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ADDITIONAL AMENDMENTS (NEW COURSE)

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AUDIT OF STOCK AND DEBTORS / UNIT INSPECTION (AUDIT OF BORROWAL ACCOUNTS) AMENDMENTS

1. UNIT INSPECTION & ITS PURPOSE

Important Part of MRS of Advances / Includes Audit of Stock & Debtors – Concurrent or **Empaneled** Auditors
– Scope & Format by Bank

Monitoring, Review and Supervision of advances of all borrowable accounts include Unit Inspection inter alia consisting of audit of stock and debtors. This audit is carried out either by Concurrent Auditors or by empaneled external auditors. The scope of audit, the percentage verification as well as format of reporting are prescribed by the Banks.

PURPOSES OF UNIT INSPECTION:

(End Use / Working / Correctness of Info etc. / Stock & Debtor)

- i. To ensure end use of funds as per terms of sanctions.
- ii. To have independent verification of working of borrowal unit.
- iii. To confirm correctness of statements and information furnished to the bank vis-à-vis the books of accounts and other records of the borrower.
- iv. To make sure that the stock exists, is marketable, is properly insured and is a paid stock.
- v. To verify whether the book debts are current and are recoverable.

2. AUDIT PROCESS FOR UNIT INSPECTION

Preparation for Inspection –
(Last Report / Documents / Securities)

1. Refer last inspection reports to note the defects already found and responses thereto by the borrower.
2. Verify documents with the bank – such as – promissory note, sanction letter, mortgage deed, visit reports, insurance, stock & debtors statement, Quarterly Information Statement submitted by the borrower, etc. and list defects.
3. List primary and secondary securities mortgaged/hypothecated to the bank.

(Locations & Expectations)

4. List the locations to be visited, such as – Bank's branch where borrower has account, borrower's office, factory, godowns, sales offices from where invoicing is done, Job workers location where goods are sent by the borrower etc.
5. Know projections to estimate the levels of stock and debtors at the time of Inspection.

(Stock Related Points)

6. Verify last 12 months stock statements to identify slow moving's stock, seasonal trends in levels and knowing break-up of percentages of Raw Material, Work In Progress, and Finished goods to total stock for stocks at different locations.
7. Arrange for physical verification of stock at all locations.
8. Understand process to know, how work in progress is valued

(Debtor Related Points)

9. Take current list of debtors and creditors including advances received and paid
10. Identify major debtor's balances.

(Other Points)

11. Make intelligent scrutiny of cash credit account to reveal diversion of funds, off balance sheet items serviced to other lenders by the borrower such as instalment of leased finance obtained, payment to parties unrelated

to business indicating investment outside business, frequent overdrawing, frequent bouncing of cheques, repeated against effects, repeated requests for adhoc limits etc.

12. Arrange to refer books of account of the borrower including excise record.

13. Information to be collected from Branch

(General Information & Regular Points in flow of Processing Loans)

1. Information of the borrower. Such as –
 - (i) Constitution
 - (ii) Nature of Activity
 - (iii) Nature of Stock
2. Information about all advances (Term Loans, C.C., OD, Bill Discounting, Guarantees, LCs) – Sanction limit, value of security, drawing power, outstanding balance and extent of irregularity.
3. Borrowing arrangements – under sole/multiple/consortium finance with share of the bank.
4. Documentation of the borrower for all loan accounts.
5. Charge creation – For first charge and second charge.
6. Particulars of Insurance cover for all Fixed and Current assets.
7. Non-Compliance of terms and Conditions of sanctions, if any
8. Interest application – rate, calculations and frequency.
9. Regularity of repayment of Term Loans.
10. Sanction limit valid up to the date.
11. Last renewal/review date.

(Identifying Defaults)

12. Overdue bills, bank guarantees and LCs.
13. Devolvement of LCs with the reason for devolvement and method of adjustment.
14. Invocation of Bank Guarantee – Reason for invocation and how adjusted.
15. Expired guarantees not reversed.
16. Excess drawings – Number of times overdrawn, Average time taken for regularization, excess neither adjusted nor confirmed by higher authorities.

(Identifying Unusual Items)

17. Debit and Credit summation for one year.
18. Rate of recurrence of Cash transaction with average amount.

(Latest Information)

19. Last available Balance confirmation.
20. Information by the borrower of –
 - (a) Recent Stock/book debt Statements
 - (b) Drawing power calculation
 - (c) Regularity of submission of quarterly/monthly statements
 - (d) Last Audited Statements
21. Reports on Inspection either by branch, or by concurrent auditors, or by Bank's Internal Inspection Team and Compliance by the borrower on the requirements and observations of the Inspectors.

Information to be collected at the time of visit to borrower

About Godown

- i. Whether access to godown is restricted
- ii. Whether Security arrangements at godown are satisfactory

About Stock

- i. General Storage condition of stock at godown
- ii. ABC categorization of stock
- iii. Stock at the time of Inspection with reconciliation of stocks in books = Physical Stock + Stock given on Job Work - Stock received for job work - Unpaid Stock
- iv. Method of stock valuation and statutory auditor's comments thereon.

About Manufacturing & related stock records

- i. Production details – such as – Licensed capacity, installed capacity and capacity utilization of each plant.
- ii. Tallying of stock with balances in Excise Register
- iii. Details of stock sent out for job work with corresponding entries of movements in Excise record.
- iv. Stock received for job work

About Book Debts

- i. Book-debt value = Book debts balance as per books of accounts - debts not ranking for DP - doubtful debts – debts not pertaining to line of business - margin
- ii. Party wise / Age wise break-up of book debt
- iii. Book debts reported to bank v/s correct balance as accounting package including correctness of ageing
- iv. Average realization time of book debts

Drawing Power Calculations & other information about Stocks

- i. Drawing power calculations = Value of Stock + Value of Debtors - Unpaid Stock – Stock under LC – Stock under Bills - Stock under packing credit - Obsolete/non-saleable stock - Unrelated stock/old stock - margin
- ii. Stock belonging to sister concerns
- iii. Stock holding as a percentage of sales
- iv. Abnormal increase /decrease in stock levels with reasons

Other Information

Details of temporary closure of unit due to lock out/strike or labour unrest.

3. FINDINGS OF INSPECTION

About Stock

- i. Address of Godown or even the borrower not matching as per documents with bank.
- ii. Physical stock and book stock showing material differences.
- iii. Stocks identified as non-moving or slow moving or non-saleable included in statement to the bank.
- iv. Stock valuation not done properly, e.g. Valuation done at selling price, interest included in cost, administrative or selling overheads included in cost, etc.
- v. Safety of material not ensured.
- vi. Arrangements of stock not appropriate making it difficult to count the same, making it impossible to use on FIFO basis, making it prone to damages.
- vii. Excess stock found.
- viii. Billing to sister concerns not supported by stock movement.
- ix. Stock in pledge old and non-saleable

Debtors

- i. Ageing of debtors indicating long outstanding debit balances or irrecoverable balances.
- ii. Advance receipt not deducted from debtor's balances.
- iii. Written-off debtors reported to bank as good and recoverable.
- iv. Debtors requested to pay directly to the creditors thereby avoiding the margin required to adjust the default in term loans.
- v. List of invoices raised in 90 days given to bank instead of outstanding balances of debtors.

Creditors

- i. Suppliers name on the bills and on the stock packing do not tally thereby indicating either stock does not belong to the borrower or the bills are fake.
- ii. Level of actual creditors substantially higher than as reported to bank.
- iii. Debit balances/Advances to creditors shown as debtors.

Others**Financing Related**

- ✓ Bank accounts opened with other banks without permission of the lending bank.
- ✓ Multiple financing availed without permission of the lending bank.
- ✓ Name plate of the bank not displayed inside the godown, thereby carrying a risk of hypothecation of same stock to other lender.
- ✓ Drawing power not properly calculate

In Flow of Business

- ✓ Change in constitution not informed to the bank, e.g. Retirement of Key Management personnel, without appropriate replacement, affecting business, not intimated to bank for the fear of cancellation of limit.
- ✓ Activity partially or fully discontinued and/or premises given on rent not informed to bank.
- ✓ All sales receipts are not deposited in bank Account.
- ✓ Substantial increase in cash sales but not deposited in bank account.
- ✓ Transactions with related parties not genuine, e.g. Accommodation bills raised against invoices having no underlying stock movement.

Insurance & Others

Some of the assets not insured.

Insurance company not informed about temporary change in location thereby running a risk of rejection of claim in case of damage to stock.

Laboratory tests of materials indicate lower potency/non-usable stock.

Excessive stock holding noticed in certain items, which is not supported by business plan.

1. REPORT

Defects found in last inspection still persisting.

(i) Report will have to be given in the format prescribed by the bank.

(ii) Any negative findings should be discussed with the borrower and also with the bank officials before writing the report.

(iii) Any difficulty in carrying out the inspection needs to be informed to the bank well in time.

(iv) Inspection should be carried out within reasonable time of appointment and report should be submitted immediately thereafter in order to help the bank act on the observations expeditiously.

ENVIRONMENTAL AUDIT AMENDMENTS

1. DEFINITION, SCOPE AND OBJECTIVE OF ENVIRONMENT AUDIT

There were 3 definitions in module, we deleted 2 of them as it was getting repetitive and confusing, further we don't expect full-fledged 4/5 marks question on defining environment audit.

(Definition / Objective / Scope all mean same here)

The **objective of the Environmental Audit** are to

- Evaluate the efficacy of the utilization of resources of man, machines and materials (*Water, RM consumption / Capacity utilization of Machines & Manpower*)
- To identify the areas of environmental risks and liabilities and weakness(es) of management system (*Air / Water / Sound / Land Pollution*)
- Problems in compliance of the directives of the regulatory agencies and
- How to Control the generation of pollutants and/or waste. (*Recommendations*)

(Status of Environment Audit in India)

As the Environmental Audit, especially in India, is still in its infancy the information usually gathered in the course of Environmental Audit is only what is required for the compliance of the statutory requirements, i.e., for Water Act, 1974, Air Act, 1981, etc., and for environmental clearance required before establishing an industry.

2. REGULATORY FRAMEWORK

(Authorities)

In Indian scenario, the Regulatory Authorities like Ministry of Environment and Forest (MOEF), State Pollution Control Board (SPCB), State Department of Environment (SDOEn.) etc., have come into play to clear the projects from environmental viewpoint before it's commissioning.

(EIA)

The Environmental Impact Assessment (EIA) is a pre-requisite to start an industry. The EIA tries to forecast the expected damage to be caused by the development of the industries to the environmental and the means required to mitigate that damage, incorporating the same in the Project Report for compliance in due course, keeping in view the serious threat to all the living beings in the universe by the rapid industrialization which is polluting the environmental on an irreparable extent.

(Legal Requirement of Environment Audit in India)

The Indian Govt. notified by GSR No. 329E dated 13.02.1992 that "Every person carrying on an industry, operation or process requiring consent under Section 25 of the Water (Prevention and Control of Pollution) Act, 1974 (6 of 1974) or under Section 21 of the Air (Prevention and Control of Pollution) Act, 1981 (4 of 1981) or both or authorization under the Hazardous Waste (Management and Handling) Rules, 1989 issued under Environment Protection Act, 1986 (29 of 1986) shall submit an environment audit report for the financial year ending the 31st March inform V to the concerned State Pollution Control Board on or before the 15th day of May every year, beginning 1993".

3. EMERGING OPPORTUNITIES FOR CHARTERED ACCOUNTANTS IN ENVIRONMENT AUDIT

CA's Role in Compliance and Certification Audits: Compliance audits are conducted to verify an entity's compliance with environmental laws, regulations, standards, industry guidelines or company's own policy. It is felt that CAs can very efficiently conduct compliance audits if they gain knowledge of relevant environmental laws and regulations. They can also conduct certification audits. Such arguments, generally, center on the

requirements outlined in ISO 14012 Guidelines for environmental auditing issued in 1996. CAs already has first set of required skills. After obtaining knowledge about environmental laws, EMS and relevant terms, they can very efficiently conduct environmental audits, particularly certifications audits. These audits may include monitoring of environmental management system of the unit, checking the status of consent orders, compliance of consent orders, water cess, other legal requirements, industrial data collection regarding product process, electric consumption, water consumption, raw materials and energy balance, etc.

In the same way, CAs can play important role in non-financial auditing or carbon audits.

CA and Environmental Information Audit: The main role of financial auditor is to express opinion on truth and fairness of assertions made in financial statements. This role can be very well extended to include environmental information audit where all types of environmental information reported by a concern through various mediums is verified with the help of all available evidences.

4. FEATURES OF ENVIRONMENTAL AUDIT

The following are features of environmental audit:

First 4 Points are Purpose Related

(ii) Aim of environmental audit – A green audit may be conducted for many purposes, for example, to comply with environmental laws or as a social responsibility measure or to meet some certification requirements. But the main and ultimate aim of any environmental audit is to evaluate and control the adverse impact of economic activities of an organization on the environment.

(viii) Environmental Performance – As mentioned before, the essence of any environmental audit is to find out how well the environmental organization, environmental management and environmental equipment's are performing. The ultimate aim is to ensure that organization's environmental performance meets the goals set in its environmental policy and also to ensure compliance with standards and regulatory requirements.

(i) Management tool – Environmental audit is generally considered as one of the management tool which is a part of internal control system and is mainly used to assess, evaluate and manage environmental performance of a company.

(iii) Different from EIA- Environmental audit should be distinguished from Environmental Impact Assessment (EIA) – EIA is a tool used to predict, evaluate and analyze environmental impacts mostly before a project commences. It assesses the potential environmental effects of a proposed facility. The essential purpose of an environmental audit is the systematic scrutiny of environmental performance throughout a company's existing operations.

Next 4 points are Environment Audit Process Related

(iv) Systematic – Environmental audit is a systematic process that must be carefully planned, structured and organized. As it is a part of a long-term process of evaluation and checking, it needs to be a repeatable process so that over time, it can be easily used by different teams of people in such a way that the results are comparable and can reflect change in both quantitative and qualitative terms.

(vii) Objective Evaluation – Though environmental auditing is conducted using pre-decided policies, procedures and a proper documented system, there is always an element of subjectivity in an audit, particularly if it is conducted internally. In addition to internal environmental audits, having independent audit teams that have specialized skills and who come back periodically (say annually) to repeat audits tends to increase objectivity in the system. Hence for the sake of objectivity, external environmental audits are preferable. This is also required under many certification guidelines (e.g. ISO 14001).

(vi) Periodic – Environmental audit is generally conducted at pre-defined intervals. It is a long- term process.

(v) Documented – Like any other audit, the base of any environmental auditing is that its findings are supported by documents and verifiable information. The audit process is designed in such a way that it seeks to verify on a sample basis past actions, activities, events and procedures with available evidences to ensure that they were

carried out according to system's requirements and in a correct manner.

5. ENVIRONMENTAL AUDIT PROCESS

Pre-audit or Planning Stage (Stage1):

Audit planning is vital to the success of the audit undertaken. During this stage of audit, generally following steps are taken:

(i) **Collect background information about the entity** – Collect information about environmental policy and goals of the organization, relevant environmental laws, regulations and standards governing the entity, persons responsible for carrying environmental duties, environmental budget, significant environmental matters like, material costs, risk areas, etc.

(ii) **Define objectives of audit** – What are the goals of the environmental audit?

(iii) **Define scope** –

What parts of a facility (operations) will be audited?

What programmes will be audited?

How far back will the audit examine?

(iv) **Choose audit criteria** – Against what will the facility be audited (e.g., for regulatory compliance audits, against what regulations or standards will the facility be audited)?

(v) **Select the audit team members** – The audit team leader selects team members based on appropriate knowledge and experience. The team both. If internal staff is going to be involved, they should be chosen in a proper way so as to avoid conflict of interest. The facility environmental manager, for example, should not be on the audit team.

(vi) **Develop audit plan and protocols** – Protocols are written guides for the auditors that outline the activities to be undertaken in conducting a review of a given topic area during the environmental audit. They often contain detailed information about audit criteria, such as, applicable regulations. Computers are often used in creating audit protocols and in locating and sharing information between team members during the audit (e.g., regulatory databases are often utilized in creating audit protocols).

(vii) **Inform the facility** – Arrangements for on-site activities need to be made.

(viii) **Desktop review**.

On-site or Field Audit (Stage2)

The following are steps involved in on-site or field audit:

(i) **Opening Conference** – Communicate the objectives and methods of the audit of key facility personnel and schedule necessary meetings and interviews.

(ii) **Facility tours** – Identify areas of concern for more detailed inspection, get a feel for the site and modify the audit schedule accordingly.

(iii) **Site/ Facility Inspection** – Established protocols should guide the inspection. The team may also wish to inspect areas of concern or interest that they have been identified in the facility tour. It may not be possible to inspect the entire facility (comprehensive inspection), therefore, sampling techniques may be an important part of determining the part of site to be inspected.

(iv) **Records/ Document Review** – The audit protocols should give instructions as to the types of records to request as well as what to look for when examining the documents.

(v) **Staff interviews** – Interviews with key informants will yield the least reliable information, due to the fallibility of human memory, but are important in the identification of potential problems and in collecting information about facility operations.

- (vi) **Evidence** – Collect sufficient, appropriate and reliable audit evidences to check the activities, performance impacts and reports.
- (vii) **Initial review of findings** – Findings are the result of the evaluation of evidence collected against audit criteria. It is Important at this stage to review where the facility does not meet the audit criteria.
- (viii) **Closing/ exit conference** – This is a chance for auditees to identify misunderstandings and to be introduced to the findings of the audit team.

Post – Audit (Stage3)

Steps involved in post – audits are as follows:

- (i) **Final evaluation of findings**: Findings must be backed by evidence. It is important to note areas of deficiency that were present during the previous audit but are not yet corrected. Often finding are labeled as major or minor depending on the level and types of risks posed and speed with which the audit team feels they should be addressed.
- (ii) Draft **preliminary audit report**
- (iii) Get **approval of the management**
- (iv) Hold **exit conference**
- (v) Discuss **recommendations**, if any
- (vi) Prepare and submit **final report**.

Follow up or Review Stage (Stage4)

This is also called **corrective action follow-up phase**. While not technically part of the audit, the audit manager or team leader may be involved in developing a corrective action plan for addressing audit findings with the facility and reporting to senior management as to the progress of this plan.

6. TOOLS AND TECHNIQUES USED IN ENVIRONMENTAL AUDITING

Q2-CROP is good technique for Environment

Some of the tools which can be used in environmental audits are:

- (i) **Questioning** – Questioning is one of the most crucial aspects of auditing yet from a training and awareness point of view, it is often given the least attention. The purpose is information gathering in nature and not an interrogation. The questioner must, therefore, be sensitive to the perspective of the auditee and avoid making the questions accusatory, judgmental or aggressive.
- (ii) **Questionnaires** – Audit protocols or audit questionnaires provide the basis and structuring for most audits. They are based upon checklist questionnaires but are more complex and include more detail and sometimes logistical information and data relating to the audit and the site being audited.
- (iii) **Checklists** – Checklists are very useful tools used to ensure that different tasks or topics are included during the audit. They are very useful in specialized cases where a complex range of issues and questions need to be asked to ensure that nothing is missed.
- (iv) **Research** – It is useful to try and undertake some background research and investigation into the site or company to be audited. Familiarization with the operations, products, raw materials reports, press material and newspaper articles etc. all provides useful background information to supplement questioning sessions and help understand the operational processes.
- (v) **Observation** – Observation is a vital component of an auditing exercise. Observation is a disciplined activity which must be carried out in a very deliberate and controlled manner. The idea of looking at something twice is important because it is part of the process that checks that the observation is accurately noted, analyzed and recorded.
- (vi) **Photographs** – These are a very valuable aid in the audit process. However, in order to use them, a number of important practical points must be borne in mind. The most important one is formal approval before using this technique.

7. ENVIRONMENTAL AUDIT REPORT

The end product of environmental audit is environmental audit report (EA Report) which contains findings or results of environmental audit and recommendations for improvement, if any (mainly required in environmental performance audit where objective is to improve performance of the organization). EA report should be concise and informative with information displayed in a format that is easy to interpret and understand. The environmental auditor must ensure that EA report should provide an accurate record of soundly based observations and of logical deductions. The report must be signed by environmental auditor.

The Audit report should be complete, precise, accurate and balanced. It should contain constructive and precise recommendations. It must be persuasive and instrumental in inspiring the managements of entities to take corrective actions. The violations and omissions should also be effectively mentioned in the report. Last but not the least, the contents of green audit report should be easy to understand and free from vagueness or ambiguity, include information which is supported by complete and relevant audit evidence and be independent, objective fair and constructive.

(Easy to interpret & understand / base on sound observations & logical deductions / complete, precise, accurate & balanced / independent, objective, fair & constructive / corrective actions / recommendations)

Contents of Report: It is to be noted that length and detail of environmental audit report may vary according to nature and type of organization audited and also on the basis of scope and object of audit. However, usually it is expected that the report should include following contents:

I Executive summary

II. Table of contents

(i) Background:

Nature and type of auditee organization, main Business, facility description, EMS, etc.

(ii) Audit objective:

To review compliance status of the organization, to check reporting of non-compliance or to verify the mechanisms for rectifying non-compliance.

(iii) Audit scope: whether it is initial audit, audit of only one site, facility or process or audit of whole organization, etc.

(iv)

(v) Audit criteria: National law, Supra-national law, International agreements, Applicable standards, Industry guidelines, or corporate policy.

(vi) Audit team

(vii) Audit schedule

(viii) Audit methodology:

- Document review
- Checklist
- Interviews, etc.

(ix) Audit findings:

- Compliance status: compliance with environmental laws, specific regulation, certification requirement or company's own environmental policy.

- Violation information: e.g. failure to have required clearance, permit or approval, failure to have required plan or failure to report to authorities.

Mention the relevant law or regulation to which the violation relates like, air, water or hazardous waste Acts.

Significant consequences of non-compliance. e.g., penalty

Areas where non-compliance was found and corrected during audit period and areas where it is yet to be corrected.

(x) Audit conclusions and recommendations

- If audit findings indicate commendable level of compliance and no non-compliance was identified, still some opportunities for improvement can be identified and listed.

- If non-compliance was found, recommendations can be made for developing some mechanism so that in

future, it is not repeated. Indicate the time until the correction is to be completed and person responsible for making corrections.

(xi) Annexes

- Environment policy and action plan of organization
- List of applicable laws and regulations
- Checklists

(xii) Signature of auditor with date and place
AUDIT OF ACCOUNTS OF NON-CORPORATE ENTITIES (BANK BORROWERS)
1. RBI CIRCULAR ON AUDIT OF NON-CORPORATE ENTITIES
RBI Circular – Audit Requirement

The Reserve Bank of India (RBI), keeping in view the need for bringing discipline in the matter of maintenance of accounts by non-corporate entities, has issued a circular dated 12th April 1985 to all Banks recommending audit of accounts of all non-corporate borrowers enjoying working capital limits of Rs 10 lacs and above from the banking system.

Computation of Working Capital Limit for Audit

For the purpose of computing the above limit, the term borrowing will include borrowing of the following types:

(In Sequence of Popularity)

- Cash credit facilities
- Overdraft
- Bill Discounting Facilities
- Packing credit facilities
- Deferred payment facilities

(Other)

- Loans-secured and unsecured
- Guarantees:
 - Performance guarantees
 - Financial guarantees
- Any other credit facilities (other than loans, guarantees, letter of credit etc.)

Submission of Audited Financial Statements

This requirement applied in respect of the accounting year of the non -corporate entity commencing on or after 1-4-1984. It is necessary for the non-corporate entity enjoying such credit facility to submit the audited statements and audit report to the concerned bank as early as possible but in any case, not later than 6 months from the close of the accounting year. The primary responsibility for maintenance of books of accounts and records is that of the non-corporate entity.

2. AUDIT PROCEDURE

Objective – True & Fair View / Professional Skills Same as Corporate Sector / For Lending Bank / Special Purpose Report

(i) The auditor is required to express his opinion as to whether the financial statements give a true and fair view of the state of affairs of the entity. For this purpose, the auditor has to use his professional skill and expertise and apply such audit tests as the circumstances of the case may require. Considering the contents of the audit report the auditor has to conduct the audit by applying the same principles which are applicable for an audit in the corporate sector. The audit report is to be given to the lending bank and therefore such report will be in the nature of a special purpose report.

Primary Responsibility to Maintain Books – Management – Get it in Engagement Letter

(ii) As already noted, the primary responsibility for maintenance of books of account and records and that for preparation of financial statements is of the non-corporate entity. The auditor should obtain the letter of engagement and list of books of account and other records maintained by the entity before undertaking the audit assignment.

