SA 705*
Modifications to the Opinion in the Independent Auditor's Report

(Effective for all audits relating to accounting periods beginning on or after April 1, 2011[1])

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised)[2], the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

Types of Modified Opinions

2. This SA establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon: (Ref: Para A1)

(a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and

(b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Effective Date

3. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2011.

Objective

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

(a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

---

*Published in February, 2010 issue of the Journal.

[1] The Council of the ICAI, in partial modification of the decision taken by it at its 291st meeting held in December 2009, has decided that the effective date/applicability of three standards *viz* SA 700 (Revised), SA 705 and SA 706 be postponed by one year and consequently the said Standards shall now be effective/applicable for audits of financial statements for periods beginning on or after 1st April, 2012 (instead of audits of financial statements for periods beginning on or after 1st April, 2011 as was earlier decided).

[2] SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements".

Definitions

5. For purposes of the SAs, the following terms have the meanings attributed below:

(a) Pervasive – A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's judgment:

  (i) Are not confined to specific elements, accounts or items of the financial statements;

  (ii) If so confined, represent or could represent a substantial proportion of the financial statements; or

  (iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.

(b) Modified opinion – A qualified opinion, an adverse opinion or a disclaimer of opinion.

Requirements

Circumstances When a Modification to the Auditor's Opinion Is Required

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

(a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or (Ref: Para. A2-A7)

(b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: Para. A8-A12)

Determining the Type of Modification to the Auditor's Opinion

Qualified Opinion

7. The auditor shall express a qualified opinion when:

(a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion

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

Disclaimer of Opinion

9. The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

10. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

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

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

12. If management refuses to remove the limitation referred to in paragraph 11, the auditor shall communicate the matter to those charged with governance and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

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

(a) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or

(b) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall: (Ref: Para A13-A14)

   (i) Resign from the audit, where practicable and not prohibited by law or regulation; or

   (ii) If resignation from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

14. If the auditor resigns as contemplated by paragraph 13(b)(i), before resigning, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion. (Ref: Para. A15)

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion

15. When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement. To include such an unmodified opinion in the same report[3] in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (Ref: Para. A16)

[3] SA 805, "Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" deals with circumstances where the auditor is engaged to express a separate opinion on one or more specific elements, accounts or items of a financial statement.

Form and Content of the Auditor's Report When the Opinion Is Modified

Basis for Modification Paragraph

16. When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by the SA 700 (Revised), include a paragraph in the auditor's report that provides a description of the matter giving rise to the modification. The auditor shall place this paragraph immediately before the opinion paragraph in the auditor's report and use the heading "*Basis for Qualified Opinion*", "*Basis for Adverse Opinion*", or "*Basis for Disclaimer of Opinion*", as appropriate. (Ref: Para. A17)

17. If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor shall include in the basis for modification paragraph a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor shall so state in the basis for modification paragraph. (Ref: Para. A18)

18. If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the basis for modification paragraph an explanation of how the disclosures are misstated.

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

(a) Discuss the non-disclosure with those charged with governance;

(b) Describe in the basis for modification paragraph the nature of the omitted information; and

(c) Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (Ref: Para. A19)

20. If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the basis for modification paragraph, the reasons for that inability.

21. Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the basis for modification paragraph the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof. (Ref: Para. A20)

Opinion Paragraph

22. When the auditor modifies the audit opinion, the auditor shall use the heading "*Qualified Opinion*", "*Adverse Opinion*", or "*Disclaimer of Opinion*", as appropriate, for the opinion paragraph. (Ref: Para. A21, A23-A24)

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

(a) The financial statements present fairly, in all material respects (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or

(b) The financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s)..." for the modified opinion. (Ref: Para. A22)

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

(a) The financial statements do not present fairly (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or

(b) The financial statements have not been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.

25. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall state in the opinion paragraph that:

(a) because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion; and, accordingly,

(b) the auditor does not express an opinion on the financial statements.

Description of Auditor's Responsibility When the Auditor Expresses a Qualified or Adverse Opinion

26. When the auditor expresses a qualified or adverse opinion, the auditor shall amend the description of the auditor's responsibility to state that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's modified audit opinion.

Description of Auditor's Responsibility When the Auditor Disclaims an Opinion

27. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the introductory paragraph of the auditor's report to state that the auditor was engaged to audit the financial statements. The auditor shall also amend the description of the auditor's responsibility and the description of the scope of the audit to state only the following: "Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India. Because of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion".

Communication with Those Charged with Governance

28. When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the proposed wording of the modification. (Ref: Para. A25)

***

Application and Other Explanatory Material

Scope of this SA

Types of Modified Opinions (Ref: Para. 2)

A1. The table below illustrates how the auditor's judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

Nature of Matter Giving Rise to the Modification	*Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements*	
	Material but Not	*Material and Pervasive*
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Nature of Material Misstatements (Ref: Para. 6(a))

A2. SA 700 (Revised) requires the auditor, in order to form an opinion on the financial statements, to conclude as to whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement[4]. This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with SA 450[5].

A3. SA 450 defines a misstatement as a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to:

(a) The appropriateness of the selected accounting policies;

(b) The application of the selected accounting policies; or

(c) The appropriateness or adequacy of disclosures in the financial statements.

Appropriateness of the Selected Accounting Policies

A4. In relation to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise when:

(a) The selected accounting policies are not consistent with the applicable financial reporting framework; or

(b) The financial statements, including the related notes, do not represent the underlying transactions and events in a manner that achieves fair presentation.

A5. Financial reporting frameworks often contain requirements for the accounting for, and disclosure of, changes in accounting policies. Where the entity has changed its selection of

[4] SA 700 (Revised), paragraph 11.

[5] SA 450,"Evaluation of Misstatements Identified during the Audit", paragraph 4(a).

significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements.

Application of the Selected Accounting Policies

A6. In relation to the application of the selected accounting policies, material misstatements of the financial statements may arise:

(a) When management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application); or

(b) Due to the method of application of the selected accounting policies (such as an unintentional error in application).

Appropriateness or Adequacy of Disclosures in the Financial Statements

A7. In relation to the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when:

(a) The financial statements do not include all of the disclosures required by the applicable financial reporting framework;

(b) The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework; or

(c) The financial statements do not provide the disclosures necessary to achieve fair presentation.

Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 6(b))

A8. The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

(a) Circumstances beyond the control of the entity;

(b) Circumstances relating to the nature or timing of the auditor's work; or

(c) Limitations imposed by management.

A9. An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements of paragraphs 7(b) and 10 apply as appropriate. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of fraud risks and consideration of engagement continuance.

A10. Examples of circumstances beyond the control of the entity include when:

- The entity's accounting records have been destroyed.
- The accounting records of a significant component have been seized indefinitely by governmental authorities.

A11. Examples of circumstances relating to the nature or timing of the auditor's work include when:

- The entity is required to use the equity method of accounting for an associated entity,

and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.

- The timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.
- The auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.

A12. Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include when:

- Management prevents the auditor from observing the counting of the physical inventory.
- Management prevents the auditor from requesting external confirmation of specific account balances.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement (Ref: Para. 13(b)-14)

A13. The practicability of resigning from the audit may depend upon the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation in the Basis for Disclaimer of Opinion paragraph prior to resigning.

A14. In certain circumstances, resignation from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. This may be the case for an auditor appointed to audit the financial statements of public sector entities. It may also be the case of entities where the auditor is appointed to audit the financial statements covering a specific period, or appointed for a specific period and is prohibited from resigning before the completion of the audit of those financial statements or before the end of that period, respectively. The auditor may also consider it necessary to include an Other Matter paragraph in the auditor's report[6].

A15. When the auditor concludes that resignation from the audit is necessary because of a scope limitation, there may be a professional, regulatory or legal requirement for the auditor to communicate matters relating to the resignation from the engagement to regulators or the entity's owners.

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion (Ref: Para. 15)

A16. The following are examples of reporting circumstances that would not contradict the auditor's adverse opinion or disclaimer of opinion:

- The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse

[6] SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", paragraph A5.

opinion on the same financial statements under a different financial reporting framework[7].

- The expression of a disclaimer of opinion regarding the results of operations, and cash flows, where relevant, and an unmodified opinion regarding the financial position (see SA 510[8]). In this case, the auditor has not expressed a disclaimer of opinion on the financial statements as a whole.

Form and Content of the Auditor's Report When the Opinion Is Modified

Basis for Modification Paragraph (Ref: Para. 16-17, 19(b), 21)

A17. Consistency in the auditor's report helps to promote the users' understanding and to identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and in the description of the basis for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.

A18. Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s), individually and in aggregate, on the financial statements should be mentioned in the auditor's report. In circumstances where it is not practicable to quantify the effect of modifications made in the audit report accurately, the auditor may do so on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on management estimates. Ordinarily, this information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the financial statements. An example of the financial effects of material misstatements that the auditor may describe in the basis for modification paragraph in the auditor's report is the quantification of the effects on income tax, profit before taxes, net profit and reserves if inventory is overstated.

A19. Disclosing the omitted information in the basis for modification paragraph would not be practicable if:

(a) The disclosures have not been prepared by management or the disclosures are otherwise not readily available to the auditor; or

(b) In the auditor's judgment, the disclosures would be unduly voluminous in relation to the auditor's report.

A20. An adverse opinion or a disclaimer of opinion relating to a specific matter described in the basis for qualification paragraph does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor's opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial statements.

Opinion Paragraph (Ref: Para. 22-23)

A21. Inclusion of this paragraph heading makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.

---

[7] See paragraph A31 of SA 700 (Revised) for a description of this circumstance.

[8] SA 510, "Initial Audit Engagements —Opening Balances", paragraph 10.

A22. When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as "with the foregoing explanation" or "subject to" in the opinion paragraph as these are not sufficiently clear or forceful.

Illustrative Auditors' Reports

A23. Illustrations 1 and 2 in the Appendix contain auditors' reports with qualified and adverse opinions, respectively, as the financial statements are materially misstated.

A24. Illustration 3 in the Appendix contains an auditor's report with a qualified opinion as the auditor is unable to obtain sufficient appropriate audit evidence. Illustration 4 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial statements. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. In each of the latter two cases, the possible effects on the financial statements of the inability are both material and pervasive.

Communication with Those Charged with Governance (Ref: Para. 28)

A25. Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor's opinion and the proposed wording of the modification enables:

(a) The auditor to give notice to those charged with governance of the intended modification(s) and the reasons (or circumstances) for the modification(s);

(b) The auditor to seek the concurrence of those charged with governance regarding the facts of the matter(s) giving rise to the expected modification(s), or to confirm matters of disagreement with management as such; and

(c) Those charged with governance to have an opportunity, where appropriate, to provide the auditor with further information and explanations in respect of the matter(s) giving rise to the expected modification(s).

Material Modifications *vis-a-vis* ISA 705, "Modifications to the Opinion in the Independent Auditor's Report"

Additions

Paragraph 17 and A18 of ISA 705 requires the auditor to include in the basis for modification paragraph, a description and quantification of the financial effect of the misstatement. Since the said paragraph covers only the effect of the individual quantification of the misstatement on the financial statements, the paragraph A18 has been changed also to include the effect of the aggregate quantifications of the misstatements on the financial statements.

Appendix

(Ref: Para. A23-24)

Illustrative Formats of Auditors' Reports with Modifications to the Opinion

Illustration 1

Circumstances include the following:

- Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.
- The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements. The audit opinion is qualified for the misstatement.
- In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion[9]

The Company's inventories are carried in the Balance Sheet at ₹ XXX. Management has not stated the inventories at the lower of cost and net realisable value but has stated them solely at cost, which constitutes a departure from the Accounting Standards referred to in sub-section (3C) of section 211 of the Act. The Company's records indicate that had management stated the inventories at the lower of cost and net realisable value, an amount of ₹ XXX would have been required to write the inventories down to their net realisable value. Accordingly, cost of sales would have been increased by ₹ XXX, and income tax, net profit and shareholders' funds would have been reduced by ₹ XXX, ₹ XXX and ₹ XXX , respectively.

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

(a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;

(b) in the case of the Profit and Loss Account, of the profit/ loss for the year ended on that date; and

(c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.

2. As required by section 227(3) of the Act, we report that:

a. We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;

b. In our opinion proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns

[9] "Basis for Qualified Opinion" and "Qualified Opinion" paragraphs are in italics as required under Sec. 227(3)(e) of the Companies Act.

adequate for the purposes of our audit have been received from branches not visited by us][10];

c. The Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us][11];

d. Except for the effects of the matter described in the Basis for Qualified Opinion paragraph, in our opinion, the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;

e. On the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.

f. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.[12]

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[13])
Membership Number

Place of Signature

Date

[10] To be included if relevant.

[11] To be included if relevant.

[12] Attention of the readers is invited to the Announcement issued by the Council of the ICAI regarding the auditor's reporting responsibilities pursuant to clause 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 and section 227(3)(g) of the Companies Act, 1956 wrt the cess payable under Section 441A of the Companies Act, 1956. The Announcement is published elsewhere in the Handbook.

[13] Partner or Proprietor, as the case may be.

Illustration 2:

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements of a parent company prepared under accounting principles generally accepted in India *(as required for compliance with SEBI's regulatory requirement).*
- The terms of the group audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- The financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so. An adverse audit opinion is given under the circumstances.

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of ABC Company Limited

We[14] have audited the accompanying consolidated financial statements of ABC Company Limited ("the Company") and its subsidiaries, which comprise the consolidated Balance Sheet as at March 31, 20XX, and the consolidated Statement of Profit and Loss and consolidated Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation of these consolidated financial statements that give a true and fair view of the consolidated financial position, consolidated financial performance and consolidated cash flows of the Company in accordance with accounting principles generally accepted in India. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the consolidated financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

[14] As there is no reporting on "Other Legal Requirements", there is no necessity of including the heading "Report on the Financial Statements" above the introductory paragraph.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

Basis for Adverse Opinion

As explained in Note X, the Company has not consolidated the financial statements of subsidiary XYZ Company it acquired during 20XX because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This acquisition is therefore accounted for as an investment. Under the accounting principles generally accepted in India, the subsidiary should have been consolidated because it is controlled by the Company. Had XYZ been consolidated, many elements in the accompanying financial statements would have been materially affected. The effects on the financial statements of the failure to consolidate have not been determined.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India:

(a) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;

(b) in the case of the consolidated Profit and Loss Account, of the profit/ loss for the year ended on that date; and

(c) in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[15])
Membership Number

Place of Signature

Date

[15] Partner or Proprietor, as the case may be.

Illustration 3:

Circumstances include the following:

- Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.
- The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign affiliate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the financial statement. The audit opinion is qualified for the misstatement.
- In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion

ABC Company Limited's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at ₹ XXX in the Balance Sheet as at March 31, 20XX, and ABC's share of XYZ Company's net income of ₹ XXX is included in ABC Company Limited's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC Company Limited's investment in XYZ Company as at March 31, 20XX and ABC Company Limited's share of XYZ Company's net income for the year because we were denied access to the financial information, management, and the auditors of XYZ Company. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the possible effects[16] of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

(a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;

(b) in the case of the Profit and Loss Account, of the profit/ loss for the year ended on that date; and

(c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.

2. As required by section 227(3) of the Companies Act, 1956, we report that:

   a. we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit except for the matter described in the Basis for Qualified Opinion paragraph;

[16] Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

b. in our opinion proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us][17];

c. the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us][18];

d. except for the possible effects[19] of the matter described in the Basis for Qualified Opinion paragraph, in our opinion, the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;

e. on the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.

f. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.[20]

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[21])
Membership Number

Place of Signature
Date

[17] To be included if relevant.
[18] To be included if relevant.
[19] Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.
[20] Attention of the readers is invited to the Announcement issued by the Council of the ICAI regarding the auditor's reporting responsibilities pursuant to clause 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 and section 227(3)(g) of the Companies Act, 1956 wrt the cess payable under Section 441A of the Companies Act, 1956. The Announcement is published elsewhere in the Handbook.
[21] Partner or Proprietor, as the case may be.

Illustration 4:

Circumstances include the following:

- Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.
- The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial statements. That is, the auditor was unable to obtain audit evidence about the financial information of a joint venture investment that represents over 90% of the Company's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. A disclaimer of audit opinion is given in the circumstances.
- In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and the Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

The Company's investment in its joint venture XYZ Company is carried at ₹ XXX in the Company's Balance Sheet, which represents over 90% of the Company's net assets as at March 31, 20XX. We were not allowed access to the management and the auditors of XYZ

Company. As a result, we were unable to determine whether any adjustments were necessary in respect of the Company's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ Company's income and expenses for the year, and the elements making up the Cash Flow Statement.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.

2. As required by section 227(3) of the Companies Act, 1956, we report that:

   a. As described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;

   b. Due to the possible effects[22] of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us][23];

   c. The Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us][24];

   d. Due to the possible effects of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;

   e. On the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.

   f. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it

[22] Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

[23] To be included if relevant.

[24] To be included if relevant.

issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.[25]

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[26])
Membership Number

Place of Signature

Date

Illustration 5:

Circumstances include the following:

- Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.
- The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was unable to obtain audit evidence about the entity's inventories and accounts receivable. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. A disclaimer of audit opinion is given in the circumstances.
- In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

[25] Attention of the readers is invited to the Announcement issued by the Council of the ICAI regarding the auditor's reporting responsibilities pursuant to clause 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 and section 227(3)(g) of the Companies Act, 1956 wrt the cess payable under Section 441A of the Companies Act, 1956. The Announcement is published elsewhere in the Handbook.

[26] Partner or Proprietor, as the case may be.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

We were appointed as auditors of the Company after March 31, 20XX and thus could not observe the counting of physical inventories at the beginning and end of the year. Accordingly, we were unable to satisfy ourselves by alternative means concerning the inventory quantities held at December 31, 20X0 and March 31, 20X1 which are stated in the Balance Sheet at ₹ XXX and ₹ XXX, respectively.

In addition, the introduction of a new computerised accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our audit report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of ₹ XXX as at March 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the Statement of Profit and Loss and Cash Flow Statement.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.

2. As required by section 227(3) of the Companies Act, 1956, we report that:

a. As described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;

b. Due to the possible effects[27] of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us][28];

c. The Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us][29];

d. Due to the possible effects of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;

e. On the basis of written representations received from the directors as on March 31, 20X1, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20X1, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.

f. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.[30]

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[31])
Membership Number

Place of Signature

Date

[27] Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

[28] To be included if relevant.

[29] To be included if relevant.

[30] Attention of the readers is invited to the Announcement issued by the Council of the ICAI regarding the auditor's reporting responsibilities pursuant to clause 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 and section 227(3)(g) of the Companies Act, 1956 wrt the cess payable under Section 441A of the Companies Act, 1956. The Announcement is published elsewhere in the Handbook.

[31] Partner or Proprietor, as the case may be.

SA 706*

Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

(Effective for all audits relating to accounting periods beginning on or after April 1, 2011[1])

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with additional communication in the auditor's report when the auditor considers it necessary to:

(a) Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or

(b) Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

2. Other Standards on Auditing (SAs) may contain specific requirements for the auditor to include Emphasis of Matter paragraphs or Other Matter paragraphs in the auditor's report. In those circumstances, the requirements in this SA regarding the form and placement of such paragraphs apply.

Effective Date

3. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2011.

Objective

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

(a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or

*Published in February, 2010 issue of the Journal.

[1] The Council of the ICAI, in partial modification of the decision taken by it at its 291st meeting held in December 2009, has decided that the effective date/applicability of three standards *viz* SA 700 (Revised), SA 705 and SA 706 be postponed by one year and consequently the said Standards shall now be effective/applicable for audits of financial statements for periods beginning on or after 1st April, 2012 (instead of audits of financial statements for periods beginning on or after 1st April, 2011 as was earlier decided).

(b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Definitions

5. For the purposes of the SAs, the following terms have the meanings attributed below:

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

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

Requirements

Emphasis of Matter Paragraphs in the Auditor's Report

6. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements. (Ref: Para. A1-A2)

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

(a) Include it immediately after the Opinion paragraph in the auditor's report;

(b) Use the heading "Emphasis of Matter", or other appropriate heading;

(c) Include in the paragraph a clear reference to the matter being emphasised and to where relevant disclosures that fully describe the matter can be found in the financial statements; and

(d) Indicate that the auditor's opinion is not modified in respect of the matter emphasised. (Ref: Para. A3-A4)

Other Matter Paragraphs in the Auditor's Report

8. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report and this is not prohibited by law or regulation, the auditor shall do so in a paragraph in the auditor's report, with the heading "Other Matter", or other appropriate heading. The auditor shall include this paragraph immediately after the Opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to the Other Reporting Responsibilities section. (Ref: Para. A5-A11)

Communication with Those Charged with Governance

9. If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the proposed wording of this paragraph. (Ref: Para. A12)

***

Application and Other Explanatory Material

Emphasis of Matter Paragraphs in the Auditor's Report

Circumstances in Which an Emphasis of Matter Paragraph May Be Necessary (Ref: Para. 6)

A1. Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- Early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

A2. A widespread use of Emphasis of Matter paragraphs diminishes the effectiveness of the auditor's communication of such matters. Additionally, to include more information in an Emphasis of Matter paragraph than is presented or disclosed in the financial statements may imply that the matter has not been appropriately presented or disclosed; accordingly, paragraph 6 limits the use of an Emphasis of Matter paragraph to matters presented or disclosed in the financial statements.

Including an Emphasis of Matter Paragraph in the Auditor's Report (Ref: Para. 7)

A3. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An Emphasis of Matter paragraph is not a substitute for either:

(a) The auditor expressing a qualified opinion or an adverse opinion, or disclaiming an opinion, when required by the circumstances of a specific audit engagement (see SA 705[2]); or

(b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make.

A4. The illustrative report in the Appendix includes an Emphasis of Matter paragraph in an auditor's report that contains a qualified opinion.

Other Matter Paragraphs in the Auditor's Report (Ref: Para. 8)

Circumstances in Which an Other Matter Paragraph May Be Necessary

Relevant to Users' Understanding of the Audit

A5. In the rare circumstance where the auditor is unable to resign from an engagement even

[2] SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a limitation on the scope of the audit imposed by management is pervasive[3], the auditor may consider it necessary to include an Other Matter paragraph in the auditor's report to explain why it is not possible for the auditor to resign from the engagement.

Relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report

A6. Law, regulation or generally accepted practice in a jurisdiction may require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon. Where relevant, one or more sub-headings may be used that describe the content of the Other Matter paragraph.

A7. An Other Matter paragraph does not deal with circumstances where the auditor has other reporting responsibilities that are in addition to the auditor's responsibility under the SAs to report on the financial statements (see "Other Reporting Responsibilities" section in SA 700 (Revised)[4]), or where the auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters.

Reporting on more than one set of financial statements

A8. An entity may prepare one set of financial statements in accordance with a general purpose framework (e.g., the national framework) and another set of financial statements in accordance with another general purpose framework (e.g., International Financial Reporting Standards), and engage the auditor to report on both sets of financial statements. If the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an Other Matter paragraph in the auditor's report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.

Restriction on distribution or use of the auditor's report

A9. Financial statements prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial statements meet their financial information needs. Since the auditor's report is intended for specific users, the auditor may consider it necessary in the circumstances to include an Other Matter paragraph, stating that the auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.

Including an Other Matter Paragraph in the Auditor's Report

A10. The content of an Other Matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the financial statements. An Other Matter paragraph does not include information that the auditor is prohibited from providing by law, regulation or other standards, for example, ethical standards relating to confidentiality of information. An Other Matter paragraph also does not include information that is required to be provided by management.

---

[3] See paragraph 13(b)(ii) of SA 705 for a discussion of this circumstance.

[4] SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements", paragraph 38.

A11. The placement of an Other Matter paragraph depends on the nature of the information to be communicated. When an Other Matter paragraph is included to draw users' attention to a matter relevant to their understanding of the audit of the financial statements, the paragraph is included immediately after the Opinion paragraph and any Emphasis of Matter paragraph. When an Other Matter paragraph is included to draw users' attention to a matter relating to Other Reporting Responsibilities addressed in the auditor's report, the paragraph may be included in the section sub-titled "Report on Other Legal and Regulatory Requirements". Alternatively, when relevant to all the auditor's responsibilities or users' understanding of the auditor's report, the Other Matter paragraph may be included as a separate section following the Report on the Financial Statements and the Report on Other Legal and Regulatory Requirements.

Communication with Those Charged with Governance (Ref: Para. 9)

A12. Such communication enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report, and provides them with an opportunity to obtain further clarification from the auditor where necessary. Where the inclusion of an Other Matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement.

Modifications *vis-à-vis* ISA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report"

SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" does not contain any modifications *vis-a-vis* ISA 706.

Appendix

(Ref: Para. A4)

Illustrative Formats of an Auditor's Report that Includes an Emphasis of Matter Paragraph/Other Matter Paragraph

Illustration 1:

Circumstances include the following:

- Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.
- The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements. The audit opinion is qualified for the misstatement.
- There is uncertainty relating to a pending exceptional litigation matter. This is highlighted in the auditor's report by an Emphasis of Matter paragraph.
- In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion

The Company's inventories are carried in the Balance Sheet at ₹ XXX. Management has not stated the inventories at the lower of cost and net realisable value but has stated them solely at cost, which constitutes a departure from the accounting standards referred to in sub-section (3C) of section 211 of the Act. The Company's records indicate that had management stated the inventories at the lower of cost and net realisable value, an amount of ₹ XXX would have been required to write the inventories down to their net realisable value. Accordingly, cost of sales would have been increased by ₹ XXX, and income tax, net profit and shareholders' funds would have been reduced by ₹ XXX, ₹ XXX and ₹ XXX, respectively.

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

(a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;

(b) in the case of the Profit and Loss Account, of the profit/ loss for the year ended on that date; and

(c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Emphasis of Matter

We draw attention to Note X to the financial statements which describes the uncertainty[5] related to the outcome of the lawsuit filed against the Company by XYZ Company. Our opinion is not qualified in respect of this matter.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.

2. As required under provisions of section 227(3) of the Companies Act, 1956, we report that:

a. we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;

b. in our opinion proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us][6];

c. the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us][7];

d. except for the matter described in the Basis for Qualified Opinion paragraph, in our opinion, the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;

[5] In highlighting the uncertainty, the auditor uses the same terminology that is used in the note to the financial statements.

[6] To be included if relevant.

[7] To be included if relevant.

e. on the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.

f. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.[8]

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[9])
Membership Number

Place of Signature

Date

Illustration 2:

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements of a parent company prepared under accounting principles generally accepted in India, as required for compliance with SEBI's regulatory requirement, which is a fair presentation framework.
- The terms of the group audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- The report includes an Other Matter paragraph in respect of the auditor's responsibility in respect of subsidiaries not audited by him but which form part of the consolidated financial statements under report.

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of ABC Company Limited

We[10] have audited the accompanying consolidated financial statements of ABC Company Limited ("the Company") and its subsidiaries, which comprise the consolidated Balance Sheet

[8] Attention of the readers is invited to the Announcement issued by the Council of the ICAI regarding the auditor's reporting responsibilities pursuant to clause 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 and section 227(3)(g) of the Companies Act, 1956 wrt the cess payable under Section 441A of the Companies Act, 1956. The Announcement is published elsewhere in the Handbook.

[9] Partner or Proprietor, as the case may be.

[10] As there is no reporting on 'Other Legal and Regulatory Requirements', there is no necessity of including the heading 'Report on the Financial Statements' above the introductory paragraph.

as at March 31, 20XX, and the consolidated Statement of Profit and Loss and consolidated Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation of these consolidated financial statements that give a true and fair view of the consolidated financial position, consolidated financial performance and consolidated cash flows of the Company in accordance with accounting principles generally accepted in India; this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the consolidated financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and presentation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion and to the best of our information and according to the explanations given to us and based on the consideration of the reports of the other auditors on the financial statements of the subsidiaries as noted below, the consolidated financial statements give a true and fair view in conformity with the accounting principles generally accepted in India:

(a) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;

(b) in the case of the consolidated Profit and Loss Account, of the profit/ loss for the year ended on that date; and

(c) in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date.

Other Matter[11]

We did not audit the financial statements of certain subsidiaries, whose financial statements reflect total assets (net) of ₹ XXXX as at March 31, 20XX, total revenues of ₹ XXXX and net cash outflows amounting to ₹ XXXX for the year then ended. These financial statements have been audited by other auditors whose reports have been furnished to us by the Management, and our opinion is based solely on the reports of the other auditors. Our opinion is not qualified in respect of this matter.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[12])
Membership Number

Place of Signature

Date

[11] This matter is given in "Other Matter" paragraph as it is currently permitted in India for an auditor to sign off a consolidated audit opinion, even where he has not performed a substantial part of the audit himself.

[12] Partner or Proprietor, as the case may be.

SA 710(Revised)*
Comparative Information—Corresponding Figures and Comparative Financial Statements

(Effective for all audits relating to accounting periods beginning on or after April 1, 2011)

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibilities regarding comparative information in an audit of financial statements. When the financial statements of the prior period have been audited by a predecessor auditor or were not audited, the requirements and guidance in SA 510[1] regarding opening balances also apply.

The Nature of Comparative Information

2. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures[2] and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement.

3. The essential audit reporting differences between the approaches are:

(a) For corresponding figures, the auditor's opinion on the financial statements refers to the current period only; whereas

(b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

This SA addresses separately the auditor's reporting requirements for each approach.

Effective Date

4. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2011.

Objectives

5. The objectives of the auditor are:

(a) To obtain sufficient appropriate audit evidence about whether the comparative

---

* Published in the April, 2010 issue of the Journal.

[1] SA 510, "Initial Audit Engagements—Opening Balances".

[2] Typically, financial reporting frameworks in India use the corresponding figures approach for general purpose financial statements.

information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting framework; and

(b) To report in accordance with the auditor's reporting responsibilities.

Definitions

6. For purposes of the SAs, the following terms have the meanings attributed below:

(a) Comparative information – The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

(b) Corresponding figures – Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements, and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as "current period figures"). The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.

(c) Comparative financial statements – Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor's opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.

For purposes of this SA, references to "prior period" should be read as "prior periods" when the comparative information includes amounts and disclosures for more than one period.

Requirements

Audit Procedures

7. The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

(a) The comparative information agrees with the amounts and other disclosures presented in the prior period; and

(b) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

8. If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560[3].

[3] SA 560, "Subsequent Events", paragraphs 14-17.

9. As required by SA 580[4], the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss.(Ref: Para. A1)

Audit Reporting

Corresponding Figures

10. When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the circumstances described in paragraphs 11, 12, and 14. (Ref: Para. A2)

11. If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

(a) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or

(b) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures. (Ref: Para. A3-A5)

12. If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein. (Ref: Para. A6)

Prior Period Financial Statements Audited by a Predecessor Auditor

13. If the financial statements of the prior period were audited by a predecessor auditor and the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report:

(a) That the financial statements of the prior period were audited by the predecessor auditor;

(b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and

(c) The date of that report. (Ref: Para. A7)

Prior Period Financial Statements Not Audited

14. If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited.

[4] SA 580, "Written Representations", paragraph 14.

Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements[5]. (Ref: Para. A7a)

Comparative Financial Statements

15. When comparative financial statements are presented, the auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed. (Ref: Para. A8-A9)

16. When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph in accordance with SA 706[6]. (Ref: Para. A10)

Prior Period Financial Statements Audited by a Predecessor Auditor

17. If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:

(a) That the financial statements of the prior period were audited by a predecessor auditor;

(b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and

(c) The date of that report,

unless the predecessor auditor's report on the prior period's financial statements is revised with the financial statements.

18. If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor shall communicate the misstatement with the appropriate level of management and those charged with governance and request that the predecessor auditor be informed. If the prior period financial statements are amended, and the predecessor auditor agrees to issue a new auditor's report on the amended financial statements of the prior period, the auditor shall report only on the current period. (Ref: Para. A11)

Prior Period Financial Statements Not Audited

19. If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph that the comparative financial statements are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements[7].

***

[5] SA 510, paragraph 6.

[6] SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", paragraph 8.

[7] SA 510, paragraph 6.

Application and Other Explanatory Material

Audit Procedures

Written Representations (Ref: Para. 9)

A1. In the case of comparative financial statements, the written representations are requested for all periods referred to in the auditor's opinion because management needs to re-affirm that the written representations it previously made with respect to the prior period remain appropriate. In the case of corresponding figures, the written representations are requested for the financial statements of the current period only because the auditor's opinion is on those financial statements, which include the corresponding figures. However, the auditor requests a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss.

Audit Reporting

Corresponding Figures

No Reference in Auditor's Opinion (Ref: Para.10)

A2. The auditor's opinion does not refer to the corresponding figures because the auditor's opinion is on the current period financial statements as a whole, including the corresponding figures.

Modification in Auditor's Report on the Prior Period Unresolved (Ref: Para. 11)

A3. When the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

A4. When the auditor's opinion on the prior period, as previously expressed, was modified, the unresolved matter that gave rise to the modification may not be relevant to the current period figures. Nevertheless, a qualified opinion, a disclaimer of opinion, or an adverse opinion (as applicable) may be required on the current period's financial statements because of the effects or possible effects of the unresolved matter on the comparability of the current and corresponding figures.

A5. Illustrative examples of the auditor's report if the auditor's report on the prior period included a modified opinion and the matter giving rise to the modification is unresolved are contained in Examples A and B of the Appendix.

Misstatement in Prior Period Financial Statements (Ref: Para. 12)

A6. When the prior period financial statements that are misstated have not been amended and an auditor's report thereon has not been issued in accordance with the requirements of SA 560, "Subsequent Events", but the corresponding figures have been properly dealt with as required under the applicable financial reporting framework and the appropriate disclosures have been made in the current period financial statements, the auditor's report may include an Emphasis of Matter paragraph describing the circumstances and referring to, where relevant, disclosures that fully describe the matter that can be found in the financial statements (see SA 706).

Prior Period Financial Statements Audited by a Predecessor Auditor (Ref: Para. 13)

A7. An illustrative example of the auditor's report if the prior period financial statements were audited by a predecessor auditor and the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures is contained in Example C of the Appendix.

Prior Period Financial Statements Not Audited (Ref: Para.14)

A7a. Where prior period financial statements were not audited, the auditor should request the management to disclose this fact on the face of the current period financial statements with respect to the corresponding figures.

Comparative Financial Statements

Reference in Auditor's Opinion (Ref: Para. 15)

A8. Because the auditor's report on comparative financial statements applies to the financial statements for each of the periods presented, the auditor may express a qualified opinion or an adverse opinion, disclaim an opinion, or include an Emphasis of Matter paragraph with respect to one or more periods, while expressing a different auditor's opinion on the financial statements of the other period.

A9. An illustrative example of the auditor's report if the auditor is required to report on both the current and the prior period financial statements in connection with the current year's audit and the prior period included a modified opinion and the matter giving rise to the modification is unresolved, is contained in Example D of the Appendix.

Opinion on Prior Period Financial Statements Different from Previous Opinion (Ref: Para. 16)

A10. When reporting on the prior period financial statements in connection with the current period's audit, the opinion expressed on the prior period financial statements may be different from the opinion previously expressed if the auditor becomes aware of circumstances or events that materially affect the financial statements of a prior period during the course of the audit of the current period. In some circumstances, the auditor may have additional reporting responsibilities designed to prevent future reliance on the auditor's previously issued report on the prior period financial statements.

Prior Period Financial Statements Audited by a Predecessor Auditor (Ref: Para. 18)

A11. The predecessor auditor may be unable or unwilling to revise the auditor's report on the prior period financial statements. An Other Matter paragraph of the auditor's report may indicate that the predecessor auditor reported on the financial statements of the prior period before amendment. In addition, if the auditor is engaged to audit and obtains sufficient appropriate audit evidence to be satisfied as to the appropriateness of the amendment, the auditor's report may also include the following paragraph:

> As part of our audit of the 20X2 financial statements, we also audited the adjustments described in Note X that were applied to amend the 20X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 20X1 financial statements of the company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 20X1 financial statements taken as a whole.

Material Modifications *vis-a-vis* ISA 710, "Comparative Information—Corresponding Figures and Comparative Financial Statements"

Deletions

1. Paragraphs 9 and 12 of ISA 710 deal with the restatement of the prior period financial statements. Since in India, Accounting Standard (AS) 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" requires that prior period items should be separately disclosed in the Statement of Profit and Loss in a manner that their impact on the current profit or loss can be perceived, the restatement of the prior period financial statements does not exist in the Indian scenario. Hence, to align with the requirements of AS 5, the requirement of restatement of prior period items has been replaced with the requirement to disclose the prior period items in the current year's Statement of Profit & Loss. Corresponding changes have also been made at the relevant places of the Standard.

2. Paragraph 17 of ISA 710 deals with the situation wherein the predecessor auditor reissue his audit report. Since in India, the nomenclature, "Reissue" is not used for the re-issuance of the audit report by an auditor, the same has been replaced with the word, "Revised". Corresponding changes have also been made at the relevant places of the Standard.

Appendix

Example Auditors' Reports

Example A - Corresponding Figures (Ref: Para. A5)

Report illustrative of the circumstances described in paragraph 11(a), as follows:

- The auditor's report on the prior period, as previously issued, included a qualified opinion.
- The matter giving rise to the modification is unresolved.
- The effects or possible effects of the matter on the current period's figures are material and require a modification to the auditor's opinion regarding the current period figures.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements[8]

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at March 31, 20X1, and the statement of profit and loss, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and presentation of these financial statements that give a true and fair view of the state of affairs, results of operations and cash flows of the

[8] The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion

As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements which constitutes a departure from the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This is the result of a decision taken by management at the start of the preceding financial year and caused us to qualify our audit opinion on the financial statements relating to that year. Based on the straight-line method of depreciation and annual rates of 5% for the building and 20% for the equipment, the loss for the year should be increased by ₹ XXX in 20X1 and ₹ XXX in 20X0, property, plant and equipment should be reduced by accumulated depreciation of ₹ XXX in 20X1 and ₹ XXX in 20X0, and the accumulated loss should be increased by ₹ XXX in 20X1 and ₹ XXX in 20X0.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the state of affairs of the Company as of March 31, 20X1, and of its results of operations and its cash flows for the year then ended in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act").

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[9])
Membership Number

Place of Signature

Date

Example B - Corresponding Figures (Ref: Para. A5)

Report illustrative of the circumstances described in paragraph 11(b), as follows:

- The auditor's report on the prior period, as previously issued, included a qualified opinion.
- The matter giving rise to the modification is unresolved.
- The effects or possible effects of the matter on the current period's figures are immaterial but require a modification to the auditor's opinion because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements[10]

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at March 31, 20X1, and the statement of profit and loss, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and presentation of these financial statements that give a true and fair view of the state of affairs, results of operations and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

[9] Partner or Proprietor, as the case may be.

[10] The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion

Because we were appointed auditors of the Company during 20X0, we were not able to observe the counting of the physical inventories at the beginning of that period or satisfy ourselves concerning those inventory quantities by alternative means. Since opening inventories affect the determination of the results of operations, we were unable to determine whether adjustments to the results of operations and opening retained earnings might be necessary for 20X0. Our audit opinion on the financial statements for the year ended 31 March, 20X0 was modified accordingly. Our opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures and the corresponding figures.

Qualified Opinion

In our opinion, except for the possible effects on the corresponding figures of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the state of affairs of the Company as of March 31, 20X1, and of its results of operations and its cash flows for the year then ended in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act").

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[11])
Membership Number

Place of Signature

Date

Example C - Corresponding Figures (Ref: Para. A7)

Report illustrative of the circumstances described in paragraph 13, as follows

- The prior period's financial statements were audited by a predecessor auditor.
- The auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures and decides to do so.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements[12]

We have audited the accompanying financial statements of ABC Company Ltd. ("the Company"), which comprise the balance sheet as at March 31, 20X1, and the statement of profit and loss, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and presentation of these financial statements that give a true and fair view of the state of affairs, results of operations and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial

[11] Partner or Proprietor, as the case may be.

[12] The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company as of March 31, 20X1, and of its results of operations and its cash flows for the year then ended in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act").

Other Matters

The financial statements of the Company for the year ended March 31, 20X1, were audited by another auditor who expressed an unmodified opinion on those statements on June 30, 20X1.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[13])
Membership Number

Place of Signature

Date

[13] Partner or Proprietor, as the case may be.

Example D - Comparative Financial Statements (Ref: Para. A9)

Report illustrative of the circumstances described in paragraph 15, as follows:

- Auditor is required to report on both the current period financial statements and the prior period financial statements in connection with the current year's audit.
- The financial reporting framework used in preparing the financial statements is other than accounting principals generally accepted in India. However, the audit is performed in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India.
- The auditor's report on the prior period, as previously issued, included a qualified opinion.
- The matter giving rise to the modification is unresolved.
- The effects or possible effects of the matter on the current period's figures are material to both the current period financial statements and prior period financial statements and require a modification to the auditor's opinion.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements[14]

We have audited the accompanying financial statements of ABC Company Ltd. ("the Company"), which comprise the balance sheets as at March 31, 20X1 and 20X0, and the statements of profit & loss, and cash flow statements for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and presentation of these financial statements that give a true and fair view of the state of affairs, results of operations and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's

[14] The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion

As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements which constitutes a departure from the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). Based on the straight-line method of depreciation and annual rates of 5% for the building and 20% for the equipment, the loss for the year should be increased by ₹ XXX in 20X1 and ₹ XXX in 20X0, property, plant and equipment should be reduced by accumulated depreciation of ₹ XXX in 20X1 and ₹ XXX in 20X0, and the accumulated loss should be increased by ₹ XXX in 20X1 and ₹ XXX in 20X0.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the state of affairs of the Company as of March 31, 20X1 and 20X0 and of its results of operations and its cash flows for the years then ended in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act").

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[15])
Membership Number

Place of Signature

Date

[15] Partner or Proprietor, as the case may be.

SA 720*

The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements

(Effective for audits of financial statements for periods beginning on or after April 1, 2010)

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibility in relation to other information in documents containing audited financial statements and the auditor's report thereon. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion does not cover other information and the auditor has no specific responsibility for determining whether or not other information is properly stated. However, the auditor reads the other information because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information. *(Ref: Para. A1)*

2. In this SA "documents containing audited financial statements" refers to annual reports (or similar documents), that are issued to owners (or similar stakeholders), containing audited financial statements and the auditor's report thereon. This SA may also be applied, adapted as necessary in the circumstances, to other documents containing audited financial statements. *(Ref: Para. A2-A4)*

Effective Date

3. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2010.

Objective

4. The objective of the auditor is to respond appropriately when documents containing audited financial statements and the auditor's report thereon include other information that could undermine the credibility of those financial statements and the auditor's report.

Definitions

5. For purposes of the SAs the following terms have the meanings attributed below:

(a) Other information – Financial and non-financial information (other than the financial statements and the auditor's report thereon) which is included, either by law, regulation or custom, in a document containing audited financial statements and the auditor's report thereon.

* Published in April, 2009 issue of the Journal.

(b) Inconsistency – Other information that contradicts information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.

(c) Misstatement of fact – Other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing audited financial statements.

Requirements

Reading Other Information

6. The auditor shall read the other information to identify material inconsistencies, if any, with the audited financial statements.

7. The auditor shall make appropriate arrangements with management or those charged with governance to obtain the other information prior to the date of the auditor's report. If it is not possible to obtain all the other information prior to the date of the auditor's report, the auditor shall read such other information as soon as practicable. *(Ref: Para. A5)*

Material Inconsistencies

8. If, on reading the other information, the auditor identifies a material inconsistency, the auditor shall determine whether the audited financial statements or the other information needs to be revised.

Material Inconsistencies Identified in Other Information Obtained Prior to the Date of the Auditor's Report

9. When revision of the audited financial statements is necessary and management refuses to make the revision, the auditor shall modify the opinion in accordance with SA 705.[1]

10. When revision of the other information is necessary and management refuses to make the revision, the auditor shall communicate this matter to those charged with governance; and

(a) Include in the auditor's report an Other Matter(s) paragraph describing the material inconsistency in accordance with SA 706[2]; or

(b) Where withdrawal is legally permitted, withdraw from the engagement. *(Ref: Para. A6-A7)*

Material Inconsistencies Identified in Other Information Obtained Subsequent to the Date of the Auditor's Report

11. When revision of the audited financial statements is necessary, the auditor shall follow the relevant requirements in SA 560.[3]

12. When revision of the other information is necessary and management agrees to make

[1] SA 705, "Modifications to the opinion in the Independent Auditor's Report".

[2] SA 706, "Emphasis of Matter paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", paragraph 8.

[3] SA 560, "Subsequent Events", paragraphs 10-17.

the revision, the auditor shall carry out the procedures necessary under the circumstances. *(Ref: Para. A8)*

13. When revision of the other information is necessary, but management refuses to make the revision, the auditor shall notify those charged with governance of the auditor's concern regarding the other information and take any further appropriate action. *(Ref: Para. A9)*

Material Misstatements of Fact

14. If, on reading the other information for the purpose of identifying material inconsistencies, the auditor becomes aware of an apparent material misstatement of fact, the auditor shall discuss the matter with management. *(Ref: Para. A10)*

15. When, following such discussions, the auditor still considers that there is an apparent material misstatement of fact, the auditor shall request management to consult with a qualified third party, such as the entity's legal counsel, and the auditor shall consider the advice received.

16. When the auditor concludes that there is a material misstatement of fact in the other information which management refuses to correct, the auditor shall notify those charged with governance of the auditor's concern regarding the other information and take any further appropriate action. *(Ref: Para. A11)*

***

Application and Other Explanatory Material

Scope of this SA (Ref: Para. 1-2)

A1. The auditor may have additional responsibilities, through statutory or other regulatory requirements, in relation to other information that are beyond the scope of this SA. For example, certain statutory and regulatory requirements may require the auditor to apply specific procedures to certain of the other information such as required supplementary data or to express an opinion on the reliability of performance indicators described in the other information. When there are such obligations, the auditor's additional responsibilities are determined by the nature of the engagement and by law, regulation and professional standards. If such other information is omitted or contains deficiencies, the auditor may be required by law or regulation to refer to the matter in the auditor's report.

A2. Other information may comprise, for example:

- A report by management or those charged with governance on operations.
- Financial summaries or highlights.
- Planned capital expenditures.
- Financial ratios.
- Selected quarterly data.

A3. For purposes of the SAs, other information does not encompass, for example:

- A press release or a transmittal memorandum, such as a covering letter, accompanying the document containing audited financial statements and the auditor's report thereon.
- Information contained in analyst briefings.
- Information contained on the entity's web site.

Considerations Specific to Smaller Entities (Ref: Para. 2)

A4. Unless required by law or regulation, smaller entities are less likely to issue documents containing audited financial statements. However, an example of such a document would be where a legal requirement exists for an accompanying report by those charged with governance.

Reading Other Information (Ref: Para. 7)

A5. Obtaining the other information prior to the date of the auditor's report enables the auditor to resolve possible material inconsistencies and apparent material misstatements of fact with management on a timely basis. An agreement with management as to when the other information will be available may be helpful.

Material Inconsistencies

Material Inconsistencies Identified in Other Information Obtained Prior to the Date of the Auditor's Report (Ref: Para. 10)

A6. When management refuses to revise the other information, the auditor may base any decision on what further action to take on advice from the auditor's legal counsel.

A7. In case of certain entities such as, Central/State governments and related government entities (for example, agencies, boards, commissions), withdrawal from the engagement may not be an option. In such cases the auditor may issue a report to the appropriate statutory body giving details of the inconsistency.

Material Inconsistencies Identified in Other Information Obtained Subsequent to the Date of the Auditor's Report (Ref: Para. 12-13)

A8. When management agrees to revise the other information, the auditor's procedures may include reviewing the steps taken by management to ensure that individuals in receipt of the previously issued financial statements, the auditor's report thereon, and the other information are informed of the revision.

A9. When management refuses to make the revision of such other information that the auditor concludes is necessary, appropriate further actions by the auditor may include obtaining advice from the auditor's legal counsel.

Material Misstatements of Fact (Ref: Para. 14-16)

A10. When discussing an apparent material misstatement of fact with management, the auditor may not be able to evaluate the validity of some disclosures included within the other information and management's responses to the auditor's inquiries, and may conclude that valid differences of judgment or opinion exist.

A11. When the auditor concludes that there is a material misstatement of fact that management refuses to correct, appropriate further actions by the auditor may include obtaining advice from the auditor's legal counsel.

Material Modifications *vis a vis* ISA 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements"

Deletions

1. Paragraph 10 of ISA 720 dealt with the circumstances where the revision of the financial

statements is necessary and management refuses to make the revision. In these circumstances, the auditor shall communicate this matter to those charged with governance and include in the auditor's report an Other Matter(s) paragraph describing the material inconsistency in accordance with ISA 706; or withhold the auditor's report; or where withdrawal is legally permitted, withdraw from the engagement. Since in India, the practice of withholding the auditor's report is not in vogue, an option of withholding the auditor's report by the auditor has been deleted. Similarly in paragraph A7 of the Application Section, an option of withholding the auditor's report by the auditor has been deleted.

2. Paragraph A2 of ISA 720 provides the examples of the other information including 'employment data' and 'names of officers and directors'. Reference to these two specific examples has been deleted so that the auditor can focus on more relevant aspects of other information.

3. Paragraph A4 of ISA 720 provides an example of the other information that may be included in a document containing the audited financial statements of a smaller entity are a detailed income statement and a management report..Since, in India, the terminology of "detailed income statement" and a "management report" do not exist; these have been deleted completely from the SA.

