

ROHINI CPE STUDY CIRCLE

of NORTHERN INDIA REGIONAL COUNCIL
of THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

At: Hotel Oasis, Pitampura, New Delhi

PRESENTATION ON

FINANCIAL REPORTING AND AUDITING

CA. Sanjay Vasudeva
SCV & Co. LLP
Chartered Accountants



July 7, 2018



Presentation Overview :



1. **Summary of SA 700; SA705; SA706 (w.e.f. 1-4-2011)**
2. **Summary of SA 700 ; SA705; SA706 Revised (w.e.f. 1-4-2018)**
3. **Highlights of SA 570 Revised (w.e.f. 1-4-2018)**
4. **Changes to Accounting Standard under Indian GAAP**
5. **Common Observed Non-Compliances**
 - i. **Standards on Auditing**
 - ii. **CARO**
 - iii. **Accounting Standards**
6. **Highlights of SA 701 : Key Audit Matters**





Summary of Standards on Auditing 700 705 706

(w.e.f. 1-4-2011)



List of Standards on Auditing on Reporting:

Standards on Auditing	Name
700-799 Audit Conclusions and Reporting	
700	Forming an Opinion and Reporting on Financial Statements
701	Communicating Key Audit Matters in the Independent Auditors Report.
705	Modifications to the Opinion in the Independent Auditor's Report
706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
710	Comparative Information—Corresponding Figures and Comparative Financial Statements
720	The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements

List of Standards on Auditing on Reporting :

Standards on Auditing	Name
800-899 Specialized Areas	
800	Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
805	Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
810	Engagements to Report on Summary Financial Statements

Objective & Scope :

- This Auditor's responsibility to form an opinion on the financial statements and the form and content of the Auditor's Report.
- Deals with 'Clean' and 'unmodified' opinion in Audit Report.
- Promotes consistency in Audit Report.
- Applicable in case of General Purpose Financial Statements – prepared in accordance with a general purpose financial reporting framework (FRF).
 - Fair presentation framework
 - Compliance framework

Forming an Opinion:

- Whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
- Whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. [SA 330 + SA 450]
- This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

Form of Opinion:

- ✓ **Unmodified [SA-700]**
 - ✓ **Modified [SA-705]**
 - ✓ **includes an Emphasis of Matter paragraph or an Other Matter paragraph [SA-706]**
- When the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, he shall express an Unmodified Opinion.
- If the auditor concludes:-
- That based on audit evidence, the financial statements are NOT free of material misstatements;
 - That he is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free of material misstatements;
- then he shall issue a modified opinion in accordance with SA705.

Form of Opinion:

Auditor's Report for Audits Conducted in Accordance with Standards on Auditing

- 1) Title
- 2) Addressee
- 3) Introductory paragraph
- 4) Management Responsibility Paragraph
- 5) Auditor's Responsibility Paragraph
- 6) Opinion Paragraph
- 7) Other Reporting Responsibilities
- 8) Auditor's Signature
- 9) Date & Place

Auditor's Report Prescribed by Law or Regulation

If the auditor is required by any law or regulation to use a specific layout or wording of the auditor's report, the auditor's report shall refer to Standards on Auditing only if the auditor's report includes, at a minimum, each of the above elements

Nature of Modification:

➤ **Three types of modifications:**

- Qualified opinion
- Adverse opinion
- Disclaimer of opinion

Nature of Modification:

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 Pervasive	Material and Pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

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

- If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.
- If management refuses; 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.
- If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:
 - (a) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
 - (b) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
 - (i) **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.
- If the auditor resigns, 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.

