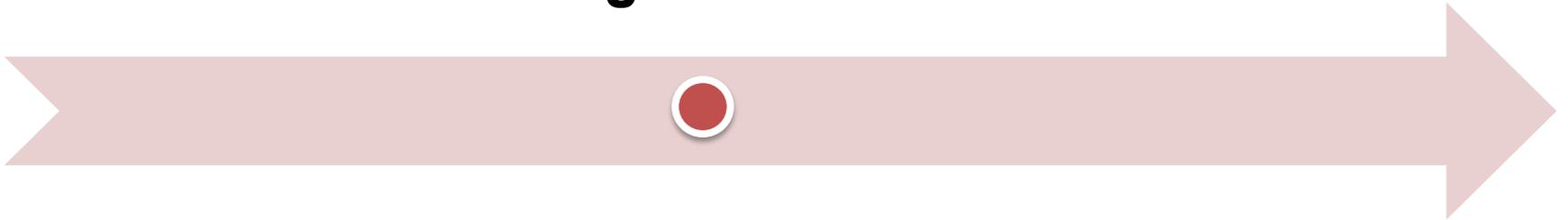
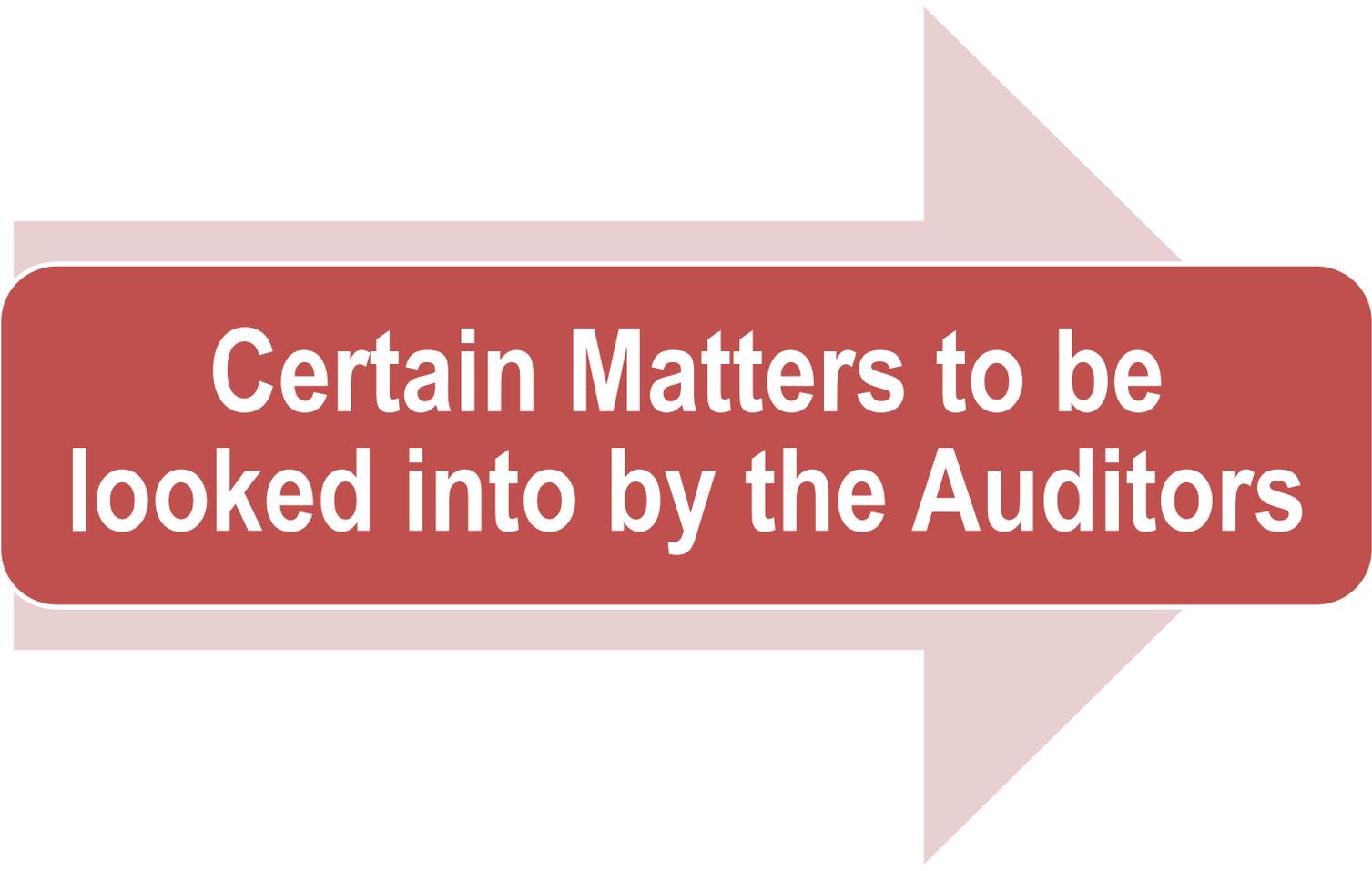