No Specific Disqualifications, communicate with previous auditor before accepting audit

(iii) The non-corporate entity is free to choose any practicing Chartered Accountant to conduct this audit. In the event of any such change it is necessary for the incoming auditor to communicate with the outgoing auditor as explained in the Institute's publication "Code of Ethics". He should also ensure that he does not resort to undercutting while accepting any such assignment.

Power to Call for Books and other info, if Refused then Qualify

(iv) Section 143 of the Companies Act gives certain powers to the auditors to call for the books of account, information, documents, explanations, etc. and to have access to all books and records. In the case of audit of a non-corporate entity, it would be in the interest of the entity to furnish all the information and explanations and produce books of accounts and records required by the auditor. If, however, the entity refuses to produce any particular record or to give any specific information or explanation the auditor would be required to report the same and qualify his report.

Governing Documents & Agreements

(v) Non-corporate entities are, in certain cases; evidenced by documents/agreements, such as, partnership deed, deed of association, trust deed etc. It would be necessary for the auditor to check the compliance with the terms of documents, agreements, so far as they relate to accounts and audits and to report all material violations of such terms.

If no internal controls don't use sampling but keep in mind materiality

(vi) If he finds that there is no internal control, it would not be advisable for him to conduct the audit by applying test checks. The auditor will also have to keep in mind the concept of materiality depending upon the circumstances of each case.

Previous Year Figures & Audit

(vii) The figures of the immediately preceding year should be given in a manner so as to enable meaningful comparison. If the accounts of such preceding year are not audited, the fact should be indicated by way of a note and also reported by the auditor.

Result of Working / Material Items / Deviation from GAAP

(viii) The audited accounts should clearly disclose the results of the working of the entity for the year, every material feature, transactions of an exceptional and non-recurring nature and also transactions pertaining to earlier years, if material. The said accounts should be prepared in conformity with the generally accepted accounting principles followed consistently. Any deviation, if material, either from the accepted principles or from the policy/treatment followed in the preceding year should be clearly brought out in the notes and/or the Auditors' Report.

Help Lending Bank

(ix) The overall consideration should be that the financial statements so prepared should give a true and fair view of the working of the entity. Moreover, these statements should also assist the lending bankers in their evaluation of the loan proposals and in ensuring strict financial discipline, coupled with uniformity, in the existing as well as prospective customers.

3. SPECIAL AUDIT REPORT

Lending Bank Can Demand Special Report

A lending bank may, in special cases, require the non-corporate entity to obtain a special report from the auditor. Such a report can be called by a lending bank if it finds that it is necessary to have more information about the working of the entity. In such a case the report will have to be given by the auditor on a quarterly basis.

This special audit report which is to be given on a quarterly basis in the specified form is in addition to the normal audit report which is to be given by the auditor on a yearly basis.

In the quarterly special audit report, the auditor will have to give information relating to:

Operating Data:

(Production Data)

For each quarter, this information will have to be classified as:

- (i) Actual production;
- (ii) Actual production as a percentage of rated capacity;
- (iii) Cost of goods sold/cost of production;
- (iv) Sales;
- (v) Gross margin
- (vi) Interest on bank borrowing;
- (vii) Interest on others

It is not necessary to work out the actual filed cost for this purpose.

(RM & FG Data)

#Ageing Data#

The age-wise classification of raw materials and finished goods is to be given.

For this purpose, age-wise classification is to be made in the following manner in respect of raw materials and finished goods separately:

- (i) Inventory for more than one year;
- (ii) Between 6 months and one year;
- (iii) Between three months and 6 months;
- (iv) Below 3 months.

Similar information about the work-in-progress i.e. the number of days of production which remains in progress should also be given.

#Valuation#

The basis of valuation of raw material and finished goods should be given. For this purpose, the following information is to be given:

- (i) The manner of determination of cost (i.e. components of cost)
- (ii) The method of valuing stock i.e. FIFO, weighted average cost, etc.

It is also necessary to state if there is any discrepancy between the quantity and value of the stock as furnished to the bank and as appearing in the books. The reasons for such discrepancy should be given in the audit report.

(Receivable Data)

Age-wise classification of bills receivable and other receivables with reference to the, bills due from domestic parties and bills in respect of exports should be given. The age-wise classification is to be done on the same basis as the classification for raw materials and finished goods as stated above.

Information in respect of the following items is also to be given:

- (i) Loans raised during the quarter from banks and from others. Separate figures to be given;
- (ii) Actual disbursement of capital expenditure during the quarter;
- (iii) Outstanding contracts on capital account at the end of the quarter giving the details about the names of parties and amounts outstanding;
- (iv) Balances at the end of each month of the quarter for major categories of stock, receivables and bills receivables;
- (v) Figures of cash losses during the last 2 years to be stated on the basis of the annual accounts. If such accounts were not audited this fact should be stated.
- (vi) Tax assessments and payments made during the quarter;

- (vii) Overdue statutory liability at the end of the quarter;
- (viii) The contingent liability which may or may not materialize during the financial year succeeding the relevant quarter;
- (ix) Amounts due but not paid at the end of the quarter in respect of (a) loans from banks, (b) public deposits, and (c) other loans; and
 - (i) Investment made during the quarter and the income from such investments including profit on sale of investments;
 - (ii) Loans given during the quarter;

(Diversion of Funds)

The funds obtained from the lending banks have to be utilized for the purpose for which they are given by the bank. If the auditor finds that these funds have been diverted for the purposes other than those for which they were given by the bank the auditor will have to give the details of the diversion for such other purposes.

In order that the lending bank may be able to ascertain the correct financial position and financial health of the entity it is necessary for the auditor to give the details of the diversion for such other purposes.

In order that the lending bank may be able to ascertain the correct financial position and financial health of the entity it is necessary for the auditor to give information about the following ratios:

Capital turnover ratio

Debt equity ratio

Interest cover ratio

Raw materials-turnover ratio

Current ratio

Acid test ratio

Finished goods-turnover ratio

Net margin ratio

Receivables-turnover ratio

Return on investment

Operating cash flow.

FORENSIC AUDIT AMENDMENTS

1. DEFINITIONS

“Forensic”

The word forensic comes from the Latin word forensic, meaning "of or before the forum." It is –

- Relating to the use of science or technology in the investigation and establishment of facts or evidence in a court of law.
- Relating to, used in, or appropriate for courts of law or for public discussion or argumentation.

(Bank Entries in Tally Data are generally not acceptable in court of law but bank entries in bank statement are acceptable)

So Forensic means “suitable for use in the court of law”. Bologna said that it is the application of financial skills and investigative mentality to unresolved issues, conducted within the context of the rules of evidence. As an emerging discipline, it encompasses financial expertise, fraud knowledge and a sound knowledge and understanding of business reality and the working of legal system.

Forensic Accounting:

(Accounting + Auditing + Investigative Skills = Forensic Accounting / Auditing)

The integration of accounting, auditing and investigative skills yields the specialty known as Forensic Accounting. It is the study and interpretation of accounting evidence. It is the application of accounting methods to the tracking and collection of forensic evidence, usually for investigation and prosecution of criminal acts such as embezzlement or fraud.

Forensic Accounting can sometimes be referred to as Forensic Auditing.

Forensic Investigation: Also known as forensic audit is the examination of documents and the interviewing of people to extract evidence. Forensic Accounting examines individual or company financial records as an investigative measure that attempts to derive evidence suitable for use in litigation.

Fraud Auditing: In a fraud audit one searches for the point where the numbers and/or financial statements do not mesh. It is a meticulous review of financial documents conducted when fraud is suspected. Some entities do them as a precaution to prevent fraud from happening and to catch it before the loss magnifies. A Fraud Audit however is not an Investigation. Fraud auditing is used to identify fraudulent transactions, not to figure out how they were created. Fraud auditors often go outside the books of accounts to find fraudulent transactions.

Red Flag: Red flags are signs or warnings of any impending danger or inappropriate behavior. Red flags do not necessarily indicate the existence of fraud however are indicators that caution needs to be exercised while investigating the situations. Red flags are classified in categories such as financial performance red flag, accounting system red flags, operational red flags and behavioral red flags.

Forensic audit can be conducted in order to prosecute a party for fraud, embezzlement or other financial claims. In addition, an audit may be conducted to determine negligence. In addition, an audit may be conducted to determine negligence.

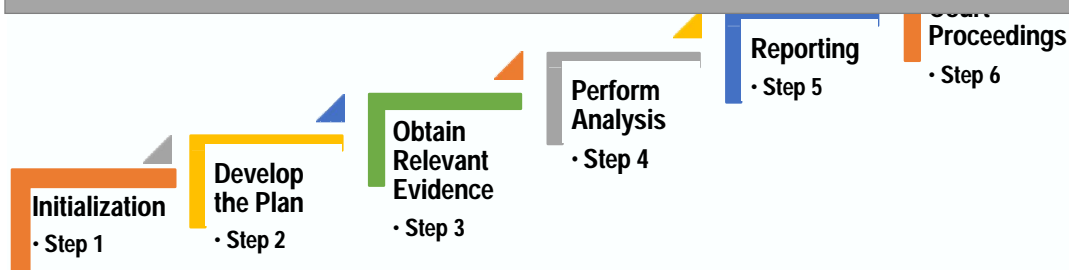
2. AUDIT V/S. FORENSIC ACCOUNTING/FORENSIC AUDIT

Sr. No.	Particulars	Other Audits	Forensic Audit
1.	Objectives	Express an opinion as to 'True & Fair presentation	Whether fraud has taken place in books
2.	Techniques	Substantive & Compliance. Sample based	Investigative, substantive or in depth checking

3.	Period	Normally for a particular accounting period.	No such limitations
4.	Verification of stock, Estimation realizable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation	Independent/verification of suspected/selected items where misappropriation in suspected
5.	Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
6.	Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.

Each Forensic Accounting assignment is unique. Accordingly, the actual approach adopted, and the procedures performed will be specific to it. However, in general, many Forensic Accounting assignments will include the steps detailed below.

3. PROCESS OF FORENSIC ACCOUNTING



Step 1. Initialization

Purpose

It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment.

Meet Client

It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand.

Conflict Check

A conflict check should be carried out as soon as the relevant parties are established. (*Whether it will affect other assignment of firm and vice versa*)

Preliminary Investigation

It is often useful to carry out a preliminary investigation prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issues.

Step 2. Develop Plan

Set Objectives & Methodology

This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and will set out the objectives to be achieved and the methodology to be utilized to accomplish them.

Step 3. Obtain Relevant Evidence

Economic Information / Documents / Assets / Person / Expert / Company

Depending on the nature of the case, this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event.

Depends on Nature of Fraud

In order to gather detailed evidence, the investigator must understand the specific type of fraud that has been carried out, and how the fraud has been committed.

Sufficient to Prove Identity of Fraudster / Mechanics of Fraud / Amount of Fraud / Clear Chain of Custody / Usable in Court

The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered. It is important that the investigating team is skilled in collecting evidence that can be used in a court case, and in keeping a clear chain of custody until the evidence is presented in court. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible. Investigators must be alert to documents being falsified, damaged or destroyed by the suspect(s).

Step 4. Perform the analysis

The actual analysis performed will be dependent upon the nature of the assignment and may involve:

- summarizing a large number of transactions;
- calculating economic damages;
- performing present value calculations utilizing appropriate discount rates;
- performing a regression or sensitivity analysis;
- utilizing a computerized application such as a spread sheet, data base or computer model;
- utilizing charts and graphics to explain the analysis.
- performing a tracing of assets;

Step 5. Reporting

Issuing an audit report is the final step of a fraud audit. Auditors will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence and a conclusion as to the amount of loss suffered as a result of the fraud.

Sections in Report

The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.

The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

Facts should be the base and not mere Opinions

The forensic auditor should have active listening skills which will enable him to summarize the facts in the report. It should be kept in mind that the report should be based on the facts assimilated during the process and not on the opinion of the person writing the report.

Step 6. Court proceedings

The investigation is likely to lead to legal proceedings against the suspect, and members of the investigative team will probably be involved in any resultant court case. The evidence gathered during the investigation will need to be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified.

4. FORENSIC AUDIT TECHNIQUES

(Fraud can be in any corner of financial statements)

Detecting fraud is difficult, especially frauds involving material financial statement misstatements, which occur only in about 2 percent of all financial statements.

(Concealed – Omission or Falsification & Collusion)

Fraud is generally concealed and often occurs through collusion. Normally, the documents supporting omitted transactions are not kept in company files. False documentation is often created, or legitimate documents are altered to support fictitious transactions.

While fraud detection techniques will not identify all fraud, the use of sound techniques can increase the likelihood that misstatements or defalcations will be discovered on a timely basis.

Forensic Audit Technique will be very important technique as per **GST - Discussion at CCD**

Some of the techniques that a forensic auditor may use are listed below:

(I) General Audit Techniques:

- **Testing defenses:** A good initial forensic audit technique is to attempt to circumvent these defenses yourself. The weaknesses you find within the organizations control will most probably guide you down the sea path taken by suspected perpetrators. This technique requires you to attempt to put yourself in the shoes and think like your suspect.

(II) Generalized Audit Software (GAS): Generalized Audit Software (GAS) is a class of CAATs that allows auditors to undertake data extraction, querying, manipulation, summarization and analytical tasks. GAS focuses on the fully exploiting the data available in the entity's application systems in the pursuit of audit objectives. GAS support auditors by allowing them to examine the entity's data easily, flexibly, independently and interactively in data based auditing.

Using GAS, an auditor can formulate a range of alternative hypotheses for a particular potential misstatement in the subject matter and then test those hypotheses immediately. "What if" scenarios can be developed with the results and the auditors can examine the generated report rapidly. Currently, the latest versions of GAS include the Audit Command Language (ACL), Interactive Data Extraction and Analysis (IDEA) and Pan audit.

(III) Statistical & Mathematical Techniques:

- **Trend Analysis:** Businesses have cycles and seasons much akin to nature itself. An expense or event within a business that would be analogous to a snowy day in the middle of summer is worth investigating. Careful review of your subject organization's historical norms is necessary in order for you to be able to discern the outlier event should it arise within your investigation.
- **Ratio Analysis:** Another useful fraud detection technique is the calculation of data analysis ratios for key numeric fields. Like financial ratios that give indications of the financial health of a company, data analysis ratios report on the fraud health by identifying possible symptoms of fraud.

(IV) Technology based /Digital Forensics Techniques: Every transaction leaves a digital footprint in today's computer-driven society. Close scrutiny of relevant emails, accounting records, phone logs and target hard drives is a requisite facet of any modern forensic audit. Before taking steps, such as obtaining data from email etc. the forensic auditor should take appropriate legal advice so that it doesn't amount to invasion of privacy. Digital investigations can become quite complex and require support from trained digital investigators. However, many open-source digital forensics tools are now available to assist you in this phase of the investigation.

CD should be checked by **S²MELL** technique

- ✓ **Cross Drive Analysis** (*Earlier each hard disk / pen drive etc. were analyzed one by one, in this approach they are analyzed at the same time*)
- ✓ **Deleted Files**
- ✓ **Stochastic Forensics** (*Analyzing change in pattern, to detect insider data theft*)

- ✓ Steganography (*Understanding hidden message in electronic file, images, communication*)
- ✓ MD5 (*Software used to investigate computers*)
- ✓ Encase (*Software used to extract evidence from sized hard drives etc.*)
- ✓ Live Analysis (*When cyber-attack takes place*)
- ✓ Log Related
- ✓ Tracking Log Files
- ✓ PC System Log
- ✓ Free Log Tools (*To extract meaningful information form logs*)

(V) Data Mining Techniques: It is a set of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns. Data mining techniques are categorized in three ways: Discovery, Predictive modeling and Deviation and Link analysis. It discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud. It explains various affinities, association, trends and variations in the form of conditional logic.

(VI) Computer Assisted Auditing Techniques (CAATs): Changing patterns of businesses, regulatory framework, scarcity of resources at auditors' disposal on one side and the ever-increasing mountainous data on other hand is making audit a complex process. Use of CAATs is, thus, indispensable to the Auditors and forensic auditors. Computer-assisted audit techniques (CAATs) or computer-assisted audit tools and techniques (CAATTs) are computer programs that the auditors use as part of the audit procedures to process data of audit significance contained in a client's information systems, without depending on him.

(VII) Common Software Tool (CST): Due to shortcomings of GASs, CSTs have become popular over a period. Spreadsheets (like MS Excel, Lotus, etc.), RDBMS (like MS Access, etc.) and Report writers (like Crystal reports, etc.) are few examples of CSTs. Their widespread acceptability is due to its instant availability and lower costs. While spreadsheets may be extremely easy to use due to its simplicity and versatility, other CSTs may need some practice.

Whether one uses GAS or CST, it is imperative that the auditor is aware about the manner and processes that have led to the data generation, the control environment revolving around the data and the source from where the data samples are imported into the GAS/CST.

(VIII) Laboratory Analysis of Physical and Electronic Evidences:

Computer Forensics

Chain of Custody
Hard disk imaging
Search for erased files

E-mail analysis
Analyze use & possible misuse
Computer software to analyze data

Protection/Validation of Evidence

Altered & Fictitious Documents
Physical examination
Document dating
Ink sampling
Fingerprint analysis
Forgeries
Federal Rules of Evidence

5. FORENSIC AUDIT REPORT

A Report is a statement of collected & considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of the full facts of the subject matter of the report.

The Forensic Audit Report is nothing, but statements of observation gathered & considered while proving conclusive evidence. It is a medium through which an auditor expresses his opinion under audit. It is an important part of the audit as it provides the results of the audit conducted by the auditor.

The main factors to be considered for the various ways for presentation of reports are:

- Nature of business of the Organization (Real Estate Related Business)
- Nature of subject or aspect appraised (Ownership of Property)
- Purpose for which report is prepared (For Understanding & Not Legal Use)
- For whom report is Intended (Directors)
- Management attitude, directives or needs (No Specific Request)
- Forensic auditor approach and caliber (MCA Records & Interviews)
- Extent of details required by auditee and management (Flow of Events)

Points to keep in mind while reporting:

Clear thinking:	<ul style="list-style-type: none"> ✓ Purpose and aim ✓ To whom the report is directed ✓ Cool and calm thinking to have logical and coherent presentation ✓ Pattern of presentation
Keep the reader uppermost in mind	<ul style="list-style-type: none"> ✓ Translate technical matters to layman's language ✓ To visualize the reader's viewpoint
Unbiased approach	<ul style="list-style-type: none"> ✓ To mention the view point of the auditee
Impact of the report	<ul style="list-style-type: none"> ✓ What be the probable reaction to reporting whether action or decision will follow in quickest possible time or to be treated as of academic interest only. ✓ To remember the universal saying - "don't jump to conclusions"
Facts and figures to be in proper sequences	

6. RETAINERS / REGULAR WORK / IMPORTANCE OF FORENSIC AUDIT

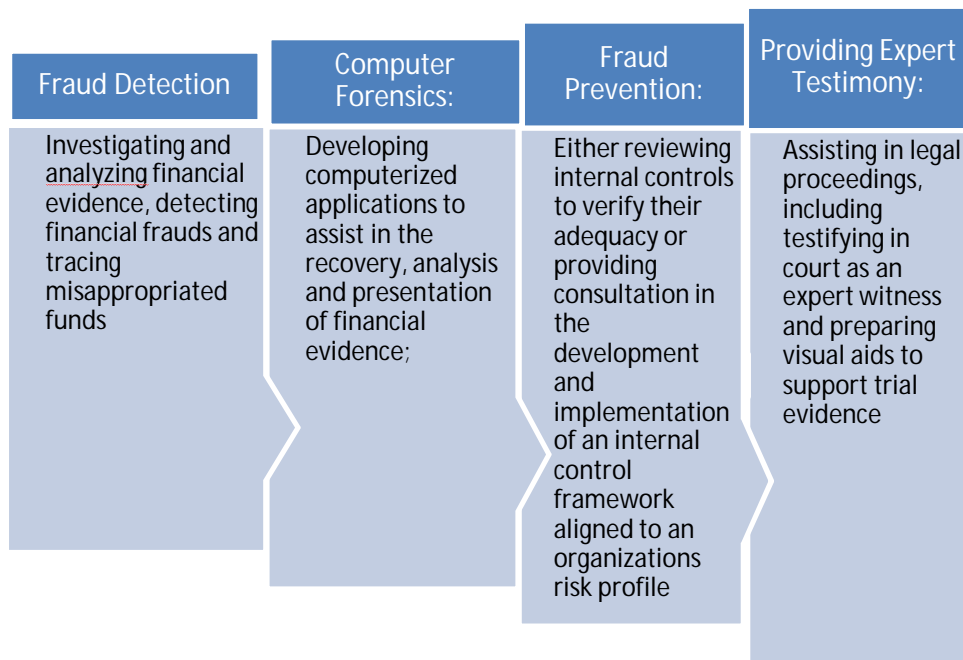
Retainers / Users of Forensic Auditors

(In Sequence of Importance)

- Courts (Eg To Determine Compensation)
- Government Regulatory Bodies & Agencies (Eg To Determine Tax fraud)
- Police Forces (Eg To Catch Fraudster)
- Banks (Eg To Decide Whether Fraud Has Happened)
- Insurance Companies (Eg To Assist in Insurance Fraud)
- Lawyers (Eg To Gather Evidence in Dispute)
- Business Community (Eg To Recover Lost Money)

Regular Work / Involvement of Forensic Auditor

A Forensic Auditor is often involved in the following:



In order to properly perform these services a Forensic Auditor must be familiar with legal concepts and procedures and have expertise in the use of IT tools and techniques that facilitate data recovery and analysis. In addition, a Forensic Auditor must be able to identify substance over form when dealing with an issue.

7. SERVICES RENDERED / PERFORMED BY FORENSIC ACCOUNTANTS

The services rendered by the forensic accountants are in great demand in the following areas:

- Identifying individuals to be most knowledgeable of facts
- Crafting Questions to be Posed
Providing Questions for Deposition and Cross Examination of Fact and Expert Witnesses
- Identifying documents to be requested and/or subpoenaed
Evaluating produced documentation and information for completeness
Analyzing produced records and other information for facts
- Conducting research relevant to facts of the case
Identifying and preserving key evidence
- Identifying alternative means to obtain key facts and information
- Responding to questions posed

8. AREAS WHERE THERE IS DEMAND OF FORENSIC AUDITOR

FD- SCAN of forensic auditor is in great demand in many areas

Fraud Investigation and Risk/Control Reviews:

Forensic accountants render such services both when called upon to investigate specific cases as well for a review of or for implementation of Internal Controls. Another area of significance is Risk Assessment and Risk Mitigation.

Dispute settlement:

- Business firms engage forensic accountants to handle contract disputes, construction claims, product liability claims, infringement of patent and trademarks cases, liability arising from breach of contracts and so on.

Settlement of insurance claims:

- Insurance companies engage forensic accountants to have an accurate assessment of claims to be settled.
- In case of policyholders seek the help of a forensic accountant when they need to challenge the claim settlement as worked out by the insurance companies. A forensic accountant handles the claims relating to

consequential loss policy, property loss due to various risks, fidelity insurance and other types of insurance claims.

Criminal Investigation:

- Matters relating to financial implications the services of the forensic accountants are availed of. The report of the accountants is considered in preparing and presentation as evidence.

Arbitration service:

- Forensic accountants render arbitration and mediation services for the business community. Their expertise in data collection and evidence presentation makes them sought after in this specialized practice area.

Professional Negligence Cases:

- Professional negligence cases are taken up by the forensic accountants. Non- conformation to Generally Accepted Accounting Standards (GAAS) or non- compliance to auditing practices or ethical codes of any profession they are needed to measure the loss due to such professional negligence or shortage in services.

10. CHARACTERISTICS & SKILLS OF FORENSIC AUDITOR

Characteristics- Forensic Auditor

(Initially as you get Assignment)

Curiosity

Inquisitiveness

(As you reach client and start work)

Confidence

Discretion *(To avoid offensive behaviour & never reveal confidential information)*

Detail-Oriented

Strong Visualization and Imagination

Skepticism

(As you go ahead in assignment)

Out of the Box Thinking

Creativity

Persistence

Sound professional judgement.

Skills - Forensic Auditor should possess

(Basic Skills)

Human Psychology

Criminology

Information Technology

Accounting & Business Reporting systems

Data Analytics

(Evidence Collection Skills)

Auditing Standards, Procedures and Related Methodologies

Investigative Techniques

Evidence gathering

Network of professional contacts in related fields' viz. enforcement, regulatory bodies, law, industry, peers etc.

