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and*

- (c) *Indicate that the auditor's opinion is not modified in respect of the matter emphasized.*

***When to issue other Matter Paragraphs in the Auditor's Report?***

*If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, the auditor shall include an Other Matter paragraph in the auditor's report, provided:*

- (a) *This is not prohibited by law or regulation; and*  
 (b) *When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.*

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

***Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:***

- *An uncertainty relating to the future outcome of exceptional litigation or regulatory action.*
- *A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.*
- *Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.*
- *A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.*

**Is there any duty communication with Those Charged with Governance?**

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

\*\*\*\*\*

**Illustration of Emphasis of Matter Para**

**INDEPENDENT AUDITOR'S REPORT**

**To the Members of ABC Company Limited**

Report on the Audit of the Standalone Financial Statements

**Opinion**

We have audited the standalone financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at March 31, 20X1, and the statement of Profit & Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at *(location of branches)*)<sup>13</sup>.

In our opinion, and to the best of our information and according to the explanations given to us the aforesaid financial statements, *give a true and fair view*, in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31<sup>st</sup>, 2XXX and profit/loss, *(changes in equity)* and its cash flows for the year ended on that date.

**Basis for Opinion**

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements as per the *ICAI's Code of Ethics and the provisions of the Companies Act, 2013*, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Emphasis of Matter**

We draw attention to Note X of the financial statements, which describes the effects of a fire in the Company's production facilities. Our opinion is not modified in respect of this matter.

**Key Audit Matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[Description of each key audit matter in accordance with SA 701.]

**Other Matter**

The financial statements of ABC Company for the year ended March 31, 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on March 31, 20X1.

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

*[Reporting in accordance with SA 700 (Revised) – see Illustration 1 in SA 700 (Revised) given in Auditing Pronouncement.]*

## Report on Other Legal and Regulatory Requirements

*[Reporting in accordance with SA 700 (Revised) – see Illustration 1 in SA 700 (Revised).]*

For XYZ & Co  
Chartered Accountants  
(Firm's Registration No.)

**8.2.5 Audit Report under the Companies Act, 2013:** The auditors of a company are required to report to its members in terms of Section 143 of the Companies Act, 2013 which is discussed in detail in Chapter 6 Company Audit under the heading duties and right of an auditor.

(i) **Statement of fact, and**

(ii) **Opinions.**

When we analyze sub-section (3) of Section 143, we find that the auditor shall also state in his report the following:

- (a) Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit and if not, the details thereof and the effect of such information on the financial statements;
- (b) Whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
- (c) Whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
- (d) Whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
- (e) whether, in his opinion, the financial statements comply with the accounting standards;
- (f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
- (g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;
- (h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

- (i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;
- (j) such other matters as may be prescribed. Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in auditor's report. The auditor's report shall also include their views and comments on the following matters, namely:-
  - (i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
  - (ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
  - (iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

**The opinions which the auditor is required to express are:**

- (i) Whether proper books of account as required by law have been kept by the company so far as it appears from the examination of the books and proper returns adequate for the purposes of the audit have been received from branches not visited by him;
- (ii) Whether the accounts give the information required by the Act in the manner so required;
- (iii) Whether in his opinion, the statement of profit and loss and balance sheet complied with the accounting standards referred to in Section 133;
- (iv) Whether the financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year.

However, it should not be understood that a distinct statement of a fact makes it unnecessary to consider the same for the purpose of opinion formation. In effect, the facts, apart from their own significance which probably account for their, distinct disclosure, are complementary to the opinion. On the face of adverse facts, no favourable opinion can be given. It should be appreciated that only certain very important and basic facts about the accounts are required to be stated under the provisions of sub-sections (3). The statement of facts by the auditor is a very significant pointer to the credibility of the accounts. If the auditor states that he has not been able to obtain all the information and explanations considered necessary by him, the reliability of the accounting information under the report would be seriously impaired. Sub-section (4) provides for reasons to be given in the auditor's report, if any of the matters required to be included in the audit report under this section are subject to qualification or negative statement.

**Note:** Students are also required to refer Guidance note on Reporting under section 143(3)(f) and (h) of the Companies Act, 2013 given in Appendix at the end of this Chapter.

**Report under Section 143(1) of the Companies Act, 2013:** Section 143(1) requires the auditor to make certain specific enquiries during the course of his audit. This requirement is without prejudice to his general rights, powers and duties regarding access to books etc. and obtaining



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information and explanations. He is however not required to report on the matters specified in this sub-section, unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. It should however be noted that the auditor is required to make only enquiries on the matters specified in the sub-section and is not to investigate into the matters referred to therein.

Clause (a) requires the auditor to inquire:

*“Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members.”*

This clause applies to loans and advances made by the company during the financial year under audit, whether they are outstanding on the date of the Balance Sheet or not. The inquiry should be made in the light of conditions prevailing when the loan or advance was made. Loans and advances have not been defined anywhere in the Act. However, having regard to the requirement of clause (d) of this sub-section, a distinction is obviously intended to be made between “loans and advances” and “deposits”. A “deposit” may be defined as the placing of money or money’s worth with a third party, either for safe keeping, or by way of security for the performance of the depositor’s obligations, or for the purpose of earning interest; in the last case deposit being with a party who customarily accepts deposits. Any item required to be disclosed under the head “Loans and Advances” in Part I of the Schedule III to the Act which do not fall within the above definition of a “deposit” should be construed for the purpose of this clause as “loans and advances”.

The clause applies to all loans and advances made “on the basis of the security”. “Security” for this purpose would include any movable or immovable property, whether belonging to the borrower or not, of which either physical possession or over which a legally effective charge is given to lender.

The loan agreement or correspondence in regard to the terms of the loan or advance should be seen. Where the loan or advance is made to a company, any charge on the assets of such a company should have been registered under Section 77 of the Act in order to constitute an effective security. The “terms” on which the loan or advance is made would primarily include the security, the interest charged and the terms of repayment. It would be difficult to lay down any general principles regarding the rate of interest which may be charged on loans and advances. Various considerations, such as the position and standing of the borrower, type of security, purpose of the loan, prevailing market rate of interest, etc., would have to be taken into account. If the loan has been given for business considerations, e.g., loans to staff for purchase of cars, houses, etc., loans to suppliers of raw materials or other goods, there may be justification for interest being charged at a rate lower than the market rate, or even, in appropriate circumstances, no interest being charged at all. However, when a loan is given only with a view to earning interest, the interest charged would be at the commercial rate.

Particular attention should be paid to loans or advances to concerns in which the directors of the company or their associates are interested. The question whether the terms on which a loan or advance has been made are “prejudicial to the interests of the company or its members” is a

difficult one. Obviously, the auditor is not to inquire as to how such transactions of the company affect the interests of individual members in their personal capacities. The reference to “members” should therefore be construed as a reference to the members of a company as a class, in their capacity as members. The members of the company would be primarily interested in a reasonable return on their investment and in the safety of their capital. The question whether a loan is prejudicial to the interests of the members should therefore be considered from this angle.

If loan or advance has been approved by the members of the company and/or the Government as required by Section 186, this would be a *prima facie* evidence to show that it is not prejudicial to the interests of the company or its members.

Under Clause (b) the auditor has to inquire:

*“Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company.”*

The transactions of a company are ordinarily matters of fact. The purpose of book entries is to correctly record transactions which have, in fact, taken place. If a book entry is passed which is not in accordance with the facts of the transaction, or is contrary thereto, this should be set right or reported upon by the auditor. Again, if book entries are passed purporting to record “transactions” which have, in fact, not taken place, similar considerations would apply. The clause is therefore intended to cover transactions of the company for which the only evidence, or the principal evidence, is the entry regarding the transactions in the books of account. In such cases, the auditor should inquire whether such transactions have in fact taken place and, if so, whether they are prejudicial to the interests of the company.

Under Clause (c) the auditor has to inquire:

*“Where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company”.*

This clause requires the auditor to inquire in all cases where shares, debentures or other securities have been sold at a price less than their cost. If, as a result of his inquiries, the auditor is satisfied that the sale is *bonafide* and the price realised is reasonable, having regard to the circumstances of the case, he has no further duty to report on the matter.

Under Clause (d) the auditor has to inquire:

*“Whether loans and advances made by the company have been shown as deposits”.*

A reference is invited to the definition of a “deposit” in contradistinction to that of a loan or advance given in the comments on clause (a) above. It should be noted that the inquiry to be made is whether loans and advances have been shown as deposits, and not vice versa.