# **Statutory and Professional aspects for CARO, Documentation, KAM Reporting, Appointment and Management Services**



**By:  
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[B. Com (H), FCA, DISA (ICAI)]  
Insolvency Professional**



**Certain Matters to be  
looked into by the Auditors**

# Certain Matters

- Auditor has mentioned his **membership number “F” is prefixed** to Auditor’s Report;
- Opening paragraphs of the Auditors Report states to have “**examined** the attached Balance Sheet....”;
- Report was **not addressed to anyone**;
- **Membership Number of auditor was only mentioned in Audit Report** – what about CARO, Balance Sheet, Statement of Profit and Loss

# Certain Matters under CARO

- None of **the fixed assets have been revalued** during the year;
- In our opinion and according to the information and explanations given to us, **the Company has not defaulted in repayment of dues to financial institutions or banks**;
- “The **management has conducted physical verification of the fixed assets** during the year and **we are informed** that discrepancies noticed were not material”;
- “**Programme of physical verification is reasonable**, though all the assets not verified. Management is in process of identifying discrepancies, if any, on such verification.”
- “The company has maintained **proper records of inventory. No material discrepancies were noticed** on physical verification of inventory except as recorded by excise department as per note....”;

# Certain Matters under CARO

- “(a) The parties to whom loans have been given by the company are **repaying the principal amounts as stipulated** and interest thereon wherever applicable;  
(d) In case of overdue amounts exceeding Rs.1 Lakh **reasonable steps have been taken by the company for recovery of principal amount and interest** thereon and necessary provisions have been made wherever such amounts appear to be doubtful of recovery”;
- “The company is **regular in depositing undisputed statutory dues** including provident fund, investor education and protection fund, employee state insurance, income tax, sales tax, wealth tax, custom duty, excise duty, Cess and other statutory dues with the appropriate authorities. **Late deposit if any has been attached in the Form 3CD attached.**”

# Certain Matters under CARO

- “According to the information and explanations given to us, **no fraud on or by the company has been noticed or reported during the course of our audit**”;
- **Physical verification of the fixed assets is covered under a scheme of verification over a period of three years.** No serious discrepancy was noticed on such verification during the period.”

- Last year = CARO was applicable
- Current (Next) year = CARO is not applicable but still it was reported by the auditor
- Any implications – ??
- ABC (P) Limited
  - Last year (17-18) = PSC = 40 lakhs and T.O. = 2.50 cr. = CARO was reported here
  - Current year (18-19) = PSC = 40 lakhs and T.O. 1.90 cr. = CARO was reported here
  - Next year (19-20) it is small company = CARO was reported here

# Books of account, etc., to be kept by company [Section 128]

- *The books of account and other relevant books and papers shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered – Rule 3(2) of Companies (Accounts) Rules, 2014.*
- **Question:** Does this mean that books maintained on software which allow alteration or back date entry are not as per law e.g Tally, Busy etc.



**Documentation (SA 230) and  
Audit Evidence (SA 500 series)**

# Documentation (SA 230)

- Working Papers help in planning the audit, supervising the audit and proving that the audit was actually carried out;
- **Audit files/ documentation/ working papers are the records comprising of:**
  - audit procedures applied
  - audit evidence obtained
  - audit conclusions achieved,  
during the course of audit examination
- Working Papers' property of the auditors - *Chantrey Martin & Co.* case

# Features of SQC 1 vis-à-vis SA 230

- Assembly of Audit File to be within 60 days after the date of Auditor's Report;
- Documentation to be preserved for 7 years.

# Question 1

- Which of the following need not be documented by the auditor:
  - a) Personal dispute between MD and Accountant having no impact on F.S
  - b) Contravention of income tax provisions
  - c) Contravention of AS
  - d) Completion memoranda

## Question 2

- Mr. A is the statutory auditor of XYZ Limited for the financial year 2018-2019. He signed the audit report on 31<sup>st</sup> August 2019. During the course of the audit examination, his article assistants and audit staff prepared working papers for various audit observations. These working papers were in loose leaflet form and were put by him into a file on 31<sup>st</sup> December, 2019.