(Legal Skills)

Legal Framework

Litigation processes & procedures

SPECIAL ASPECTS OF AUDITING IN AN AUTOMATED ENVIRONMENT AMENDMENTS

1. KEY FEATURES OF AN AUTOMATED ENVIRONMENT

1. Computer Based & Process Combines People & Computers

Typically, the automated environment is driven by computer-based systems which are also known as information technology (IT) systems or information systems (IS).

An automated environment is an ecosystem that combines people, processes and technology within an overall business environment.

2. Many Applications are Used

There are several types of applications that could exist in a business depending on several factors including the nature, size, location of a business.

(Example)

In a hotel there could be one application for front desk & reservations, another application for restaurant & kitchen orders, a guest billing system, and an accounting system. In large multinational companies, specifically in the financial services, the number of applications could be hundreds and even thousands of applications.

(Types of Application)

Business applications can be broadly categorized as follows:

Category of Business Applications	Example of Category
➤ Packaged software (also called off-the-shelf applications) used by micro and small business.	For example, QuickBooks, Tally.
➤ Small ERPs used in small to medium business.	For example, Tally ERP, Focus ERP, SAP Business One,
➤ ERP applications used in medium to large companies.	For example, SAP R/3, Oracle R12 Enterprise Business Suite.

3. Layers of Automated Environment

The applications described above form one layer of the overall automated environment. The other layers are made up of the technology infrastructure and the physical & environmental aspect including: *(In the Sequence of establishing Automated Environment)*

- Physical and environmental – access to IT facilities, CCTVs, temperature control, firefighting equipment, etc.
- Storage devices - disks, tapes, network storage;
- Operating systems - Windows, Unix, Linux;
- Databases - Oracle 12g, MS-SQL Server;
- Network devices - switches, routers and firewalls;
- Networks - local area networks, wide area networks, virtual private networks, etc.;

2. KEY CONCEPTS OF AUDITING IN REAL-TIME ENVIRONMENT SUCH AS E-COMMERCE, ERP, CORE BANKING, ETC.

Definition - Transactions happen immediately, without any delay

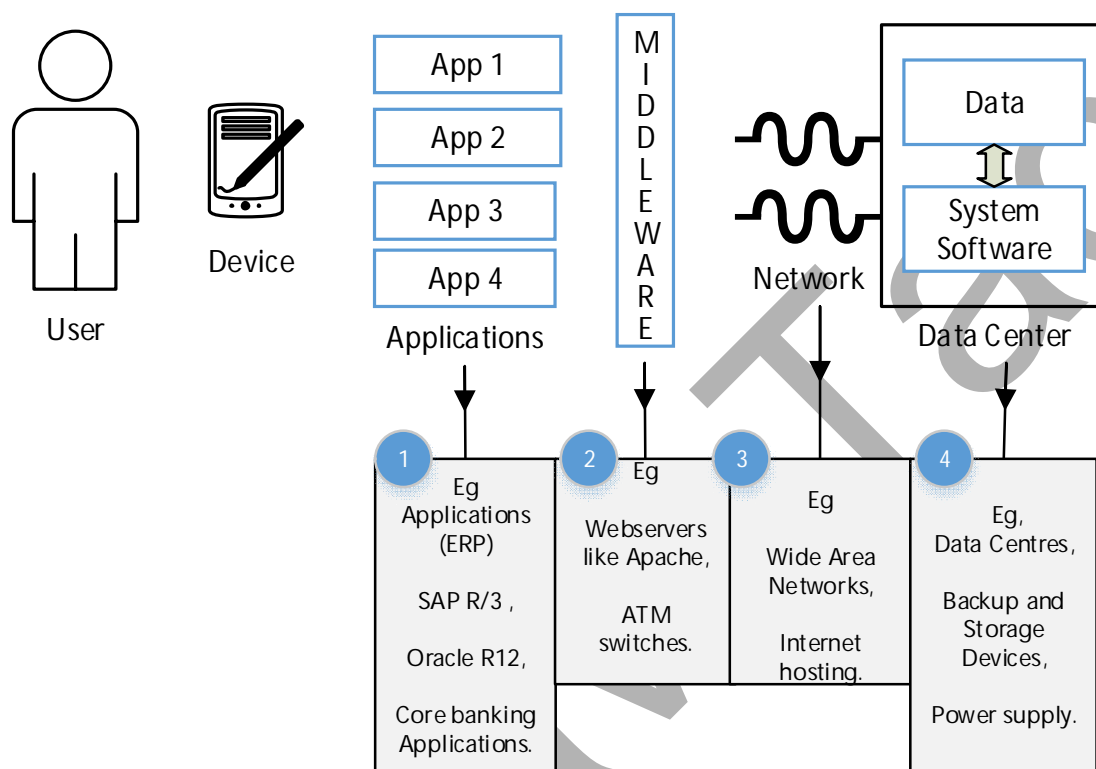
A real-time environment is a type of automated environment in which business operations and transactions are initiated, processed and recorded immediately as they happen without delay.

Example of Real Time Environment

In a bank that is using core banking system a customer account balance is instantly updated when the customer withdraws cash from an ATM. If there is a time delay in updating the customer account, there is a risk that the customer may initiate another transaction through internet or mobile banking channel and this could result in withdrawing more than account balance. Similarly, when a customer makes an online order on a shopping e-commerce portal using credit card, the credit limit of the customer will be reduced immediately.

Components of Real Time Automated Environment

A real-time environment has several critical IT components that enable anytime, anywhere transactions to take place. They include:



One Component Fails, Whole System Fails

To facilitate transactions in real-time, it is essential to have the systems, networks and applications available during all times. Any failure even in one component could render the real-time system unavailable and could result in a loss of revenue.

(Example of Failure)

If an e-commerce portal that normally processes a several hundred of orders per day goes down for an hour due to a malware attack on one of the webservers hosting the portal, the revenue loss could be significant.

Vulnerable to Attacks

Most real-time systems and environments are accessible through public domain and internet and hence, they are more likely to be vulnerable to network and cyber-attacks including denial of service (*Flooding From One Source*), distributed denial of service (*Flooding From Multiple Sources*).

Hence, it is critical for a company that operates in a real-time environment to constantly monitor all the IT components to identify and resolve issues and failures. Understanding of the automated environment, the risks and controls that should be considered and audit approach will be covered in the following sections of this chapter.

3. UNDERSTANDING AND DOCUMENTING AUTOMATED ENVIRONMENT

Understanding of the automated environment of a company is required as per SA 315. The auditor's understanding of the automated environment should include the following:

Application & IT Structure

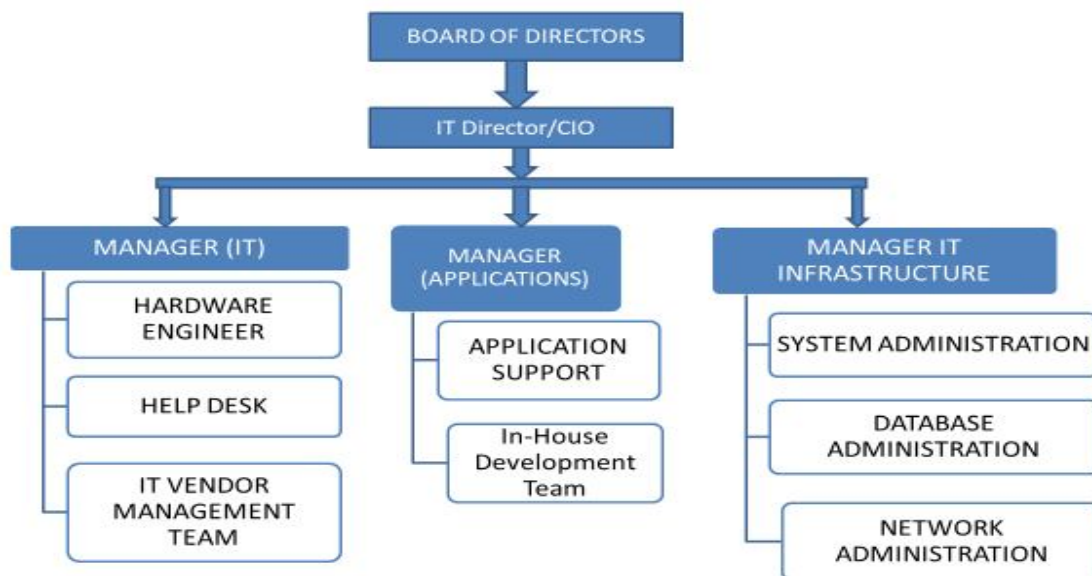
- The applications that are being used by the company;
- Details of the IT infrastructure components for each of the application;

Risks & Controls

- IT risks and controls.

The auditor is required to document the understanding of a company's automated environment as per SA 230.

(The illustration below is an example of an IT organization)



(The illustration below is an example of how an auditor can document details of an automated environment)

Application should have **-SOUND** automated environment

Application	Storage	Operating System	Used for	Network	Database
SAP R/3	NAS	HP-UX	Financial Accounting	LAN, WAN	Oracle 12g
REVS	Server Internal HDD	Windows 2012 Server	Front Desk, Guest Reservations	In-house developed	MS-SQL Server 2008
KOTS	Server Internal HDD	Windows 2012 Server	Restaurant and Kitchen Orders	In-house developed	MS-SQL Server 2008
BILLSYS	Server Internal HDD	Windows 2008 Server	Billing	Packaged Software	Oracle 11i

4. CONSIDERATION OF AUTOMATED ENVIRONMENT AT EACH PHASE OF AUDIT CYCLE

Phases of Audit

In a controls-based audit, the audit approach can be classified into three broad phases comprising of

- Planning,

- Execution, and
- Completion.

Relevance of Automated Environment

In this approach, the considerations of automated environment will be relevant at every phase as given below:

Planning Phase

- When obtaining an understanding of the business process and performing walkthroughs the use of IT systems and applications should be considered; *(Which locations & Processes are Computerized?)*
- While assessing the entity level controls the aspects related to IT governance need to be understood and reviewed; *(How IT system are used for Decision Making & Monitoring?)*
- Pervasive controls including segregation of duties, general IT controls and applications should be considered and reviewed; *(Affects many users & applications, such as job rotation, access passwords)*
- During risk assessment, the auditor should consider risk arising from the use of IT systems at the company; *(System Outage / Data safety & security / Recovery etc.)*

Execution / Testing

- During testing phase, the results of general IT controls would impact the nature, timing and extent of testing;
- When testing of reports and information produced by the entity (IPE) generated through IT systems and applications;

Completion / Reporting

- At completion stage, evaluation of control deficiencies may require using data analytics and CAATs.

5. ASSESSING IT-RELATED RISKS AND CONTROLS

The auditing standards SA 315 and SA 330 require an auditor to understand, assess and respond to the risks within a company, including those risks that pertain to the use of IT systems and applications in an automated environment. When assessing IT risks in the automated environment, the auditor should consider the following:

➤ Entity level aspects of risks that are related to the governance, organization and management of IT.

(Example)

- Has management established an IT Security Policy (Control Environment), communicated the policy to all employees and provided relevant training (Information & Communication)?
- How does management monitor adherence to the established policies (Monitoring)?

➤ IT risks at each layer of the automated environment.

(Example)

- As systems evolve and version updates happen so will new risks emerge. For example, as systems these days are highly interconnected and accessible through public networks like the internet, cyber risks are an emerging threat.
- Are direct data changes to database prevented, are strong passwords used in the operating system?

➤ Risks in the IT processes and procedures being followed.

(Example)

- Are unauthorized changes to IT systems applications prevented and detected in a timely manner?
- Is user access to systems commensurate with roles and responsibilities of the user?

Types of Controls in an Automated Environment

- General IT Controls
- Application Controls
- IT-Dependent Controls

6. GENERAL IT CONTROLS (AS PER SA 315)

Definition

General IT controls includes infrastructure, policies and procedures that support, affects IT system of organization and relate to many applications and support the effective functioning of application controls. They apply to mainframe, mainframe, and end-user environments.

Objective

General IT-controls that maintain the Integrity of information (*Accuracy*), Safety & Security of Data

Mitigates Risk

These are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes.

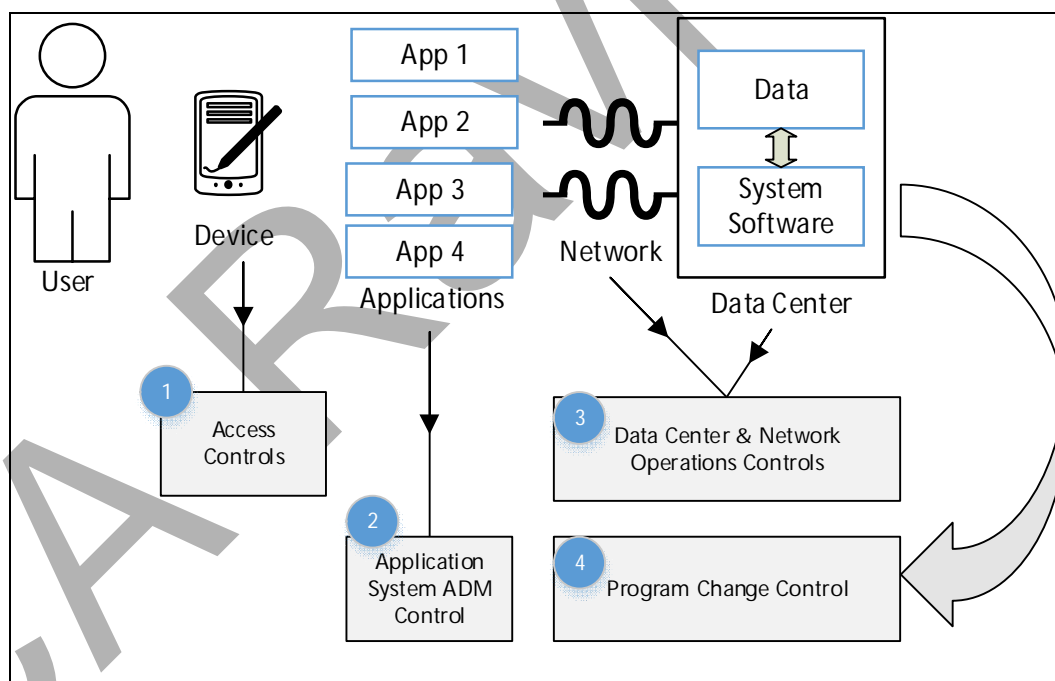
Pervasive / Indirect Controls

Hence, General IT controls are known as "pervasive" controls or "indirect" controls.

Types of General IT Controls

Commonly include controls over the following:

- Access security Controls
- Application system acquisition, development, and maintenance (Business Applications) Controls
- Data center and network operations Controls
- Program change Controls



Let us now learn about each of the General IT controls in more detail.

6A. ACCESS SECURITY

Objective:

- To ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives.

Activities:*(Auditor Met Security Team)*

- Security Organization & Management *(Adequate People, Knowledge, Skills of Team)*
- Security Policies & Procedures *(Well defined roles & responsibility)*
- System Administration & Privileged Accounts – Sysadmins, DBAs, Super users *(Track of these accounts & powers)*

(Auditor Entered IT Department)

- Physical Security – access controls, environment controls *(Id controlled doors, guard, entry register, temperature controls, water control)*
- Network Security – internal network, perimeter network *(boundary between private & public network)*

(Auditor accesses Computer)

- Operating System Security *(Boot Password / Windows Password)*
- Data Security *(Id wise data access)*
- Application Security *(Id wise application access)*

6B. APPLICATION SYSTEM ACQUISITION, DEVELOPMENT, AND MAINTENANCE (BUSINESS APPLICATIONS) CONTROLS

Objective: To ensure that systems are developed, configured and implemented to meet financial reporting objectives.

Activities:*(Company Level Meeting)*

- Overall Mgmt. of Development Activities *(GST Proposed / Development Head called for cross section meeting of different departments / Briefed Everyone / Called for fortnightly meetings)*

(Committee Formation)

- Project Initiation *(Formed committee consisting CA / Lawyer / IITian)*

(Progress)

- Analysis & Design *(After analysis of act & rules changes in design were proposed)*

(Coding)

- Construction *(Coding started)*

(Testing)

- Testing & Quality Assurance *(beta version was checked through dummy entries by employees of various departments)*

(Data Migration)

- Data Conversion *(All entries were completed by 30th June & Data conversion started 12pm on 30th June)*

(New software live)

- Go-Live Decision *(After testing by all department heads between 12pm to 3pm on 1st July)*

(Documentation)

- Documentation & Training *(On week training of employees & documentation of whole process)*

6C. DATA CENTER AND NETWORK OPERATIONS

Objective: To ensure that information systems are processed to meet financial reporting objectives.

Activities:

- Overall Management of Computer Operations Activities *(Number of computers, servers, its allocation, identification, safety and Security)*
- Batch jobs – preparing, scheduling and executing *(Daily transaction processing)*

- Help Desk Functions – recording, monitoring & tracking (*Error Solving*)
- Performance Monitoring – operating system, database and networks (*Quantum processing / Speed of Processing / Response Time etc*)
- Backups – monitoring, storage & retention
- Recovery from Failures – BCP, DRP
- Service Level Agreements – monitoring & compliance (*System Audit*)
- Documentation – operations manuals, service reports

6D. PROGRAM CHANGE

Objective: To ensure that modified systems continue to meet financial reporting objectives.

Activities (Similar to Application System ADM)

Change Management Process – definition, roles & responsibilities

Change Requests – record, manage, track

Making Changes – analyze, design, develop

Test Changes – test plan, test cases, UAT Apply Changes in Production Emergency & Minor Changes

Documentation – user/technical manuals

User Training

7. APPLICATION CONTROLS & IT DEPENDENT CONTROLS

Application Controls

Application controls include both automated or manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems.

Examples of automated applications include edit checks and validation of input data, sequence number checks, user limit checks, reasonableness checks, mandatory data fields.

IT Dependent Controls

IT dependent controls are basically manual controls that make use of some form of data or information or report produced from IT systems and applications. In this case, even though the control is performed manually, the design and effectiveness of such controls depends on the reliability of source data.

Due to the inherent dependency on IT, the effectiveness and reliability of Automated application controls and IT dependent controls require the General IT Controls to be effective.

8. GENERAL IT CONTROLS VS. APPLICATION CONTROLS

- These two categories of control over IT systems are interrelated.
- The relationship between the application controls and the General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems.

9. EVALUATING RISKS AND CONTROLS AT ENTITY LEVEL AND PROCESS LEVEL

Entity Level Risks and Controls: The controls that operate across a company at all levels i.e., from board and top management to the department and transaction level are known as entity level controls or ELCs. **The characteristics of ELCs include the following:**

- Entity Level controls are known as pervasive controls since they operate across all organization levels.
- ELCs are part of a company's overall internal control framework and relate to the internal control components other than control activities.
- Entity level controls are subjective by nature and hence require application of more professional judgement in their evaluation and testing.

(Hiring Ethical People / Having Adequate Team / All use company hardware & software)

There are direct entity level controls and indirect entity level controls.

(i) Direct ELCs operate at a level higher than business activity or transaction level such as a business process or sub-process level, account balance level, at a sufficient level of precision, to prevent, detect or correct a misstatement in a timely manner.

Examples include:

- Business performance reviews;
- Monitoring of effectiveness of controls activities by Internal Audit function;

(ii) Indirect ELCs do not relate to any specific business process, transaction or account balance and hence, cannot prevent or detect misstatements. However, they contribute indirectly to the effective operation of direct ELC and other control activities.

Examples include:

- Company code of conduct and ethics policies;
- Human resource policies;
- Employee job roles & responsibilities.

As per these examples, a company that has established policies and procedures, hires people with good background, promotes a culture of fairness and follows ethical practices, is less likely to see the occurrence of a fraud being committed in the company.

Auditor's Responsibility

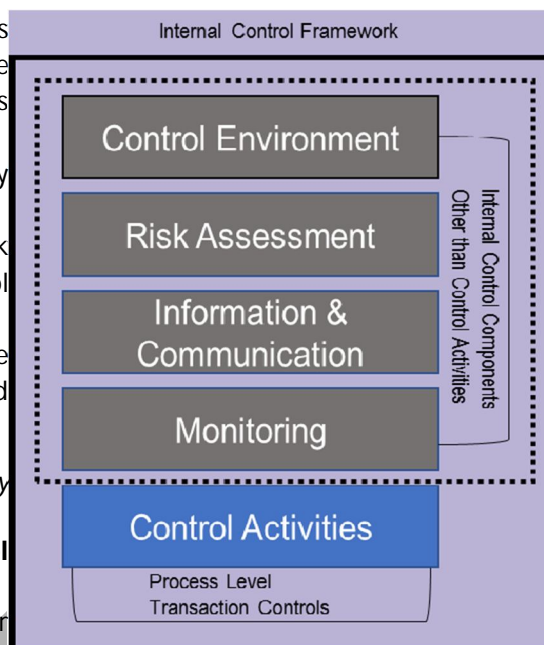
Auditors are required to understand, evaluate and validate the entity level controls as a part of an audit engagement. The results of testing entity level controls could have an impact on the nature, timing and extent of other audit procedures including testing of controls.

For example, when the entity level controls at a company are effective, the auditor may consider reducing the number of samples in the test of controls and where the auditor finds the entity level controls ineffective, the auditor may consider to increase the rigour of testing by increasing sample sizes.

In small and less complex companies, the entity level controls may not formally define or documented. In such situations, the auditor should design audit procedures accordingly to obtain evidence of the existence and effectiveness of entity level controls.

Example

The following example shows how the auditor performs an understanding and evaluation of the whistleblower policy in a company:



- Does the company have a whistle-blower policy?
- Is this policy documented and approved?
- Has the whistle-blower policy been communicated to all the employees?
- Are employees aware of this policy and understand its purpose and their obligations?
- Has the company taken measures viz., training, to make the employees understand the contents and purpose of the policy?
- Does the company monitor effectiveness of the policy from time-to-time?
- How does the company deal with deviations and non-compliance?

10. INFORMATION & COMMUNICATION

Most important Component

From the perspective of an ERP environment, the internal control component that is more relevant is the Information & Communication component.

Understanding & Evaluation

As part of understanding and evaluation of the Information & Communication component the auditor is required to obtain an understanding of:

- how business processes operate; (*Purchase / Production / Sale*)
- the relevant information systems used in the processing of business transactions and activities; (*Information based decision in Purchase / Production / Sale*)
- the risks and controls pertaining to the information systems and underlying infrastructure; (*Inaccurate information, time lag , wrong people, leak etc.*)
- reliability of information generated from systems.

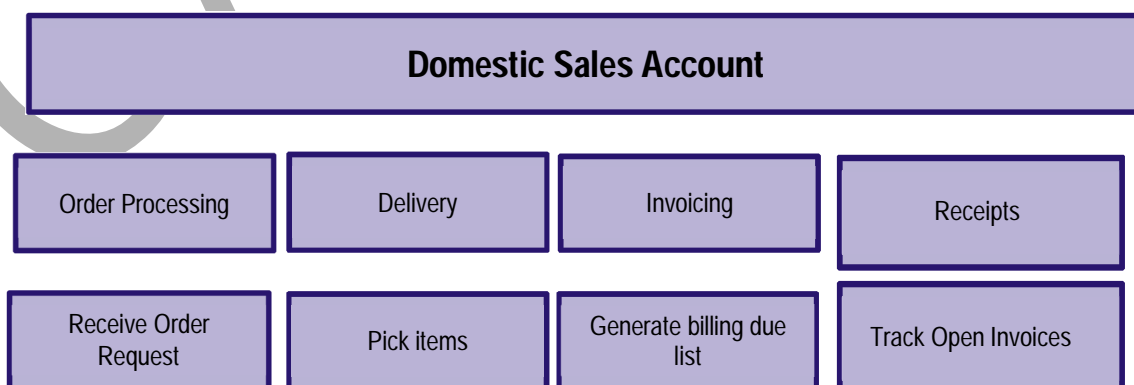
Other Components are also Relevant

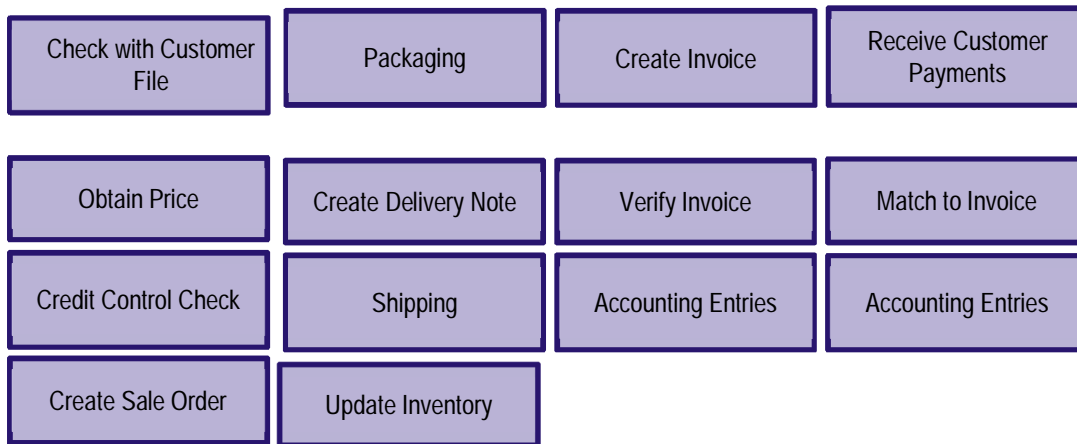
While Information & Communication is more relevant to the use of information systems in a company, in large and complex ERP environments it is very likely that the other components of internal controls viz., Control Environment, Risk Assessment and Monitoring will also be relevant.