Clause (e) requires the auditor to inquire:

*“Whether personal expenses have been charged to revenue account.”*

The practice of meeting certain types of personal expenses of employees is normal and is recognized both by the Income tax Authorities and the Company Law Board. Illustration of such

expenses are the provision of rent-free quarters, conveyance for personal use, medical expenses, expenses on leave travel, maternity benefits, canteen facilities, etc. The charging to revenue of such personal expenses, either on the basis of the company's contractual obligations, or in accordance with accepted business practice, is perfectly normal and legitimate and does not call for any special comment by the auditor. Where, however, personal expenses not covered by contractual obligations or by accepted business practice are incurred by the company and charged to revenue account, it would be the duty of the auditor to report thereon.

Clause (f) requires the auditor to inquire:

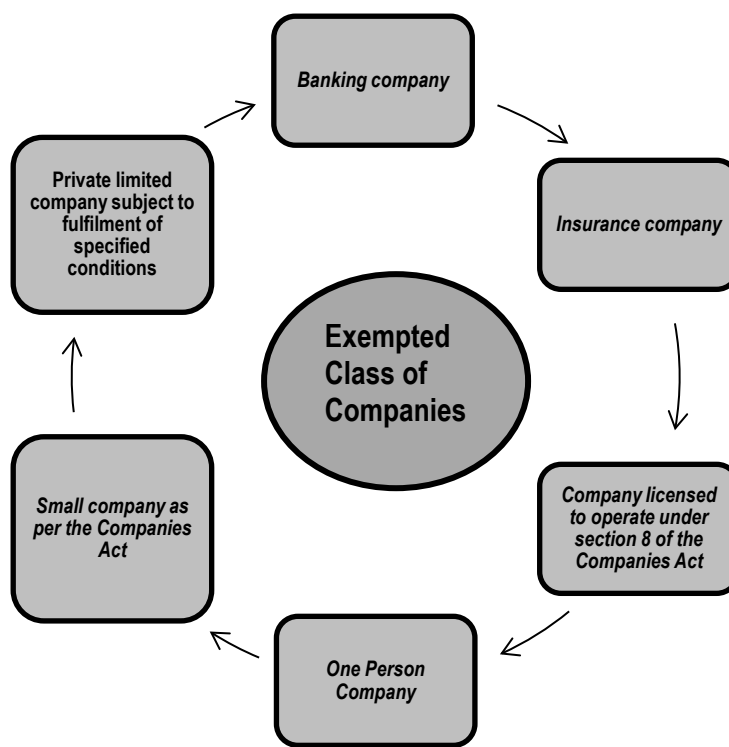
*"Where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading."*

### **8.3 Reporting Under CARO, 2016**

***In exercise of the powers conferred by section 143(11) of the Companies Act, 2013, the Central Government, after consultation with the Institute of Chartered Accountants of India, has issued the Companies (Auditor's Report) Order, 2016, (CARO, 2016) dated 29<sup>th</sup> March, 2016.***

***8.3.1 Applicability of the Order: The CARO, 2016 is an additional reporting requirement Order. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013. However, the Order specifically exempts the following class of companies***

- (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);***
- (ii) an insurance company as defined under the Insurance Act, 1938 (4 of 1938);***
- (iii) a company licensed to operate under section 8 of the Companies Act;***
- (iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and***
- (v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.***



**8.3.2 Auditor's report to contain matters specified in paragraphs 3 and 4.** - Every report made by the auditor under section 143 of the Companies Act, 2013 on the accounts of every company audited by him, to which this Order applies, for the financial years commencing on or after 1st April, 2015, shall in addition, contain the matters specified in paragraphs 3 and 4, as may be applicable: It may be noted that the Order shall not apply to the auditor's report on consolidated financial statements.

**8.3.3 Matters to be included in the auditor's report.** - The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-

- (i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;
- (b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
- (c) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;
- (ii) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;

- (iii) *whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,*

  - (a) *whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;*
  - (b) *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;*
- (iv) *in respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.*
- (v) *in case, the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed there under, where applicable, have been complied with? If not, the nature of such contraventions be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?*
- (vi) *whether maintenance of cost records has been specified by the Central Government under section 148(1) of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.*
- (vii) (a) *whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;*

  - (b) *where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).*
- (viii) *whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).*

- (ix) *whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans 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;*
- (x) *whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;*
- (xi) *whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same;*
- (xii) *whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;*
- (xiii) *whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;*
- (xiv) *whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;*
- (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, 2013 have been complied with;*
- (xvi) *whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.*

#### **Examples**

1. **ABC Pvt. Ltd. is a holding company of XYZ Ltd. Whether CARO is applicable to ABC Pvt. Ltd.?**  
  
CARO 2016 will be applicable to a private limited company which is holding company of a public company, which was not there in previous CARO. Therefore, CARO is applicable on ABC Pvt. Ltd.

2. *Physical verification of only 50% (in value) of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources.*

*Reporting for Physical Verification of Inventory: clause (ii) of Para 3 of CARO, 2016 requires the auditor to state in his report whether physical verification of inventory has been conducted at reasonable interval by the management. Physical verification of inventory is the responsibility of the management which should verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification.*

*In the given case, the above requirement of CARO, 2016 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable. He may consider the impact on financial statement and report accordingly.*

3. *K Ltd. has taken a term loan from a nationalized bank in 2010 for ₹ 200 lakhs repayable in five equal instalments of ₹ 40 lakhs from 31<sup>st</sup> March, 2011 onwards. It had repaid the loans due in 2011 & 2012, but defaulted in 2013, 2014 & 2015. As the auditor of K Ltd. what is your responsibility assuming that company has sought reschedulement of loan?*

*Reporting for Default in Repayment of Dues: As per clause (viii) of Para 3 of CARO, 2016, the auditor of a company has to report whether the Company has defaulted in repayment of its dues to a financial institution or bank or debentures holders and if yes, the period and amount of default to be reported.*

*In this case, K Ltd. has defaulted in repayment of dues for three years. Application for rescheduling will not change the default position. Hence the auditor has to report in his audit report that the Company has defaulted in its repayment of dues to the bank to the extent of ₹ 120 lakhs.*

4. *LM Ltd. had obtained a Term Loan of ₹ 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in short term deposits.*

*Term Loan Invested in Short Term Deposits: As per clause (ix) of Para 3 of CARO, 2016, an auditor need to state in his report that whether the term loans were applied for the purpose for which the loans were obtained.*

*In the present case, the term loan obtained by LM Ltd. have not been put to use for construction activities and temporarily invested the same in short term deposit.*

*Here, the auditor should report the fact in his report that pending utilization of the term loan for construction of a factory, the funds were temporarily used for the purpose other than the purpose for which the loan was sanctioned as per clause (ix) of Para 3 of CARO, 2016.*

5. ***For the purpose of availing exemption from CARO what kind of loan to be considered?***  
*All sorts of loan whether term loan, demand loan, export credit, working credit limits, cash credits. Overdrafts, bill purchased or discounted, but does not include non-fund based facilities like LC BG.*
6. ***Whether CARO is Applicable to the auditor of consolidated financial statement? Order shall not apply to the auditor's report on consolidated financial statements. In previous order it was not expressly provided hence CFS auditors used to include CARO in their report.***
7. ***What documents Constitute Title Deed?***  
*Following constitute title deeds of the immovable property:-*
  - (i) *Registered sale deed / transfer deed / conveyance deed, etc. of land, land & building together, etc. purchased, allotted, transferred by any person including any government, government authority / body / agency/ corporation, etc. to the company.*
  - (ii) *In case of leasehold land and land & buildings together, covered under the head fixed assets, the lease agreement duly registered with the appropriate authority.*
8. ***Should the auditor examine the cost record in detail while reporting under CARO?***  
*CARO does not require a detailed examination of Cost Records. The Auditor should, therefore, conduct a general review of Cost Records to ensure that the records as prescribed are made and maintained. The word "made" applies in respect of Cost Accounts, and the word "maintained" applies in respect of Cost Records relating to Materials, Labour, Overheads, etc.*

#### **8.3.4 Reasons to be stated for unfavourable or qualified answers-**

- (1) ***Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.***
- (2) ***Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.***

***(Note : Refer Appendix for Illustrative report)***

## **8.4 Distinction between Audit Report and Certificate**

The term 'report' is used where an expression of opinion is involved. The term 'certificate' is preferable where the auditor comments on or verifies facts such as a verification of investment by inspection or the checking of ballot papers on a poll in a company meeting. Under the Companies Act, 2013, a number of situations are there where an auditor is required to issue a certificate rather than a report like as per Section 66 of the Companies Act, 2013, an auditor is



### 8.33 Advanced Auditing and Professional Ethics

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required to file a certificate in the tribunal where company proposing for the reduction of capital. However, the report under Section 143 of the Companies Act, 2013, is an opinion based report and is not a certificate.