# Question 3

- Mr. X is the statutory auditor of PQR Limited for past five years. He resigned from the engagement and in his place Mr. Y was appointed as the statutory auditor. The management of PQR Limited is insisting Mr. X to furnish the copies of his working papers for all the five years.

# Question 4

- The auditee client has provided Rs. 2 lakhs as provision for bad and doubtful debts in the books of account while the auditor is challenging this provision and opines that it should be Rs. 5 lakhs. After much deliberations and considerations both auditor and auditee concluded at a provision of Rs. 4 lakhs. The auditor did not document these deliberations and considerations as he is of the view that once he is satisfied there is no need keep any such record in his file.

# Factors on which Form, Content and Extent of Documentation Depends

- **SCAM DEN**

1. **S** = Size of the entity;
2. **C** = Complexity of the entity;
3. **A** = Audit procedures;
4. **M** = Audit Methodology;
5. **D** = Documentation of conclusion which is not readily determinable;
6. **E** = Audit Evidence significance;
7. **N** = Nature of exceptions identified

# Recording of Documentation

- **Can be on paper/ electronic/ other media;**
- Examples of Audit Documentation: **PALE MSC**
  1. **P** = Audit **P**rogrammes;
  2. **A** = **A**nalyses;
  3. **L** = Confirmation & Representation **L**etters;
  4. **E** = **E**mail & other significant correspondence;
  5. **M** = **M**emoranda;
  6. **S** = **S**ummaries of important matters;
  7. **C** = **C**hecklists

# Other Points

- Audit documentation is not a substitute for the entity's accounting records;
- **Documentation for matters arising after the date of audit report:**
  1. Circumstances encountered;
  2. Audit procedures performed;
  3. Audit evidence obtained;
  4. Conclusions reached;
  5. Effect on auditor's report

# Auditor's Duty for Electronic Records

- The **nature and timing of the audit procedures to be used may be affected** by the fact that some of the accounting data and other **information may be available only in electronic form** or only at certain points or periods in time;
- For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce, or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference;
- Certain electronic information may not be retrievable after a specified period of time, for example, if files are changed and if backup files do not exist.
- Accordingly, the **auditor may find it necessary as a result of an entity's data retention policies to request retention of some information for the auditor's review** or to perform audit procedures at a time when the information is available.

# External Confirmation – electronic means

- **Responses received electronically**, for example by facsimile or electronic mail, **involve risks as to reliability** because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect;
- A **process used by the auditor and the respondent that creates a secure environment** for responses received electronically **may mitigate these risks**;
- If the auditor is satisfied that such a process is secure and properly controlled, the reliability of the related responses is enhanced;
- An **electronic confirmation process might incorporate various techniques for validating** the identity of a sender of information in electronic form, for example, through the use of encryption, electronic digital signatures, and procedures to verify website authenticity.
- When a **confirming party responds by electronic mail**, the auditor may telephone the confirming party to determine whether the confirming party did, in fact, send the response.



**Communicating Key Audit Matters in the  
Independent Auditor's Report  
[SA 701]**

# Key audit matters

- Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period;
- **Key audit matters are selected from matters communicated with those charged with governance.**

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

<b>Determining KAMs</b>	<b>Communicating KAMs</b>
Areas of higher <b>assessed risk of material misstatement</b> , or significant risks identified	State that these matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and <b>the auditor does not provide a separate opinion on these matters.</b>
<b>Significant auditor judgments</b> relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.	
The <b>effect on the audit of significant events or transactions</b> that occurred during the period.	

## Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the Standalone Ind AS financial statements for the financial year ended March 31, 2019. These matters were addressed in the context of our audit of the Standalone Ind AS financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have determined the matters described below to be the key audit matters to be communicated in our report. We have fulfilled the responsibilities described in the Auditor's responsibilities for the audit of the Standalone Ind AS financial statements section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the Standalone Ind AS financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying Standalone Ind AS financial statements.