4. Paragraph A7 of ISA 720 provides that in case of public sector entitles, withdrawal from the engagement or withholding the auditor's report may not be the options. In such cases the auditor may issue a report to the appropriate statutory body giving details of the inconsistency. Since as mentioned in the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services", the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted.

Further, it is also possible that withdrawal from the engagement may not be an option even in case of non public sector entities pursuant to a requirement under the statute or regulation under which they operate. Paragraph A7 has, accordingly, been made more generic in its application.

SA 800*
Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks

(Effective for all audits relating to accounting periods beginning on or after April 1, 2011)

Introduction

Scope of this SA

1. The Standards on Auditing (SAs) in the 100-700 series apply to an audit of financial statements. This SA deals with special considerations in the application of those SAs to an audit of financial statements prepared in accordance with a special purpose framework.

2. This SA is written in the context of a complete set of financial statements prepared in accordance with a special purpose framework. SA 805[1], deals with special considerations relevant to an audit of a single financial statement or of a specific element, account or item of a financial statement.

3. This SA does not override the requirements of the other SAs; nor does it purport to deal with all special considerations that may be relevant in the circumstances of the engagement.

Effective Date

4. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2011.

Objective

5. The objective of the auditor, when applying SAs in an audit of financial statements prepared in accordance with a special purpose framework, is to address appropriately the special considerations that are relevant to:

(a) The acceptance of the engagement;

(b) The planning and performance of that engagement; and

(c) Forming an opinion and reporting on the financial statements.

Definitions

6. For purposes of the SAs, the following terms have the meanings attributed below:

(a) Special purpose financial statements – Financial statements prepared in accordance with a special purpose framework. (Ref: Para. A4)

---

* Published in April, 2010 issue of the Journal.

[1] SA 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement".

(b) Special purpose framework – A financial reporting framework designed to meet the financial information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework[2]. (Ref: Para. A1-A4)

7. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The requirements of the applicable financial reporting framework determine the form and content of the financial statements, and what constitutes a complete set of financial statements.

Requirements

Considerations When Accepting the Engagement

Acceptability of the Financial Reporting Framework

8. SA 210 requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements[3]. In an audit of special purpose financial statements, the auditor shall obtain an understanding of: (Ref: Para. A5-A8)

(a) The purpose for which the financial statements are prepared;

(b) The intended users; and

(c) The steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances.

Considerations When Planning and Performing the Audit

9. SA 200 requires the auditor to comply with all SAs relevant to the audit[4]. In planning and performing an audit of special purpose financial statements, the auditor shall determine whether application of the SAs requires special consideration in the circumstances of the engagement. (Ref: Para. A9-A12)

10. SA 315 requires the auditor to obtain an understanding of the entity's selection and application of accounting policies[5]. In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements. An interpretation is significant when adoption of another reasonable interpretation would have produced a material difference in the information presented in the financial statements.

Forming an Opinion and Reporting Considerations

11. When forming an opinion and reporting on special purpose financial statements, the auditor shall apply the requirements in SA 700 (Revised)[6]. (Ref: Para. A13)

---

[2] SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", paragraph 13(a).
[3] SA 210, "Agreeing the Terms of Audit Engagements", paragraph 6 (a).
[4] SA 200, paragraph 18.
[5] SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment", paragraph 11(c).
[6] SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements".

Description of the Applicable Financial Reporting Framework

12. SA 700 (Revised) requires the auditor to evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework[7]. In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall evaluate whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based.

13. SA 700 (Revised) deals with the form and content of the auditor's report. In the case of an auditor's report on special purpose financial statements:

(a) The auditor's report shall also describe the purpose for which the financial statements are prepared and, if necessary, the intended users, or refer to a note in the special purpose financial statements that contains that information; and

(b) If management has a choice of financial reporting frameworks in the preparation of such financial statements, the explanation of management's responsibility for the financial statements shall also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

Alerting Readers that the Financial Statements Are Prepared in Accordance with a Special Purpose Framework

14. The auditor's report on special purpose financial statements shall include an Emphasis of Matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. The auditor shall include this paragraph under an appropriate heading. (Ref: Para. A14-A15)

***

Application and Other Explanatory Material

Special Purpose Frameworks[8] (Ref: Para. 6)

A1. Examples of special purpose frameworks are:

- The cash receipts and disbursements basis of accounting for cash flow information that an entity may be requested to prepare for creditors;
- The financial reporting provisions established by a regulator to meet the requirements of that regulator; or
- The financial reporting provisions of a contract, such as a bond indenture, a loan agreement, or a project grant.

A2. There may be circumstances where a special purpose framework is based on a financial reporting framework established by an authorised or recognised standards setting

[7] SA 700 (Revised), paragraph 15.

[8] In India, financial statements prepared for filing with income tax authorities are considered to be general purpose financial statements. Attention of the readers are also invited to the announcement published in "The Chartered Accountant", August 1994 (page 224) which states that: "*It is hereby clarified that the mandatory accounting standards also apply in respect of financial statements audited under section 44AB of the Income Tax Act, 1961. Accordingly, members should examine compliance with the mandatory accounting standards when conducting such audit*".

organization or by law or regulation, but does not comply with all the requirements of that framework. An example is a contract that requires financial statements to be prepared in accordance with most, but not all, of the Financial Reporting Standards of Jurisdiction X. When this is acceptable in the circumstances of the engagement, it is inappropriate for the description of the applicable financial reporting framework in the special purpose financial statements to imply full compliance with the financial reporting framework established by the authorised or recognized standards setting organization or by law or regulation. In the above example of the contract, the description of the applicable financial reporting framework may refer to the financial reporting provisions of the contract, rather than make any reference to the Financial Reporting Standards of Jurisdiction X.

A3. In the circumstances described in paragraph A2, the special purpose framework may not be a fair presentation framework even if the financial reporting framework on which it is based is a fair presentation framework. This is because the special purpose framework may not comply with all the requirements of the financial reporting framework established by the authorized or recognized standards setting organization or by law or regulation that are necessary to achieve fair presentation of the financial statements.

A4. Financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements in those circumstances, the financial statements are still considered to be special purpose financial statements for purposes of the SAs. The requirements in paragraphs 13-14 are designed to avoid misunderstandings about the purpose for which the financial statements are prepared.

Considerations When Accepting the Engagement

Acceptability of the Financial Reporting Framework (Ref: Para. 8)

A5. In the case of special purpose financial statements, the financial information needs of the intended users are a key factor in determining the acceptability of the financial reporting framework applied in the preparation of the financial statements.

A6. The applicable financial reporting framework may encompass the financial reporting standards established by an organization that is authorized or recognized to promulgate standards for special purpose financial statements. In that case, those standards will be presumed acceptable for that purpose if the organization follows an established and transparent process involving deliberation and consideration of the views of relevant stakeholders. Some law(s) or regulation(s) may prescribe the financial reporting framework to be used by management in the preparation of special purpose financial statements for a certain type of entity. For example, a regulator may establish financial reporting provisions to meet the requirements of that regulator. In the absence of indications to the contrary, such a financial reporting framework is presumed acceptable for special purpose financial statements prepared by such entity.

A7. Where the financial reporting standards referred to in paragraph A6 are supplemented by legislative or regulatory requirements, SA 210 requires the auditor to determine whether any conflicts between the financial reporting standards and the additional requirements exist, and

prescribes actions to be taken by the auditor if such conflicts exist[9].

A8. The applicable financial reporting framework may encompass the financial reporting provisions of a contract, or sources other than those described in paragraphs A6 and A7. In that case, the acceptability of the financial reporting framework in the circumstances of the engagement is determined by considering whether the framework exhibits attributes normally exhibited by acceptable financial reporting frameworks as described in Appendix 2 of SA 210. In the case of a special purpose framework, the relative importance to a particular engagement of each of the attributes normally exhibited by acceptable financial reporting frameworks is a matter of professional judgment. For example, for purposes of establishing the value of net assets of an entity at the date of its sale, the vendor and the purchaser may have agreed that very prudent estimates of allowances for uncollectible accounts receivable are appropriate for their needs, even though such financial information is not neutral when compared with financial information prepared in accordance with a general purpose framework.

Considerations When Planning and Performing the Audit (Ref: Para. 9)

A9. SA 200 requires the auditor to comply with (a) relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements, and (b) all SAs relevant to the audit. It also requires the auditor to comply with each requirement of an SA unless, in the circumstances of the audit, the entire SA is not relevant or the requirement is not relevant because it is conditional and the condition does not exist. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement[10].

A10. Application of some of the requirements of the SAs in an audit of special purpose financial statements may require special consideration by the auditor. For example, in SA 320, judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group[11]. In the case of an audit of special purpose financial statements, however, those judgments are based on a consideration of the financial information needs of the intended users.

A11. In the case of special purpose financial statements, such as those prepared in accordance with the requirements of a contract, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose financial statements.

A12. Communication with those charged with governance in accordance with SAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility; for example, when the financial information is prepared solely for management's use. In such cases, the

[9] SA 210, paragraph 18.
[10] SA 200, paragraphs 14, 18 and 22-23.
[11] SA 320, "Materiality in Planning and Performing an Audit", paragraph 2.

requirements of SA 260[12] may not be relevant to the audit of the special purpose financial statements, except when the auditor is also responsible for the audit of the entity's general purpose financial statements or, for example, has agreed with those charged with governance of the entity to communicate to them relevant matters identified during the audit of the special purpose financial statements.

Forming an Opinion and Reporting Considerations (Ref: Para. 11)

A13. The Appendix to this SA contains illustrations of auditors' reports on special purpose financial statements.

Alerting Readers that the Financial Statements Are Prepared in Accordance with a Special Purpose Framework (Ref: Para. 14)

A14. The special purpose financial statements may be used for purposes other than those for which they were intended. For example, a regulator may require certain entities to place the special purpose financial statements on public record. To avoid misunderstandings, the auditor alerts users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and, therefore, may not be suitable for another purpose.

Restriction on Distribution or Use (Ref: Para. 14)

A15. In addition to the alert required by paragraph 14, the auditor may consider it appropriate to indicate that the auditor's report is intended solely for the specific users. Depending on the law or regulation of the particular jurisdiction, this may be achieved by restricting the distribution or use of the auditor's report. In these circumstances, the paragraph referred to in paragraph 14 may be expanded to include these other matters, and the heading modified accordingly.

Modifications *vis-a-vis* ISA 800, "Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks"

Deletion

Paragraph A1 of ISA 800 deals with the examples of special purpose frameworks, which also includes a tax basis of accounting for a set of financial statements that accompany an entity's tax return. Since in India, financial statements prepared for filing with income tax authorities are considered to be general purpose financial statements and as per the announcement issued under the authority of the Council of the Institute of Chartered Accountants of India (ICAI) in August, 1994, the mandatory accounting standards should also be applied in respect of financial statements audited under section 44AB of the Income Tax Act, 1961, an example, "A tax basis of accounting for a set of financial statements that accompany an entity's tax return" has been deleted.

[12] SA 260, "Communication with Those Charged with Governance".

Appendix

(Ref: Para. A13)

Illustrations of Auditors' Reports on Special Purpose Financial Statements

Illustration 1: An auditor's report on a complete set of financial statements prepared in accordance with the financial reporting provisions of a contract (for purposes of this illustration, a compliance framework).

Illustration 2: An auditor's report on a complete set of financial statements prepared in accordance with the financial reporting provisions established by a regulator (for purposes of this illustration, a fair presentation framework).

Illustration 1

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with the financial reporting provisions of a contract (i.e., a special purpose framework) to comply with the provisions of that contract. Management does not have a choice of financial reporting frameworks.
- The applicable financial reporting framework is a compliance framework.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- Distribution and use of the auditor's report are restricted.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the accompanying financial statements of ABC Company Ltd., which comprise the balance sheet as at March 31, 20X1, and the statement of profit and loss, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information. The financial statements have been prepared by management of ABC Company Ltd. based on the financial reporting provisions of section/ clause Z of the contract dated July 1, 20X0 between ABC Company Ltd. and DEF Company Ltd. ("the contract").

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements in accordance with the financial reporting provisions of section/ clause Z of the contract; this includes the design, implementation and maintenance of internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements of ABC Company Ltd. for the year ended March 31, 20X1 are prepared, in all material respects, in accordance with the financial reporting provisions of section/ clause Z of the contract.

Basis of Accounting and Restriction on Distribution and Use

Without modifying our opinion, we draw attention to Note X to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist ABC Company Ltd. to comply with the financial reporting provisions of the contract referred to above. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for ABC Company Ltd. and DEF Company Ltd. and should not be distributed to or used by parties other than ABC Company Ltd. or DEF Company Ltd.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[13])
Membership Number

Place of Signature

Date

[13] Partner or Proprietor, as the case may be.

Illustration 2:

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with the financial reporting provisions established by a regulator (i.e., a special purpose framework) to meet the requirements of that regulator. Management does not have a choice of financial reporting frameworks.
- The applicable financial reporting framework is a fair presentation framework.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- Distribution or use of the auditor's report is not restricted.
- The Other Matter paragraph refers to the fact that the auditor has also issued an auditor's report on financial statements prepared by ABC Company Ltd. for the same period in accordance with a general purpose framework.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the accompanying financial statements of ABC Company Ltd., which comprise the balance sheet as at March 31, 20X1, and the statement of profit and loss, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information. The financial statements have been prepared by management based on the financial reporting provisions of Section Y of Regulation Z.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the state of affairs, results of operations and cash flows of the Company in accordance with the financial reporting provisions of Section Y of Regulation Z; this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion and to the best of our information and according to the explanations given to us, the financial statements give a true and fair view of the state of affairs of ABC Company Ltd. as at March 31, 20X1, and of its results of operations and its cash flows for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z.

Basis of Accounting

Without modifying our opinion, we draw attention to Note X to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist ABC Company Ltd. to meet the requirements of Regulator DEF. As a result, the financial statements may not be suitable for another purpose.

Other Matter

ABC Company Ltd. has prepared a separate set of financial statements for the year ended March 31, 20X1 in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") on which we issued a separate auditor's report to the shareholders of ABC Company Ltd. dated June 30, 20X1.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[14])
Membership Number

Place of Signature

Date

[14] Partner or Proprietor, as the case may be.

SA 805*
Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement

(Effective for all audits relating to accounting periods beginning on or after April 1, 2011)

Introduction

Scope of this SA

1. The Standards on Auditing (SAs) in the 100-700 series apply to an audit of financial statements and are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. This SA deals with special considerations in the application of those SAs to an audit of a single financial statement or of a specific element, account or item of a financial statement. The single financial statement or the specific element, account or item of a financial statement may be prepared in accordance with a general or special purpose framework. If prepared in accordance with a special purpose framework, SA 800[1] also applies to the audit. (Ref: Para. A1-A4)

2. This SA does not apply to the report of a component auditor, issued as a result of work performed on the financial information of a component at the request of a group engagement team for purposes of an audit of group financial statements (see Proposed Revised SA 600[2]).

3. This SA does not override the requirements of the other SAs; nor does it purport to deal with all special considerations that may be relevant in the circumstances of the engagement.

Effective Date

4. This SA is effective for audits of single financial statements or of specific elements, accounts or items for periods beginning on or after April 1, 2011. In the case of audits of single financial statements or of specific elements, accounts or items of a financial statement prepared as at a specific date, this SA is effective for audits of such information prepared as at a date on or after April 1, 2011.

Objective

5. The objective of the auditor, when applying SAs in an audit of a single financial statement or of a specific element, account or item of a financial statement, is to address appropriately the special considerations that are relevant to:

---

* Published in the April, 2010 issue of the Journal.

[1] SA 800, "Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks".

[2] Currently, SA 600, 'Using the Work of Another Auditor' is in force. The standard is being revised in light of the corresponding international standard.

(a) The acceptance of the engagement;

(b) The planning and performance of that engagement; and

(c) Forming an opinion and reporting on the single financial statement or on the specific element, account or item of a financial statement.

Definitions

6. For purposes of this SA, reference to:

(a) "Element of a financial statement" or "element" means an "element, account or item of a financial statement";

(b) "Financial Reporting Standards" means the Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI) or Accounting Standards, notified by the Central Government by publishing the same as the Companies (Accounting Standards) Rules, 2006, or the Accounting Standards for Local Bodies issued by the Institute of Chartered Accountants of India, as may be applicable; and

(c) A single financial statement (for example, a cash flow statement) or to a specific element of a financial statement (for example, cash and bank balances) includes the related notes. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information relevant to the financial statement or to the element.

Requirements

Considerations When Accepting the Engagement

Application of SAs

7. SA 200 requires the auditor to comply with all SAs relevant to the audit[3]. In the case of an audit of a single financial statement or of a specific element of a financial statement, this requirement applies irrespective of whether the auditor is also engaged to audit the entity's complete set of financial statements. If the auditor is not also engaged to audit the entity's complete set of financial statements, the auditor shall determine whether the audit of a single financial statement or of a specific element of those financial statements in accordance with SAs is practicable. (Ref: Para. A5-A6)

Acceptability of the Financial Reporting Framework

8. SA 210 requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements[4]. In the case of an audit of a single financial statement or of a specific element of a financial statement, this shall include whether application of the financial reporting framework will result in a presentation that provides adequate disclosures to enable the intended users to understand the information conveyed in the financial statement or the element, and the effect of material transactions and events on the information conveyed in the financial statement or the element. (Ref: Para. A7)

Form of Opinion

9. SA 210 requires that the agreed terms of the audit engagement include the expected

[3] SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", paragraph 18.

[4] SA 210, "Agreeing the Terms of Audit Engagements", paragraph 6(a).

form of any reports to be issued by the auditor[5]. In the case of an audit of a single financial statement or of a specific element of a financial statement, the auditor shall consider whether the expected form of opinion is appropriate in the circumstances. (Ref: Para. A8-A9)

Considerations When Planning and Performing the Audit

10. SA 200 states that SAs are written in the context of an audit of financial statements; they are to be adapted as necessary in the circumstances when applied to audits of other historical financial information.[6] [7] In planning and performing the audit of a single financial statement or of a specific element of a financial statement, the auditor shall adapt all SAs relevant to the audit as necessary in the circumstances of the engagement. (Ref: Para. A10-A14)

Forming an Opinion and Reporting Considerations

11. When forming an opinion and reporting on a single financial statement or on a specific element of a financial statement, the auditor shall apply the requirements in SA 700 (Revised)[8], adapted as necessary in the circumstances of the engagement. (Ref: Para. A15-A16)

Reporting on the Entity's Complete Set of Financial Statements and on a Single Financial Statement or on a Specific Element of Those Financial Statements

12. If the auditor undertakes an engagement to report on a single financial statement or on a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements, the auditor shall express a separate opinion for each engagement.

13. An audited single financial statement or an audited specific element of a financial statement may be published together with the entity's audited complete set of financial statements. If the auditor concludes that the presentation of the single financial statement or of the specific element of a financial statement does not differentiate it sufficiently from the complete set of financial statements, the auditor shall ask management to rectify the situation. Subject to paragraphs 15 and 16, the auditor shall also differentiate the opinion on the single financial statement or on the specific element of a financial statement from the opinion on the complete set of financial statements. The auditor shall not issue the auditor's report containing the opinion on the single financial statement or on the specific element of a financial statement until satisfied with the differentiation.

Modified Opinion, Emphasis of Matter Paragraph or Other Matter Paragraph in the Auditor's Report on the Entity's Complete Set of Financial Statements

14. If the opinion in the auditor's report on an entity's complete set of financial statements is modified, or that report includes an Emphasis of Matter paragraph or an Other Matter paragraph, the auditor shall determine the effect that this may have on the auditor's report on a single financial statement or on a specific element of those financial statements. When

[5] SA 210, paragraph 10(e).

[6] SA 200, paragraph 2.

[7] SA 200, paragraph 13(f), explains that the term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework.

[8] SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements".

deemed appropriate, the auditor shall modify the opinion on the single financial statement or on the specific element of a financial statement, or include an Emphasis of Matter paragraph or an Other Matter paragraph in the auditor's report, accordingly. (Ref: Para. A17)

15. If the auditor concludes that it is necessary to express an adverse opinion or disclaim an opinion on the entity's complete set of financial statements as a whole, SA 705 does not permit the auditor to include in the same auditor's report an unmodified opinion on a single financial statement that forms part of those financial statements or on a specific element that forms part of those financial statements[9]. This is because such an unmodified opinion would contradict the adverse opinion or disclaimer of opinion on the entity's complete set of financial statements as a whole. (Ref: Para. A18)

16. If the auditor concludes that it is necessary to express an adverse opinion or disclaim an opinion on the entity's complete set of financial statements as a whole but, in the context of a separate audit of a specific element that is included in those financial statements, the auditor nevertheless considers it appropriate to express an unmodified opinion on that element, the auditor shall only do so if:

(a) The auditor is not prohibited by law or regulation from doing so;

(b) That opinion is expressed in an auditor's report that is not published together with the auditor's report containing the adverse opinion or disclaimer of opinion; and

(c) The specific element does not constitute a major portion of the entity's complete set of financial statements.

17. The auditor shall not express an unmodified opinion on a single financial statement of a complete set of financial statements if the auditor has expressed an adverse opinion or disclaimed an opinion on the complete set of financial statements as a whole. This is the case even if the auditor's report on the single financial statement is not published together with the auditor's report containing the adverse opinion or disclaimer of opinion. This is because a single financial statement is deemed to constitute a major portion of those financial statements.

***

Application and Other Explanatory Material

Scope of this SA (Ref: Para. 1)

A1. SA 200 defines the term "historical financial information" as information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past[10].

A2. SA 200 defines the term "financial statements" as a structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term ordinarily refers to a complete

[9] SA 705, "Modifications to the Opinion in the Independent Auditor's Report", paragraph 15.

[10] SA 200, paragraph 13(g).

set of financial statements as determined by the requirements of the applicable financial reporting framework[11].

A3. SAs are written in the context of an audit of financial statements[12]; they are to be adapted as necessary in the circumstances when applied to an audit of other historical financial information, such as a single financial statement or a specific element of a financial statement. This SA assists in this regard. (Appendix 1 lists examples of such other historical financial information.)

A4. A reasonable assurance engagement other than an audit of historical financial information is performed in accordance with Proposed Standard on Assurance Engagements (SAE) 3000[13].

Considerations When Accepting the Engagement

Application of SAs (Ref: Para. 7)

A5. SA 200 requires the auditor to comply with (a) relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements, and (b) all SAs relevant to the audit. It also requires the auditor to comply with each requirement of an SA unless, in the circumstances of the audit, the entire SA is not relevant or the requirement is not relevant because it is conditional and the condition does not exist. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement[14].

A6. Compliance with the requirements of SAs relevant to the audit of a single financial statement or of a specific element of a financial statement may not be practicable when the auditor is not also engaged to audit the entity's complete set of financial statements. In such cases, the auditor often does not have the same understanding of the entity and its environment, including its internal control, as an auditor who also audits the entity's complete set of financial statements. The auditor also does not have the audit evidence about the general quality of the accounting records or other accounting information that would be acquired in an audit of the entity's complete set of financial statements. Accordingly, the auditor may need further evidence to corroborate audit evidence acquired from the accounting records. In the case of an audit of a specific element of a financial statement, certain SAs require audit work that may be disproportionate to the element being audited. For example, although the requirements of SA 570[15] are likely to be relevant in the circumstances of an audit of a schedule of accounts receivable, complying with those requirements may not be practicable because of the audit effort required. If the auditor concludes that an audit of a single financial statement or of a specific element of a financial statement in accordance with SAs may not be practicable, the auditor may discuss with management whether another type of engagement might be more practicable.

---

[11] SA 200, paragraph 13(f).

[12] SA 200, paragraph 2.

[13] The Exposure Draft of SAE 3000, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information" has been published in the March, 2010 issue of the Journal.

[14] SA 200, paragraphs 14, 18 and 22-23.

[15] SA 570, "Going Concern".

Acceptability of the Financial Reporting Framework (Ref: Para. 8)

A7. A single financial statement or a specific element of a financial statement may be prepared in accordance with an applicable financial reporting framework that is based on a financial reporting framework established by an authorised or recognised standards setting organisation for the preparation of a complete set of financial statements (e.g., Financial Reporting Standards). If this is the case, determination of the acceptability of the applicable framework may involve considering whether that framework includes all the requirements of the framework on which it is based that are relevant to the presentation of a single financial statement or of a specific element of a financial statement that provides adequate disclosures.

Form of Opinion (Ref: Para. 9)

A8. The form of opinion to be expressed by the auditor depends on the applicable financial reporting framework and any applicable laws or regulations[16]. In accordance with SA 700 (Revised)[17]:

(a) When expressing an unmodified opinion on a complete set of financial statements prepared in accordance with a fair presentation framework, the auditor's opinion, unless otherwise required by law or regulation, uses one of the following phrases: (i) the financial statements present fairly, in all material respects, in accordance with [the applicable financial reporting framework]; or (ii) the financial statements give a true and fair view in accordance with [the applicable financial reporting framework]; and

(b) When expressing an unmodified opinion on a complete set of financial statements prepared in accordance with a compliance framework, the auditor's opinion states that the financial statements are prepared, in all material respects, in accordance with [the applicable financial reporting framework].

A9. In the case of a single financial statement or of a specific element of a financial statement, the applicable financial reporting framework may not explicitly address the presentation of the financial statement or of the element. This may be the case when the applicable financial reporting framework is based on a financial reporting framework established by an authorised or recognised standards setting organization for the preparation of a complete set of financial statements (e.g., Financial Reporting Standards). The auditor therefore considers whether the expected form of opinion is appropriate in the light of the applicable financial reporting framework. Factors that may affect the auditor's consideration as to whether to use the phrases "presents fairly, in all material respects", or "gives a true and fair view" in the auditor's opinion include:

- Whether the applicable financial reporting framework is explicitly or implicitly restricted to the preparation of a complete set of financial statements.
- Whether the single financial statement or the specific element of a financial statement will:
  - Comply fully with each of those requirements of the framework relevant to the particular financial statement or the particular element, and the presentation of the financial statement or the element include the related notes.

[16] SA 200, paragraph 8.

[17] SA 700 (Revised), paragraphs 35-36.

- If necessary to achieve fair presentation, provide disclosures beyond those specifically required by the framework or, in exceptional circumstances, depart from a requirement of the framework.

The auditor's decision as to the expected form of opinion is a matter of professional judgment. It may be affected by whether use of the phrases "presents fairly, in all material respects", or "gives a true and fair view" in the auditor's opinion on a single financial statement or on a specific element of a financial statement prepared in accordance with a fair presentation framework is generally accepted in the particular jurisdiction.

Considerations When Planning and Performing the Audit (Ref: Para. 10)

A10. The relevance of each of the SAs requires careful consideration. Even when only a specific element of a financial statement is the subject of the audit, SAs such as SA 240[18], SA 550[19] and SA 570 are, in principle, relevant. This is because the element could be misstated as a result of fraud, the effect of related party transactions, or the incorrect application of the going concern assumption under the applicable financial reporting framework.

A11. Furthermore, SAs are written in the context of an audit of financial statements; they are to be adapted as necessary in the circumstances when applied to the audit of a single financial statement or of a specific element of a financial statement[20]. For example, written representations from management about the complete set of financial statements would be replaced by written representations about the presentation of the financial statement or the element in accordance with the applicable financial reporting framework.

A12. When auditing a single financial statement or a specific element of a financial statement in conjunction with the audit of the entity's complete set of financial statements, the auditor may be able to use audit evidence obtained as part of the audit of the entity's complete set of financial statements in the audit of the financial statement or the element. SAs, however, require the auditor to plan and perform the audit of the financial statement or element to obtain sufficient appropriate audit evidence on which to base the opinion on the financial statement or on the element.

A13. The individual financial statements that comprise a complete set of financial statements, and many of the elements of those financial statements, including their related notes, are interrelated. Accordingly, when auditing a single financial statement or a specific element of a financial statement, the auditor may not be able to consider the financial statement or the element in isolation. Consequently, the auditor may need to perform procedures in relation to the interrelated items to meet the objective of the audit.

A14. Furthermore, the materiality determined for a single financial statement or for a specific element of a financial statement may be lower than the materiality determined for the entity's complete set of financial statements; this will affect the nature, timing and extent of the audit procedures and the evaluation of uncorrected misstatements.

[18] SA 240,'The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements'.

[19] SA 550, "Related Parties".

[20] SA 200, paragraph 2.

Forming an Opinion and Reporting Considerations (Ref: Para. 11, 14)

A15. SA 700 (Revised) requires the auditor, in forming an opinion, to evaluate whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements[21]. In the case of a single financial statement or of a specific element of a financial statement, it is important that the financial statement or the element, including the related notes, in view of the requirements of the applicable financial reporting framework, provides adequate disclosures to enable the intended users to understand the information conveyed in the financial statement or the element, and the effect of material transactions and events on the information conveyed in the financial statement or the element.

A16. Appendix 2 of this SA contains illustrations of auditors' reports on a single financial statement and on a specific element of a financial statement.

Modified Opinion, Emphasis of Matter Paragraph or Other Matter Paragraph in the Auditor's Report on the Entity's Complete Set of Financial Statements (Ref: Para. 14-15)

A17. Even when the modified opinion on the entity's complete set of financial statements, Emphasis of Matter paragraph or Other Matter paragraph does not relate to the audited financial statement or the audited element, the auditor may still deem it appropriate to refer to the modification in an Other Matter paragraph in an auditor's report on the financial statement or on the element because the auditor judges it to be relevant to the users' understanding of the audited financial statement or the audited element or the related auditor's report (see SA 706)[22].

A18. In the auditor's report on an entity's complete set of financial statements, the expression of a disclaimer of opinion regarding the results of operations and cash flows, where relevant, and an unmodified opinion regarding the state of affairs is permitted since the disclaimer of opinion is being issued in respect of the results of operations and cash flows only and not in respect of the financial statements as a whole[23].

Modifications *vis-a-vis* ISA 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement"

Addition

Paragraph 6(b) of ISA 805 defines the meaning of the International Financial Reporting Standards (IFRS). Since in India, financial reporting standards, used for the preparation and presentation of financial statements, can be 'Accounting Standards issued by the Institute of Chartered Accountants of India or Accounting Standards, notified by the Central Government by publishing the same as Companies (Accounting Standards) Rules, 2006' or 'Accounting Standards for Local Bodies issued by the Institute of Chartered Accountants of India (ICAI)', the paragraph 6(b) has, accordingly, been changed. Corresponding changes have also been made at the relevant places of the Standard.

---

[21] SA 700 (Revised), paragraph 13(e).

[22] SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", paragraph 6.

[23] SA 510, "Initial Audit Engagements—Opening Balances", paragraph A5, and SA 705, paragraph A16.

Appendix 1

(Ref: Para. A3)

Examples of Specific Elements, Accounts or Items of a Financial Statement

- Accounts receivable, allowance for doubtful accounts receivable, inventory, the liability for accrued benefits of a private pension plan, the recorded value of identified intangible assets, or the liability for "incurred but not reported" claims in an insurance portfolio, including related notes.
- A schedule of externally managed assets and income of a private pension plan, including related notes.
- A schedule of net tangible assets, including related notes.
- A schedule of disbursements in relation to a lease property, including explanatory notes.
- A schedule of profit participation or employee bonuses, including explanatory notes.

Appendix 2

(Ref: Para. A16)

Illustrations of Auditors' Reports on a Single Financial Statement and on a Specific Element of a Financial Statement

- Illustration 1: An auditor's report on a single financial statement prepared in accordance with a general purpose framework (for purposes of this illustration, a fair presentation framework).
- Illustration 2: An auditor's report on a single financial statement prepared in accordance with a special purpose framework (for purposes of this illustration, a fair presentation framework).
- Illustration 3: An auditor's report on a specific element, account or item of a financial statement prepared in accordance with a special purpose framework (for purposes of this illustration, a compliance framework).

Illustration 1:

Circumstances include the following:

- Audit of a balance sheet (i.e., a single financial statement).
- The balance sheet has been prepared by management of the entity in accordance with the requirements of the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") relevant to preparing a balance sheet.
- The applicable financial reporting framework is a fair presentation framework designed to meet the common financial information needs of a wide range of users.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- The auditor has determined that it is appropriate to use the phrase "presents a true and fair view", in the auditor's opinion.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the accompanying balance sheet of ABC Company Ltd. as at March 31, 20X1 and a summary of significant accounting policies and other explanatory information (together "the financial statement").

Management's[24] Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with the requirements of the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"), relevant to preparing such a financial statement. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statement based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, if any, made by management, as well as evaluating the overall presentation of the financial statement.

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

Opinion

In our opinion, the financial statement presents a true and fair view of the state of affairs of ABC Company Ltd. as at March 31, 20X1 in accordance with those requirements of the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"), relevant to preparing such a financial statement.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

[24] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

Signature
(Name of the Member Signing the Audit Report)
(Designation[25])
Membership Number

Place of Signature
Date

Illustration 2:

Circumstances include the following:

- Audit of a statement of cash receipts and disbursements (i.e., a single financial statement).
- The financial statement has been prepared by management of the entity in accordance with the cash receipts and disbursements basis of accounting to respond to a request for cash flow information received from a creditor. Management has a choice of financial reporting frameworks.
- The applicable financial reporting framework is a fair presentation framework designed to meet the financial information needs of specific users [26].
- The auditor has determined that it is appropriate to use the phrase "true and fair view" in the auditor's opinion.
- Distribution or use of the auditor's report is not restricted.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the accompanying statement of cash receipts and disbursements of ABC Company Ltd. for the year ended March 31, 20X1 and a summary of significant accounting policies and other explanatory information (together "the financial statement"). The financial statement has been prepared by management using the cash receipts and disbursements basis of accounting described in Note X.

Management's[27] Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with the cash receipts and disbursements basis of accounting described in Note X; this includes determining that the cash receipts and disbursements basis of accounting is an acceptable basis for the preparation of the financial statement in the circumstances, and the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

[25] Partner or Proprietor, as the case may be.

[26] SA 800 contains requirements and guidance on the form and content of financial statements prepared in accordance with a special purpose framework.

[27] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statement based on our audit. We conducted our audit in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, if any, made by management, as well as evaluating the overall presentation of the financial statement.

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

Opinion

In our opinion, the financial statement presents a true and fair view of the cash receipts and disbursements of ABC Company Ltd. for the year ended March 31, 20X1 in accordance with the cash receipts and disbursements basis of accounting described in Note X.

Basis of Accounting

Without modifying our opinion, we draw attention to Note X to the financial statement, which describes the basis of accounting. The financial statement is prepared to provide information to XYZ Creditor. As a result, the statement may not be suitable for another purpose.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[28])
Membership Number

Place of Signature

Date

[28] Partner or Proprietor, as the case may be.

Illustration 3:

Circumstances include the following:

- Audit of the liability for "incurred but not reported" claims in an insurance portfolio (i.e., element, account or item of a financial statement).
- The financial information has been prepared by management of the entity in accordance with the financial reporting provisions established by a regulator to meet the requirements of that regulator. Management does not have a choice of financial reporting frameworks.
- The applicable financial reporting framework is a compliance framework designed to meet the financial information needs of specific users[29].
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- Distribution of the auditor's report is restricted.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the accompanying schedule of the liability for "incurred but not reported" claims of ABC Insurance Company as of March 31, 20X1 ("the schedule"). The schedule has been prepared by management based on [describe the financial reporting provisions established by the regulator].

Management's[30] Responsibility for the Schedule

Management is responsible for the preparation of the schedule in accordance with [describe the financial reporting provisions established by the regulator]; this includes the design, implementation and maintenance of internal control relevant to the preparation of the schedule that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the schedule based on our audit. We conducted our audit in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the schedule is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the schedule. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the schedule in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of

[29] SA 800 contains requirements and guidance on the form and content of financial statements prepared in accordance with a special purpose framework.

[30] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the schedule.

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

Opinion

In our opinion, the financial information in the schedule of the liability for "incurred but not reported" claims of ABC Insurance Company as of March 31, 20X1 is prepared, in all material respects, in accordance with [describe the financial reporting provisions established by the regulator].

Basis of Accounting and Restriction on Distribution

Without modifying our opinion, we draw attention to Note X to the schedule, which describes the basis of accounting. The schedule is prepared to assist ABC Insurance Company to meet the requirements of Regulator DEF. As a result, the schedule may not be suitable for another purpose. Our report is intended solely for ABC Insurance Company and Regulator DEF and should not be distributed to parties other than ABC Insurance Company or Regulator DEF.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[31])
Membership Number

Place of Signature

Date

[31] Partner or Proprietor, as the case may be.

SA 810*

Engagements to Report on Summary Financial Statements

(Effective for all audits relating to accounting periods beginning on or after April 1, 2011)

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibilities when undertaking an engagement to report on summary financial statements derived from financial statements audited in accordance with SAs by that same auditor.

Effective Date

2. This SA is effective for engagements for periods beginning on or after April 1, 2011.

Objectives

3. The objectives of the auditor are to:

(a) Determine whether it is appropriate to accept the engagement to report on summary financial statements;

(b) Form an opinion on the summary financial statements based on an evaluation of the conclusions drawn from the evidence obtained; and

(c) Express clearly that opinion through a written report that also describes the basis for that opinion.

Definitions

4. For purposes of this SA, the following terms have the meanings attributed below:

(a) Applied criteria – The criteria applied by management in the preparation of the summary financial statements.

(b) Audited financial statements – Financial statements[1] audited by the auditor in accordance with SAs, and from which the summary financial statements are derived.

(c) Summary financial statements – Historical financial information that is derived from financial statements but that contains less detail than the financial statements, while still providing a structured representation consistent with that provided by the financial statements of the entity's economic resources or obligations at a point in time or the

* Published in April, 2010 issue of the Journal. Pursuant to issuance of SA 810, the 'Guidance Note on Audit of Abridged Financial Statements' issued in 1990 has been withdrawn.

[1] SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", paragraph 13(f).

changes therein for a period of time[2]. Different jurisdictions may use different terminology to describe such historical financial information.

Requirements

Engagement Acceptance

5. The auditor shall, ordinarily, accept an engagement to report on summary financial statements in accordance with this SA only when the auditor has been engaged to conduct an audit in accordance with SAs of the financial statements from which the summary financial statements are derived[3]. (Ref: Para. A1)

6. Before accepting an engagement to report on summary financial statements, the auditor shall: (Ref: Para. A2)

(a) Determine whether the applied criteria are acceptable; (Ref: Para. A3-A7)

(b) Obtain the agreement of management that it acknowledges and understands its responsibility:

   i. For the preparation of the summary financial statements in accordance with the applied criteria;

   ii. To make the audited financial statements available to the intended users of the summary financial statements without undue difficulty (or, if law or regulation provides that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements, to describe that law or regulation in the summary financial statements); and

   iii. To include the auditor's report on the summary financial statements in any document that contains the summary financial statements and that indicates that the auditor has reported on them.

(c) Agree with management the form of opinion to be expressed on the summary financial statements (see paragraphs 9-11).

7. If the auditor concludes that the applied criteria are unacceptable or is unable to obtain the agreement of management set out in paragraph 6(b), the auditor shall not accept the engagement to report on the summary financial statements, unless required by law or regulation to do so. An engagement conducted in accordance with such law or regulation does not comply with this SA. Accordingly, the auditor's report on the summary financial statements shall not indicate that the engagement was conducted in accordance with this SA. The auditor shall include appropriate reference to this fact in the terms of the engagement. The auditor shall also determine the effect that this may have on the engagement to audit the financial statements from which the summary financial statements are derived.

---

[2] SA 200, paragraph 13(f).

[3] In some cases however the auditor may be required by a law or a regulation governing the entity to report on summary financial statements even for such accounting periods for which the former was not engaged to conduct the audit in accordance with SAs of the financial statements pertaining to such accounting periods. For example, in case of the report of the auditor of the company to be included in a prospectus under Clauses 1, 2, 3 of Part IIB of Schedule II to the Companies Act, 1956, such auditor might not necessarily have been the auditor of all or some of the financial statements of the company in respect of the accounting periods relating to which financial information has been reported upon by him/ her in the aforementioned report.

Nature of Procedures

8. The auditor shall perform the following procedures, and any other procedures that the auditor may consider necessary, as the basis for the auditor's opinion on the summary financial statements:

(a) Evaluate whether the summary financial statements adequately disclose their summarised nature and identify the audited financial statements.

(b) When summary financial statements are not accompanied by the audited financial statements, evaluate whether they describe clearly:

  (i) From whom or where the audited financial statements are available; or

  (ii) The law or regulation that specifies that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements.

(c) Evaluate whether the summary financial statements adequately disclose the applied criteria.

(d) Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with or can be re-calculated from the related information in the audited financial statements.

(e) Evaluate whether the summary financial statements are prepared in accordance with the applied criteria.

(f) Evaluate, in view of the purpose of the summary financial statements, whether the summary financial statements contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.

(g) Evaluate whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty, unless law or regulation provides that they need not be made available and establishes the criteria for the preparation of the summary financial statements. (Ref: Para. A8)

Form of Opinion

9. When the auditor has concluded that an unmodified opinion on the summary financial statements is appropriate, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases: (Ref: Para. A9)

(a) The summary financial statements are consistent, in all material respects, with the audited financial statements, in accordance with [the applied criteria]; or

(b) The summary financial statements are a fair summary of the audited financial statements, in accordance with [the applied criteria].

10. If law or regulation prescribes the wording of the opinion on summary financial statements in terms that are different from those described in paragraph 9, the auditor shall:

(a) Apply the procedures described in paragraph 8 and any further procedures necessary to enable the auditor to express the prescribed opinion; and

(b) Evaluate whether users of the summary financial statements might misunderstand the auditor's opinion on the summary financial statements and, if so, whether additional

explanation in the auditor's report on the summary financial statements can mitigate possible misunderstanding.

11. If, in the case of paragraph 10(b), the auditor concludes that additional explanation in the auditor's report on the summary financial statements cannot mitigate possible misunderstanding, the auditor shall not accept the engagement, unless required by law or regulation to do so. An engagement conducted in accordance with such law or regulation does not comply with this SA. Accordingly, the auditor's report on the summary financial statements shall not indicate that the engagement was conducted in accordance with this SA.

Timing of Work and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements

12. The auditor's report on the summary financial statements may be dated later than the date of the auditor's report on the audited financial statements. In such cases, the auditor's report on the summary financial statements shall state that the summary financial statements and audited financial statements do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements that may require adjustment of, or disclosure in, the audited financial statements. (Ref: Para. A10)

13. The auditor may become aware of facts that existed at the date of the auditor's report on the audited financial statements, but of which the auditor previously was unaware. In such cases, the auditor shall not issue the auditor's report on the summary financial statements until the auditor's consideration of such facts in relation to the audited financial statements in accordance with SA 560[4] has been completed.

Auditor's Report on Summary Financial Statements

Elements of the Auditor's Report

14. The auditor's report on summary financial statements shall include the following elements[5]: (Ref: Para. A15)

(a) A title clearly indicating it as the report of an independent auditor. (Ref: Para. A11)

(b) An addressee. (Ref: Para. A12)

(c) An introductory paragraph that:

  (i) Identifies the summary financial statements on which the auditor is reporting, including the title of each statement included in the summary financial statements; (Ref: Para. A13)

  (ii) Identifies the audited financial statements;

  (iii) Refers to the auditor's report on the audited financial statements, the date of that report, and, subject to paragraphs 17-18, the fact that an unmodified opinion is expressed on the audited financial statements;

  (iv) If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, states that the

[4] SA 560, "Subsequent Events".

[5] Paragraphs 17-18, which deal with circumstances where the auditor's report on the audited financial statements has been modified, require additional elements to those listed in this paragraph.

summary financial statements and the audited financial statements do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements; and

(v) A statement indicating that the summary financial statements do not contain all the disclosures required by the financial reporting framework applied in the preparation of the audited financial statements, and that reading the summary financial statements is not a substitute for reading the audited financial statements.

(d) A description of management's responsibility for the summary financial statements, explaining that management is responsible for the preparation of the summary financial statements in accordance with the applied criteria.

(e) A statement that the auditor is responsible for expressing an opinion on the summary financial statements based on the procedures required by this SA.

(f) A paragraph clearly expressing an opinion. (see paragraphs 9-11)

(g) The auditor's signature along with the firm registration number, wherever applicable, and the membership number assigned by the Institute of Chartered Accountants of India (ICAI).

(h) The date of the auditor's report. (Ref: Para. A14)

(i) The place of signature.

15. If the addressee of the summary financial statements is not the same as the addressee of the auditor's report on the audited financial statements, the auditor shall evaluate the appropriateness of using a different addressee. (Ref: Para. A12)

16. The auditor shall date the auditor's report on the summary financial statements no earlier than: (Ref: Para. A14)

(a) The date on which the auditor has obtained sufficient appropriate evidence on which to base the opinion, including evidence that the summary financial statements have been prepared and those with the recognised authority have asserted that they have taken responsibility for them; and

(b) The date of the auditor's report on the audited financial statements.

Modifications to the Opinion, Emphasis of Matter Paragraph or Other Matter Paragraph in the Auditor's Report on the Audited Financial Statements (Ref: Para. A15)

17. When the auditor's report on the audited financial statements contains a qualified opinion, an Emphasis of Matter paragraph, or an Other Matter paragraph, but the auditor is satisfied that the summary financial statements are consistent, in all material respects, with or are a fair summary of the audited financial statements, in accordance with the applied criteria, the auditor's report on the summary financial statements shall, in addition to the elements in paragraph 14:

(a) State that the auditor's report on the audited financial statements contains a qualified opinion, an Emphasis of Matter paragraph, or an Other Matter paragraph; and

(b) Describe:

(i) The basis for the qualified opinion on the audited financial statements, and that

qualified opinion; or the Emphasis of Matter or the Other Matter paragraph in the auditor's report on the audited financial statements; and

(ii) The effect thereof on the summary financial statements, if any.

18. When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, the auditor's report on the summary financial statements shall, in addition to the elements in paragraph 14:

(a) State that the auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion;

(b) Describe the basis for that adverse opinion or disclaimer of opinion; and

(c) State that, as a result of the adverse opinion or disclaimer of opinion, it is inappropriate to express an opinion on the summary financial statements.

Modified Opinion on the Summary Financial Statements

19. If the summary financial statements are not consistent, in all material respects, with or are not a fair summary of the audited financial statements, in accordance with the applied criteria, and management does not agree to make the necessary changes, the auditor shall express an adverse opinion on the summary financial statements. (Ref: Para. A15)

Restriction on Distribution or Use or Alerting Readers to the Basis of Accounting

20. When distribution or use of the auditor's report on the audited financial statements is restricted, or the auditor's report on the audited financial statements alerts readers that the audited financial statements are prepared in accordance with a special purpose framework, the auditor shall include a similar restriction or alert in the auditor's report on the summary financial statements.

Comparatives

21. If the audited financial statements contain comparatives, but the summary financial statements do not, the auditor shall determine whether such omission is reasonable in the circumstances of the engagement. The auditor shall determine the effect of an unreasonable omission on the auditor's report on the summary financial statements. (Ref: Para. A16)

22. If the summary financial statements contain comparatives that were reported on by another auditor, the auditor's report on the summary financial statements shall also contain the matters that SA 710 requires the auditor to include in the auditor's report on the audited financial statements[6]. (Ref: Para. A17)

Unaudited Supplementary Information Presented with Summary Financial Statements

23. The auditor shall evaluate whether any unaudited supplementary information presented with the summary financial statements is clearly differentiated from the summary financial statements. If the auditor concludes that the entity's presentation of the unaudited supplementary information is not clearly differentiated from the summary financial statements, the auditor shall ask management to change the presentation of the unaudited supplementary information. If management refuses to do so, the auditor shall explain in the auditor's report on the summary financial statements that such information is not covered by that report. (Ref: Para. A18)

[6] SA 710, "Comparative Information—Corresponding Figures and Comparative Financial Statements".

Other Information in Documents Containing Summary Financial Statements

24. The auditor shall read other information included in a document containing the summary financial statements and related auditor's report to identify material inconsistencies, if any, with the summary financial statements. If, on reading the other information, the auditor identifies a material inconsistency, the auditor shall determine whether the summary financial statements or the other information needs to be revised. If, on reading the other information, the auditor becomes aware of an apparent material misstatement of fact, the auditor shall discuss the matter with management. (Ref: Para. A19)

Auditor Association

25. If the auditor becomes aware that the entity plans to state that the auditor has reported on summary financial statements in a document containing the summary financial statements, but does not plan to include the related auditor's report, the auditor shall request management to include the auditor's report in the document. If management does not do so, the auditor shall determine and carry out other appropriate actions designed to prevent management from inappropriately associating the auditor with the summary financial statements in that document. (Ref: Para. A20)

26. The auditor may be engaged to report on the financial statements of an entity, while not engaged to report on the summary financial statements. If, in this case, the auditor becomes aware that the entity plans to make a statement in a document that refers to the auditor and the fact that summary financial statements are derived from the financial statements audited by the auditor, the auditor shall be satisfied that:

(a) The reference to the auditor is made in the context of the auditor's report on the audited financial statements; and

(b) The statement does not give the impression that the auditor has reported on the summary financial statements.