#### **Some situations where Audit Reports and Certificates are required is given below -**

(1) *Under the Payment of Bonus Act, 1965, a chartered accountant may be required to issue a 'report' on the computation of bonus payable. The report may be as under:*

"We have reviewed the figures in the above computation in comparison with the books and records produced to us, the audit of which has already been completed by us and report that subject to the notes given on face of the computation in our opinion, and to the best of our knowledge and belief and according to the information and explanation given to us, the above computation is in due accordance therewith and has been made on a basis reasonably consistent with the provisions of the Payment of Bonus Act, 1965."

Place:

For X & Co.

Date:

Chartered Accountants

(2) *Auditor's Report in accordance with Regulation 54 of the SEBI (Mutual Fund) Regulations, 1993.*

- (i) All Mutual funds shall be required to get their accounts audited in terms of a provision to that effect in their trust deeds. The Auditor's Report shall form a part of the Annual Report. It should accompany the Abridged Balance Sheet and Revenue Account. The auditor shall report to the Board of Trustees and not to the unit holders.
- (ii) The auditor shall state whether:
  - 1. He has obtained all information and explanations which, to the best of his knowledge and belief, were necessary for the purpose of his audit.
  - 2. The Balance Sheet and the Revenue Account are in agreement with the books of account of the fund.
- (iii) The auditor shall give his opinion as to whether:
  - 1. The Balance Sheet gives a true and fair view of the scheme wise state of affairs' of the fund as at the balance sheet date, and
  - 2. The Revenue Account gives a true and fair view of the scheme wise surplus/deficit of the fund for the year/period ended at the balance sheet date.

#### **MANNER OF SIGNING OF CERTIFICATES BY CHARTERED ACCOUNTANTS:**

*The Council of the Institute of Chartered Accountants of India (ICAI), at its 349th meeting held on 17th and 18th January, 2016 considered an issue relating to manner of signing of certificates by Chartered Accountants. The Council noted that presently different practices were in vogue in respect of the manner of signing of various certificates issued by the members of the ICAI. On a consideration of the matter, the Council, with a view to*

*bring uniformity in the manner of signing of certificates, has decided to require the members of the ICAI to include (in addition to any other requirements in this regard prescribed by the relevant law or regulation under which the certificate is being issued) the following details in their "Signatures" on the certificates issued by them:*

- **Name of the CA firm\***
- **Firm Registration Number (FRN)\***
- **Name of the member**
- **Designation (Partner/Proprietor)**
- **Membership Number**

## 8.5 Audit Reports and Certificates for Special Purposes

In this first part, the relevant extracts from the Guidance Note on Audit Reports and Certificates for Special Purposes are given below (Also refer SA 800, SA 805 and SA 810):

Government authorities may, under various statutes or notifications, require reports or certificates from auditors in support of statements or other information prepared by an enterprise. Reports or certificates on specific matters may also be required from auditors by an enterprise, for its own special purposes. These reports or certificates to specific requirements of the individual users is unlike a 'general purposes report' e.g. an auditor's report on financial statements which is intended for general use. An audit report or certificate for special purposes is one to which the format of general purpose audit report is not applicable.

**8.5.1 Scope of Special Purpose Audit Reports and Certificates:** Audit reports or certificates for special purposes may be issued in connection with:

- (a) financial statements which are prepared in addition to general purpose financial statements;
- (b) specified elements, accounts or items of financial statements;
- (c) compliance with requirements of any agreement or statute or regulation;
- (d) financial information given in special purpose formats or schedules; or
- (e) compilation of statistics or ascertainment of basic figures e.g., for the purposes of fixed quotas or levies.

**8.5.2 Responsibility for Preparation of Special Purpose Statements:** The primary responsibility for the contents of special purpose statement rests with the enterprise and this would be evidenced by a suitable declaration or authentication by the management on the face of the statement.

**8.5.3 Scope of Reporting Auditor's Function:** A reporting auditor should have a clear understanding of the scope and nature of the terms of his assignment. It is desirable for him to obtain the terms in writing to avoid any misunderstanding. A reporting auditor is not an expert on purely technical matters and as such, when he is required to report on or certify such matters (e.g., composition or quality of a product) which are of paramount importance and constitute the

very basis of the figures contained in the statement, he should state his limitations clearly in the report or certificate. At the same time he should indicate the extent to which he has been able to exercise his own professional skill and judgement with regard to the matters being reported upon. For instance, he may state that, for the purposes of forming his opinion he has relied upon a certificate from technical experts. He should, of course, satisfy himself about the technical qualifications of the expert, and subject the expert's certificate to a reasonable review.

**8.5.4 Contents of Reports and Certificates for Special Purposes:** In many cases, a reporting auditor can choose the form and contents of his report or certificate. In other cases the form and contents of the report or certificate are specified by statute or notification and hence cannot be changed. Where a reporting auditor is free to draft his report or certificate, he should consider the following:

- (a) Specific elements, accounts or items covered by the report or certificate should be clearly identified and indicated.
- (b) The report or certificate should indicate the manner in which the audit was conducted, e.g., by the application of generally accepted auditing practices, or any other specific tests.
- (c) If the report or certificate is subject to any limitations in scope, such limitations should be clearly mentioned.
- (d) Assumptions on which the special purpose statement is based should be clearly indicated if they are fundamental to the appreciation of the statement.
- (e) Reference to the information and explanations obtained should be included in the report or certificate. In certain cases, apart from a general reference to information and explanations obtained, a reporting auditor may also find it necessary to refer in his report or certificate to specific information or explanations on which he has relied.
- (f) The title of the report or certificate should clearly indicate its nature, i.e., whether it is a report or a certificate. Similarly, the language should be unambiguous, i.e., it should clearly bring out whether the reporting auditor is expressing an opinion (as in the case of a report) or whether he is only confirming the accuracy of certain facts (as in the case of a certificate). For this, the choice of appropriate words and phrases is important.
- (g) If the special purposes statement is based on general purpose financial statements, the report or certificate should contain a reference to such statements. However, the report or certificate should not contain a reference to any other statement unless the same is attached herewith. It should be clearly indicated whether or not the statutory audit of the general purposes financial statements has been completed and also, whether such audit has been conducted by the reporting auditor or by another auditor. In case the general purposes financial statements have been audited by another auditor, the reporting auditor should specify the extent to which he has relied on them. He may communicate with the statutory auditor for securing his co-operation and in appropriate circumstances, discuss relevant matters with him, if possible.
- (h) Where a report requires the interpretation of statute, the reporting auditor should clearly indicate the fact that he is merely expressing his opinion in the matter. He should take sufficient

care to ensure that in respect of matters which are capable of more than one interpretation, his report is not misconstrued as representing a settled legal position.

(i) An audit report or certificate should ordinarily be a self-contained document. It should not confine itself to a mere reference to another report or certificate issued by the reporting auditor but should include all relevant information contained in such report or certificate.

(j) The reporting auditor should clearly indicate in his report or certificate, the extent of responsibility which he assumes. Where the statement on which he is required to give his report or certificate, includes some information which has not been audited, he should clearly indicate in his report or certificate the particulars of such information.

In certain cases, the form and/or contents of the report or certificate, as prescribed by a statute or a notification, may not be appropriate or adequate. In such situations, the reporting auditor may consider modifying the report or certificate on the basis of the suggestion made in above para to the extent applicable. In case this is not possible, he should clearly indicate the limitations in his report or certificate itself.

**8.5.5 Extent of Reliance on General Purpose Audit Report:** Where a special purpose engagement is undertaken after the statutory audit has been completed, a reporting auditor should invariably review the statutory audit report to ascertain whether there are any matters which have a bearing on his report or certificate. In cases, where a reporting auditor is required to report or certify certain specific matter arising from the financial statements taken as a whole, he should not normally issue his report or certificate until the statutory audit has been completed. For instance, a reporting auditor may be required to state whether, in the case of an Indian branch of a foreign company, the profit shown in the accounts represents the remittable surplus of the branch, or he may be asked to report on the computation of 'gross profit' for the purpose of bonus under the Payment of Bonus Act, 1965. In such cases, it would normally not be proper for him to give his report or certificate until the statutory audit has been completed, since he would not really be in a position to state whether the profit shown in the accounts itself has been properly computed.

Where an audit report or certificate is required before the statutory audit is completed, a reporting auditor should state clearly in his audit report or certificate that he is reporting on or certifying specific matters arising out of the financial statements of the enterprise, the statutory audit of which has not been completed. Where the reporting auditor prepares his report or certificate on the basis of duly audited general purpose financial statements he may take the following precautions:

- (i) He may clearly state in his report or certificate that the figures from the audited general purpose financial statements have been used and relied upon.
- (ii) He may include in his report or certificate a statement showing the reconciliation between the figures in the general purpose financial statements and the figures appearing in his report or certificate.