Key audit matters	How our audit addressed the key audit matter
<p><b>Revenue Recognition</b>  <i>(as described in note 2.2.c of the standalone Ind AS financial statements)</i></p>	
<p>For the year ended March 31, 2019 the Company has recognized revenue from contracts with customers amounting to 3,371.18 Crores.</p> <p>Revenue from contracts with customers is recognised when control of the goods or services are transferred to the customer at an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. The Company has generally concluded that as principal, it typically controls the goods or services before transferring them to the customer.</p> <p>The variety of terms that define when control are transferred to the customer, as well as the high value of the transactions, give rise to the risk that revenue is not recognized in the correct period.</p> <p>Revenue is measured net of net of returns and allowances, cash discounts, trade discounts and volume rebates (collectively 'discount and rebates'). There is a risk that these discount and rebates are incorrectly recorded as it also requires a certain degree of estimation, resulting in understatement of the associated expenses and accrual.</p> <p>Revenue is also an important element of how the Company measures its performance. The Company focuses on revenue as a key performance measure, which could create an incentive for revenue to be recognized before the risk and rewards have been transferred.</p> <p>Accordingly, due to the significant risk associated with revenue recognition in accordance with terms of Ind AS 115 'Revenue from contracts with customers', it was determined to be a key audit matter in our audit of the standalone Ind AS financial statements.</p>	<p>Our audit procedures included the following:</p> <ul style="list-style-type: none"> <li>• Assessed the Company's revenue recognition policy prepared as per Ind AS 115 'Revenue from contracts with customers'.</li> <li>• Assessed the design and tested the operating effectiveness of internal controls related to revenue recognition, discounts and rebates.</li> <li>• Performed sample tests of individual sales transaction and traced to sales invoices, sales orders and other related documents. Further, in respect of the samples checked that the revenue has been recognized as per the shipping terms.</li> <li>• To test cut off selected sample of sales transactions made pre- and post-year end, agreeing the period of revenue recognition to third party support, such as transporter invoice and customer confirmation of receipt of goods.</li> <li>• Tested the provision calculations related to management incentives, discounts and rebates by agreeing a sample of amounts recognized to underlying arrangements with customers and other supporting documents.</li> <li>• Performed monthly analytical procedures of revenue by streams to identify any unusual trends.</li> <li>• Obtained confirmations from customers on sample basis to support existence assertion of trade receivables and assessed the relevant disclosures made in the financial statements; to ensure revenue from contracts with customers are in accordance with the requirements of relevant accounting standards.</li> </ul>

- Communicating key audit matters in the auditor's report is **not a substitute**:
  1. for disclosures required in F.S. as per FRF;
  2. for expression of Q/ A/ D opinion;
  3. for reporting as per SA 570 on Going Concern

# How to communicate “Key Audit Matters” [Para 13]

- **Use an appropriate subheading**, in a separate section of the auditor’s report under the heading “Key Audit Matters”;
- Disclose why the matter is considered “Key Audit Matter” and it is being dealt in audit of F.S.;

**Para 14**

**Despite being Key Matters, no disclosure is required**

**If prohibited under any Law or regulation**

**If against Public interest**

**Para 15**

**Despite being Key Matters, no separate reporting as Key Matters is required**

**Q/ A/ D Opinion**

**Going Concern**

# Question 1

- ABC Limited (a listed company) is under investigation by SFIO and the investigation proceedings are not yet concluded as on 31<sup>st</sup> March, 2020.
- The statutory auditor has discussed this fact with TCWG and considers it as a significant matter.
- The SFIO officials have taken undertaking of confidentiality from all the officers and employees of the company for preventing any such disclosure w.r.t. ongoing investigation.
- Whether this matter should be reported as KAM by the statutory auditor

# Question 2

- ABC Limited (a listed company) is under investigation by SFIO and the investigation proceedings are not yet concluded as on 31<sup>st</sup> March, 2020.
- The information about this investigation has already been disclosed to the Stock Exchanges by the company in terms of Regulation 30 of SEBI-LODR.
- The statutory auditor has discussed this fact with TCWG and considers it as a significant matter.
- Whether this matter should be reported as KAM by the statutory auditor

# Question 3

- RST Limited (a listed company) is engaged in manufacturing of heavy vehicles, combat equipments, defence equipments etc.
- The company was awarded a contract by Ministry of Defence for supplying high speed sustainable combat tanks during the year.
- The revenue from such contract accounts for around 25% of total revenue of the company.
- The statutory auditor has discussed this fact with TCWG and considers it as a significant matter.
- Whether this matter should be reported as KAM by the statutory auditor



**Audit & Auditors under  
Companies Act, 2013**

## Firm or CA himself or his Relative or Partner

Holding any security of or interest in	Indebted to	Given a guarantee or security for indebtedness of <u>any third person</u> to
--	-------------	--

1. company; or
2. its subsidiary; or
3. its holding co.; or
4. associate company; or
5. subs. of such holding co.