Emphasis of Matter & Other Matter:

SA706 deals with **additional communication** [having formed an opinion on the financial statements] in the auditor's report when the auditor considers it necessary to:

- 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
- 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**.
- ✓ **Definition - 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.*
- ✓ **Definition - 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.*
- ✓ *If auditor expects to include an EOM or OM paragraph, the auditor shall communicate with those charged with governance regarding this expectation and the proposed wording of this paragraph.*

Emphasis of Matter:

Emphasis of Matter paragraph is **not a substitute** for either the auditor expressing a qualified opinion or an adverse opinion, or disclaiming an opinion. Insertion of an emphasis of matter paragraph in the auditor's report **does not make the opinion "modified"**

Circumstances in Which an Emphasis of Matter Paragraph May Be Necessary

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
- *Certain specific standards contain specific requirements for the auditor to include EOM in the auditors report in certain circumstances (eg: subsequent events).*

Other Matter:

Other paragraph may be required to enhance users' understanding of an audit

Circumstances in which an Other Matter Paragraph May Be Necessary

- Relevant to Users' Understanding of the Audit
- Relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report
- Reporting on more than one set of financial statements
- Restriction on distribution or use of the auditor's report

Other Matter:

- **Other Matter Paragraph does not include:**
 - Any matter that is required to be presented or disclosed in the financial statements
 - Any information that the auditor is prohibited from providing by law, regulation or other Standards
 - Information that is required to be provided by management

Differences – Emphasis of Matter Paragraph & Other Matter Paragraph

Emphasis of Matter	Other Matter
It contains matters that are appropriately presented or disclosed in the financial statements	It contains matters <i>other than those presented or disclosed in the financial statements</i> but the auditor feels the need to bring them to the users' attention
In its definition it uses "... is fundamental to users' understanding of the financial statements"	In its definition it uses "... is relevant to the users' understanding of the audit, the auditor's responsibilities or the auditor's report"
Here, the auditor specifically points the readers' attention to these matters	Here, the information is not given in the financial statement so the users are likely to be unaware of them
It includes matters related to the financial statements	It includes only information related to the audit, the auditor's responsibility or the auditor's report



Summary of Standards on Auditing 700(R) 705(R) 706(R) (w.e.f. 1-4-2018)



Relevant Announcements by ICAI on Reporting Standards

<p>I. Announcement on New / Revised Standards on Auditing (17-05-2016)</p>	<p>The ICAI. vide Announcement dated 17th May 2016 has notified various Revised Standards on Auditing as under:</p> <ul style="list-style-type: none">➤ Revised SA 700, Forming an Opinion and Reporting on Financial Statements➤ New SA 701, Communicating Key Audit Matters in the Independent Auditor's Report➤ Revised SA 705, Modifications to the Opinion in the Independent Auditor's Report➤ Revised SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report➤ Revised SA 260, Communication with Those Charged with Governance➤ Revised SA 570, Going Concern <p>On 3rd December, 2015 ICAI had issued Exposure Drafts of above Revised Standards on Auditing, for Comments from it's Members to be sent latest by January 18, 2016. After consideration of the suggestions/ comments from it's members, the ICAI has issued these standards [<i>Effective for audits of financial statements for periods beginning on or after April 1, 2017</i>].</p>
<p>I. Important Announcement on Revised Effective Date of SA 701 and Revised SAs 700, 705, 706 (01-04-2017)</p>	<p>The effective date/applicability of the above-mentioned Standards on Auditing be deferred by one year and consequently the said Standards shall now be effective/applicable for audits of financial statements for periods beginning on or after April 1, 2018 (instead of audits of financial statements for periods beginning on or after April 1, 2017 as was earlier decided</p>

Key Amendments:

- **Audit Report Presentation- Opinion Paragraph.**
- **Going Concern.**
[Mention in Management Responsibility Paragraph as well as Auditors Responsibilities Paragraph]
- **Key Audit Matters [Refer SA 701]**
- **Under para “Basis of Opinion”;** a statement that the auditor is independent of the entity in accordance with the **relevant ethical requirements** relating to the audit.
- **Management Responsibility [new clauses]**
- **Auditors’ Responsibility [new clauses]**

Auditor's Report :

SA 700 Revised (wef 1-4-2018)

