B S R & Co. LLP
Chartered Accountants

# AUDIT COMMITTEE UPDATE

Quarter ended 30 September 2023

# Agenda

| 01 | 02 | 03 | 04 |
|---|---|---|---|
| Key takeaways from orders and media releases of regulators | Audit trail – Key considerations | Overview of ISA 600 (Revised) | Other regulatory updates |

# Agenda

01

**Key takeaways from orders and media releases of regulators**

02

Audit trail – Key considerations

03

Overview of ISA 600 (Revised)

04

Other regulatory updates

# Overview of observations

Regulators (such as NFRA ) are emphasising on the need for transparency and good governance

Management, board, independent directors and auditors should comply with the Companies Act 2013, Indian Accounting Standards and Standards on Auditing in true spirit

Measures should be taken to prevent frauds and failure of internal financial controls and ensure true and fair accounts

- Regulators have identified discrepancies in recognition and disclosure of items in the financial statements such as material uncertainty related to going concern, disclosure of related party transactions, etc.
- Discrepancies also identified in documenting auditing procedures.

# Key observations – Going concern

**Management assessment**

- Management is required to assess an entity's ability to continue as a going concern
  - Material uncertainty that cast significant doubt
  - No material uncertainty that cast significant doubt but involve significant judgement
- Provide adequate disclosure in the financial statements such as:
  - details of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's evaluation of their significance in relation to the going concern assessment
  - management's plans to mitigate the effect of these events or conditions
  - significant judgements made by management in their going concern assessment, including their determination of whether there are material uncertainties; and
  - an explicit statement that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, and therefore that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

**Impact on auditor reporting**

- SA 570 (Revised), *Going Concern* requires
  - Apply knowledge of particular entity, its circumstances and the industry within which it operates
  - Objectively challenge management's plans and significant assumptions and they are realistic and achievable
  - Critically evaluate the evidence management uses to support assertions
  - Whether assessment covers at least 12 months from the reporting date
  - Whether assessment has been updated to consider all relevant information available up to the date of the financial statements are authorized to issue
  - Maintain professional skepticism
- Inadequate disclosures would impact auditor's opinion i.e. qualified opinion or adverse opinion

# Related Party Transactions (RPTs)

- Related party transactions
  - The Companies Act, 2013
  - SEBI (Listing Obligation and Disclosure Requirements) Regulations
  - Ind AS or AS
  - Auditing Standard

# Related Party Transactions (RPTs)

## Management responsibility

- Understand the scope of related parties and identify those and continuously update
  - Directors, managers, key managerial personnel
  - Entire group companies
  - Controlling individuals/entities
  - Promoter group.
- Identify related party transactions.
- Ensure approvals of audit committees, board and shareholders for RPTs are obtained as per statutory requirements.
- Loans and investments to/in RPTs should comply with the provisions of Section 186 of the 2013 Act such as:

  a) Rate of interest on loan should not be lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan

  b) In case loan amount exceed the prescribed limit - Ensure Board of Directors and shareholders' resolutions passed before sanctioning of loans.

  c) Provide adequate disclosure relating to loans given, investment made or guarantee given or security provided
- Also obtain approval of the Board of Directors for taking and disbursing loans as per the provisions of Section 179(3).

## Key considerations

- Understand business relationship/transaction, examine terms and conditions including tenure of loans and rate of interest, contract/agreement, whether security obtained, evaluate the purpose and utilisation of loans given.
- Evaluate the business rationale of the significant transactions outside the normal course of business or appear unusual.
- Conduct in-depth analysis by exercising professional skepticism and asking questions to Those Charged With Governance (TCWG)/management.
- Verify bank statements and Bank Reconciliation Statements (BRS) to identify round tripping of funds and structured circulation transaction.
- Obtain balance confirmations from related parties and verify the arithmetical accuracy of the RPTs.
- Verify completeness of related parties list, obtain management representation, check authorisation of RPT and including those entered outside the normal course of business.
- Ensure compliance with disclosure requirements stipulated in Ind AS 24, *Related Party Disclosures such as* nature of relationship and transaction, amount of outstanding balances (including commitments), terms and conditions etc.

# Other key observations

## Determination of provision/contingent liability

- Assess financial implications of the Orders passed by regulatory authorities (e.g. income tax).
- Recognise the impact as a provision for liability or as a contingent liability under Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*
- Disclose a brief description of the nature of the obligation and an indication of the uncertainties about the amount or timing of those outflows.

## Deferred Tax Asset (DTA)

- DTA should be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised.
- Comply with disclosure requirements stipulated in Ind AS 12, *Income Taxes* regarding DTA:
  a) Amount and expiry of deductible temporary differences, unused tax losses, and unused tax credits for which no DTA is recognised is not provided
  b) Nature of evidence supporting recognition of DTA in case of continuing losses.