If (a) or (b) are not met, the auditor shall request management to change the statement to meet them, or not to refer to the auditor in the document. Alternatively, the entity may engage the auditor to report on the summary financial statements and include the related auditor's report in the document. If management does not change the statement, delete the reference to the auditor, or include an auditor's report on the summary financial statements in the document containing the summary financial statements, the auditor shall advise management that the auditor disagrees with the reference to the auditor, and the auditor shall determine and carry out other appropriate actions designed to prevent management from inappropriately referring to the auditor. (Ref: Para. A20)

***

Application and Other Explanatory Material

Engagement Acceptance (Ref: Para. 5-6)

A1. The audit of the financial statements from which the summary financial statements are derived provides the auditor with the necessary knowledge to discharge the auditor's responsibilities in relation to the summary financial statements in accordance with this SA. Application of this SA will not provide sufficient appropriate evidence on which to base the opinion on the summary financial statements if the auditor has not also audited the financial statements from which the summary financial statements are derived.

A2. Management's agreement with the matters described in paragraph 6 may be evidenced by its written acceptance of the terms of the engagement.

Criteria (Ref: Para. 6(a))

A3. Management is responsible for the determination of the information that needs to be reflected in the summary financial statements so that they are consistent, in all material respects, with or represent a fair summary of the audited financial statements. Because summary financial statements by their nature contain aggregated information and limited disclosure, there is an increased risk that they may not contain the information necessary so as not to be misleading in the circumstances. This risk increases when established criteria for the preparation of summary financial statements do not exist.

A4. Factors that may affect the auditor's determination of the acceptability of the applied criteria include:

- The nature of the entity;
- The purpose of the summary financial statements;
- The information needs of the intended users of the summary financial statements; and
- Whether the applied criteria will result in summary financial statements that are not misleading in the circumstances.

A5. The criteria for the preparation of summary financial statements may be established by an authorised or recognised standards setting organisation or by law or regulation. Similar to the case of financial statements, as explained in SA 210[7], in many such cases, the auditor may presume that such criteria are acceptable.

A6. Where established criteria for the preparation of summary financial statements do not exist, criteria may be developed by management, for example, based on practice in a particular industry. Criteria that are acceptable in the circumstances will result in summary financial statements that:

(a) Adequately disclose their summarised nature and identify the audited financial statements;

(b) Clearly describe from whom or where the audited financial statements are available or, if law or regulation provides that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements, that law or regulation;

(c) Adequately disclose the applied criteria;

(d) Agree with or can be re-calculated from the related information in the audited financial statements; and

(e) In view of the purpose of the summary financial statements, contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.

[7] SA 210, "Agreeing the Terms of Audit Engagements", paragraphs A3 and A8-A9.

A7. Adequate disclosure of the summarised nature of the summary financial statements and the identity of the audited financial statements, as referred to in paragraph A6(a), may, for example, be provided by a title such as "Summary Financial Statements Prepared from the Audited Financial Statements for the Year Ended March 31, 20X1".

Evaluating the Availability of the Audited Financial Statements (Ref: Para. 8(g))

A8. The auditor's evaluation whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty is affected by factors such as whether:

- The summary financial statements describe clearly from whom or where the audited financial statements are available;
- The audited financial statements are on public record; or
- Management has established a process by which the intended users of the summary financial statements can obtain ready access to the audited financial statements.

Form of Opinion (Ref: Para. 9)

A9. A conclusion, based on an evaluation of the evidence obtained by performing the procedures in paragraph 8, that an unmodified opinion on the summary financial statements is appropriate enables the auditor to express an opinion containing one of the phrases in paragraph 9. The auditor's decision as to which of the phrases to use may be affected by generally accepted practice in the particular jurisdiction.

Timing of Work and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements (Ref: Para. 12)

A10. The procedures described in paragraph 8 are often performed during or immediately after the audit of the financial statements. When the auditor reports on the summary financial statements after the completion of the audit of the financial statements, the auditor is not required to obtain additional audit evidence on the audited financial statements, or report on the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements since the summary financial statements are derived from the audited financial statements and do not update them.

Auditor's Report on Summary Financial Statements

Elements of the Auditor's Report

Title (Ref: Para. 14(a))

A11. A title indicating the report is the report of an independent auditor, for example, "Report of the Independent Auditor", affirms that the auditor has met all of the relevant ethical requirements regarding independence. This distinguishes the report of the independent auditor from reports issued by others.

Addressee (Ref: Para. 14(b), 15)

A12. Factors that may affect the auditor's evaluation of the appropriateness of the addressee of the summary financial statements include the terms of the engagement, the nature of the entity, and the purpose of the summary financial statements.

Introductory Paragraph (Ref: Para. 14(c)(i))

A13. When the auditor is aware that the summary financial statements will be included in a document that contains other information, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the summary financial statements are presented. This helps readers to identify the summary financial statements to which the auditor's report relates.

Date of the Auditor's Report (Ref: Para. 14(h), 16)

A14. The person or persons with recognised authority to conclude that the summary financial statements have been prepared and take responsibility for them depend on the terms of the engagement, the nature of the entity, and the purpose of the summary financial statements.

Illustrations (Ref: Para.14, 17-18, 19)

A15. The Appendix to this SA contains illustrations of auditors' reports on summary financial statements that:

(a) Contain unmodified opinions;

(b) Are derived from audited financial statements on which the auditor issued modified opinions; and

(c) Contain a modified opinion.

Comparatives (Ref: Para. 21-22)

A16. If the audited financial statements contain comparatives, there is a presumption that the summary financial statements also would contain comparatives. Comparatives in the audited financial statements may be regarded as corresponding figures or as comparative financial information. SA 710 describes how this difference affects the auditor's report on the financial statements, including, in particular, reference to other auditors who audited the financial statements for the prior period.

A17. Circumstances that may affect the auditor's determination whether an omission of comparatives is reasonable include the nature and objective of the summary financial statements, the applied criteria, and the information needs of the intended users of the summary financial statements.

Unaudited Supplementary Information Presented with Summary Financial Statements (Ref: Para. 23)

A18. SA 700 (Revised)[8] contains requirements and guidance to be applied when unaudited supplementary information is presented with audited financial statements that, adapted as necessary in the circumstances, may be helpful in applying the requirement in paragraph 23.

Other Information in Documents Containing Summary Financial Statements (Ref: Para. 24)

A19. SA 720[9] contains requirements and guidance relating to reading other information included in a document containing the audited financial statements and related auditor's

[8] SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements", paragraphs 46-47.

[9] SA 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements".

report, and responding to material inconsistencies and material misstatements of fact. Adapted as necessary in the circumstances, they may be helpful in applying the requirement in paragraph 24.

Auditor Association (Ref: Para. 25-26)

A20. Other appropriate actions the auditor may take when management does not take the requested action may include informing the intended users and other known third-party users of the inappropriate reference to the auditor. The auditor's course of action depends on the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

Material Modifications *vis-a-vis* ISA 810, "Engagements to Report on Summary Financial Statements"

Additions

1. Paragraph 5 of ISA 810 requires the auditor to accept an engagement to report on summary financial statements in accordance with this SA only when the auditor has been engaged to conduct an audit in accordance with SAs of the financial statements from which the summary financial statements are derived. In India, in some cases, the auditor may be required by a law or a regulation governing the entity to report on summary financial statements even for such accounting periods for which the former was not engaged to conduct the audit in accordance with SAs of the financial statements pertaining to such accounting periods. For example, in case of the report of the auditor of the company to be included in a prospectus under Clauses 1, 2, 3 of Part IIB of Schedule II to the Companies Act, 1956, such auditor might not necessarily have been the auditor of all or some of the financial statements of the company in respect of the accounting periods relating to which financial information has been reported upon by him/ her in the aforementioned report, accordingly, the word "ordinarily" has been added in the Paragraph 5 to cover these situations and also added the correspondingly footnote no. 5.

2. Paragraph 14 of ISA 810 deals with the elements of the summary financial statements that also include the auditor's address. Since the Revised SA 700, "Forming an Opinion and Reporting on Financial Statements" requires the auditor to mention the "Place of Signature" instead of the "Auditor's Address" in the auditor's report, the requirement of mentioning the auditor's address has been replaced with the place of signature.

3. Paragraph 14 of ISA 810 deals with the elements of the summary financial statements that also include auditor's signature. Since as per the Revised SA 700, "Forming an Opinion and Reporting on Financial Statements", the partner/proprietor signing the audit report also needs to mention the firm registration number, wherever applicable, and the membership number assigned by the Institute of Chartered Accountants of India, the said requirement has also been incorporated in the paragraph 14(g) of SA 810.

Appendix

(Ref: Para. A15)

Illustrations of Reports on Summary Financial Statements

- Illustration 1: An auditor's report on summary financial statements prepared in accordance with established criteria. An unmodified opinion is expressed on the audited financial

statements. The auditor's report on the summary financial statements is dated later than the date of the auditor's report on the financial statements from which summary financial statements are derived.

- Illustration 2: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. An unmodified opinion is expressed on the audited financial statements.
- Illustration 3: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. A qualified opinion is expressed on the audited financial statements.
- Illustration 4: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. An adverse opinion is expressed on the audited financial statements.
- Illustration 5: An auditor's report on summary financial statements prepared in accordance with established criteria. An unmodified opinion is expressed on the audited financial statements. The auditor concludes that it is not possible to express an unmodified opinion on the summary financial statements.

Illustration 1:

Circumstances include the following:

- An unmodified opinion is expressed on the audited financial statements.
- Established criteria for the preparation of summary financial statements exist.
- The auditor's report on the summary financial statements is dated later than the date of the auditor's report on the financial statements from which the summary financial statements are derived.

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

[Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at March 31, 20X1, the summary statement of profit & loss, and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated May 15, 20X1. Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements.

The summary financial statements do not contain all the disclosures required by the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") [applied in the preparation of the audited financial statements of ABC

Company Ltd.]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company Ltd.

Management's Responsibility for the Summary Financial Statements

Management is responsible for the preparation of a summary of the audited financial statements in accordance with [Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") and accounting principles generally accepted in India].

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Standard on Auditing (SA) 810 , "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.

Opinion

In our opinion, the summary financial statements derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1 are a fair summary of those financial statements, in accordance with [Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") and accounting principles generally accepted in India].

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[10])
Membership Number

Place of Signature

Date

Illustration 2:

Circumstances include the following:

- An unmodified opinion is expressed on the audited financial statements.
- Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.

[10] Partner or Proprietor, as the case may be.

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

[Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at March 31, 20X1, the summary statement of profit & loss, and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated May 15, 20X1[11].

The summary financial statements do not contain all the disclosures required by the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") [applied in the preparation of the audited financial statements of ABC Company Ltd.]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company Ltd.

Management's Responsibility for the Summary Financial Statements

Management is responsible for the preparation of a summary of the audited financial statements on the basis described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Standard on Auditing (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.

Opinion

In our opinion, the summary financial statements derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1 are a fair summary of those financial statements, on the basis described in Note X.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[12])
Membership Number

Place of Signature
Date

[11] When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements".

[12] Partner or Proprietor, as the case may be.

Illustration 3:

Circumstances include the following:

- A qualified opinion is expressed on the audited financial statements.
- Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

[Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at March 31, 20X1, the summary statement of profit & loss, and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1[13]. We expressed a qualified audit opinion on those financial statements in our report dated May 15, 20X1 (see below).

The summary financial statements do not contain all the disclosures required by the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") [applied in the preparation of the audited financial statements of ABC Company Ltd.]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company Ltd.

Management's Responsibility for the Summary Financial Statements

Management is responsible for the preparation of a summary of the audited financial statements on the basis described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Standard on Auditing (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.

Opinion

In our opinion, the summary financial statements derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1 are a fair summary of those financial statements, on the basis described in Note X. However, the summary financial statements are misstated to the equivalent extent as the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1.

The misstatement of the audited financial statements is described in our qualified audit opinion in our report dated May 15, 20X1. Our qualified audit opinion is based on the fact that the company's inventories are carried in the balance sheet in those financial statements at ₹ XXX. Management has not stated the inventories at the lower of cost and net realisable value

[13] When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements".

but has stated them solely at cost, which constitutes a departure from the Accounting Standard (AS) 2, "Valuation of Inventories". The company's records indicate that had management stated the inventories at the lower of cost and net realisable value, an amount of ₹ XXX would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by ₹ XXX, and income tax, net income and shareholders' equity would have been reduced by ₹ XXX, ₹ XXX and ₹ XXX, respectively. Our qualified audit opinion states that, except for the effects of the described matter, those financial statements give a true and fair view of the state of affairs of ABC Company Ltd. as of March 31, 20X1, and (*of*) its results of operations and its cash flows for the year then ended in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act").

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[14])
Membership Number

Place of Signature

Date

Illustration 4:

Circumstances include the following:

- An adverse opinion is expressed on the audited financial statements.
- Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

[Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at March 31, 20X1, the summary statement of profit & loss, and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1[15].

The summary financial statements do not contain all the disclosures required by the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act,

[14] Partner or Proprietor, as the case may be.

[15] When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements".

1956 ("the Act") [applied in the preparation of the audited financial statements of ABC Company Ltd.]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company Ltd.

Management's Responsibility for the Summary Financial Statements

Management is responsible for the preparation of a summary of the audited financial statements on the basis described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Standard on Auditing (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.

Denial of Opinion

In our report dated May 15, 20X1, we expressed an adverse audit opinion on the financial statements of ABC Company Ltd. for the year ended March 31, 20X1. The basis for our adverse audit opinion was [describe basis for adverse audit opinion]. Our adverse audit opinion stated that [describe adverse audit opinion].

Because of the significance of the matter discussed above, it is inappropriate to express an opinion on the summary financial statements of ABC Company Ltd. for the year ended March 31, 20X1.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[16])
Membership Number

Place of Signature

Date

[16] Partner or Proprietor, as the case may be.

Illustration 5:

Circumstances include the following:

- An unmodified opinion is expressed on the audited financial statements.
- Established criteria for the preparation of summary financial statements exist.
- The auditor concludes that it is not possible to express an unmodified opinion on the summary financial statements.

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

[Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at March 31, 20X1, the summary statement of profit & loss, and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated May 15, 20X1[17].

The summary financial statements do not contain all the disclosures required by the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") [applied in the preparation of the audited financial statements of ABC Company Ltd.]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company Ltd.

Management's Responsibility for the Summary Audited Financial Statements

Management is responsible for the preparation of a summary of the audited financial statements in accordance with [Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") and accounting principles generally accepted in India].

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Standard on Auditing (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.

Basis for Adverse Opinion

[Describe matter that caused the summary financial statements not to be a fair summary of the audited financial statements, in accordance with the applied criteria.]

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the summary financial statements referred to above are not a fair summary of the audited financial statements of ABC Company Ltd. for the year ended March

[17] When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements".

31, 20X1, in accordance with [Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") and accounting principles generally accepted in India].

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[18])
Membership Number

Place of Signature

Date

[18] Partner or Proprietor, as the case may be.

SRE 2400 (Revised)*
Engagements to Review Financial Statements
(Effective for reviews of financial statements for periods beginning on or after April 1, 2010)

Introduction

1. The purpose of this Standard on Review Engagements (SRE) is to establish standards and provide guidance on the practitioner's[1] professional responsibilities when a practitioner, who is not the auditor of an entity, undertakes an engagement to review financial statements and on the form and content of the report that the practitioner issues in connection with such a review. A practitioner, who is the auditor of the entity, engaged to perform a review of interim financial information performs such a review in accordance with SRE 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity".

2. This SRE is directed towards the review of financial statements. However, it is to be applied, adapted as necessary in the circumstances, to engagements to review other historical financial information. Guidance in the Standards on Auditing (SAs) may be useful to the practitioner in applying this SRE.

Objective of a Review Engagement

3. The objective of a review of financial statements is to enable a practitioner to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the practitioner's attention that causes the practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework (negative assurance).

General Principles of a Review Engagement

4. The practitioner should comply with the *Code of Ethics* issued by the Institute of Chartered Accountants of India. Ethical principles governing the practitioner's professional responsibilities are:

(a) Independence;
(b) Integrity;
(c) Objectivity;
(d) Professional competence and due care;
(e) Confidentiality;
(f) Professional behaviour; and
(g) Technical standards.

---

* Published in May, 2010 issue of the Journal.

[1] The term "practitioner" means professional accountants in public practice, i.e., a member of the Institute of Chartered Accountants of India who is in practice in terms of section 2 of the Chartered Accountants Act, 1949. The term is also used to refer to a firm of chartered accountants in public practice.

5. The practitioner should conduct a review in accordance with this SRE.

6. The practitioner should plan and perform the review with an attitude of professional skepticism recognising that circumstances may exist which cause the financial statements to be materially misstated.

7. For the purpose of expressing negative assurance in the review report, the practitioner should obtain sufficient appropriate evidence primarily through inquiry and analytical procedures to be able to draw conclusions.

Scope of a Review

8. The term "scope of a review" refers to the review procedures deemed necessary in the circumstances to achieve the objective of the review. The procedures required to conduct a review of financial statements should be determined by the practitioner having regard to the requirements of this SRE, relevant professional bodies, legislation, regulation and, where appropriate, the terms of the review engagement and reporting requirements.

Moderate Assurance

9. A review engagement provides a moderate level of assurance that the information subject to review is free of material misstatement, this is expressed in the form of negative assurance.

Terms of Engagement

10. The practitioner and the client should agree on the terms of the engagement. The agreed terms would be recorded in an engagement letter or other suitable form such as a contract.

11. An engagement letter will be of assistance in planning the review work. It is in the interests of both the practitioner and the client that the practitioner sends an engagement letter documenting the key terms of the appointment. An engagement letter confirms the practitioner's acceptance of the appointment and helps avoid misunderstanding regarding such matters as the objectives and scope of the engagement, the extent of the practitioner's responsibilities and the form of reports to be issued.

12. Matters that would be included in the engagement letter include the following:

- The objective of the service being performed.
- Management's responsibility for the financial statements.
- The scope of the review, including reference to this SRE (or relevant national standards or practices).
- Unrestricted access to whatever records, documentation and other information requested in connection with the review.
- The anticipated form and content of the report to be issued, including the identity of the addressee of the report.
- The fact that the engagement cannot be relied upon to disclose errors, illegal acts or other irregularities, for example, fraud or defalcations that may exist.
- A statement that an audit is not being performed and that an audit opinion will not be expressed. To emphasise this point and to avoid confusion, the practitioner may also

consider pointing out that a review engagement will not satisfy any statutory or third party requirements for an audit.

A specimen of an engagement letter for a review of financial statements appears in Appendix 1 to this SRE.

Planning

13. The practitioner should plan the work so that an effective engagement will be performed.

14. In planning a review of financial statements, the practitioner should obtain or update the knowledge of the business including consideration of the entity's organisation, accounting systems, operating characteristics and the nature of its assets, liabilities, revenues and expenses.

15. The practitioner needs to possess an understanding of such matters and other matters relevant to the financial statements, for example, a knowledge of the entity's production and distribution methods, product lines, operating locations and related parties. The practitioner requires this understanding to be able to make relevant inquiries and to design appropriate procedures, as well as to assess the responses and other information obtained.

Work Performed by Others

16. When using work performed by another practitioner or an expert, the practitioner should be satisfied that such work is adequate for the purposes of the review.

Documentation

17. The practitioner should document matters which are important in providing evidence to support the review report, and evidence that the review was carried out in accordance with this SRE.

Procedures and Evidence

18. The practitioner should apply judgment in determining the specific nature, timing and extent of review procedures. The practitioner will be guided by such matters as the following:

- Any knowledge acquired by carrying out audits or reviews of the financial statements for prior periods.
- The practitioner's knowledge of the business including knowledge of the accounting principles and practices of the industry in which the entity operates.
- The entity's accounting systems.
- The extent to which a particular item is affected by management judgment.
- The materiality of transactions and account balances.

19. The practitioner should apply the same materiality considerations as would be applied if an audit opinion on the financial statements were being given. Although there is a greater risk that misstatements will not be detected in a review than in an audit, the judgment as to what is material is made by reference to the information on which the practitioner is reporting and the needs of those relying on that information, not to the level of assurance provided.

20. Procedures for the review of financial statements will ordinarily include the following:

- Obtaining an understanding of the entity's business and the industry in which it operates.

- Inquiries concerning the entity's accounting principles and practices.
- Inquiries concerning the entity's procedures for recording, classifying and summarising transactions, accumulating information for disclosure in the financial statements and preparing financial statements.
- Inquiries concerning all material assertions in the financial statements.
- Analytical procedures designed to identify relationships and individual items that appear unusual. Such procedures would include:
  - Comparison of the financial statements with statements for prior periods.
  - Comparison of the financial statements with anticipated results and financial position.
  - Study of the relationships of the elements of the financial statements that would be expected to conform to a predictable pattern based on the entity's experience or industry norm.

  In applying these procedures, the practitioner would consider the types of matters that required accounting adjustments in prior periods.
- Inquiries concerning actions taken at meetings of shareholders, the board of directors, committees of the board of directors and other meetings that may affect the financial statements.
- Reading the financial statements to consider, on the basis of information coming to the practitioner's attention, whether the financial statements appear to conform with the basis of accounting indicated.
- Obtaining reports from other practitioners, if any and if considered necessary, who have been engaged to audit or review the financial statements of components of the entity.
- Inquiries of persons having responsibility for financial and accounting matters concerning, for example:
  - Whether all transactions have been recorded.
  - Whether the financial statements have been prepared in accordance with the basis of accounting indicated.
  - Changes in the entity's business activities and accounting principles and practices.
  - Matters as to which questions have arisen in the course of applying the foregoing procedures.
  - Obtaining written representations from management when considered appropriate.

Appendix 2 to this SRE provides an illustrative list of procedures which are often used. The list is not exhaustive, nor is it intended that all the procedures suggested apply to every review engagement.

21. The practitioner should inquire about events subsequent to the date of the financial statements that may require adjustment of or disclosure in the financial statements. The practitioner does not have any responsibility to perform procedures to identify events occurring after the date of the review report.

22. If the practitioner has reason to believe that the information subject to review may be materially misstated, the practitioner should carry out additional or more extensive

procedures as are necessary to be able to express negative assurance or to confirm that a modified report is required.

Conclusions and Reporting

23. The review report should contain a clear written expression of negative assurance. The practitioner should review and assess the conclusions drawn from the evidence obtained as the basis for the expression of negative assurance.

24. Based on the work performed, the practitioner should assess whether any information obtained during the review indicates that the financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the applicable financial reporting framework.

25. The report on a review of financial statements describes the scope of the engagement to enable the reader to understand the nature of the work performed and make it clear that an audit was not performed and, therefore, that an audit opinion is not expressed.

26. The report on a review of financial statements should contain the following basic elements, ordinarily in the following layout:

(a) Title[2];

(b) Addressee;

(c) Opening or introductory paragraph including:

  (i) Identification of the financial statements on which the review has been performed; and

  (ii) A statement of the responsibility of the entity's management and the responsibility of the practitioner;

(d) Scope paragraph, describing the nature of a review, including:

  (i) A reference to this SRE applicable to review engagements, or to relevant national standards or practices;

  (ii) A statement that a review is limited primarily to inquiries and analytical procedures; and

  (iii) A statement that an audit has not been performed, that the procedures undertaken provide less assurance than an audit and that an audit opinion is not expressed;

(e) Statement of negative assurance;

(f) Date of the report;

(g) Place of Signature;

(h) Practitioner's signature and membership number assigned by the Institute of Chartered Accountants of India (ICAI); and

(i) The Firm's registration number of the member of the Institute, wherever applicable, as allotted by ICAI.

Appendices 3 and 4 to this SRE contain illustrations of review reports.

[2] It may be appropriate to use the term "independent" in the title to distinguish the practitioner's report from reports that might be issued by others, such as officers of the entity, or from the reports of other practitioners who may not have to abide by the same ethical requirements as an independent practitioner.

27. The review report should:

(a) State that nothing has come to the practitioner's attention based on the review that causes the practitioner to believe the financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the applicable financial reporting framework (negative assurance); or

(b) If matters have come to the practitioner's attention, describe those matters that impair a true and fair view (or a fair presentation, in all material respects) in accordance with the applicable financial reporting framework, including, unless impracticable, a quantification of the possible effect(s) on the financial statements, and either:

   (i) Express a qualification of the negative assurance provided; or

   (ii) When the effect of the matter is so material and pervasive to the financial statements that the practitioner concludes that a qualification is not adequate to disclose the misleading or incomplete nature of the financial statements, give an adverse statement that the financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the applicable financial reporting framework; or

(c) If there has been a material scope limitation, describe the limitation and either:

   (i) Express a qualification of the negative assurance provided regarding the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed; or

   (ii) When the possible effect of the limitation is so significant and pervasive that the practitioner concludes that no level of assurance can be provided, not provide any assurance.

28. The practitioner should date the review report as of the date the review is completed, which includes performing procedures relating to events occurring up to the date of the report. However, since the practitioner's responsibility is to report on the financial statements as prepared and presented by management, the practitioner should not date the review report earlier than the date on which the financial statements were approved by management.

Effective Date

29. This SRE is effective for reviews of financial statements for periods beginning on or after April 1, 2010.

Material Modifications *vis-à-vis* ISRE 2400, "Engagements to Review Financial Statements"

Addition

Paragraph 26 of ISRE 2400 deals with the basic elements of the report on a review of financial statements, which also includes the Practitioner's Address. Since in India, Revised Standard on Auditing (SA) 700 requires the auditor also to mention the "Place of Signature", i.e., name of specific location, which is ordinarily the city where the review report is signed, in his report, the requirement to mention the practitioner's address in the practitioner's report has been replaced with the requirement to mention the place of signature in the practitioner's report.

Appendix 1

Specimen of an Engagement Letter for a Review of Financial Statements

The following letter is for use as a guide in conjunction with the consideration outlined in paragraph 10 of this SRE and will need to be varied according to individual requirements and circumstances.

To the Board of Directors (or the appropriate representative of senior management):

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will review the balance sheet of ABC Company as at March 31, 20XX, and the related statement of profit and loss and the cash flows for the year then ended, in accordance with the Revised Standard on Review Engagements (SRE) 2400, "Engagements to Review Financial Statements", issued by the Institute of Chartered Accountants of India (ICAI). We will not perform an audit of such financial statements and, accordingly, we will not express an audit opinion on them. Accordingly, we expect to report on the financial statements as follows:

(see Appendix 3 to this SRE)

Responsibility for the financial statements, including adequate disclosure, is that of the management of the company. This includes the maintenance of adequate accounting records and internal controls and the selection and application of accounting policies. (As part of our review process, we will request written representations from management concerning assertions made in connection with the review).

This letter will be effective for future years unless it is terminated, amended or superseded (if applicable).

Our engagement cannot be relied upon to disclose whether fraud or errors, or illegal acts exist. However, we will inform you of any material matters that come to our attention.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our review of the financial statements.

For ABC and Co.,
Chartered Accountants
Firm's Registration Number
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[3])
(Membership Number)

Acknowledged on behalf of ABC Company by

(signed)

.....

Name and Title

Date

[3] Partner or proprietor, as the case may be.

Appendix 2

Illustrative Detailed Procedures that may be Performed in an Engagement to Review Financial Statements

1. The inquiry and analytical review procedures carried out in a review of financial statements are determined by the practitioner's judgment. The procedures listed below are for illustrative purposes only. It is not intended that all the procedures suggested apply to every review engagement. This Appendix is not intended to serve as a program or checklist in the conduct of a review.

General

2. Discuss terms and scope of the engagement with the client and the engagement team.
3. Prepare an engagement letter setting forth the terms and scope of the engagement.
4. Obtain an understanding of the entity's business activities and the system for recording financial information and preparing financial statements.
5. Inquire whether all financial information is recorded:
   (a) Completely;
   (b) Promptly; and
   (c) After the necessary authorisation.
6. Obtain the trial balance and determine whether it agrees with the general ledger and the financial statements.
7. Consider the results of previous audits and review engagements, including accounting adjustments required.
8. Inquire whether there have been any significant changes in the entity from the previous year (e.g., changes in ownership or changes in capital structure).
9. Inquire about the accounting policies and consider whether:
   (a) They comply with the applicable accounting standards;
   (b) They have been applied appropriately; and
   (c) They have been applied consistently and, if not, consider whether disclosure has been made of any changes in the accounting policies.
10. Read the minutes of meetings of shareholders, the board of directors and other appropriate committees in order to identify matters that could be important to the review.
11. Inquire if actions taken at shareholder, board of directors or comparable meetings that affect the financial statements have been appropriately reflected therein.
12. Inquire about the existence of transactions with related parties, how such transactions have been accounted for and whether related parties have been properly disclosed.
13. Inquire about contingencies and commitments.
14. Inquire about plans to dispose of major assets or business segments.
15. Obtain the financial statements and discuss them with management.
16. Consider the adequacy of disclosure in the financial statements and their suitability as to classification and presentation.

17. Compare the results shown in the current period financial statements with those shown in financial statements for comparable prior periods and, if available, with budgets and forecasts.
18. Obtain explanations from management for any unusual fluctuations or inconsistencies in the financial statements.
19. Consider the effect of any unadjusted errors – individually and in aggregate. Bring the errors to the attention of management and determine how the unadjusted errors will influence the report on the review.
20. Consider obtaining a representation letter from management.

Cash

21. Obtain the bank reconciliations. Inquire about any old or unusual reconciling items with client personnel.
22. Inquire about transfers between cash accounts for the period before and after the review date.
23. Inquire whether there are any restrictions on cash accounts.

Receivables

24. Inquire about the accounting policies for initially recording trade receivables and determine whether any allowances are given on such transactions.
25. Obtain a schedule of receivables and determine whether the total agrees with the trial balance.
26. Obtain and consider explanations of significant variations in account balances from previous periods or from those anticipated.
27. Obtain an age analysis of the trade receivables. Inquire about the reason for unusually large accounts, credit balances on accounts or any other unusual balances and inquire about the collectibility of receivables.
28. Discuss with management the classification of receivables, including non-current balances, net credit balances and amounts due from shareholders, directors and other related parties in the financial statements.
29. Inquire about the method for identifying “slow payment” accounts and setting allowances for doubtful accounts and consider it for reasonableness.
30. Inquire whether receivables have been pledged, factored or discounted.
31. Inquire about procedures applied to ensure that a proper cut-off of sales transactions and sales returns has been achieved.
32. Inquire whether accounts represent goods shipped on consignment and, if so, whether adjustments have been made to reverse these transactions and include the goods in inventory.
33. Inquire whether any large credits relating to revenue recorded have been issued after the balance sheet date and whether provision has been made for such amounts.

Inventories

34. Obtain the inventory list and determine whether:
    (a) The total agrees with the balance in the trial balance; and
    (b) The list is based on a physical count of inventory.

35. Inquire about the method for counting inventory.
36. Where a physical count was not carried out on the balance sheet date, inquire whether:
    (a) A perpetual inventory system is used and whether periodic comparisons are made with actual quantities on hand; and
    (b) An integrated cost system is used and whether it has produced reliable information in the past.
37. Discuss adjustments made resulting from the last physical inventory count.
38. Inquire about procedures applied to control cut-off and any inventory movements.
39. Inquire about the basis used in valuing each category of the inventory and, in particular, regarding the elimination of inter-branch profits. Inquire whether inventory is valued at the lower of cost and net realisable value.
40. Consider the consistency with which inventory valuation methods have been applied, including factors such as material, labour and overhead.
41. Compare amounts of major inventory categories with those of prior periods and with those anticipated for the current period. Inquire about major fluctuations and differences.
42. Compare inventory turnover with that in previous periods.
43. Inquire about the method used for identifying slow moving and obsolete inventory and whether such inventory has been accounted for at net realisable value.
44. Inquire whether any of the inventory has been consigned to the entity and, if so, whether adjustments have been made to exclude such goods from inventory.
45. Inquire whether any inventory is pledged, stored at other locations or on consignment to others and consider whether such transactions have been accounted for appropriately.

Investments (Including Associated Companies and Marketable Securities)

46. Obtain a schedule of the investments as at the balance sheet date and determine whether it agrees with the trial balance.
47. Inquire about the accounting policy applied to investments.
48. Inquire from management about the carrying values of investments. Consider whether there are any realisation problems.
49. Consider whether there has been proper accounting for gains and losses and investment income.
50. Inquire about the classification of long-term and short-term investments.

Property and Depreciation

51. Obtain a schedule of the property indicating the cost and accumulated depreciation and determine whether it agrees with the trial balance.
52. Inquire about the accounting policy applied regarding the provision for depreciation and distinguishing between capital and maintenance items. Consider whether the property has suffered a material, permanent impairment in value.
53. Discuss with management the additions and deletions to property accounts and accounting for gains and losses on sales or retirements. Inquire whether all such transactions have been accounted for.
54. Inquire about the consistency with which the depreciation method and rates have been applied and compare depreciation provisions with prior years.

55. Inquire whether there are any liens on the property.
56. Discuss whether lease agreements have been properly reflected in the financial statements in conformity with current accounting pronouncements.

Prepaid Expenses, Intangibles and Other Assets

57. Obtain schedules identifying the nature of these accounts and discuss with management the recoverability thereof.
58. Inquire about the basis for recording these accounts and the amortisation methods used.
59. Compare balances of related expense accounts with those of prior periods and discuss significant variations with management.
60. Discuss the classification between long-term and short-term accounts with management.

Loans Payable

61. Obtain from management a schedule of loans payable and determine whether the total agrees with the trial balance.
62. Inquire whether there are any loans where management has not complied with the provisions of the loan agreement and, if so, inquire as to management's actions and whether appropriate adjustments have been made in the financial statements.
63. Consider the reasonableness of interest expense in relation to loan balances.
64. Inquire whether loans payable are secured.
65. Inquire whether loans payable have been classified between non-current and current.

Trade Payables

66. Inquire about the accounting policies for initially recording trade payables and whether the entity is entitled to any allowances given on such transactions.
67. Obtain and consider explanations of significant variations in account balances from previous periods or from those anticipated.
68. Obtain a schedule of trade payables and determine whether the total agrees with the trial balance.
69. Inquire whether balances are reconciled with the creditors' statements and compare with prior period balances. Compare turnover with prior periods.
70. Consider whether there could be material unrecorded liabilities.
71. Inquire whether payables to shareholders, directors and other related parties are separately disclosed.

Accrued and Contingent Liabilities

72. Obtain a schedule of the accrued liabilities and determine whether the total agrees with the trial balance.
73. Compare major balances of related expense accounts with similar accounts for prior periods.
74. Inquire about approvals for such accruals, terms of payment, compliance with terms, collateral and classification.
75. Inquire about the method for determining accrued liabilities.
76. Inquire as to the nature of amounts included in contingent liabilities and commitments.

77. Inquire whether any actual or contingent liabilities exist which have not been recorded in the accounts. If so, discuss with management whether provisions need to be made in the accounts or whether disclosure should be made in the notes to the financial statements.

Income and Other Taxes

78. Inquire from management if there were any events, including disputes with taxation authorities, which could have a significant effect on the taxes payable by the entity.
79. Consider the tax expense in relation to the entity's income for the period.
80. Inquire from management as to the adequacy of the recorded deferred and current tax liabilities including provisions in respect of prior periods.

Subsequent Events

81. Obtain from management the latest interim financial statements and compare them with the financial statements being reviewed or with those for comparable periods from the preceding year.
82. Inquire about events after the balance sheet date that would have a material effect on the financial statements under review and, in particular, inquire whether:
    (a) Any substantial commitments or uncertainties have arisen subsequent to the balance sheet date;
    (b) Any significant changes in the share capital, long-term debt or working capital have occurred up to the date of inquiry; and
    (c) Any unusual adjustments have been made during the period between the balance sheet date and the date of inquiry.

    Consider the need for adjustments or disclosure in the financial statements.
83. Obtain and read the minutes of meetings of shareholders, directors and appropriate committees subsequent to the balance sheet date.

Litigation

84. Inquire from management whether the entity is the subject of any legal actions threatened, pending or in process. Consider the effect thereof on the financial statements.

Equity

85. Obtain and consider a schedule of the transactions in the equity accounts, including new issues, retirements and dividends.
86. Inquire whether there are any restrictions on retained earnings or other equity accounts.

Operations

87. Compare results with those of prior periods and those expected for the current period. Discuss significant variations with management.
88. Discuss whether the recognition of major sales and expenses have taken place in the appropriate periods.
89. Consider extraordinary and unusual items.
90. Consider and discuss with management the relationship between related items in the revenue account and assess the reasonableness thereof in the context of similar relationships for prior periods and other information available to the practitioner.

Appendix 3

Form of Unqualified Review Report

REVIEW REPORT TO...

We have reviewed the accompanying balance sheet of ABC Company as at March 31, 20XX, and related statement of profit and loss, and the cash flow statement for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with the Revised Standard on Review Engagements (SRE) 2400, "Engagements to Review Financial Statements", issued by the Institute of Chartered Accountants of India (ICAI). This Standard requires that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the accompanying financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the Financial Reporting Standards[4].

For ABC and Co.,
Chartered Accountants
Firm's Registration Number

Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[5])
Membership Number

Place of Signature
Date

Appendix 4

Examples of Review Reports Other than Unqualified

Qualification for a Departure from Financial Reporting Standards

REVIEW REPORT TO ...

We have reviewed the accompanying balance sheet of ABC Company as at March 31, 20XX, and the related statement of profit and loss, and the cash flow statement for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with the Revised Standard on Review Engagements (SRE) 2400, "Engagements to Review Financial Statements", issued by the Institute of Chartered Accountants of India (ICAI). This Standard requires that we plan and perform the

[4] Accounting Standards issued by the Institute of Chartered Accountants of India or Accounting Standards notified by the Central Government as the Companies (Accounting Standards) Rules, 2006, or the Accounting Standards for Local Bodies issued by the Institute of Chartered Accountants of India, as may be applicable.

[5] Partner or proprietor, as the case may be.

review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit, and, accordingly, we do not express an audit opinion.

Management has informed us that inventory has been stated at its cost, which is in excess of its net realisable value. Management's computation, which we have reviewed, shows that inventory, if valued at the lower of cost and net realisable value as required by Accounting Standard (AS) 2, "Valuation of Inventories" notified by the Central Government under the Companies (Accounting Standards) Rules, 2006[6], would have been decreased by ₹ X, and net profit and reserves would have been decreased by ₹ X.

Based on our review, except for the effects of the overstatement of inventory described in the previous paragraph, nothing has come to our attention that causes us to believe that the accompanying financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the aforesaid Rules, 2006[7].

For ABC and Co.,
Chartered Accountants
Firm's Registration Number
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[8])
Membership Number

Place of Signature
Date

Adverse Report for a Departure from Financial Reporting Standards

REVIEW REPORT TO .....

We have reviewed the accompanying balance sheet of ABC Company as at March 31, 20XX, and the related statement of profit and loss, and the cash flow statement for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with the Revised Standard on Review Engagements (SRE) 2400, "Engagements to Review Financial Statements", issued by the Institute of Chartered Accountants of India (ICAI). This Standard requires that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

As noted in note X, the Company has adopted the method of taking entire profits on construction contracts to the statement of profit and loss on entering into the contract. This has resulted in anticipating the profit in cases where the contracts have not even been commenced or where only a very minor part of the expenditure relating to the construction

[6] See footnote 5.
[7] See footnote 5.
[8] Partner or proprietor, as the case may be.

contracts has been incurred. This method of accounting is contrary to the requirements of Accounting Standard (AS) 7, "Accounting for Construction Contracts", notified by the Central Government under the Companies (Accounting Standards) Rules, 2006[9].

Based on our review, because of the pervasive effect on the financial statements of the matter discussed in the preceding paragraph, the accompanying financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the aforesaid Rules, 2006[10].

For ABC and Co.,
Chartered Accountants
Firm's Registration Number
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[11])
Membership Number

Place of Signature
Date

[9] See footnote 5.
[10] See footnote 5.
[11] Partner or proprietor, as the case may be.

SRE 2410*
Review of Interim Financial Information Performed by the Independent Auditor of the Entity

(Effective for reviews of interim financial information for periods beginning on or after April 1, 2010)

Introduction

1. The purpose of this Standard on Review Engagements (SRE) is to establish standards and provide guidance on the auditor's professional responsibilities when the auditor undertakes an engagement to review interim financial information of an audit client, and on the form and content of the report. The term "auditor" is used throughout this SRE, not because the auditor is performing an audit function but because the scope of this SRE is limited to a review of interim financial information performed by the independent auditor of the financial statements of the entity.

2. For purposes of this SRE, interim financial information is financial information that is prepared and presented in accordance with an applicable financial reporting framework[1] and comprises either a complete or a condensed set of financial statements for a period that is shorter than the entity's financial year.

3. The auditor who is engaged to perform a review of interim financial information should perform the review in accordance with this SRE. Through performing the audit of the annual financial statements, the auditor obtains an understanding of the entity and its environment, including its internal control. When the auditor is engaged to review the interim financial information, this understanding is updated through inquiries made in the course of the review, and assists the auditor in focusing the inquiries to be made and the analytical and other review procedures to be applied. A practitioner who is engaged to perform a review of interim financial information, and who is not the auditor of the entity, performs the review in accordance with SRE 2400 (Revised), "Engagements to Review Financial Statements." As the practitioner does not ordinarily have the same understanding of the entity and its environment, including its internal control, as the auditor of the entity, the practitioner needs to carry out different inquiries and procedures to meet the objective of the review.

3a. This SRE is directed towards a review of interim financial information by an entity's auditor. However, it is to be applied, adapted as necessary in the circumstances, when an entity's auditor undertakes an engagement to review historical financial information other than interim financial information of an audit client.

---

* Published in May, 2010 issue of the Journal.

[1] For example, Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI) or Accounting Standards, notified by the Central Government by publishing the same as the Companies (Accounting Standards) Rules, 2006, or the Accounting Standards for Local Bodies issued by the ICAI, as may be applicable.

General Principles of a Review of Interim Financial Information

4. **The auditor should comply with the ethical requirements relevant to the audit of the annual financial statements of the entity.** These ethical requirements govern the auditor's professional responsibilities in the following areas: independence, integrity, objectivity, professional competence and due care, confidentiality, professional behavior, and technical standards.

5. **The auditor should implement quality control procedures that are applicable to the individual engagement.** The elements of quality control that are relevant to an individual engagement include leadership responsibilities for quality on the engagement, ethical requirements, acceptance and continuance of client relationships and specific engagements, assignment of engagement teams, engagement performance, and monitoring.

6. **The auditor should plan and perform the review with an attitude of professional skepticism, recognizing that circumstances may exist that cause the interim financial information to require a material adjustment for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework.** An attitude of professional skepticism means that the auditor makes a critical assessment, with a questioning mind, of the validity of evidence obtained and is alert to evidence that contradicts or brings into question the reliability of documents or representations by management of the entity.

Objective of an Engagement to Review Interim Financial Information

7. The objective of an engagement to review interim financial information is to enable the auditor to express a conclusion whether, on the basis of the review, anything has come to the auditor's attention that causes the auditor to believe that the interim financial information is not prepared, in all material respects, in accordance with an applicable financial reporting framework. The auditor makes inquiries, and performs analytical and other review procedures in order to reduce to a moderate level the risk of expressing an inappropriate conclusion when the interim financial information is materially misstated.

8. The objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with Standards on Auditing (SAs). A review of interim financial information does not provide a basis for expressing an opinion whether the financial information gives a true and fair view, or is presented fairly, in all material respects, in accordance with an applicable financial reporting framework.

9. A review, in contrast to an audit, is not designed to obtain reasonable assurance that the interim financial information is free from material misstatement. A review consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review may bring significant matters affecting the interim financial information to the auditor's attention, but it does not provide all of the evidence that would be required in an audit.

Agreeing the Terms of the Engagement

10. **The auditor and the client should agree on the terms of the engagement.**

11. The agreed terms of the engagement are ordinarily recorded in an engagement letter. Such a communication helps to avoid misunderstandings regarding the nature of the engagement and, in particular, the objective and scope of the review, management's

responsibilities, the extent of the auditor's responsibilities, the assurance obtained, and the nature and form of the report. The communication ordinarily covers the following matters:

- The objective of a review of interim financial information.
- The scope of the review.
- Management's responsibility for the interim financial information.
- Management's responsibility for establishing and maintaining effective internal control relevant to the preparation of interim financial information.
- Management's responsibility for making all financial records and related information available to the auditor
- Management's agreement to provide written representations to the auditor to confirm representations made orally during the review, as well as representations that are implicit in the entity's records.
- The anticipated form and content of the report to be issued, including the identity of the addressee of the report.
- Management's agreement that where any document containing interim financial information indicates that the interim financial information has been reviewed by the entity's auditor, the review report will also be included in the document.

An illustrative engagement letter is set out in Appendix 1 to this SRE. The terms of engagement to review interim financial information can also be combined with the terms of engagement to audit the annual financial statements.

Procedures for a Review of Interim Financial Information

Understanding the Entity and its Environment, Including its Internal Control

12. The auditor should have an understanding of the entity and its environment, including its internal control, as it relates to the preparation of both annual and interim financial information, sufficient to plan and conduct the engagement so as to be able to:

(a) Identify the types of potential material misstatement and consider the likelihood of their occurrence; and

(b) Select the inquiries, analytical and other review procedures that will provide the auditor with a basis for reporting whether anything has come to the auditor's attention that causes the auditor to believe that the interim financial information is not prepared, in all material respects, in accordance with the applicable financial reporting framework.

13. As required by SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment," the auditor who has audited the entity's financial statements for one or more annual periods has obtained an understanding of the entity and its environment, including its internal control, as it relates to the preparation of annual financial information that was sufficient to conduct the audit. In planning a review of interim financial information, the auditor updates this understanding. The auditor also obtains a sufficient understanding of internal control as it relates to the preparation of interim financial information as it may differ from internal control as it relates to annual financial information.

14. The auditor uses the understanding of the entity and its environment, including its internal control, to determine the inquiries to be made and the analytical and other review

procedures to be applied, and to identify the particular events, transactions or assertions to which inquiries may be directed or analytical or other review procedures applied.

15. The procedures performed by the auditor to update the understanding of the entity and its environment, including its internal control, ordinarily include the following:

- Reading the documentation, to the extent necessary, of the preceding year's audit and reviews of prior interim period(s) of the current year and corresponding interim period(s) of the prior year, to enable the auditor to identify matters that may affect the current-period interim financial information.
- Considering any significant risks, including the risk of management override of controls, that were identified in the audit of the prior year's financial statements.
- Reading the most recent annual and comparable prior period interim financial information.
- Considering materiality with reference to the applicable financial reporting framework as it relates to interim financial information to assist in determining the nature and extent of the procedures to be performed and evaluating the effect of misstatements.
- Considering the nature of any corrected material misstatements and any identified uncorrected immaterial misstatements in the prior year's financial statements.
- Considering significant financial accounting and reporting matters that may be of continuing significance such as material weaknesses in internal control.
- Considering the results of any audit procedures performed with respect to the current year's financial statements.
- Considering the results of any internal audit performed and the subsequent actions taken by management.
- Inquiring of management about the results of management's assessment of the risk that the interim financial information may be materially misstated as a result of fraud.
- Inquiring of management about the effect of changes in the entity's business activities.
- Inquiring of management about any significant changes in internal control and the potential effect of any such changes on the preparation of interim financial information.
- Inquiring of management of the process by which the interim financial information has been prepared and the reliability of the underlying accounting records to which the interim financial information is agreed or reconciled.

16. The auditor determines the nature of the review procedures, if any, to be performed for components and, where applicable, communicates these matters to other auditors involved in the review. Factors to be considered include the materiality of, and risk of misstatement in, the interim financial information of components, and the auditor's understanding of the extent to which internal control over the preparation of such information is centralized or decentralized.

17. In order to plan and conduct a review of interim financial information, a recently appointed auditor, who has not yet performed an audit of the annual financial statements in accordance with SAs, should obtain an understanding of the entity and its environment, including its internal control, as it relates to the preparation of both annual and interim financial information.

18. This understanding enables the auditor to focus the inquiries made, and the analytical and other review procedures applied in performing a review of interim financial information in accordance with this SRE. As part of obtaining this understanding, the auditor ordinarily makes inquiries of the predecessor auditor and, peruses the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements. In doing so, the auditor considers the nature of any corrected misstatements, and any uncorrected misstatements aggregated by the predecessor auditor, any significant risks, including the risk of management override of controls, and significant accounting and any reporting matters that may be of continuing significance, such as material weaknesses in internal control.

Inquiries, Analytical and Other Review Procedures

19. The auditor should make inquiries, primarily of persons responsible for financial and accounting matters, and perform analytical and other review procedures to enable the auditor to conclude whether, on the basis of the procedures performed, anything has come to the auditor's attention that causes the auditor to believe that the interim financial information is not prepared, in all material respects, in accordance with the applicable financial reporting framework.

20. A review ordinarily does not require tests of the accounting records through inspection, observation or confirmation. Procedures for performing a review of interim financial information are ordinarily limited to making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures, rather than corroborating information obtained concerning significant accounting matters relating to the interim financial information. The auditor's understanding of the entity and its environment, including its internal control, the results of the risk assessments relating to the preceding audit and the auditor's consideration of materiality as it relates to the interim financial information, affects the nature and extent of the inquiries made, and analytical and other review procedures applied.