- ✓ Title
- ✓ Addressee
- ✓ **Auditor's Opinion**
- ✓ Basis for Opinion
- ✓ **Going Concern**
- ✓ **Key Audit Matters**
- ✓ Management's Responsibility
- ✓ Auditor's Responsibility
- ✓ Other Reporting Responsibilities
- ✓ Date, Place of Signature

SA 700 (wef 1-4-2011)

- ✓ Title
- ✓ Addressee
- ✓ Introductory Paragraph
- ✓ Management's Responsibility
- ✓ Auditor's Responsibility
- ✓ Auditor's Opinion-
- ✓ Other Reporting Responsibilities
- ✓ Date, Place of Signature

Unmodified

Qualified

EOM

Unmodified

Qualified

EOM



Sample Audit Report



Sample Audit Report - Qualified



Sample Audit Report - Emphasis of M



Sample Audit Report



Sample Audit Report - Qualified



Sample Audit Report - Emphasis of M

Auditor's Report :

Basis of Opinion:

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

Auditor's Report :

Going Concern:

- Where applicable, the auditor shall report in accordance with SA 570 (Revised).

Key Audit Matters

- For audits of complete sets of general purpose financial statements of **listed entities**, the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701.
- When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.

Auditor's Report :

Responsibilities of Management for the Financial Statements

- This section of the auditor's report shall describe management's responsibility for:
 - (a) Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - (b) Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.
- This section shall also identify those responsible for the oversight of the financial reporting process, when those responsible for such oversight are different from those who fulfill the responsibilities described as above.
- When the financial statements are prepared in accordance with a fair presentation framework, the description of responsibilities for the financial statements in the auditor's report shall refer to "the preparation and fair presentation of these financial statements" or "the preparation of financial statements that give a true and fair view," as appropriate in the circumstances.

Auditor's Report :

Auditors' Responsibilities

- Shall state that the objectives of the auditor are to :
 - (a) obtain reasonable assurance about whether the financial statement as a whole are free from material misstatement, whether due to fraud or error.
 - (b) Issue an auditor's report that includes the auditor's opinion.

- State that reasonable assurance is a high level of assurance, **but is not a guarantee** that an audit conducted in accordance with SAs will always detect a material misstatement when it exists

- State that misstatements can arise from fraud or error, and either
 - describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users or
 - provide a definition or description of materiality in accordance with the applicable financial reporting framework.

Auditor's Report :

Auditors' Responsibilities

- **Shall state that the auditor exercises professional judgment and maintains professional skepticism throughout the audit.**

- **The auditor shall describe that the auditor's responsibilities are :**
 - To identify and assess the risk of material misstatement
 - To design and perform audit procedures responsive to those risks
 - To obtain audit evidence that is sufficient and appropriate to provide basis for the auditor's opinion.
 - To obtain an understanding of internal control relevant to the audit
 - To evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
 - To conclude on the appropriateness of management's use of the going concern basis of accounting
 - To evaluate the overall presentation, structure and content of the financial statements, including the disclosures.

Auditor's Report :

Auditors' Responsibilities

- **State that the auditor communicates with those charged with governance regarding the planned scope and timing of the audit and significant audit findings, including any significant deficiencies identified in internal control.**
- **State that the auditor provides those charged with governance with a statement that the auditor has complied with relevant ethical requirements**
- **For all such entities for which key audit matters are communicated in accordance with SA 701, state that, from the matters communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit.**

Note: The description of the auditor's responsibilities shall be located:

- ◆ within the body of the auditor's report.
- ◆ Within an appendix to the auditor's report
- ◆ By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority



Standard on Auditing (SA) 570 (R)

“Going Concern”



Going Concern Basis of Accounting

- This SA deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.
- Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future.
- When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.
- **Objectives**
 - To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;
 - To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and
 - To report in accordance with this SA.