## Recognition of finance cost

- Financial liability or a part of it should be derecognised only when a borrower is legally released from the primary responsibility for the liability (or part of it) either by process of law or by the creditor.

## Recognition of receivables and revenue

- Disclose reconciliation of contract liabilities which includes advance from customers and deferred revenue
- Disclosure of significant payment terms as per Ind AS 115, *Revenue from Contracts with Customer*
- Provide reconciliation of the amount of revenue recognised in the statement of profit and loss with the contracted price showing separately each of the adjustments made to the contract price and specify the nature and amount of each such adjustment separately.
- Policy for recognition of interest income to be disclosed separately from revenue from contract with customers policy (for non-financial services company)
- Policy in relation to export and other incentives should comply with requirements of Ind AS 20, *Accounting for Government Grant and Disclosure of Government Assistance*
- Trade receivables and payables ageing schedule to include separate column for unbilled dues/not due categories including details of disputed and undisputed.

# Other key observations

## Property, Plant and Equipment (PPE) and Intangible assets

- Physical verification at appropriate intervals is the primary responsibility of the management
- Impairment test should be conducted in accordance with Ind AS 36, *Impairment of Assets.* Ind AS 36 stipulates minimum indicators for impairment.
- Provide reconciliation of carrying value of Capital work-in-progress (CWIP) and Intangible assets under development [Ind AS 16 and 38].
- Provide appropriate disclosures of useful life/residual value even in case they are different from those specified in Schedule II to the Companies Act, 2013.
- Disclose impairment testing of intangible assets with indefinite useful life and goodwill [Ind AS 36.134].

## Fair value measurements, financial instruments including investments and impairment

- Ind AS 113, *Fair Value Measurement* should be considered for valuation of investments
- Provide reconciliation from the opening balances to the closing balances for assets/liabilities categorised as Level 3 (fair value hierarchy) [Ind AS 113.93(e)].
- Fair value hierarchy disclosures of Ind AS 107 should not include investment in subsidiaries/associates at cost.
- Disclosure on financial risk management on credit risk to include not only information for trade receivables but also for other financial assets like security deposits or loans [Ind AS 107.34 -35].
- Disclose valuation technique for all financial assets/liabilities at amortised cost except for which financial assets/liabilities for which fair value approximates carrying value [Ind AS 113.91(a),93(d), 93(h)(i), 99].

# Auditor’s reporting responsibilities1

Management representations is evidential element but cannot substitute auditing procedures necessary to obtain sufficient and appropriate audit evidence to form an opinion regarding the financial statements

Approval of the financial statements by the Board and its signing by the persons authorised by the Board are prerequisites before issuing signed audit report on such approved and signed financial statements. Further, the certified copy of the Board resolution and signed financial statements should be included in the audit file before assembly.

The Emphasis of Matter (EOM) paragraph should not be misused to report matters requiring separate evaluated resulting in qualification of the audit opinion is required as per SA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*.

In case disclaimer of opinion is provided for one matter, it does not discharge the auditor from its responsibilities to report other unreported material deficiencies/misstatements in the financial statements.

In case of modification in audit report, consider implications on the other information paragraph and other regulatory reporting.

In case a disclaimer of opinion is issued, auditor’s responsibility paragraph is required to be updated in both the main audit report as well as Internal Financial Control (IFC) report in line with SA 705 (Revised) and Guidance Note on IFC respectively.

Information (of revenue, assets and cash flows) for components audited by other auditor and unaudited components to be given before consolidation adjustments in the Other matter paragraph as required by Guidance note on Consolidated Financial Statements 2016.

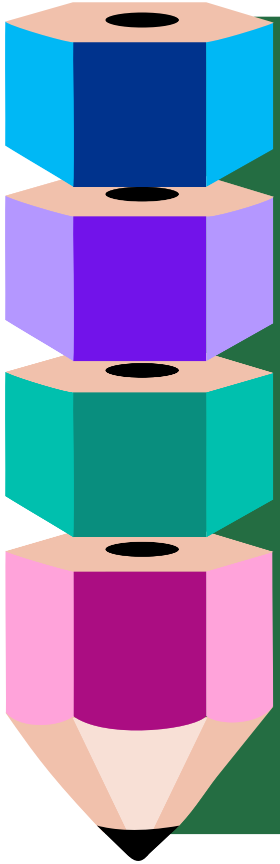
Ensure that there is no material inconsistency between other information in annual report and financial statements. The audit file should contain documentation reflecting that the auditors had verified draft annual report. This is in accordance with the requirements of SA 720, *Auditor’s responsibilities relating to Other Information.*