**8.5.6 Reports and Certificates on Specified Accounts or Items of Financial Statements:** The test of materiality which a reporting auditor uses in connection with special purpose reports

may be different, depending upon the circumstances, from the test he would use in connection with a general purpose report. For example, where he is required to express an opinion on specified accounts or items of financial statements, he may judge the materiality of an item solely in relation to such individual accounts or items rather than to the aggregate thereof or to the financial statements as a whole. A reporting auditor's examination of certain records for an audit report or certificate for special purpose may also be more intensive than the examination of the same records by the statutory auditor for the purpose of expressing an opinion on the general purpose financial statements as a whole. Certain accounts or items of financial statements are inter - related, e.g., sales and trade receivables, purchases and trade payables, fixed assets and depreciation, etc. Therefore, where the reporting auditor is required to examine and report upon or certify a specified account or items of financial statement, he may also need to examine the related accounts or items to discover the inconsistencies, if any, between these inter - related accounts or items.

**8.5.7 Communication of Report or Certificate:** The reporting auditor may address his report or certificate to the client or to the public authority or person requiring it, as the case may be. In appropriate circumstances, a certificate may be issued without reference to any particular person or authority by using the words. 'To whomsoever it may concern'. The report or certificate should normally be issued to the client who should be responsible for forwarding the same to the connected authority, where so required.

**8.5.8 Communication with the Previous Reporting Auditor:** It should be a healthy tradition if the practice of communicating with the member who had done the work previously is followed in every case where a member is required to give a report or certificate for a special purpose.

## **8.6 Reporting Requirements in case of Comparative Information**

SA 710 Comparative Information-Corresponding Figures and Comparative Financial Statements deals with auditor's responsibility regarding comparative information in an audit of financial statement. There are two different broad approaches to the auditor's responsibilities in respect of comparative information: Corresponding figures and Comparative financial statement.

The essential audit reporting differences between the approaches are:

- (a) For corresponding figures, the auditor's opinion on the financial statements refers to the current period only; whereas
- (b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

The objectives of the auditor are to obtain sufficient appropriate audit evidence about whether the comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting framework; and to report in accordance with the auditor's reporting responsibilities.

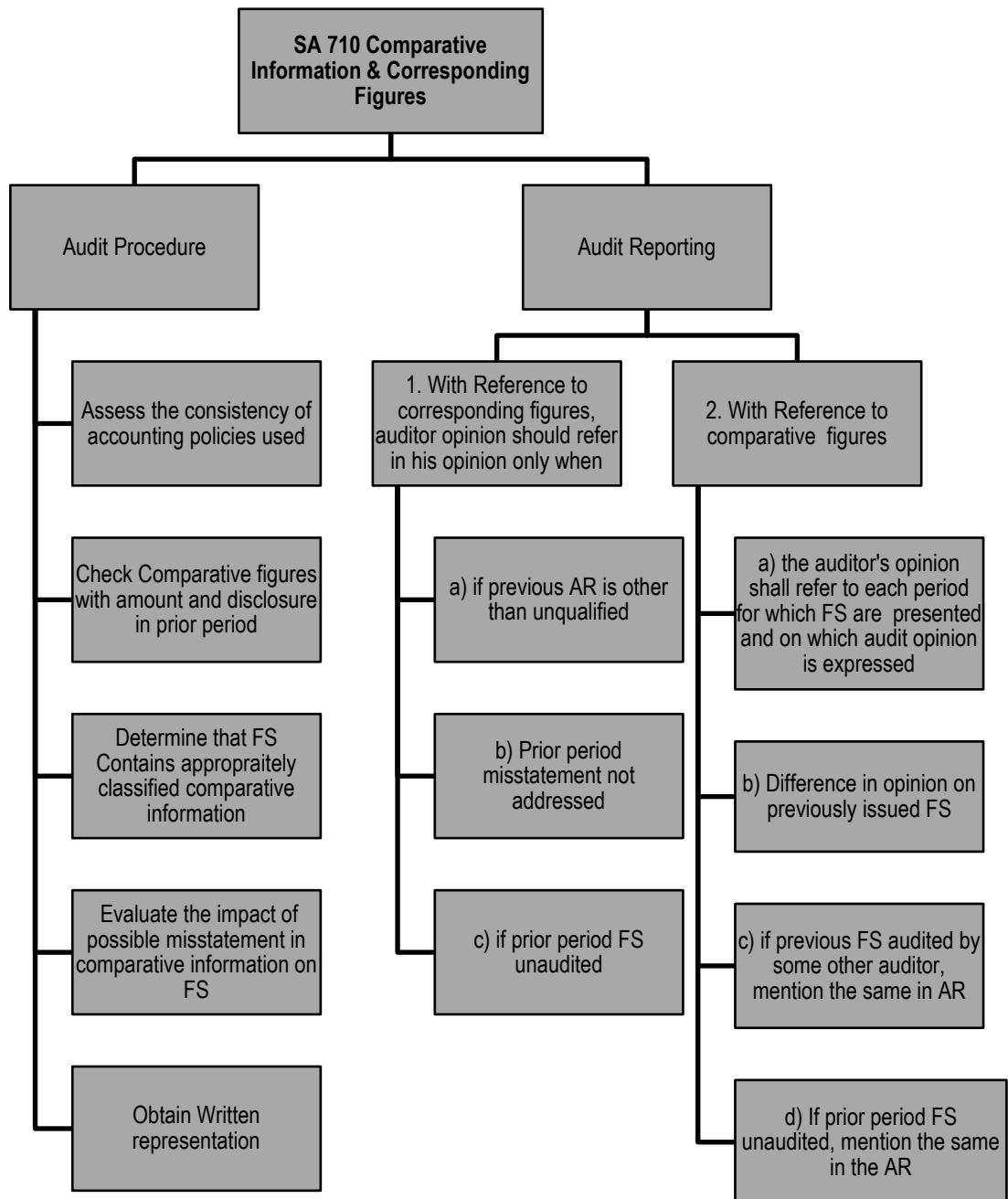
### **8.6.1 Audit Procedures for Comparative Information:**

- (a) **Perform Specific audit Procedure:** For determining that the financial statement contains appropriately classified comparative information, the auditor should:

- Ensure that comparative information agrees with the amount and other disclosure presented in the prior period.
  - The accounting policies applied are consistent with those applied in current period.
  - If there have been any changes in the application of accounting policies than they are properly disclosed and presented.
- (b) **Evaluating the impact on financial statement:** If the auditor becomes aware of any possible misstatement in the comparative information, then:
- He should perform the necessary audit procedures to obtain sufficient audit evidence.
  - If the auditor had audited the prior period's financial statement than he should follow the relevant requirements of SA 560.
- (c) **Written Representation:** As required by SA 580, the auditor should also request written representation. He should also obtain a specific written representation regarding any prior period item that is disclosed in current year's financial statement.

#### **8.6.2 Audit Reporting**

- (a) **With Reference to Corresponding Figures:** When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances:
- If the auditor's report of the previous period contains other than an unqualified opinion.
  - If the auditor is of the opinion, and he has sufficient evidence in this regard, that a material misstatement exists in the financial statement of prior period, which was not addressed earlier.
  - If the prior period financial statement are not audited, than he should obtain sufficient audit evidence that the opening balance does not contain any material misstatement.
- (b) **With Reference to Comparative Financial Statement:** When comparative financial statement are presented -
- The auditor's opinion shall refer to each period for which the financial statements are presented.
  - When reporting on current period's audit, if the auditor's opinion on such prior period financial statement differs from the opinion previously issued on such financial statement, the auditor shall disclose the substantive reason for the different opinion in other matter paragraph in his report.
  - If the auditor concludes that a material misstatement is present in the previously audited figures of financial statement, he should report it to the appropriate level of the management and request that the predecessor auditor be informed. If then the prior years statements are amended with new report by the predecessor auditor, then the auditor shall report only on the current period.



**(c) Reporting treatment common to both (for corresponding figures and comparative information):**

(i) If the financial statement of the prior period were audited by a predecessor auditor, the auditor (is permitted by law or regulation to refer to the predecessor audit report – on case of corresponding figures and decides to do so) shall state in his audit report:

- That the financial statement of the prior period were audited by a predecessor auditor;
- The type of the opinion expressed by the predecessor auditor;
- The date of that audit report.