Use of Going Concern Basis of Accounting Is Appropriate but a Material Uncertainty Exists

- **Adequate Disclosure of a Material Uncertainty Is Made in the Financial Statements**
 - If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:
 - (a) Draw attention to the note in the financial statements that discloses the matters set out in paragraph 19; and
 - (b) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

- **Adequate Disclosure of a Material Uncertainty Is Not Made in the Financial Statements**
 - If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:
 - (a) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and
 - (b) In the Basis for Qualified / Adverse Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

Use of Going Concern Basis of Accounting Is Appropriate but a Material Uncertainty Exists

- Adequate Disclosure of a Material Uncertainty Is Made in the Financial Statements
- **“Material Uncertainty Related to Going Concern”**

Material Uncertainty Related to Going Concern

We draw attention to Note XX in the financial statements, which indicates that the Company incurred a net loss of ZZZ during the year ended December 31, 20X1 and, as of that date, the Company’s current liabilities exceeded its total assets by YYY. As stated in Note 6, these events or conditions, along with other matters as set forth in Note XX, indicate that a material uncertainty exists that may cast significant doubt on the Company’s ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Use of Going Concern Basis of Accounting Is Appropriate but a Material Uncertainty Exists

- **Adequate Disclosure of a Material Uncertainty Is Not Made in the Financial Statements**
 - **Qualified opinion**
 - [when the auditor has concluded that a material uncertainty exists and that the financial statements are materially misstated **due to inadequate disclosure**].

Basis for Qualified Opinion

As discussed in Note YY, the Company's financing arrangements expire and amounts outstanding are payable on April 30, 20X2. The Company has been unable to conclude re-negotiations or obtain replacement financing. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this matter.

Use of Going Concern Basis of Accounting Is Appropriate but a Material Uncertainty Exists

- Adequate Disclosure of a Material Uncertainty Is Not Made in the Financial Statements
 - Adverse opinion
 - [when the auditor has concluded that a material uncertainty exists and the financial statements omit the required disclosures relating to a material uncertainty]

Basis for Adverse Opinion

The entity's financing arrangements expired and the amount outstanding was payable on March 31, 20X1. The entity has been unable to conclude re-negotiations or obtain replacement financing and is considering filing for bankruptcy. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this fact.



Changes to Accounting Standards under Indian GAAP



Background

- **On 30 March 2016, the Ministry of Corporate Affairs (MCA) notified the Companies (Accounting Standards) Amendment Rules, 2016, for amending the Companies (Accounting Standards) Rules, 2006 (Indian GAAP).**
- **The amended standards are effective from financial year ending 2016-17 as clarified by MCA general circular dated 4/2016 dated 27th April, 2016.**

➤ **Amendments**

- **AS 2 Valuation of Inventories**
- **AS 4 Contingencies and Event Occurring After Balance Sheet Date**
- **AS 10 Accounting for Fixed Assets and AS 6 Depreciation Accounting, replaced with a new AS 10 Property, Plant and Equipment.**
- **AS 13 Accounting for Investments**
- **AS 14 Accounting for Amalgamations**
- **AS 21 Consolidated Financial Statements**
- **AS 29 Provisions, Contingent Liabilities and Contingent Assets**

AS 2 - Valuation of Inventories

Ref.	Old Standard	Revised Standard
Para 4	<p>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, consumables and loose tools awaiting use in the production process. Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular; such machinery spares are accounted for in accordance with Accounting Standard (AS) 10, Accounting for Fixed Assets.</p>	<p>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, consumables and loose tools awaiting use in the production process. Inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10, Property, Plant and Equipment. Such items are accounted for in accordance with Accounting Standard (AS) 10, Property, Plant and Equipment.</p>

AS 4 - Contingencies and Events Occurring After the Balance Sheet Date

Ref.	Old Standard	Revised Standard
Para 8.5	<p>There are events which, although they take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. Such items include the amount of dividend proposed or declared by the enterprise after the balance sheet date in respect of the period covered by the financial statements.</p>	<p>There are events which, although they take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. For example, if dividends are declared after the balance sheet date but before the financial statements are approved for issue, the dividends are not recognised as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes.</p>
Para 14	<p>Dividends stated to be in respect of the period covered by the financial statements, which are proposed or declared by the enterprise after the balance sheet date but before approval of the financial statements, should be adjusted.</p>	<p>If an enterprise declares dividends to shareholders after the balance sheet date, the enterprise should not recognise those dividends as a liability at the balance sheet date unless a statute requires otherwise. Such dividends should be disclosed in notes.</p>