21. The auditor ordinarily performs the following procedures:

- Reading the minutes of the meetings of shareholders, those charged with governance, and other appropriate committees to identify matters that may affect the interim financial information, and inquiring about matters dealt with at meetings for which minutes are not available that may affect the interim financial information.
- Considering the effect, if any, of matters giving rise to a modification of the audit or review report, accounting adjustments or unadjusted misstatements, at the time of the previous audit or reviews.
- Communicating, where appropriate, with other auditors who are performing a review of the interim financial information of the reporting entity's significant components.
- Inquiring of members of management responsible for financial and accounting matters, and others as appropriate about the following:
  - ♦ Whether the interim financial information has been prepared and presented in accordance with the applicable financial reporting framework.
  - ♦ Whether there have been any changes in accounting principles or in the methods of applying them.

- Whether any new transactions have necessitated the application of a new accounting principle.
- Whether the interim financial information contains any known uncorrected misstatements.
- Unusual or complex situations that may have affected the interim financial information, such as a business combination or disposal of a segment of the business.
- Significant assumptions that are relevant to the fair value measurement or disclosures and management's intention and ability to carry out specific courses of action on behalf of the entity.
- Whether related party transactions have been appropriately accounted for and disclosed in the interim financial information.
- Significant changes in commitments and contractual obligations.
- Significant changes in contingent liabilities including litigation or claims.
- Compliance with debt covenants.
- Matters about which questions have arisen in the course of applying the review procedures.
- Significant transactions occurring in the last several days of the interim period or the first several days of the next interim period.
- Knowledge of any fraud or suspected fraud affecting the entity involving:
  - Management;
  - Employees who have significant roles in internal control; or
  - Others where the fraud could have a material effect on the interim financial information.
- Knowledge of any allegations of fraud, or suspected fraud, affecting the entity's interim financial information communicated by employees, former employees, analysts, regulators, or others.
- Knowledge of any actual or possible noncompliance with laws and regulations that could have a material effect on the interim financial information.

- Applying analytical procedures to the interim financial information designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement in the interim financial information. Analytical procedures may include ratio analysis and statistical techniques such as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted techniques. Appendix 2 to this SRE contains examples of analytical procedures the auditor may consider when performing a review of interim financial information.
- Reading the interim financial information, and considering whether anything has come to the auditor's attention that causes the auditor to believe that the interim financial information is not prepared, in all material respects, in accordance with the applicable financial reporting framework.

22. The auditor may perform many of the review procedures before or simultaneously with the entity's preparation of the interim financial information. For example, it may be practicable

to update the understanding of the entity and its environment, including its internal control, and begin reading applicable minutes before the end of the interim period. Performing some of the review procedures earlier in the interim period also permits early identification and consideration of significant accounting matters affecting the interim financial information.

23. The auditor performing the review of interim financial information is also engaged to perform an audit of the annual financial statements of the entity. For convenience and efficiency, the auditor may decide to perform certain audit procedures concurrently with the review of interim financial information. For example, information gained from reading the minutes of meetings of the board of directors in connection with the review of the interim financial information also may be used for the annual audit. The auditor may also decide to perform, at the time of the interim review, auditing procedures that would need to be performed for the purpose of the audit of the annual financial statements, for example, performing audit procedures on significant or unusual transactions that occurred during the period, such as business combinations, restructurings, or significant revenue transactions.

24. A review of interim financial information ordinarily does not require corroborating the inquiries about litigation or claims. It is, therefore, ordinarily not necessary to send an inquiry letter to the entity's lawyer. Direct communication with the entity's lawyer with respect to litigation or claims may, however, be appropriate if a matter comes to the auditor's attention that causes the auditor to question whether the interim financial information is not prepared, in all material respects, in accordance with the applicable financial reporting framework, and the auditor believes the entity's lawyer may have pertinent information.

25. The auditor should obtain evidence that the interim financial information agrees or reconciles with the underlying accounting records. The auditor may obtain evidence that the interim financial information agrees or reconciles with the underlying accounting records by tracing the interim financial information to:

(a) The accounting records, such as the general ledger, or a consolidating schedule that agrees or reconciles with the accounting records; and

(b) Other supporting data in the entity's records as necessary.

26. The auditor should inquire whether management has identified all events up to the date of the review report that may require adjustment to or disclosure in the interim financial information. It is not necessary for the auditor to perform other procedures to identify events occurring after the date of the review report.

27. The auditor should inquire whether management has changed its assessment of the entity's ability to continue as a going concern. When, as a result of this inquiry or other review procedures, the auditor becomes aware of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, the auditor should:

(a) Inquire of management as to its plans for future actions based on its going concern assessment, the feasibility of these plans, and whether management believes that the outcome of these plans will improve the situation; and

(b) Consider the adequacy of the disclosure about such matters in the interim financial information.

28. Events or conditions which may cast significant doubt on the entity's ability to continue as a going concern may have existed at the date of the annual financial statements or may be

identified as a result of inquiries of management or in the course of performing other review procedures. When such events or conditions come to the auditor's attention, the auditor inquires of management as to its plans for future action, such as its plans to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital. The auditor also inquires as to the feasibility of management's plans and whether management believes that the outcome of these plans will improve the situation. However, it is not ordinarily necessary for the auditor to corroborate the feasibility of management's plans and whether the outcome of these plans will improve the situation.

29. When a matter comes to the auditor's attention that leads the auditor to question whether a material adjustment should be made for the interim financial information to be prepared, in all material respects, in accordance with the applicable financial reporting framework, the auditor should make additional inquiries or perform other procedures to enable the auditor to express a conclusion in the review report. For example, if the auditor's review procedures lead the auditor to question whether a significant sales transaction is recorded in accordance with the applicable financial reporting framework, the auditor performs additional procedures sufficient to resolve the auditor's questions, such as discussing the terms of the transaction with senior marketing and accounting personnel, or reading the sales contract.

Evaluation of Misstatements

30. The auditor should evaluate, individually and in the aggregate, whether uncorrected misstatements that have come to the auditor's attention are material to the interim financial information.

31. A review of interim financial information, in contrast to an audit engagement, is not designed to obtain reasonable assurance that the interim financial information is free from material misstatement. However, misstatements which come to the auditor's attention, including inadequate disclosures, are evaluated individually and in the aggregate to determine whether a material adjustment is required to be made to the interim financial information for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework.

32. The auditor exercises professional judgment in evaluating the materiality of any misstatements that the entity has not corrected. The auditor considers matters such as the nature, cause and amount of the misstatements, whether the misstatements originated in the preceding year or interim period of the current year, and the potential effect of the misstatements on future interim or annual periods.

33. The auditor may designate an amount below which misstatements need not be aggregated, because the auditor expects that the aggregation of such amounts clearly would not have a material effect on the interim financial information. In so doing, the auditor considers the fact that the determination of materiality involves quantitative as well as qualitative considerations, and that misstatements of a relatively small amount could nevertheless have a material effect on the interim financial information.

Management Representations

34. The auditor should obtain written representation from management that:

(a) It acknowledges its responsibility for the design and implementation of internal control to prevent and detect fraud and error;

(b) The interim financial information is prepared and presented in accordance with the applicable financial reporting framework;

(c) It believes the effect of those uncorrected misstatements aggregated by the auditor during the review are immaterial, both individually and in the aggregate, to the interim financial information taken as a whole. A summary of such items is included in or attached to the written representations;

(d) It has disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity;

(e) It has disclosed to the auditor the results of its assessment of the risks that the interim financial information may be materially misstated as a result of fraud[2];

(f) It has disclosed to the auditor all known actual or possible noncompliance with laws and regulations whose effects are to be considered when preparing the interim financial information; and

(g) It has disclosed to the auditor all significant events that have occurred subsequent to the balance sheet date and through to the date of the review report that may require adjustment to or disclosure in the interim financial information.

35. The auditor obtains additional representations as are appropriate related to matters specific to the entity's business or industry. An illustrative management representation letter is set out in Appendix 3 to this SRE.

Auditor's Responsibility for Accompanying Information

36. The auditor should read the other information that accompanies the interim financial information to consider whether any such information is materially inconsistent with the interim financial information. If the auditor identifies a material inconsistency, the auditor considers whether the interim financial information or the other information needs to be amended. If an amendment is necessary in the interim financial information and management refuses to make the amendment, the auditor considers the implications for the review report. If an amendment is necessary in the other information and management refuses to make the amendment, the auditor considers including in the review report an additional paragraph describing the material inconsistency, or taking other actions, such as withholding the issuance of the review report or withdrawing from the engagement. For example, management may present alternative measures of earnings that more positively portray results of operations than the interim financial information, and such alternative measures are given excessive prominence, are not clearly defined, or not clearly reconciled to the interim financial information such that they are confusing and potentially misleading.

37. If a matter comes to the auditor's attention that causes the auditor to believe that the other information appears to include a material misstatement of fact, the auditor should discuss the matter with the entity's management. While reading the other information for the purpose of identifying material inconsistencies, an apparent material misstatement of fact may come to the auditor's attention (i.e., information, not related to matters appearing in the interim financial information, that is incorrectly stated or presented). When discussing the matter with the entity's management, the auditor considers the validity of the other information and management's responses to the auditor's inquiries, whether valid

[2] Refer SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements".

differences of judgment or opinion exist and whether to request management to consult with a qualified third party to resolve the apparent misstatement of fact. If an amendment is necessary to correct a material misstatement of fact and management refuses to make the amendment, the auditor considers taking further action as appropriate, such as notifying those charged with governance and obtaining legal advice.

Communication

38. When, as a result of performing the review of interim financial information, a matter comes to the auditor's attention that causes the auditor to believe that it is necessary to make a material adjustment to the interim financial information for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework, the auditor should communicate this matter as soon as practicable to the appropriate level of management.

39. When, in the auditor's judgment, management does not respond appropriately within a reasonable period of time, the auditor should inform those charged with governance. The communication is made as soon as practicable, either orally or in writing. The auditor's decision whether to communicate orally or in writing is affected by factors such as the nature, sensitivity and significance of the matter to be communicated and the timing of such communications. If the information is communicated orally, the auditor documents the communication.

40. When, in the auditor's judgment, those charged with governance do not respond appropriately within a reasonable period of time, the auditor should consider:

(a) Whether to modify the report; or

(b) The possibility of withdrawing from the engagement; and

(c) The possibility of resigning from the appointment to audit the annual financial statements.

41. When, as a result of performing the review of interim financial information, a matter comes to the auditor's attention that causes the auditor to believe in the existence of fraud or noncompliance by the entity with laws and regulations the auditor should communicate the matter as soon as practicable to the appropriate level of management. The determination of which level of management is the appropriate one is affected by the likelihood of collusion or the involvement of a member of management. The auditor also considers the need to report such matters to those charged with governance and considers the implication for the review.

42. The auditor should communicate relevant matters of governance interest arising from the review of interim financial information to those charged with governance. As a result of performing the review of the interim financial information, the auditor may become aware of matters that in the opinion of the auditor are both important and relevant to those charged with governance in overseeing the financial reporting and disclosure process. The auditor communicates such matters to those charged with governance.

Reporting the Nature, Extent and Results of the Review of Interim Financial Information

43. The auditor should issue a written report that contains the following:

(a) An appropriate title.

(b) An addressee, as required by the circumstances of the engagement.

(c) Identification of the interim financial information reviewed, including identification of the title of each of the statements contained in the complete or condensed set of financial statements and the date and period covered by the interim financial information.

(d) If the interim financial information comprises a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation, a statement that management is responsible for the preparation and fair presentation of the interim financial information in accordance with the applicable financial reporting framework.

(e) In other circumstances, a statement that management is responsible for the preparation and presentation of the interim financial information in accordance with the applicable financial reporting framework.

(f) A statement that the auditor is responsible for expressing a conclusion on the interim financial information based on the review.

(g) A statement that the review of the interim financial information was conducted in accordance with Standard on Review Engagements (SRE) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity," and a statement that that such a review consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

(h) A statement that a review is substantially less in scope than an audit conducted in accordance with Standards on Auditing and consequently does not enable the auditor to obtain assurance that the auditor would become aware of all significant matters that might be identified in an audit and that accordingly no audit opinion is expressed.

(i) If the interim financial information comprises a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation, a conclusion as to whether anything has come to the auditor's attention that causes the auditor to believe that the interim financial information does not give a true and fair view, or does not present fairly, in all material respects, in accordance with the applicable financial reporting framework (including a reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[3] applicable in India).

(j) In other circumstances, a conclusion as to whether anything has come to the auditor's attention that causes the auditor to believe that the interim financial information is not prepared, in all material respects, in accordance with the applicable financial reporting framework (including a reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards applicable in India).

[3] AccountingStandards issued by the Institute of Chartered Accountants of India or Accounting Standards notified by the Central Government as the Companies (Accounting Standards) Rules, 2006, or the Accounting Standards for Local Bodies issued by the Institute of Chartered Accountants of India, as may be applicable.

(k) The date of the report.

(l) Place of Signature.

(m) The auditor's signature and membership number assigned by the Institute of Chartered Accountants of India (ICAI).

(n) The Firm's registration number of the member of the Institute, wherever applicable, as allotted by ICAI.

Illustrative review reports are set out in Appendix 4 to this SRE.

44. In some jurisdictions, law or regulation governing the review of interim financial information may prescribe wording for the auditor's conclusion that is different from the wording described in paragraph 43(i) or (j). Although the auditor may be obliged to use the prescribed wording, the auditor's responsibilities as described in this SRE for coming to the conclusion remain the same.

Departure from the Applicable Financial Reporting Framework

45. The auditor should express a qualified or adverse conclusion when a matter has come to the auditor's attention that causes the auditor to believe that a material adjustment should be made to the interim financial information for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework.

46. If matters have come to the auditor's attention that cause the auditor to believe that the interim financial information is or may be materially affected by a departure from the applicable financial reporting framework, and management does not correct the interim financial information, the auditor modifies the review report. The modification describes the nature of the departure and, if practicable, states the effects on the interim financial information. If the information that the auditor believes is necessary for adequate disclosure is not included in the interim financial information, the auditor modifies the review report and, if practicable, includes the necessary information in the review report. The modification to the review report is ordinarily accomplished by adding an explanatory paragraph to the review report, and qualifying the conclusion. Illustrative review reports with a qualified conclusion are set out in Appendix 5 to this SRE.

47. When the effect of the departure is so material and pervasive to the interim financial information that the auditor concludes a qualified conclusion is not adequate to disclose the misleading or incomplete nature of the interim financial information, the auditor expresses an adverse conclusion. Illustrative review reports with an adverse conclusion are set out in Appendix 7 to this SRE.

Limitation on Scope

48. A limitation on scope ordinarily prevents the auditor from completing the review.

49. When the auditor is unable to complete the review, the auditor should communicate, in writing, to the appropriate level of management and to those charged with governance the reason why the review cannot be completed, and consider whether it is appropriate to issue a report.

Limitation on Scope Imposed by Management

50. The auditor does not accept an engagement to review the interim financial information if the auditor's preliminary knowledge of the engagement circumstances indicates that the

auditor would be unable to complete the review because there will be a limitation on the scope of the auditor's review imposed by management of the entity.

51. If, after accepting the engagement, management imposes a limitation on the scope of the review, the auditor requests the removal of that limitation. If management refuses to do so, the auditor is unable to complete the review and express a conclusion. In such cases, the auditor communicates, in writing, to the appropriate level of management and those charged with governance the reason why the review cannot be completed. Nevertheless, if a matter comes to the auditor's attention that causes the auditor to believe that a material adjustment to the interim financial information is necessary for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework, the auditor communicates such matters in accordance with the guidance in paragraphs 38-40.

52. The auditor also considers the legal and regulatory responsibilities, including whether there is a requirement for the auditor to issue a report. If there is such a requirement, the auditor disclaims a conclusion, and provides in the review report the reason why the review cannot be completed. However, if a matter comes to the auditor's attention that causes the auditor to believe that a material adjustment to the interim financial information is necessary for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework, the auditor also communicates such a matter in the report.

Other Limitations on Scope

53. A limitation on scope may occur due to circumstances other than a limitation on scope imposed by management. In such circumstances, the auditor is ordinarily unable to complete the review and express a conclusion and is guided by paragraphs 51-52. There may be, however, some rare circumstances where the limitation on the scope of the auditor's work is clearly confined to one or more specific matters that, while material, are not in the auditor's judgment pervasive to the interim financial information. In such circumstances, the auditor modifies the review report by indicating that, except for the matter which is described in an explanatory paragraph to the review report, the review was conducted in accordance with this SRE, and by qualifying the conclusion. Illustrative review reports with a qualified conclusion are set out in Appendix 6 to this SRE.

54. The auditor may have expressed a qualified opinion on the audit of the latest annual financial statements because of a limitation on the scope of that audit. The auditor considers whether that limitation on scope still exists and, if so, the implications for the review report.

Going Concern and Significant Uncertainties

55. In certain circumstances, an emphasis of matter paragraph may be added to a review report, without affecting the auditor's conclusion, to highlight a matter that is included in a note to the interim financial information that more extensively discusses the matter. The paragraph would preferably be included after the conclusion paragraph and ordinarily refers to the fact that the conclusion is not qualified in this respect.

56. If adequate disclosure is made in the interim financial information, the auditor should add an emphasis of matter paragraph to the review report to highlight a material uncertainty relating to an event or condition that may cast significant doubt on the entity's ability to continue as a going concern.

57. The auditor may have modified a prior audit or review report by adding an emphasis of matter paragraph to highlight a material uncertainty relating to an event or condition that may

cast significant doubt on the entity's ability to continue as a going concern. If the material uncertainty still exists and adequate disclosure is made in the interim financial information, the auditor modifies the review report on the current interim financial information by adding a paragraph to highlight the continued material uncertainty.

58. If, as a result of inquiries or other review procedures, a material uncertainty relating to an event or condition comes to the auditor's attention that may cast significant doubt on the entity's ability to continue as a going concern, and adequate disclosure is made in the interim financial information the auditor modifies the review report by adding an emphasis of matter paragraph.

59. If a material uncertainty that casts significant doubt about the entity's ability to continue as a going concern is not adequately disclosed in the interim financial information, the auditor should express a qualified or adverse conclusion, as appropriate. The report should include specific reference to the fact that there is such a material uncertainty.

60. The auditor should consider modifying the review report by adding a paragraph to highlight a significant uncertainty (other than a going concern problem) that came to the auditor's attention, the resolution of which is dependent upon future events and which may affect the interim financial information.

Other Considerations

61. The terms of the engagement include management's agreement that where any document containing interim financial information indicates that such information has been reviewed by the entity's auditor, the review report will also be included in the document. If management has not included the review report in the document, the auditor considers seeking legal advice to assist in determining the appropriate course of action in the circumstances[4].

62. If the auditor has issued a modified review report and management issues the interim financial information without including the modified review report in the document containing the interim financial information, the auditor considers seeking legal advice to assist in determining the appropriate course of action in the circumstances, and the possibility of resigning from the appointment to audit the annual financial statements[5].

63. Interim financial information consisting of a condensed set of financial statements does not necessarily include all the information that would be included in a complete set of financial

---

[4] The Council of the ICAI, at its 308th meeting held in August 2011, considered an issue relating to difficulties being faced by the members of the Institute in compliance with paragraphs 61 and 62 of the SRE 2410 raised by the Auditing and Assurance Standards Board of the Institute. On a consideration of the matter, the Council was of the opinion that paragraphs 61 and 62 did not envisage the auditor to take steps to ensure that on every occasion when the review results were published by the management, it also published the review report therewith. The responsibility of the auditor was upto issuance of the review report on the results, at most till the time the interim results, along with the review report, were filed by the company with the concerned stock exchange. Further, since such filing led to the concerned interim results and the review report thereon becoming available in the public domain, the same would be construed as sufficient compliance by the auditor with the requirements of paragraphs 61 and 62 of SRE 2410. The complete text of the Announcement issued regarding this decision of the Council is published as Annexure to this Standard. Readers are requested to refer to the complete text of this Announcement.

[5] *ibid*

statements, but may rather present an explanation of the events and changes that are significant to an understanding of the changes in the state of affairs and performance of the entity since the annual reporting date. This is because it is presumed that the users of the interim financial information will have access to the latest audited financial statements, such as is the case with listed entities. In other circumstances, the auditor discusses with management the need for such interim financial information to include a statement that it is to be read in conjunction with the latest audited financial statements. In the absence of such a statement, the auditor considers whether, without a reference to the latest audited financial statements, the interim financial information is misleading in the circumstances, and the implications for the review report.

Documentation

64. **The auditor should prepare review documentation that is sufficient and appropriate to provide a basis for the auditor's conclusion and to provide evidence that the review was performed in accordance with this SRE and applicable legal and regulatory requirements.** The documentation enables an experienced auditor having no previous connection with the engagement to understand the nature, timing and extent of the inquiries made, and analytical and other review procedures applied, information obtained, and any significant matters considered during the performance of the review, including the disposition of such matters.

Effective Date

65. This SRE is effective for reviews of interim financial information for periods beginning on or after April 1, 2010.

Material Modifications *vis-a-vis* ISRE 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity"

Additions

Paragraph 43 of ISRE 2410 deals with the basic elements of the written report of an auditor on the Review of Interim Financial Information, which also includes the location in the country or jurisdiction where the auditor practices. Since in India, Revised Standard on Auditing (SA) 700 requires the auditor to mention the "Place of Signature", i.e., name of specific location, which is ordinarily the city where the review report is signed, in his report, the requirement of mentioning the location in the country or jurisdiction where the auditor practices has been replaced with the requirement to mention the place of signature in the auditor's report.

Deletion

Paragraph 18 of ISRE 2410 deals with the procedures for obtaining the understanding of the entity and its environment for conducting the review of the interim financial information. These procedures also include the review of the predecessor auditor's documentation for the preceding annual audit, and for any prior interim periods in the current year that have been reviewed by the predecessor auditor. Since in India, Clause 1 of Part I of the Second Schedule to the Code of Ethics provides that a Chartered Accountant in Practice shall be deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, an auditor cannot provide access to his working paper to the another auditor. Therefore, keeping in view the requirements of the Code of Ethics, the requirement of reviewing the predecessor auditor's documentation has been replaced with the requirement of perusing the copies of the audited

financial statements including the other relevant documents relating to the prior period financial statements.

Annexure

Announcement regarding Compliance with Paragraphs 61 and 62 of the Standard on Review Engagements (SRE) 2410

1. The Council of the Institute of Chartered Accountants of India, at its 308th meeting, considered an issue relating to difficulties being faced by the members of the Institute in compliance with paragraphs 61 and 62 of the SRE 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*, raised by the Auditing and Assurance Standards Board of the Institute.
2. The Council noted that paragraphs 61 and 62 of SRE 2410 require as under:

   "61. The terms of the engagement include management's agreement that where any document containing interim financial information indicates that such information has been reviewed by the entity's auditor, the review report will also be included in the document. If management has not included the review report in the document, the auditor considers seeking legal advice to assist in determining the appropriate course of action in the circumstances.

   62. If the auditor has issued a modified review report and management issues the interim financial information without including the modified review report in the document containing the interim financial information, the auditor considers seeking legal advice to assist in determining the appropriate course of action in the circumstances, and the possibility of resigning from the appointment to audit the annual financial statements."
3. The Council noted that a number of entities were publishing interim financial results with a declaration that the "results have been approved by the Board of Directors at its meeting held on xxxxx and have been subjected to limited review by the statutory auditors." The companies, however, were not publishing the review report along with such published results. Accordingly, it was either that the auditors had not obtained an agreement with the management that they would publish the review report along with the reviewed results or that despite the said agreement, the management had not complied therewith. The Council noted that in the latter cases, the auditor would be penalised under the requirements of SRE 2410 even when the default/ breach had been committed by the management.
4. The Council was of the view that it is not practically feasible for the auditor to ensure that every document released by the management containing the interim financial information indicating that such information has been reviewed by the entity's auditor, the review report has been included in the said document.
5. On a consideration of the matter, the Council is of the opinion that paragraphs 61 and 62 did not envisage the auditor to take steps to ensure that on every occasion when the review results were published by the management, it also published the review report therewith. The responsibility of the auditor was upto issuance of the review report on the results, at most till the time the interim results, along with the review report, were filed by the company with the concerned stock exchange. Further, since such filing led to the concerned interim results and the review report thereon

becoming available in the public domain, the same would be construed as sufficient compliance by the auditor with the requirements of paragraphs 61 and 62 of SRE 2410.

6. The Council, however, felt that if, subsequent to the issuance of the review report, the auditor became aware of situations where the management had not published the review report especially where the review report contained auditor's reservations, he would need to bring the same to the attention of the management and, if considered necessary, take legal advice.

Appendix 1

Example of an Engagement Letter for a Review of Interim Financial Information

The following letter is to be used as a guide in conjunction with the consideration outlined in paragraph 10 of this SRE and will need to be adapted according to individual requirements and circumstances.

To the Board of Directors of ABC Company Ltd. (or the appropriate representative of senior management)

We are providing this letter to confirm our understanding of the terms and objectives of our engagement to review the entity's interim balance sheet as at September 30, 20X1 and the related statement of profit & loss and cash flows for the six-month period then ended.

Our review will be conducted in accordance with Standard on Review Engagements (SRE) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Institute of Chartered Accountants of India (ICAI) with the objective of providing us with a basis for reporting whether anything has come to our attention that causes us to believe that the interim financial information is not prepared, in all material respects, in accordance with the [indicate applicable financial reporting framework, including a reference to the relevant jurisdiction of the financial reporting when the financial reporting framework used is not Financial Reporting Standards[6] applicable in India]. Such a review consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures and does not, ordinarily, require corroboration of the information obtained. The scope of a review of interim financial information is substantially less than the scope of an audit conducted in accordance with Standards on Auditing whose objective is the expression of an opinion regarding the financial statements and, accordingly, we shall express no such opinion.

We expect to report on the interim financial information as follows:

[Include text of sample report.]

Responsibility for the interim financial information, including adequate disclosure, is that of management of the entity. This includes designing, implementing and maintaining internal control relevant to the preparation and presentation of interim financial information that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. As part of our review, we will request written representations from management concerning assertions made in connection with the review. We will also request

[6] See footnote 4.

that where any document containing interim financial information indicates that the interim financial information has been reviewed, our report will also be included in the document.

A review of interim financial information does not provide assurance that we will become aware of all significant matters that might be identified in an audit. Further, our engagement cannot be relied upon to disclose whether fraud or errors, or illegal acts exist. However, we will inform you of any material matters that come to our attention.

We look forward to full cooperation with your staff and we trust that they will make available to us whatever records, documentation and other information are requested in connection with our review.

[Insert additional information here regarding fee arrangements and billings, as appropriate.]

This letter will be effective for future years unless it is terminated, amended or superseded (if applicable).

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our review of the interim financial information including our respective responsibilities.

XYZ & Co.
Chartered Accountants
Firm's Registration Number
……

……
(Signature)
(Name of the Member)
(Designation[7])

Date:
Place:
Acknowledged on behalf of ABC Company by
……..

(Signature)
Name and Designation
Date

[7] Partner or proprietor, as the case may be.

Appendix 2

Analytical Procedures the Auditor May Consider When Performing a Review of Interim Financial Information

Examples of analytical procedures the auditor may consider when performing a review of interim financial information include the following:

- Comparing the interim financial information with the interim financial information of the immediately preceding interim period, with the interim financial information of the corresponding interim period of the preceding financial year, with the interim financial information that was expected by management for the current period, and with the most recent audited annual financial statements.
- Comparing current interim financial information with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes to pretax income in the current interim financial information with corresponding information in (a) budgets, using expected rates, and (b) financial information for prior periods).
- Comparing current interim financial information with relevant non-financial information.
- Comparing the recorded amounts, or ratios developed from recorded amounts, to expectations developed by the auditor. The auditor develops such expectations by identifying and applying relationships that are reasonably expected to exist based on the auditor's understanding of the entity and of the industry in which the entity operates.
- Comparing ratios and indicators for the current interim period with those of entities in the same industry.
- Comparing relationships among elements in the current interim financial information with corresponding relationships in the interim financial information of prior periods, for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables.
- Comparing disaggregated data. The following are examples of how data may be disaggregated:
    - By period, for example, revenue or expense items disaggregated into quarterly, monthly, or weekly amounts.
    - By product line or source of revenue.
    - By location, for example, by component.
    - By attributes of the transaction, for example, revenue generated by designers, architects, or craftsmen.
    - By several attributes of the transaction, for example, sales by product and month.

Appendix 3

Example of a Management Representation Letter

The following letter is not intended to be a standard letter. Representations by management will vary from entity to entity and from one interim period to the next.

(Entity Letterhead)

(To Auditor) (Date)

Opening paragraphs if interim financial information comprises condensed financial statements:

This representation letter is provided in connection with your review of the condensed balance sheet of ABC Entity as of June 30, 20X1 and the related condensed statements of profit & loss and cash flows for the three-month period then ended for the purposes of expressing a conclusion whether anything has come to your attention that causes you to believe that the interim financial information is not prepared, in all material respects, in accordance with [indicate applicable financial reporting framework, including a reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[8] applicable in India].

We acknowledge our responsibility for the preparation and presentation of the interim financial information in accordance with [indicate applicable financial reporting framework].

Opening paragraphs if interim financial information comprises a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation:

This representation letter is provided in connection with your review of the balance sheet of ABC Entity as of June 30, 20X1 and the related statements of income, changes in equity and cash flows for the three-month period then ended and a summary of the significant accounting policies and other explanatory notes for the purposes of expressing a conclusion whether anything has come to your attention that causes you to believe that the interim financial information does not give a true and fair view of *(or "does not present fairly, in all material respects,")* the state of affairs of ABC Entity as at June 30, 20X1, and of its results of operations and its cash flows in accordance with [indicate applicable financial reporting framework, including a reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[9] applicable in India].

We acknowledge our responsibility for the fair presentation of the interim financial information in accordance with [indicate applicable financial reporting framework].

We confirm, to the best of our knowledge and belief, the following representations:

- The interim financial information referred to above has been prepared and presented in accordance with [indicate applicable financial reporting framework].
- We have made available to you all books of account and supporting documentation, and all minutes of meetings of shareholders and the board of directors (namely those held on [insert applicable dates]).

[8] See footnote 4.

[9] See footnote 4.

- There are no material transactions that have not been properly recorded in the accounting records underlying the interim financial information.
- There has been no known actual or possible noncompliance with laws and regulations that could have a material effect on the interim financial information in the event of noncompliance.
- We acknowledge responsibility for the design and implementation of internal control to prevent and detect fraud and error.
- We have disclosed to you all significant facts relating to any known frauds or suspected frauds that may have affected the entity.
- We have disclosed to you the results of our assessment of the risk that the interim financial information may be materially misstated as the result of fraud.
- We believe the effects of uncorrected misstatements summarized in the accompanying schedule are immaterial, both individually and in the aggregate, to the interim financial information taken as a whole.
- We confirm the completeness of the information provided to you regarding the identification of related parties.
- The following have been properly recorded and, when appropriate, adequately disclosed in the interim financial information:
  - ♦ Related party transactions, including sales, purchases, loans, transfers, leasing arrangements and guarantees, and amounts receivable from or payable to related parties;
  - ♦ Guarantees, whether written or oral, under which the entity is contingently liable; and
  - ♦ Agreements and options to buy back assets previously sold.
- The presentation and disclosure of the fair value measurements of assets and liabilities are in accordance with [indicate applicable financial reporting framework]. The assumptions used reflect our intent and ability to carry specific courses of action on behalf of the entity, where relevant to the fair value measurements or disclosure.
- We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the interim financial information.
- We have no plans to abandon lines of product or other plans or intentions that will result in any excess or obsolete inventory, and no inventory is stated at an amount in excess of realizable value.
- The entity has satisfactory title to all assets and there are no liens or encumbrances on the entity's assets.
- We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent.
- [Add any additional representations related to new accounting standards that are being implemented for the first time and consider any additional representations required by a new Standard on Auditing that are relevant to interim financial information.]

To the best of our knowledge and belief, no events have occurred subsequent to the balance sheet date and through the date of this letter that may require adjustment to or disclosure in the aforementioned interim financial information.

_____ _____

(Senior Executive Officer) (Senior Financial Officer)

Appendix 4

Examples of Review Reports on Interim Financial Information

Complete Set of General Purpose Financial Statements Prepared in Accordance with a Financial Reporting Framework Designed to Achieve Fair Presentation (see paragraph 43(i))

Report on Review of Interim Financial Information

(Appropriate addressee)

Introduction

We have reviewed the accompanying balance sheet of ABC Entity as of June 30, 20X1 and the related statements of profit & loss and cash flows for the three-month period then ended, and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with [indicate applicable financial reporting framework]. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with Standard on Review Engagements (SRE) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity"[10]. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not give a true and fair view of *(or "does not present fairly, in all material respects,")* the state of affairs of the entity as at June 30, 20X1, and of its results of operations and its cash flows for the three month period then ended in accordance with [applicable financial reporting framework, including a reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[11] applicable in India].

[10] In the case of a review of historical financial information other than interim financial information, this sentence should read as follows: "We conducted our review in accordance with Standard on Review Engagements 2410, which applies to a review of historical financial information performed by the independent auditor of the entity." The remainder of the report should be adapted as necessary in the circumstances.

[11] See footnote 4.

For ABC and Co.,
Chartered Accountants
Firm's Registration Number
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[12])
Membership Number

Place of Signature
Date

Other Interim Financial Information (see paragraph 43(j))

Report on Review of Interim Financial Information

(Appropriate addressee)

Introduction

We have reviewed the accompanying [condensed] balance sheet of ABC Entity as of June 30, 20X1 and the related [condensed] statements of profit & loss and cash flows for the three-month period then ended. Management is responsible for the preparation and presentation of this interim financial information in accordance with [indicate applicable financial reporting framework]. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with Standard on Review Engagements (SRE) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity"[13]. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information is not prepared, in all material respects, in accordance with [applicable financial reporting framework, including a reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[14] applicable in India].

For ABC and Co.,
Chartered Accountants
Firm's Registration Number

[12] Partner or proprietor, as the case may be.

[13] In the case of a review of historical financial information other than interim financial information, this sentence should read as follows: "We conducted our review in accordance with Standard on Review Engagements 2410, which applies to a review of historical financial information performed by the independent auditor of the entity." The remainder of the report should be adapted as necessary in the circumstances.

[14] See footnote 4.

Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[15])
Membership Number

Place of Signature

Date

Appendix 5

Examples of Review Reports with a Qualified Conclusion for a Departure from the Applicable Financial Reporting Framework

Complete Set of General Purpose Financial Statements Prepared in Accordance with a Financial Reporting Framework Designed to Achieve Fair Presentation (see paragraph 43(i))

Report on Review of Interim Financial Information

(Appropriate addressee)

Introduction

We have reviewed the accompanying balance sheet of ABC Entity as of June 30, 20X1 and the related statements of profit & loss and cash flows for the three-month period then ended, and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with [indicate applicable financial reporting framework]. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with Standard on Review Engagements (SRE) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity"[16]. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Basis for Qualified Conclusion

Based on information provided to us by management, ABC Entity has excluded from property and long-term debt certain lease obligations that we believe should be capitalized to conform with [indicate applicable financial reporting framework]. This information indicates that if these lease obligations were capitalized at June 30, 20X1, property would be increased by ₹ _____, long-term debt by ₹ _____, and net income and earnings per share would be increased (decreased) by ₹ _____, ₹ _____, ₹ _____, and ₹ _____, respectively for the three-month period then ended.

[15] Partner or proprietor, as the case may be.

[16] In the case of a review of historical financial information other than interim financial information, this sentence should read as follows: "We conducted our review in accordance with Standard on Review Engagements 2410, which applies to a review of historical financial information performed by the independent auditor of the entity." The remainder of the report should be adapted as necessary in the circumstances.

Qualified Conclusion

Based on our review, with the exception of the matter described in the preceding paragraph, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not give a true and fair view of *(or "does not present fairly, in all material respects,")* the state of affairs of the entity as at June 30, 20X1, and of its results of operations and its cash flows for the three month period then ended in accordance with [indicate applicable financial reporting framework, including the reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[17] applicable in India].

For ABC and Co.,
Chartered Accountants
Firm's Registration Number
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[18])
Membership Number

Place of Signature
Date

Other Interim Financial Information (see paragraph 43(j))

Report on Review of Interim Financial Information

(Appropriate addressee)

Introduction

We have reviewed the accompanying [condensed] balance sheet of ABC Entity as of June 30, 20X1 and the related [condensed] statements of profit & loss and cash flows for the three-month period then ended. Management is responsible for the preparation and presentation of this interim financial information in accordance with [indicate applicable financial reporting framework]. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with Standard on Review Engagements (SRE) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity"[19]. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

[17] See footnote 4.

[18] Partner or proprietor, as the case may be.

[19] In the case of a review of historical financial information other than interim financial information, this sentence should read as follows: "We conducted our review in accordance with Standard on Review Engagements 2410, which applies to a review of historical financial information performed by the independent auditor of the entity." The remainder of the report should be adapted as necessary in the circumstances.

Basis for Qualified Conclusion

Based on information provided to us by management, ABC Entity has excluded from property and long-term debt certain lease obligations that we believe should be capitalized to conform with [indicate applicable financial reporting framework]. This information indicates that if these lease obligations were capitalized at June 30, 20X1, property would be increased by ₹ _____, long-term debt by ₹ _____, and net income and earnings per share would be increased (decreased) by ₹ _____, ₹ _____, ₹ _____, and ₹ _____, respectively for the three-month period then ended.

Qualified Conclusion

Based on our review, with the exception of the matter described in the preceding paragraph, nothing has come to our attention that causes us to believe that the accompanying interim financial information is not prepared, in all material respects, in accordance with [indicate applicable financial reporting framework, including a reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[20] applicable in India].

For ABC and Co.,
Chartered Accountants
Firm's Registration Number
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[21])
Membership Number

Place of Signature
Date

Appendix 6

Examples of Review Reports with a Qualified Conclusion for a Limitation on Scope Not Imposed By Management

Complete Set of General Purpose Financial Statements Prepared in Accordance with a Financial Reporting Framework Designed to Achieve Fair Presentation (see paragraph 43(i))

Report on Review of Interim Financial Information

(Appropriate addressee)

Introduction

We have reviewed the accompanying balance sheet of ABC Entity as of June 30, 20X1 and the related statements of profit & loss and cash flows for the three-month period then ended, and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in

[20] See footnote 4.

[21] Partner or proprietor, as the case may be.

accordance with [indicate applicable financial reporting framework]. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

Except as explained in the following paragraph, we conducted our review in accordance with Standard on Review Engagements (SRE) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity"[22]. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Basis for Qualified Conclusion

As a result of a fire in a branch office on (date) that destroyed its accounts receivable records, we were unable to complete our review of accounts receivable totaling ₹ _____ included in the interim financial information. The entity is in the process of reconstructing these records and is uncertain as to whether these records will support the amount shown above and the related allowance for uncollectible accounts. Had we been able to complete our review of accounts receivable, matters might have come to our attention indicating that adjustments might be necessary to the interim financial information.

Qualified Conclusion

Except for the adjustments to the interim financial information that we might have become aware of had it not been for the situation described above, based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not give a true and fair view of *(or "does not present fairly, in all material respects,")* the state of affairs of the entity as at June 30, 20X1, and of its Results of Operations and its cash flows for the three-month period then ended in accordance with [indicate applicable financial reporting framework, including a reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[23] applicable in India].

For ABC and Co.,
Chartered Accountants
Firm's Registration Number
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[24])
Membership Number

Place of Signature

[22] In the case of a review of historical financial information other than interim financial information, this sentence should read as follows: "We conducted our review in accordance with Standard on Review Engagements 2410, which applies to a review of historical financial information performed by the independent auditor of the entity." The remainder of the report should be adapted as necessary in the circumstances.

[23] See footnote 4.

[24] Partner or proprietor, as the case may be.

Date

Other Interim Financial Information (see paragraph 43(j))

Report on Review of Interim Financial Information

(Appropriate addressee)

Introduction

We have reviewed the accompanying [condensed] balance sheet of ABC Entity as of June 30, 20X1 and the related [condensed] statements of profit & loss and cash flows for the three-month period then ended. Management is responsible for the preparation and presentation of this interim financial information in accordance with [indicate applicable financial reporting framework]. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

Except as explained in the following paragraph, we conducted our review in accordance with Standards on Review Engagements (SRE) 2410, "Review of Interim Financial Information Performed by the Auditor of the Entity"[25]. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Basis for Qualified Conclusion

As a result of a fire in a branch office on (date) that destroyed its accounts receivable records, we were unable to complete our review of accounts receivable totaling ₹ _____ included in the interim financial information. The entity is in the process of reconstructing these records and is uncertain as to whether these records will support the amount shown above and the related allowance for uncollectible accounts. Had we been able to complete our review of accounts receivable, matters might have come to our attention indicating that adjustments might be necessary to the interim financial information.

Qualified Conclusion

Except for the adjustments to the interim financial information that we might have become aware of had it not been for the situation described above, based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information is not prepared, in all material respects, in accordance with [indicate applicable financial reporting framework, including a reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[26] applicable in India].

[25] In the case of a review of historical financial information other than interim financial information, this sentence should read as follows: "We conducted our review in accordance with Standard on Review Engagements 2410, which applies to a review of historical financial information performed by the independent auditor of the entity." The remainder of the report should be adapted as necessary in the circumstances.

[26] See footnote 4.

For ABC and Co.,
Chartered Accountants
Firm's Registration Number
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[27])
Membership Number

Place of Signature
Date

Appendix 7

Examples of Review Reports with an Adverse Conclusion for a Departure from the Applicable Financial Reporting Framework

Complete Set of General Purpose Financial Statements Prepared in Accordance with a Financial Reporting Framework Designed to Achieve Fair Presentation (see paragraph 43(i))

Report on Review of Interim Financial Information

(Appropriate addressee)

Introduction

We have reviewed the accompanying balance sheet of ABC Entity as of June 30, 20X1 and the related statements of profit & loss and cash flows for the three-month period then ended, and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with [indicate applicable financial reporting framework]. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with Standard on Review Engagements (SRE) 2410, "Review of Interim Financial Information Performed by the Auditor of the Entity"[28]. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Basis for Adverse Conclusion

Commencing this period, management of the entity ceased to consolidate the financial statements of its subsidiary companies since management considers consolidation to be inappropriate because of the existence of new substantial non-controlling interests. This is not

[27] Partner or proprietor, as the case may be.

[28] In the case of a review of historical financial information other than interim financial information, this sentence should read as follows: "We conducted our review in accordance with Standard on Review Engagements 2410, which applies to a review of historical financial information performed by the independent auditor of the entity." The remainder of the report should be adapted as necessary in the circumstances.

in accordance with [indicate applicable financial reporting framework, including a reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[29] applicable in India]. Had consolidated financial statements been prepared, virtually every account in the interim financial information would have been materially different.

Adverse Conclusion

Our review indicates that, because the entity's investment in subsidiary companies is not accounted for on a consolidated basis, as described in the preceding paragraph, this interim financial information does not give a true and fair view of *(or "does not present fairly, in all material respects,")* the state of affairs of the entity as at June 30, 20X1, and of its results of operations and its cash flows for the three-month period then ended in accordance with [indicate applicable financial reporting framework, including a reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[30] applicable in India].

For ABC and Co.,
Chartered Accountants
Firm's Registration Number
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[31])
Membership Number

Place of Signature
Date

Other Interim Financial Information (see paragraph 43(j))

Report on Review of Interim Financial Information

(Appropriate addressee)

Introduction

We have reviewed the accompanying [condensed] balance sheet of ABC Entity as of June 30, 20X1 and the related [condensed] statements of profit & loss and cash flows for the three-month period then ended. Management is responsible for the preparation and presentation of this interim financial information in accordance with [indicate applicable financial reporting framework]. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with Standard on Review Engagements (SRE) 2410, "Review of Interim Financial Information Performed by the Independence Auditor of the

[29] See footnote 4.
[30] See footnote 4.
[31] Partner or proprietor, as the case may be.

Entity"[32]. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Basis for Adverse Conclusion

Commencing this period, management of the entity ceased to consolidate the financial statements of its subsidiary companies since management considers consolidation to be inappropriate because of the existence of new substantial non-controlling interests. This is not in accordance with [indicate applicable financial reporting framework, including the reference to the relevant jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[33] applicable in India]. Had consolidated financial statements been prepared, virtually every account in the interim financial information would have been materially different.

Adverse Conclusion

Our review indicates that, because the entity's investment in subsidiary companies is not accounted for on a consolidated basis, as described in the preceding paragraph, this interim financial information is not prepared, in all material respects, in accordance with [indicate applicable financial reporting framework, including a reference to the jurisdiction of the financial reporting framework when the financial reporting framework used is not Financial Reporting Standards[34] applicable in India].

For ABC and Co.,
Chartered Accountants
Firm's Registration Number
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation[35])
Membership Number

Place of Signature
Date

[32] In the case of a review of historical financial information other than interim financial information, this sentence should read as follows: "We conducted our review in accordance with Standard on Review Engagements 2410, which applies to a review of historical financial information performed by the independent auditor of the entity." The remainder of the report should be adapted as necessary in the circumstances.

[33] See footnote 4.

[34] See footnote 4.

[35] Partner or proprietor, as the case may be.

SAE 3400
The Examination of Prospective Financial Information

(Effective in relation to reports on projections/forecasts issued on or after April 1, 2007)

Introduction

1. The purpose of this Standard on Assurance Engagement (SAE) is to establish standards and provide guidance on engagements to examine and report on prospective financial information including examination procedures for best-estimate and hypothetical assumptions. This SAE does not apply to the examination of prospective financial information expressed in general or narrative terms, such as that found in management's discussion and analysis in an entity's annual report, though many of the procedures outlined herein may be suitable for such an examination[1]. Further, the principles laid down in the other Standards on Auditing, issued by the Institute of Chartered Accountants of India, should be used by the auditor, to the extent practicable, in applying this SAE.

2. In an engagement to examine prospective financial information, the auditor[2] should obtain sufficient appropriate evidence as to whether:

(a) management's best-estimate assumptions on which the prospective financial information is based are not unreasonable and, in the case of hypothetical assumptions, such assumptions are consistent with the purpose of the information;

(b) the prospective financial information is properly prepared on the basis of the assumptions;

(c) the prospective financial information is properly presented and all material assumptions are adequately disclosed, including a clear indication as to whether they are best-estimate assumptions or hypothetical assumptions; and

[1] The guidance provided in this Standard is in line with the provisions of clause (3) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 [as amended by the Chartered Accountants (Amendment) Act, 2006]. This clause provides that a chartered accountant in practice shall be deemed to be guilty of professional misconduct "if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast." As per the opinion of the Council while finalising the Guidance Note on Accountant's Report on Profit Forecasts and/or Financial Forecasts at its 100th meeting held on 22nd through 24th July 1982, a chartered accountant can participate in the preparation of profit or financial forecasts and can review them, provided he indicates clearly in his report **the sources of information, the basis of forecasts** and also the **major assumptions** made in arriving at the forecasts and so long as he does not vouch for the accuracy of the forecasts. The Council has further opined that the same opinion would also apply to projections made on the basis of hypothetical assumptions about future events and management actions which are not necessarily expected to take place so long as the auditor does not vouch for the accuracy of the projection. (*emphasis added*)

[2] The term "auditor" is used throughout this SAE when describing services involving examination of prospective financial information. Such reference is not intended to imply that a member performing such services need necessarily be the statutory auditor of the entity's financial statements.

(d) the prospective financial information is prepared on a consistent basis with historical financial statements, using appropriate accounting principles.

3. "*Prospective financial information*" means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It is highly subjective in nature and its preparation requires the exercise of considerable judgment. Prospective financial information can be in the form of a forecast, a projection, or a combination of both, for example, a one year forecast plus a five year projection.

4. A "*forecast*" means prospective financial information prepared on the basis of assumptions as to future events which management expects to take place and the actions management expects to take as of the date the information is prepared (best-estimate assumptions).

5. A "*projection*" means prospective financial information prepared on the basis of:

(a) hypothetical assumptions about future events and management actions which are not necessarily expected to take place, such as when some entities are in a start-up phase or are considering a major change in the nature of operations; or

(b) a mixture of best-estimate and hypothetical assumptions.

Such information illustrates the possible consequences as of the date the information is prepared if the events and actions were to occur (a "what-if" scenario).

6. Prospective financial information can include financial statements or one or more elements of financial statements and may be prepared:

(a) as an internal management tool, for example, to assist in evaluating a possible capital investment; or

(b) for the distribution/submission to third parties in, for example:

- a prospectus to provide potential investors with information about future expectations.
- an annual report to provide information to shareholders, regulatory bodies and other interested parties.
- a document, for example, cash flow forecasts, for the information of lenders.

7. Management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purposes.

The Auditor's Assurance Regarding Prospective Financial Information

8. Prospective financial information relates to events and actions that have not yet occurred and might not occur. While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future- oriented and, therefore, speculative in nature, as distinct from the evidence ordinarily available in the examination of historical financial information. The auditor is, therefore, not in a position to express an opinion as to whether the results shown in the prospective financial information will be achieved.

9. Further, given the types of evidence available in assessing the assumptions on which the prospective financial information is based, it may be difficult for the auditor to obtain a level of satisfaction sufficient to provide a positive expression of opinion that the assumptions are free of material misstatement. Consequently, in this SAE, when reporting on the reasonableness of management's assumptions, the auditor provides only a moderate level of assurance.

Acceptance of Engagement

10. Before accepting an engagement to examine prospective financial information, the auditor would consider, amongst other things:

- the intended use of the information;
- whether the information will be for general or limited distribution;
- the nature of the assumptions, that is, whether they are best-estimates or hypothetical assumptions;
- the elements to be included in the information; and
- the period covered by the information.