### EXCEPTIONS

1. Relative of an auditor may hold securities <u>in the Co.</u> of face value $\leq$ Rs. 1 Lakh	1. Indebtedness $\leq$ Rs. 5 Lakhs	1. Guarantee/ Security $\leq$ Rs. 1 Lakh
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Auditor to take corrective action within 60 days	N.A.	N.A.
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- CA. X in practice is also teaching at P R Academy (P) Limited and gets remuneration of Rs. 10,000
- Mrs. X holds 25% equity share capital in ABC (P) Limited worth Rs. 80,000. Can Mr. X be appointed as an auditor
- Friend of CA. X has taken loan of Rs. 6 lakhs from ABC (P) Limited. Can he be appointed as auditor of ABC (P) Limited
- CA. X gave a guarantee of Rs. 2 lakhs for the loan of Rs. 6 lakhs being taken by his friend from ABC (P) Limited. Can he be appointed as auditor of ABC (P) Limited

Disqualification u/s 141(3)(e) for a **person or a firm** who, whether **directly or indirectly**, has **business relationship** with:

- **the company; or**
- **its subsidiary; or**
- **its holding company; or**
- **associate company; or**
- **subsidiary of such:**
  - **holding company; or**
  - **associate company**

**Business relationship – meaning thereof:** would be any transaction entered into for a **commercial purpose except:**

- **commercial transaction which are in the nature of permitted professional services;**
- **commercial transactions which are in the ordinary course of business of the Co. at ALP - like sale of products or services to the auditor, as customer, **by the Companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses****

# Can CA. X continue as the auditor of Le Meriden Hotel Limited:

- 1) X is liable for a sum of `2.5 Lakhs to Le Meriden Hotel Limited for the birthday party of his son;
- 2) X is liable for a sum of `2.5 Lakhs to Le Meriden Hotel Limited for the birthday party of his son and his brother is liable for a sum of `3 lakhs for the birthday party of his daughter;
- 3) Brother of CA X is liable for a sum of `4.5 Lakhs to Le Meriden Hotel Limited for the reception party of his son's marriage. CA X has provided the guarantee for the payment of such debt by his brother;

# Can CA. X continue as the auditor of Le Meriden Hotel Limited:

- 4) Friend of CA X is liable for a sum of `5.5 Lakhs to Le Meriden Hotel Limited for the reception party of his son's marriage;
- 5) Friend of CA X is liable for a sum of `4.5 Lakhs to Le Meriden Hotel Limited for the reception party of his son's marriage. CA X has provided the guarantee for the payment of such debt by his friend

# Special Point about Rotation

- During such cooling off period any other auditor firm which is having common partner, brand, control or networking with the previous firm, can not be appointed as the auditor of same company.

- 6) CA. M was the partner in LMN & Co., Chartered Accountants. This firm was rotated by ABC Limited and RST & Co., Chartered Accountants were appointed as the statutory auditors. After two year of its appointment CA. M was admitted as a new partner in RST & Co.;
- 7) CA. J was the partner in JKL & Co., Chartered Accountants. This firm was rotated by ABC Limited and RST & Co., Chartered Accountants were appointed as the statutory auditors in which CA. P son of CA. J, is a partner

# Section 144 Services

- 1) Accounting and book keeping services.
- 2) Internal audit
- 3) Design and implementation of any financial information system
- 4) Actuarial Services
- 5) Investment advisory services, Investment banking services
- 6) Rendering of outsourced financial services;
- 7) Management services [Not defined in the Act. Thus, Regulation 190A of CA Regulations, 1988 need to be referred]
- 8) Such other services as may be prescribed

# Section 144 Services

1. These Services cannot be provided **“directly or indirectly”** to:
  - Company;
  - Holding company;
  - Subsidiary company
2. The expression “indirectly” will include even his relatives, persons under his control/ significant influence/ brand/ trade mark, etc.

# Steps for assessing disqualification due to Management Services

- **Step 1:** Whether the service is permitted under Regulation 190A of CA Regulations, 1988;
- **Step 2:** Whether the auditor will be reviewing or auditing his or her own work, rendered in Step 1
- **Step 3:** If answer to Step 1 and Step 2 is Yes, then appointment as statutory auditor cannot be accepted

**Thank You**



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