AS 13 – Accounting for Investments

Ref.	Old Standard	Revised Standard
Para 20	20. The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.	20. An investment property is accounted for in accordance with cost model as prescribed in Accounting Standard (AS) 10, Property, Plant and Equipment. The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.
Para 30	30. An enterprise holding investment properties should account for them as long term investments.	30. An enterprise holding investment properties should account for them in accordance with cost model as prescribed in AS 10, Property, Plant and Equipment.

AS 29 - Provisions, Contingent Liabilities and Contingent Assets

Ref.	Old Standard	Revised Standard
Para 35	35. The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The amount of a provision should not be discounted to its present value.	35. The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The amount of a provision should not be discounted to its present value except in case of decommissioning, restoration and similar liabilities that are recognised as cost of Property, Plant and Equipment. The discount rate (or rates) should be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted. Periodic unwinding of discount should be recognised in the statement of profit and loss.
Para 73		73. All the existing provisions for decommissioning, restoration and similar liabilities (see paragraph 35) should be discounted prospectively, with the corresponding effect to the related item of property, plant and equipment.

AS 10 – Property, Plant & Equipment

Ref.	Old Standard	Revised Standard
Component Accounting	Component accounting was not mandatory under accounting standards, although Companies Act, 2013 Schedule II required component accounting.	Accounting standard has been aligned to the requirements of Companies Act, 2013 by mandating component accounting.
Cost of PPE	Separation of financing element not required to from cost of an asset purchased on deferred payment basis.	The cost of an item of PPE is its cash price equivalent at the recognition date. If the payment is deferred beyond normal credit terms, the difference between the cash price equivalent and total payment is charged as interest cost.
Major Repairs and Overhaul Expense	Major repairs that increase the future benefits from the existing asset beyond its previously assessed standard of performance is capitalized.	Major repairs and overhaul expenditure capitalized as replacement costs, if they satisfy the recognition criteria. The carrying amount of those parts that are replaced is derecognised.

AS 10 – Property, Plant & Equipment

Ref.	Old Standard	Revised Standard
Spares Parts	Machinery spares are generally expensed to profit and loss as and when consumed. If spares can be only used in connection with an item of fixed asset and their use is expected to be irregular, they are capitalised and depreciated over the period not exceeding the useful life of the principal item.	Spare parts, stand-by equipment and servicing equipment are capitalised when they meet the definition of PPE. The transitional provisions state that if a spare part, previously recognized as inventory, is required to be capitalized as a PPE; it is capitalized at its carrying amount and depreciated prospectively over its remaining useful life.
Decommissioning, Restoration and Similar Liabilities	No specific provision.	The initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'decommissioning, restoration and similar liabilities' is capitalised. The provision is created at the discounted amount.
Change in Depreciation Method	Any change in depreciation method treated as an accounting policy change and applied retrospectively.	Change in depreciation method treated as a change in accounting estimate and applied prospectively.



Practical issues in Financial Reporting and Auditing



Standards on Auditing

Practical issues in Financial Reporting and Auditing in respect of Standards on Auditing

Issue 1:

Report on the Financial Statements

“We have audited the accompanying financial statements of XYZ LTD. (“the company”) *which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss for the year ended, and a summary of significant accounting policies and other explanatory information.***(emphasis supplied)**”

Opinion

“In our opinion and to the best of our information and according to the explanations given to us, 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:

- in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- in the case of the Profit and Loss Account, of the profit for the year ended on that date; and
- in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.”

Practical issues in Financial Reporting and Auditing in respect of Standards on Auditing

Issue 2:

“We conducted our audit in accordance with the accounting standards generally accepted in India“

Accounting Standards ?????