11. PROCESS LEVEL RISKS AND CONTROLS

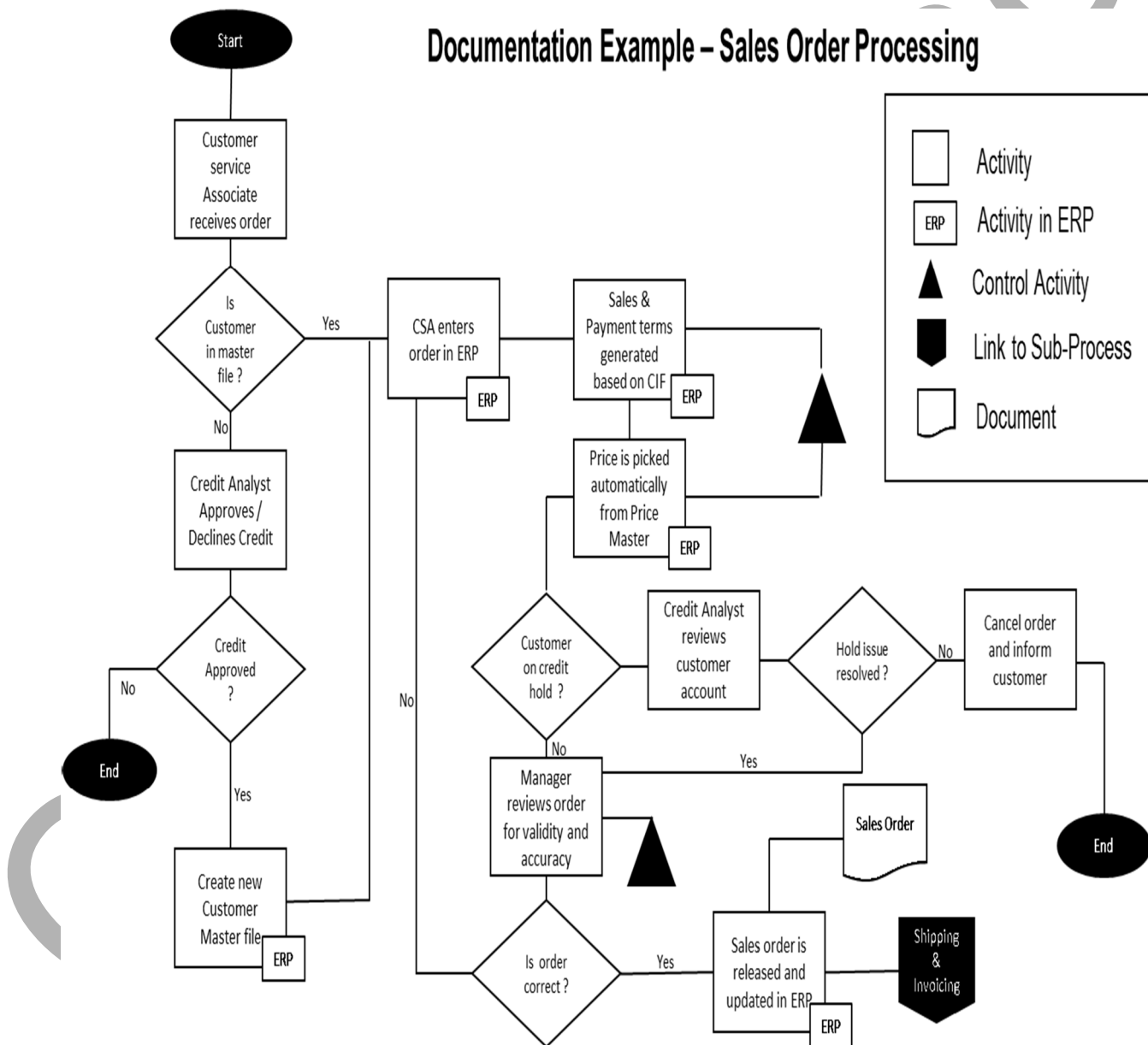
In an audit of financial statements, the auditor determines the significant account balances and disclosures. Auditing standards (SA 315) require the auditor to understand the business process that makes up an account balance or financial statement line item (FSLI). A business process is a sequence of activities that take place from the initiation of a transaction, recording it, approving, posting accounting entries and reporting. A business process is typically made up of sub-process - a logical grouping of related activities.

Domestic Sales account balance in the financial statements is an example of an FSLI. The Domestic Sales account balance represents all the sales transactions that were processed during an accounting period. The illustration below shows the business process, sub process and activities for the Domestic Sales Process - also known as Revenue or OTC (Order to Cash) Process.





Documentation Example – Sales Order Processing



Understanding the business process helps the auditor in identification of risks and controls within each process, sub-process and activity. The auditor should document this understanding of the company's business process and flow of transactions in the audit file in accordance with SA 230.

Given below is an example of documentation using flowcharts for one of the sub-process in Domestic auditguru.in

Sales process:

(Data saved in IT systems can give Insights)

In an automated environment, the data stored and processed in systems can be used to get various insights into the way business operates.

(Can be used for MIS)

This data can be useful for preparation of management information system (MIS) reports and electronic dashboards that give a high-level snapshot of business performance.

(Definition of Data Analytics)

Generating and preparing meaningful information from raw system data using processes, tools, and techniques is known as Data Analytics.

(Use of Data Analytics for Audit)

The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs.

(Uses in Audit)

When auditing in an automated environment, auditors can apply the concepts of data analytics for several aspects of an audit including the following:

- Preliminary analytics; *(Comparison with Own Estimates)*
- Risk Assessment; *(Identify fluctuating Items)*
- Control Testing; *(% Rejections in Quality control checks)*
- Non-Standard Journal Analysis; *(Identifying frequent entries, its nature and effect)*
- Evaluation of Deficiencies; *(Control failure in North East, how many transactions will get Affected)*
- Fraud Risk Assessment. *(Unusual Trends in Income / Expense)*

There are several steps that should be followed to achieve success with CAATs and any of the supporting tools. A suggested approach to benefit from the use of CAATs is given in the illustration below:

- Understand Business Environment including IT *(Business uses ERP)*
- Define the Objectives and Criteria *(Use of analytical procedures to verify cash discount)*
- Identify Source and Format of Data *(ERP, CSV File)*
- Extract Data *(Export Data from ERP)*
- Verify the Completeness and Accuracy of Extracted Data *(Match total from ERP)*
- Apply Criteria on Data Obtained *(Identify transactions eligible for cash discount and check whether only these transactions are given cash discount)*
- Validate and Confirm Results *(See documentary evidence for few items)*
- Report and Document Results and Conclusions *(Document Results)*

13. STANDARDS, GUIDELINES AND PROCEDURES USING RELEVANT FRAMEWORKS AND BEST PRACTICES

12. USING RELEVANT ANALYTICAL PROCEDURES AND TESTS USING DATA ANALYTICS

When auditing in an automated environment the auditor should be aware, adhere to and be guided by the various standards, guidelines and procedures that may be relevant to both audit and the automated environment. Given below are some of the common standards and guidelines that are relevant in this context include:

(Shortcut to remember 9 points)

SIC PIC²S² are below Standards

- **Standards on Auditing** issued by the Institute of Chartered Accountants of India, are required to be followed for an audit of financial statements. *(SA 315 explains, IT Risk SA 330 explains precautions while testing IT controls)*
- **ISO 27001:2013** is the Information Security Management System (I-SMS) Standards



(Issued by ISO)

Issued by the International Organization for Standardization (ISO).

(Framework for Information Security controls)

This standard provides the framework, guidelines and procedures for implementing information security and related controls in a company.

(Areas Covered)

For example, this standard cover password security, application security, physical security, backup and recovery, that are relevant when auditing in an automated environment.

- **Companies Act 2013 Sec 143** requires statutory auditors to provide an Independent Opinion on the Design and Operating Effectiveness of Internal Financial Controls Over Financial Reporting (IFC-FR) of the company as at Balance Sheet date. For this purpose, the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India, provides the framework, guidelines and procedures for an audit of financial statements. *(It will include automated environment related guidance)*
- **The Payment Card Industry – Data Security Standard or PCI-DSS**, is the most widely adopted information security standard for the payment cards industry. Any company that is involved in the storage, retrieval, transmission or handling of credit card/debit card information are required to implement the security controls in accordance with this standard. *(Only for Card based Payment Systems, Founders Include VISA & Master Card)*
- **ITIL (Information Technology Infrastructure Library) and ISO 20000** provide a set of best practice processes and procedures for **IT service management in a company**. For example, change management, incident management, problem management, IT operations, IT asset management are some of the areas that could be relevant to audit. *(How to make IT Dept. as Service Unit?)*
- **Control Objectives for Information and Related Technologies (CoBIT)** is best practice IT Governance and Management framework published by Information Systems Audit and Control Association. CoBIT provides the required tools, resources and guidelines that are relevant to IT governance, risk, compliance and information security.
- **The Cyber Security Framework (CSF)** published by the National Institute of Standards and Technology is one of the most popular framework for improving critical infrastructure cyber security. This framework provides a set of standards and best practices for companies to manage cyber security risks.
- **Sarbanes Oxley Act of 2002**, commonly known as SOX, is a requirement in America. Section 404 of this act requires public listed companies to implement, assess and ensure effectiveness of internal controls over financial reporting and auditors independent opinion on the design and operating effectiveness of internal controls over financial reporting (ICFR) – which is similar to the requirements of IFC-FR for Indian companies. Similar legal and statutory requirements over internal controls exist in several other countries including Japan, China, European Countries, etc.
- **Statement on Standards for Attest Engagements** the American Institute of Certified Public Accountants has published a framework under the Statements on Standards for Attest Engagements (SSAE) No.16 for reporting on controls at a service organization that include:
 - ❖ **SOC 1 for reporting** on controls at a service organization relevant to user entities' *internal control over financial reporting (ICFR)*.
 - ❖ **SOC 2 and SOC 3** for reporting on controls at a service organization relevant to security, availability, processing integrity, confidentiality or privacy i.e., *controls other than ICFR*.
 - ❖ **While SOC 1 and SOC 2 are restricted use reports, SOC 3 is general use report.**

14. ENTERPRISE RISK MANAGEMENT OVERVIEW

What do you mean by Risk?

Risk is the possibility that something could go wrong. In other words, Risk is the possibility that an event will happen which prevents a company from achieving business objectives.

Dynamic Business Environment

Businesses today operate in a dynamic environment. The volatility, unpredictability and pace of changes that exist in the business environment today is far greater than in the past.

Reason for Dynamic Environment

Some of the reasons for this dynamic environment include globalization, use of technology, new regulatory requirements, etc. Because of this dynamic environment the associated risks to business have also increased and companies have a need to continuously manage risks.

Examples of risks include:

- Market Risks;
- Regulatory & Compliance Risks;
- Business Partner Risk;
- Technology & Security Risks;
- Product or Project Risk;
- Operational Risks;
- Credit Risk;
- Environmental Risks.
- Financial Reporting Risks;

Definition of Risk Management

Risk Management is a combination of process, people, tools and techniques through which companies

- Identify,
- Assess,
- Respond,
- Mitigate and
- Monitor risks.

Enterprise Risk Management is a formal program or framework that is implemented across an enterprise or company for enabling risk management.

Legal Requirement

Globally, companies in several countries are required by law to have a formal enterprise risk management program. In India, the Companies Act, 2013 requires the board report to include a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the board may threaten the existence of the company.

Internal Financial Controls & Enterprise Risk Management

The existence of an appropriate system of internal financial control does not by itself provide an assurance to the board of directors that the company has developed and implemented an appropriate risk management policy.

While the law makes the Board of directors responsible, an Enterprise Risk Management program of a company is implemented by the board of directors, top management and employees across all levels.

The internal control framework of a company is not separate, though it is an integral part of an Enterprise Risk Management program.

ERM includes both Internal & External Factors

The scope of an Enterprise Risk Management program is much broader than an internal control framework and encompasses both internal and external factors that are relevant to business strategy, governance, business process and transaction and activity level.

ERM is broader than IFC

The focus of an internal control framework is primarily around financial reporting, operations and compliance risks associated with an account balance, business process, transaction and activity level, which form a subset of the overall enterprise risks.

COSO

One of the most common framework that is suitable for implementing an effective enterprise risk management is the COSO Enterprise Risk Management – Integrated Framework developed by the Committee of Sponsoring Organizations (COSO) in 2004 and subsequently updated in 2016 to address the changes in business environment.

Apart from COSO framework, another relevant and widely available framework is the ISO 31000 Risk Management standard published by the International Organization for Standardization. The ISO 31000:2009, published in 2009, provides a set of principles and guidelines and risk assessment techniques for implementing a risk management framework in a company.

Factors considered in Risk Assessment Process

One of the most critical component of Enterprise Risk Management is the Risk Assessment process.

The risk assessment process involves considerations for:

- Qualitative and Quantitative factors;
- Definition of key performance and risk indicators;
- Risk appetite;
- Risk scores, scales and maps;
- Use of data & metrics;
- Benchmarking.

Steps in risk assessment Process

A typical risk assessment process would be as given below:



QUALITY REVIEW

1. MEANING OF QUALITY & ELEMENTS OF QUALITY CONTROL

Meaning of Quality

(General)

Quality means doing it right when no one is looking.

(Technical)

Every audit firm is required to establish a system of quality control designed to provide it with reasonable assurance that the

- Firm and its personnel comply with legal requirements, regulatory and professional standards
- That reports issued by the firm or engagement partner(s) are appropriate in the circumstances.

Elements of Quality Control

Standard on Quality Control (SQC) 1 requires that every firm's system of quality control should include policies and procedures addressing each of the following elements:

Injuries need to **HE²AL** for Quality Performances

- (a) Human resources
- (b) Ethical requirements
- (c) Engagement performance
- (d) Acceptance and continuance of client relationships and specific engagements
- (e) Leadership responsibilities for quality within the firm

2. OBJECTIVES OF QUALITY REVIEW

Evaluate Audit Quality

Quality review is directed towards evaluation of audit quality and adherence to various statutory and other regulatory requirements.

Identify & Address Weaknesses & Identify Deficiency & Failures

They are designed to identify, and address weaknesses and deficiencies related to how the audits were performed by the audit firms.

In the course of reviewing aspects of selected audits, a review may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, aspects in which an entity's financial statements do not present fairly the financial position or the results of operations in conformity with the applicable Generally Accepted Accounting Principles (GAAP) and other technical standards.

Review Aspects of Selected Statutory Audits & Firms Quality Control System

To achieve that goal, quality reviews included reviews of certain aspects of selected statutory audits performed by the firm and reviews of other matters related to the firm's quality control system.

Not the Purpose to Review all Audits

It is not the purpose of a review, however, to review all of a firm's audits or to identify every aspect in which a reviewed audit is deficient. Accordingly, a review should not be understood to provide any assurance that the firm's audits, or its clients' financial statements or reporting thereon, are free of any deficiencies.

3. SCOPE OF QUALITY REVIEW

Only Statutory Audit Service & Not Internal Audit Services

Presently, the review undertaken by QRB covers statutory audit services only and does not extend to internal audit services provided by the members of the Institute. These are proposed to be covered by the Board at a later stage. Further, this review also does not extend to services provided by the members of the Institute, in employment.

Audit Firm has system as per SQC 1 and it is implemented

(a) Examining whether the Audit firm has implemented a system of quality control as envisaged in line with the Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.

EP has ensured compliance with LAW / Regulations / Professional / Ethical / Technical Standards

(b) Examining whether the Engagement Partner has ensured compliance with the relevant laws and regulations.
(c) Examining whether the Engagement Partner has ensured compliance with the applicable technical standards in India and other applicable professional and ethical standards and requirements.

Technical Standards

(Code of Ethics – Framework for Financial Statements – Quality Control & Engagement Standards – AS / SAs – Guidance Notes – Notifications / Directions / Guidelines by ICAI)

The Code of Ethics issued by the Institute of Chartered Accountants of India.

The Framework for the Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India;

The applicable Quality Control and Engagement Standards issued by the Institute of Chartered Accountants of India;

The Accounting Standards notified under section 133 of the Companies Act, 2013;

The Accounting Standards issued by the Institute of Chartered Accountants of India;

The Statements on Auditing issued by the Institute of Chartered Accountants of India;

The Guidance Notes on accounting and auditing matters issued by the Institute of Chartered Accountants of India;

The Notifications/Directions/Guidelines issued by the Institute of Chartered Accountants of India including those of a self-regulatory nature.

4. THE QUALITY REVIEW BOARD (QRB)

Constituted by ICAI -- Sec 28A of CA Act – Chairperson+ 10 members – Law/ Eco/ Busi/ Fin/ Acc

The Quality Review Board (hereinafter “QRB”/ “the Board”) has been set up by the Central Government under section 28A of the Chartered Accountants Act, 1949 (hereinafter “the Act”). The first Quality Review Board was constituted by the Central Government, in exercise of the powers conferred by section 28A of the Chartered Accountants Act, 1949, *vide* Notification GSR. 448 (E) dated 28th June 2007.

In terms of section 28A of the Chartered Accountants Act, 1949, the Board comprises of a Chairperson and ten other members. Sub-section (2) of section 28A of the aforesaid Act requires that the Chairperson and members of the Board shall be appointed from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy.

5 members by ICAI & 5 Members by CG

With a view to provide a fair balance between the interests of the external stakeholders vis a vis audit Profession in the Board's functioning, sub-section (3) of section 28A of the Act provides that five members of the Board shall be nominated by the Central Government and other five members shall be nominated by the Council of the Institute of Chartered Accountants of India (hereinafter “ICAI”/“the Institute”).

Functions of Quality Review Board:*(Sec 28B – Review Quality / Recommend Council / Guide Members)*

As per Sec 28B. The Board shall perform the following functions, namely: —

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

Quality Review –(Quality Control Framework /Compliance of AS Etc /Quality of Audit & Reporting)

A quality review carried by the QRB is directed towards inspection/evaluation of audit quality and adherence to various statutory and other regulatory requirements. It involves inspection and assessment of the work of the practitioner while carrying out their audit function so as to enable QRB to assess:

- the quality control framework adopted by the practitioner/audit firms in conducting audit.
- the quality of compliance with the accounting standards and disclosure requirements followed by the entity on which the audit report is issued;
- the quality of audit and reporting by the practitioner; and

5. POWERS OF QUALITY REVIEW BOARD**Issued by Government of India – Rules for Quality Review Board**

The Government of India has, in exercise of the powers conferred by clauses (f) and (g) of Sub-section (2) of Section 29A read with Section 28C and Sub-section (1) of Section 28D of the Chartered Accountants Act, 1949 (38 of 1949), made 'Chartered Accountants Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board Rules, 2006'.

Powers to facilitate to discharge procedures to be followed by QRB

To facilitate the discharge of its functions, Rule 6 of aforesaid rules provides:

Procedures to be followed by the Board, - In the discharge of its functions, the Board may, -

*(Lay Down Procedure for Review Quality of Work –Select Firms for Review of Quality -- Evaluate & Review Quality – Call information form ICAI – Invite Experts – Make Recommendation)**(Lay Down Procedure & Select Firms)*

(b) Lay down the procedure or evaluation criteria to evaluate various services being provided by the members of the Institute and to select, in such manner and form as it may decide, the individuals and firms rendering such services for review;

(Evaluate & Review)

(a) On its own or through any specialized arrangement set up under the Institute, evaluate and review the quality of work and services provided by the members of the Institute in such manner as it may decide;

(Call for Information)

(c) call for information from the Institute, the Council or its Committees, Members, Clients of members or other persons or organizations in such form and manner as it may decide, and may also give a hearing to them;

(Invite Experts)

(d) invite experts to provide expert/technical advice or opinion or analysis or any matter or issue which the Board may feel relevant for the purpose of assessing the quality of work and services offered by the members of the Institute;

(Make Recommendation)

(e) make recommendations to the Council to guide the members of the Institute to improve their professional competence and qualifications, quality of work and services offered and adherence to various statutory and other regulatory requirements and other matters related thereto.

(If information is not provided)

The Rules also provide that where the Board does not receive the information called for by it from any member of the Institute, the Board may request the Institute to obtain the information from the member and furnish the same to the Board. Similarly, if the Board does not receive the information called for by it from any company registered under the Companies Act, 1956/Companies Act, 2013, the Board may request the Central Government through the Ministry of Corporate Affairs for assistance in obtaining the information.

6. STAGE-WISE APPROACH OF QUALITY REVIEW PROCESS

Quality Review Groups

(i) The Board may constitute one or more Quality Review Groups (hereinafter referred to as Review Groups) to conduct preliminary reviews of the general purpose financial statements, with a view to assessing the quality of audit and reporting by the auditors, in consultation with the Board. There could be two categories of the Review Groups:

(a) Industry Specific (for reviewing general purpose financial statements of enterprises associated with a particular industry, for example, banking, insurance, electricity, mutual funds, merchant bankers, etc.

(b) Generic.

Assistance of Technical Reviewers

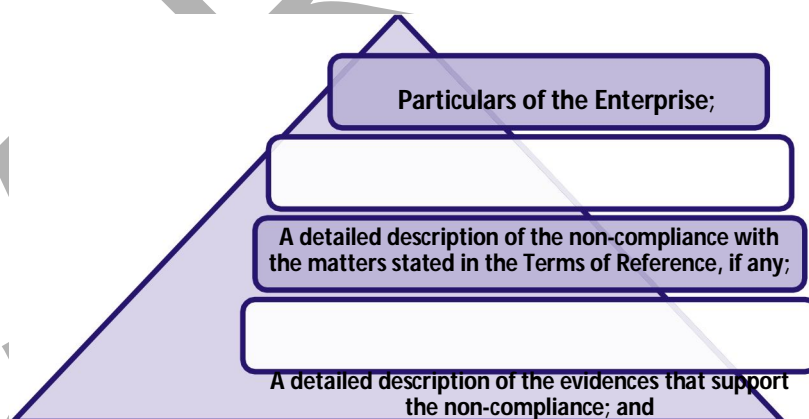
(ii) Each of the Review Group would be assisted by Technical Reviewer(s), who may be an outsourced service provider. The job of the Technical Reviewer(s) would be to prepare a report on the review of general purpose financial statements, with a view to assessing the quality of audit and reporting by the auditors, and the review of quality control framework adopted by the auditors/audit firms in conducting audit.

Report Submission to Board

(iii) The Technical Reviewer, after completion of his review, is required to submit a preliminary report to the audit firm on the review of the quality of audit and reporting by the auditors in the general purpose financial statements within the specified period of time before submitting the final report to the Board. The Board may, however, extend the time limit for submission of preliminary review report.

Key contents of Review Report

(iv) The report of the Review Group shall expressly state the following:



Report Discussion by Audit Groups

(v) The report, so prepared by the Technical Reviewer, may be considered at the meetings of the Review Group. The Review Group may also consult the Board on any issue, on which the Group feels that the guidance of the Board is necessary.

The Review Group may complete the review of cases referred to it and submit its report on the same to the Board within the specified period of time. The Board may, however, extend this time limit for submission of

reports by the Review Group.