11. The auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use.

12. In accordance with SA 210, "*Terms of Audit Engagement*", it is necessary that the auditor and the client should agree on the terms of the engagement. It is in the interest of both client and auditor that the auditor sends an engagement letter to help in avoiding misunderstandings regarding the engagement. An engagement letter would address the matters in paragraph 10 and set out the management's responsibilities for the assumptions and for providing the auditor with all relevant information and source data used in developing the assumptions.

Knowledge of the Business

13. The auditor should obtain a sufficient level of knowledge of the business to be able to evaluate whether all significant assumptions required for the preparation of the prospective financial information have been identified. The auditor would also need to become familiar with the entity's process for preparing prospective financial information, for example, by considering:

(a) The internal controls over the system used to prepare prospective financial information and the expertise and experience of those persons preparing the prospective financial information.

(b) The nature of the documentation prepared by the entity supporting management's assumptions.

(c) The extent to which statistical, mathematical and computer-assisted techniques are used.

(d) The methods used to develop and apply assumptions.

(e) The accuracy of prospective financial information prepared in prior periods, if any, and the reasons for any significant variances therein.

14. The auditor should consider the extent to which reliance on the entity's historical financial information is justified. The auditor requires knowledge of the entity's historical financial information to assess whether the prospective financial information has been

prepared on a basis consistent with the historical financial information and to provide a historical yardstick for considering management's assumptions. The auditor will need to establish, for example, whether relevant historical information was audited or reviewed and whether acceptable accounting principles were used in its preparation.

15. If the audit or review report on prior period historical financial information was other than a clean report[3] or if the entity is in a start-up/expansion phase, the auditor would consider the relevant facts and the effect on the examination of the prospective financial information.

Period Covered

16. The auditor should consider the period of time covered by the prospective financial information. Since assumptions become more speculative as the length of the period covered increases, as that period lengthens, the ability of management to make best-estimate assumptions decreases. The period would not extend beyond the time for which management has a reasonable basis for the assumptions. The following are some of the factors that are relevant to the auditor's consideration of the period of time covered by the prospective financial information:

(a) The operating cycle, for example, in the case of a major construction project undertaken by a construction company, the time required to complete the project may dictate the period covered.

(b) The degree of reliability of assumptions, for example, if the entity is introducing a new product, the prospective period covered could be short and broken into small segments, such as weeks or months. Alternatively, if for example, the entity's sole business is owning a property under long-term lease, a relatively long prospective period might be reasonable.

(c) The needs of users, for example, prospective financial information may be prepared in connection with an application for a loan for the period of time required to generate sufficient funds for repayment. Alternatively, the information may be prepared for investors in connection with the issue of securities to illustrate the intended use of the proceeds in the subsequent period.

Examination Procedures

17. When determining the nature, timing and extent of examination procedures, the auditor should consider matters such as:

(a) the knowledge obtained during any previous engagements;

(b) management's competence regarding the preparation of prospective financial information;

(c) the likelihood of material misstatement;

(d) the extent to which the prospective financial information is affected by the management's judgment;

(e) the sources of information considered by the management for the purpose, their adequacy, reliability of the underlying data, including data derived from third parties, such as industry statistics, to support the assumptions;

[3] Alternatively known as the unmodified report in terms of the Standard on Auditing (SA) 700, "The Auditor's Report on Financial Statements".

(f) the stability of entity's business; and

(g) the engagement team's experience with the business and the industry in which the entity operates and with reporting on prospective financial information.

18. The auditor would assess the source and reliability of the evidence supporting management's best-estimate assumptions. Sufficient appropriate evidence supporting such assumptions would be obtained from internal and external sources including consideration of the assumptions in the light of historical information and an evaluation of whether they are based on plans that are within the entity's capacity. Examples of external sources are government publications, industry publications, economic forecast, existing or proposed legislation, and reports of changing technology. Examples of internal sources are budgets, the economic substance and viability of the entity and/or transaction or project of the entity, reputation of management responsible for assumptions underlying the prospective financial information, wage agreements, patents, royalty agreements and records, sales backlog records, debt agreements, and actions of the board of directors involving entity plans, etc.

19. The auditor would consider whether, when hypothetical assumptions are used, all significant implications of such assumptions have been taken into consideration. For example, if sales are assumed to grow beyond the entity's current plant capacity, the prospective financial information will need to include the necessary investment in the additional plant capacity or the costs of alternative means of meeting the anticipated sales, such as subcontracting production.

20. The auditor would need to be satisfied that the hypothetical assumptions are consistent with the purpose of the prospective financial information and that there is no reason to believe they are clearly unrealistic.

21. The auditor will need to be satisfied that the prospective financial information is properly prepared from management's assumptions by, for example, making checks such as recomputation and reviewing internal consistency, that is, the actions management intends to take are compatible with each other and there are no inconsistencies in the determination of the amounts that are based on common variables such as interest rates.

22. The auditor would focus on the extent to which those areas that are particularly sensitive to variation will have a material effect on the results shown in the prospective financial information. This will influence the extent to which the auditor will seek appropriate evidence. It will also influence the auditor's evaluation of the appropriateness and adequacy of disclosure.

23. When engaged to examine one or more elements of prospective financial information, such as an individual financial statement, it is important that the auditor considers the interrelationship of other components in the financial statements.

24. When any elapsed portion of the current period is included in the prospective financial information, the auditor would consider the extent to which procedures need to be applied to the historical information. Procedures will vary depending on the circumstances, for example, how much of the prospective period has elapsed.

25. The auditor should obtain written representations from management regarding the intended use of the prospective financial information, the completeness of significant management assumptions and management's acceptance of its responsibility for the prospective financial information. The management is also responsible for identification

and disclosure of uncontrollable factors, outstanding litigations, commitments, or any other material factors that are likely to affect the prospective financial information.

Presentation and Disclosure

26. When assessing the presentation and disclosure of the prospective financial information and the underlying assumptions, in addition to the specific requirements of any relevant statutes, regulations as well as the relevant professional pronouncements, the auditor will need to consider whether:

(a) the presentation of prospective financial information is informative and not misleading;

(b) the accounting policies are clearly disclosed in the notes to the prospective financial information;

(c) the assumptions are adequately disclosed in the notes to the prospective financial information. It needs to be clear whether assumptions represent management's best-estimates or are hypothetical and, when assumptions are made in areas that are material and are subject to a high degree of uncertainty, this uncertainty and the resulting sensitivity of results needs to be adequately disclosed;

(d) the date as of which the prospective financial information was prepared is disclosed. Management needs to confirm that the assumptions are appropriate as of this date, even though the underlying information may have been accumulated over a period of time;

(e) the basis of establishing points in a range is clearly indicated and the range is not selected in a biased or misleading manner when results shown in the prospective financial information are expressed in terms of a range; and

(f) there is any change in the accounting policy of the entity from that disclosed in the most recent historical financial statements and whether reason for the change and the effect of such change on the prospective financial information has been adequately disclosed.

Documentation

27. The auditor should document matters, which are important in providing evidence to support his report on examination of prospective financial information, and evidence that such examination was carried out in accordance with this SAE. The working papers will include the sources of information, basis of forecasts and the assumptions made in arriving the forecasts, hypothetical assumptions, evidence supporting the assumptions, management representations regarding the intended use and distribution of the information, completeness of material assumptions, management's acceptance of its responsibility for the information, audit plan, the nature, timing and extent of examination procedures performed, and, in case the auditor expresses a modified opinion or withdraws from the engagement, the reasons forming the basis of such decision.

Report on Examination of Prospective Financial Information

28. The report by an auditor on an examination of prospective financial information should contain the following:

(a) Title;

(b) Addressee;

(c) Identification of the prospective financial information;

(d) Reference to the Standards on Auditing applicable to the examination of prospective financial information;

(e) Statement that management is responsible for the prospective financial information including the underlying assumptions;

(f) When applicable, a reference to the purpose and/or restricted distribution of the prospective financial information;

(g) Statement that the examination procedures included examination, on a test basis, of evidence supporting the assumptions, amounts and other disclosures in the forecast or projection;

(h) Statement of negative assurance as to whether the assumptions provide a reasonable basis for the prospective financial information;

(i) Opinion as to whether the prospective financial information is properly prepared on the basis of the assumptions and is presented in accordance with the relevant financial reporting framework;

(j) Appropriate caveats concerning the achievability of the results indicated by the prospective financial information;

(k) Date of report (which should be the date procedures have been completed);

(l) Place of signature; and

(m) Signature.

29. Such a report would:

- State whether, based on the examination of the evidence supporting the assumptions, anything has come to the auditor's attention, which causes the auditor to believe that the assumptions do not provide a reasonable basis for the prospective financial information.
- Express an opinion as to whether the prospective financial information is properly prepared on the basis of the assumptions and is presented in accordance with the relevant financial reporting framework.
- State that:
  - Actual results are likely to be different from the prospective financial information since anticipated events frequently do not occur as expected and the variation could be material. Likewise, when the prospective financial information is expressed as a range, it would be stated that there can be no assurance that actual results will fall within the range; and
  - In the case of a projection, the prospective financial information has been prepared for (intended use), using a set of assumptions that include hypothetical assumptions about future events and management's actions that are not necessarily expected to occur. Consequently, readers are cautioned that the prospective financial information should not be used for purposes other than the abovementioned intended use.

30. The following is an example of an extract from an unmodified report on a projection:

We have examined the projection of _____ (project)_____ (name of the entity) for the period from _____ to _____ as given in[4] ____ to the Prospective

[4] Provide suitable identification, such as by reference to page numbers or by identifying the individual schedule.

Financial Information from page __to ___in accordance with Standard on Assurance Engagement 3400, "The Examination of Prospective Financial Information", issued by the Institute of Chartered Accountants of India. The preparation and presentation of the projection including the underlying assumptions, set out in note ____ to _____ to the prospective financial information, is the responsibility of the Management and has been approved by the Board of Directors[5] of the company. Our responsibility is to examine the evidence supporting the assumptions (excluding the hypothetical assumption) and other information in the prospective financial information. Our responsibility does not include verification of the accuracy of the projections. Therefore, we do not vouch for the accuracy of the same.

This projection has been prepared for (describe purpose). As the entity is in a start-up phase the projection has been prepared using a set of assumptions that include hypothetical assumptions about future events and management's actions that are not necessarily expected to occur. Consequently, readers are cautioned that this projection may not be appropriate for purposes other than that described above.

We have carried out our examination of the prospective financial information on a test basis. Based on our examination of the evidence supporting the assumptions, nothing has come to our attention which causes us to believe that these assumptions do not provide a reasonable basis for the projection, assuming that _____ (state or refer to the hypothetical assumptions).

Further, in our opinion the projection is properly prepared on the basis of the assumptions as set out in Note _____ to the Prospective Financial Information and on a consistent basis in accordance with the historical financial statements, using appropriate accounting principles. Even if the events anticipated under the hypothetical assumptions described above occur, actual results are still likely to be different from the projection since other anticipated events frequently do not occur as expected and the variation may be material.

A complete illustrative format of an unmodified report on a projection is given in Appendix 1.

31. The following is an example of an extract from an unmodified report on a forecast:

We have examined the forecast of _____ (*project*) of the _____ (*name of the entity*) for the period from _____ to _____ in accordance with the Standard on Assurance Engagements (SAE) 3400, "The Examination of Prospective Financial Information", issued by the Institute of Chartered Accountants of India. The preparation and presentation of the forecast including the underlying assumptions, set out in Note _____ to the Prospective Financial Information is the responsibility of the management and has been approved by the Board of Directors of the Company. The sources of information are set out in Annexure _____ to the prospective financial information. Our responsibility is to examine the evidence supporting the forecast. Our responsibility does not include verification of the accuracy of the forecasts. Therefore, we do not vouch for the accuracy of the same.

Based on our examination of the evidence supporting the assumptions, nothing has come to our attention which causes us to believe that these assumptions do

[5] Other corresponding approving authority in the case of entities other than companies.

not provide a reasonable basis for the forecast. Further, in our opinion the forecast is properly prepared on the basis of the assumptions as set out in Note ____ and on consistent basis with historical financial statements, using appropriate accounting principles.

Actual results are likely to be different from the forecast since anticipated events frequently do not occur as expected and the variation may be material.

A complete illustrative format of an unmodified report on a forecast is given in Appendix 2.

32. When the auditor believes that the presentation and disclosure of the prospective financial information is not adequate, the auditor should express a qualified or adverse opinion in the report on the prospective financial information, or withdraw from the engagement as appropriate. An example would be where financial information fails to disclose adequately the consequences of any assumptions, which are highly sensitive.

33. When the auditor believes that one or more significant assumptions do not provide a reasonable basis for the prospective financial information prepared on the basis of best-estimate assumptions or that one or more significant assumptions do not provide a reasonable basis for the prospective financial information given the hypothetical assumptions, the auditor should either express an adverse opinion setting out the reasons in the report on the prospective financial information, or withdraw from the engagement.

34. When the examination is affected by conditions that preclude application of one or more procedures considered necessary in the circumstances, the auditor should either withdraw from the engagement or disclaim the opinion and describe the scope limitation in the report on the prospective financial information.

Effective Date

35. This SAE is effective in relation to reports on projections/forecasts, issued on or after April 1, 2007. However, earlier application of the Standard is encouraged.

Compatibility with International Standard on Assurance Engagement (ISAE) 3400

Except for the matters noted below, the basic principles and essential procedures of this SAE and International Standard on Assurance Engagement (ISAE) 3400 "The Examination of Prospective Financial Information", are consistent in all material respects:

(a) SAE precludes the auditor from expressing positive assurance regarding the assumptions as it may tantamount to vouching for the accuracy of the forecast/projection/hypothetical assumptions. Whereas, the ISAE 3400 permits the auditor to express positive assurance when in his judgment an appropriate level of satisfaction has been obtained.

(b) The sub points in paragraph 17 (corresponding to paragraph 17 of the ISAE 3400) have been rearranged. Sub point (e) has been elucidated for the sake of better understanding of the readers. The sub points (f) and (g) have been added in the SAE as additional factors to be considered by the auditor.

(c) In paragraph 20 of the SAE, the phrase "although evidence supporting hypothetical assumptions need not be obtained" has been deleted since it is felt that such a phrase is

inconsistent with the necessity for the auditor to obtain evidence to support his conclusions.

(d) In paragraph 26 (corresponding to paragraph 26 of the ISAE 3400), the term "professional standards" has been changed to "professional pronouncements" since pronouncements would include standards as well as other relevant documents, such as Guidance Notes, announcement(s), issued by the ICAI.

(e) In line with requirement of SA 700, "The Auditor's Report on Financial Statements" this SAE requires the auditor to include a scope section in the examination report to explain the nature and extent of the auditor's work. ISAE 3400 does not contain an equivalent requirement.

(f) SAE specifically provides for the documentation required to be done by the auditor in regard to any engagement of examination of prospective financial information. However, ISAE 3400 does not contain such explicit provision.

Appendix 1

Illustrative Format of
an Unmodified Report on a Projection
Report on Examination of
Prospective Financial Information

To the ...(addressee)……..

We have examined the projection of _____ (project)_____ (name of the entity) for the period from _____ to _____ as given in[6] ____ to the Prospective Financial Information from page __to ___in accordance with Standard on Assurance Engagement 3400, "The Examination of Prospective Financial Information", issued by the Institute of Chartered Accountants of India. The preparation and presentation of the projection including the underlying assumptions, set out in note ____ to _____ to the prospective financial information, is the responsibility of the Management and has been approved by the Board of Directors[7] of the company. Our responsibility is to examine the evidence supporting the assumptions (excluding the hypothetical assumption) and other information in the prospective financial information. Our responsibility does not include verification of projections. Therefore, we do not vouch for the accuracy of the same.

This projection has been prepared for _____ (intended use). The projection has been prepared using a set of assumptions that include hypothetical assumptions about future events and management's actions that are not necessarily expected to occur. Consequently, users are cautioned that this projection may not be appropriate for purposes other than that described above.

We have carried out our examination of the prospective financial information on a test basis. Based on our examination of the evidence supporting the assumptions, nothing has come to our attention which causes us to believe that these assumptions do not provide a reasonable basis for the projection, assuming that _____ (state or refer to the hypothetical assumptions).

---

[6] Provide suitable identification, such as by reference to page numbers or by identifying the individual schedule.

[7] Other corresponding approving authority in the case of entities other than companies.

Further, in our opinion the projection is properly prepared on the basis of the assumptions as set out in Note _____ to the Prospective Financial Information and on a consistent basis with the historical financial statements, using appropriate accounting principles. Even if the events anticipated under the hypothetical assumptions described above occur, actual results are still likely to be different from the projection since other anticipated events frequently do not occur as expected and the variation may be material.

For ABC & Co.,
Chartered Accountants

Signature
(Name of the member signing the report)

Date : (Designation)[8]

Place of Signature : Membership Number

Appendix 2

Illustrative Format of an Unmodified Report on a Forecast

Report on Examination of Prospective Financial Information

To the ……(addressee)…….

We have examined the forecast of _____(project)_____of the _____ (name of the entity) for the period from ___ to ___ as given[9] in ____ to ____ of the prospective financial information in accordance with Standard on Assurance Engagement __, The Examination of Prospective Financial Information, issued by the Institute of Chartered Accountants of India. The preparation and presentation of the forecast including the underlying assumptions, set out in Note _____ to the Prospective Financial Information, is the responsibility of the management and has been approved by the Board of Directors of the company[10]. The sources of information are set out in Annexure ____ to the prospective financial information. Our responsibility is to examine the evidence supporting the forecast. Our responsibility does not include verification of the forecasts. Therefore, we do not vouch for the accuracy of the same.

This forecast has been prepared for _____ (intended use). The forecast has been prepared using a set of assumptions as set out in Note ____ to the prospective financial information.

We have carried out our examination of the prospective financial information on a test basis.

Based on our examination of the evidence supporting the assumptions, nothing has come to our attention, which causes us to believe that assumptions do not provide a reasonable basis for the forecast. Further, in our opinion the forecast, read with the notes thereon, is properly prepared on the basis of the assumptions as set out in Note _____ and on a consistent basis with the historical financial statements, using appropriate accounting principles.

[8] Partner or proprietor, as the case may be.

[9] Provide suitable identification, such as by reference to page numbers or by identifying the individual schedule.

[10] Other corresponding approving authority in the case of entities other than companies.

Actual results are likely to be different from the forecast since anticipated events might not occur as expected and the variation might be material.

For ABC & Co.,
Chartered Accountants

Signature
(Name of the member signing the report)
(Designation)[11]
Membership Number

Place of Signature:
Date:

[11] Partner or proprietor, as the case may be.

SAE 3402
Assurance Reports on Controls At a Service Organisation

(Effective for service auditors' assurance reports covering periods ending on or after April 1, 2011)

Introduction

Scope of this SAE

1. This Standard on Assurance Engagements (SAE) deals with assurance engagements undertaken by a professional accountant in public practice[1] to provide a report for use by user entities and their auditors on the controls at a service organization that provides a service to user entities that is likely to be relevant to user entities' internal control as it relates to financial reporting. It complements SA 402[2], in that reports prepared in accordance with this SAE are capable of providing appropriate evidence under SA 402. (Ref: Para. A1)

2. The "Framework for Assurance Engagements" states that an assurance engagement may be a "reasonable assurance" engagement or a "limited assurance" engagement; that an assurance engagement may be either an "assertion-based" engagement or a "direct reporting" engagement; and, that the assurance conclusion for an assertion-based engagement can be worded either in terms of the responsible party's assertion or directly in terms of the subject matter and the criteria[3]. This SAE only deals with assertion-based engagements that convey reasonable assurance, with the assurance conclusion worded directly in terms of the subject matter and the criteria[4].

3. This SAE applies only when the service organization is responsible for, or otherwise able to make an assertion about, the suitable design of controls. This SAE does not deal with assurance engagements:

(a) To report only on whether controls at a service organization operated as described, or

(b) To report only on controls at a service organization other than those related to a service that is likely to be relevant to user entities' internal control as it relates to financial reporting (for example, controls that affect user entities' production or quality control). (Ref: Para. A2)

4. In addition to issuing an assurance report on controls, a service auditor may also be engaged to provide reports such as the following, which are not dealt with in this SAE:

(a) A report on a user entity's transactions or balances maintained by a service organization; or

[1] As per the Framework for Assurance Engagements, issued by the Institute of Chartered Accountants of India, the term "professional accountant in public practice (practitioner)" refers to the member of the Institute of Chartered Accountants of India who is in practice in terms of section 2 of the Chartered Accountants Act, 1949. The term is also used to refer to a firm of chartered accountants in public practice.

[2] SA 402, "Audit Considerations Relating to an Entity Using a Service Organization".

[3] Framework for Assurance Engagements, paragraphs 9, 10 and 56.

[4] Paragraphs 13 and 53(k) of this SAE.

(b) An agreed-upon procedures report on controls at a service organization.

Relationship with Other Professional Pronouncements

5. Framework for Assurance Engagements provides requirements in relation to such topics as engagement acceptance, planning, evidence, and documentation that apply to all assurance engagements, including engagements in accordance with this SAE. This SAE expands on how such requirements are to be applied in a reasonable assurance engagement to report on controls at a service organization. The Framework for Assurance Engagements, which also defines and describes the elements and objectives of an assurance engagement, provides the context for understanding this SAE.

6. Compliance with Framework for Assurance Engagements requires, among other things, that the service auditor comply with the Code of Ethics of the Institute of Chartered Accountants of India, and implement quality control procedures that are applicable to the individual engagement[5].

Effective Date

7. This SAE is effective for service auditors' assurance reports covering periods ending on or after April 1, 2011.

Objectives

8. The objectives of the service auditor are:

(a) To obtain reasonable assurance about whether, in all material respects, based on suitable criteria:

  (i) The service organization's description of its system fairly presents the system as designed and implemented throughout the specified period (or in the case of a type 1 report, as at a specified date);

  (ii) The controls related to the control objectives stated in the service organization's description of its system were suitably designed throughout the specified period (or in the case of a type 1 report, as at a specified date);

  (iii) Where included in the scope of the engagement, the controls operated effectively to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved throughout the specified period.

(b) To report on the matters in (a) above in accordance with the service auditor's findings.

Definitions

9. For purposes of this SAE, the following terms have the meanings attributed below:

(a) *Carve-out method* – Method of dealing with the services provided by a subservice organization, whereby the service organization's description of its system includes the nature of the services provided by a subservice organization, but that subservice organization's relevant control objectives and related controls are excluded from the service organization's description of its system and from the scope of the service auditor's engagement. The service organization's description of its system and the scope of the service auditor's engagement include controls at the service organization to

[5] Framework for Assurance Engagements, paragraph 4. Members attention is also drawn to ISAE 3000, paragraphs 4 and 6.

monitor the effectiveness of controls at the subservice organization, which may include the service organization's review of an assurance report on controls at the subservice organization.

(b) *Complementary user entity controls* – Controls that the service organization assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve control objectives stated in the service organization's description of its system, are identified in that description.

(c) *Control objective* – The aim or purpose of a particular aspect of controls. Control objectives relate to risks that controls seek to mitigate.

(d) *Controls at the service organization* – Controls over the achievement of a control objective that is covered by the service auditor's assurance report. (Ref: Para. A3)

(e) *Controls at a subservice organization* – Controls at a subservice organization to provide reasonable assurance about the achievement of a control objective.

(f) *Criteria* – Benchmarks used to evaluate or measure a subject matter including, where relevant, benchmarks for presentation and disclosure.

(g) *Inclusive method* – Method of dealing with the services provided by a subservice organization, whereby the service organization's description of its system includes the nature of the services provided by a subservice organization, and that subservice organization's relevant control objectives and related controls are included in the service organization's description of its system and in the scope of the service auditor's engagement. (Ref: Para. A4)

(h) *Internal audit function* – An appraisal activity established or provided as a service to the service organization. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control.

(i) *Internal auditors* – Those individuals who perform the activities of the internal audit function. Internal auditors may belong to an internal audit department or equivalent function.

(j) *Report on the description and design of controls at a service organization (referred to in this SAE as a "type 1 report")* – A report that comprises:

  (i) The service organization's description of its system;

  (ii) A written assertion by the service organization that, in all material respects, and based on suitable criteria:

    a. The description fairly presents the service organization's system as designed and implemented as at the specified date;

    b. The controls related to the control objectives stated in the service organization's description of its system were suitably designed as at the specified date; and

  (iii) A service auditor's assurance report that conveys reasonable assurance about the matters in (ii)a.-b. above.

(k) *Report on the description, design and operating effectiveness of controls at a service organization (referred to in this SAE as a "type 2 report")* – A report that comprises:

  (i) The service organization's description of its system;

(ii) A written assertion by the service organization that, in all material respects, and based on suitable criteria:

a. The description fairly presents the service organization's system as designed and implemented throughout the specified period;

b. The controls related to the control objectives stated in the service organization's description of its system were suitably designed throughout the specified period; and

c. The controls related to the control objectives stated in the service organization's description of its system operated effectively throughout the specified period; and

(iii) A service auditor's assurance report that:

a. Conveys reasonable assurance about the matters in (ii)a.-c. above; and

b. Includes a description of the tests of controls and the results thereof.

(l) *Service auditor* – A professional accountant in public practice who, at the request of the service organization, provides an assurance report on controls at a service organization.

(m) *Service organization* – A third-party organization (or segment of a third-party organization) that provides services to user entities that are likely to be relevant to user entities' internal control as it relates to financial reporting.

(n) *Service organization's system (or the system)* – The policies and procedures designed and implemented by the service organization to provide user entities with the services covered by the service auditor's assurance report. The service organization's description of its system includes identification of: the services covered; the period, or in the case of a type 1 report, the date, to which the description relates; control objectives; and related controls.

(o) *Service organization's assertion* – The written assertion about the matters referred to in paragraph 9(k)(ii) (or paragraph 9(j)(ii) in the case of a type 1 report).

(p) *Subservice organization* – A service organization used by another service organization to perform some of the services provided to user entities that are likely to be relevant to user entities' internal control as it relates to financial reporting.

(q) *Test of controls* – A procedure designed to evaluate the operating effectiveness of controls in achieving the control objectives stated in the service organization's description of its system.

(r) *User auditor* – An auditor who audits and reports on the financial statements of a user entity[6].

(s) *User entity* – An entity that uses a service organization.

Requirements

Framework for Assurance Engagements

10. The service auditor shall not represent compliance with this SAE unless the service auditor has complied with the requirements of this SAE and the requirements of the Framework for Assurance Engagements.

[6] In the case of a subservice organization, the service auditor of a service organization that uses the services of the subservice organization is also a user auditor.

Ethical Requirements

11. The service auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to assurance engagements. (Ref: Para. A5)

Management and Those Charged with Governance

12. Where this SAE requires the service auditor to inquire of, request representations from, communicate with, or otherwise interact with the service organization, the service auditor shall determine the appropriate person(s) within the service organization's management or governance structure with whom to interact. This shall include consideration of which person(s) have the appropriate responsibilities for and knowledge of the matters concerned. (Ref: Para. A6)

Acceptance and Continuance

13. Before agreeing to accept, or continue, an engagement the service auditor shall:

(a) Determine whether:

- (i) The service auditor has the capabilities and competence to perform the engagement; (Ref: Para. A7)
- (ii) The criteria to be applied by the service organization to prepare the description of its system will be suitable and available to user entities and their auditors; and
- (iii) The scope of the engagement and the service organization's description of its system will not be so limited that they are unlikely to be useful to user entities and their auditors.

(b) Obtain the agreement of the service organization that it acknowledges and understands its responsibility:

- (i) For the preparation of the description of its system, and accompanying service organization's assertion, including the completeness, accuracy and method of presentation of that description and assertion; (Ref: Para. A8)
- (ii) To have a reasonable basis for the service organization's assertion accompanying the description of its system; (Ref: Para. A9)
- (iii) For stating in the service organization's assertion the criteria it used to prepare the description of its system;
- (iv) For stating in the description of its system:
  - a. The control objectives; and,
  - b. Where they are specified by law or regulation, or another party (for example, a user group or a professional body), the party who specified them;
- (v) For identifying the risks that threaten achievement of the control objectives stated in the description of its system, and designing and implementing controls to provide reasonable assurance that those risks will not prevent achievement of the control objectives stated in the description of its system, and therefore that the stated control objectives will be achieved; and (Ref: Para. A10)
- (vi) To provide the service auditor with:
  - a. Access to all information, such as records, documentation and other matters, including service level agreements, of which the service

organization is aware that is relevant to the description of the service organization's system and the accompanying service organization's assertion;

b. Additional information that the service auditor may request from the service organization for the purpose of the assurance engagement; and

c. Unrestricted access to persons within the service organization from whom the service auditor determines it necessary to obtain evidence.

Acceptance of a Change in the Terms of the Engagement

14. If the service organization requests a change in the scope of the engagement before the completion of the engagement, the service auditor shall be satisfied that there is a reasonable justification for the change. (Ref: Para. A11-A12)

Assessing the Suitability of the Criteria

15. As required by Framework for Assurance Engagements, the service auditor shall assess whether the service organization has used suitable criteria in preparing the description of its system, in evaluating whether controls are suitably designed, and, in the case of a type 2 report, in evaluating whether controls are operating effectively.[7].

16. In assessing the suitability of the criteria to evaluate the service organization's description of its system, the service auditor shall determine if the criteria encompass, at a minimum:

(a) Whether the description presents how the service organization's system was designed and implemented, including, as appropriate:

(i) The types of services provided, including, as appropriate, classes of transactions processed;

(ii) The procedures, within both information technology and manual systems, by which services are provided, including, as appropriate, procedures by which transactions are initiated, recorded, processed, corrected as necessary, and transferred to the reports and other information prepared for user entities;

(iii) The related records and supporting information, including, as appropriate, accounting records, supporting information and specific accounts that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the reports and other information prepared for user entities;

(iv) How the service organization's system deals with significant events and conditions, other than transactions;

(v) The process used to prepare reports and other information for user entities;

(vi) The specified control objectives and controls designed to achieve those objectives;

(vii) Complementary user entity controls contemplated in the design of the controls; and

(viii) Other aspects of the service organization's control environment, risk assessment process, information system (including the related business processes) and

[7] Framework for Assurance Engagements, paragraphs 33-36.

communication, control activities and monitoring controls that are relevant to the services provided.

(b) In the case of a type 2 report, whether the description includes relevant details of changes to the service organization's system during the period covered by the description.

(c) Whether the description omits or distorts information relevant to the scope of the service organization's system being described, while acknowledging that the description is prepared to meet the common needs of a broad range of user entities and their auditors and may not, therefore, include every aspect of the service organization's system that each individual user entity and its auditor may consider important in its particular environment.

17. In assessing the suitability of the criteria to evaluate the design of controls, the service auditor shall determine if the criteria encompass, at a minimum, whether:

(a) The service organization has identified the risks that threaten achievement of the control objectives stated in the description of its system; and

(b) The controls identified in that description would, if operated as described, provide reasonable assurance that those risks do not prevent the stated control objectives from being achieved.

18. In assessing the suitability of the criteria to evaluate the operating effectiveness of controls in providing reasonable assurance that the stated control objectives identified in the description will be achieved, the service auditor shall determine if the criteria encompass, at a minimum, whether the controls were consistently applied as designed throughout the specified period. This includes whether manual controls were applied by individuals who have the appropriate competence and authority. (Ref: Para. A13-A15)

Materiality

19. When planning and performing the engagement, the service auditor shall consider materiality with respect to the fair presentation of the description, the suitability of the design of controls and, in the case of a type 2 report, the operating effectiveness of controls. (Ref: Para. A16-A18)

Obtaining an Understanding of the Service Organization's System

20. The service auditor shall obtain an understanding of the service organization's system, including controls that are included in the scope of the engagement. (Ref: Para. A19-A20)

Obtaining Evidence Regarding the Description

21. The service auditor shall obtain and read the service organization's description of its system, and shall evaluate whether those aspects of the description included in the scope of the engagement are fairly presented, including whether: (Ref: Para. A21-A22)

(a) Control objectives stated in the service organization's description of its system are reasonable in the circumstances; (Ref: Para. A23)

(b) Controls identified in that description were implemented;

(c) Complementary user entity controls, if any, are adequately described; and

(d) Services performed by a subservice organization, if any, are adequately described, including whether the inclusive method or the carve-out method has been used in relation to them.

22. The service auditor shall determine, through other procedures in combination with inquiries, whether the service organization's system has been implemented. Those other procedures shall include observation, and inspection of records and other documentation, of the manner in which the service organization's system operates and controls are applied. (Ref: Para. A24)

Obtaining Evidence Regarding Design of Controls

23. The service auditor shall determine which of the controls at the service organization are necessary to achieve the control objectives stated in the service organization's description of its system, and shall assess whether those controls were suitably designed. This determination shall include: (Ref: Para. A25-A27)

(a) Identifying the risks that threaten the achievement of the control objectives stated in the service organization's description of its system; and

(b) Evaluating the linkage of controls identified in the service organization's description of its system with those risks.

Obtaining Evidence Regarding Operating Effectiveness of Controls

24. When providing a type 2 report, the service auditor shall test those controls that the service auditor has determined are necessary to achieve the control objectives stated in the service organization's description of its system, and assess their operating effectiveness throughout the period. Evidence obtained in prior engagements about the satisfactory operation of controls in prior periods does not provide a basis for a reduction in testing, even if it is supplemented with evidence obtained during the current period. (Ref: Para. A28-A32)

25. When designing and performing tests of controls, the service auditor shall:

(a) Perform other procedures in combination with inquiry to obtain evidence about:

  (i) How the control was applied;

  (ii) The consistency with which the control was applied; and

  (iii) By whom or by what means the control was applied;

(b) Determine whether controls to be tested depend upon other controls (indirect controls) and, if so, whether it is necessary to obtain evidence supporting the operating effectiveness of those indirect controls; and (Ref: Para. A33-A34)

(c) Determine means of selecting items for testing that are effective in meeting the objectives of the procedure. (Ref: Para. A35-A36)

26. When determining the extent of tests of controls, the service auditor shall consider matters including the characteristics of the population to be tested, which includes the nature of controls, the frequency of their application (for example, monthly, daily, a number of times per day), and the expected rate of deviation.

Sampling

27. When the service auditor uses sampling, the service auditor shall: (Ref: Para. A35-A36)

(a) Consider the purpose of the procedure and the characteristics of the population from which the sample will be drawn when designing the sample;

(b) Determine a sample size sufficient to reduce sampling risk to an appropriately low level;

(c) Select items for the sample in such a way that each sampling unit in the population has a chance of selection;

(d) If a designed procedure is not applicable to a selected item, perform the procedure on a replacement item; and

(e) If unable to apply the designed procedures, or suitable alternative procedures, to a selected item, treat that item as a deviation.

Nature and Cause of Deviations

28. The service auditor shall investigate the nature and cause of any deviations identified and shall determine whether:

(a) Identified deviations are within the expected rate of deviation and are acceptable; therefore, the testing that has been performed provides an appropriate basis for concluding that the control is operating effectively throughout the specified period;

(b) Additional testing of the control or of other controls is necessary to reach a conclusion on whether the controls relative to a particular control objective are operating effectively throughout the specified period; or (Ref: Para. A25)

(c) The testing that has been performed provides an appropriate basis for concluding that the control did not operate effectively throughout the specified period.

29. In the extremely rare circumstances when the service auditor considers a deviation discovered in a sample to be an anomaly and no other controls have been identified that allow the service auditor to conclude that the relevant control objective is operating effectively throughout the specified period, the service auditor shall obtain a high degree of certainty that such deviation is not representative of the population. The service auditor shall obtain this degree of certainty by performing additional procedures to obtain sufficient appropriate evidence that the deviation does not affect the remainder of the population.

The Work of an Internal Audit Function[8]

Obtaining an Understanding of the Internal Audit Function

30. If the service organization has an internal audit function, the service auditor shall obtain an understanding of the nature of the responsibilities of the internal audit function and of the activities performed in order to determine whether the internal audit function is likely to be relevant to the engagement. (Ref: Para. A37)

Determining Whether and to What Extent to Use the Work of the Internal Auditors

31. The service auditor shall determine:

(a) Whether the work of the internal auditors is likely to be adequate for purposes of the engagement; and

(b) If so, the planned effect of the work of the internal auditors on the nature, timing or extent of the service auditor's procedures.

32. In determining whether the work of the internal auditors is likely to be adequate for purposes of the engagement, the service auditor shall evaluate:

(a) The objectivity of the internal audit function;

(b) The technical competence of the internal auditors;

(c) Whether the work of the internal auditors is likely to be carried out with due professional care; and

[8] This SAE does not deal with instances when individual internal auditors provide direct assistance to the service auditor in carrying out audit procedures.

(d) Whether there is likely to be effective communication between the internal auditors and the service auditor.

33. In determining the planned effect of the work of the internal auditors on the nature, timing or extent of the service auditor's procedures, the service auditor shall consider: (Ref: Para. A38)

(a) The nature and scope of specific work performed, or to be performed, by the internal auditors;

(b) The significance of that work to the service auditor's conclusions; and

(c) The degree of subjectivity involved in the evaluation of the evidence gathered in support of those conclusions.

Using the Work of the Internal Audit Function

34. In order for the service auditor to use specific work of the internal auditors, the service auditor shall evaluate and perform procedures on that work to determine its adequacy for the service auditor's purposes. (Ref: Para. A39)

35. To determine the adequacy of specific work performed by the internal auditors for the service auditor's purposes, the service auditor shall evaluate whether:

(a) The work was performed by internal auditors having adequate technical training and proficiency;

(b) The work was properly supervised, reviewed and documented;

(c) Adequate evidence has been obtained to enable the internal auditors to draw reasonable conclusions;

(d) Conclusions reached are appropriate in the circumstances and any reports prepared by the internal auditors are consistent with the results of the work performed; and

(e) Exceptions relevant to the engagement or unusual matters disclosed by the internal auditors are properly resolved.

Effect on the Service Auditor's Assurance Report

36. If the work of the internal audit function has been used, the service auditor shall make no reference to that work in the section of the service auditor's assurance report that contains the service auditor's opinion. (Ref: Para. A40)

37. In the case of a type 2 report, if the work of the internal audit function has been used in performing tests of controls, that part of the service auditor's assurance report that describes the service auditor's tests of controls and the results thereof shall include a description of the internal auditor's work and of the service auditor's procedures with respect to that work. (Ref: Para. A41)

Written Representations

38. The service auditor shall request the service organization to provide written representations: (Ref: Para. A42)

(a) That reaffirm the assertion accompanying the description of the system;

(b) That it has provided the service auditor with all relevant information and access agreed to;[9] and

[9] Paragraph 13(b)(vi) of this SAE.

(c) That it has disclosed to the service auditor any of the following of which it is aware:

(i) Non-compliance with laws and regulations, fraud, or uncorrected deviations attributable to the service organization that may affect one or more user entities;

(ii) Design deficiencies in controls;

(iii) Instances where controls have not operated as described; and

(iv) Any events subsequent to the period covered by the service organization's description of its system up to the date of the service auditor's assurance report that could have a significant effect on the service auditor's assurance report.

39. The written representations shall be in the form of a representation letter addressed to the service auditor. The date of the written representations shall be as near as practicable to, but not after, the date of the service auditor's assurance report.

40. If, having discussed the matter with the service auditor, the service organization does not provide one or more of the written representations requested in accordance with paragraph 38(a) and (b) of this SAE, the service auditor shall disclaim an opinion. (Ref: Para. A43)

Other Information

41. The service auditor shall read the other information, if any, included in a document containing the service organization's description of its system and the service auditor's assurance report, to identify material inconsistencies, if any, with that description. While reading the other information for the purpose of identifying material inconsistencies, the service auditor may become aware of an apparent misstatement of fact in that other information.

42. If the service auditor becomes aware of a material inconsistency or an apparent misstatement of fact in the other information, the service auditor shall discuss the matter with the service organization. If the service auditor concludes that there is a material inconsistency or a misstatement of fact in the other information that the service organization refuses to correct, the service auditor shall take further appropriate action. (Ref: Para. A44-A45)

Subsequent Events

43. The service auditor shall inquire whether the service organization is aware of any events subsequent to the period covered by the service organization's description of its system up to the date of the service auditor's assurance report that could have a significant effect on the service auditor's assurance report. If the service auditor is aware of such an event, and information about that event is not disclosed by the service organization, the service auditor shall disclose it in the service auditor's assurance report.

44. The service auditor has no obligation to perform any procedures regarding the description of the service organization's system, or the suitability of design or operating effectiveness of controls, after the date of the service auditor's assurance report.

Documentation

45. The service auditor shall prepare documentation that is sufficient to enable an experienced service auditor, having no previous connection with the engagement, to understand:

(a) The nature, timing, and extent of the procedures performed to comply with this SAE and applicable legal and regulatory requirements;

(b) The results of the procedures performed, and the evidence obtained; and

(c) Significant matters arising during the engagement, and the conclusions reached thereon and significant professional judgments made in reaching those conclusions.

46. In documenting the nature, timing and extent of procedures performed, the service auditor shall record:

(a) The identifying characteristics of the specific items or matters being tested;

(b) Who performed the work and the date such work was completed; and

(c) Who reviewed the work performed and the date and extent of such review.

47. If the service auditor uses specific work of the internal auditors, the service auditor shall document the conclusions reached regarding the evaluation of the adequacy of the work of the internal auditors, and the procedures performed by the service auditor on that work.

48. The service auditor shall document discussions of significant matters with the service organization and others including the nature of the significant matters discussed and when and with whom the discussions took place.

49. If the service auditor has identified information that is inconsistent with the service auditor's final conclusion regarding a significant matter, the service auditor shall document how the service auditor addressed the inconsistency.

50. The service auditor shall assemble the documentation in an engagement file and complete the administrative process of assembling the final engagement file on a timely basis after the date of the service auditor's assurance report[10].

51. After the assembly of the final engagement file has been completed, the service auditor shall not delete or discard documentation before the end of its retention period. (Ref: Para. A46)

52. If the service auditor finds it necessary to modify existing engagement documentation or add new documentation after the assembly of the final engagement file has been completed and that documentation does not affect the service auditor's report, the service auditor shall, regardless of the nature of the modifications or additions, document:

(a) The specific reasons for making them; and

(b) When and by whom they were made and reviewed.

Preparing the Service Auditor's Assurance Report

Content of the Service Auditor's Assurance Report

53. The service auditor's assurance report shall include the following basic elements: (Ref: Para. A47)

(a) A title that clearly indicates the report is an independent service auditor's assurance report.

(b) An addressee.

(c) Identification of:

  (i) The service organization's description of its system, and the service organization's assertion, which includes the matters described in paragraph 9(k)(ii) for a type 2 report, or paragraph 9(j)(ii) for a type 1 report.

  (ii) Those parts of the service organization's description of its system, if any, that are not covered by the service auditor's opinion.

[10] Standard on Quality Control (SQC) 1, paragraphs 74-76, provide further guidance.

(iii) If the description refers to the need for complementary user entity controls, a statement that the service auditor has not evaluated the suitability of design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the service organization's description of its system can be achieved only if complementary user entity controls are suitably designed or operating effectively, along with the controls at the service organization.

(iv) If services are performed by a subservice organization, the nature of activities performed by the subservice organization as described in the service organization's description of its system and whether the inclusive method or the carve-out method has been used in relation to them. Where the carve-out method has been used, a statement that the service organization's description of its system excludes the control objectives and related controls at relevant subservice organizations, and that the service auditor's procedures do not extend to controls at the subservice organization. Where the inclusive method has been used, a statement that the service organization's description of its system includes control objectives and related controls at the subservice organization, and that the service auditor's procedures extended to controls at the subservice organization.

(d) Identification of the criteria, and the party specifying the control objectives.

(e) A statement that the report and, in the case of a type 2 report, the description of tests of controls are intended only for user entities and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by user entities themselves, when assessing the risks of material misstatements of user entities' financial statements. (Ref: Para. A48)

(f) A statement that the service organization is responsible for:

(i) Preparing the description of its system, and the accompanying assertion, including the completeness, accuracy and method of presentation of that description and that assertion;

(ii) Providing the services covered by the service organization's description of its system;

(iii) Stating the control objectives (where not identified by law or regulation, or another party, for example, a user group or a professional body); and

(iv) Designing and implementing controls to achieve the control objectives stated in the service organization's description of its system.

(g) A statement that the service auditor's responsibility is to express an opinion on the service organization's description, on the design of controls related to the control objectives stated in that description and, in the case of a type 2 report, on the operating effectiveness of those controls, based on the service auditor's procedures.

(h) A statement that the engagement was performed in accordance with SAE 3402, "Assurance Reports on Controls at a Service Organization," which requires that the service auditor comply with ethical requirements and plan and perform procedures to obtain reasonable assurance about whether, in all material respects, the service organization's description of its system is fairly presented and the controls are suitably designed and, in the case of a type 2 report, are operating effectively.

(i) A summary of the service auditor's procedures to obtain reasonable assurance and a statement of the service auditor's belief that the evidence obtained is sufficient and appropriate to provide a basis for the service auditor's opinion, and, in the case of a type 1 report, a statement that the service auditor has not performed any procedures regarding the operating effectiveness of controls and therefore no opinion is expressed thereon.

(j) A statement of the limitations of controls and, in the case of a type 2 report, of the risk of projecting to future periods any evaluation of the operating effectiveness of controls.

(k) The service auditor's opinion, expressed in the positive form, on whether, in all material respects, based on suitable criteria:

  (i) In the case of a type 2 report:

    a. The description fairly presents the service organization's system that had been designed and implemented throughout the specified period;

    b. The controls related to the control objectives stated in the service organization's description of its system were suitably designed throughout the specified period; and

    c. The controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the specified period.

  (ii) In the case of a type 1 report:

    a. The description fairly presents the service organization's system that had been designed and implemented as at the specified date; and

    b. The controls related to the control objectives stated in the service organization's description of its system were suitably designed as at the specified date.

(l) The date of the service auditor's assurance report, which shall be no earlier than the date on which the service auditor has obtained sufficient appropriate evidence on which to base the opinion.

(m) Practitioner's Signature-The report should be signed by the practitioner in his personal name. Where the firm is appointed, the report should be signed in the personal name of the engagement partner and in the name of the firm. The partner/proprietor signing the assurance report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India (the Institute). If Partnership/proprietorship firm is appointed, the registration number of the firm, as may be allotted by the Institute, also needs to be mentioned in the assurance reports signed by them.

(n) The place of signature – the report should name specific location, which is ordinarily the city where the report is signed.

54. In the case of a type 2 report, the service auditor's assurance report shall include a separate section after the opinion, or an attachment, that describes the tests of controls that were performed and the results of those tests. In describing the tests of controls, the service auditor shall clearly state which controls were tested, identify whether the items tested represent all or a selection of the items in the population, and indicate the nature of the tests in sufficient detail to enable user auditors to determine the effect of such tests on their risk

assessments. If deviations have been identified, the service auditor shall include the extent of testing performed that led to identification of the deviations (including the sample size where sampling has been used), and the number and nature of the deviations noted. The service auditor shall report deviations even if, on the basis of tests performed, the service auditor has concluded that the related control objective was achieved. (Ref: Para. A18 and A49)

Modified Opinions

55. If the service auditor concludes that: (Ref: Para. A50-A52)

(a) The service organization's description does not fairly present, in all material respects, the system as designed and implemented;

(b) The controls related to the control objectives stated in the description were not suitably designed, in all material respects;

(c) In the case of a type 2 report, the controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved, did not operate effectively, in all material respects; or

(d) The service auditor is unable to obtain sufficient appropriate evidence, the service auditor's opinion shall be modified, and the service auditor's assurance report shall contain a clear description of all the reasons for the modification.

Other Communication Responsibilities

56. If the service auditor becomes aware of non-compliance with laws and regulations, fraud, or uncorrected errors attributable to the service organization that are not clearly trivial and may affect one or more user entities, the service auditor shall determine whether the matter has been communicated appropriately to affected user entities. If the matter has not been so communicated and the service organization is unwilling to do so, the service auditor shall take appropriate action. (Ref: Para. A53)

***

Application and Other Explanatory Material

Scope of this SAE (Ref: Para. 1 and 3)

A1. Internal control is a process designed to provide reasonable assurance regarding the achievement of objectives related to the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. Controls related to a service organization's operations and compliance objectives may be relevant to a user entity's internal control as it relates to financial reporting. Such controls may pertain to assertions about presentation and disclosure relating to account balances, classes of transactions or disclosures, or may pertain to evidence that the user auditor evaluates or uses in applying auditing procedures. For example, a payroll processing service organization's controls related to the timely remittance of payroll deductions to government authorities may be relevant to a user entity as late remittances could incur interest and penalties that would result in a liability for the user entity. Similarly, a service organization's controls over the acceptability of investment transactions from a regulatory perspective may be considered relevant to a user entity's presentation and disclosure of transactions and account balances in its financial statements. The determination of whether controls at a service organization related to operations and compliance are likely to be relevant to user entities' internal control

as it relates to financial reporting is a matter of professional judgment, having regard to the control objectives set by the service organization and the suitability of the criteria.

A2. The service organization may not be able to assert that the system is suitably designed when, for example, the service organization is operating a system that has been designed by a user entity or is stipulated in a contract between a user entity and the service organization. Because of the inextricable link between the suitable design of controls and their operating effectiveness, the absence of an assertion with respect to the suitability of design will likely preclude the service auditor from concluding that the controls provide reasonable assurance that the control objectives have been met and thus from opining on the operating effectiveness of controls. As an alternative, the practitioner may choose to accept an agreed-upon procedures engagement to perform tests of controls, or an assurance engagement to conclude on whether, based on tests of controls, the controls have operated as described.