Practical issues in Financial Reporting and Auditing in respect of Standards on Auditing

Issue 3:

“Abstract of Signature in Auditor’s Report given in the Annual Report:”

“For and on behalf of”
XYZ & Associates

Practical issues in Financial Reporting and Auditing in respect of Standards on Auditing

Issue 4:

Matter Contained in the Annual Report:

➤ REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

d) In our opinion, the Balance Sheet , Statement of Profit and Loss and Cash Flow Statement comply with Accounting Standards notified under the Act read with General Circular 15/2013 dated 13th September, 2013 of the Ministry of Corporate Affairs in respect of the Section 133 of the Companies Act, 2013, *subject to note no. XXX of the notes to the accounts regarding non-provision of diminution of the value of the long term quoted investments Rs. XXX/- which is not in accordance with the Accounting Standard 13 on “Accounting for Investments. (Emphasis Supplied)”*

Practical issues in Financial Reporting and Auditing in respect of Standards on Auditing

Issue 4 (cont..):

There were two issues in the above note:

1. The auditor has qualified his report on this issue in paragraph (d) of 'Report on other Legal and Regulatory requirements'. It was viewed that the auditor has given qualification under the Paragraph 'Report on other Legal and Regulatory Requirements', however, the auditor is required to report on other reporting responsibilities in the auditor's report on the financial statements in place of giving qualification under the said paragraph.
2. It was further noted that the long term investments were made in XYZ Limited out of which the holding of the company represents 19.58% holding in the said company. Further, the investment made in the aforesaid company constitutes 95.83% of the assets of the company, therefore the effect is material and pervasive. Accordingly, it was viewed that although the auditor has given his opinion on the non – provision of diminution of the value of long term investment, the effect of the same on the financial statements was material and pervasive as it represent the substantial portion of the financial statements.

It was further viewed that provision of diminution in value of long term investments should be made in accordance with the requirements of Paragraph 32 of AS 13. However, in the given case, no provision has been made as it would be settled at the time of final settlement of investments. It was viewed that firstly non-provision of diminution in value of long term investments is non-compliance of AS 13 and secondly the auditor should express adverse opinion rather than giving his qualified opinion under Paragraph 'Report on other Legal and Regulatory Requirements' which is not in accordance with requirements of SA 700 as well as SA 705.

Practical issues in Financial Reporting and Auditing in respect of Standards on Auditing

Issue 5

- *According to the information and explanations given to us, in the opinion of the management there is no need of any provision to be made for impairment of its intangible assets (namely goodwill and customer relationships) which are being carried in the books at a written down value of Rs. XXX (Previous year Rs. XXX).*

Qualification / EOM / OM ????

Issue 6

- *The Company has paid Rs xx cr under protest against claims of Rs xx cr for expenses which the Company has disputed in matters that are in various stages of litigation. Pending resolution of these disputes by the relevant courts, these expenses have been accounted for in the financial statements based on the management's expectation of the amounts due.*

Qualification / EOM / OM ????

Issue 7

- *“The Company does not have process in place to perform periodical reconciliation of balance with customers and vendors”*

Qualification / EOM / OM ????

Practical issues in Financial Reporting and Auditing in respect of Standards on Auditing

Issue 8

➤ **Emphasis of Matter**

We draw attention to Note xxx to the financial statements which, describes the change in accounting policy with respect to bad debts of debtors of the company has been changed from 0 to 50% for receivable more than 90 days.

Issue 9

➤ **Emphasis of Matter**

Attention is invited to Note xxx to the financial statements regarding pending confirmation of balance for various loans aggregating to ` xxx lacs by lender banks and pending confirmation of balances for banks balances aggregating to xxx lacs.

Practical issues in Financial Reporting and Auditing in respect of Standards on Auditing

Case-Study:

When is the effect of a misstatement or a possible misstatement considered to be “pervasive”?