7. INDEPENDENCE AND QUALIFICATIONS OF TECHNICAL REVIEWERS

While assigning the quality review work to the respective Technical Reviewers, in order to ensure independence and avoid conflict of interest, the following eligibility conditions were specified for carrying out the specified quality review assignment to the Technical Reviewers who were required to submit a declaration of eligibility before starting the assignment. **For being a technical reviewer:**

- A member or his/her firm or any of the network firms or any of the partners of the firm or that of the network firms should not have been the statutory auditor of the company, as specified, or have rendered any other services to the said company/entity during last three financial years and /or thereafter.
- A member or his/her firm or any of the network firms or any of the partners of the firm or that of the network firms should not have had any association with the specified statutory audit firm, during the last three financial years and /or thereafter.
- A member to comply with all the eligibility conditions laid down for appointment as an auditor of a company u/s 141(3) of the Companies Act, 2013 which apply mutatis mutandis in respect of the review of the quality of statutory audit of the company/entity, as specified, so far as applicable.
- A member should not have disciplinary proceeding under the Chartered Accountants Act, 1949 pending against him/her or any disciplinary action under the Chartered Accountants Act, 1949 / penal action under any other law taken/pending against you during last three financial years and/or thereafter.

8. EMPANELMENT OF TECHNICAL REVIEWERS

Further to the above, with a view to further augment the number of Technical Reviewers empanelled with the Board, the Board decided the following criteria for empanelment of Technical Reviewers with the Board during the financial year 2015-16:

- Reviewer should have minimum 15 years of post-qualification experience as a chartered accountant and be currently active in the practice of accounting and auditing.
- Reviewer should have handled assigning partner/ proprietor at least 3 statutory audit assignments as a Central Statutory Auditor of Banks/ Public Limited Companies/ Government Companies/ Private Limited Companies having annual turnover of rupees fifty crores and above during the last ten financial years; Provided that out of the aforesaid three statutory audit assignments, at least one must be in respect of entities other than Private Limited Companies.
- Reviewer should not currently be a Member of the QRB or ICAI's Central Council/ Regional Council/ Branch level Management Committee.
- Reviewer should not have any disciplinary proceeding under the Chartered Accountants Act, 1949 pending against you or any disciplinary action under the Chartered Accountants Act, 1949 / penal action under any other law taken/p ending against you during last three financial years and/or thereafter.

9. ON-SITE VISIT AND QUALIFIED ASSISTANT

Maximum Number of Visits & Maximum Number of Days

The technical reviewers for carrying out the quality review assignment, could undertake a maximum of one on-site visit to the Statutory Audit firm which shall not extend beyond seven days or, in exceptional circumstances, such other extended period, for specific reasons to be recorded in writing, with the prior approval of the Chairperson, Quality Review Board, which shall not, in any case, extend beyond fourteen days.

Maximum Number of Assistants & Qualifications

For this purpose, they could also take the assistance of not more than three assistants who:

- (a) shall be chartered accountant;
- (b) should have been working with them for at least one year as a member/a partner in the CA firm with them;
- (c) do not attract any of the disqualifications prescribed under the Chartered Accountants Act, 1949;
- (d) should not have been associated with the Statutory auditor/audit firm under review and the company/ entity selected during last three financial years and/or thereafter.
- (e) shall have no direct interface either with the audit firm under review or the Board;
- (f) shall also have to sign the statement of confidentiality in a prescribed format;

10. SELECTION OF AUDIT FIRMS

The quality review has been introduced in stages, with firms selected from different classes or types of audit firms being subjected to review at each stage. The selection of an audit firm for review can be either based on the financial statements of the enterprise/s audited by it or certain other factors identified by the QRB.

Initial Selection was on the basis of financial statements of clients audited by CA Firms

(a) Selection of Audit Firm based on the Financial Statements of the Enterprise/s Audited by the latter: Under this category, in the initial stage, the audited accounts of companies having wider public interest, such as listed companies, insurance companies, NBFCs, unlisted public-sector undertakings, asset management companies may be selected by QRB on the basis of one or more of the following:

(Suo Moto – Risk – Accounting Irregularity -- Regulatory Concern – Fraud – Major Non-Compliance – Reference by Regulatory Body)

- reported fraud or likelihood of fraud (*Sahara, Kingfisher*)
- serious accounting irregularities reported in media or other reports (*Satyam*)
- major non-compliances with provisions relating to disclosures under relevant statutes (*Non-compliance of schedule III*)
- reference made to it by any regulatory body such as Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, Ministry of Corporate Affairs, etc.
- regulatory concerns pointing towards stakeholder risks
- on account of being a part of a sector otherwise identified as being susceptible to risk on the basis of market intelligence reports
- Suo moto or random selection from particular class of enterprises/audit firms

(Separate Criteria for PSU, Secretariat places entities selected – board decides about review)

The criteria for selection of general purpose financial statements of the Public-Sector Undertakings may be separately determined by the Board.

The Secretariat of QRB places the details of the enterprises selected for review before the Board for its consideration. The Board may consider whether the case warrants a review by a Quality Review Group constituted for this purpose and may refer the cases selected for review to the relevant Quality Review Group. The Board may obtain the Annual Report of the company concerned.

(b) Criteria based on Audit Firms Auditing the Accounts:

Selection of audit firms may also be made for review of their work on random basis, the volume of work handled by them represented by the number and nature of clients, their involvement in sectors that may be identified as facing high risk, as well as on account of their reported involvement in fraud or likelihood of fraud. Audit firms auditing large as well as mid-cap/small cap companies may be selected for the purpose.

11. OBJECTIVE OF TECHNICAL REVIEW

The objective of the technical review in conducting the quality review is to obtain sufficient appropriate evidence to support the conclusion in the quality review report to be issued pursuant to the Review. As per the Reporting Guidelines issued by the Board, the technical reviewer is required to examine the procedures and

implementation thereof in the Audit firm under review (AFUR) for ensuring:

- (a) implementation of a system of quality control with reference to the applicable quality control standards;
- (b) compliance with the applicable technical standards in India, other applicable professional and ethical standards and relevant laws and regulations;
- (c) whether there is no material misstatement of assets and liabilities as at the reporting date in respect of the Company/entity audited by the AFUR.
- (d) Consideration of SA 240, "The Auditors' Responsibilities relating to Fraud in an Audit of Financial Statements" issued by The Institute of Chartered Accountants of India (ICAI); and

A quality review of the audit services of the firm in terms of the Procedure for Quality Review of Audit Services of Audit Firms issued by the QRB ("the Procedures") involves interviewing, making enquiries and performing such other procedures to examine whether the Firm has complied with the applicable technical standards relating to the audit of the financial statements, the professional and ethical standards as issued by the Institute of Chartered Accountants of India (ICAI) including whether the Firm has considered SA 240 "The Auditors' Responsibilities relating to Fraud in an Audit of Financial Statements" issued by ICAI and considered relevant laws and regulations. It also includes review of the system of quality control which the Firm has implemented as required by such technical standards.

Knowledge Required for Conducting Review

In order to effectively discharge the responsibilities, the Technical reviewers are expected to have the knowledge of inter alia, SOC 1, Standards on Auditing issued by the Institute of Chartered Accountants of India, the applicable financial reporting framework and the applicable laws and regulations. The reviewer is also expected to have knowledge about the independence and ethical requirements.

12. THE QUALITY REVIEW PROCESS (TECHNICAL REVIEW)

Maintain Quality of Technical Review (Quality Review)

A quality review is an engagement that needs to be carried out in a manner that ensures that the work performed by the Technical Reviewer appointed for the review and the review team meet the professional standards established by ICAI. Any shortcomings in the quality of the quality review would defeat the very purpose of the process of a quality review established by the Quality Review Board. It is, therefore, of utmost importance that ensuring quality in a quality review remains a priority for a technical reviewer.

Factors affecting quality of technical review – Ultimate Responsibility of Quality Reviewer

In so far as the technical reviewer is concerned, the quality of a quality review is directly affected by factors such as:

- Knowledge and experience of the technical reviewer
- Composition of the quality review team
- Time devoted by the technical reviewer
- Understanding of the objective and scope of work
- Monitoring, direction and supervision of the quality review team by the technical reviewer

In fact, maintaining the quality in a quality review as also the final report of the quality review is and remains the responsibility of the technical reviewer.

Stages of Quality Review

Various Stages involved in the Conduct of the Quality Review Assignments: The following table describes the various stages involved in the conduct of the quality review assignments:

(Selection of Audit Firm & TR – Offer Letter to TR – TR Acceptance – Confidentiality Statement – Intimation to Audit Firm – TR to send Quality Review Programme General Questionnaire – Call for Additional Firm – Carry out Quality Review, Visit Audit Firm – TR will send Preliminary Report – Audit Firm to submit Representation – TR to submit Final Report – Within 45 days from Acceptance – Audit Firm to send Submission to QRB – TR to submit final findings on reply of Audit Firm—Quality Review Group will consider Report, Reply of audit firm and TR's

final findings and send recommendations to Quality Review Board – QRB to consider final course of action)

- Selection of Audit Firm and Technical Reviewer to conduct Quality Review and
- Sending Offer Letter of Engagement to the Technical Reviewer.
- Technical Reviewer to convey his acceptance of Letter of Engagement by sending necessary declarations for meeting eligibility conditions and furnishing statement of confidentiality by the Technical Reviewer and his assistant/s, if any.
- Intimation to the Audit Firm about the proposed Quality Review and acceptance of the assignment by the Technical Reviewer. Also marking a copy of the intimation to the Technical Reviewer.
- Technical Reviewer to send the specified Quality Review Program General Questionnaire to the Audit firm for filling-up and call for additional information from the Audit Firm, if required.
- Technical Reviewer to carry out the Quality Review by visiting the office of the Audit Firm by fixing the date as per mutual consent.
- Technical Reviewer to send the preliminary report to Audit firm.
- Audit firm to submit representation on the preliminary report to the Technical Reviewer.
- Technical Reviewer to submit final report along with a copy of Annual report of the company/entity for the year, to the Board in the specified format, on their (individual) letterhead, duly signed and dated within 45 days from the date of acceptance of the assignment.
- Technical Reviewer should also send a copy of their final report to the Statutory Auditor/Audit firm, requesting the firm to send their submissions thereon to the Board within 7 days of receipt of the final report with a copy to Technical Reviewer. Upon receipt of their final submission, Technical Reviewer shall submit within next 7 days a summary of their findings, reply of the audit firm thereon along with their final comments in the specified format.
- Quality Review Group to consider the report of the Technical Reviewer and responses of the Audit firm and make recommendations to Quality Review Board.
- Quality Review Board to consider the report of the Quality Review Group and decide the final course of action.

13. EVALUATION OF FINDINGS

The Technical reviewer or Quality review team may note a non-compliance with one or more standards on auditing or accounting standards or disclosure requirements as may be applicable to the engagement. Whenever such a finding is noted, the Technical reviewer/ Quality reviewer's team are required to evaluate the finding in the light of the following considerations:

- (a) Accounting and auditing practices under the legal and regulatory framework applicable to the industry to which the audit client belongs; and
- (b) Materiality of the items of the financial statements involved;
- (c) The responses given by the engagement team;
- (d) If the findings are related to non-compliance with the procedures required to be performed in accordance with the Standards on Auditing, whether the engagement team carried out alternative procedures to obtain sufficient appropriate audit evidence in relation to the financial statement assertion under question.

The responses given by the engagement team are also important to determine the extent of non-compliance. The Technical reviewer must consider the responses provided by the engagement team. These responses may help the Technical reviewer in understanding the perspective and the circumstances in which the audit procedures were carried out. As mentioned earlier, the Technical reviewer should evaluate the findings of quality review and the responses given by the engagement team based on the facts and circumstances that existed at the time when the AFUR issued the audit opinion.

14. REPORTING AND OTHER PROCEDURES

The reviewer, after completion of his review, is required to submit a preliminary report to the audit firm on the review of the quality of audit and reporting by the auditors in the general purpose financial statements within the specified period of time before submitting the final report to the Board. The Board may, however, extend

the time limit for submission of preliminary review report. The reviewer, based upon his satisfaction from the representation by the audit firm, may decide to issue either an interim report or a final report to the Board. The purpose is to establish the guidelines on the form and contents of the reviewer's report issued pursuant to review of the quality of audit services of an audit firm.

The reviewer should adhere to the principle requirements mentioned while preparing his report. It may be noted that the requirements mentioned apply to the interim as well as the final reports of the reviewer.

Reviewers, based on the conclusions drawn from the review, shall issue a preliminary report and subsequently the final report. A clean report indicates that the reviewer is of the opinion that the affairs are being conducted in a manner that ensures the quality of services rendered. However, a **reviewer may qualify the report due to one or more of the following:**

- ◆ quality control system design deficiency;
- ◆ non-compliance with quality control policies and procedures; or
- ◆ non-existence of adequate training programmes for staff.
- ◆ non-compliance with relevant laws and regulations;
- ◆ non-compliance with technical standards;

Basic Elements of the Reviewer's Report:

The report should contain:

(a) Elements relating to audit quality of companies:

- i. A reference to the description of the scope of the review and the period of review of audit firm conducted along with existence of limitation(s), if any, on the review conducted with reference to the scope as envisaged.
- ii. A statement indicating the instances of lack of compliance with relevant laws and regulations.
- iii. A statement indicating the instances of lack of compliance with technical standards and other professional and ethical standards.

(b) Elements relating to quality control framework adopted by the audit firm in conducting audit:

- i. A statement indicating that the system of quality control is the responsibility of the reviewed firm.
- ii. An attachment which describes the quality review conducted including an overview and information on planning and performing the review.
- iii. An opinion on whether the reviewed firm's system of quality control has been designed to meet the requirements of the quality control standards for attestation services and whether it was complied with during the period reviewed to provide the reviewer with reasonable assurance of complying with technical standards in all material respects.
- iv. An indication of whether the firm has implemented a system of quality control with reference to the quality control standards.
- v. Where the reviewer concludes that a modification in the report is necessary, a description of the reasons for modification. The report of the reviewer should also contain the suggestions.
- vi. A reference to the preliminary report.

The Quality Review Report should be issued on the reviewer's (individual) letterhead and signed by the reviewer. The report should be addressed to the Board and should be dated as of the date of the conclusion of the review.

15. TYPE OF REPORT TO BE ISSUED

In deciding on the type of report to be issued, a reviewer should consider the evidence obtained and should document the overall conclusions with respect to the year being reviewed in respect of following matters:

(a) whether the policies and procedures that constitute the reviewed firm's system of quality control for its attestation services have been designed to ensure quality control to provide the firm with reasonable assurance of complying with technical standards.

(b) whether independence of audit firm/ auditors is maintained in conducting audit.

(c) whether the firm has instituted adequate mechanism for training of staff.

(d) whether the skill and competence of assistants are considered before assignment of attestation

engagement.

(e) whether the audit firm has established procedure to record the audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidences obtained.

(f) whether the progress of attestation service is monitored, and work performed by each assistant is reviewed by the service in-charge and necessary guidance is provided to assistants.

(g) whether the audit firm ensures the availability of expertise and/or experienced individuals for consultation with the consent of the auditee.

(h) whether personnel of the reviewed firm complied with such policies and procedures in order to provide the firm with reasonable assurance of complying with technical standards.

(i) whether the audit firm maintains the permanent file and the current file as per the standards laid down by the ICAI.

(j) whether the internal controls within the audit firm contribute towards maintenance of quality of reporting.

(k) whether the audit firm verifies compliance with laws and regulations to the extent it has material effect on financial statement.

Illustrative Qualifications – Non –compliance with Standards on Auditing

(SQC 1)

Independence confirmation not received from all members.

Independence declaration from audit members received on sign off date of auditor's report.

(SA 230)

No process of maintaining standard checklists, manuals, working papers to ensure consistency in the quality of each engagement.

(SA 240)

It was difficult to conclude whether fraud risk factors were considered during the audit of the Company's financial statements. Audit process in relation to fraud inquiry procedures were not performed and hence not documented.

(SA 250)

As envisaged by Para 13 of SA 250 that the firm shall obtain sufficient appropriate audit evidence, however no copy of legal advice was available in auditor's file with regard to the legal advice obtained against crystallization of liability on account of demand raised by fiscal authorities which had been disputed.

(SA 260)

No presentations were made to the Audit Committee about the audit plan, audit strategy and the audit findings.

(SA 265)

There was no documentation to substantiate communication by the auditor with management in writing, about significant deficiencies in internal control that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances.

(SA 505)

No confirmations of balances have been obtained pertaining to parties to Debtors, Creditors, Advances and related party balances.

(SA 540)

No audit evidences for evaluation of estimates made by the management.

(SA 560)

No hard copies were kept for identification to obtain sufficient and appropriate audit evidence for all subsequent events up to the date of the auditor's report that requires adjustments/ disclosures in the financial statements.

(SA 580)

Management representation letter had been obtained for the general points covering the financial statements not on other specific items of the financial statements.

(SA 705)

Provisions of AS-10 and AS-16 had not been complied with, however, the auditor in their audit report under the head Basis for Qualified opinion and in addition to this para 2(d) of report on other legal and regulatory requirements had stated that qualification constitutes departure from accounting standards but in the report, there was no clear mention of which AS were not complied with.

Illustrative Qualifications – Non –compliance with Accounting Standards

(AS 1)

Significant Accounting Policies did not include disclosures of policies in respect of:

- Recognition of Insurance claims.
- Accounting of Leases.
- Treatment of IPO Expenses.

(AS 2) Inventory of traded goods was not shown separately from that of finished goods.

Method of preparation of cash flow statement had not been disclosed in standalone financial statements and consolidated financial statements. Company had not disclosed the components of

(AS 3) Cash and Cash Equivalent in the Cash Flow Statement in consonance of the AS 3.

(AS 9) Accounting policy on revenue recognition did not capture the point of recognition where significant risks and rewards were transferred.

(AS 11) In respect of derivative contracts, premium paid, gain/losses on settlement and provision for losses on restatement were recognized along with the underlying transactions and charged to statement of profit and loss which was not in accordance with AS 11.

(AS 13) Amount provided for diminution in value of investments was not disclosed.

(AS 15) AS 15 detailed disclosures like assumptions, movements in P&L, movements in Balance sheet had not been provided.

(AS 18) Disclosures relating to previous year figures in regard to related parties were not given.

(AS 20) Basic & Diluted Earnings per share had not been separately disclosed on the face of the Statement of Profit and Loss as per AS-20, even though both were same.

(AS 22) Measurement of Deferred tax assets and liabilities was on the basis of effective tax rate instead of the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

(AS 26) There was no distinction between internally generated intangible assets and other intangible assets. Non-disclosure & policy was not in line as per AS-26.

(AS 29) AS -29 Disclosure for claim against the Bank had not been disclosed in Schedule of Contingent Liabilities.

16. GENERAL FAILURES QUALITY CONTROL FRAMEWORK (SQC-1)

- Failure to implement various elements of the system of quality control was the most common finding.
- Other findings included failure to set out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time;
- failure to establish policies and procedures designed to provide with reasonable assurance that firm has sufficient personnel with the capabilities, competence and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements.
- failure to establish policies and procedures designed to provide reasonable assurance that the firm and its personnel comply with relevant ethical requirements;

17. CONSIDERATION OF THE REPORTS OF THE REVIEW GROUPS

PSU Audits

The Review Group's Report on the quality of audit by the auditor of a Public-Sector Undertaking (PSU) should be furnished to the Office of Comptroller and Auditor General of India (C&AG), on case to case basis, and the C&AG's views, if any, shall be put-up before the Board along with the Report (on the particular PSU) of the Review Group.

In all other cases, the Review Group's Report along with the decision of the Board on the quality of audit by the auditor of a PSU should be furnished to the Office of the C&AG for information.

Other Audits

(Submission to Board)

The reports of the Review Groups on the quality of audits by the auditors of enterprises (other than those covered above) shall be placed before the Board for its consideration directly.

(Accept or Reject)

The Board may, after due consideration of the report and comments of Office of C&AG, wherever applicable, decide whether the recommendation made by the Review Group should be accepted or otherwise.

(Further Action)

The Board may, Suo moto, take such further action, as it may deem appropriate. If the Board decides against the recommendations made by the Review Group in its report, the Board shall record the reasons for doing so. Actions to be recommended by the Board.

Formats Specified by Board

The Board had specified the format for the Final Report, and the Quality Review Program General Questionnaire containing questions concerning various aspects of an audit firm such as Quality control, ethical requirements & audit independence; leadership and responsibilities; assurance practices; client relationships & engagements; human resources, consultation; differences of opinion; engagement quality control review; engagement documentation; audit planning & risk assessment; materiality; audit sampling & other selective testing procedures; audit documentation; audit evidence; written representations; and Auditor's report.

18. ACTIONS THAT MAY BE RECOMMENDED BY THE QUALITY REVIEW BOARD

The actions that may be recommended by the Board include one or more of the following:

In Sequence of Severity of Action, Easy to Remember

- (a) Consider the matter complete and inform the audit firm/auditor accordingly.
- (b) Referring the case to the Director (Discipline) of the Institute for necessary action under the Chartered Accountants Act, 1949;
- (c) Informing the details of the non-compliance to the regulatory bod(y)/ies relevant to the enterprise; Intimating the concerned auditor as to the findings of the Report as well as action initiated under(b) and/or (c) above;

19. CONFIDENTIALITY

Requirement

Confidentiality of information pertaining to the quality review assignments is of paramount importance. Technical Reviewers should ensure that all information, papers, materials, documents etc. relating to the company/audit firm, as selected and assigned to them, that they will gain during the course of assignment are kept in strict confidence.

Statement of Confidentiality

They are required to send duly signed statement of confidentiality including by each one of their assistants in a prescribed format.

Conflict of Interest & Confidentiality by All Connected

There should be no conflict of interest of all those connected with the entire review process.

The persons involved with the entire review process including members of Board/Group, Technical Reviewers, his/her assistants and QRB secretariat shall maintain confidentiality of information obtained during reviews and also appropriately disclose to the Board, from time to time, their interests or that of the partners of their firm or their relatives, if any, in relation to statutory audit firm being reviewed by Board or entity concerned whose audit was selected for review.

AUDIT OF INSURANCE COMPANIES AMENDMENTS

1. FORM AND CONTENTS OF FINANCIAL STATEMENTS

Compulsory to Prepare 4 Statements

Section 11 of the Insurance Act, 1938 provides that every insurer, in respect of insurance business transacted and in respect of shareholder's funds, is required to prepare

- a Balance Sheet,
- a Revenue Account
- a Profit and Loss Account,
- a separate Account of Receipts and Payments,

for each year in accordance with the Regulations as may be specified.

Separate Statement for Policyholders & Shareholders

Every insurer should keep separate accounts relating to funds of shareholders and policyholders. (*Revenue Account for Policyholders & P&L Account for Shareholders*)

Regulation

(Sec 114A)

The Authority, in pursuance of the powers conferred to it by the provisions of Section 114A of the Insurance Act, 1938, has issued regulations for the preparation of the financial statements and auditor's report of companies carrying on insurance business.

The Regulations contain three schedules.

- Schedule A is applicable to companies carrying on Life Insurance business. (*Accounting of LIB*)
- Schedule B is applicable to Companies carrying on General Insurance business. (*Accounting of GIB*)
- Schedule C to the Regulations lays down the matters to be dealt with by the auditor's report of an insurance company. Schedule C is applicable to insurers carrying on general insurance business as well as life insurance business. (*Audit Report for LIB & GIB*)

2. AUDIT OF ACCOUNTS

Companies in Insurance Business

Companies doing insurance business will get these financial statements audited as specified in Company Act 2013

Entities Other than Companies

Entities other than companies will get their books of accounts audited annually under Sec 12 of Insurance Act 1938.

Qualification

Section 2(4) of the Insurance Act, 1938 defines the term 'auditor' as a person qualified under the Chartered Accountants Act, 1949 to act as an auditor of a company.

Powers to Discharge Duties

The auditor, for audit of financial statements, has the powers to exercise the rights vested in, and discharge the duties and be subject to the liabilities.

Penalties

Penalties will be imposed on auditors as per Sec 147 of Companies Act, 2013.

Half Yearly Review

There is also a requirement by IRDAI that half year accounts ended September 2016 need to be reviewed by

the statutory auditor

Financial Statements Covered

The financial statements under section 12 include

- Balance Sheet,
- Profit and Loss Account,
- Revenue Account.

Receipts & Payments Not Covered under Sec 12 but Sec 11 Considers it as Financial Statements

Section 12 of the Insurance Act, 1938 does not cover the requirement for audit of the Receipts and Payments Account of an insurer. However, sub-section (1) of section 11 of the Insurance Act, 1938 requires that every insurer, in respect of insurance business transacted by him and in respect of his shareholders' funds, should prepare, at the end of each financial year, a Balance Sheet, a Profit and Loss Account, a separate Account of Receipts and Payments and a Revenue Account in accordance with the regulations as may be specified. Since Receipts and Payments Account has been made a part of financial statements of an insurer, it is implied that the Receipts and Payment Account is also required to be audited.