Definitions (Ref: Para. 9(d) and 9(g))

A3. The definition of "controls at the service organization" includes aspects of user entities' information systems maintained by the service organization, and may also include aspects of one or more of the other components of internal control at a service organization. For example, it may include aspects of a service organization's control environment, monitoring, and control activities when they relate to the services provided. It does not, however, include controls at a service organization that are not related to the achievement of the control objectives stated in the service organization's description of its system, for example, controls related to the preparation of the service organization's own financial statements.

A4. When the inclusive method is used, the requirements in this SAE also apply to the services provided by the subservice organization, including obtaining agreement regarding the matters in paragraph 13(b)(i)-(v) as applied to the subservice organization rather than the service organization. Performing procedures at the subservice organization entails coordination and communication between the service organization, the subservice organization, and the service auditor. The inclusive method generally is feasible only if the service organization and the subservice organization are related, or if the contract between the service organization and the subservice organization provides for its use.

Ethical Requirements (Ref: Para. 11)

A5. The service auditor is subject to relevant independence requirements, which ordinarily comprise *Code of Ethics* of the Institute. In performing an engagement in accordance with this SAE, the *Code of Ethics* of the ICAI does not require the service auditor to be independent from each user entity.

Management and Those Charged with Governance (Ref: Para. 12)

A6. Management and governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. Such diversity means that it is not possible for this SAE to specify for all engagements the person(s) with whom the service auditor is to interact regarding particular matters. For example, the service organization may be a segment of a third-party organization and not a separate legal entity. In such cases, identifying the appropriate management personnel or those charged with governance from whom to request written representations may require the exercise of professional judgment.

Acceptance and Continuance

Capabilities and Competence to Perform the Engagement (Ref: Para. 13(a)(i))

A7. Relevant capabilities and competence to perform the engagement include matters such as the following:

- Knowledge of the relevant industry;
- An understanding of information technology and systems;
- Experience in evaluating risks as they relate to the suitable design of controls; and
- Experience in the design and execution of tests of controls and the evaluation of the results.

Service Organization's Assertion (Ref: Para. 13(b)(i))

A8. Refusal, by a service organization, to provide a written assertion, subsequent to an agreement by the service auditor to accept, or continue, an engagement, represents a scope limitation that causes the service auditor to withdraw from the engagement. If law or regulation does not allow the service auditor to withdraw from the engagement, the service auditor disclaims an opinion.

Reasonable Basis for Service Organization's Assertion (Ref: Para. 13(b)(ii))

A9. In the case of a type 2 report, the service organization's assertion includes a statement that the controls related to the control objectives stated in the service organization's description of its system operated effectively throughout the specified period. This assertion may be based on the service organization's monitoring activities. Monitoring of controls is a process to assess the effectiveness of controls over time. It involves assessing the effectiveness of controls on a timely basis, identifying and reporting deficiencies to appropriate individuals within the service organization, and taking necessary corrective actions. The service organization accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of both. The greater the degree and effectiveness of ongoing monitoring activities, the less need for separate evaluations. Ongoing monitoring activities are often built into the normal recurring activities of a service organization and include regular management and supervisory activities. Internal auditors or personnel performing similar functions may contribute to the monitoring of a service organization's activities. Monitoring activities may also include using information communicated by external parties, such as customer complaints and regulator comments, which may indicate problems or highlight areas in need of improvement. The fact that the service auditor will report on the operating effectiveness of controls is not a substitute for the service organization's own processes to provide a reasonable basis for its assertion.

Identification of Risks (Ref: Para. 13(b)(iv))

A10. As noted in paragraph 9(c), control objectives relate to risks that controls seek to mitigate. For example, the risk that a transaction is recorded at the wrong amount or in the wrong period can be expressed as a control objective that transactions are recorded at the correct amount and in the correct period. The service organization is responsible for identifying the risks that threaten achievement of the control objectives stated in the description of its system. The service organization may have a formal or informal process for identifying relevant risks. A formal process may include estimating the significance of identified risks, assessing the likelihood of their occurrence, and deciding about actions to

address them. However, since control objectives relate to risks that controls seek to mitigate, thoughtful identification of control objectives when designing and implementing the service organization's system may itself comprise an informal process for identifying relevant risks.

Acceptance of a Change in the Terms of the Engagement (Ref: Para. 14)

A11. A request to change the scope of the engagement may not have a reasonable justification when, for example, the request is made to exclude certain control objectives from the scope of the engagement because of the likelihood that the service auditor's opinion would be modified; or the service organization will not provide the service auditor with a written assertion and the request is made to perform the engagement under Framework for Assurance Engagements.

A12. A request to change the scope of the engagement may have a reasonable justification when, for example, the request is made to exclude from the engagement a subservice organization when the service organization cannot arrange for access by the service auditor, and the method used for dealing with the services provided by that subservice organization is changed from the inclusive method to the carve-out method.

Assessing the Suitability of the Criteria (Ref: Para. 15-18)

A13. Criteria need to be available to the intended users to allow them to understand the basis for the service organization's assertion about the fair presentation of its description of the system, the suitability of the design of controls and, in the case of a type 2 report, the operating effectiveness of the controls related to the control objectives.

A14. Framework for Assurance Engagements requires the service auditor, among other things, to assess the suitability of criteria, and the appropriateness of the subject matter[11]. The subject matter is the underlying condition of interest to intended users of an assurance report. The following table identifies the subject matter and minimum criteria for each of the opinions in type 2 and type 1 reports.

	Subject matter	Criteria	Comment
Opinion about the fair presentation of the description of the service organization's system (type 1 and type 2 reports)	The service organization's system that is likely to be relevant to user entities' internal control as it relates to financial reporting and is covered by the service auditor's assurance report.	The description is fairly presented if it: (a) presents how the service organization's system was designed and implemented including, as appropriate, the matters identified in paragraph 16(a)(i)-(viii); (b) in the case of a type 2 report,	The specific wording of the criteria for this opinion may need to be tailored to be consistent with criteria established by, for example, law or regulation, user groups, or a professional body. Examples of criteria for this opinion are provided in the illustrative service organization's assertion in Appendix 1. Paragraphs A21-A24 offer further guidance on determining whether these

[11] Framework for Assurance Engagements, paragraph 16(b). Members attention is also drawn to ISAE 3000, paragraphs 18-19.

		includes relevant details of changes to the service organization's system during the period covered by the description; and (c) does not omit or distort information relevant to the scope of the service organization's system being described, while acknowledging that the description is prepared to meet the common needs of a broad range of user entities and may not, therefore, include every aspect of the service organization's system that each individual user entity may consider important in its own particular environment.	criteria are met. (The subject matter information[12] for this opinion is the service organization's description of its system and the service organization's assertion that the description is fairly presented.)	
Opinion about suitability of design, and operating effectiveness (type 2 reports)	The suitability of the design and operating effectiveness of those controls that are necessary to achieve the control objectives stated in the service organization's description of its	The controls are suitably designed and operating effectively if: (a) the service organization has identified the risks that threaten achievement of the control objectives stated in the description of its system; (b) the controls identified in	When the criteria for this opinion are met, controls will have provided reasonable assurance that the related control objectives were achieved throughout the specified	The control objectives, which are stated in the service organization's description of its system, are part of the criteria for these opinions. The stated control

[12] The "subject matter information" is the outcome of the evaluation or measurement of the subject matter.

	system.	that description would, if operated as described, provide reasonable assurance that those risks do not prevent the stated control objectives from being achieved; and (c) the controls were consistently applied as designed throughout the specified period. This includes whether manual controls were applied by individuals who have the appropriate competence and authority.	period. (The subject matter information for this opinion is the service organization's assertion that controls are suitably designed and that they are operating effectively.)	objectives will differ from engagement to engagement. If, as part of forming the opinion on the description, the service auditor concludes the stated control objectives are not fairly presented then those control objectives would not be suitable as part of the criteria for forming an opinion on either the design or operating effectiveness of controls.
Opinion about suitability of design (type 1 reports)	The suitability of the design of those controls that are necessary to achieve the control objectives stated in the service organization's description of its system.	The controls are suitably designed if: (a) the service organization has identified the risks that threaten achievement of the control objectives stated in the description of its system; and (b) the controls identified in that description would, if operated as described, provide reasonable assurance that those risks do not prevent the stated control objectives from being achieved.	Meeting these criteria does not, of itself, provide any assurance that the related control objectives were achieved because no assurance has been obtained about the operation of controls. (The subject matter information for this opinion is the service organization's assertion that controls are suitably designed.)	

A15. Paragraph 16(a) identifies a number of elements that are included in the service organization's description of its system as appropriate. These elements may not be appropriate if the system being described is not a system that processes transactions, for example, if the system relates to general controls over the hosting of an IT application but not the controls embedded in the application itself.

Materiality (Ref: Para. 19 and 54)

A16. In an engagement to report on controls at a service organization, the concept of materiality relates to the system being reported on, not the financial statements of user entities. The service auditor plans and performs procedures to determine whether the service organization's description of its system is fairly presented in all material respects, whether controls at the service organization are suitably designed in all material respects and, in the case of a type 2 report, whether controls at the service organization are operating effectively in all material respects. The concept of materiality takes into account that the service auditor's assurance report provides information about the service organization's system to meet the common information needs of a broad range of user entities and their auditors who have an understanding of the manner in which that system has been used.

A17. Materiality with respect to the fair presentation of the service organization's description of its system, and with respect to the design of controls, includes primarily the consideration of qualitative factors, for example: whether the description includes the significant aspects of processing significant transactions; whether the description omits or distorts relevant information; and the ability of controls, as designed, to provide reasonable assurance that control objectives would be achieved. Materiality with respect to the service auditor's opinion on the operating effectiveness of controls includes the consideration of both quantitative and qualitative factors, for example, the tolerable rate and observed rate of deviation (a quantitative matter), and the nature and cause of any observed deviation (a qualitative matter).

A18. The concept of materiality is not applied when disclosing, in the description of the tests of controls, the results of those tests where deviations have been identified. This is because, in the particular circumstances of a specific user entity or user auditor, a deviation may have significance beyond whether or not, in the opinion of the service auditor, it prevents a control from operating effectively. For example, the control to which the deviation relates may be particularly significant in preventing a certain type of error that may be material in the particular circumstances of a user entity's financial statements.

Obtaining an Understanding of the Service Organization's System (Ref: Para. 20)

A19. Obtaining an understanding of the service organization's system, including controls, included in the scope of the engagement, assists the service auditor in:

- Identifying the boundaries of that system, and how it interfaces with other systems.
- Assessing whether the service organization's description fairly presents the system that has been designed and implemented.
- Determining which controls are necessary to achieve the control objectives stated in the service organization's description of its system.
- Assessing whether controls were suitably designed.
- Assessing, in the case of a type 2 report, whether controls were operating effectively.

A20. The service auditor's procedures to obtain this understanding may include:

- Inquiring of those within the service organization who, in the service auditor's judgment, may have relevant information.
- Observing operations and inspecting documents, reports, printed and electronic records of transaction processing.
- Inspecting a selection of agreements between the service organization and user entities to identify their common terms.
- Reperforming control procedures.

Obtaining Evidence Regarding the Description (Ref: Para. 21-22)

A21. Considering the following questions may assist the service auditor in determining whether those aspects of the description included in the scope of the engagement are fairly presented in all material respects:

- Does the description address the major aspects of the service provided (within the scope of the engagement) that could reasonably be expected to be relevant to the common needs of a broad range of user auditors in planning their audits of user entities' financial statements?
- Is the description prepared at a level of detail that could reasonably be expected to provide a broad range of user auditors with sufficient information to obtain an understanding of internal control in accordance with SA 315[13]? The description need not address every aspect of the service organization's processing or the services provided to user entities, and need not be so detailed as to potentially allow a reader to compromise security or other controls at the service organization.
- Is the description prepared in a manner that does not omit or distort information that may affect the common needs of a broad range of user auditors' decisions, for example, does the description contain any significant omissions or inaccuracies in processing of which the service auditor is aware?
- Where some of the control objectives stated in the service organization's description of its system have been excluded from the scope of the engagement, does the description clearly identify the excluded objectives?
- Have the controls identified in the description been implemented?
- Are complementary user entity controls, if any, described adequately? In most cases, the description of control objectives is worded such that the control objectives are capable of being achieved through effective operation of controls implemented by the service organization alone. In some cases, however, the control objectives stated in the service organization's description of its system cannot be achieved by the service organization alone because their achievement requires particular controls to be implemented by user entities. This may be the case where, for example, the control objectives are specified by a regulatory authority. When the description does include complementary user entity controls, the description separately identifies those controls along with the specific control objectives that cannot be achieved by the service organization alone.

[13] SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment".

- If the inclusive method has been used, does the description separately identify controls at the service organization and controls at the subservice organization? If the carve-out method is used, does the description identify the functions that are performed by the subservice organization? When the carve-out method is used, the description need not describe the detailed processing or controls at the subservice organization.

A22. The service auditor's procedures to evaluate the fair presentation of the description may include:

- Considering the nature of user entities and how the services provided by the service organization are likely to affect them, for example, whether user entities are from a particular industry and whether they are regulated by government agencies.
- Reading standard contracts, or standard terms of contracts, (if applicable) with user entities to gain an understanding of the service organization's contractual obligations.
- Observing procedures performed by service organization personnel.
- Reviewing the service organization's policy and procedure manuals and other systems documentation, for example, flowcharts and narratives.

A23. Paragraph 21(a) requires the service auditor to evaluate whether the control objectives stated in the service organization's description of its system are reasonable in the circumstances.

Considering the following questions may assist the service auditor in this evaluation:

- Have the stated control objectives been designated by the service organization or by outside parties such as a regulatory authority, a user group, or a professional body that follows a transparent due process?
- Where the stated control objectives have been specified by the service organization, do they relate to the types of assertions commonly embodied in the broad range of user entities' financial statements to which controls at the service organization could reasonably be expected to relate? Although the service auditor ordinarily will not be able to determine how controls at a service organization specifically relate to the assertions embodied in individual user entities' financial statements, the service auditor's understanding of the nature of the service organization's system, including controls, and services being provided is used to identify the types of assertions to which those controls are likely to relate.
- Where the stated control objectives have been specified by the service organization, are they complete? A complete set of control objectives can provide a broad range of user auditors with a framework to assess the effect of controls at the service organization on the assertions commonly embodied in user entities' financial statements.

A24. The service auditor's procedures to determine whether the service organization's system has been implemented may be similar to, and performed in conjunction with, procedures to obtain an understanding of that system. They may also include tracing items through the service organization's system and, in the case of a type 2 report, specific inquiries about changes in controls that were implemented during the period. Changes that are significant to user entities or their auditors are included in the description of the service organization's system.

Obtaining Evidence Regarding Design of Controls (Ref: Para. 23 and 28(b))

A25. From the viewpoint of a user entity or a user auditor, a control is suitably designed if, individually or in combination with other controls, it would, when complied with satisfactorily, provide reasonable assurance that material misstatements are prevented, or detected and corrected. A service organization or a service auditor, however, is not aware of the circumstances at individual user entities that would determine whether or not a misstatement resulting from a control deviation is material to those user entities. Therefore, from the viewpoint of a service auditor, a control is suitably designed if, individually or in combination with other controls, it would, when complied with satisfactorily, provide reasonable assurance that control objectives stated in the service organization's description of its system are achieved.

A26. A service auditor may consider using flowcharts, questionnaires, or decision tables to facilitate understanding the design of the controls.

A27. Controls may consist of a number of activities directed at the achievement of a control objective. Consequently, if the service auditor evaluates certain activities as being ineffective in achieving a particular control objective, the existence of other activities may allow the service auditor to conclude that controls related to the control objective are suitably designed.

Obtaining Evidence Regarding Operating Effectiveness of Controls

Assessing Operating Effectiveness (Ref: Para. 24)

A28. From the viewpoint of a user entity or a user auditor, a control is operating effectively if, individually or in combination with other controls, it provides reasonable assurance that material misstatements, whether due to fraud or error, are prevented, or detected and corrected. A service organization or a service auditor, however, is not aware of the circumstances at individual user entities that would determine whether a misstatement resulting from a control deviation had occurred and, if so, whether it is material. Therefore, from the viewpoint of a service auditor, a control is operating effectively if, individually or in combination with other controls, it provides reasonable assurance that control objectives stated in the service organization's description of its system are achieved. Similarly, a service organization or a service auditor is not in a position to determine whether any observed control deviation would result in a material misstatement from the viewpoint of an individual user entity.

A29. Obtaining an understanding of controls sufficient to opine on the suitability of their design is not sufficient evidence regarding their operating effectiveness, unless there is some automation that provides for the consistent operation of the controls as they were designed and implemented. For example, obtaining information about the implementation of a manual control at a point in time does not provide evidence about operation of the control at other times. However, because of the inherent consistency of IT processing, performing procedures to determine the design of an automated control, and whether it has been implemented, may serve as evidence of that control's operating effectiveness, depending on the service auditor's assessment and testing of other controls, such as those over program changes.

A30. To be useful to user auditors, a type 2 report ordinarily covers a minimum period of six months. If the period is less than six months, the service auditor may consider it appropriate to describe the reasons for the shorter period in the service auditor's assurance report. Circumstances that may result in a report covering a period of less than six months include

when (a) the service auditor is engaged close to the date by which the report on controls is to be issued; (b) the service organization (or a particular system or application) has been in operation for less than six months; or (c) significant changes have been made to the controls and it is not practicable either to wait six months before issuing a report or to issue a report covering the system both before and after the changes.

A31. Certain control procedures may not leave evidence of their operation that can be tested at a later date and, accordingly, the service auditor may find it necessary to test the operating effectiveness of such control procedures at various times throughout the reporting period.

A32. The service auditor provides an opinion on the operating effectiveness of controls throughout each period, therefore, sufficient appropriate evidence about the operation of controls during the current period is required for the service auditor to express that opinion. Knowledge of deviations observed in prior engagements may, however, lead the service auditor to increase the extent of testing during the current period.

Testing of Indirect Controls (Ref: Para. 25(b))

A33. In some circumstances, it may be necessary to obtain evidence supporting the effective operation of indirect controls. For example, when the service auditor decides to test the effectiveness of a review of exception reports detailing sales in excess of authorized credit limits, the review and related follow up is the control that is directly of relevance to the service auditor. Controls over the accuracy of the information in the reports (for example, the general IT controls) are described as "indirect" controls.

A34. Because of the inherent consistency of IT processing, evidence about the implementation of an automated application control, when considered in combination with evidence about the operating effectiveness of the service organization's general controls (in particular, change controls), may also provide substantial evidence about its operating effectiveness.

Means of Selecting Items for Testing (Ref: Para. 25(c) and 27)

A35. The means of selecting items for testing available to the service auditor are:

(a) Selecting all items (100% examination). This may be appropriate for testing controls that are applied infrequently, for example, quarterly, or when evidence regarding application of the control makes 100% examination efficient;

(b) Selecting specific items. This may be appropriate where 100% examination would not be efficient and sampling would not be effective, such as testing controls that are not applied sufficiently frequently to render a large population for sampling, for example, controls that are applied monthly or weekly; and

(c) Sampling. This may be appropriate for testing controls that are applied frequently in a uniform manner and which leave documentary evidence of their application.

A36. While selective examination of specific items will often be an efficient means of obtaining evidence, it does not constitute sampling. The results of procedures applied to items selected in this way cannot be projected to the entire population; accordingly, selective examination of specific items does not provide evidence concerning the remainder of the population. Sampling, on the other hand, is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from it.

The Work of an Internal Audit Function

Obtaining an Understanding of the Internal Audit Function (Ref: Para. 30)

A37. An internal audit function may be responsible for providing analyses, evaluations, assurances, recommendations, and other information to management and those charged with governance. An internal audit function at a service organization may perform activities related to the service organization's own system of internal control, or activities related to the services and systems, including controls, that the service organization is providing to user entities.

Determining Whether and to What Extent to Use the Work of the Internal Auditors (Ref: Para. 33)

A38. In determining the planned effect of the work of the internal auditors on the nature, timing or extent of the service auditor's procedures, the following factors may suggest the need for different or less extensive procedures than would otherwise be the case:

- The nature and scope of specific work performed, or to be performed, by the internal auditors is quite limited.
- The work of the internal auditors relates to controls that are less significant to the service auditor's conclusions.
- The work performed, or to be performed, by the internal auditors does not require subjective or complex judgments.

Using the Work of the Internal Audit Function (Ref: Para. 34)

A39. The nature, timing and extent of the service auditor's procedures on specific work of the internal auditors will depend on the service auditor's assessment of the significance of that work to the service auditor's conclusions (for example, the significance of the risks that the controls tested seek to mitigate), the evaluation of the internal audit function and the evaluation of the specific work of the internal auditors. Such procedures may include:

- Examination of items already examined by the internal auditors;
- Examination of other similar items; and
- Observation of procedures performed by the internal auditors.

Effect on the Service Auditor's Assurance Report (Ref: Para. 36-37)

A40. Irrespective of the degree of autonomy and objectivity of the internal audit function, such function is not independent of the service organization as is required of the service auditor when performing the engagement. The service auditor has sole responsibility for the opinion expressed in the service auditor's assurance report, and that responsibility is not reduced by the service auditor's use of the work of the internal auditors.

A41. The service auditor's description of work performed by the internal audit function may be presented in a number of ways, for example:

- By including introductory material to the description of tests of controls indicating that certain work of the internal audit function was used in performing tests of controls.
- Attribution of individual tests to internal audit.

Written Representations (Ref: Para. 38 and 40)

A42. The written representations required by paragraph 38 are separate from, and in addition to, the service organization's assertion, as defined at paragraph 9(o).

A43. If the service organization does not provide the written representations requested in

accordance with paragraph 38(c) of this SAE, it may be appropriate for the service auditor's opinion to be modified in accordance with paragraph 55(d) of this SAE.

Other Information (Ref: Para. 42)

A44. The *Code of Ethics* of the ICAI requires that a service auditor not be associated with information where the service auditor believes that the information:

(a) Contains a materially false or misleading statement;

(b) Contains statements or information furnished negligently; or

(c) Omits or obscures information required to be included where such omission or obscurity would be misleading[14].

If other information included in a document containing the service organization's description of its system and the service auditor's assurance report contains future-oriented information such as recovery or contingency plans, or plans for modifications to the system that will address deviations identified in the service auditor's assurance report, or claims of a promotional nature that cannot be reasonably substantiated, the service auditor may request that information be removed or restated.

A45. If the service organization refuses to remove or restate the other information, further actions that may be appropriate include, for example:

- Requesting the service organization to consult with its legal counsel as to the appropriate course of action.
- Describing the material inconsistency or material misstatement of fact in the assurance report.
- Withholding the assurance report until the matter is resolved.
- Withdrawing from the engagement.

Documentation (Ref: Para. 51)

A46. SQC 1 requires firms to establish policies and procedures for the timely completion of the assembly of engagement files[15]. An appropriate time limit within which to complete the assembly of the final engagement file is ordinarily not more than 60 days after the date of the service auditor's report[16].

Preparing the Service Auditor's Assurance Report

Content of the Service Auditor's Assurance Report (Ref: Para. 53)

A47. Illustrative examples of service auditors' assurance reports and related service organizations' assertions are contained in Appendices 1 and 2.

Intended Users and Purposes of the Service Auditor's Assurance Report (Ref: Para. 53(e))

A48. The criteria used for engagements to report on controls at a service organization are relevant only for the purposes of providing information about the service organization's system, including controls, to those who have an understanding of how the system has been used for financial reporting by user entities. Accordingly this is stated in the service auditor's

[14] The Code of Ethics of the ICAI, paragraph 110.2.

[15] SQC 1, paragraph 74.

[16] SQC 1, paragraph 75.

assurance report. In addition, the service auditor may consider it appropriate to include wording that specifically restricts distribution of the assurance report other than to intended users, its use by others, or its use for other purposes.

Description of the Tests of Controls (Ref: Para. 54)

A49. In describing the nature of the tests of controls for a type 2 report, it assists readers of the service auditor's assurance report if the service auditor includes:

- The results of all tests where deviations have been identified, even if other controls have been identified that allow the service auditor to conclude that the relevant control objective has been achieved or the control tested has subsequently been removed from the service organization's description of its system.
- Information about causative factors for identified deviations, to the extent the service auditor has identified such factors.

Modified Opinions (Ref: Para. 55)

A50. Illustrative examples of elements of modified service auditor's assurance reports are contained in Appendix 3.

A51. Even if the service auditor has expressed an adverse opinion or disclaimed an opinion, it may be appropriate to describe in the basis for modification paragraph the reasons for any other matters of which the service auditor is aware that would have required a modification to the opinion, and the effects thereof.

A52. When expressing a disclaimer of opinion because of a scope limitation, it is not ordinarily appropriate to identify the procedures that were performed nor include statements describing the characteristics of a service auditor's engagement; to do so might overshadow the disclaimer of opinion.

Other Communication Responsibilities (Ref: Para. 56)

A53. Appropriate actions to respond to the circumstances identified in paragraph 56 may include:

- Obtaining legal advice about the consequences of different courses of action.
- Communicating with those charged with governance of the service organization.
- Communicating with third parties (for example, a regulator) when required to do so.
- Modifying the service auditor's opinion, or adding an Other Matter paragraph.
- Withdrawing from the engagement.

Appendix 1

(Ref. Para. A47)

Example Service Organization's Assertions

The following examples of service organization's assertions are for guidance only and are not intended to be exhaustive or applicable to all situations.

Example 1: Type 2 Service Organization's Assertion

Assertion by the Service Organization

The accompanying description has been prepared for customers who have used [the type or name of] system and their auditors who have a sufficient understanding to consider the description, along with other information including information about controls operated by

customers themselves, when assessing the risks of material misstatements of customers' financial statements. [Entity's name] confirms that:

(a) The accompanying description at pages [bb-cc] fairly presents [the type or name of] system for processing customers' transactions throughout the period [date] to [date]. The criteria used in making this assertion were that the accompanying description:

(i) Presents how the system was designed and implemented, including:

- The types of services provided, including, as appropriate, classes of transactions processed.
- The procedures, within both information technology and manual systems, by which those transactions were initiated, recorded, processed, corrected as necessary, and transferred to the reports prepared for customers.
- The related accounting records, supporting information and specific accounts that were used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information was transferred to the reports prepared for customers.
- How the system dealt with significant events and conditions, other than transactions.
- The process used to prepare reports for customers.
- Relevant control objectives and controls designed to achieve those objectives.
- Controls that we assumed, in the design of the system, would be implemented by user entities, and which, if necessary to achieve control objectives stated in the accompanying description, are identified in the description along with the specific control objectives that cannot be achieved by ourselves alone.
- Other aspects of our control environment, risk assessment process, information system (including the related business processes) and communication, control activities and monitoring controls that were relevant to processing and reporting customers' transactions.

(ii) Includes relevant details of changes to the service organization's system during the period [date] to [date].

(iii) Does not omit or distort information relevant to the scope of the system being described, while acknowledging that the description is prepared to meet the common needs of a broad range of customers and their auditors and may not, therefore, include every aspect of the system that each individual customer may consider important in its own particular environment.

(b) The controls related to the control objectives stated in the accompanying description were suitably designed and operated effectively throughout the period [date] to [date]. The criteria used in making this assertion were that:

(i) The risks that threatened achievement of the control objectives stated in the description were identified;

(ii) The identified controls would, if operated as described, provide reasonable assurance that those risks did not prevent the stated control objectives from being achieved; and

(iii) The controls were consistently applied as designed, including that manual controls were applied by individuals who have the appropriate competence and authority, throughout the period [date] to [date].

Example 2: Type 1 Service Organization's Assertion

The accompanying description has been prepared for customers who have used [the type or name of] system and their auditors who have a sufficient understanding to consider the description, along with other information including information about controls operated by customers themselves, when obtaining an understanding of customers' information systems relevant to financial reporting. [Entity's name] confirms that:

(a) The accompanying description at pages *[bb-cc]* fairly presents *[the type or name of]* system for processing customers' transactions as at *[date]*. The criteria used in making this assertion were that the accompanying description:

(i) Presents how the system was designed and implemented, including:

- The types of services provided, including, as appropriate, classes of transactions processed.
- The procedures, within both information technology and manual systems, by which those transactions were initiated, recorded, processed, corrected as necessary, and transferred to the reports prepared for customers.
- The related accounting records, supporting information and specific accounts that were used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the reports prepared customers.
- How the system dealt with significant events and conditions, other than transactions.
- The process used to prepare reports for customers.
- Relevant control objectives and controls designed to achieve those objectives.
- Controls that we assumed, in the design of the system, would be implemented by user entities, and which, if necessary to achieve control objectives stated in the accompanying description, are identified in the description along with the specific control objectives that cannot be achieved by ourselves alone.
- Other aspects of our control environment, risk assessment process, information system (including the related business processes) and communication, control activities and monitoring controls that were relevant to processing and reporting customers' transactions.

(ii) Does not omit or distort information relevant to the scope of the system being described, while acknowledging that the description is prepared to meet the common needs of a broad range of customers and their auditors and may not, therefore, include every aspect of the system that each individual customer may consider important in its own particular environment.

(b) The controls related to the control objectives stated in the accompanying description were suitably designed as at [date]. The criteria used in making this assertion were that:

(i) The risks that threatened achievement of the control objectives stated in the

description were identified; and

(ii) The identified controls would, if operated as described, provide reasonable assurance that those risks did not prevent the stated control objectives from being achieved.

Appendix 2

(Ref. Para. A47)

Example Service Auditor's Assurance Reports

The following examples of reports are for guidance only and are not intended to be exhaustive or applicable to all situations.

Example 1: Type 2 Service Auditor's Assurance Report

Independent Service Auditor's Assurance Report on the Description of Controls, their Design and Operating Effectiveness

To: XYZ Service Organization

Scope

We have been engaged to report on XYZ Service Organization's description at pages *[bb-cc]* of its *[type or name of]* system for processing customers' transactions throughout the period *[date]* to *[date]* (the description), and on the design and operation of controls related to the control objectives stated in the description[17].

XYZ Service Organization's Responsibilities

XYZ Service Organization is responsible for: preparing the description and accompanying assertion at page *[aa]*, including the completeness, accuracy and method of presentation of the description and assertion; providing the services covered by the description; stating the control objectives; and designing, implementing and effectively operating controls to achieve the stated control objectives.

Service Auditor's Responsibilities

Our responsibility is to express an opinion on XYZ Service Organization's description and on the design and operation of controls related to the control objectives stated in that description, based on our procedures. We conducted our engagement in accordance with Standard on Assurance Engagements 3402, "Assurance Reports on Controls at a Service Organization," issued by the Institute of Chartered Accountants of India. That standard requires that we comply with ethical requirements and plan and perform our procedures to obtain reasonable assurance about whether, in all material respects, the description is fairly presented and the controls are suitably designed and operating effectively.

An assurance engagement to report on the description, design and operating effectiveness of controls at a service organization involves performing procedures to obtain evidence about the disclosures in the service organization's description of its system, and the design and operating effectiveness of controls. The procedures selected depend on the service auditor's judgment, including the assessment of the risks that the description is not fairly presented, and that controls are not suitably designed or operating effectively. Our procedures included testing the operating effectiveness of those controls that we consider necessary to provide reasonable assurance that the control objectives stated in the description were achieved. An assurance engagement of this type also includes evaluating the overall presentation of the

[17] If some elements of the description are not included in the scope of the engagement, this is made clear in the assurance report.

description, the suitability of the objectives stated therein, and the suitability of the criteria specified by the service organization and described at page *[aa]*.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Limitations of Controls at a Service Organization

XYZ Service Organization's description is prepared to meet the common needs of a broad range of customers and their auditors and may not, therefore, include every aspect of the system that each individual customer may consider important in its own particular environment. Also, because of their nature, controls at a service organization may not prevent or detect all errors or omissions in processing or reporting transactions. Also, the projection of any evaluation of effectiveness to future periods is subject to the risk that controls at a service organization may become inadequate or fail.

Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion are those described at page *[aa]*. In our opinion, in all material respects:

(a) The description fairly presents the *[the type or name of]* system as designed and implemented throughout the period from *[date]* to *[date]*;

(b) The controls related to the control objectives stated in the description were suitably designed throughout the period from *[date]* to *[date]*; and

(c) The controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the period from *[date]* to *[date]*.

Description of Tests of Controls

The specific controls tested and the nature, timing and results of those tests are listed on pages *[yy-zz]*.

Intended Users and Purpose

This report and the description of tests of controls on pages *[yy-zz]* are intended only for customers who have used XYZ Service Organization's *[type or name of]* system, and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by customers themselves, when assessing the risks of material misstatements of customers' financial statements.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number
Signature
(Name of the Member Signing the Audit Report)
(Designation[18])
Membership Number

Place of Signature
Date

[18] Partner or Proprietor, as the case may be.

Example 2: Type 1 Service Auditor's Assurance Report

Independent Service Auditor's Assurance Report on the Description of Controls and their Design

To: XYZ Service Organization

Scope

We have been engaged to report on XYZ Service Organization's description at pages *[bb-cc]* of its *[type or name of]* system for processing customers' transactions as at *[date]* (the description), and on the design of controls related to the control objectives stated in the description[19].

We did not perform any procedures regarding the operating effectiveness of controls included in the description and, accordingly, do not express an opinion thereon.

XYZ Service Organization's Responsibilities

XYZ Service Organization is responsible for: preparing the description and accompanying assertion at page *[aa]*, including the completeness, accuracy and method of presentation of the description and the assertion; providing the services covered by the description; stating the control objectives; and designing, implementing and effectively operating controls to achieve the stated control objectives.

Service Auditor's Responsibilities

Our responsibility is to express an opinion on XYZ Service Organization's description and on the design of controls related to the control objectives stated in that description, based on our procedures. We conducted our engagement in accordance with Standard on Assurance Engagements 3402, "Assurance Reports on Controls at a Service Organization," issued by the Institute of Chartered Accountants of India. That standard requires that we comply with ethical requirements and plan and perform our procedures to obtain reasonable assurance about whether, in all material respects, the description is fairly presented and the controls are suitably designed in all material respects.

An assurance engagement to report on the description and design of controls at a service organization involves performing procedures to obtain evidence about the disclosures in the service organization's description of its system, and the design of controls. The procedures selected depend on the service auditor's judgment, including the assessment that the description is not fairly presented, and that controls are not suitably designed. An assurance engagement of this type also includes evaluating the overall presentation of the description, the suitability of the control objectives stated therein, and the suitability of the criteria specified by the service organization and described at page *[aa]*.

As noted above, we did not perform any procedures regarding the operating effectiveness of controls included in the description and, accordingly, do not express an opinion thereon.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Limitations of Controls at a Service Organization

XYZ Service Organization's description is prepared to meet the common needs of a broad

[19] If some elements of the description are not included in the scope of the engagement, this is made clear in the assurance report.

range of customers and their auditors and may not, therefore, include every aspect of the system that each individual customer may consider important in its own particular environment. Also, because of their nature, controls at a service organization may not prevent or detect all errors or omissions in processing or reporting transactions.

Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion are those described at page *[aa]*. In our opinion, in all material respects:

(a) The description fairly presents the *[the type or name of]* system as designed and implemented as at *[date]*; and

(b) The controls related to the control objectives stated in the description were suitably designed as at *[date]*.

Intended Users and Purpose

This report is intended only for customers who have used XYZ Service Organization's *[type or name of]* system, and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by customers themselves, when obtaining an understanding of customers' information systems relevant to financial reporting.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation[20])
Membership Number

Place of Signature
Date

[20] Partner or Proprietor, as the case may be.

Appendix 3

(Ref. Para. A50)

Example Modified Service Auditor's Assurance Reports

The following examples of modified reports are for guidance only and are not intended to be exhaustive or applicable to all situations. They are based on the examples of reports in Appendix 2.

Example 1: Qualified opinion – the service organization's description of the system is not fairly presented in all material respects

…

Service Auditor's Responsibilities

…

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Basis for Qualified Opinion

The accompanying description states at page *[mn]* that XYZ Service Organization uses operator identification numbers and passwords to prevent unauthorized access to the system. Based on our procedures, which included inquiries of staff personnel and observation of activities, we have determined that operator identification numbers and passwords are employed in Applications A and B but not in Applications C and D.

Qualified Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion were those described in XYZ Service Organization's assertion at page *[aa]*. In our opinion, except for the matter described in the Basis for Qualified Opinion paragraph:

(a) …

Example 2: Qualified opinion – the controls are not suitably designed to provide reasonable assurance that the control objectives stated in the service organization's description of its system will be achieved if the controls operate effectively

…

Service Auditor's Responsibilities

…

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Basis for Qualified Opinion

As discussed at page *[mn]* of the accompanying description, from time to time XYZ Service Organization makes changes in application programs to correct deficiencies or to enhance capabilities. The procedures followed in determining whether to make changes, in designing the changes and in implementing them, do not include review and approval by authorized individuals who are independent from those involved in making the changes. There are also no specified requirements to test such changes or provide test results to an authorized reviewer prior to implementing the changes.

Qualified Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion were those described in XYZ Service Organization's assertion at page *[aa]*. In our opinion, except for the matter described in the Basis for Qualified Opinion paragraph:

(a) ...

Example 3: Qualified opinion – the controls did not operate effectively throughout the specified period (type 2 report only)

...

Service Auditor's Responsibilities

...

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Basis for Qualified Opinion

XYZ Service Organization states in its description that it has automated controls in place to reconcile loan payments received with the output generated. However, as noted at page *[mn]* of the description, this control was not operating effectively during the period from *dd/mm/yyyy* to *dd/mm/yyyy* due to a programming error. This resulted in the non-achievement of the control objective "Controls provide reasonable assurance that loan payments received are properly recorded" during the period from *dd/mm/yyyy* to *dd/mm/yyyy*. XYZ implemented a change to the program performing the calculation as of *[date]*, and our tests indicate that it was operating effectively during the period from *dd/mm/yyyy* to *dd/mm/yyyy*.

Qualified Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion were those described in XYZ Service Organization's assertion at page *[aa]*. In our opinion, except for the matter described in the Basis for Qualified Opinion paragraph:

...

Example 4: Qualified opinion – the service auditor is unable to obtain sufficient appropriate evidence

...

Service Auditor's Responsibilities

...

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Basis for Qualified Opinion

XYZ Service Organization states in its description that it has automated controls in place to reconcile loan payments received with the output generated. However, electronic records of the performance of this reconciliation for the period from *dd/mm/yyyy* to *dd/mm/yyyy* were deleted as a result of a computer processing error, and we were therefore unable to test the operation of this control for that period. Consequently, we were unable to determine whether

the control objective "Controls provide reasonable assurance that loan payments received are properly recorded" operated effectively during the period from *dd/mm/yyyy* to *dd/mm/yyyy.*

Qualified Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion were those described in XYZ Service Organization's assertion at page *[aa]*. In our opinion, except for the matter described in the Basis for Qualified Opinion paragraph:

(a) ...

SRS 4400
Engagements to Perform Agreed-upon Procedures regarding Financial Information

(Effective for all agreed upon procedures engagements on or after April 1, 2004)

Introduction

1. The purpose of this Standard on Related Services (SRS) is to establish standards and provide guidance on the auditor's[1] professional responsibilities when an engagement to perform agreed-upon procedures regarding financial information is undertaken and on the form and content of the report that the auditor issues in connection with such an engagement.

2. In an engagement to perform agreed-upon procedures, the auditor is engaged by the client to issue a report of factual findings, based on specified procedures performed on specified subject matter of specified elements, accounts or items of a financial statement. For example, an engagement to perform agreed-upon procedures may require the auditor to perform certain procedures concerning individual items of financial data, say, accounts payable, accounts receivable, purchases from related parties and sales and profits of a segment of an entity, or a financial statement, say, a balance sheet or even a complete set of financial statements.

3. This SRS is directed towards engagements regarding financial information. However, it may provide useful guidance for engagements to perform agreed-upon procedures regarding non-financial information; provided the auditor has adequate knowledge of the subject matter in question and reasonable criteria exist on which to base his findings. These Standards on Auditing is to be read in conjunction with the "Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services"[2]. The principles laid down in the other SAs, issued by the Institute of Chartered Accountants of India, may be used by the auditor, to the extent practicable, in applying this SRS.

Objective of an Agreed-upon Procedures Engagement

4. The objective of an agreed-upon procedures engagement is for the auditor to carry out procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings.

5. As the auditor simply provides a report of the factual findings of agreed-upon procedures, no assurance is expressed by him in his report. Instead, users of the report

[1] The term "auditor" is used throughout this SRS when describing services involving performance of agreed-upon procedures. Such reference is not intended to imply that a person performing related services need necessarily be the auditor of the entity's financial statements.

[2] The Framework issued in 2001 has been withdrawn pursuant to the issuance of the "Framework for Assurance Engagements", which is applicable from April 1, 2008. The text of the Revised Framework is reproduced elsewhere in this Handbook.

assess for themselves the procedures and the findings reported by the auditor and draw their own conclusions from the work done by the auditor.

6. The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures, may misinterpret the results. However, it is possible in certain circumstances that the report of the engagement may not be restricted only to those parties that have agreed to the procedures to be performed, but made available to a wider range of entities or individuals, e.g., in case of government organisations.

General Principles of an Agreed-upon Procedures Engagement

7. The auditor should comply with the *Code of Ethics,* issued by the Institute of Chartered Accountants of India. Ethical principles governing the auditor's professional responsibilities for this type of engagement are:

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality;

(e) Professional conduct; and

(f) Technical standards

Independence is not a requirement for agreed-upon procedures engagement, however, the terms or objective of the engagement may require the auditor to comply with the independence requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India. Where the auditor is not independent, a statement to that effect should be made in the report of factual findings.

8. The auditor should conduct an agreed-upon procedure engagement in accordance with this SRS and the terms of the engagement.

Defining the Terms of the Engagement

9. The auditor should ensure with representatives of the entity and, ordinarily, other specified parties who will receive copies of the report of factual findings, that there is a clear understanding regarding the agreed procedures and the conditions of the engagement. Matters to be agreed include the following:

(a) Nature of the engagement including the fact that the procedures performed will not constitute an audit or a review and that accordingly no assurance will be expressed.

(b) Stated purpose for the engagement.

(c) Identification of the financial information to which the agreed-upon procedures will be applied.

(d) Nature, timing and extent of the specific procedures to be applied.

(e) Limitations on distribution of the report of factual findings. When such limitation would be in conflict with the legal requirements, if any, the auditor would not accept the engagement.

10. In certain circumstances, for example, when the procedures have been agreed to between the regulator, industry representatives and representatives of the accounting profession, the auditor may not be able to discuss the procedures with all the parties who will receive the report. In such cases, the auditor may consider, for example, discussing the procedures to be applied with appropriate representatives of the parties involved, reviewing relevant correspondence from such parties.

11. It is in the interests of both the client and the auditor that the auditor sends an engagement letter documenting the key terms of the appointment. An engagement letter confirms the auditor's acceptance of the appointment and helps avoid misunderstanding regarding such matters as the objectives and scope of the engagement, the extent of the auditor's responsibilities and the form of reports to be issued.

12. Matters that would be included in the engagement letter include:

- A listing of the procedures to be performed as agreed-upon between the parties.
- A statement that the distribution of the report of factual findings would be restricted to the specified parties who have agreed to the procedures to be performed.

An example of an engagement letter appears in Appendix I to this SRS.

Planning

13. The auditor should plan the work so that an effective engagement will be performed.

Documentation

14. The auditor should document matters which are important in providing evidence to support the report of factual findings, and evidence that the engagement was carried out in accordance with this SRS and the terms of the engagement.

Procedures and Evidence

15. The auditor should carry out the procedures agreed-upon and use the evidence obtained as the basis for the report of factual findings.

16. The procedures applied in an engagement to perform agreed-upon procedures may include:

- Inquiry and analysis.
- Recomputation, comparison and other clerical accuracy checks.
- Observation.
- Inspection.
- Obtaining confirmations.

Appendix II to this SRS is an example report which contains an illustrative list of procedures which may be used as one part of a typical agreed-upon procedures engagement.

Reporting

17. The report on an agreed-upon procedures engagement needs to describe the purpose and the agreed-upon procedures of the engagement in sufficient detail to

enable the reader to understand the nature and the extent of the work performed. The report should also clearly mention that no audit or review has been performed.

18. The report of factual findings should contain:

(a) Title;

(b) Addressee (ordinarily, the appointing authority);

(c) Identification of specific financial or non-financial information to which the agreed-upon procedures have been applied;

(d) A statement that the procedures performed were those agreed-upon with the recipient;

(e) A statement that the engagement was performed in accordance with the Standard on Related Services applicable to agreed-upon procedures engagements;

(f) Identification of the purpose for which the agreed-upon procedures were performed;

(g) A listing of the specific procedures performed;

(h) A description of the auditor's factual findings including sufficient details of errors and exceptions found;

(i) A statement that the procedures performed do not constitute either an audit or a review and, as such, no assurance is expressed;

(j) A statement that had the auditor performed additional procedures, an audit or a review, other matters might have come to light that would have been reported;

(k) A statement that the report is restricted to those parties that have agreed to the procedures to be performed;

(l) A statement (when applicable) that the report relates only to the elements, accounts, items or financial and non-financial information specified and that it does not extend to the entity's financial statements taken as a whole;

(m) Date of the report;

(n) Place of signature ; and

(o) Auditor's signature

The report should be signed by the accountant in his personal name. Where the firm is appointed, the report should be signed in the personal name of the accountant and in the name of the firm. The partner/proprietor signing the report on agreed-upon procedures should also mention the membership number assigned by the Institute of Chartered Accountants of India

Appendix II to this SRS contains an example of a report of factual findings issued in connection with an engagement to perform agreed-upon procedures regarding financial information.

Effective Date

19. This Standard on Related Services is applicable to all agreed upon procedures engagements beginning on or after April 1, 2004.

Compatibility with the International Standard on Auditing (ISA)** 920

The standards established in this Standard on Related Services are generally consistent in all material respects with those set out in the International Standard on Auditing (ISA) 920, "Engagements to Perform Agreed-upon Procedures regarding Financial Information".

Appendix I

Example of an Engagement Letter for an Agreed-upon Procedures Engagement

The following letter is for use as a guide in conjunction with paragraph 12 of this Standard on Related Services and is not intended to be a standard letter. The engagement letter will need to be varied according to individual requirements and circumstances.

Date

To the Board of Directors (or other appropriate representatives of the client who engaged the auditor).

This is in reference to your letter dated _____, appointing us to perform agreed-upon procedures in respect of _____ *(identify the items, e.g., sales, profit of a segment, accounts receivables, etc., of the entity).*

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services that we will provide.

Our engagement will be conducted in accordance with the Standard on Related Services (SRS) 4400, "Engagements to Perform Agreed-upon Procedures regarding Financial Information", issued by the Institute of Chartered Accountants of India and we will indicate so in our report.

We have agreed to perform the following procedures and report to you the factual findings resulting from our work:

(Describe the nature, timing and extent of the procedures to be performed, including specific reference, where applicable, to the identity of documents and records to be read, individuals to be contacted and parties from whom confirmations will be obtained.)

The procedures that we will perform are solely to assist you in _____ *(state purpose)*. Our report is not to be used for any other purpose and is solely for your information, and/ or for use by _____ *(in case the terms of reference so require).*

The procedures that we will perform will not constitute an audit or a review made in accordance with the generally accepted auditing standards in India and, consequently, no assurance will be expressed.

We look forward to your full cooperation and trust that you will make available to us whatever records, documentation and other information requested in connection with our engagement.

Our fees will be billed as work progresses.

** Now the International Standard on Related Services (ISRS) 4400.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the terms of the engagement including the specific procedures, which we have agreed will be performed.

For XYZ & Co
Chartered Accountants
……

Signature
(Name of the Member)
Designation[3]

Date:
Address:

Acknowledged on behalf of ABC Company by
(signed)
.....
Name and Title
Date
Address

Appendix II

Example of a Report of Factual Findings in Connection with Accounts Receivable

CONFIDENTIAL

Report Of Factual Findings In Connection With
Agreed-upon Procedures Assignment Related To Accounts Receivable

To *(those who engaged the auditor)*

We have performed the procedures agreed with you and enumerated below with respect to the accounts receivable of ABC Company as at _____*(date)*, set forth in the accompanying schedules *(not shown in this example)*. Our engagement was undertaken in accordance with the Standard on Related Services (SRS) 4400, "Engagements to Perform Agreed-upon Procedures regarding Financial Information", issued by the Institute of Chartered Accountants of India. The procedures were performed solely to assist you in evaluating the validity of the accounts receivable and are summarized as follows:

1. We obtained and checked the addition of the trial balance of accounts receivable as at _____ *(date),* prepared by ABC Company, and we compared the total to the balance in the related general ledger account.

2. We compared the attached list *(not shown in this example)* of major customers and the amounts outstanding at _____ *(date)* to the related names and amounts in the trial balance.

[3] Partner or proprietor, as the case may be.

3. We obtained customers' statements or confirmations from customers to confirm balances outstanding at _____ *(date).*

4. We compared such statements or confirmations to the amounts referred to in 2 above. For amounts which did not agree, we obtained reconciliations from ABC Company. For reconciliations obtained, we identified and listed outstanding invoices, debit notes and outstanding cheques, each of which was greater than ₹ XXX. We located and examined such invoices and debit notes subsequently raised and cheques subsequently received and we ascertained that they have been rightly listed as outstanding on the reconciliations.