(ii) If the prior period financial statement were not audited than he shall report the same in other matter paragraph in his audit report that the corresponding/comparative figures are unaudited. However, the disclosure does not relieve him from his responsibility of obtaining sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

(Note: Students are advised to refer Series of SA 700 on Audit Reporting and Conclusion in addition to SA 800 Series for better understanding)



## **Appendix 1**

### **Comprehensive Format on the Audit Report:**

#### ***Independent Auditor's Report***

***To the Members of ABC Limited***

#### ***Opinion***

***We have audited the standalone financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at 31st March 20XX, and the statement of Profit and Loss, (statement of changes in equity) and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information [in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at (location of branches)].***

***In our opinion and to the best of our information and according to the explanations given to us, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31, 20XX, and profit/loss, (changes in equity) and its cash flows for the year ended on that date.***

#### ***Basis of our opinion***

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

#### ***Key Audit Matters***

***Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.***

#### ***Management's Responsibility for the Standalone Financial Statements***

***The Company's Board of Directors is responsible for the matters stated in Section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation and presentation of these***

*standalone financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.*

#### **Auditor's Responsibility**

*Our responsibility is to express an opinion on these standalone financial statements based on our audit.*

*We have taken into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of the Act and the Rules made thereunder.*

*We conducted our audit in accordance with the Standards on Auditing specified under Section 143(10) of the Act. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.*

*An audit involves performing procedures to obtain audit evidence about the amounts and the disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal financial control relevant to the*

*Company's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of the accounting estimates made by the Company's Directors, as well as evaluating the overall presentation of the financial statements.*

*We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the standalone financial statements.*

#### **Report on Other Legal and Regulatory Requirements**

1. *As required by the Companies (Auditor's Report) Order, 2016 ("the Order") issued by the Central Government of India in terms of sub-section (11) of section 143 of the Act, we give in the Annexure A, a statement on the matters specified in the paragraph 3 and 4 of the order.*
2. *As required by Section 143 (3) of the Act, we report that:*

- (a) *we have sought and obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit.*
- (b) *in our opinion proper books of account as required by law have been kept by the Company so far as it appears from our examination of those books;*
- (c) *the balance sheet, the statement of profit and loss and the cash flow statement dealt with by this Report are in agreement with the books of account;*
- (d) *in our opinion, the aforesaid standalone financial statements comply with the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014;*
- (e) *on the basis of the written representations received from the directors as on 31<sup>st</sup> March 2016 taken on record by the Board of Directors, none of the directors is disqualified as on 31 March 2016 from being appointed as a director in terms of Section 164 (2) of the Act;*
- (f) *with respect to the adequacy of the internal financial controls over financial reporting of the Company and the operating effectiveness of such controls, refer to our separate report in "Annexure B"; and*
- (g) *with respect to the other matters to be included in the Auditor's Report in accordance with Rule 11 of the Companies (Audit and Auditors) Rules, 2014, in our opinion and to the best of our information and according to the explanations given to us:*
  - i. *the Company has disclosed the impact of pending litigations on its financial position in its financial statements.*
  - ii. *the Company has made provision, as required under the applicable law or accounting standards, for material foreseeable losses, if any, on long-term contracts including derivative contracts.*
  - iii. *There has been no delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the Company.*

**For XYZ LLP**

**Chartered Accountants**

**Firm's registration number:**

**Partner**

**Membership number:**

**Mumbai**

**18 April 2016**

**Annexure - A to the Auditors' Report**

*The Annexure referred to in Independent Auditors' Report to the members of the Company on the standalone financial statements for the year ended 31 March 2016, we report that:*

- (i) (a) The Company has maintained proper records showing full particulars, including quantitative details and situation of fixed assets*
- (b) The Company has a regular programme of physical verification of its fixed assets by which fixed assets are verified in a phased manner over a period of three years. In accordance with this programme, certain fixed assets were verified during the year and no material discrepancies were noticed on such verification. In our opinion, this periodicity of physical verification is reasonable having regard to the size of the Company and the nature of its assets.*
- (c) According to the information and explanations given to us and on the basis of our examination of the records of the Company, the title deeds of immovable properties are held in the name of the Company.*
- (ii) The Company is a service company, primarily rendering software services. Accordingly, it does not hold any physical inventories. Thus, paragraph 3(ii) of the Order is not applicable to the Company.*
- (iii) The Company has granted loans to five bodies corporate covered in the register maintained under section 189 of the Companies Act, 2013 ('the Act').*
  - (a) In our opinion, the rate of interest and other terms and conditions on which the loans had been granted to the bodies corporate listed in the register maintained under Section 189 of the Act were not, prima facie, prejudicial to the interest of the Company*
  - (b) In the case of the loans granted to the bodies corporate listed in the register maintained under section 189 of the Act, the borrowers have been regular in the payment of the principal and interest as stipulated.*
  - (c) There are no overdue amounts in respect of the loan granted to a body corporate listed in the register maintained under section 189 of the Act.*
- (iv) In our opinion and according to the information and explanations given to us, the Company has complied with the provisions of section 185 and 186 of the Act, with respect to the loans and investments made.*
- (v) The Company has not accepted any deposits from the public.*
- (vi) The Central Government has not prescribed the maintenance of cost records under section 148(1) of the Act, for any of the services rendered by the Company.*
- (vii) (a) According to the information and explanations given to us and on the basis of our examination of the records of the Company, amounts deducted/ accrued in the books of account in respect of undisputed statutory dues including provident fund, income-tax, sales tax, value added tax, duty of customs, service tax, cess and other*

*material statutory dues have been regularly deposited during the year by the Company with the appropriate authorities. As explained to us, the Company did not have any dues on account of employees' state insurance and duty of excise.*

*According to the information and explanations given to us, no undisputed amounts payable in respect of provident fund, income tax, sales tax, value added tax, duty of customs, service tax, cess and other material statutory dues were in arrears as at 31 March 2016 for a period of more than six months from the date they became payable.*

- (b) *According to the information and explanations given to us, there are no material dues of duty of customs which have not been deposited with the appropriate authorities on account of any dispute. However, according to information and explanations given to us, the following dues of income tax, sales tax, duty of excise, service tax and value added tax have not been deposited by the Company on account of disputes:*

<i>Name of the statute</i>	<i>Nature of dues</i>	<i>Amount (in Rs)</i>	<i>Period to which the amount relates</i>	<i>Forum where dispute is pending</i>

- (viii) *The Company does not have any loans or borrowings from any financial institution, banks, government or debenture holders during the year. Accordingly, paragraph 3(viii) of the Order is not applicable.*
- (ix) *The Company did not raise any money by way of initial public offer or further public offer (including debt instruments) and term loans during the year. Accordingly, paragraph 3 (ix) of the Order is not applicable.*
- (x) *According to the information and explanations given to us, no material fraud by the Company or on the Company by its officers or employees has been noticed or reported during the course of our audit.*
- (xi) *According to the information and explanations give to us and based on our examination of the records of the Company, the Company has paid/provided for managerial remuneration in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Act.*
- (xii) *In our opinion and according to the information and explanations given to us, the Company is not a nidhi company. Accordingly, paragraph 3(xii) of the Order is not applicable.*

- (xiii) According to the information and explanations given to us and based on our examination of the records of the Company, transactions with the related parties are in compliance with sections 177 and 188 of the Act where applicable and details of such transactions have been disclosed in the financial statements as required by the applicable accounting standards.
- (xiv) According to the information and explanations give to us and based on our examination of the records of the Company, the Company has not made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year.
- (xv) According to the information and explanations given to us and based on our examination of the records of the Company, the Company has not entered into non-cash transactions with directors or persons connected with him. Accordingly, paragraph 3(xv) of the Order is not applicable.
- (xvi) The Company is not required to be registered under section 45-IA of the Reserve Bank of India Act 1934.

For XYZ LLP

Chartered Accountants

Firm's registration number:

Partner

Membership number:

Mumbai

18 April 2017

#### **Annexure - B to the Auditors' Report**

**Report on the Internal Financial Controls under Clause (i) of Sub-section 3 of Section 143 of the Companies Act, 2013 ("the Act")**

We have audited the internal financial controls over financial reporting of ABC Limited ("the Company") as of 31 March 2016 in conjunction with our audit of the standalone financial statements of the Company for the year ended on that date.