Regulation covers Receipts & Payments

The Authority, in exercise of the powers conferred by the Insurance Act, 1938, issued the IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002. These Regulations require the auditor of an insurance company to report

- Whether the Receipts and Payments Account of the insurer is in agreement with the books of account and returns.
- The auditor is also required to express an opinion as to whether the Receipts and Payments Account has been prepared in accordance with the provisions of the relevant statutes
- and whether the Receipts and Payments Account gives a true and fair view of the receipts and payments of the insurer for the period under audit.

This also implies that the auditor is required to audit the Receipts and Payments Account of the insurer.

3. REQUIREMENTS OF THE INSURANCE ACT, 1938 VIS A VIS THE COMPANIES ACT, 2013

Sec 129 (1) of Companies Act 2013

(For True & Fair View Compliance with AS & Sch III)

129. (1) The financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.

Provided that the items contained in such financial statements shall be in accordance with the accounting standards:

(Exemption to Insurance Companies & few more companies from Sec 129(1))

Provided further that nothing contained in this sub-section shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company:

(Non-Disclosure of Sch III not to affect True & Fair view)

Provided also that the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose—

(a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938 (4 of 1938), or the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999);

(Schedule III disclosures are optional for Insurance Companies)

So Sec 129(1) is not applicable to Insurance Companies by virtue of proviso as given in companies act itself. However, if an insurance company so desires, it may disclose additional information that is not specifically required to be disclosed under the Insurance Act, 1938.

(Example Bajaj Allianz General Insurance Company)

Ministry of Corporate Affairs Notification no. GSR 308(E) dated March 30, 2017 requires a disclosure on holdings as well as dealings of Specified Bank Notes (SBN) under Schedule III of the Companies Act, 2013. By virtue of Proviso (2) of sub section (1) of Section 129 of the Companies Act, 2013, provisions of Schedule III do not apply to Insurance companies. Accordingly, the Company has not made any disclosure in this regard.

Sec 117 of Insurance Act 1938

Section 117 of Insurance Act, 1938, provides that nothing in the Insurance Act, 1938 shall affect the liability of an insurer, being a company, to comply with the provisions of the Companies Act, 2013 in matters not otherwise specifically provided for by Insurance Act, 1938.

Therefore, the provisions of the Companies Act, 2013 would be applicable wherever the Insurance Act, 1938 does not cover the relevant aspects and the insurer is a company within the meaning of the Companies Act, 2013.

The provisions of the Companies Act, 2013 should be applied in a harmonized manner with the provisions of the Insurance Act, 1938, and the rules and regulations framed thereunder.

4. AUDITING IN AN INFORMATION TECHNOLOGY ENVIRONMENT

No Change in Scope & Objectives

The Information Technology environment does not materially affect the scope and objectives of an audit.

Understanding of IT Environment

However, in view of the computerization in general and the insurance industry in particular, the auditor has to familiarize himself with the IT environment in insurance companies. He should gain an understanding to the workflow of various important transactions.

(Trace transactions of each type to understand flow and audit trail)

The auditor may select a few transactions of each type and trace them through the system, i.e., identify the audit trail. This would help him in not only understanding flow of transactions and manner of processing, but it will also provide him evidence as to whether the results of processing are correct.

(Design & Operation of IT System)

Where the auditor is satisfied about the design and operation of the IT system, he may limit the extent of his checking of transactions in so far as those aspects are concerned, where the IT system has in-built control.

Written Representation

The auditor should seek a written representation from the management about any changes in the IT systems that have taken place during the year. Where different systems have been in operation during the year, the auditor should separately examine the efficacy of each such system. The auditor should also obtain a written representation from the management that there have been no changes in the system during the year other than those specified.

5. TAX AUDIT

Audit under Sec 44AB

It is necessary for general insurance companies to get their accounts audited under Section 44 AB of the said Act.

Appointment of Tax Auditor

For this purpose, the tax auditor(s) may be appointed by the company itself by means of a resolution of the Board of Directors or by the Chairman/ Managing Directors if so authorized in this behalf. The company is expected to fix separate remuneration for the auditor(s) appointed for this purpose.

Form of Audit Report

The Form of tax audit report applicable would be Form 3CB and the prescribed particulars would have to be given in Form 3CD, in accordance with Rule 6G of the Income Tax Rules, 1962, pursuant to Section 44AB of the Income Tax Act, 1961.

6. TYPES OF LIFE INSURANCE PRODUCTS

Life Insurance Industry in India has witnessed varied product designs during last 5 decades. Based on the peculiarities involved, Life Insurance Products can broadly be categorized as follows:

1. Term / Protection:

(Pays if Death Occurs during Policy Period)

Term Insurance covers the policy holder for specific period and pays the death benefits only if the policy holder dies during the policy period.

(For Income Requirements)

Term life Insurance is traditional form of Life Insurance Product. Term Insurance generally takes care of pure income replacement needs rather than Capital appreciation requirements.

2. Whole Life Insurance Product: -

(Term Insurance + Covers whole life and not few years)

It provides cover through the life time of the person. Unlike Endowment plans they do not carry any maturity value and sum assured is paid to the family in case of unfortunate death of the policyholder.

3. Endowment/ Pure Endowment:

(Death & Maturity Benefits)

Endowment policies cover the risk for a specified period and at the end of the policy the sum assured is paid back to the policyholder along with all bonus accumulated during the policy term.

4. Unit Linked Insurance Plan (ULIP):

(Example LIC New Endowment Plus)

(Money Invested in Underlying Assets + Value changes as per Underlying Assets + Protection Against Downfall)

The Premium paid is used for the purchase of units in Investment assets. Unit Linked Insurance Plans are such Insurance plans where the value of the policy changes as per the underlying Investment Assets. It allows protection and flexibility in Investment.

5. Money Back Plan:

(Example LIC NEW Money Back Plan 20 Years)

(Type of Endowment Policy with Periodic Payments of Partial Benefits)

Money Back policies are type of Endowment policies which provides periodic payments of partial benefits during the term of policy so long as the policy holder is alive.

(Full death benefits no deduction of partial payments made before)

Peculiar nature of these policies is that, in event of death at any time during policy term, the death claim would comprise of full sum assured without deduction of any survival benefit amounts. Also, bonus is calculated on sum assured.

6. Pension or Retirement Plans:

(Example LIC's New Jeevan Nidhi)

(Decide retirement age and pay till time of retirement, then get regular income)

A pension plan is retirement solution where policyholder decides the age retirement age and agrees to pay premium till the time of the retirement and thereafter he has option to commute a part of his fund value and take an annuity for the balance. Pension plan provides Income protection as well as the Life Cover.

7. Annuities:

Example LIC's Jeevan Akshay 6 Pension Plan)

(First periodical payments, till fixed date then periodical receipts after fixed date)

Annuity is a contract where Insurer in return for the payment at regular intervals till fixed date make series of agreed payments at regular intervals from fixed date.

8. Group Insurance:

Example LIC's Group Credit Life Insurance)

(Sum assured is paid, if there is death of any group member)

Group Insurance is an insurance that covers a group of people, who are the members of the societies, employees of an organization or professionals in common group.

7. REQUIREMENTS OF SCHEDULE A TO THE IRDA (PREPARATION OF FINANCIAL STATEMENTS AND AUDITORS' REPORT OF INSURANCE COMPANIES) REGULATIONS, 2002.

7.1. PART-I: ACCOUNTING PRINCIPLES FOR PREPARATION OF FINANCIAL STATEMENTS

1. **Premium:** Premium shall be recognized as income when due. For linked business the due date for payment may be taken as the date when the associated units are created.
2. **Claims:** The ultimate cost of claims shall comprise the policy benefit amount and specific claims settlement costs, wherever applicable.
3. **Acquisition Costs:** Acquisition costs if any shall be expensed in the period in which they are incurred. Acquisition costs are those costs that vary with and are primarily related to the acquisition of new and renewal insurance contracts. The most essential test is the obligatory relationship between costs and the execution of insurance contracts (i.e. commencement of risks)
4. **Procedure to determine 'Value of Investments':** An insurer shall determine value of investments in the following manner:

(a) Real estate investment property –

(Historical Cost + Revaluation Once in 3 Years → Transfer Profit to Revaluation Reserve)

The value of investment property shall be determined at historical cost, subject to revaluation at least once in every three years. The change in the carrying cost of the investment property shall be taken to revaluation reserve. Gains/losses arising due to changes in the carrying amount of real estate shall be taken to equity under 'Revaluation Reserve'.

(Disclosure of revaluation in notes to accounts)

- The bases for revaluation shall be disclosed in the notes to accounts. The authority may issue directions specifying the amount to be released from the revaluation reserve for declaring bonus to the policyholders. For the removal of doubt, it is clarified that except for the amount that is released to policyholders as per the authority's direction, no other amount shall be distributed to shareholders out of revaluation reserve account.

(Assess whether impairment has happened)

- The insurer shall assess at each balance sheet date whether any impairment of the property has occurred.

(Treatment of Impairment Loss)

- An impairment loss of shall be recognized as an expense in the revenue/ Profit and loss account immediately, unless the asset is carried at revalued amount. Any impairment loss of a revalued asset shall be treated as a revaluation decrease of that asset and if the impairment loss exceeds the corresponding revaluation reserve, such excess shall be recognized as expense in the Revenue/Profit and loss account.

(Profit / Loss on Sale of Investment = Profit / Loss as per Book Value + Balance in Revaluation Reserve)

- The Profit on sale of investments or loss on sale of investments, as the case maybe shall include any accumulated changes in the carrying amount previously recognized in equity under the heading revaluation reserve in respect of particular property and being recycled to the relevant revenue account or profit and loss account on sale of that property.

(b) Debt Securities –*(Historical Cost Subject to Amortization)*

Debt securities, including government securities and redeemable preference shares, shall be considered as 'held to maturity' securities and shall be measured at historical cost subject to amortization.

(c) Equity Securities and Derivative Instruments that are traded in markets –*(Fair value on Balance Sheet Date)*

Listed equity securities and derivative instruments that are traded in active markets shall be measured at fair value on the balance sheet date.

(Fair Value = Last Quoted Closing Price)

For the purpose of calculation of fair value, the lowest of the last quoted closing price at the stock exchanges where the securities are listed shall be taken.

(Meaning of Active Market)

An active market shall mean a market, where the securities traded are homogenous, availability of willing buyers and willing sellers is normal, and the prices are publicly available.

(Treatment of Unrealized Gain = Fair Value Change Account)

Unrealized gains/losses arising due to changes in the fair value of the listed equity shares and the derivative instruments shall be taken to equity under the head 'Fair value change account'.

(Profit / Loss on Sale of Investment)

The profit on sale of investments or loss on sale of investment as the case maybe shall include accumulated changes in the fair value previously recognized under equity under the heading 'Fair value changes account' in respect of a particular security and being recycled to the relevant Revenue account or Profit and loss account on actual sale of that security.

(Treatment of Fair Value Change Account by Authority)

The Authority may issue directions specifying the amount to be released from the Fair Value Change Account for declaring bonus to the policyholders. For the removal of doubt, it is clarified that except for the amount that is released to policyholders as per the Authority's prescription, no other amount shall be distributed to shareholders out of Fair Value Change Account. Also, any debit balance in Fair Value Change Account shall be reduced from profit/free reserves while declaring dividends.

(Assess for impairment on each balance sheet date)

The insurer shall assess on each balance sheet date whether any impairment of listed equity security(ies)/ derivative(s) instruments has occurred.

(Treatment of Impairment Loss)

The insurer shall assess, on each balance sheet date, whether any impairment has occurred. An impairment loss shall be recognized as an expense in Revenue/Profit and Loss Account to the extent of the difference between the re-measured fair value of the security/investment and its acquisition cost as reduced by any previous impairment loss recognized as expense in Revenue/ Profit and Loss Account. Any reversal of impairment loss earlier recognized in Revenue/Profit and Loss Account shall be recognized in Revenue/Profit and Loss Account.

(d) Unlisted and other than actively traded Equity Securities and Derivative Instruments–*(Historical Cost)*

Unlisted equity securities and derivative instruments and listed equity securities and derivative instruments that are not regularly traded in active markets shall be measured at historical cost.

(Provision for diminution in value of investment)

Provision shall be made for diminution value of such investments. The provision so made shall be reversed in subsequent periods if estimates based on external evidence show an increase in the value of the investment over its carrying amount. The increased carrying amount of the investment due to the reversal of the provision shall not exceed the historical cost.

(Meaning of not Actively Traded = Thinly Traded as per SEBI)

For the purposes of this regulation, a security shall be considered as being not actively traded, if as per guidelines governing mutual funds laid down from time to time by SEBI, such a security is classified as "thinly traded".

(Thinly Traded as per SEBI)

Equity / equity-related security shall be considered to be thinly traded when the value of the trades of that security in a month is less than Rs. 5 lacs by value and the total volume of the trades in that security is less than 50,000 shares. In order to determine whether a security is thinly traded, the volumes traded in NSE and BSE shall be considered.

5. **Loans:**

(Loans to Policyholders)

Insurance companies not only cater valuable death cover under policy but also extend helping hand by way of granting loan under policies during life time of policyholder when he is in need of funds. As per the privileges and conditions given on the policy documents, insurer grants loan on the security of policy document to the person who is entitled for the same.

(Historical Cost – Impairment)

Loans shall be measured at historical cost subject to impairment provisions. The impairment provisions shall not be lower than the amounts derived on the basis of guidelines prescribed from time to time by the Reserve bank of India, that apply to Companies and Financial institutions.

6. **Actuarial valuation- Liability for Life Policies:** The estimation of liability against life policies shall be determined by the appointed actuary of the insurer pursuant to his annual investigation of the life insurance business. Actuarial assumptions are to be disclosed by way of notes to the account.

The liability shall be so calculated that together with future premium payments and investment income, the insurer can meet all future claims (Including bonus entitlements to policyholders) and expenses.

7. **Funds for Future Appropriation:**

The funds for future appropriation represent all funds, the allocation of which, either to policyholders or to the shareholders, has not been determined by the end of the financial year.

8. **Applicability of Accounting Standards:** Every balance sheet, Revenue Account (Policy holders account), Receipts and Payments account (Cash flow statement) and Profit and Loss account (Shareholder's account) of an insurer shall be in conformity with the Accounting standards (AS) issued by the ICAI, to the extent insurers carrying on life insurance business, except that:

- Accounting standard 3 (AS 3) – Cash flow statements – Cash flow statement shall be prepared only under the direct method.
- Accounting standard 17 (AS 17) – Segment Reporting – shall apply to all insurers irrespective of the requirements regarding the listing and turnover mentioned therein.

9. **Linked (ULIP) Business:**

(Separate Set of Financial Statements)

The accounting principles used for valuation of Investments are to be consistent with principles as Enumerated above. A separate set of financial statements, for each segregated fund of the linked business should be annexed.

(Income Gain / Loss = Policy Holders)

Segregated funds represent funds maintained in accounts to meet specific investment objectives of policy holders who bear the Investment risk. Investment income/ gains and losses generally directly accrue to the policy holders.

7.2. PART II: DISCLOSURES FORMING PART OF FINANCIAL STATEMENTS

A. The following shall be disclosed by way of notes to the Balance Sheet:

1. **Operating expenses** relating to insurance business, basis of allocation of expenditure to various segments of business.
2. Computation of **managerial remuneration**.
3. **Historical costs of those Investments** valued on fair value basis.
4. Basis of **Amortization of debt securities**
5. **Basis of revaluation** of Investment property.
6. **Value of Contracts in relation to Investment** for
 - ✓ Purchases where deliveries are pending;
 - ✓ Sales where payments are overdue.
7. **Encumbrances** to the assets of the Company in and outside India.
8. **Claims settled and remaining unpaid** for a period of more than six months as on closing date.
9. **Actuarial assumptions** for valuation of liabilities for life policies in force.
10. **Contingent Liabilities**
 - ✓ Partly-paid up investments
 - ✓ Underwriting commitments outstanding
 - ✓ Claims, other than those under policies, not acknowledged as debts
 - ✓ Guarantees given by or on behalf of the company
 - ✓ Statutory demands/liabilities in dispute, not provided for
 - ✓ Reinsurance Obligations to the extent not provided for in accounts
 - ✓ Others (to be specified).
11. **Commitments** made and outstanding for Loans, Investments and Fixed Assets.

B. The following accounting policies shall form an integral part of the financial statements

1. All **significant accounting policies** in terms of the accounting standards issued by the ICAI, and significant principles and policies given in Part I of Accounting Principles. Any other accounting policies, followed by the insurer, shall be stated in the manner required under Accounting Standard AS 1 issued by the ICAI.
2. Any **departure from the accounting policies** shall be separately disclosed with reasons for such departure.

C. The following information shall also be disclosed:

1. **Investments made in accordance with any statutory requirement** should be disclosed separate amount, nature, security and any special rights in and outside India;
2. Segregation into **performing/non-performing investments** for purpose of Income recognition directions, if any, issued by the Authority;
3. Bases of **allocation of investments and income** thereon between Policy-holders' Account;
4. **Assets to the extent required to be deposited** under local laws or otherwise **encumber**
5. **Accounting Ratios** as may be prescribed by the Authority.
6. **Percentage of business** sector-wise;
7. A **summary of financial statements for the last five years**, in the manner as may be Authority;

7.3. PART III: GENERAL INSTRUCTIONS FOR PREPARATION OF FINANCIAL STATEMENTS:

1. **Interest, dividends and rentals receivable** in connection with an investment should be stated at **gross**

amount, the amount of income-tax deducted at source should be included under 'advance taxes paid and taxes deducted at source.

2. Any debit balance of the Profit and Loss Account shall be shown as deduction from uncommitted reserves and the balance, if any, shall be shown separately.
3. (I) For the purposes of financial statements, unless the context otherwise requires —
 - (a) the expression 'reserve' shall not, subject to as aforesaid, include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability or loss;
 - (b) the expression 'capital reserve' shall not include any amount regarded as free for distribution through the profit and loss account; and the expression 'revenue reserve' shall mean any reserve other than a capital reserve;
 - (c) the expression "liability" shall include all liabilities in respect of expenditure contracted for and all disputed or contingent liabilities.
 - (d) the expression 'provision' shall, subject to (II) below mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing for any known liability or loss of which the amount cannot be determined with substantial accuracy;
 (II) Where:
 - (a) any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or
 - (b) any amount retained by way of providing for any known liability or loss, is in excess of the amount which in the opinion of the directors is reasonably necessary for the purpose, the excess shall be treated as a reserve and not provision.
4. The company shall make provisions for damages under lawsuits where the management is of the opinion that the award may go against the insurer.
5. The corresponding amounts for the immediately preceding financial year for all items shown in the Balance Sheet, Revenue Account, Profit and Loss Account and Receipts and Payments Account shall be given.
6. The figures in the financial statements may be rounded off to the nearest thousands.
7. Extent of risk retained, and re-insured shall be separately disclosed.

7.4. PART IV: CONTENTS OF MANAGEMENT REPORT

There shall be attached to the financial statements, a management report containing, inter alia, the following duly authenticated by the management:

1. Ageing of claims indicating the trends in average claim settlement time during the preceding five years;
2. Certification that all the dues payable to the statutory authorities have been duly paid;
3. Certification to the effect that the values of all the assets have been reviewed on the date of the Balance Sheet and that in his (Insurer) belief the assets set forth in the Balance Sheets are shown in the aggregate at amounts not exceeding their realizable or market value under respective headings of the Assets.
4. Declaration that the management has not directly or indirectly invested outside in India the funds of the holders of policies issued in India.
5. Certification to the effect as to how valuation of Investments has been carried out.
6. Review of asset quality and performance of investment in terms of portfolios, i.e., separately in terms of real estate, loans, investments, etc.
7. Confirmation that the required solvency margins have been maintained.
8. Confirmation to the effect that the shareholding pattern and any transfer of shares during the year are in accordance with the statutory or regulatory requirements;
9. Certification to the effect that no part of the life insurance fund has been directly or indirectly applied in contravention of the provisions of the Insurance Act, 1938 (4 of 1938) relating to the application and investment of the Life Insurance funds.
10. Confirmation regarding the continued validity of the registration granted by the Authority;

11. Disclosure with regards to the **overall risk exposure and strategy** adopted to mitigate the same.
12. **Operations in other countries**, if any, with a separate statement giving the Management's estimate of country risk and exposure risk and the hedging strategy adopted.
13. A responsibility statement indicating therein that:
- the management has taken proper and sufficient care for the **maintenance of adequate accounting records** with the applicable provisions of the Insurance Act, 1938 (4 of 1938)/ Companies Act, 2013, for safeguarding the assets of the Company and for preventing and detecting fraud and other irregularities;
 - in the preparation of financial statements, the **applicable accounting standards**, principles and policies have been followed along with proper explanations relating to material departures, if any;
 - the management has adopted **accounting policies and applied them consistently** and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the Company at the end of the financial year and of the Operating profit or loss of the Company for the year.
 - the management has prepared the financial statements on a **going concern basis**;
 - the management has ensured that an **internal audit system** commensurate with the size and nature of the business exists and is operating effectively;
14. A **schedule of payments**, which have been made to individuals, firms, companies and organization in which **Directors** of the Insurer are interested.

7.5. PART V PREPARATION OF FINANCIAL STATEMENTS

Format & Segment Information

(1) An insurer shall prepare the Revenue Account [Policyholders' Account], Profit and Loss Account [Shareholders' Account] and the Balance Sheet in Form A-RA, Form A-PL and Form A-BS, as prescribed in this Part, or as near thereto as the circumstances permit.

Provided that an insurer shall prepare Revenue Account for the undermentioned businesses separately and to that extent the application of AS 17 shall stand modified: -

- Participating policies and Non-participating policies;
- Linked, Non-Linked, and Health Insurance;
- Business within India and Business outside India.

Cash Flow Statement

(2.) An insurer shall prepare separate Receipts and Payments Account in accordance with the Direct Method prescribed in AS 3 – "Cash Flow Statement" issued by the ICAI.

8. SPECIAL / PECULIAR AREAS OF AUDIT IN LIFE INSURANCE COMPANIES

Actuarial Process:

(Change in Role from Supervision to Certification)

Actuaries in Life Insurance business have gained tremendous importance. The role of Actuary in life insurance has shifted from supervising compliance to certify whether products and financial reports are in accordance with the general regulatory guidelines.

(Affects Pricing & Valuations)

The job of actuary or actuarial department in any Life Insurance Company involves, detailed analysis of data to quantify risk. The actuarial department is calculating and modelling hub of the Company. Within the department fundamentals of Insurance business is determined from pricing to policy valuations techniques.

Role of Auditor:

(Certification of Actuarial Valuation)

Auditors in the Audit report are required to certify, whether the actuarial valuation of liabilities is duly certified by the appointed actuary, including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the authority and/or the Actuarial Society of India in concurrence with the IRDA.

(Certificate of Actuary & Evaluation of Actuaries Work)

Hence, Auditors generally rely on the Certificate issued by the Appointed Actuary, certifying the Policy liabilities. However, Auditor may discuss with the Actuaries with respect to process followed and assumptions made by him before certifying the Policy liabilities.

Work of Actuarial Department

Actuarial department broadly concentrates following key areas of Insurance business:

(Initially)

- Business Planning.

(Regular Reports)

- Management reporting on various business valuations and profitability models of the Life Insurance business.

(New Policies)

- Product Development/ Pricing and Experience analysis.
- Model Development.

(Statutory Requirements)

- Statutory Valuations and reserving.
- Solvency management.

Underwriting:

(Definition of Underwriting)

A proposal is an application for an insurance cover. The process of verifying the level of risk in each new entrant is called 'selection' or 'underwriting'. The underwriters may either decline the risk or may provide a quotation in which the premiums have been loaded or in which various exclusions have been stipulated, which restrict the circumstances under which a claim would be accepted and paid.

(Premium Determination and Risk Selection)

The underwriter assesses the risk and determines the premium to be charged. The function of the underwriter is to acquire-or to "write"-business that will bring money to the insurance company, and to protect the company's business from risks that they feel will make a loss.

Role of Auditor:

(IRDA Act & Regulation / Policy / Internal Control System)

While verifying the process of underwriting, the objective of the Audit should be to review the process of acceptance of risk through the underwriting process, and evaluate and test the effectiveness of internal controls in place to ensure timely and accurate Insurance policy, adherence to the IRDA Act and Rules and regulations made thereunder.