We report our findings below:

(a) With respect to item 1, we found the addition to be correct and the total amount to be in agreement.

(b) With respect to item 2, we found the amounts compared to be in agreement.

(c) With respect to item 3, we found there were suppliers' statements for all such customers.

(d) With respect to item 4, we found the amounts agreed, or with respect to amounts which did not agree, we found the Company had prepared reconciliations and that the debit notes, invoices and outstanding cheques over ₹ XXX were appropriately listed as reconciling items with the following exceptions:

(Detail the exceptions)

Because the above procedures do not constitute either an audit or a review made in accordance with the generally accepted auditing standards in India, we do not express any assurance on the accounts receivable as at _____*(date)*.

Had we performed additional procedures or had we performed an audit or review of the financial statements in accordance with the generally accepted auditing standards in India, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties. This report relates only to the accounts and items specified above and does not extend to any financial statements of ABC Company, taken as a whole.

Date: For XYZ & Co

Place: Chartered Accountants

……

Signature

(Name of the Member and Membership number)

Designation[4]

[4] Partner or proprietor as the case may be.

SRS 4410

Engagements to Compile Financial Information

(Effective for all compilation engagements beginning on or after April 1, 2004)

Introduction

1. The purpose of this Standard on Related Services (SRS) is to establish standards on professional responsibilities of an accountant[1] when an engagement to compile financial statements or other financial information is undertaken and the form and content of the report to be issued in connection with such a compilation so that the association of the name of the accountant with such financial statements or financial information is not misconstrued by a user of those statements or information as having been audited by him.

2. This SRS is directed towards the compilation of financial information. However, it should be applied to the extent practicable, to engagements to compile non-financial information, provided the accountant has adequate knowledge of the subject matter in question. Engagements to provide limited assistance to a client in the preparation of financial statements (for example, selection of an appropriate accounting policy), do not constitute an engagement to compile financial statements. This SRS should be read in conjunction with the "Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services[2]".

Objective of a Compilation Engagement

3. **The objective of a compilation engagement is for an accountant to use accounting expertise, as opposed to auditing expertise, to collect, classify and summarise financial information.** This ordinarily entails reducing detailed data to a manageable and understandable form without the requirement to test the assertions underlying that information. The procedures employed are not designed and do not enable the accountant to express any assurance on the financial information. However, users of the compiled financial information derive some benefit as a result of the accountant's involvement because the service has been performed with professional competence and due care.

4. A compilation engagement would ordinarily include the preparation of financial statements (which may or may not be a complete set of financial statements) but may also include the collection, classification and summarisation of other financial information, for example, preparation of quarterly financial results, restatement of financial statements in

[1] For the purpose of this Standard on Related Services and to distinguish between an audit and a compilation engagement, the term 'accountant' (rather than 'auditor') has been used throughout to refer to a member of the Institute in practice.

[2] The Framework issued in 2001 has been withdrawn pursuant to the issuance of the "Framework for Assurance Engagements", which is applicable from April 1, 2008. The text of the Revised Framework is reproduced elsewhere in this Handbook.

accordance with a financial reporting framework other than in accordance with which the financial statements to be restated are already prepared and presented.

General Principles of a Compilation Engagement

5. The accountant should comply with the "Code of Ethics" issued by the Institute of Chartered Accountants of India. The ethical principles governing the accountant's professional responsibilities for this type of engagement are:

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality;

(e) Professional conduct; and

(f) Technical standards.

Independence is not a requirement for a compilation engagement. However, where the accountant is not independent, a statement to that effect should be made in the accountant's report.

6. In all circumstances when an accountant's name is associated with financial information compiled by him, the accountant should issue a report.

Responsibility of Management

7. The management is responsible for taking reasonable steps to prevent and detect errors, fraud or other irregularities. This includes:

a) Ensuring that the financial information generated in the entity is correct, complete and reliable;

b) Maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;

c) Establishing controls designed to safeguard the assets of the entity and also to deter fraudulent or other dishonest conduct and to detect any fraud that occurs;

d) Establishing controls to provide reasonable assurance that the entity complies with laws and regulations applicable to its activities, or for detecting any non-compliance with laws or regulations that occurs.

8. A compilation engagement cannot be regarded as providing assurance on the adequacy of the client's internal control systems or on the actual incidence of fraud or non-compliance with laws and regulations. A compilation engagement carried out by the accountant does not relieve the management of these responsibilities.

9. The management is also responsible for preparation and presentation of financial statements or other financial information in accordance with the applicable laws and regulations, if any. The accountant should, accordingly, obtain an acknowledgement from the management of its responsibility for the appropriate preparation and presentation of the financial statements or other information and of its approval of such information to be compiled. The accountant should also obtain an acknowledgement

from management of its responsibility for the accuracy and completeness of the underlying accounting data and the complete disclosure of all material and relevant information to the accountant.

Defining the Terms of the Engagement

10. An engagement letter will be of assistance in planning the compilation work. The scope of a compilation engagement would, normally, be defined by the instructions of the client, though in certain cases, for example, in case of compilation of financial statements of a company, the form and content of such financial statements might be laid down under a statute. The accountant should, therefore, ensure that there is a clear understanding between the client and the accountant regarding the terms of the engagement by means of an engagement letter or such other suitable form of contract. Thus, it is in the interest of both the accountant and the entity that the accountant sends an engagement letter documenting the key terms of the appointment. An engagement letter confirms the accountant's acceptance of the engagement and helps avoid misunderstanding regarding matters such as the objective and scope of the engagement and the extent of the auditor's responsibilities.

11. The engagement letter would include matters such as the following:

(a) Nature of the engagement including the fact that neither an audit nor a review will be carried out and that accordingly no assurance will be expressed.

(b) Fact that the engagement cannot be relied upon to disclose fraud or defalcations that may exist but that the accountant will bring to the attention of the management any such matter which might come to his attention during the course of his engagement.

(c) Nature of the information to be supplied by the client.

(d) Fact that management is responsible for:

- the accuracy and completeness of the information supplied to the accountant, including maintenance of adequate accounting records and internal controls and selection and application of appropriate accounting policies.
- preparation and presentation of the financial statements of the entity, in accordance with the applicable laws and regulations, if any.
- safeguarding the assets of the entity and also establishing appropriate controls designed to prevent and detect fraud and other irregularities.
- ensuring that the activities of the entity are carried in accordance with applicable laws and regulations and that it institutes appropriate controls to prevent and detect any non-compliance.
- ensuring complete disclosure of all material and relevant information to the accountant.

(e) Intended use and distribution of the information, once compiled.

(f) Basis of accounting on which financial information is to be compiled and the fact that the basis, and any known departures therefrom, if any will be disclosed.

(g) The fact that the management is responsible to the users for the information to be compiled by the accountant.

(h) Unrestricted access to whatever records, documents and other information is requested in connection with the compilation engagement.

(i) Basis on which fees would be computed and any billing arrangements.

(j) Request for the client to confirm the terms of engagement by acknowledging the receipt of the engagement letter.

An example of an engagement letter for a compilation engagement appears in Appendix I.

Planning

12. The accountant should plan the work so that an effective engagement will be performed.

Documentation

13. The accountant should document matters, which are important in providing evidence that the engagement was carried out in accordance with this Standard on Related Services and the terms of the engagement.

Procedures

14. The accountant should obtain a general knowledge of the business and operations of the entity and should be familiar with the accounting principles and practices of the industry in which the entity operates and with the form and content of the financial statements/ other financial information that is appropriate in the circumstances.

15. To compile financial information, the accountant requires a general understanding of the nature of the entity's business transactions, the form of its accounting records and the accounting basis on which the financial information is to be presented. The accountant ordinarily obtains knowledge of these matters through experience with the entity or inquiry of the entity's personnel.

16. Other than as noted in this Standard on Related Services, the accountant is not, ordinarily, required to:

(a) make any inquiries of management to assess the reliability and completeness of the information provided;

(b) assess internal controls;

(c) verify any matters; or

(d) verify any explanations.

In a compilation engagement, an accountant would normally have to rely on the management for most of the information needed to compile the financial statements or other financial information, including accounting estimates as well as the fact that the information given to the accountant is complete and reliable. The accountant should request management representation letter covering significant information or explanations given orally on which he considers representations are required.

17. If the accountant becomes aware that the information supplied by management is incorrect, incomplete, or otherwise unsatisfactory, the accountant should consider performing the procedures listed in Paragraph 16 and request management to provide additional information. If management refuses to provide additional information, the accountant should withdraw from the engagement, informing the entity of the reasons for the withdrawal.

18. The accountant should read the compiled information and consider whether it appears to be appropriate in form and free from obvious material misstatements. In this sense, material misstatements include:

(a) mistakes in the application of the identified financial reporting framework.

(b) non-disclosure of the financial reporting framework and any known departures therefrom.

(c) non-disclosure of any other significant matters of which the accountant has become aware.

The identified financial reporting framework and any known departures therefrom should be disclosed within the financial information, though their effects need not be quantified.

Special Considerations

Clients Having an Identified Financial Reporting Framework

19. As far as practicable, in case of compilation of financial statements prepared within an identified financial reporting framework[3], the accountant should ensure that the financial statements or other financial information compiled comply with the requirements of the identified financial reporting framework. In case of any material departures from the requirements of the identified financial reporting framework, the fact should be stated in the Notes to the Accounts or other compiled financial information as well as in the accountant's report on the compilation.

Clients Having No Identified Financial Reporting Framework

20. In case of clients for whom compliance with an identified financial reporting framework is not required or the Accounting Standards issued by the Institute of Chartered Accountants of India are not mandatory, the client may specify that the accounts should be compiled on, for example, based on the requirements of the Income Tax Act, 1961. However, since,

---

[3] Paragraph 3 of the Framework for Statements on Standard Auditing Practices and Guidance Notes on Related Services states as follows:

> "Financial statements are ordinarily prepared and presented annually and are directed toward the common information needs of a wide range of users. Many of those users rely on the financial statements as their major source of information because they do not have the power to obtain additional information to meet their specific information needs. Thus, financial statements need to be prepared in accordance with one, or a combination of :
>
> (a) relevant statutory requirements, e.g., the Companies Act, 1956, for companies;
>
> (b) accounting standards issued by the Institute of Chartered Accountants of India; and
>
> (c) other recognised accounting principles and practices, e.g., those recommended in the Guidance Notes issued by the Institute of Chartered Accountants of India."

(The readers may note that the Framework issued in 2001 has been withdrawn pursuant to the issuance of the "Framework for Assurance Engagements", which is applicable from April 1, 2008. The text of the Revised Framework is reproduced elsewhere in this Handbook.)

accounts are normally assumed to be compliant with the generally accepted accounting practices, including the Accounting Standards issued by the Institute of Chartered Accountants of India, the different basis of compilation should be set out in the Notes to the Accounts or other compiled financial information as well as the report issued by the accountant on compilation.

Non-Compliance with the Accounting Standards

21. In the case of a company, the financial statements compiled must comply with the relevant provisions of the Companies Act, 1956, including the Accounting Standards and, accordingly, give a true and fair view. However, without carrying out the procedures necessary for an audit, the accountant cannot form any opinion on whether the accounts give a true and fair view, even though he has compiled these financial statements. The compilation is based on the information supplied to the accountant by the client and does not include any verification thereof. However, if the accountant becomes aware of material non-compliance with any applicable Accounting Standard(s), the same should be brought to the attention of the management and, if the same is not rectified by the management, it should be included in the Notes to the Accounts and the compilation report of the accountant.

Accounting Estimates Made by Clients

22. Often in compilation engagements, it is necessary for certain items in the accounts, for example, work in progress, to be based on estimates by the client. Such estimated items should be so described where material. If, based on the information provided to the accountant, it appears that certain estimates are unreasonable, the accountant should draw these to the attention of the management for reconsideration.

23. If the accountant becomes aware of material misstatements, the accountant should persuade the management to carry out necessary amendments in the financial statements or other compiled financial information. If such amendments are not made and the financial statements are still considered to be misleading, the accountant should withdraw from the engagement.

24. The financial statements or other financial information compiled should be approved by the client before the compilation report is signed by the accountant. The client should be asked to sign a statement on the face of the accounts retained by the accountant. The accountant should ensure that the users of the financial statements or other financial information so compiled are aware of the extent of his/her involvement with the accounts so that the users do not derive unwarranted assurance. Accordingly, the word 'audit' should not be used in describing the nature of services involving compilation of financial statements or other financial information, nor the fee for these services be described as "auditors' fee", or remuneration in the accounts, correspondence or any other document. The accountant should also take note that the financial statements or other financial information so compiled should not be prepared on the letter-heads or other stationery of the accountant, carrying his (or firm's) name and address since it is liable to be misinterpreted.

Reporting on a Compilation Engagement

25. It is essential that the accountant clearly brings out the nature of association with the financial statements and the nature of the work performed by him. The report on compilation engagements should, ordinarily, be in the following lay out:

(a) *Title*: The title of the report should be "Accountant's Report on Compilation of Unaudited Financial Statements" (and not "Auditor's Report");

(b) *Addressee*: The report should ordinarily be addressed to the appointing authority;

(c) Identification of the financial information also noting that it is based on the information provided by the management;

(d) When relevant, a statement that the accountant is not independent of the entity;

(e) A statement that the management is responsible for:

- completeness and accuracy of the underlying data and complete disclosure of all material and relevant information to the accountant;
- maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;
- preparation and presentation of financial statements or other financial information in accordance with the applicable laws and regulations, if any;
- establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities;
- establishing controls for ensuring that the activities of the entity are carried out in accordance with the applicable laws and regulations and preventing and detecting any non-compliance;

(f) A statement that the engagement was performed in accordance with this Standard on Related Services ;

(g) A statement that neither an audit nor a review has been carried out and that accordingly no assurance is expressed on the financial information;

(h) A paragraph, when considered necessary, drawing attention to the disclosure of material departures from the identified financial reporting framework;

(i) Date of the report;

(j) Place of signature; and

(k) Accountant's signature: The report on compilation of financial information should be signed by the auditor in his personal name. Where a firm is appointed for the engagement, the report should be signed in the personal name of the accountant and in the name of the firm. The partner/proprietor signing the report on compilation of financial information should also mention the membership number assigned by the Institute of Chartered Accountants of India

Appendix II to this Standard contains examples of compilation reports.

26. The financial statements or other financial information compiled by the accountant should contain a reference such as "Unaudited," "Compiled without Audit or Review"

and also "Refer to Compilation Report" on each page of the financial information or on the front of the complete set of financial statements.

Effective Date

27. This Standard on Related Services is applicable to all compilation engagements beginning on or after April 1, 2004.

Compatibility with International Standard on Auditing (ISA)** 930

The standards for compilation engagements established in this Standard on Related Services are generally consistent in all material respects with those set out in the International Standard on Auditing (ISA) 930, "Engagements to Compile Financial Information", except for the additional section titled, "Special Considerations", as given in paragraphs 19 to 22 of this Standard on Related Services .

The said section has been added to provide guidance to members in respect of certain typical issues which might be faced by the members in carrying out compilation engagements. For example, duties and responsibilities of the accountant in case of clients having an identified financial reporting framework, such as the Companies Act, 1956 and any material departures therefrom; clients having no identified financial reporting framework, say, where the financial statements are based on the requirements of the Income Tax Act, 1961. The section also provides guidance in respect of situations where the accountant becomes aware of a material non-compliance with the applicable Accounting Standards; as also duties of the accountant relating to accounting estimates made by the client.

Moreover, the Standard on Related Services , in paragraph 24, unlike the International Standard on Auditing (ISA) 930, also requires that the financial statements should be approved by the client before compilation report is signed by the accountant. The SRS also requires the accountant to ensure that the users of the compiled financial statements are aware of the extent of his/ her involvement with the accounts so that the users do not derive any unwarranted assurance. The SRS, unlike the ISA, also prohibits the accountant from preparing the financial statements on his letter head or other stationery bearing his (or firm's) name or address.

In addition, the SRS, unlike the ISA, does not require the accountant to send a form of expected report to the client alongwith the engagement letter. Also, the SRS requires the accountant to mention the place of signature in his report as compared to the ISA which requires the accountants to give his address.

** Now the International Standard on Related Services (ISRS) 4410.

Appendix I

Example of an Engagement Letter for a Compilation Engagement

The following letter is for use as a guide in conjunction with the considerations outlined in paragraph 11 of this Standard on Related Services . This example is for the compilation of financial statements of a company and will need to be varied according to individual requirements and circumstances.

(Date)

To the Board of Directors *(or other appropriate representatives of senior management)*:

You have, vide your letter dated _____ requested that we compile the balance sheet of _____*(name of the company)* as at _____*(date)* and the related profit and loss account and the (cash flow statement)[4] for the year ended on that date. We are pleased to confirm our acceptance and understanding of the engagement by means of this letter. As no audit or review engagement procedures would be carried out, no opinion on the financial statements will be expressed. Further, our engagement cannot be relied upon to disclose whether frauds or defalcations, or illegal acts exist. However, we will inform you of any such matters which might come to our attention in the course of the engagement.

As management, you are responsible for:

(a) the accuracy and completeness of the information supplied to us, including maintenance of adequate accounting records and internal controls and selection and application of appropriate accounting policies.

(b) preparation and presentation of the financial statements of the entity, in accordance with the applicable laws and regulations, if any.

(c) safeguarding the assets of the entity and also establishing appropriate controls designed to prevent and detect fraud and other irregularities.

(d) ensuring that the activities of the entity are carried in accordance with applicable laws and regulations and that it institutes appropriate controls to prevent and detect any non-compliance.

You will confirm that events and transactions are recorded in accordance with the applicable Accounting Standard(s), issued by the Institute of Chartered Accountants of India and other recognised accounting principles and practices and inform us of any departures therefrom.

As part of our normal procedures, we may request you to provide written confirmations of any information or explanations given to us orally during the course of our work.

We understand that the intended use and distribution of the information we have compiled is _____ *(specify).*

We look forward to full cooperation with your staff and we trust that they will make available to us whatever records, documentation and other information requested in connection with our engagement.

Our fees will be billed as the work progresses.

[4] Only in cases where relevant.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our compilation of your financial statements.

XYZ & Co.
Chartered Accountants
……
Signature
(Name of the Member)
Designation[5]

Address:
Date:

For ABC & Co.
Acknowledged on behalf of _____*(name of the company)*

Signature
Name and Designation

Date
Address

Appendix II

Examples of a Report of an Engagement to Compile Financial Statements

Illustration 1: Report on Compilation of Financial Statements

ACCOUNTANT'S REPORT ON COMPILATION OF UNAUDITED FINANCIAL STATEMENTS

To…….

On the basis of the accounting records and other information and explanations provided to us by the management, we have compiled, the unaudited balance sheet of ……..*(name of the entity)* as at March 31, XXXX and the related profit and loss account and the cash flow statement[6] for the period then ended.

The management of the _____ *(name of the entity)* is responsible for:

(a) Completeness and accuracy of the underlying data and complete disclosure of all material and relevant information to the accountant.

(b) Maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;

(c) Preparation and presentation of financial statements in accordance with the applicable laws and regulations, if any.

(d) Establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities.

(e) Establishing controls for ensuring that the activities of the entity are carried out in accordance with the applicable laws and regulations and preventing and detecting any non compliance.

[5] Partner or proprietor, as the case may be.
[6] Where applicable.

The compilation engagement was carried out by us in accordance with the Standard on Related Services (SRS) 4410 , "Engagements to Compile Financial Information", issued by the Institute of Chartered Accountants of India.

The balance sheet and the profit and loss account are in agreement with the books of account. We have not audited or reviewed these financial statements and accordingly express no opinion thereon.

For ABC & Co.

Chartered Accountants

……..

Signature

(Name of the accountant and membership number)

Designation[7]

Date:

Place:

Illustration 2: Compiled Financial Statements Where Such Financial Statements do not Comply with the Generally Accepted Accounting Practices in India.

ACCOUNTANT'S REPORT ON
COMPILATION OF UNAUDITED FINANCIAL STATEMENTS

To……

On the basis of the accounting records and other information and explanations provided to us by the management, we have compiled the unaudited balance sheet of _____ *(name of the entity)* as of March 31, XXXX and the related profit and loss account and the cash flow statement[8] for the period then ended.

The management of the _____ *(name of the entity)* is responsible for:

(a) Completeness and accuracy of the underlying data and complete disclosure of all material and relevant information to the accountant.

(b) Maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;

(c) Preparation and presentation of financial statements in accordance with the applicable laws and regulations, if any.

(d) Establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities.

(e) Establishing controls for ensuring that the activities of the entity are carried out in accordance with the applicable laws and regulations and preventing and detecting any non-compliance.

The compilation engagement was carried out by us in accordance with the Standard on Related Services (SRS) 4410 , "Engagements to Compile Financial Information", issued by the Institute of Chartered Accountants of India.

[7] Partner or Proprietor, as the case may be.

[8] Where applicable.

Since the financial statements have been compiled for the Income Tax Department and have been drawn up on cash basis of accounting to reflect the necessary adjustments for computation of the income by the Department, these financial statements, accordingly, do not comply with the generally accepted accounting principles in India.

The balance sheet and the profit and loss account are in agreement with the books of account. We have not audited or reviewed these financial statements and accordingly express no opinion thereon.

Date:

Place:

For ABC & Co.
Chartered Accountants
……..
Signature
(Name of the accountant and membership number)
Designation[9]

[9] Partner or proprietor.

Statements on The Companies (Auditor's Report) Order, 2003

The Central Government, in exercise of the powers conferred, under sub-section (4A) of section 227 of the Companies Act, 1956 (hereinafter referred to as "the Act"), has issued the Companies (Auditor's Report) Order, 2003 (hereinafter referred to as "the Order" or "the CARO, 2003"), *vide* Notification No. G.S.R. 480(E) dated June 12, 2003. The Order contains certain matters on which the auditors of companies (except of those categories of companies which are specifically exempted under the Order) have to make a statement in their audit report. The Central Government vide Notification No.GSR.766(E) dated November 25, 2004 amended the said Order and issued the Companies (Auditor's Report) (Amendment) Order, 2004.

General provisions regarding Auditor's Report

The requirements of the Order are supplemental to the existing provisions of section 227 of the Act regarding the auditor's report. It may be noted that the Order is supplemental to the directions given by the Comptroller and Auditor General of India under section 619 in respect of government companies. These directions continue to be in force. Therefore, in respect of government companies, the matters specified in the Order will form part of the auditor's report submitted to the members and the replies to the questionnaire issued by the Comptroller and Auditor General of India under section 619 will continue to be furnished as hitherto. The Order is not intended to limit the duties and responsibilities of auditors but only requires a statement to be included in the audit report in respect of the matters specified therein. For example, examination of the system of internal control is one of the basic audit procedures employed by the auditor. The fact that the Order requires a statement regarding the internal control applicable to purchases of inventories, fixed assets and sale of goods only is no justification for the auditor to conclude that an examination of internal control regarding the other areas of a company's business is not important or not required.

Applicability of the Order

Companies Covered by the Order

The Order applies to all companies except certain categories of companies specifically exempted from the application of the Order. The Order also applies to foreign companies as defined in section 591 of the Act. The Order is also applicable to the audits of branch(es) of a company under the Act since sub-section 3(a) of section 228 of the Act clearly specifies that a branch auditor has the same duties in respect of audit as the company's auditor. It is, therefore, necessary that the report submitted by the branch auditor contains a statement on all the matters specified in the Order to enable the company's auditor to consider the same while complying with the provisions of the Order.

Companies not Covered by the Order

The Order provides that it shall not apply to:

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an insurance company as defined in clause (21) of section 2 of the Companies Act, 1956 (1 of 1956);

(iii) a company licensed to operate under section 25 of the Companies Act, 1956 (1 of 1956); and

(iv) a private limited company with a paid-up capital and reserves not more than rupees fifty lakhs and does not have outstanding loan exceeding rupees twenty five lakhs or more from any bank or financial institution and does not have a turnover exceeding rupees five crores.

The Order specifically exempts banking companies, insurance companies and companies which have been licensed to operate under section 25 of the Act.

The Order also exempts from its application a private limited company which fulfils all the following conditions:

(i) its paid-up capital and reserves are rupees fifty lakhs or less;

(ii) it has no outstanding loan exceeding rupees twenty five lakhs from any bank or financial institution; and

(iii) its turnover does not exceed rupees five crores at any point of time during the financial year.

A private limited company, in order to be exempt from the applicability of the Order, must satisfy all the conditions mentioned above cumulatively. In other words, even if one of the conditions is not satisfied, a private limited company's auditor has to report on the matters specified in the Order.

(i) Private Limited Company The term "private limited company", as used in the Order, should be construed to mean a company registered as a "private company" {as defined in clause (iii) of sub-section (1) of section 3 of the Act} and which has a limited liability. In other words, the Order would be applicable to private unlimited companies irrespective of the size of their paid-up capital and reserves, turnover, borrowings from banks/financial institutions.

(ii) Paid-up Capital and Reserves Sub-section (32) of section 2 of the Act defines the term "paid-up capital" as capital credited as paid-up. The Guidance Note on Terms Used in Financial Statements, issued by the Institute of Chartered Accountants of India, defines the term "paid-up share capital" as, "that part of the subscribed share capital for which consideration in cash or otherwise has been received. This includes bonus shares allotted by the corporate enterprise". Paid-up share capital would include both equity share capital as well as the preference share capital. While calculating the paid-up capital, amount of calls unpaid should be deducted from and the amount originally paid-up on forfeited shares should be added to the figure of paid-up capital. Share application money received should not be considered as part of the paid-up capital.

For determining the applicability of the Order to a private limited company, both capital as well as revenue reserves should be taken into consideration while computing the limit of rupees fifty lakhs prescribed for paid-up capital and reserves. Revaluation reserve, if any, should also be taken into consideration while determining the figure of reserves for the limited purpose of determining the applicability of the Order. The credit balance in the profit and loss account should also be considered as a part of reserve since the balance in the profit and loss account is available for general purposes like declaration of dividend. The debit balance of the profit and loss account, if any, should be reduced from the figure of revenue reserves. However, miscellaneous expenditure to the extent not written off should not be deducted from the figure of reserves for the purpose of computing the above limit.

(iii) Loan Outstanding Loans from banks or financial institutions are normally in the form of term loans, demand loans, export credits, working capital limits, cash credits, overdraft facilities, bills purchased or discounted. Outstanding balances of such loans should be considered as loan outstanding for the purpose of computing the limit of rupees twenty five lakhs. Non-fund based credit facilities to the extent such facilities have devolved and have been converted into fund-based credit facilities should also be considered as outstanding loan. In case of term loans, interest accrued and due is considered as a loan whereas interest accrued but not due is not considered as a loan. It is clarified that since the words used by the Order are 'any bank or financial institution', the limit of exceeding twenty five lakh rupees applies in aggregate to all loans and not with reference to each bank or financial institution. For example, if a private limited company has three outstanding loans of rupees ten lakhs each from two banks and a financial institution, the Order would be applicable to such a private limited company irrespective of the fulfilment of the other conditions laid down for exemption from the applicability of the Order.

(iv) Financial Institution Explanation to sub-clause (xi) of Rule 2(b) of the Companies (Acceptance of Deposits) Rules, 1975 explains the term "financial institution" for the purposes of the said sub-clause. Therefore, the term "financial institution" used in the Order should be construed to have the same meaning as assigned to it in the explanation to the said sub-clause in the Companies (Acceptance of Deposits) Rules, 1975. It may, however, be noted that a non-banking financial company is not a "financial institution".

(v) Turnover The term, "turnover", has not been defined by the Order. Part II of Schedule VI to the Act, however, defines the term "turnover" as the aggregate amount for which sales are effected by the company. It may be noted that the "sales effected" would include sale of goods as well as services rendered by the company. In an agency relationship, turnover is the amount of commission earned by the agent and not the aggregate amount for which sales are effected or services are rendered. The term "turnover" is a commercial term and it should be construed in accordance with the method of accounting regularly employed by the company. For ascertaining the limit of rupees five crores:

(a) sales tax collected or excise duties collected should not be taken into account if they are credited separately to sales tax account or excise duty account;

(b) trade discounts should be deducted from the figure of turnover;

(c) commission allowed to third parties should not be deducted from the figure of turnover; and

(d) sales returns should be deducted from the figure of turnover even if the returns are from the sales made in the earlier years.

(vi) Date of Determination of Limits The Order does not clarify the point of time at which various limits laid down by the Order are to be tested for determining its applicability to a private limited company. It is clarified that the Order would become applicable to a private limited company. If, at any point of time, during the financial year covered by the audit report:

(a) its paid-up capital and reserves exceed the limit of rupees fifty lakhs; or

(b) its Outstanding Loans exceed rupees twenty five lakhs ; or

(c) its turnover exceeds rupees five crore.

Date of Coming into Force of the Order

The Companies (Auditor's Report) Order, 2003 was issued in June 2003 and comes into force on the 1st day of July, 2003. The said Order, from the date it came into force, superceded the MAOCARO, 1988. Further, the Order requires that every report made by the auditor under section 227 of the Act on the accounts of every company examined by him to which the Order applies, for every financial year ending on any day on or after the commencement of this Order, shall contain matters specified in paragraphs 4 and 5 of the Order. This implies that the auditor's report, on accounts in respect of financial year ending on or before 30th June 2003, even if issued on or after 1st July, 2003 is not required to contain report on-matters specified in the CARO, 2003. However, the auditor's report, in such cases, should include a statement on matters specified in the erstwhile MAOCARO, 1988.

The Government's Notification notifying the Companies (Auditor's Report) (Amendment) Order, 2004 clarifies that the Amendment Order would be effective from the date of its publication in the Official Gazette; i.e., November 25, 2004. Therefore, all audit reports issued on or after November 25, 2004 are required to comply with amendments contained herein read with the Companies (Auditor's Report) Order, 2003 of June 12, 2003.

Matters To Be Included In The Auditor's Report

Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets. [Paragraph 4(i)(a)]

Comments

1. The clause requires the auditor to comment whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets. Accounting Standard (AS) 10, "Accounting for Fixed Assets" defines "fixed asset" as an "asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business".

2. The Order is silent as to what constitutes 'proper records'. In general, however, the records relating to fixed assets should contain, *inter alia*, the following details:

   (i) sufficient description of the asset to make identification possible;

   (ii) classification, that is, the head under which it is shown in the accounts, e.g., plant and machinery, office equipment, etc;

(iii) situation;

(iv) quantity, i.e., number of units;

(v) original cost;

(vi) year of purchase;

(vii) adjustment for revaluation or for any increase or decrease in cost, e.g., on revaluation of foreign exchange liabilities;

(viii) date of revaluation, if any;

(ix) rate(s)/basis of depreciation or amortisation, as the case may be;

(x) depreciation/amortisation for the current year;

(xi) accumulated depreciation/amortisation;

(xii) particulars regarding impairment;

(xiii) particulars regarding sale, discarding, demolition, destruction, etc.

3. The records should contain the above-mentioned particulars in respect of all items of fixed assets, whether tangible or intangible, self-financed or acquired through finance lease. These records should also contain particulars in respect of those items of fixed assets that have been fully depreciated or amortised or have been retired from active use and held for disposal. The records should also contain necessary particulars in respect of item of fixed assets that have been fully impaired during the period covered by the audit report.

4. It is necessary that the aggregate original cost, depreciation or amortisation to date, and impairment loss, if any, as per these records under individual heads should tally with the figures shown in the books of account.

5. In cases where the original cost cannot be ascertained, Schedule VI to the Act provides that the book value as at 1st April, 1956 may be considered as cost. For the limited purpose of determining whether proper records are maintained, it should be considered as sufficient if, in respect of assets acquired prior to 1st April, 1956 where the original cost cannot be ascertained, the book value as on that date is considered as the cost.

   (Note : Although, this stipulation is not present in the Revised Schedule VI, it would be in harmony with the legislative intent even if the same stipulation is borrowed in post Revised Schedule VI scenario as well.)

6. Schedule XIV to the Act provides that depreciation on assets, whose actual cost does not exceed rupees five thousand, shall be provided at the rate of hundred percent. The records of fixed assets should include the necessary particulars in respect of such assets also.

7. The purpose of showing the situation of the assets is to make verification possible. There may, however, be certain classes of fixed assets whose situation keeps changing, for example, construction equipment which has to be moved to sites. In such circumstances, it should be sufficient if record of movement/custody of the equipment is maintained.

8. Where assets like furniture, etc., are located in the residential premises of members of the staff, the fixed assets register should indicate the name/designation of the person who has custody of the asset for the time being. In this connection, it may be necessary for the auditor to consider whether there are good reasons for the asset to be so located.
9. In cases where the details regarding allocation of cost over identified units of assets are not available, it would have to be made by an analysis of the purchases and the disposals of the preceding years.

Whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account. [Paragraph 4(i)(b)]

Comments

1. The clause requires the auditor to comment whether the fixed assets of the company have been physically verified by the management at reasonable intervals. The clause further requires the auditor to comment whether any material discrepancies were noticed on such verification and if so, whether those discrepancies have been properly dealt with in the books of account.
2. Physical verification of the assets has to be made by the management and not by the auditor. It is, however, necessary that the auditor satisfies himself that such verification was done and that there is adequate evidence on the basis of which he can arrive at such a conclusion. The auditor may prefer to observe the verification, particularly when verification of all assets can be made by the management on a single day or within a relatively short period of time. If, however, verification is a continuous process or if the auditor is not present when verification is made, then he should examine the instructions issued to the staff (which should, therefore, be in writing) by the management and should examine the working papers of the staff to substantiate the fact that verification was done and to determine the name and competence of the person who did the verification. In making this examination, it is necessary to ensure that the person making the verification had the necessary technical knowledge where such knowledge is required. It is not necessary that only the company's staff should make verification. It is also possible for verification to be made by outside expert agencies engaged by the management for the purpose.
3. The Order requires the auditor to report whether the management "at reasonable intervals" has verified the fixed assets. What constitutes "reasonable intervals" depends upon the circumstances of each case. The factors to be taken into consideration in this regard include the number of assets, the nature of assets, the relative value of assets, difficulty in verification, situation and spread of the assets, etc. The management may decide about the periodicity of physical verification of fixed assets considering the above factors. While an annual verification may be reasonable, it may be impracticable to carry out the same in some cases. Even in such cases, the verification programme should be such that all assets are verified at least once in every three years. Where verification of all assets is not made during the year, it will be necessary for the auditor to report that

fact, but if he is satisfied regarding the frequency of verification he should also make a suitable comment to that effect.

4. Apart from the audit procedures mentioned above, it would be appropriate for the auditor to obtain a management representation letter confirming that the fixed assets are physically verified by the company in accordance with the policy of the company. The management representation letter should also mention the periodicity of the physical verification of fixed assets. The letter should also include the details of the material discrepancies noticed during the physical verification of the fixed assets. If no discrepancies were noticed during the physical verification, the management representation letter should also mention this fact clearly.

If a substantial part of fixed assets have been disposed off during the year, whether it has affected the going concern. [Paragraph 4(i)(c)]

Comments

1. This clause requires the auditor to comment, in case where a substantial part of the fixed assets has been disposed off during the year, whether such disposal has affected the going concern status of the company.
2. Accounting Standard (AS) 1, "Disclosure of Accounting Policies" states, "the enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations".
3. The auditor, in the normal course, when planning and performing audit procedures and in evaluating the results thereof, is required to consider the appropriateness of the going concern assumption underlying the preparation of financial statements in accordance with the requirements of SA 570, "Going Concern". As a result of such audit procedures and evaluation, if the auditor is of the opinion that there exists any indication of risk that the going concern assumption might not be appropriate, the auditor should gather sufficient appropriate audit evidence to resolve, to his satisfaction, the question regarding the company's ability to continue operations for the foreseeable future.
4. The Order does not define the word "substantial". The response to the issue as to what constitutes "substantial part of fixed assets" depends primarily upon the facts and circumstances of each case. The auditor should use his professional judgement to determine whether an asset or group of assets sold by the company is a substantial part of fixed assets.
5. The auditor should carry out audit procedures to gather sufficient appropriate audit evidence to satisfy himself that the company shall be able to continue as a going concern for the foreseeable future despite the sale of substantial part of fixed assets. These procedures may include:
   (i) discussion with the management and analysis as to the significance of the fixed asset to the company as a whole;

(ii) scrutiny of the minutes of the meetings of the board of directors and important committees for understanding the entity's business plans for the future (for example, replacement of the substantial part of the fixed asset disposed off with another fixed asset having more capacity or for taking up a more profitable line of business);

(iii) review of events after the balance sheet date for analysing the effect of such disposal of substantial part of fixed asset on the going concern.

6. The auditor should also obtain sufficient appropriate audit evidence that the plans of the management are feasible, are likely to be implemented and that the outcome of these plans would improve the situation. The auditor should also seek written representation from the management in this regard.

Whether physical verification of inventory has been conducted at reasonable intervals by the management. *[Paragraph 4(ii)(a)]*

Comments

1. Inventories encompass goods purchased and held for resale, for example, merchandise purchased by a retailer and held for resale, computer software held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, stores and spares, consumables and loose tools awaiting use in the production process. It may be noted that packing materials are also included in inventories. Inventories do not include machinery spares covered by Accounting Standard (AS) 10, "Accounting for Fixed Assets", which can be used only in connection with an item of fixed asset and the use of which is expected to be irregular.

2. Physical verification of inventory is the responsibility of the management of the company which should verify all material items at least once in a year and more often in appropriate cases. It is, however, necessary that the auditor satisfies himself that the physical verification of inventories has been conducted at reasonable intervals by the management and that there is adequate evidence on the basis of which the auditor can arrive at such a conclusion. For example, the auditor may examine the documents relating to physical verification conducted by the management during the year as also at the end of the financial year covered by the auditor's report.

3. What constitutes "reasonable intervals" depends on circumstances of each case. The periodicity of the physical verification of inventories depends upon the nature of inventories, their location and the feasibility of conducting a physical verification. The management of a company normally determines the periodicity of the physical verification of inventories considering these factors. Normally, wherever practicable, all the items of inventories should be verified by the management of the company at least once in a year. It may be useful for the company to determine the frequency of verification by 'A-B-C' classification of inventories, 'A' category items being verified more frequently than 'B' category and the latter more frequently than 'C' category items.

Are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its

business? If not, the inadequacies in such procedures should be reported. [Paragraph 4(ii)(b)]

Comments

1. This clause requires the auditor to comment on the reasonableness and adequacy of the inventory verification procedures followed by the management of the company. In case the procedures of physical verification of inventories, in the opinion of the auditor, are not reasonable and adequate in relation to the size of the company and the nature of its business, the auditor has to report the same.
2. While the physical verification of inventories is primarily the duty of the management, the auditor is expected to examine the methods and procedures of such verification. The auditor may, if considered appropriate by him, be also present at the time of stock-taking. The auditor should establish the reasonableness and adequacy of procedures adopted for physical verification of inventories having regard to the nature of inventories, their locations, quantities and feasibility of conducting the physical verification. This would require the auditor to make use of his professional judgement. The SA 501, Audit Evidence – Additional Consideration for Specific Items, lays down the guidance regarding the audit procedures to be applied for physical verification of inventory.
3. While commenting on this clause, the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable or adequate.

Whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account. [Paragraph 4(ii)(c)]

Comments

1. The clause requires the auditor to comment whether the company is maintaining proper records of inventory. The clause also requires the auditor to comment whether any material discrepancies were noticed on physical verification of inventory and if so, whether those material discrepancies have been properly dealt with in the books of account.
2. What constitutes "proper records" has not been defined. However, in general, records relating to inventories should contain, *inter alia*, the following:
   - (i) particulars of the item like nomenclature, nature, etc.
   - (ii) identification code of the item;
   - (iii) details regarding quantity of the receipts, issues, balances and dates of transactions in a chronological manner;
   - (iv) relevant document number and department identification, if any;
   - (v) location.
3. If priced stores ledger is maintained, the records of the inventory should also disclose the prices at which the recording of the issues and receipts is made.

4. The records should contain the particulars in respect of all items of inventories. The auditor should also satisfy himself that the stock registers are updated as and when the transactions occur. The auditor should also verify that the transactions entered in stock registers are duly supported by relevant documents.

Has the company either granted or taken any loans, secured or unsecured to/from companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and amount involved in the transactions. [Paragraph 4 (iii)(a)]

Comments

1. The duty of the auditor, under this clause, is to determine whether the company has either granted or taken any loans, secured or unsecured to/from companies, firms or other parties in the register maintained under section 301 of the Act. If the company has done so, the clause requires that the auditor's report should disclose the "number of parties" and "amount involved" in such cases.

   For this purpose, the auditor should obtain a list of companies, firms or other parties covered in the register maintained under section 301 of the Act from the management. The auditor is required to disclose the requisite information in his report in respect of all parties covered in the register maintained under section 301 of the Act irrespective of the period to which such loan relates.

2. It may so happen that a party listed in the register maintained under section 301 of the Act might take a loan from the company and repays it to the company during the financial year concerned. Similar situation may exist in the case of loans taken by the company. Therefore, while examining the loans, the auditor should also take into consideration the loan transactions that have been squared-up during the year and report such transactions under the clause.

Whether the rate of interest and other terms and conditions of loans given or taken by the company, secured or unsecured, are prima facie prejudicial to the interest of the company. [Paragraph 4 (iii)(b)]

Comments

1. This clause, read with Paragraph 4(iii)(a) of the Order, requires the auditor to examine and comment whether the rate of interest and other terms and conditions of loans given or taken by the company (whether secured or unsecured) to companies, firms or other parties covered in the register maintained under section 301 of the Act are *prima facie* prejudicial to the interest of the company

2. The auditor's duty is to determine whether, in his opinion, the rate of interest and other terms and conditions of the loans given or taken are *prima facie* prejudicial to the interest of the company. The "other terms" would primarily include security, terms and period of repayment and restrictive covenants, if any. In determining whether the terms of the loans are "*prima facie*" prejudicial, the auditor would have to give due consideration to a number of factors connected with the loan, including the company's/borrower's financial standing, its ability to borrow/lend, the nature of the security, the availability of alternative

sources of finance, the urgency of the borrowing, purpose of the loan, prevailing market rate of interest and so on.

3. It may be mentioned that clause (a) of sub-section (1A) of section 227 of the Act also requires the auditor to inquire whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company or its members. The auditor's inquiry under the aforesaid clause may also be useful for the purposes of reporting under this clause.

Whether the payment of principal amount and interest are also regular. [Paragraph 4 (iii)(c)]

Comments

1. This part of the clause requires the auditor to report upon the regularity of payment of principal amount of loans and interest thereon. Again, read with clause 4(iii)(a) of the Order, the scope of auditor's inquiry under this clause shall be restricted in respect of companies, firms or other parties covered in the register maintained under section 301 of the Act.
2. The auditor has to examine whether the payment of principal and interest is regular. The word 'regular' should be taken to mean that the principal and interest should normally be paid or received whenever they fall due respectively. If a due date for payment of interest is not specified, it would be reasonable to assume that it falls due annually.
3. Where no stipulation has been made for the repayment of the loan , the auditor is not in a position to make any specific comments. However, the auditor should state the fact that he has not made any comments because the terms of repayment have not been stipulated.

If overdue amount is more than one lakh, whether reasonable steps have been taken by the company for recovery/payment of the principal and interest. [Paragraph 4(iii)(d)]

Comments

1. This clause requires the auditor to state whether reasonable steps have been taken by the company for recovery/payment of the principal and interest, wherever the overdue amount is more than rupees one lakh. A loan is considered to be overdue when the payment has not been made or received on the due date as per the borrowing/lending arrangements. In such cases, the auditor has to examine the steps, if any, taken for recovery/repayment of this amount. It may, however, be noted that the scope of the auditor's inquiry under this clause is restricted to loans given to/taken by the company to parties covered in the register maintained under section 301 of the Act.
2. In making this examination, the auditor would have to consider the facts and circumstances of each case, including the amounts involved. It is not necessary that steps to be taken must necessarily be legal steps. Depending upon the circumstances, the degree of delay in recovery/repayment and other similar factors, issue of reminders or the sending of an advocate's or solicitor's notice, may amount to "reasonable steps" even though no legal action is taken. The auditor is not, therefore, required to comment

adversely on the mere absence of legal steps if he is otherwise satisfied that reasonable steps have been taken by the company. The auditor should ask the management to give in writing the steps which have been taken. The auditor should arrive at his opinion only after consideration of the management's representations.

Is there an adequate internal control procedure commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods? Whether there is a continuing failure to correct major weaknesses in internal control. [Paragraph 4(iv)]

Comments

1. The clause requires the auditor to comment whether there is an adequate internal control procedure commensurate with the size of the company and the nature of its business, for the purchase of inventory, fixed assets and sale of goods. Further, the clause also requires the auditor to report whether there is a continuing failure by the company to correct major weaknesses in the internal controls in regard to purchase of inventory, fixed assets and the sale of goods and services.

2. "Internal Control System" means all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

3. In making the evaluation, the auditor has to give due regard not merely to the size of the company and the nature of its business but also to the organisational structure. This suggests that whereas detailed internal control procedures may be absolutely essential for a large company with a diversified business operating at several locations, internal control may be less formal in an "owner-managed" or a small company where there is a greater degree of personal supervision. Reference in this regard may also be made to SA 330.

The Auditor's Responses to Assessed Risks

4. The auditor should review the reports of internal auditor, if any. The reports of internal auditors may point out cases of weaknesses in the design of internal controls and non-observance of the laid down controls. The auditor should also review the minutes of the meetings of the board of directors and audit committee, if any, with a view to determine the cases of weaknesses in internal controls. The auditor may come across situations where a weakness in internal control has been placed before the board of directors or the audit committee but the same has not been considered. Such cases may point out the instances where there is a continuing failure to correct a major weakness in internal controls. The auditor should also review his previous years' working papers to determine the weaknesses in the internal controls, if any, already communicated to the management. Further, the Auditor should examine the follow-up actions taken by the management in response to weaknesses communicated to the management.

5. In case there is a continuing failure on the part of the company to correct major weakness in the internal controls, the auditor should also make a re-assessment of the control risk, at the assertion level, for each material account balance or class of transactions related to purchase of inventory, fixed assets and sale of goods so that appropriate audit procedures can be designed to reduce the overall risk to an acceptably low level. Further, if the auditor is of the opinion that the major weaknesses in the internal control have serious implications on the adequacy or reliability of the books of account of the company, the auditor should consider modifying his audit report on the financial statements. Where the auditor decides to do so, he should comply with the requirements of the SA 700, "Forming an Opinion and Reporting on Financial Statements" and SA 705, Modifications to the Opinion in the Independent Auditor's Report" " in this regard.

Whether of the particulars or arrangements referred to in section 301 of the Act have been entered in the register required to be maintained under that section. [Paragraph 4(v) (a)]

Comments

1. This part of the clause requires that the auditor should report whether the transactions that need to be entered into a register in pursuance of section 301 of the Act have been so entered. Section 301 of the Act requires that every company shall keep one or more registers in which shall be entered separately particulars of all contracts or arrangements to which sections 297 and 299 of the Act apply. The following are salient features of sections 301, 297 and 299 of the Act:

   (i) Under section 301 of the Act, every company is required to maintain one or more registers which contains the particulars of all contracts or arrangements to which section 297 or section 299 of the Act applies. The particulars of contracts and arrangements required to be entered in the register maintained under section 301 include, among other things, names of the parties to the contract or arrangement.

   (ii) Under section 297 of the Act, except with the consent of the Board of Directors of a company, a director of the company or his relative, a firm in which, a director or his relative is a partner or any other partner in such a firm, or a private company of which the director is a member or director, shall not enter into any contract with the company –

      (a) for the sale, purchase or supply of any goods, materials or services; or

      (b) after the commencement of this Act, for underwriting the subscription of any shares in or debentures of, the company.

   It may also be noted that in the case of a company having a paid-up capital of not less than rupees one crore, no such contract can be entered into without the previous approval of the Central Government. Whenever a contract, to which section 297 applies, is entered into, the board of directors accords its approval by a resolution passed at a meeting of the Board, before the date the contract is entered into or within three months of the date on which the contract was entered into. The particulars of such contracts or arrangements including names of the parties to the

contract or arrangement are required to be entered into the register maintained under section 301 of the Act.

(iii) Under section 299 of the Act, every director of a company, who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into, by or on behalf of the company, is required to disclose the nature of his concern or interest at a meeting of the Board of Directors. The disclosure required under section 299 of the Act can be made by a director either at a meeting of the Board under sub-section (2) or by way giving a general notice for disclosure of interest to the Board of Directors under sub-section (3) of section 299 of the Act. The disclosure of interest is made in Form 24AA of Companies (Central Government's) General Rules & Forms, 1956. Based on the disclosures made by directors in Form 24AA, particulars of contracts and arrangements including, among other things, the names of the parties concerned are entered into the register maintained under section 301 of the Act.

2. It may, however, be noted that as per section 299(6) of the Act, the requirements of section 301 of the Act do not apply to a contract or arrangement entered into or to be entered into between two companies where any of the directors of one of the company or two or more of them together holds or hold not more than two percent of the paid-up share capital in the other company. For example, the mere fact that a director is a shareholder in a public limited company will not mean that he is interested unless, of course he, together with other directors, holds more than 2% or more of the share capital.

3. The auditor should verify, on the basis of information provided by the management and on the basis of the results of the procedures performed by him, whether transactions that need to be entered into a register in pursuance of section 301 of the Act have been so entered or not. The auditor also evaluates whether the registers under section 301 are updated and maintained properly. The auditor should also examine, wherever applicable, secretarial compliance certificate issued under section 383A of the Act in regard to the completeness of the register maintained under section 301 of the Act.

Whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time. [Paragraph 4(v) (b)]

[This information is required only in case of transactions exceeding the value of five lakh rupees in respect of any party and in any one financial year.]

Comments

1. This clause requires the auditor to comment upon the reasonableness of the prices of all the transactions, which have been entered in pursuance of contracts or arrangements covered in the register(s) maintained under section 301 of the Act if such transactions in respect of any party and in any one financial year exceed the value of rupees five lakhs. The auditor is required to determine the reasonableness of prices having regard to the

prevailing market prices at the relevant time. It is clarified here that the scope of the auditor's inquiry under this clause is restricted to such transactions to which sections 297 and 299 of the Act apply and thereby required to be entered in the register maintained under section 301 of the Act.

2. The auditor is not expected to make a roving market inquiry to determine the market prices prevailing at the time the transactions were entered into. However, he may examine information such as price lists, quotations, and records relating to prices at which similar transactions have been entered into with other parties, etc., at the relevant time. The auditor has to satisfy himself, taking into account all the relevant information as well as any explanations given by the management, whether the prices at which various transactions have been made are reasonable. In determining the reasonableness of the prices, the auditor should take into account all the factors surrounding the transactions such as the delivery period/schedule of implementation, the quality and the quantity of the product/service, the credit terms, the previous record of supplier/buyer/client, etc. For example, in a transaction of purchase, it is not necessary that purchases be made in all cases at the lowest rates. When the rates paid are higher than the prevailing market prices, the auditor have to use his professional judgement to determine whether the difference in rates is reasonable having regard to the other factors mentioned above. This may often be the case where the company wishes to have more than one source of supply or where there is limit to the manufacturing capacity of the supplier who quotes a lower price.

In case the company has accepted deposits from the public, whether directives issued by the Reserve Bank of India and the provisions of sections 58A and 58AA or any other relevant provisions of the Act and the rules framed there under, where applicable, have been complied with. If not, the nature of contraventions should be stated; if an order has been passed by Company Law Board or National company Law Tribunal or Reserve bank of India or any Court or any other Tribunal whether the same has been complied with or not ?[Paragraph 4(vi)]

Comments

1. The clause, in addition to requiring the auditors to report on compliance with the requirements of section 58A and the directives of the Reserve Bank of India for acceptance of public deposits, also requires the auditor to:

   (i) report on compliance with the provisions of section 58AA of the Act; and

   (ii) report on compliance with the order, if any, passed by the company Law Board or National company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal.

2. Section 58A of the Act empowers the Central Government to prescribe, in consultation with the Reserve Bank of India, the limits up to which, the manner in which and the conditions subject to which deposits may be invited or accepted by a company either from the public or from its members. The section does not apply to a banking company or to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in that behalf.

3. On 3rd February 1975, the Central Government issued the Companies (Acceptance of Deposits) Rules, 1975. The Rules apply only to such companies as are not banking companies and are also not financial companies. Thus, financial companies are not covered by the Rules. Such companies continue to be governed by the directives issued by the Reserve Bank of India.

4. Section 58AA was inserted by the Companies (Amendment) Act, 2000 with effect from 13th December 2000. The section deals with small depositors. According to the section, a small depositor is a depositor who has deposited in a financial year, a sum not exceeding twenty thousand rupees in a company. The section lays down certain requirements to be complied with by the companies which have accepted deposits from such small depositors. Audit considerations similar to those that have been mentioned for section 58A would apply in regard to section 58AA also.

5. Non-compliance of section 58AA would occur in the event when a company fails to intimate the Company Law Board any default in repayment of deposit made by small depositors or part thereof or any interest thereupon. The auditor has to, therefore, first determine whether there is a default in any repayment of such deposits. This would require the auditor to examine all the accounts related to small depositors. In case where a company has large number of deposits accepted from small depositors, it may not be feasible for the auditor to first verify each account for default in repayment and then check whether the company has complied with the requirements of section 58AA of the Act. The auditor, in such a case, should examine the internal control in place in this regard and determine its efficacy. The auditor should obtain a schedule of repayment of loans taken from small depositors from the management of the company. The auditor, thereafter, should make reasonable test checks of the repayments made by the company. In case the results of the test check reveal that the management has defaulted in repayment of deposits made by small depositors or part thereof or interest thereupon, the auditor should examine whether the same has been intimated to the Company Law Board.

6. Apart from the audit procedures mentioned above, the auditor should also enquire of the management about the possible instances of non-compliance with sections 58A, 58AA and the relevant rules. The auditor should also enquire of the management about any order passed by the Company Law Board for contravention of sections 58A, 58AA and the relevant rules. The auditor should obtain a management representation to the effect whether:

   (a) the company has complied with the directives issued by the Reserve Bank of India and the provision of section 58A and 58AA of the Act and the relevant rules; and

   (b) Where an order has been passed by the Company Law Board, the company has complied with the requirements of the Order.

In the case of listed companies and/or other companies having a paid-up capital and reserves exceeding ₹ 50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crores rupees for a period of three consecutive financial years immediately preceding the financial year concerned, whether the company has

an internal audit system commensurate with its size and nature of its business. [Paragraph 4(vii)]

Comments

1. This clause requires the auditor to comment whether the company has an internal audit system commensurate with the size and nature of the business. The clause is required to be commented upon by the auditor in case of companies having a paid-up capital and reserves exceeding rupees 50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crores rupees for a period of three consecutive financial years immediately preceding the financial year concerned. 'Financial year concerned' means the financial year under audit.
2. This clause has a mandatory application for the listed companies irrespective of the size of paid-up capital and reserves or turnover. It may be noted that the Order does not specify the date with reference to which the listing status of the company should be determined. In this regard, it is clarified that if the company is listed on a recognised stock exchange as on the date of the balance sheet, it should be considered as listed for the purpose of this clause. In respect of non-listed companies the clause is applicable only if:
   (i) the paid-up capital and reserves of the company are more than rupees fifty lakhs as at the commencement of the financial year; or
   (ii) average annual turnover exceeds rupees five crores for a period of three consecutive financial years immediately preceding the financial year concerned.
3. The auditor has to examine whether the internal audit system is commensurate with the size of the company and the nature of its business. The following are some of the factors to be considered in this regard:
   (i) What is the size of the internal audit department? In considering the adequacy of internal audit staff, it is necessary to consider the nature of the business, the number of operating points, the extent to which control is decentralised, the effectiveness of other forms of internal control, etc.
   (ii) What are the qualifications of the persons who undertake the internal audit work? Internal auditing, as its name implies, is an aspect of audit and, therefore, it is reasonable to expect that the internal audit department should normally be headed by a chartered accountant and that, depending upon the size of the department, it employs other qualified persons. In deciding the adequacy of the internal audit department, it is, therefore, necessary that there is adequate number of qualified personnel.
   (iii) To whom does the internal auditor report? In general, the higher the level to which the internal auditor reports, the greater will be his independence.
   (iv) What are the areas covered by the internal audit? Internal audit can cover a large number of areas including operational auditing, organisation and methods studies, special investigations and the like. For the purposes of the Order, however, the

important areas which should be covered by internal audit are the examination of the operating systems to ensure that the systems are adequate and functioning in practice.

(v) Has the internal auditor adequate technical assistance? In a number of companies, where the operations are highly technical in nature, an internal auditor cannot function effectively unless he has adequate technical assistance. This can be provided either by having full-time technically qualified persons in the internal audit department or by such persons being deputed to the internal audit department for specific assignments. Similar considerations would apply where a large part of the transactions are computerised. In such cases, the internal auditor should have the assistance of persons who are able to audit computer systems.

(vi) What are the reports which are submitted by the internal auditor or what other evidence is there of his work? It is important that the auditor should satisfy himself that not merely does an internal audit system exist but also that it is functioning effectively. He can do so by examining the reports submitted by the internal auditor.

(vii) What is the follow-up? It is not sufficient that the internal audit system should point out errors in operation or deficiencies in the internal control system. It is equally necessary that there is an adequate follow-up system to ensure that the errors pointed out are corrected and remedial action taken on the deficiencies reported upon.

4. The auditor should examine the minutes of the meetings of the audit committee, if any. These minutes would provide the auditor with useful evidence regarding the efficiency and efficacy of the internal audit system.

Where maintenance of cost records has been prescribed by the Central Government under clause (d) of sub-section (1) of Section 209 (1) (d) of the Act, whether such accounts and records have been made and maintained. [Paragraph 4(viii)]

Comments

1. Section 209 (1) (d) of the Act requires a company pertaining to a class of companies engaged in production, processing, manufacturing or mining activities to maintain proper books of account showing particulars relating to utilization of material or labour or to other items of cost as may be prescribed, if the Central Government requires such class of companies to maintain such records. Pursuant to this requirement and in exercise of the powers conferred by sub-section (1) of section 642, the Central Government has made rules in respect of a number of classes of companies. These books of account and records form part of the books of account of the company within the meaning of section 209.

2. The Cost Accounting Records Rules issued for various industries contain requirements relating to two matters:

   (i) maintenance of proper books of account relating to materials, labour, and other items of cost; and

(ii) preparation of cost statements at the end of the financial year in accordance with the rules specific to the industry concerned.

While the records relating to materials, labour, etc., are required to be maintained on a day-to-day basis, the cost statements have to be prepared periodically.

3. The Order requires the auditor to report whether cost accounts and records have been made and maintained. The word "made" applies in respect of cost accounts (or cost statements) and the word "maintained" applies in respect of cost records relating to materials, labour, overheads, etc. The auditor has to report under the clause irrespective of whether a cost audit has been ordered by the Central Government. The auditor should obtain a written representation from the management stating (a) whether cost records are required to be maintained for any product(s) of the company under section 209(1)(d); and (b) whether cost accounts and records are being made and maintained regularly. The auditor should also obtain a list of books/records made and maintained in this regard. The Order does not require a detailed examination of such records.

4. The Order does not require a detailed examination of such records. The auditor should, therefore, conduct a general review of the cost records to ensure that the records as prescribed are made and maintained. He should, of course, make such reference to the records as is necessary for the purposes of his audit.

Is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth tax, Custom Duty, Excise Duty, Cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor. [Paragraph 4(ix) (a)]

Comments

1. This clause requires the auditor to report upon the regularity of the company in depositing undisputed statutory dues including provident fund, investor education and protection fund, employees' state insurance, income-tax, sales-tax, wealth-tax, custom duty, excise duty, cess and any other statutory dues to appropriate authorities. If the company is not regular in depositing the above mentioned undisputed statutory dues, the auditor is required to state the extent of arrears of statutory dues which have remained outstanding as at the last day of the financial year concerned for a period of more than six months from the date they became payable.

2. It may be noted that the use of the words "any other statutory dues" indicates that the clause covers all type of dues under various statues which may be applicable to a company having regard to its nature of business.

3. The intention of the Government, in this clause is to ascertain how regular the company is in depositing statutory dues with the appropriate authorities. Since the emphasis of the clause is on the regularity, the scope of auditor's inquiry is restricted to only those statutory dues which the company is required to deposit regularly to an authority.

4. It may be noted that the auditor has to report on the regularity of deposit of statutory dues irrespective of the fact whether or not there are any arrears on the balance sheet date. This is because there may be situations where a company has deposited the relevant dues before the end of the year while it has been in default in the matter for a significant part of the year. In cases where there are no arrears on the balance sheet date but the company has been irregular during the year in depositing the statutory dues, the auditor should state this fact in his audit report.
5. For the purpose of this clause, the auditor should consider a matter as "disputed" where there is a positive evidence or action on the part of the company to show that it has not accepted the demand for payment of tax or duty, e.g., where it has gone into appeal. For this purpose, where an application for rectification of mistake (e.g., under section 154 of the Income Tax Act, 1961) has been made by the company, the amount should be regarded as disputed. Where the demand notice/intimation for the payment of a statutory due is for a certain amount and the dispute relates only to a part and not the whole of such amount, only such amount should be treated as disputed and the balance amount should be regarded as undisputed.
6. It may be noted that penalty and/or interest levied under the respective laws would be covered within the term "amounts payable".
7. The auditor should obtain a written representation with reference to the date of the balance sheet from the management -
   (i) specifying the cases and the amounts considered disputed;
   (ii) containing a list of the cases and the amounts in respect of the statutory dues which are undisputed and have remained outstanding for a period of more than six months from the date they became payable;
   (iii) containing a statement as to the completeness of the information provided by the management.
8. While the auditor has to report upon the regularity of the deposit, he is not required to specify in detail each instance where there has been a delay or the extent of the delay. It should be sufficient if he indicates whether generally the deposits have been regular or otherwise.

In case dues of sales tax/income tax/custom tax/wealth tax/excise duty/cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending may please be mentioned. [Paragraph 4(ix)(b)]

{A mere representation to the Department shall not constitute the dispute.}

Comments

1. This clause requires that in case of disputed statutory dues, the amounts involved should be stated along with the forum where the dispute is pending.
2. It is clarified here that mere representation to the concerned Department does not constitute dispute. According to the Order, it is necessary that there should be an appeal

before the relevant appellate authority. It is, however, reiterated that where an application for rectification of mistake (i.e., under Section 154 of the Income tax Act, 1961) has been made by the company, the amount should be regarded as disputed.

3. A show-cause or similar notice generally contains the requirements /queries of the assessing officer. Normally, issuance of a show cause notice by the concerned department should not be construed to be a demand payable by the company. However, in some cases, a show cause notice and demand may be combined in one document. Normally, in such cases, the demand would not be constructed to have arisen till the time the assessee has disposed off the requirements of the show cause order. Hence, it would be necessary to evaluate each situation individually.

4. It is possible that in respect of same nature of statutory dues, there may be more than one dispute pertaining to different periods for which, appeals might have been filed separately. For example, different years' income tax liabilities might have been disputed at different levels of appellate authorities. Hence, in such cases, the information required by the clause should be given separately in respect of each period.

The information required by the clause may be reported in the following format:

Statement of Disputed Dues

Name of the Statute	Nature of the Dues	Amount (₹)	Period to which the amount relates	Forum where dispute is pending

Whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year. [Paragraph 4(x)]

Comments

1. The clause is applicable to all the companies that are in existence for more than five years from the date of registration till the last day of the financial year covered by the auditor's report. The clause requires the auditor to report:

   whether the accumulated losses at the end of the financial year are more than 50% of its net worth; and

   whether the company has incurred cash losses during the period covered by the report and in the financial year immediately preceding the period covered by the report.

2. A question arises about the exact connotation of the term "loss" for ascertaining the amount of accumulated losses. More specifically, the issue is whether, for the purpose of reporting by the auditor, the net loss shown by the profit and loss account should be taken as the loss or whether any adjustments need to be made in the figure of such net profit/loss. The term "loss" should be construed to mean the net profit/loss shown by the profit and loss account of the company as adjusted after taking into account qualifications in the audit report to the extent the qualifications are quantified.

3. Section 2(29A) of the Act defines the term "net worth" as "sum total of the paid-up capital and free reserves after deducting the provisions or expenses as may be prescribed". The explanation to the definition further provides that for the purpose of this definition, "free reserves" means all reserves created out of profits and share premium account but does not include reserves created out of revaluation of assets, write back of depreciation provisions and amalgamation. The provisions or expenses to be deducted from the paid-up capital and reserves for calculating net-worth have not yet been prescribed. It, thereby, implies that the 'net worth' is the sum total of the paid-up capital and free reserves until the provisions or expenses to be deducted therefrom are prescribed under section 2(29A) of the Act. The figure of net worth computed from the balance sheet of the company should also be adjusted for the effect of qualifications in the audit report to the extent the qualifications are quantified.
4. The figure of cash loss of the company for the financial year covered by the audit report and the immediately preceding financial year should also be adjusted for the effect of qualifications in the respective audit reports to the extent the qualifications are quantified.
5. The auditor while reporting on this clause should indicate that his opinion on the matters specified in the clause has been arrived at after considering the effect of the qualifications on the figures of accumulated losses, net worth and cash losses. Where any of the qualifications in the audit report is not capable of being quantified, the auditor should state that the effect of such unquantified qualification(s) has not been taken into consideration for the purpose of making comments in respect of this clause.

Whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported. [Paragraph 4 (xi)]

Comments

1. Under this clause, the auditor is required to report whether the company has defaulted in repayment of dues to a financial institution or bank or to debenture holders. If the answer is in the affirmative, the auditor is also required to mention the period of default and the amount of default. Dues to financial institutions, banks or debenture holders would include the principle as well as interest.
2. A question that arises is whether the scope of the auditor's inquiry would cover defaults made by the company during the year only or whether the defaults committed in previous years and continuing until the year end would also be covered. It is clarified that the auditor should report the period and amount of all defaults existing at the balance sheet date irrespective of when those defaults have occurred.
3. The auditor should obtain a schedule of repayments to banks, financial institutions and debenture holders from the management of the company. The schedule should indicate the amount and the due dates of the payments that the company is required to make to banks, financial institutions and debenture holders.
4. The auditor should examine the agreement or other documents containing the terms and conditions of the loans and borrowings of the company from banks and financial institutions. The auditor should also examine the debenture trust deed. This examination

would enable the auditor in verifying the amount and due dates of the payments mentioned in schedule of repayments provided by the management of the company. The auditor should then verify whether the repayments as per the books of account are in accordance with the terms and conditions of the relevant agreement. The auditor should also satisfy himself that the repayment have actually been made to the party concerned.

5. It may happen that the company might have submitted application for reschedulement/ restructuring proposals to the lenders, which may be in different stages of processing. Submission of application for reschedulement/restructuring does not mean that no default has occurred. Accordingly, in such situations also the auditor should report the period of default and the amount of default. However, if the application for reschedulement of loan has been approved by the concerned bank or financial institution or if the default has been made good by the company during the accounting period covered by the auditor's report, the auditor should state in his audit report the fact of reschedulement of loan or the fact of default having been made good.

6. The auditor may come across a situation where there may be disputes between the company and the lender on certain issues relating to repayments. In all such situations, the auditor should give a disclaimer that since there is a dispute between the company and the lender; he is unable to determine whether there is a default in repayment of dues to the lender concerned.

7. The following is an example of negative reporting under the clause:

   "The company has defaulted in repayment of dues to debenture holders. Debentures amounting to ₹ 50,00,000/- became due for redemption on 30th May 20X4 which were redeemed by the company on 15th March 20X5."

Whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities; If not, the deficiencies to be pointed out. [Paragraph 4 (xii)]

Comments

1. The clause requires the auditor to comment on the adequacy of documents and records maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities. If the auditor is not satisfied about the adequacy of documents and records, he has to report the inadequacies and point out deficiencies in maintenance of records.

2. This requirement is confined to loans and advances which are secured by way of pledge of shares, debentures and other securities, and do not extend to other forms of security, e.g., hypothecation, guarantee, etc.

3. Pledge implies that the physical possession of the security must be transferred to the company along with a power to sale of the security in the case of default. This transfer can be actual or constructive. For example, the share or debenture may be physically in the custody of the company or it may be with a person like a bank which holds it on behalf of the company.

4. A question may arise as to the exact meaning of the term "other securities". The term, 'other securities' may be construed to mean bonds or promissory notes issued by a government or semi-government authority.

5. The auditor has to report whether adequate documents and records have been maintained. What records would be considered adequate depends upon the nature of the security and the party to whom the loan or advance is granted. But the records should generally include the following particulars:

   (i) the full name and address of the borrower;

   (ii) the amount of the loan or advance;

   (iii) stipulations regarding period of repayment, the rate of interest, the security to be pledged and all other terms of the loan or advance;

   (iv) the record of the disbursements, repayments towards the loan or advance and recovery of the interest;

   (v) full particulars of the security pledged, for example, if the security consists of shares, the particulars would include the names of the companies, number of shares, class of shares, distinctive numbers of the shares, particulars of the parties in whose names the shares stand, etc.;

   (vi) the documents needed to transfer the ownership of the security in case of need;

   (vii) periodical acknowledgements from the parties confirming the balances due;

   (viii) proof that the party has power to borrow, e.g., in case the borrower is a company, its memorandum of association, board resolution or shareholders' resolution; etc.

6. The clause does not cast a duty upon the auditor to examine the adequacy of the security on the basis of which loans have been granted. This may be due to the fact that an inquiry in this regard has to be made by the auditor in terms of section 227 (1A) of the Act. In any event, it remains the duty of the auditor to ensure by physical verification that, where a loan or advance is given on the basis of a pledge of shares, debentures or other securities, the securities are in the custody of the company and that the market value of the securities is adequate to cover the outstanding amount of the loan and interest.

Whether the provisions of any special statute applicable to chit fund have been duly complied with? [Paragraph 4(xiii) First Part]

Comments

1. The clause requires the auditor to comment whether the provisions of any special statute applicable to chit fund have been complied with. It may be noted that clause is required to be commented upon by the auditor only in case of a chit fund company. Therefore, the auditor should determine whether the company is carrying on the chit fund business. It may be noted that the Order contains a single definition of the terms "chit fund company", "*nidhi* company" or "mutual benefit company". According to the Order, "chit fund company", "*nidhi* company" or "mutual benefit company" means a company engaged in the business of managing, conducting or supervising as a foreman or agent of any

transaction or arrangement by which it enters into an agreement with a number of subscribers that every one of them shall subscribe to a certain sum of instalments for a definite period and that each subscriber, in his turn, as determined by lot or by auction or by tender or in such other manner as may be provided for in the agreement, shall be entitled to a prize amount, and includes companies whose principal business is accepting fixed deposits from, and lending money to, members."

2. This is a very wide requirement and taken literally would mean that the auditor has to ensure that the company complies with all the requirements of the relevant special statutes. Obviously, this cannot be the intention. A more rational interpretation would, therefore, be that the auditor has to satisfy himself and report that the company has complied with all the provisions of the special statutes in so far as they are applicable to the accounts of the chit fund company. It is necessary that the audit report should clearly state the above interpretation. The following is an example of the report:

   "According to the information and explanations give to us, the company has complied with the provisions of ..... in so far as those provisions are applicable to the accounts under report."

In respect of nidhi/mutual benefit fund/societies:

(a) whether the net-owned funds to deposit liability ratio is more than 1:20 as on the date of balance sheet;

(b) whether the company has complied with the prudential norms on income recognition and provisioning against sub-standard/default/loss assets;

(c) whether the company has adequate procedures for appraisal of credit proposals/ requests, assessment of credit needs and repayment capacity of the borrowers;

(d) whether the repayment schedule of various loans granted by the nidhi is based on the repayment capacity of the borrower and would be conducive to recovery of the loan amount. [Paragraph 4(xiii) Second Part; sub-clauses (a) to (d)]

Comments

1. It may be noted that a "*nidhi*" or a "mutual benefit society" may accept deposits not exceeding twenty times of its net owned funds as per last audited balance sheet.

2. According to the directions issued by the Central Government vide notification number GSR 555(E) dated 26th July, 2001 [as modified by notification number GSR 308(E) dated 30th April, 2002], the term "net owned funds" means the aggregate of paid-up equity capital and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet of the company. A reserve is considered as a "free reserve" if it is available for distribution as dividend. Further, the amount representing the proceeds of issue of preference shares shall not be included for calculating net-owned funds. However, for *nidhis* or mutual benefit societies existing on or before 26.7.2001, the proceeds of issue of preference shares shall be included for calculation of net-owned funds up to the financial year 31st March 2004.

3. A *nidhi* or a mutual benefit society can accept fixed deposits, recurring deposits accounts and savings deposits from its members in accordance with the directions notified by the Central Government. The aggregate of such deposits is referred to as "deposit liability".

4. The auditor should ask the management to provide the computation of the deposit liability and net-owned funds on the basis of the requirements contained herein above. This would enable him to verify that the ratio of deposit liability to net owned funds is in accordance with the requirements prescribed in this regard. The auditor should verify the ratio using the figures of net owned funds and deposit liability computed in accordance with what is stated above. The comments of the auditor should be based upon such a statement provided by the management and verification of the same by the auditor.

5. *Nidhis* and mutual benefit societies can give loans to its shareholders or members against the security of gold, silver, jewellery, immovable property, fixed deposit, kisan vikas patra, national savings certificates, insurance policies and other Government securities. The Central Government, *vide* notification number GSR 309 (E) dated 30th April 2002 issued prudential norms for revenue recognition and classification of assets in respect of mortgage or loans.

6. The sub-clause (c) requires the auditor to comment upon whether the company has adequate procedures for appraisal of credit proposals/requests, assessments of credit needs and repayment capacity of the borrowers. The auditor should study the procedures regarding appraisal of credit proposals/requests, assessment of credit needs and repayment capacity of the borrowers. It may so happen that a company might have a separate set of procedures for appraisal of credit proposals/requests of employees. The auditor should also study the same. Such procedures should normally include steps to be followed for detailed verification of the proposal to assess need of credit and the repayment capacity of the borrower. Study of the individual borrower files would indicate whether proper systems and procedures have been followed.

7. The sub-clause (d) requires the auditor to comment on whether the repayment schedule of various loans granted by the *nidhi* is based on the repayment capacity of the borrower and would be conducive to recovery of the loan amount. It may be noted that the scope of the auditors' enquiry for this clause is limited to examination of the documentation available with the company in regard to grant of loans. Based on his examination of the documentation in regard to grant of loans, the auditor would form an opinion whether the repayment schedule of various loans granted by the *nidhi* is based on the repayment capacity of the borrower. Where the number of loans granted by the company is very large, it is obviously not feasible for the auditor to satisfy himself that every single loan's repayment schedule granted by the *nidhi* is based on the repayment capacity of the borrower and would be conducive to recovery of the loan amount. It is important to note that the auditor's comments on this clause would have to be based on the auditor's examination of the documentation of all large loans, say, exceeding a particular limit determined by the auditor having regard to the concept of materiality and a test check of the documentation of other loans with a view to determine that the repayment schedule of various loans granted by the *nidhi* is based on the repayment capacity of the borrower.

If the company is dealing or trading in shares, securities, debentures and other investments, whether proper records have been maintained of the transactions and contracts and whether timely entries have been made therein; also whether the shares, securities, debentures and other investments have been held by the company, in its own name except to the extent of the exemption, if any, granted under section 49 of the Act. [Paragraph 4(xiv)]

Comments

1. The requirement applies to companies, which deal or trade in shares, debentures and other securities. To deal or trade implies a purchase or sale with a view to make profit. Therefore, this requirement does not apply to companies which are not dealing or trading in investments but which purchase investments with a view to hold such investments and earn income from dividend or interest thereon.
2. This requirement can be considered in three parts, namely:
   (i) whether records regarding transactions and contracts are maintained;
   (ii) whether timely entries have been made in such records; and
   (iii) whether the investments are in the company's own name.
3. In deciding whether records have been properly maintained, the auditor has to examine both, whether the form in which records are maintained is adequate and also whether the records themselves are properly written up and preserved. Some of the features to be examined in this connection would be the following:
   (i) Details regarding the purchase and sale, that is, market or off market, the rate at which the purchase or sale was made, the number of shares or other investments and the document, for example, bought note or sale note evidencing the sale.
   (ii) The adjustment, if any, necessary when securities are purchased or sold and whether the quotations are exclusive of interest accrued or, when shares are purchased or sold ex-dividend whether dividend has to be paid or received.
   (iii) The details of holdings in individual companies, the classes of investments (e.g., equity shares, preference shares, debentures, etc.), the basis on which the closing stock is valued and the profit or loss on sale is to be computed.
   (iv) The recording of shares received as bonus shares; the accounting of rights subscribed for or sold.
   (v) The individual accounts of the parties from whom moneys are due for sale or to whom moneys are payable for purchases and the settlements made there against.
4. The auditor is also required to examine whether timely entries are made in the records. This may be done by one or more of the following methods:
   (i) a surprise inspection of the records;
   (ii) an examination of the system of internal control with particular reference to the manner in which and the time at which entries are made in the records; and

(iii) an examination of the internal audit reports to ensure if the programme of internal audit specifically covers an inspection of the records to determine whether entries are made in time.

5. Section 49 of the Act requires that all investments have to be made and held in the company's own name. The exemptions provided by the section are:

   (i) where a person is appointed as a nominee of the company on the board of directors of another company and such nominee is required to hold qualification shares, then to the extent of such qualification shares;

   (ii) where a company has a subsidiary and it is necessary to ensure that the number of members of the subsidiary is not reduced below seven in the case of a public company and two in the case of a private company;

   (iii) in the case of a company whose principal business consists of the buying and selling of shares or securities;

   (iv) in the case of investments deposited with a bank for collection of dividend or interest or for transfer into such bank's name to facilitate transfer; and

   (v) in the case of investments pledged as security for loans or for performance of obligations.

6. When a company deals or trades in investments it is possible that investments which are intended or contracted to be sold immediately may not have been transferred to the company's own name. The auditor should, therefore, use his discretion to ascertain whether, in the circumstances of each case, the failure to transfer the investments to the company's name is understandable.

Whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company. [Paragraph 4 (xv)]

Comments

1. It may be noted that several types of guarantees are in vogue. The type of guarantee within the scope of the clause is the one which the company has provided to a bank or financial institution in respect of loans taken by a third party. In other words, the company has a legal binding to indemnify the bank or financial institution if the third party, on behalf of whom the guarantee has been furnished, fails to fulfill the conditions subject to which the loan was granted by the bank or financial institution. Section 126 of the Indian Contract Act, 1872 defines a contract of guarantee as a contract to perform the promise, or discharge the liability, of a third person in case of his default.

2. Guarantee given by a company is a contingent liability. In respect of contingent liabilities, the auditor is normally concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued and disclosed as an off-balance sheet item. The auditor should obtain a written representation from the management that:

(i) there are no guarantees issued up to the year-end which are yet to be recorded; and

(ii) all obligations in respect of guarantees have been duly recorded in the register of guarantees and disclosed.

3. The auditor should examine the Memorandum of Association of the company with a view to determine whether the company can give a guarantee. It may be noted that if a company provides any guarantee without having a clause in this regard in the Memorandum of Association, the act of providing guarantee would be *ultra vires*. The auditor, in such a situation, should make necessary disclosure in the audit report.

4. The auditor should review the issuance of guarantee(s) to establish the reasonableness thereof in the light of previous experience and knowledge of the current year's activities. In determining whether the guarantee is prejudicial to the interest of the company, the auditor would have to give due consideration to a number of factors connected with the guarantee, including the financial standing of the party on whose behalf the company has given the guarantee, party's ability to borrow, the nature of the security offered by the party, the availability of alternative sources of finance and the urgency of the borrowing, if available, for which the company has given guarantee and so on. The auditor should obtain this information from the management.

5. The auditor should also verify whether the company has complied with the requirements of sections 295 and 372A of the Act. If the company has obtained the previous approval of the Central Government under section 295, it should be construed that the guarantee is not prejudicial to the interest of the company.

Whether the term loans were applied for the purpose for which the loans were obtained. [Paragraph 4 (xvi)]

Comments

1. This clause requires the auditor to examine whether term loans were applied for the purpose for which these loans were obtained. First of all, the auditor should ascertain whether the company has taken any "term loans". Term loans normally have a fixed or pre-determined repayment schedule. In the common parlance of the expression, loans with repayment period beyond 36 months are usually known as "term loans". Cash credit, overdraft and call money accounts/deposits are, therefore, not covered by the expression "term loans". Terms loans are generally provided by banks and financial institutions for acquisition of capital assets which then become the security for the loan, i.e., end use of funds is normally fixed.

2. The auditor should examine the terms and conditions subject to which the company has obtained the term loans. The auditor should compare the purpose for which term loans were sanctioned with the actual utilisation of the loans. The auditor should obtain sufficient appropriate audit evidence regarding the utilisation of the amounts raised. If the auditor finds that the funds have not been utilized for the purpose for which they were obtained, the auditor's report should state the fact.

3. It is not necessary to establish a one-to-one relationship with the amount of term loan and its utilisation. It is quite often found that the amount of term loan disbursed by the bank is deposited in the common account of the company from which subsequently the utilisation is made. In such cases, it should not be construed that the amount has not been utilised for the purpose it was raised.
4. During construction phase, companies, generally, temporarily invest the surplus funds to reduce the cost of capital or for other business reasons. However, subsequently the same are utilised for the stated objectives. In such cases, the auditor should mention the fact that pending utilisation of the term loan for the stated purpose, the funds were temporarily used for the purpose other than for which the loan was sanctioned but were ultimately utilised for the stated end-use.
5. It may so happen that the term loans taken during the year might not have been applied for the stated purpose during the year, for example, the loan was disbursed at the fag end of the year. In such a case, the auditor should mention in his audit report that the term loan obtained during the year has not been utilised. This also implies that the auditor, while making inquiry in respect of this clause, should also consider the term loans which although were taken in the previous accounting period but have been actually utilised during the current accounting period.

Whether the funds raised on short-term basis have been used for long-term investment. If yes, the nature and amount is to be indicated. [Paragraph 4 (xvii)]

Comments

1. The principles of financial management suggest that the long-term assets of an enterprise should be financed from long-term funds. The genesis of the principle is that if funds raised from short-term sources are used for long-term investments, the enterprise can face liquidity problems as soon as the short-term sources fall due for payment. The application of the principle is considered to be of utmost importance for the financial health of an enterprise. The clause requires the auditor to comment whether the funds raised on short-term basis have been used for long-term investment, so that the readers can assess whether the company has followed the above-mentioned principle of financial management.
2. Short-term sources of funds include temporary credit facilities like cash credits, overdraft. Reduction in current assets or increase in current liabilities are also sources of short-term increase in funds. Long-term sources of funds would include share capital, reserves and surplus, provision for depreciation, long-term debt securities, long-term loans. Long-term application of funds includes investment in fixed assets, long-term investments in share debentures and other securities and other assets of similar nature, repayment of long-term loans and advances or redemption of long-term debt or securities, etc.
3. The auditor should determine the long-term sources and the long-term application of funds by a company using the data contained in the financial statements. If the quantum of long-term funds of a company is not significantly different from the long-term application of funds, it is an indication that the long-term assets of the company are

financed from the long-term sources. However, if the quantum of long-term funds is significantly less than the long-term application of funds, it is an indication that short-term funds have been used to finance the long-term assets of the company. Similarly, if the quantum of long-term funds is significantly more than the long-term application of funds, it is an indication that long-term funds have been used to finance the short-term assets of the company. The difference between the figures of long-term funds and long-term assets of the company indicate the extent to which short-term funds have been used to finance long-term assets of the company.

4. Working capital is normally understood to be a short-term application of funds which keeps on changing its form throughout the working capital cycle. It may, however, be noted that core or permanent working capital of an enterprise should be financed from long-term funds (preferably the owners' capital). Core or permanent working capital is that component of the working capital of the enterprise that always remains invested in business and is never allowed to exit.

5. An example of negative reporting under the clause is as follows:

   "According to the information and explanations given to us and on an overall examination of the balance sheet of the company, we report that the company has used funds raised on short-term basis for long-term investment. The company has accepted public deposits amounting to rupees 5 crores which would fall due for repayment two years from the date of their acceptance. The company has invested the money for the increase of the production capacity which would be completed in the next four years."

Whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under Section 301 of the Act, and if so whether the price at which shares have been issued is prejudicial to the interest of the company. [Paragraph 4 (xviii)]

Comments

1. It may be noted that the term "preferential allotment" is not defined under the Act. It may also be noted that the clause requires the auditor to report on the preferential allotment only in the case of shares issued by the company and not on preferential allotment of other securities issued by the company. The term "shares" includes both equity as well as preference shares. For the purpose of this clause, preferential allotment of shares would mean an allotment of shares to parties and companies covered in the register maintained under section 301 of the Act in preference to others. The preference can be with regard to the price or other terms and conditions associated with the allotment.

2. In the case of a listed company, preferential allotment of securities is governed by the SEBI (Issue of Capital and Disclosure Requirements) Regulations) , 2009. A listed company can make preferential issues of equity shares, fully convertible debentures, partly convertible debentures or any other instrument which may be converted into or exchanged with equity shares at a later date. A listed company can issue shares on a preferential basis at a price not less than the higher of the following:

(i) the average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date;

or

(ii) the average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

3. In the case of a private company and an unlisted public company, the auditor would have to examine whether the price at which the company has made the preferential allotment of shares is prejudicial to the interest of the company. In so far as the price at which preferential allotment is made is concerned, it may be noted that valuation of shares of a company involves use of judgment, knowledge of the business, analysis and interpretation and the use of different methods, which may result in assigning different values based on different methods. There are certain basic factors, which affect the value of a company's shares for which the price calculated is adjusted. The factors are earnings, dividends declared, asset value and goodwill of the company. Methods generally used for determining the fair value of the business by the company, which take into consideration one or more factors mentioned above are:

(i) Net Assets Basis—considers the valuation of assets, subtracting therefrom liabilities, etc., to arrive at the value of the equity shares.

(ii) Maintainable Profits Basis—this is based on the future maintainable profits/earnings of the company.

(iii) Yield Basis—this method recognises the yield/dividends as a base for arriving at the fair value of the shares.

(iv) Discounted Cash Flow Method — this method estimates the value of shares by estimating the future cash flows from operations and discounting the cash flows at a specified rate.

It is not rare to find a combination of different methods used in the context of valuation of shares; for example, an averaging of maintainable profits basis and the net assets basis.

4. Companies sometimes do make allotment of shares based on the valuation reports issued by experts in this field. While the auditor uses the report of an expert to determine whether the price for the preferential allotment of share is not prejudicial to the interest of the company, the auditor should also comply with the requirements of SA 620, "Using the Work of an Expert".

5. In case, the company has made preferential issue of shares by passing an ordinary resolution under clause (b) of sub-section (1A) of section 81 of the Act, apart from examining the method used for valuation of shares of the company and ascertaining the reasonableness of the assumptions underlying the calculation, the auditor should also examine the Order of the Government as to its satisfaction that the proposal is most beneficial to the company. Where the Government is satisfied in this regard, the auditor need not make his assessment as to the reasonableness of the prices of the shares for

the preferential allotment of shares. The auditor, however, is not precluded from doing so. If the auditor forms his opinion on the basis of the Order issued by the Government, he should state the fact of his reliance on the Government Order for the purpose of reporting.

Whether securities have been created in respect of debentures issued? [Paragraph 4(xix)]

Comments

1. The auditor, under this clause, is required to examine whether the company has created proper 'security' or charge on the assets for the debentures issued by it.
2. Where the company has issued any debentures, the auditor should also examine the debenture trust deed executed under section 117A of the Act. The auditor should pay particular attention to verify whether proper security or charge has been created in favour of the debenture trust. The auditor can examine the relevant documents creating the charge in favour of the trustees for the debenture holders duly registered in the concerned Registrar's office if the security is an immovable property.
3. If the company has not created any security, the auditor should report the fact in this report.

Whether the management has disclosed on the end use of money raised by public issues and the same has been verified. [Paragraph 4(xx)]

Comments

1. In case the company has made a public issue of any of its securities like shares, preference shares, debentures and other securities, the auditor is required to report upon the disclosure of end-use of the money by the management in the financial statements. The auditor is also required to state whether he has verified the disclosure made by the management in this regard.
2. Currently, there is no legal requirement under the Act to disclose the end use of money raised by public issues in the financial statements. The companies, however, make such a disclosure in the Board's Report. Schedule VI to the Act requires that only unutilized amount of any public issue made by the company should be disclosed in the financial statements of a company. In the absence of any legal requirement of such disclosure, it appears that the clause envisages that the companies should disclose the end use of money raised by the public issue in the financial statements by way of notes and the auditor should verify the same

   (Note : Revised Schedule VI to the Act requires that where in respect of an issue of securities made for a specific purpose, the whole or part of the amount has not been used for the specific purpose at the balance sheet date, there shall be indicated by way of note how such unutilized amounts have been used or invested..
3. It may also be noted that according to the Regulation 16 of Chapter II of SEBI (Issue of Capital and Disclosure Requirments) Regulations, 2009, in case the issue exceeds ₹ 500 crores, the issuer company is required to make arrangements for the use of proceeds of the issue to be monitored by financial institutions. The monitoring agency so

appointed is required to submit its report to the SEBI, on a half-yearly basis, till the completion of the project. In case, the company has appointed a monitoring agency for the purpose of the issue, reports of the monitoring agency would also be helpful to the auditor while reporting under the clause.

4. Normally, the companies do mention the end-use of the money proposed to be raised through the public issues in the prospectus. An examination of the prospectus would provide the auditor an understanding of the proposed end-use of money raised from public. The auditor should verify that the amount of end-use of money disclosed in the financial statements by the management is not significantly different from the proposed and actual end use. The auditor should obtain a representation from the management as to the completeness of the disclosure with regard to the end-use of money raised by public issues. If the auditor is of the opinion that adequate disclosure in this regard has not been made in the financial statements, the auditor should state the fact of inadequate disclosures in his audit report. If, for any reason, the auditor is not able to verify the end-use of money raised from public issues, he should state that he is not able to comment upon the disclosure of end-use of money by the company since he could not verify the same. He should also mention the reasons, which contributed to the auditor's inability to verify the disclosure.

Whether any fraud on or by the company has been noticed or reported during the year, If yes, the nature and the amount involved is to be indicated. [Paragraph 4(xxi)]

Comments

1. This clause requires the auditor to report whether any fraud has been noticed or reported either on the company or by the company during the year. If yes, the auditor is required to state the amount involved and the nature of fraud. The clause does not require the auditor to discover the frauds on the company and by the company. Irrespective of the auditor's comments under this clause, the auditor is also required to comply with the requirements of SA 240, "The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements".

2. The term "fraud" refers to an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Although fraud is a broad legal concept, the auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements.

3. Two types of intentional misstatements are relevant to the auditor's consideration of fraud—misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

4. Fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting may involve:

   Deception such as manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared.

Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information.

Intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure.

5. Misappropriation of assets involves the theft of an entity's assets. Misappropriation of assets can be accomplished in a variety of ways (including embezzling receipts, stealing physical or intangible assets, or causing an entity to pay for goods and services not received); it is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.
6. The auditor should examine the reports of the internal auditor with a view to ascertain whether any fraud has been reported or noticed by the management. The auditor should examine the minutes of the audit committee, if available, to ascertain whether any instance of fraud pertaining to the company has been reported and actions taken thereon. The auditor should enquire of the management about any frauds on or by the company that it has noticed or that have been reported to it. The auditor should also discuss the matter with other employees of the company. The auditor should also examine the minute book of the board meeting of the company in this regard.
7. Because management is responsible for adjusting the financial statements to correct material misstatements, it is important that the auditor obtains written representation from management that any uncorrected misstatements resulting from fraud are, in management's opinion, immaterial, both individually and in the aggregate. Such representations are not a substitute for obtaining sufficient appropriate audit evidence.

Form of Report

The Order requires that the auditor should make a statement on all the matters contained therein. This requirement applies even where the answers to any of the questions are unfavourable or qualified. The Order further provides that where an auditor is unable to express any opinion, he should indicate such fact. The auditor is also required to give reasons for any unfavourable or qualified answer or for his inability to express an opinion on any of the matters specified in the Order.

There may be situations where one or more of the clauses are not applicable. For example, the requirement regarding internal audit system does not apply in case of all the companies. In such situations, it would be appropriate for the auditor to make a suitable comment in his report bringing out the fact of non-applicability of a particular clause. To illustrate, where the maintenance of cost records has not been prescribed by the Central Government under section 209(1)(d) of the Act, the auditor may state:

> "The Central Government has not prescribed maintenance of cost records under section 209(1)(d) of the Companies Act, 1956 for any of the products of the company".

A question may also arise whether it is necessary for the auditor to include in his report the management's explanation for any matter on which he makes an adverse comment. Normally, such an explanation need not be included but there may be circumstances where the auditor

feels such inclusion is necessary. Examples of such circumstances would be:

(a) to make the comment itself more meaningful and complete. For example, physical verification of inventories, though planned, may not have been carried out because of a strike or a lockout. An adverse comment without this explanation would be misleading;

(b) to explain the fact why in spite of an adverse comment, the true and fair view of the financial statements is not vitiated. For example, physical verification of a part of the inventories at the year-end may not have been carried out, but there is sufficient other evidence produced by the management which satisfies the auditor regarding the existence, condition and value of the inventories.

It is suggested that the sequence of the items as appearing in the report should be: first, the comments, if any, under sub-section (1A); second, the comments under the Order; and finally, the report under sub-sections (2), (3) and (4) of section 227. The comments under the Order may, alternatively, be given in the form of an Annexure to the report. However, when the comments are given in an Annexure, it is necessary to refer to the Annexure in the main report and it is advisable to sign the Annexure in addition to signing the main report.

If any of the comments on matters specified in the Order are adverse, the auditor should consider whether his comments have a bearing on the true and fair view presented by the financial statements and, therefore, might warrant a modification in the report under sub-sections (2), (3) and (4) of section 227. For example, in case where a company has disposed off a substantial part of fixed assets and consequently the going concern assumption is not resolved, the auditor apart from giving an appropriate comment under the Order, should also make a suitable qualification in the audit report on the financial statements.

If the auditor is of the opinion that any of the adverse comments on matters specified in the Order results in a qualification under sub-sections (2), (3) and (4) of section 227 the auditor may prefer to preface his report under those sub-sections by stating the qualification(s). Such a qualification(s) should be made against the specific item which is being qualified.

Even where there are no adverse comments under the Order, it may be advisable for the auditor to preface his report under sub-sections (2), (3) and (4) of section 227 with the words:

"Further to our comments in the Annexure, we state that....."

It should not, however, be assumed that every adverse comment under the Order would necessarily result in a qualification in the report under sub-sections (2), (3) and (4) of section 227.

Where there is a qualification both under sub-section (1A) and under the Order, it is suggested that the qualification under sub-section (1A) precede the qualification under the Order.

It is important to note that replies to many of the requirements of the Order will involve expression of opinion and not necessarily statement of facts. It is necessary, therefore, that this is indicated when making the report under the Order. This can be done in either of the following ways:

(a) By a general preface to the comments under the Order on the following lines:

"In terms of the information and explanations given to us and the books and records examined by us in the normal course of audit and to the best of our knowledge and belief, we state that....."

or

(b) by a preface to individual comments, for example,

"In our opinion" or "In our opinion and according to the information and explanations given to us during the course of the audit..."

The Order requires that where the answer to a question is unfavourable or qualified, the auditor's report should also state the reasons for such unfavourable or qualified answer. The requirement is similar to the requirement of sub-section (4) of section 227 and the same considerations would apply. Thus, while it is not necessary for the auditor to give very detailed reasons for an unfavourable or qualified answer, he is expected to explain the nature of the qualification or adverse comment in clear and unambiguous terms.

Similar considerations would apply when the auditor is unable to express an opinion. For example, if the internal audit department is unable to produce any audit programme, working papers, report, or other evidence of work done, the auditor may not be in a position to report whether the system is commensurate with the size and nature of the business of the company. In such circumstances, he should clearly state that he is unable to express an opinion because such records or evidence have not been produced before him.

In expressing an opinion, auditor should be quite clear as to whether the circumstances of the case warrant a negative answer or whether his opinion can be expressed subject to a qualification. To illustrate, if the system of internal audit has basic defects which render it totally ineffective, for example, due to grossly inadequate number of qualified staff, then the answer may be unfavourable. However, if there are minor defects in the system, for example, if the coverage is inadequate in certain areas, the auditor may state in his report that the coverage is inadequate in a particular area (to be specified) but otherwise the system is commensurate with the size of the company and the nature of its business.

Section 227(3)(e) of the Act requires that the auditor's report should also state in thick type or in italics the observations or comments of the auditor which have any adverse effect on the functioning of the company. The auditor should also consider whether any observations or comments made by the auditor in his report under the Order contain such matters, which, in his opinion, might have any adverse effect on the functioning of the company. If so, the auditor should give his comment in thick type or italics as required by the said section. An example in this regard may be where accumulated losses of the company at the end of the financial year are more than fifty per cent of its net worth and it has incurred cash losses in period covered by the audit report and in the financial year immediately preceding financial year also.

The auditor's report under sub-section (3) of section 227 is required to state whether the auditor has obtained all the information and explanations which, to the best of his knowledge and belief, were necessary for the purposes of his audit. The term "audit" would include the reporting requirements under the Order. Therefore, when making his report, the auditor has to consider whether he has obtained the information and explanations needed not merely for the purposes of normal audit, but also for the purpose of reporting in terms of the Order. If he has

not received the information and explanations necessary for reporting in terms of the Order, he should mention that fact both when reporting on the specific question in the Order and also when reporting generally in terms of sub-section (3) of section 227.

A specimen form of report is given in Appendix I.

Board's Report

Section 217 of the Act requires that the board of directors shall be bound to give in its report the fullest information and explanations regarding every reservation, qualification or adverse remark contained in the auditor's report. The auditor's comments in terms of the Order form part of his report and, therefore, the board will be bound to give in its report the fullest information and explanations regarding every adverse comment therein.

The auditor's comments in terms of the Order may be in respect of matters of fact or they may be an expression of opinion. It is necessary that there should be no inconsistency in the facts as stated by the auditor and as explained in the board's report. It is, therefore, suggested that wherever possible, a draft report should be submitted to the board to verify and confirm the facts stated therein.

It is, however, possible that, on the same facts, there may be a genuine difference of opinion between the auditor and the board. In such a case, each is entitled to hold his or its view. Therefore, the expression of a different opinion in the board's report should not be regarded as any reflection on the opinion expressed by the auditor.