#### **Management's Responsibility for Internal Financial Controls**

The Company's management is responsible for establishing and maintaining internal financial controls based on the internal control over financial reporting criteria established by the Company considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the Institute of Chartered Accountants of India ('ICAI'). These responsibilities include the design,

*implementation and maintenance of adequate internal financial controls that were operating effectively for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information, as required under the Companies Act, 2013.*

#### **Auditors' Responsibility**

*Our responsibility is to express an opinion on the Company's internal financial controls over financial reporting based on our audit. We conducted our audit in accordance with the Guidance Note on Audit of Internal Financial Controls over Financial Reporting (the "Guidance Note") and the Standards on*

*Auditing, issued by ICAI and deemed to be prescribed under section 143(10) of the Companies Act, 2013, to the extent applicable to an audit of internal financial controls, both applicable to an audit of Internal Financial Controls and, both issued by the Institute of Chartered Accountants of India. Those Standards and the Guidance Note require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether adequate internal financial controls over financial reporting was established and maintained and if such controls operated effectively in all material respects.*

*Our audit involves performing procedures to obtain audit evidence about the adequacy of the internal financial controls system over financial reporting and their operating effectiveness. Our audit of internal financial controls over financial reporting included obtaining an understanding of internal financial controls over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.*

*We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the Company's internal financial controls system over financial reporting.*

#### **Meaning of Internal Financial Controls over Financial Reporting**

*A company's internal financial control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal financial control over financial reporting includes those policies and procedures that*

*(1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company; and (3) provide reasonable assurance regarding*

*prevention or timely detection of unauthorised acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.*

***Inherent Limitations of Internal Financial Controls Over Financial Reporting***

*Because of the inherent limitations of internal financial controls over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal financial controls over financial reporting to future periods are subject to the risk that the internal financial control over financial reporting may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.*

***Opinion***

*In our opinion, the Company has, in all material respects, an adequate internal financial controls system over financial reporting and such internal financial controls over financial reporting were operating effectively as at 31 March 2016, based on the internal control over financial reporting criteria established by the Company considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India.*

*For XYZ LLP*

***Chartered Accountants***

***Firm's Registration Number:***

***Partner***

***Membership Number:***

***Mumbai***

***18 April 2017***



**Appendix 2****Comprehensive Case Studies on CARO 2016**

**1. Whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability? [Paragraph 3(xii)]**

**Ans.**

**Relevant Provisions**

- (a) This clause requires the auditor to report whether, in the case of a Nidhi Company, net-owned funds to deposit liability ratio is more than 1:20 and the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules 2014 to meet out the liability.**
- (b) Section 406(1) of the Act defines “Nidhi” to mean a company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit, and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.**
- (c) It may be noted that Ministry of Corporate Affairs on 31st March 2014, vide its Notification No. GSR 258(E) notified the ‘Nidhi Rules 2014’, which came into force on the first day of April 2014. These Rules apply to Nidhi company incorporated as a Nidhi pursuant to the provisions of Section 406 of the Act and also to the Nidhi companies declared under sub-section (1) of section 620A of the Companies Act 1956.**

**Audit Procedures and Reporting**

- (d) It may be noted that Rule 5(1) prescribes the requirements for minimum number of members, net owned fund etc. As per Rule 5(1) every Nidhi shall, within a period of one year from the commencement of these rules, ensure that it has— (i) not less than two hundred members; (ii) net owned funds of ten lakh rupees or more; (iii) unencumbered term deposits of not less than ten per cent of the outstanding deposits as specified in Rule 14; and (iv) ratio of net owned funds to deposits of not more than 1:20. The auditor should note that as such a Nidhi Company can accept deposits not exceeding twenty times of its net owned funds as per last audited balance sheet. Furthermore, as per Rule 14, every Nidhi is to invest and continue to keep invested, in encumbered term deposits with a Scheduled commercial bank (other than a co-operative bank or a regional rural bank), or post office deposits in its own name an amount which shall not be less than ten per cent of the deposits outstanding at the close of business on the last working day of the second preceding month, which needs to be examined.**
- (e) As per Rule 3(d) Net Owned Funds are defined as the aggregate of paid up equity share capital and free reserves as reduced by accumulated losses and intangible assets**

*appearing in the last audited balance sheet: Provided that, the amount representing the proceeds of issue of preference shares, shall not be included for calculating Net Owned Funds.*

- (f) (A Nidhi company can accept fixed deposits, recurring deposits accounts and savings deposits from its members in accordance with the directions notified by the Central Government. The aggregate of such deposits is referred to as "deposit liability".*
- (g) The auditor should ask the management to provide the computation of the deposit liability and net owned funds on the basis of the requirements contained herein above. This would enable him to verify that the ratio of deposit liability to net owned funds is in accordance with the requirements prescribed in this regard. The auditor should verify the ratio using the figures of net owned funds and deposit liability computed in accordance with what is stated above. The comments of the auditor should be based upon such a statement provided by the management and verification of the same by the auditor.*
- (h) The auditor may report, incorporating the following as at the balance sheet date:- (i) In case of shortfall in the ratio of net owned funds to the deposits, report the amount of shortfall and state the actual ratio of net owned funds to the deposits. (ii) In case of shortfall with regard to the minimum amount of 10% as unencumbered term deposits, as specified in Nidhi Rules 2014, report the amount thereof.*

**2. Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated? [Paragraph 3(x)]**

**Ans.**

#### **Relevant Provisions**

- (a) This clause requires the auditor to report whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year. If yes, the auditor is required to state the amount involved and the nature of fraud. The clause does not require the auditor to discover such frauds. The scope of auditor's inquiry under this clause is restricted to frauds 'noticed or reported' during the year. The use of the words "noticed or reported" indicates that the management of the company should have the knowledge about the frauds by the company or on the company by its Officer and employees that have occurred during the period covered by the auditor's report. It may be noted that this clause of the Order, by requiring the auditor to report whether any fraud by the company or on the company by its Officer or employees has been noticed or reported, does not relieve the auditor from his responsibility to consider fraud and error in an audit of financial statements. In other words, irrespective of the auditor's comments under this clause, the auditor is also required to comply with the requirements of Standard on Auditing (SA) 240, "The Auditor's Responsibility Relating to Fraud in an Audit of Financial Statements". In this*

*context, the auditor should also have regard to the Guidance Note on Reporting on Fraud under Section 143(12) of the Companies Act, 2013, issued by ICAI.*

- (b) The term "fraud" refers to an intentional act by one or more individuals among management, those charged with governance, employees, involving the use of deception to obtain an unjust or illegal advantage. Although fraud is a broad legal concept, the auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements. Misstatement of the financial statements may not be the objective of some frauds. Auditors do not make legal determinations of whether fraud has actually occurred. Fraud involving one or more members of management or those charged with governance is referred to as "management fraud"; fraud involving only employees including officers of the entity is referred to as "employee fraud". In either case, there may be collusion with third parties outside the entity. In fact, generally speaking, the "management fraud" can be construed as "fraud by the company".*
- (c) Two types of intentional misstatements are relevant to the auditor's consideration of fraud - misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.*
- (d) Fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting may involve: (i) Deception such as manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared. (ii) Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information. (iii) Intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure.*
- (e) Misappropriation of assets involves the theft of an entity's assets. Misappropriation of assets can be accomplished in a variety of ways (including embezzling receipts, stealing physical or intangible assets, or causing an entity to pay for goods and services not received); it is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.*
- (f) Fraudulent financial reporting may be committed by the company because management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target particularly when the consequences to management of failing to meet financial goals can be significant. The auditor must appreciate that a perceived opportunity for fraudulent financial reporting or misappropriation of assets may exist when an individual believes internal control could be circumvented, for example, because the individual is in a position of trust or has knowledge of specific weaknesses in the internal control system. Audit Procedures and Reporting*

**Audit Procedures and Reporting**

- (g) While planning the audit, the auditor should discuss with other members of the audit team, the susceptibility of the company to material misstatements in the financial statements resulting from fraud. While planning, the auditor should also make inquiries of management to determine whether management is aware of any known fraud or suspected fraud that the company is investigating.**
- (h) The auditor should examine the reports of the internal auditor with a view to ascertain whether any fraud has been reported or noticed by the management. The auditor should examine the minutes of the audit committee, if available, to ascertain whether any instance of fraud pertaining to the company has been reported and actions taken thereon. The auditor should enquire from the management about any frauds on the company that it has noticed or that have been reported to it. The auditor should also discuss the matter with other employees including officers of the company. The auditor should also examine the minute book of the board meeting of the company in this regard.**
- (i) The auditor should obtain written representations from management that: (i) it acknowledges its responsibility for the implementation and operation of accounting and internal control systems that are designed to prevent and detect fraud and error; (ii) it believes the effects of those uncorrected misstatements in financial statements, aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such items should be included in or attached to the written representation; (iii) it has disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity; and (iv) it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.**
- (j) Because management is responsible for adjusting the financial statements to correct material misstatements, it is important that the auditor obtains written representation from management that any uncorrected misstatements resulting from fraud are, in management's opinion, immaterial, both individually and in the aggregate. Such representations are not a substitute for obtaining sufficient appropriate audit evidence. In some circumstances, management may not believe that certain of the uncorrected financial statement misstatements aggregated by the auditor during the audit are misstatements. For that reason, management may want to add to their written representation words such as, "We do not agree that items constitute misstatements because [description of reasons]."**
- (k) The auditor should consider if any fraud has been reported by them during the year under section 143(12) of the Act and if so whether that same would be reported under this Clause. It may be mentioned here that section 143(12) of the Act requires the auditor has reasons to believe that a fraud is being committed or has been committed by an employee or officer. In such a case the auditor needs to report to the Central Government**

*or the Audit Committee. However, this Clause will include only the reported frauds and not suspected fraud.*