Free Look Cancellation (FLC):

(Policy holder can ask for cancellation within 15 Days)

As per clause 6(2) of IRDA (Protection of Policyholders Interest) Regulations, 2002, "the insurer shall inform by the letter forwarding the policy that he has a period of 15 days from the date of receipt of the policy document to review the terms and conditions of the policy and where the insured disagrees to any of those terms or conditions, he has the option to return the policy stating the reasons for his objection, when he shall be entitled to a refund of the premium paid, Accordingly, FLC is an option provided to the policyholder wherein he has a period of 15 days from the date of receipt of the policy document to review the Terms & Conditions of the policy and in case of disagreement to any of the terms & conditions, he/ she has the option to return the policy stating the reason for policy's cancellation.

(Allowed Deductions)

Subject only to a deduction of a proportionate risk premium for the period on cover and the expenses incurred by the insurer on medical examination of the proposer and stamp duty charges".

FLC refund is calculated as follows:	
FLC premium paid	XXX
(Less)- medical charges. If any, by the insurer.	(XXX)

(Modes Allowed)

FLC requests can be received through any mode –e-mail, fax and letters depending on insurer's policy. In case of written letters, the signature of the policy holder should be matched with the original proposal form.

(Reasons – Not Satisfied with terms & Conditions)

FLC request is processed only when the policy holder is not satisfied with the terms and conditions of the policy document and not for any other reasons. FLC refund is paid either by cheque or in case the policy holder wants direct credit, then consent for direct credit along with cancelled cheque for bank account details is submitted.

Role of Auditor:*(Signature Verification / Accounting Entries)*

The primary objective of the audit is to check and confirm that FLC requests are received within 15 days from receipt of policy document by the policy holder, verification of signatures of the policy holder and processing of FLC request within TAT (Turn Around Time) defined by the insurer. Also checking of appropriate accounting entries are recorded for refund.

Policy Lapse and Revival:*(How to keep Policy "In Force")*

In order to keep a life insurance policy "in force" the policy holder is required to pay premiums when due (either monthly/ quarterly/annual/bi-annual).

(Grace Period)

If payment is missed, the insurer allows a period of 15/30 day from the premium due date for making the payment. This period is termed as "grace period". If the policy holder does not make the payment within the grace period, the policy gets "lapsed". Thus, a payment within the grace period is deemed to be a payment on the due date.

(Lapse not defined but its treatment is defined)

"Lapse" is the discontinuance of the policy owing to non-payment of premium dues. The term "lapse" is not defined in the insurance legislation, except stating that "a policy which has acquired a surrender value shall be kept alive to the extent of the paid-up sum assured (*Proportionate Sum Assured*)" - vide section 113(2) of the Insurance Act, 1938. (*Policy acquires surrender value when premiums for full 3 years is paid to insurance company*)

(Affects Stakeholders)

Lapsation affects all the stakeholders – the policy holder, agents and the insurer. A lapsed policy ceases to provide insurance protection to the insured. It forfeits the benefits under the policy and cost of new policy is higher. Agents do not get renewal premium commission if the policy is lapsed.

(Revival)

The terms and conditions of the policy stipulate, that where the premium is not paid within the grace period, the policy lapses but may be revived during the life time of the life assured. Some insurers do not allow revival, if the policy has remained in lapsed condition for more than five years. This is because of the possibility that the arrears of premiums on such a policy would be too heavy and that it would be better to take out a fresh policy.

(Monitoring Renewal Premiums)

The insurer should have taken persistent measures for monitoring receipt of renewal premium within the due dates. In case of most of insurers, policy lapsation is tracked over the PMS (Policy Management System), wherein premium due dates are monitored by the system once initial data of the policy is entered in the system.

Role of Auditor:*(Monitoring / Lapsed & Revival Treatment)*

The primary objective of the audit is to check and confirm that due dates are recorded and monitored properly and policies are marked as "lapsed" on non-receipt of renewal premium within due dates/grace period. In case of revival request, whether adequate checks are in place for receipt of outstanding amounts and adequate documents are obtained before reviving the policy.

Policy Surrender:*(Meaning)*

Surrender of an insurance policy refers to the voluntary termination of the insurance contract before the expiry of the term of the contract. The process of surrender is initiated by the policy holder.

(Eligibility)

A policy becomes eligible for surrender on completion of 3 years from the commencement of the policy provided that 3 years premium have been paid within the due dates.

(Process)

The policy holder has to submit surrender request form duly signed off by him at branch/processing centre along with the original policy document and the discharge voucher. Eligibility for surrender is mentioned in the policy document. The policy can be surrendered only when the insured person is alive.

Role of Auditor:*(Authenticity of Surrender Requests / Surrender Amount Computation)*

The primary objective of the audit is to check and confirm that surrender requests are received from the policy holder only, and that adequate controls are in place to ensure proper verification process for checking of request, whether premiums are paid on regular basis. Check whether surrender amount is paid only to the policy holder and is paid only as per terms and conditions mentioned in the policy document and appropriate accounting entries are passed.

Reinsurance:*(Transfer of Risk)*

Reinsurance is a risk mitigating tool adopted by Insurer whereby the risk underwritten by one Insurer is transferred partially to another Insurer. In other words, Reinsurance means one insurer purchasing coverage from a second insurance company for a risk that the first insurer is insuring.

Role of Auditor:*(Premium Computation & Provisions)*

The primary objective of the audit should be to check and confirm that reinsurance premium calculation and payment is in accordance with the agreement with the reinsurer. Necessary provision has been made for outstanding reinsurance premium and is properly accounted for in books of accounts under respective heads.

(Agreements – Renewals – Payments)

The audit in this regard would normally cover the followings areas of the reinsurance:

- i. Verification of agreements entered with the reinsurer.
- ii. Updating/ renewals of agreements, and verifying whether Insurer has adhered to the terms and conditions of the agreement.
- iii. Verification of payments made to the reinsurer and verifying whether adequate provisions are carried out in books.

9. AUDIT OF VARIOUS ITEMS OF FINANCIAL STATEMENTS OF LIFE INSURANCE COMPANY

PREMIUM

1. SYSTEM Related Points

(SOPs -> Computation-- Authorization – Collection – Booking – Banking – Accounting – Reconciliation)

a. Check whether there are appropriate SOPs developed by the Companies and are strictly followed by all the departments/ branches of the Company. Auditors should also evaluate various sub-processes, employed by the Insurance Companies in accounting of premiums like collection of premium from the policy holders, booking of premium, banking, accounting and reconciliation of the same.

(Segregation)

b. Premium recognition and refund of premium are independent processes with adequate segregation of duties amongst the personnel.

(Admin Accounting Interface)

c. Check the robustness of interface between administration and accounting system.

Auditors may also refer to IRDA (Preparation of Financial Statements & Auditors Report of Insurance Companies) Regulations, 2000 for premium accounting.

2. COMPUTATION Related Points

(Accuracy of premium computation)

a. Check that Accounting system, employed by the Company, calculates premium amounts and its respective due dates correctly *(Different system for premium computation)*

b. Check that system employed as such is equipped to calculate all types of premium modes correctly.

3. Authorization Related Points

(Authorization Limits)

a. Ensure duly approved Delegation of Authority parameters matrix already in place for authorization limits.

4. Collection Related Points

(How Advance Premium is Identified & Recognized)

a. Check, whether system has capability to identify regular and advance premium.

(Application of Advance to Premium Due)

b. Check whether there is a process of applying advance premium to a contract when premium is due.

5. Banking Related Points

(All collections – banked)

a. Check that there is appropriate mechanism to ensure all the collections are deposited into the Bank on timely basis.

6. Accounting Related Points

(Definition of Premium Accounting)

a. Premium accounting refers to recognizing the premium earned by the insurer as income in the accounting system.

(Recognition of Premium Income)

b. Income is recognized as:

New business premium – premium received for the first policy year and

Renewal premium – premium received for subsequent policy years.

Premium received but not identifiable against any policy would be treated as 'unallocated premium'/ 'suspense amount'.

(Premium on New Policy)

c. When the new policy is issued by the Insurer, new business premium is recognized on the receipt of premium. Generally, Policy is underwritten only after the receipt of the first premium. However, in certain cases, policies are issued awaiting realization of premiums, for eg policies are issued subject to realization of cheques issued by the Insured. Auditors are required to check these cases and ensure proper accounting of the same.

(Renewal Premium)

d. Renewal income is recognized (1) when premium is due but not received up to the end of grace period. Or (2) on realization of the premium amount after grace period.

(Issued Policies Vs Underwriting Dates)

e. Check that premium is recognized only on the basis of 'Issued Policies' and not on underwriting dates.

7. Allocation Related Points

(Allocation of Premium)

Check that there is inbuilt mechanism the system all the premium collected are correctly allocated all various components of the Policies.

8. MIS & IRDA Reporting Related Points

(MIS Generation)

(a) Check the methodology for generation of MIS from the system and there is no manual intervention.

(Maker Checker)

(b) Check the procedure for Maker/ Checker before finalizing the MIS.

(Reconciliation between Reported to IRDA and Financials)

(c) Check whether there is a reconciliation process between premium Income as per financials and as reported.

9. Reconciliation Related Points

(Reconciliation between Collection – Booking – Banking)

(d) Check whether there is daily reconciliation process to reconcile the amounts collected, entered into the system and deposited into the bank.

(Reconciliation)

(e) Check that there is appropriate mechanism in place to conduct reconciliation on daily basis and reconciling items, if any, are rectified/ followed up.

(Premium Reconciliation)

(f) Check that the Company conducts premium reconciliation on daily basis.

Interest, Dividend and Rent: An insurance enterprise, like any other, earns interest dividend and rent through its assets. The interest, dividend and rent earned are to be apportioned between Revenue Account and Profit and Loss Account.

The Regulations require that basis of allocation of interest, dividend and rent between the Revenue Account and Profit and Loss Account should be clearly indicated in the company's accounting policy.

The interest or dividend earned as against the policyholders' funds is required to be apportioned to the Revenue Account. The interest earned on, say, grant of vehicle loans, housing loans, deposits with banks of the shareholders, funds, rent received on let out properties owned by the company, by way of investments shareholders, funds, etc. are required to be shown under the profit and Loss Account.

Claims:

Focus while Reviewing Claims

(Types of Claims)

Claims pay-outs would include a wide variety of customer benefits including:

Death Claims / Maturity Claims / Annuities / Health Claims / Rider Claims / Policy surrenders /Other Survival benefits.

(Lodging Claim)

Claims lodgement and processing

(Approval)

Authority matrix for approval of claims

(Pay-outs & Disbursements)

Review of pay-outs and disbursements

(Compliance with Insurance Act & IRDA Regulations)

Review of compliance to applicable IRDA Regulations, relevant sections of Insurance Act 1938 and the prevention of Money Laundering Act, 2002.

(Reinsurance Recovery)

Review of Reinsurance recovery process

(Reporting of Claims)

Review of reporting of claims (life & health) and benefits paid.

Audit Procedures for Claim

Following are the certain illustrative points, Auditors are required to follow during the Audit of Claims:

(Standard Policy Document)

Auditor should review the standard policy document template to ensure that the policy document prescribes the minimum documentary evidence needed to support a claim.

(Claim Register)

Ensure that the Insurer maintains a register or record of claims, in which every claim is entered along with the date of the claim and date on which the claim was discharged.

(Inclusion of All Received Claims)

Check whether all claims received are registered and enter into the system.

(KYC Documents)

It should be ensured that there is a system of collecting appropriate KYC documents, as required, and discrepancies, if any, are intimated to the policyholders within 15 days of intimation.

(Recording of all processed claims)

It should be ensured that all the processed claims are accounted in to the system properly.

(Claim Settlement Costs)

It should be ensured that Claims cost includes the Claims Settlement Cost.

(Reasons for Rejection)

In case the claims are rejected, the reasons for the rejections should be closely reviewed.

(Reconciliation claim management system & ledger)

It should be ensured that there is system of regular reconciliation is carried out between claims management system and General ledger.

SPECIAL CASES*(Other than death claims)*

In case of living/ survival/ maturity / annuity benefits it should be ensured that liability is automatically triggered.

(Provision for IBNR)

It should be ensured that appropriate provisioning has been carried out, in the cases of all the claims intimated but not paid.

(Net of Reinsurance)

Liability of claims should be booked net of reinsurance.

Operating Expenses related to Insurance Business (Expenses of Management):

Covered in Revenue Accounts

In so far as financial statements are concerned, this Schedule is part of the Revenue Account to be prepared for insurance business.

Division in 14 Heads

All the administrative expenses in an insurance company are broadly classified under 14 heads as mentioned in Schedule 3 forming part of Financial Statements given under Schedule A to the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002.

Separate Disclosure

Any other expenses are required to be disclosed under the head 'Others'. Any major expenses (5 lacs or in excess of 1% of net premium, whichever is higher) are required to be shown separately.

Role of Auditor:

(First Aggregate & Then Allocate)

The auditor should ensure that these expenses are first aggregated and then apportioned to the Revenue Account of each class of business on a reasonable and equitable basis.

(Disclose Policy of Allocation)

The accounting policy should clearly indicate the basis of apportionment of these expenses to the respective Revenue Accounts (i.e., Participating and Non-participating policies and in between Linked and Non- Linked business) along with the certificate that all expenses of management, wherever incurred, directly or indirectly, read with the accounting policy, have been fully debited to the respective Revenue Account as expenses.

Legal and Professional Charges:

(Legal Costs Related to Claim)

As far as legal and professional charges are concerned, attention is drawn to the head 'Claims Incurred' under Schedule 2 where it is clearly stated that fees, legal and other expenses should form part of claim cost, and therefore, are not to be included under the head Legal and Professional Charges.

Role of Auditor: The auditor should ensure that all other expenses which are not covered under the claims cost are required to be included under this head.

Employees' Remuneration and Welfare Benefits:

(Includes Medical Expenses)

The employees' remuneration includes all kinds of payments made to employees in consideration of their services. The reimbursement of medical expenses or premium in respect of employees' health cover is covered under the employees' remuneration and welfare. Any medical fees incurred towards maintenance of health care policies (which are not for employees) are required to be debited to the claims cost under the health care and not to be included under this head. Any expenses towards medical treatment of employees incurred by the company should also be included under this head. Non-training expenses have to be shown separately.

Role of Auditor: The auditor is required to ensure the compliance of above.

Interest and Bank Charges:

All expenses incurred towards maintenance of Bank Account, interest and other charges levied by bankers to the normal course of business other than bank expenses relating to investments (interest, bank charges, custodial charges, etc.) are shown under the head, "Interest and Bank Charges". Any other interest charged on the borrowings which could not form part of the Revenue Account not to be included under this head.

Depreciation:

Charging of depreciation is governed by Schedule II to the Companies Act, 2013. In addition, compliance of relevant Accounting Standard is also to be taken care.

Investments:

Shareholders' Investment Vs Policyholders Investment

The Investment portfolio of Life Insurance companies comprise of Shareholders' funds and Policyholders' funds.

Categories of Policyholders Fund

Policyholders' funds can further be segregated as linked and non - linked. Investment regulations are however prescribed separately for the following investment categories:

- Linked Funds
- Pension and Annuity Funds
- Controlled Funds

Effective Governance / Internal Controls System / Financial Transparency

As Insurers essentially manage the funds for policyholders it becomes imperative for the insurer to have adequate systems and processes that should not only ensure robust internal controls, financial transparency and equity but also bring effective governance so as to serve the interests of the management, stakeholders, consumers and the society, at large.

Pattern of Investment

IRDA (Investment) regulations, 2000 gives details of the pattern in which Funds of the Life Insurance business, should be kept invested at any given point of time.

Independent Sub Functions in Investment Function

The overall functioning of the Investment function should include the following independent functions:

- Investments front office / dealing desk
- Treasury – Cash Management, Deal settlement, Broker empanelment, Custody
- Investment accounting – Fund accounting, NAV computation and declaration.
- Investments mid office – Compliance, Risk Management, Reporting, Reconciliations

Role of Auditor:

The Auditor during his review of Investment Department should mainly consider the following:

(Compliance with Regulations)

- Compliance of all Investment regulations, various other circulars specified by IRDA and other regulations specified in the Insurance Act, 1938

(Split)

- Ensure that there is split between Shareholders' and Policyholders' funds, and earmarking of securities between various funds namely Life (Participating & Non-Participating), Pension & Group (Participating & Non-Participating) and Unit Linked Fund

(Investment Policy)

- Review of insurer's Investment policy

(Investment Management Structure)

- Review the investment management structure to ensure adequate segregation of duties between Investment Front office, Mid Office and Back office

(Accounting & Valuation Policy)

- Review and check insurer's Investment Accounting and valuation policy and the controls around this process

(Risk Management Policy)

- Insurer's risk management policies and processes to manage investment risk such as Market risk,

Liquidity risk, Settlement risks, etc.

(SOPs)

- Review of insurer's Standard Operating Procedures which are prescribed by the IRDA Regulations and are required to cover the entire gamut of investment related processes and policies

(Disaster Recovery etc.)

- Review of insurer's Disaster Recovery, Backup and Contingency Plan

(Policy Management System Vs Investment System)

- Flow of data from PMS to the Investment Accounting system

(Control over Outsourcing)

- Determine the extent of activities outsourced and the controls over such activities

(Controls over Interfaces)

- Controls over various system interfaces such as Seamless integration of data, between front office and back office, in the Investments accounting system

(Access Controls, Authorization Process & Deal Execution)

- Review of access Controls, authorization process for Orders and Deal execution, etc.

(Controls Over NAV Computation)

- Controls over NAV computation and declaration

(Cash Management System)

- Review of insurer's Cash Management System to track funds available for Investment considering the settlement obligations and subscription and redemption of units, etc. The system should be validated not to accept any commitment beyond availability of funds and restrict Short Sales at the time of placing the order. Further insurer's system should be able to determine the amount of Investible surplus

(Investment Committee)

- Review of functioning and scope and minutes of Investment Committee.

(Fund wise Reconciliation)

- Review of fund wise reconciliation with Investment Accounts, Bank, and Custodian records

(Reconciliation between holdings & custodian)

- Review the arrangements and reconciliations of holdings with the insurer's custodian

(Monitoring)

- Ensure that the system is be able to automatically monitor various Regulatory limits on Exposure and Rating of debt instruments

(Personal, Insider Trading, Front Running Avoidance)

- Controls around personal dealings, insider trading and front running.

10.SPECIFIC CONTROL PROCEDURES RELATED TO AUDIT OF GENERAL INSURANCE COMPANY.

The system of recording, classifying and summarizing the transactions in insurance companies, is, in substance, no different from other entities. However, in case of insurance companies, the ledger accounts specially those of premiums, claims, commissions, etc. need to be given greater attention. The functions of accounting system in general insurance business under IT environment may be based on:

- ◆ Premium receipting & issuance of policies based on Underwriting done
- ◆ Claims module
- ◆ Agency management module
- ◆ Accounts module
- ◆ Investment module

◆ Reinsurance module

Every insurer, in respect of insurance business transacted and in respect of shareholder's funds, is required to prepare a Balance Sheet, a Profit and Loss Account (in respect of transactions of the shareholders, in their capacity as shareholders), a separate Account of Receipts and Payments, a Revenue Account (in respect of transactions with policy holders on account of insurance) for each year in accordance with the Regulations as may be specified. Every insurer should keep separate accounts relating to funds of shareholders and policyholders.

11. REQUIREMENTS OF SCHEDULE B TO THE IRDA (PREPARATION OF FINANCIAL STATEMENTS AND AUDITORS' REPORT OF INSURANCE COMPANIES) REGULATIONS, 2002.

Part I: Accounting Principles for Preparation of Financial Statements

1. Premium-

(Over a Period of Time or Period of Risk)

Premium shall be recognized as income over the contract period or the period of risk, whichever is appropriate.

Premium revenue recognition is based on the pattern of risk to which the insurer is exposed. An insurer, based on past experience can reliably estimate the pattern of risk for a particular type of insurance business. Most insurers bring premium revenue to account on the basis of the passage of time. This is generally appropriate where the risk of events occurring that give rise to claims is more or less uniform throughout the policy period subject to any regulatory prescription in this regard.

For some classes of insurance, it is usual for the premium to be adjusted as a result of events and information that becomes known during or after the policy period, e.g. marine cargo. Further, in some cases, risk pattern may not be evenly spread over the period of insurance because of the very nature of the risk covered e.g. some infrastructure projects involving varying degrees of risk factors. A deposit premium is paid in such cases at the beginning of the policy period and subsequently adjusted. The basis of determination of premium earned shall be adequately justified, preferably supported by external evidence such as by certification from an actuary and/or other technical experts. Adequate disclosure of such basis shall be made.

(Unearned Premium & Advance Premium Received)

Unearned premium as well as premium received in advance, both of which represent premium income not relating to the current accounting period, shall be disclosed separately in the financial statements.

Premium Received in Advance, which represents premium received prior to the commencement of the risk, shall be shown separately under the head '*Current Liabilities*' in the financial statements. Unearned premium shall be shown separately under the head '*Current Liabilities*' and appropriate disclosures regarding management's basis of assessment shall be made in the financial statements.

Premium received in advance shall not be included in the unearned premium and shall be shown separately.

(Reserve for Unearned Premium). A reserve for Unearned Premium, may be created as the amount representing that part of the premium written which is attributable and to be allocated to the succeeding accounting periods.

2. **Premium Deficiency**-Premium deficiency shall be recognized if the sum of expected claim costs, related expenses and maintenance costs exceeds related unearned premiums. For contracts exceeding four years, once a premium deficiency has occurred, future changes to the liability shall be based on actuarial/technical evaluation.

3. **Claims**-The components of the ultimate cost of claims to an insurer comprise the claims under policies and claims settlement costs. Claims under policies comprise the claims made for losses incurred, and those estimated or anticipated under the policies. A liability for outstanding claims shall be brought to account in respect of both direct business and inward reinsurance business. The liability shall include: -

(a) Future payments in relation to unpaid reported claims;

(b) Claims Incurred but Not Reported (IBNR) including inadequate reserves (sometimes referred to as Claims

Incurred But Not Enough Reported (IBNER)).

which will result in future cash/asset outgo for settling liabilities against those claims. Change in estimated liability represents the difference between the estimated liability for outstanding claims in respect of claims under policies whether due or intimated at the beginning and at the end of the financial period. The accounting estimate shall also include claims cost adjusted for estimated salvage value if there is sufficient degree of certainty of its realization.

Actuarial Valuation of claim liability - in some cases: Estimate of claims made in respect of contracts exceeding four years shall be recognized on an actuarial basis, subject to regulations that may be prescribed by the Authority. In such cases, certificate from a recognized actuary as to the fairness of liability assessment must be obtained. Actuarial assumptions shall be suitably disclosed by way of notes to the account.

Necessary provision for unexpired risk shall be made subject to any minimum, statutorily required.

(i) interest remaining unpaid for over a period of six months; and

(ii) instalment(s) of loan falling due and remaining unpaid during the last six months.

4. **Acquisition Costs**-Acquisition costs, if any, shall be expensed in the period in which they are incurred. Acquisition costs are those costs that vary with, and are primarily related to, the acquisition of new and renewal insurance contracts. The most essential test is the obligatory relationship between costs and the execution of insurance contracts (i.e. commencement of risk).

5. **Procedure to determine the value of investments** -An insurer shall determine the values of investments in the following manner: -

a) **Real Estate – Investment Property**- Investment Property shall be measured at historical cost less accumulated depreciation and impairment loss, residual value being considered zero and no revaluation being permissible.

The Insurer shall assess at each balance sheet date whether any impairment of the investment property has occurred.

An impairment loss shall be recognized as an expense in the Revenue/Profit and Loss Account immediately.

Fair value as at the balance sheet date and the basis of its determination shall be disclosed in the financial statements as additional information.

b) **Debt Securities**-Debt securities including government securities and redeemable preference shares shall be considered as "held to maturity" securities and shall be measured at historical cost subject to amortization.

c) **Equity Securities and Derivative Instruments** that are traded in active markets -Listed equity securities and derivative instruments that are traded in active markets shall be measured at fair value as at the balance sheet date. For the purpose of calculation of fair value, the lowest of the last quoted closing price of the stock exchanges where the securities are listed shall be taken.

The insurer shall assess on each balance sheet date whether any impairment of listed equity security(ies)/ derivative(s) instruments has occurred.