# Key considerations relating to fraud scenarios

**Mandatory reporting obligations on auditors to report fraud and/or suspected fraud under the Companies Act, 2013, CARO 2020 and SA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.***

| | |
|---|---|
| **Mandatory obligation** | Mandatory obligation on statutory auditors to report fraud or suspected fraud if they observe suspicious activities, transactions or operating circumstances in a company that indicate **reasons to believe** that an offence of fraud is being or has been committed against the company by its officers or employees |
| **Steps to be initiated** | Statutory Auditor to initiate the steps prescribed under Rule 13 of the Companies (Audit and Auditors) Rules 2014. The matter should be reported to the Board/Audit Committee **within two days** of statutory auditor's knowledge of the fraud. |
| **Reporting by the auditor to the Central Government** | If the fraud involves or expected to involve **individually an amount of INR1 crore or above,** then the Statutory Auditor shall forward a report in the specified form - ADT-4 to Secretary, Ministry of Corporate Affairs, Government of India (Section 143(12)) |
| **Not the first person to identify fraud** | The statutory auditor is duty bound to submit Form ADT-4 to the Central Government under Section 143 (12) even in cases where the statutory auditor is not the first person to identify the fraud/ suspected fraud. |
| **Resignation by auditor** | Resignation does not absolve the auditor of his/her responsibility to report suspected fraud or fraud as mandated by the law. |
| **Apply professional skepticism** | Statutory auditor should exercise professional skepticism while evaluating fraud, and need not be influenced by legal opinion provided by the company or its management |

# Key messages



- Enhanced regulatory scrutiny places greater onus on the company and its management
- Robust financial reporting enhances the confidence of investors and other stakeholders
- Competent and independent finance function is the pillar of the corporate governance
- Top management should formulate a process for internal financial control and should ensure that the accounts are true and fair.
- Schedule III to Companies Act,2 013 require disclosures of many financial ratios which could strengthen the auditors’ ability to comment upon the going concern status of the company.
- Greater emphasis on ‘two-way’ communication between the stakeholders and auditors

# Agenda

| 01 | 02 | 03 | 04 |
|---|---|---|---|
| Key takeaways from orders and media releases of regulators | **Audit trail – Key considerations** | Overview of ISA 600 (Revised) | Other regulatory updates |

# Regulatory requirement

| The Companies (Accounts) Rules, 2014 | The Companies (Audit and Auditors) Rules, 2014 |
|---|---|
| **For Companies {Rule3(1)}:** Every company which uses an accounting software for maintaining its books of account, should use only such an accounting software which has the following features:<br>• Which records an audit trail of each and every transaction<br>• Creates an edit log of each change made in the books of account along with the date when such changes were made<br>• Companies would need to ensure that the audit trail is not disabled. | **For Auditors {Rule 11(g)}:** An auditor is required to provide his/her comments in the auditor's report that the company has used such an accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility. Further, an auditor should also comment on whether:<br>• The audit trail feature has been in operation throughout the year for all the transactions recorded in the software<br>• The audit trail feature has not been tampered with<br>• The audit trail has been preserved by the company as per the statutory requirements for record retention. |

**Applicability**

- All class of companies including Section 8 companies and foreign companies
- Auditor's reporting on audit trail required in case of standalone financial statements and consolidated financial statements.

# Audit approach

**01** Identify the records and transactions that constitute books of account under section 2(13) of the 2013 Act.

**02** Identify the software i.e., IT environment including applications, web-portals, databases, interfaces, data warehouses, data lakes, cloud infrastructure, or any other IT component used for processing and or storing data for creation and maintenance of books of account.

**03** Ensure such software have the audit trail feature.

**04** Ensure that the audit trail captures changes to each and every transaction of books of account; information that needs to be captured may include the following:

- when changes were made,
- who made those changes,
- what data was changed.

**05** Ensure that the audit trail feature is always enabled (not disabled).

**06** Ensure that the audit trail is enabled at the database level (if applicable) for logging any direct data changes.

**07** Ensure that the audit trail is appropriately protected from any modification.

**08** Ensure that the audit trail is retained as per statutory requirements for record retention.

**09** Ensure that controls over maintenance and monitoring of audit trail and its feature are designed and operating effectively throughout the period of reporting.

# Agenda

01

Key takeaways from orders and media releases of regulators

02

Audit trail – Key considerations

03

**Overview of ISA 600 (Revised) – Group Audit**

04

Other regulatory updates

# ISA 600 (Revised) – Introduction

ISA 600 (Revised), *Audits of Group Financial Statements (Including the Work of Component Auditors)*, deals with the special considerations that apply to a group audit, including in those circumstances when component auditors are involved.