- (l) Where the auditor notices that any fraud by the company or on the company by its officers or employees has been noticed by or reported during the year, the auditor should, apart from reporting the existence of fraud, also required to report, the nature of fraud and amount involved. For reporting under this clause, the auditor may consider the following: (i) This clause requires all frauds noticed or reported during the year shall be reported indicating the nature and amount involved. As specified the fraud by the company or on the company by its officers or employees are only covered. (ii) Of the frauds covered under section 143(12) of the Act, only noticed frauds shall be included here and not the suspected frauds. (iii) While reporting under this clause with regard to the nature and the amount involved of the frauds noticed or reported, the auditor may also consider the principles of materiality outlined in Standards on Auditing.*
- 3. Whether the company has entered into any noncash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with? [Paragraph 3(xv)]*

**Ans.**

**Relevant Provisions:**

- (a) Section 192 of the Act deals with restriction on noncash transactions involving directors or persons connected with them. The section prohibits the company from entering into following types of arrangements unless it meets the conditions laid out in the said section:*
- i. An arrangement by which a director of the company or its holding, subsidiary or associate company or a person connected with such director acquires or is to acquire assets for consideration other than cash, from the company.*
  - ii. An arrangement by which the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.*
- (b) Arrangements, as discussed herein above, can only be entered by the company on fulfillment of the conditions laid out in Section 192 of the Act which are as under:*
- I. The company should have obtained prior approval for such arrangement through a resolution of the company in general meeting.*
  - II. In case the concerned director or the person connected therewith, is also a director of its holding company, a similar approval should have been obtained by the holding company through a resolution at its general meeting.*
- (c) The reporting requirements under this clause are in two parts. The first part requires the auditor to report on whether the company has entered into any non-cash transactions with the directors or any persons connected with such director/s. The second part of the clause requires the auditor to report whether the provisions of section 192 of the Act*

*have been complied with. Therefore, the second part of the clause becomes reportable only if the answer to the first part is in affirmative.*

- (d) *In other words, such transactions involving change in the assets or liabilities of a company but not involving “cash” or cash equivalents” as defined under Accounting Standard (AS) 3, “Cash Flow Statement” may be construed as non-cash transactions. At this point, it may be appropriate to also refer to the definition and discussion on “non-cash transactions” & “cash and cash equivalents”, as given in AS 3.*
- (e) *There may be a situation where the acquisition of the asset takes place in one year and the corresponding liability is created in the financial statements, the corresponding settlement in the following year. The said transaction will not be considered as non-cash transaction. Further, mergers under Court schemes would be entered into subject to requisite approvals of Court etc., would not be considered non-cash transactions.*
- (f) *The term “person connected with the director” has not been defined in the Act, or the Rules thereunder. Instead, the term “to any other person in whom the director is interested” is defined in the Explanation to sub section*
  - (1) *of section 185 of the Act, which is reproduced as under and may be used as the reference point for reporting under this clause.*

*“(a) any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;*

  - (b) *any firm in which any such director or relative is a partner;*
  - (c) *any private company of which any such director is a director or member;*
  - (d) *any body corporate at a general meeting of which not less than twenty-five per cent. of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or (e) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.”*
- (g) *Section 2(77) of the Companies Act, 2013 read with Rule 4 of the Companies (Specification of Definition Details) Rules, 2014 defines the term “relative”. As per the aforesaid section 2(77), “Relative, with reference to any person, means anyone who is related to another, if –*
  - (i) *they are members of a Hindu Undivided Family;*
  - (ii) *they are husband and wife; or*
  - (iii) *one person is related to the other in such manner as may be prescribed” As per Rule 4 of the Companies (Specification of Definition Details) Rules, 2014, a person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely –*
    - (i) *Father, including step father*

- (ii) *Mother, including step mother*
  - (iii) *Son, including step son*
  - (iv) *Son's wife*
  - (v) *Daughter*
  - (vi) *Daughter's husband*
  - (ii) *Brother, including step brother*
  - (viii) *Sister, including step sister*
- (h) *The term "acquire" simply means to come into possession of something. A thing that cannot be sold cannot be acquired. Thus, an acquisition would necessarily involve existence of two parties and a transfer of rights and/or obligations in a thing. In the context of section 192 of the Act, this transfer is between the company and the director and/or a person connected with a director. Such "director" is not restricted to being a director of the concerned company, but extends to director of a holding company, subsidiary or associate of the company under question.*
- (i) *As provided in section 192, the acquisition by/from the company has to be that of an "asset". Further, the term assets should be construed to have the same meaning as described in the Framework for Preparation and Presentation of Financial Statements, issued by the Institute of Chartered Accountants of India. The auditor would need to evaluate whether the subject matter of acquisition by/ from the company satisfies the characteristic of an "asset".*

#### **Audit Procedures and Reporting**

- (j) *For reporting on the first leg of the reporting clause, the starting point of the auditor's procedures could be obtaining a management representation as to whether the company has undertaken any non-cash transactions with the directors or persons connected with the directors, as envisaged in section 192(1) of the Act. The auditor would need to corroborate the management representation with sufficient appropriate audit evidence. A scrutiny of the following books of account, records and documents could provide source of such audit evidence to the auditor as to the existence of such non cash transactions as well as persons connected with the Directors:*

<i>Persons connected with Director</i>	<i>Acquisition by/ From Company</i>
<i>Form No. MBP 1, Notice of Interest by Director, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014 [Ref: Sec 184(1) and Rule 9(1)]</i>	<i>Form No. MBP 2, Register of Loans, Guarantee, Security and Acquisition Made by the Company, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014 [Ref: Sec 186(9) and Rule 12(1)]</i>
	<i>Form No. MBP 4, Register of Contracts with Related Party and Contracts and</i>

	<i>Bodies etc. in which Directors are Interested, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014 [Ref: Sec 189(1) and Rule 16(1)]</i>
	<i>Movements in the Fixed Asset Register</i>
	<i>Minutes book of the General Meeting and Meetings of Directors</i>
	<i>Report on Annual General Meeting pursuant to Companies (Management and Administration) Rules, 2014 {Ref Sec 121(1) and Rule 31(2)}</i>

- (k) *The above documents and records would provide evidence of any such non-cash transactions that have actually taken place. The language of section 192(1) also uses the term “is to acquire” in the context of such transactions, indicating the existence of intention to acquire. The management may be requested to provide details of its intention to enter into transactions covered under section 192, after the date of the financial statements under audit. The minutes of the meetings of the Board of Directors and the Audit Committee may provide evidence of such intention. Besides, a scrutiny of the information for subsequent period as contained in the aforesaid records and documents may provide corroborative audit evidence of such intention having existed as at the date of the auditor’s report.*
- (l) *Where the company has entered into/is to enter into any non-cash transactions as discussed above, the auditor would make a report to that effect under this clause. The second leg of the clause requires the auditor to report whether the Company has complied with the provisions of section 192 in this regard. Section 192(1) and (2) envisage the following compliances in respect of such transactions:*
- (i) *The company should have obtained a prior approval for such arrangement by a resolution in the General Meeting.*
  - (ii) *If the concerned Director or connected person is a director of the company’s holding company, the latter too should have obtained a similar prior approval for the arrangement by a resolution at its General Meeting.*
  - (iii) *Notice for approval of the resolution should contain details of the arrangement along with the value of assets involved duly calculated by a registered valuer. The auditor should check compliance with Section 192(2) and verify the notice of the General Meeting that it includes particulars of arrangement along with the value of the assets involved such arrangements. The said value should be calculated by the register valuer.*



- (m) *In case where the concerned director/connected person is also a director of the holding company, the auditor would need to check whether the holding company has complied with the requirements. For this purpose, the auditor would need to obtain a management representation letter from the holding company through the management of the auditee company.*

***Suggested paragraph on reporting:***

***According to the information and explanations given to us, the Company has entered into non-cash transactions with one of the directors/ person connected with the director during the year, by the acquisition of assets by assuming directly related liabilities, which in our opinion is covered under the provisions of Section 192 of the Act, and for which approval has not yet been obtained in a general meeting of the Company.***

**Appendix 3****Key Aspects discussed in Guidance Note on Reporting of Fraud under section 143(12) of the Companies Act 2013****1. What is Duty to report on frauds under Companies Act?**

As per sub-section (12) of section 143 of the Companies Act, 2013,

- if an auditor of a company
- in the course of the performance of his duties as auditor,
- has reason to believe that
- an offence of fraud involving such amount or amounts as may be prescribed,
- is being or has been committed in the company
- by its officers or employees,
- the auditor shall report the matter to the Central Government
- within such time and in such manner as may be prescribed.