An active market shall mean a market, where the securities traded are homogenous, availability of willing buyers and willing sellers is normal, and the prices are publicly available. Unrealized gains/losses arising due to changes in the fair value of listed equity shares and derivative instruments shall be taken to equity under the head 'Fair Value Change Account' and on realization reported in Profit and Loss Account. The 'Profit on sale of investments' or 'Loss on sale of investments', as the case may be, shall include accumulated changes in the fair value previously recognized in equity under the heading Fair Value Change Account in respect of a particular security and being recycled to Profit and Loss Account on actual sale of that listed security.

For the removal of doubt, it is clarified that balance, or any part thereof shall not be available for distribution as dividends. Also, any debit balance in the said Fair Value Change Account shall be reduced from the profits/free reserves while declaring dividends.

The insurer shall assess, at each balance sheet date, whether any impairment has occurred. An impairment loss shall be recognized as an expense in Revenue/Profit and Loss Account to the extent of the difference between the remeasured fair value of the security/ investment and its acquisition cost as reduced by any previous impairment loss recognized as expense in Revenue/Profit and Loss Account. Any reversal of impairment loss, earlier recognized in Revenue/Profit and Loss Account shall be recognized in Revenue/Profit and Loss Account.

d) Unlisted and other than actively traded Equity Securities and Derivative Instruments- Unlisted equity securities and derivative instruments and listed equity securities and derivative instruments that are not regularly traded in active market will be measured at historical costs. Provision shall be made for diminution in value of such investments. The provision so made shall be reversed in subsequent periods if estimates based on external evidence show an increase in the value of the investment over its carrying amount. The increased carrying amount of the investment due to the reversal of the provision shall not exceed the historical cost.

For the purposes of this regulation, a security shall be considered as being not actively traded, if its trading volume does not exceed ten thousand units in any trading session during the last twelve months.

6. Loans-Loans shall be measured at historical cost subject to impairment provisions.

The insurer shall assess the quality of its loan assets and shall provide for impairment. The impairment provision shall not be less than the aggregate amount of loans which are subject to defaults of the nature mentioned below: -

7. Applicability of Accounting Standards-Every Balance Sheet, Receipts and Payments Account [Cash Flow statement] and Profit and Loss Account [Shareholders' Account] of the insurer shall be in conformity with the Accounting Standards (AS) issued by the ICAI, to the extent applicable to the insurers carrying on general insurance business, except that:

Accounting Standard 3 (AS 3) – Cash Flow Statements – Cash Flow Statement shall be prepared only under the Direct Method.

Accounting Standard 13 (AS 13) – Accounting for Investments, shall not be applicable.

Accounting Standard 17 (AS 17) - Segment Reporting – shall apply irrespective of whether the securities of the insurer are traded publicly or not.

8. Catastrophe Reserve- Catastrophe reserve shall be created in accordance with norms, if any, prescribed by the Authority. Investment of funds out of catastrophe reserve shall be made in accordance with prescription of the Authority.

It is clarified that this reserve is towards meeting losses which might arise due to an entirely unexpected set of events and not for any specific known purpose. This reserve is in the nature of an amount set aside for the potential future liability against the insurance policies in force.

Part II: Disclosures forming part of Financial Statements: -

A. The following shall be disclosed by way of notes to the Balance Sheet:

1. Premiums, less reinsurance, written from business in/outside India.
2. Extent of premium income recognized, based on varying risk pattern, category wise, with basis and justification therefor, including whether reliance has been placed on external evidence.
3. Claims, less reinsurance, paid to claimants in/outside India.
4. Ageing of claims – distinguishing between claims outstanding for more than six months and other claims.
5. Operating expenses relating to insurance business: basis of allocation of expenditure to various classes of business.
6. Computation of managerial remuneration.
7. Historical costs of those investments valued on fair value basis.

8. Fair value of investment property and the basis therefor.
9. Basis of amortization of debt securities.
 - (a) Unrealized gain/losses arising due to changes in the fair value of listed equity shares and derivative instruments are to be taken to equity under the head 'Fair Value Change Account' and on realization reported in profit and loss Account.
 - (b) Pending realization, the credit balance in the 'Fair Value Change Account' is not available for distribution.
10. Value of Contracts in relation to Investment for
 - (a) Purchases where deliveries are pending;
 - (b) Sales where payments are overdue.
11. Encumbrances to assets of the company in and outside India.
12. Claims settled and remaining outstanding for a period of more than six months on the balance sheet date.
13. Actuarial assumptions for claim liabilities in the case of policies exceeding four years.
14. Contingent Liabilities:
 - (a) Partly-paid up investments
 - (b) Underwriting commitments outstanding
 - (c) Claims, other than those under policies, not acknowledged as debts
 - (d) Guarantees given by or on behalf of the company
 - (e) Statutory demands/liabilities in dispute, not provided for
 - (f) Reinsurance Obligations to the extent not provided for in accounts
 - (g) Others (to be specified).
15. Commitments made and outstanding for Loans, Investments and Fixed Assets.

B. The following accounting policies shall form an integral part of the financial statements

1. All significant accounting policies in terms of the accounting standards issued by the ICAI, and significant principles and policies given in Part I of Accounting Principles. Any other accounting policies, followed by the insurer, shall be stated in the manner required under Accounting Standard AS 1 issued by the ICAI.
2. Any departure from the accounting policies shall be separately disclosed with reasons for such departure.

C. The following information shall also be disclosed:

1. Investments made in accordance with any statutory requirement should be disclosed separately together with its amount, nature, security and any special rights in and outside India.
2. Segregation into performing/ non-performing investments for purpose of income recognition as per the directions, if any, issued by the Authority.
3. Basis of allocation of Interest, Dividends and Rent between Revenue Account and Profit and Loss Account.
4. Percentage of business sector-wise.
5. Accounting Ratios as may be prescribed by the Authority.
6. A summary of financial statements for the last five years, in the manner as may be prescribed by the Authority.

PART III: General Instructions for Preparation of Financial Statements

1. Income from rent shall not include any notional rent.
2. Interest, dividends and rentals receivable in connection with an investment should be stated as gross value, the amount of income tax deducted at source being included under 'advance taxes paid'.
3. Any debit balance of Profit and Loss Account shall be shown as deduction from uncommitted reserves and the balance if any, shall be shown separately.
4. For the purposes of financial statements, unless the context otherwise requires -
 - (a) the expression "reserve" shall not, subject to as aforesaid, include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability;
 - (b) the expression capital reserve shall not include any amount regarded as free for distribution through the

profit and loss account; and the expression "revenue reserve" shall mean any reserve other than a capital reserve;

(c) The expression "liability" shall include all liabilities in respect of expenditure contracted for and all disputed or contingent liabilities.

(d) the expression "provision" shall, subject to note II below mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing for any known liability or loss of which the amount cannot be determined with substantial accuracy;

(II) Where:

(a) any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or

(b) any amount retained by way of providing for any known liability is in excess of the amount which in the opinion of the directors is reasonably necessary for the purpose, the excess shall be treated for the purposes of these accounts as a reserve and not as a provision.

5. The company should make provisions for damages under lawsuits where the management is of the opinion that the award may go against the insurer.

6. The corresponding amounts for the immediately preceding financial year for all items shown in the Balance Sheet, Revenue Account and Profit and Loss Account should be given.

7. The figures in the financial statements may be rounded off to the nearest thousands.

8. Risks assumed in excess of the statutory provisions, if any, shall be separately disclosed indicating the amount of premiums involved and the amount of risks covered. The auditor shall, however, make an appropriate qualification in this regard in his report.

Part IV: Contents of Management Report

There shall be attached to the financial statements, a management report containing, inter alia, the following duly authenticated by the management:

1. Ageing of claims indicating the trends in average claim settlement time during the preceding five years;

2. Certification that all the dues payable to the statutory authorities have been duly paid;

3. Certification to the effect that the values of all the assets have been reviewed on the date of the Balance Sheet and that in his (insurer's) belief the assets set forth in the Balance-sheets are shown in the aggregate at amounts not exceeding their realizable or market value under the several headings – "Loans", "Investments", "Agents balances", "Outstanding Premiums", "Interest, Dividends and Rents outstanding", "Interest, Dividend and Rents accruing but not due", "Amounts due from other persons or Bodies carrying on insurance business", "Sundry Debtors", "Bills Receivable", "Cash" and the several items specified under "Other Accounts";

4. Declaration that the management has not directly or indirectly invested outside India the funds of the holders of policies issued in India;

5. Certification to the effect as to how the values, as shown in the balance sheet, of the investments and stocks and shares have been arrived at, and how the market value thereof has been ascertained for the purpose of comparison with the values so shown;

6. Review of asset quality and performance of investment in terms of portfolios, i.e., separately in terms of real estate, loans, investments, etc.

7. Confirmation that the required solvency margins have been maintained;

8. Confirmation to the effect that the shareholding pattern and any transfer of shares during the year are in accordance with the statutory or regulatory requirements;

9. Confirmation regarding the continued validity of the registration granted by the Authority;

10. Disclosure with regard to the overall risk exposure and strategy adopted to mitigate the same;

11. Operations in other countries, if any, with a separate statement giving the management's estimate of country risk and exposure risk and the hedging strategy adopted;

12. A responsibility statement indicating therein that:

(i) the management has taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the applicable provisions of the Insurance Act 1938 (4 of 1938) / Companies Act, 1956 (1 of 1956), for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(ii) in the preparation of financial statements, the applicable accounting standards, principles and policies have been followed along with proper explanations relating to material departures, if any;

(iii) the management has adopted accounting policies and applied them consistently and made judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the operating profit or loss and of the profit or loss of the company for the year;

(iv) the management has prepared the financial statements on a going concern basis

(v) the management has ensured that an internal audit system commensurate with the size and nature of the business exists and is operating effectively.

13. A schedule of payments, which have been made to individuals, firms, companies and organization in which Directors of the insurer are interested.

PART V: Preparation of Financial Statements

Format & Segment Information

(1) An insurer shall prepare the Revenue Account, Profit and Loss Account [Shareholders' Account] and the Balance Sheet in Form B-RA, Form B-PL, and Form B-BS, or as near thereto as the circumstances permit. It may be noted that an insurer shall prepare Revenue Account separately for fire, marine, and miscellaneous insurance business.

Cash Flow Statement

(2) An insurer shall prepare separate Receipts and Payments Account in accordance with the Direct Method prescribed in AS 3 – "Cash Flow Statement" issued by the ICAI.

AUDIT REPORTS & CERTIFICATES FOR SPECIAL PURPOSES ENGAGEMENT AMENDMENTS

1. INTRODUCTION

The purpose of this Guidance Note is to provide guidance on engagements which require a professional accountant to issue reports other than those which are issued in audits or reviews of historical financial information. The reports which are issued pursuant to audits or reviews of historical financial information are dealt with in Standards on Auditing (SAs) and Standards on Review Engagements (SREs), respectively, issued by the Institute of Chartered Accountants of India (ICAI).

This requirement was felt as there were numerous situations where regulatory authorities like SEBI, ROC, Income Tax, Central Board of Excise and Customs (CBEC), Reserve Bank of India etc. requires a professional accounting firm or the statutory auditor of the organization to provide opinion on certain specific matters which are provided by the organization as part of statutory requirements.

Examples

SEBI requires statutory auditor to issue certification on accounting treatment in case of a merger of two entities or reorganization, Income Tax authorities requires auditor to certify amount eligible Minimum Alternative tax under Section 115JB of Income Tax Act, 1961.

Sr. No.	Authorities	Examples of Various types of Certificates
1	Reserve Bank of India	<ol style="list-style-type: none"> 1. Certificate for adherence to guidelines as per RBI circular 2. Certificate of unhedged foreign currency exposure as at year end 3. Annual activity certificate for branch office, Liaison office, Project office etc. 4. Certificate of probable exposure
2	Companies Act, 2013	Certificate pursuant to proviso to Section 230(7) of the Companies Act, 2013 in relating to accounting treatment prescribed under the Scheme of Arrangement.
3	Income Tax Act, 1961	Reporting on Expenditure incurred on R&D Centre approved under Section 35(2AB)
4	Others	<ol style="list-style-type: none"> 1. Certificate for net worth required for a tender document 2. Certificate for value of fixed assets in a particular location required by a regulatory agency to process tax incentives 3. Certificate of service tax refund or VAT refund

Assurance Expected

Sometimes, the applicable law and regulation or a contractual arrangement that an entity might have entered into, prescribe the wording of report or certificates. The wording often requires the use of word or phrase like "certify" or "true and correct" to indicate absolute level of assurance expected to be provided by the practitioner on the subject matter. Absolute assurance indicates that a practitioner has performed procedures as considered appropriate to reduce the engagement risk to zero.

A practitioner is expected to provide either a reasonable assurance (about whether the subject matter of examination is materially misstated) or a limited assurance (stating that nothing has come to the practitioner's attention that causes the practitioner to believe that the subject matter is materially misstated) since it is difficult to reduce engagement risk to zero due to inherent limitations of the audit like nature of evidence, internal control, professional judgement, time etc.

2. INHERENT LIMITATIONS

The inherent limitations could arise from:

- (a) the nature of financial reporting;
- (b) the inherent limitations of internal controls;
- (c) the use of selective testing;
- (d) the nature of procedures to be performed in a specific situation; (*Inquiry*)
- (e) the fact that much of the evidence available to the practitioner is persuasive rather than conclusive;
- (f) the use of professional judgment in gathering and evaluating evidence and forming conclusions based on that evidence;
- (g) in some cases, the characteristics of the underlying subject matter when evaluated or measured against the criteria; and (*R&D Expenses*)
- (h) the need for the engagement to be conducted within a reasonable period of time and at a reasonable cost.

Therefore, whenever a practitioner is required to give a "certificate" or a "report" for special purpose, the practitioner needs to undertake a careful evaluation of the scope of the engagement, i.e., whether the practitioner would be able to provide reasonable assurance or limited assurance on the subject matter.

3. REASONABLE ASSURANCE AND LIMITED ASSURANCE

A. Reasonable assurance is the reduction in assurance engagement risk to an acceptably low level in Circumstances of engagement as a basis of a positive form of expression of practitioner's conclusion.

B. Limited assurance is the reduction of assurance engagement risks to a level that is acceptable in the Circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement as a basis of negative form.

The key differences between limited assurance and reasonable engagement as stated below: -

Limited Assurance	Reasonable Assurance
The practitioner should be designing and perform procedures to address the subject matter and <u>to obtain Limited Assurance</u> to support practitioner's conclusion.	The practitioner should be designing and perform procedures to address the subject matter and <u>to obtain Reasonable Assurance</u> to support practitioner's conclusion.
In <u>obtaining an understanding of the underlying subject matter</u> and other engagement circumstances, the practitioner should <u>consider the process used to prepare the subject matter information</u> .	In obtaining an <u>understanding of the underlying subject matter</u> and other engagement circumstances, the practitioner should obtain an <u>understanding of internal control over the preparation of the subject matter information relevant to the engagement</u> .
Based on the practitioner's understanding, the practitioner should: (a) <u>Identify areas where a material misstatement of the subject matter information is likely to arise</u> ; (b) <u>Design and perform procedures to address the areas and to obtain limited assurance</u> to support the practitioner's conclusion.	Based on the practitioner's understanding the practitioner should: (a) <u>Identify and assess the risks of material misstatement</u> in the subject matter information; and (b) <u>Design and perform procedures to respond to the assessed risks and to obtain reasonable assurance</u> to support the practitioner's opinion. In addition to any other procedures on the subject matter information that are appropriate in the engagement circumstances, the practitioner's procedures would include <u>obtaining sufficient appropriate evidence as to the operating effectiveness of relevant controls over the subject matter information when</u> : (i) <u>Practitioner's assessment of the risks of material misstatement includes an expectation that controls are operating effectively, or</u>

	(ii) Procedures other than testing of controls cannot provide sufficient appropriate evidence.
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4. ASSURANCE REPORT CONTENT

The assurance report should include at a minimum, the following basic elements:

(Title)

(a) A *title* that clearly indicates the report is an independent assurance report. An appropriate title helps to identify the nature of the assurance report, and to distinguish it from reports issued by others, such as those who do not have to comply with the same ethical requirements as the practitioner.

(Addressee)

(b) An *addressee*. An addressee identifies the party or parties to whom the assurance report is directed. The assurance report is ordinarily addressed to the engaging party, but in some cases, there may be other intended users like government agencies, bankers etc.

(Intro Related Points)

(c) Identification and description of the subject matter information and, when appropriate, the underlying subject matter may include, for example:

- The point in time or period of time to which the measurement or evaluation of the underlying subject matter relates.

(Management Responsibility Related)

(d) Where applicable, the name of the responsible party or component of the responsible party to which the underlying subject matter relates.

(e) *Identification of the applicable criteria*. The assurance report identifies the applicable criteria against which the underlying subject matter was measured or evaluated so that the intended users can understand the basis for the practitioner's opinion/conclusion. The assurance report may include the applicable criteria, or refer to them if they are included in the subject matter information or if they are otherwise available from a readily accessible source. It may be relevant in the circumstances, to disclose:

- The source of the applicable criteria, and whether or not the applicable criteria are embodied in law or regulation or issued by authorized or recognized bodies of experts that follow a transparent due process, that is, whether they are established criteria in the context of the underlying subject matter (and if they are not, a description of why they are considered suitable).
- Measurement or evaluation methods used when the applicable criteria allow for choice between a number of methods.
- Any significant interpretations made in applying the applicable criteria in the engagement circumstances.
- Whether there have been any changes in the measurement or evaluation methods used.

(Auditor Responsibility Related)

(f) An *identification or description of the level of assurance obtained by the practitioner, the subject matter information and, when appropriate, the underlying subject matter*.

(g) A statement that the practitioner complies with the independence and other ethical requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India. The following is an illustration of a statement in the assurance report regarding compliance with ethical requirements:

"We conducted our engagement in accordance with the Guidance Note on Reports or Certificates for Special Purposes issued by the Institute of Chartered Accountants of India. That Guidance Note requires that we comply with the ethical requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India."

(h) An informative summary of the work performed as the basis for the practitioner's opinion/conclusion. In the case of a limited assurance engagement, the nature, timing, and extent of procedures performed is essential to understanding the practitioner's opinion/conclusion. In a limited assurance engagement, the summary of the work performed should state that:

- (i) The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement; and
- (ii) Consequently, the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed.

(i) Where appropriate, a description of any significant inherent limitations associated with the measurement or evaluation of the underlying subject matter against the applicable criteria.

While in some cases, inherent limitations can be expected to be well-understood by the intended users of an assurance report, in other cases, it may be appropriate to make explicit reference to them in the assurance report. For example, in an assurance report related to the effectiveness of internal control, it may be appropriate to note that the historic evaluation of effectiveness is not relevant to future periods due to the risk that internal control may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

- An explanation of those characteristics of the underlying subject matter or the subject matter information of which the intended users should be aware, and how such characteristics may influence the precision of the measurement or evaluation of the underlying subject matter against the applicable criteria, or the persuasiveness of available evidence. For example:
 - ✓ The degree to which the subject matter information is qualitative versus quantitative, objective versus subjective, or historical versus prospective.
 - ✓ Changes in the underlying subject matter or other engagement circumstances that affect the comparability of the subject matter information from one period to the next.

(Opinion Related)

(i) The practitioner's opinion/conclusion:

- (i) When appropriate, the opinion/conclusion should inform the intended users of the context in which the practitioner's opinion/conclusion is to be read.

It may be appropriate to inform the intended users of the context in which the practitioner's opinion/conclusion is to be read when the assurance report includes an explanation of particular characteristics of the underlying subject matter of which the intended users should be aware. The practitioner's opinion/conclusion may, for example, include wording such as: "This opinion/conclusion has been formed on the basis of the matters outlined elsewhere in this independent assurance report."

- (ii) In a reasonable assurance engagement, the opinion is expressed in a positive form.

Example

Opinion expressed in a form appropriate for a reasonable assurance engagement include:

When expressed in terms of the underlying subject matter and the applicable criteria,

- (i) "In our opinion, the entity has complied, in all material respects, with XYZ law";
- (ii) When expressed in terms of the subject matter information and the applicable criteria, "In our opinion, the Statement of Net Worth is properly prepared, in all material respects, based on XYZ criteria"; or
- (iii) When expressed in terms of a statement made by the appropriate party, "In our opinion, the [appropriate party's] statement that the entity has complied with XYZ law is, in all material respects, fairly stated," or "In our opinion, the [appropriate party's] statement that the key performance indicators are presented in accordance with XYZ criteria is, in all material respects, fairly stated".

The opinion/conclusion in (ii) or (iii) should be phrased using appropriate words for the underlying subject matter and applicable criteria given the engagement circumstances and need to be phrased in terms of:

- a. The underlying subject matter and the applicable criteria;
- b. The subject matter information and the applicable criteria; or
- c. A statement made by the appropriate party.

Examples: -

Conclusions expressed in a form appropriate for a limited assurance engagement include:

- When expressed in terms of the underlying subject matter and the applicable criteria, "Based on the

procedures performed an evidence obtained, nothing has come to our attention that causes us to believe that [the entity] has not complied, in all material respects, with XYZ law."

- When expressed in terms of the subject matter information and the applicable criteria, "Based on the procedures performed and evidence obtained, we are not aware of any material amendments that need to be made to the assessment of key performance indicators for them to be in accordance with XYZ criteria."; or
- When expressed in terms of a statement made by the appropriate party, "Based on the procedures performed and evidence obtained, nothing has come to our attention that causes us to believe that the [appropriate party's] statement that [the entity] has complied with XYZ law, is not, in all material respects, fairly stated."
- When expressed in terms of the underlying subject matter and the applicable criteria, "Based on the procedures performed an evidence obtained, nothing has come to our attention that causes us to believe that [the entity] has not complied, in all material respects, with XYZ law."
- When expressed in terms of the subject matter information and the applicable criteria, "Based on the procedures performed and evidence obtained, we are not aware of any material amendments that need to be made to the assessment of key performance indicators for them to be in accordance with XYZ criteria."; or
- When expressed in terms of a statement made by the appropriate party, "Based on the procedures performed and evidence obtained, nothing has come to our attention that causes us to believe that the [appropriate party's] statement that [the entity] has complied with XYZ law, is not, in all material respects, fairly stated."

Forms of expression which may be useful for underlying subject matters include, for example, one, or a combination of, the following:

- For compliance engagements- "in compliance with" or "in accordance with."
- For engagements when the applicable criteria describe a process or methodology for the preparation or presentation of the subject matter information- "properly prepared."
- For engagement when the principles of fair presentation are embodied in the applicable criteria- "fairly stated."

(iii) When the practitioner expresses a modified opinion/conclusion, the assurance report should contain:

- a. A section that provides a description of the matter(s) giving rise to the modification; and
- b. A section that contains the practitioner's modified opinion/conclusion.

(OMP Related)

(k) When the applicable criteria are designed for a specific purpose, a statement alerting readers to this fact and that, as a result, the subject matter information may not be suitable for another purpose. In some cases, the applicable criteria used to measure or evaluate the underlying subject matter may be designed for a specific purpose. For example, a regulator may require certain entities to use particular applicable criteria designed for regulatory purposes. To avoid misunderstandings, the practitioner alerts readers of the assurance report to this fact and that therefore, the subject matter information may not be suitable for another purpose.

In addition to the alert as required in the preceding paragraph, the practitioner may consider it appropriate to indicate that the assurance report is intended solely for specific users.

(l) A statement to identify the responsible party and the measurer or evaluator if different, and to describe their responsibilities and the practitioner's responsibilities. Identifying relative responsibilities informs the intended users that the responsible party is responsible for the underlying subject matter, that the measurer or evaluator is responsible for the measurement or evaluation of the underlying subject matter against the applicable criteria, and that the Practitioner's role is to independently express an opinion/conclusion about the subject matter information.

(m) A statement that the engagement was performed in accordance with the Guidance Note.

(n) A statement that the firm, of which the practitioner is a partner has applied SQC 1, *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements*.

(Signature)

(o) *The practitioner's signature.* The assurance report is signed by the practitioner in his personal name. Where a Firm is appointed to carry out the engagement, the report is signed in the personal name of the practitioner and in the name of the audit firm. The partner/proprietor signing the assurance report also needs to mention the membership number assigned by the ICAI. They also include the registration number of the Firm, wherever applicable, as allotted by ICAI, in the assurance reports signed by them.

(Date)

(p) *The date of the assurance report.* The assurance report should be dated no earlier than the date on which the practitioner has obtained the evidence on which the practitioner's opinion/conclusion is based, including evidence that those with the recognized authority have asserted that they have taken responsibility for the subject matter information.

(Place)

(q) The place of signature