Effective for audit of group financial statements for periods beginning on or after **15 December 2023.**

**Key changes include:**

- Risk-based approach to group audit scoping
- Increased direction and supervision of component auditors
- Increased two-way communication throughout the audit
- Includes new and revised requirements which aligns with recently revised standards such as ISQM 1*, ISA 220 (Revised)** and ISA 315 (Revised 2019)***

* International Standard on Quality Management 1 (ISQM 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

**ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

***ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

# Enhanced definition

| | Existing | Revised |
|---|---|---|
| **Group financial statements** | Financial statements that **include the financial information of more than one component**. The term “group financial statements” also refers to combined financial statements aggregating the financial information prepared by components that have no parent but are under common control. | Financial statements that **include the financial information of more than one entity or business unit through a consolidation process**. For purposes of this ISA/SAS, a consolidation process includes:<br>i) Consolidation, proportionate consolidation, or an equity method of accounting;<br>ii) The presentation in combined financial statements of the financial information of entities or business units that have no parent but are under common control or common management; or<br>iii) The aggregation of the financial information of entities or business units such as branches or divisions. |

# Revised definition of engagement team and communication with component auditor

**One engagement team**

**Group auditor**

- Engagement team includes group auditor and component auditor (*In line with change in definition of 'engagement team' as per ISA 220R*).
- Two way on-going communication.
- Communicate relevant ethical requirements, determine competence and capabilities of the component auditor, and determine the appropriate nature, timing and extent of involvement by the group auditor in the work of the component auditor.

**Component auditor**

# Agenda

01

Key takeaways from orders and media releases of regulators

02

Audit trail – Key considerations

03

Overview of ISA 600 (Revised)

04

**Other regulatory updates**

# Other regulatory updates (1/2)

## SEBI extends timeline for verification of market rumours by listed entities

**Regulation 30(11) of SEBI Listing Regulation:** Mandatory confirmation, denial or clarification of any reported event or information in the mainstream media which is not general in nature and which indicates that rumours of an impending specific material event or information are circulating amongst the investing public. This requirement is applicable to:

| | |
|---|---|
| Top 100 listed entities** | From 1 February 2024 (*earlier 1 October 2023*) |
| Top 250 listed entities** | From 1 August 2024 (*earlier 1 April 2024*) |

** As per market capitalisation as at the end of the immediately preceding financial year.

## Listing of subsequent issues of Non-Convertible Debt securities (NCDs) (Regulation 62A)

A listed entity issuing NCDs should list the following securities on the stock exchange(s):

- If subsequent issues of unlisted NCDs are made on or before 31 December 2023 and are outstanding on the said date, such securities are to be listed.
- If NCDs are already listed, then all NCDS proposed to be issued on or after 1 January 2024 should be listed
- If NCDs are proposed to be listed on after 1 January 2024, then all outstanding unlisted NCDs, previously issued on or after 1 January 2024 are to be listed within three months from the date of the listing of the NCDs proposed to be listed.

**Effective date**: The amendments are effective from 19 September 2023.

# Other regulatory updates (cont.) (2/2)

## Key amendments for Large Corporate (LCs)

- LCs consist of all listed entities (except for Scheduled Commercial Banks), which as on last day of the FY, satisfy certain requirements such as specified securities or debt securities or non-convertible redeemable preference shares, listed on a recognised stock exchange(s) in terms of SEBI Listing Regulations and outstanding long term borrowing exceeds the specified threshold.
- SEBI issued Consultation Paper (CP) on 10 August 2023 to provide flexibility in the framework. Subsequently, on 21 September 2023, SEBI approved the proposals however, the board meeting press release only provides a brief overview and not the specifications with respect to the amendments to be made.

**Key proposals approved:**

- A higher threshold limit to be specified for defining LCs.

  (Note*: As per existing requirement, threshold for the criteria of outstanding long-term borrowings is INR100 crore or above. CP proposed to increase this limit to INR500 crore or above which is also in accordance with the threshold for High Value Debt Listed Entity (HVDLE).*)
- Removal of penalty on LCs which are not able to raise a specified level of borrowing from the debt market

  (Note: *As per existing requirement, monetary penalty/fine of 0.2 per cent of the shortfall in the borrowed amount.*)
- Introduction of incentives and moderated disincentives.
- Requirement for compliance with the framework to be met over a contiguous block of three years is retained.

## MCA has extended the time period for conducting AGMs and EGMs through video conference

- Companies may hold their Annual General Meeting (AGM) which are due in years 2023 and 2024, and EGM through Video Conference (VC) or Other Audio Visual Means (OVAM) till 30 September 2024 (*earlier till 30 September 2023*).
- However, statutory timelines provided in Companies Act, 2013 are required to be complied.

# Q&A

B S R & Co. LLP
Chartered Accountants

# Thank you!