**2. What is the monetary threshold prescribed for such reporting?**

**Case-1** *Fraud amounting to ₹ 1 crore or more:- If auditor has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.*

*The manner of reporting the matter to the Central Government is as follows:*

- (a) *the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;*
- (b) *on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;*
- (c) *in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;*
- (d) *the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;*
- (e) *the report shall be on the letter-head of the auditor containing postal address, e-mail*

*address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and*

*(f) the report shall be in the form of a statement as specified in Form ADT-4.*

**Case 2 Fraud amounting to less than ₹ 1 Crore.:-** Sub-section (12) of section 143 of the Companies Act, 2013 further prescribes that in case of a fraud involving lesser than the specified amount [i.e. less than ₹ 1 crore], the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.

*In this regard, sub-rule (3) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that in case of a fraud involving lesser than the amount specified in sub-rule (1) [i.e. less than ₹1 crore], the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:*

- (a) Nature of Fraud with description;*
- (b) Approximate amount involved; and*
- (c) Parties involved.*

**3. What are disclosure requirements of FRAUD in Board's report?**

*Sub-section (12) of section 143 of the Companies Act, 2013 further prescribes that the*

- companies, whose auditors have reported frauds under this sub-section (12)*
- to the audit committee or the Board,*
- but not reported to the Central Government,*
- shall disclose the details about such frauds in the Board's report*
- in such manner as may be prescribed.*

*In this regard, sub-rule (4) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that the auditor is also required to disclose in the Board's Report the following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year:*

- (a) Nature of Fraud with description;*
- (b) Approximate Amount involved;*
- (c) Parties involved, if remedial action not taken; and*
- (d) Remedial actions taken.*

## **Appendix 4**

### **Key Aspects discussed in Guidance Note on Reporting under Section 143(3) (f) and (h) of the Companies Act, 2013**

#### **1. What are the reporting requirements under section 143(3)(f) and (h) of the Companies Act, 2013?**

According to Section 143 (3) lays down certain matters required to be reported upon by the auditor in his report. Sub-section (3) of section 143 of Act provides as follows:

**"(3) The auditor's report shall also state -**

- (a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;**
- (b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;**
- (c) whether the report on the accounts of any branch office of the company audited under sub- section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;**
- (d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;**
- (e) whether, in his opinion, the financial statements comply with the accounting standards;**
- (f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;**
- (g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;**
- (h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;**
- (i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;**
- (j) such other matters as may be prescribed.**

#### **2. What should be considered while reporting under clause (f) of subsection 3 of section 143:- "the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company"?**

- According to the Guidance note:- The words “observations” or “comments” as appearing in clause (f) of section 143(3) are construed to have the same meaning as referring to “emphasis of matter paragraphs, situations leading to modification in the auditor’s report. Accordingly, the auditor should have made an “observation” or “comment” in the auditor’s report in order to determine the need to report under clause (f) of section 143(3). Therefore, only such “observations” or “comments” of the auditors on financial transactions or matters that have been made by the auditor in the auditor’s report which have an adverse effect on the functioning of the company are required to be reported under this clause.
- It should be noted that there is no change in the objective and scope of an audit of financial statements because of inclusion of clause (f) in sub-section (3) of section 143 of the Act.

3. Whether every qualification, disclaimer, adverse opinion, or emphasis of matter para required to be included in above reporting?

According to this Guidance Note - The auditor expresses his opinion on the true and fair view presented by the financial statements through his report which may be modified in certain circumstances. However, the auditor would now have to evaluate the subject matters leading to modification of the audit report or emphasis of matter in the auditor’s report to make judgment as to which of them has an adverse effect on the functioning of the company within the overall context of audit of financial statements of the company. Only such matters which, in the opinion of the auditor, have an adverse effect on the functioning of the company should be reported under this clause. Hence such qualifications or adverse opinions or disclaimer of opinion or emphasis of matters of the auditor, which do not deal with matters that have adverse effect on the functioning of the company, need not be reported under this clause.

4. Illustrate which type of modifications in auditor’s report will require to report under 143(3)(f) and which are not?

Examples of emphasis of matter which may have an adverse effect on the functioning of the company include situations where:

- The going concern assumption is appropriate but there are several factors leading to a material uncertainty that may cast a significant doubt about the Company’s ability to continue as a going concern; or
- a material uncertainty regarding the outcome of a litigation wherein an unfavourable decision could result in a significant outflow of resources for the company, etc.

Examples of emphasis of matter which may not have an adverse effect on the functioning of the company include a situation where there is an emphasis of matter:

- on managerial remuneration which is subject to the approval of the Central Government;
- relating to accrual of a contractually receivable claim based on management estimate where the ultimate realisation could be different from the amount accrued;

- *on frauds that have been dealt with in the financial statements of the company and would not have any continuing effect on the financial statements*

**5. What is scope of auditor while reporting under 143(3)(h) “any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith”?**

*According to Guidance Note, the words “qualification”, “adverse remark” and “reservation” used in clause (h) of section 143(3) should be considered to be similar to the terms “qualified opinion”, “adverse opinion” and “disclaimer of opinion”, respectively, referred to in SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”. Hence, the auditor would need to report under clause (h) of section 143(3) any matter that causes a qualification, adverse remark or disclaimer of opinion on the financial statements since such matters will or possibly will have an effect on the books of account maintained by the company. It should be noted that the auditor may have made an observation on maintenance of cost records under clause (b) of section 143(3) and this may not have had an effect on the financial statements of the company or the auditor’s opinion on the financial statements. Further, any material weakness in internal financial controls that is reported by the auditor under clause (i) of section 143(3) may not have an impact on the maintenance of books of account if such material weakness did not result in a modification to the opinion on the financial statements of the company. However, if the material weakness in internal financial controls resulted in a modification to the audit opinion on the financial statements, then such modification may be covered for reporting under clause (h) of section 143(3).*

## **Appendix 5**

### **Key Aspects discussed in Guidance Note on Internal Financial Control over Financial Reporting**

#### **1. What is Internal Financial Control (IFC)? (Sec 134)**

**As per Section 134 of the Companies Act 2013, the term Internal Financial Controls means the policies and procedures adopted by the company for ensuring:**

- **Orderly and efficient conduct of its business, including adherence to Company's policies,**
- **Safeguarding of its assets,**
- **Prevention and detection of frauds and errors,**
- **Accuracy and completeness of the accounting records, and**
- **Timely preparation of reliable financial information.**

#### **2. What is Internal Controls over financial Reporting (ICFR)?**

**As per Guidance Note issued by ICAI on Guidance Note on Audit of Internal Financial Controls Over Financial Reporting (September, 2015), "Internal Financial Controls Over Financial Reporting (ICFR) shall mean:**

**"A Process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles". A Company's internal financial control over financial reporting includes those policies and procedures:**

**Pertain to the maintenance of the records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company:**

**It provides reasonable assurance that transactions are recorded as necessary to permit preparation of financial statement in accordance with generally accepted accounting principles, and those receipts and expenditures of the company are being made only in accordance with authorizations of management and director of the company.**

**Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effects of the financial statement.**

#### **3. Which provision of Companies Act requires such IFC and Reporting? Section 134:**

**In the case of a listed company, the Directors' Responsibility states that directors, have laid down IFC to be followed by the company and that such controls are adequate and operating effectively.**

#### **Section 143:**

**The auditor's report should also state whether the company has adequate IFC system in place and the operating effectiveness of such controls**

***Section 177:***

***Audit committee may call for comments of auditors about internal control systems before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.***

***Schedule IV***

***The independent directors should satisfy themselves on the integrity of financial information and ensure that financial controls and systems of risk management are robust and defensible.***

***Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 –***

***The director's report should contain details in respect of adequacy of internal financial controls with reference to the financial reporting.***

***4. To whom does this apply?***

***The guidance note clarifies that reporting on ICFR by auditors will be applicable to both listed and unlisted companies, including small and one person companies. This is in line with the requirements of section 143(3)(i) of the Companies Act, 2013.***

***Furthermore, it states that auditors will have to report on ICFR in respect of both stand alone and consolidated financial statements.***

***5. When does this apply and for financial statements of which period?***

***The guidance note clarifies that auditors will have to report whether a company has an adequate ICFR system in place and whether the same was operating effectively as at the balance sheet date of 31 March 2016. In practice, this will mean that when forming its audit opinion on ICFR, the auditor will surely test transactions during the financial year ending 31 March 2016 and not just as at the balance sheet date, though the extent of testing at or near the balance sheet date may be higher. If control issues or deficiencies are identified during the interim period and are remediated before the balance sheet date, then the auditor may still be able to express an unqualified opinion on the ICFR. This is particularly important for companies for the current year ending 31 March 2016, as it will be the first year when auditor validation of ICFR will be required.***

***6. What is extent of reporting?***

***The auditor needs to obtain reasonable assurance to state whether an adequate internal financial controls system was maintained and whether such internal financial controls system operated effectively in the company in all material respects with respect to financial reporting only. The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.***