Eg:1

An auditor detects a bias in the valuation of estimates on the assets side of a balance sheet (such as increasing the useful lives of fixed assets without justification, not treating impairment in investments as other than temporary, treating doubtful receivables as good, not providing adequately for inventory obsolescence, etc.) all building up to an overstatement of earnings.

Eg:2

When the misstatement is in valuing inventory of a major raw material at cost in stead of at net realisable value when clear evidence is available that the fair value of the material was substantially lower than cost and the selling price of the finished product is pegged to current raw material prices, and the difference in valuation, if booked, could wipe out a substantial portion of the profit before tax of the entity.

Eg:3

The entity is unable to resolve to the satisfaction of the auditor a going concern issue in relation to one of its major subsidiaries in which the entity has substantial exposure in terms of equity, debt and guarantee commitments and it refuses to either make a provision or a satisfactory disclosure of the matter.

Companies (Auditor Report) Order 2003

Companies (Auditor's Report) Order, 2016

Newly Added (Clauses)	Modified (Clauses)	Retained (Clauses)	Deleted (Clauses)
Managerial Remuneration	Fixed assets	Acceptance of deposits	Accumulated losses
Nidhi Company	Inventory	Maintenance of cost records	Internal control system
Related party transaction	Loans ,Investments, securities & guarantee's		Loans taken from related parties
Private placement/ preferential allotment	Repayment of Loans granted by company		Statutory register related parties transactions
Non cash transactions	Payment of statutory dues		Internal Audit
Registration with RBI	Default in repayment of dues		company is dealing or trading in shares
	Application of funds raised		loans on basis of pledge of securities
	Reporting of frauds		End use – Loan & Capital

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Practical issues in Financial Reporting and Auditing in respect of CARO ‘ 2003

Issue 1:

➤ Clause (i) (a) of CARO, 2003

Matter contained in report:

- “a) The Company has generally maintained proper records showing full particulars including quantitative details and situation of fixed assets.”

Practical issues in Financial Reporting and Auditing in respect of CARO ‘ 2003

Issue 2:

➤ Clause (vi) of CARO, 2003

Matter contained in report:

“vi. The Company has not accepted deposits from the public, under the directives issued by the Reserve Bank of India and the provisions of the section 58A and 58AA of the Act and the rules framed there under. However, temporary loans have been taken from employee welfare trust without adequate records.”

Practical issues in Financial Reporting and Auditing in respect of CARO ‘ 2003

Issue 3:

Clause (ix) (a) and (b) of CARO, 2003

Matter contained in report:

“(a) The company is regular in depositing statutory dues including Provident Fund, Employees State Insurance, Income Tax, Sales Tax/Value Added Tax, Excise Duty & other statutory dues with the appropriate authorities and at the end of last financial year there were no amounts outstanding which were due for more than 6 months from the date they became payable.

(b) According to the information and explanations given to us, no undisputed amounts are payable in respect of PF, ESI, Income Tax, cess and any other statutory dues as at the end of the period, for a period more than six months from the date they became payable.”

Practical issues in Financial Reporting and Auditing in respect of CARO ‘ 2003

Issue 4:

Clause (ix) (b) of CARO, 2003

Matter contained in report:

“According to information and explanation given to us there are no dues relating to sales tax, wealth tax, income tax, service tax etc. which have not been deposited on account of any dispute.”

Practical issues in Financial Reporting and Auditing in respect of CARO ‘ 2003

Issue 5:

Clause (ix) (b) of CARO, 2003

Matter contained in the report :

“The company has disputed the dues of income tax, customs tax, and excise duty as mentioned in the notes of accounts. In case of income tax the appeal is pending before ITAT, in case of excise duty the case is pending before CESTAT and in case of Customs duty the appeal is preferred before Supreme Court of India.”

Practical issues in Financial Reporting and Auditing in respect of CARO ‘ 2003

Issue 6:

Clause (xxi) of CARO, 2003

Matter contained in report : “According to information and explanations given to us, no fraud on or by the Company has been noticed or reported **during the course of our audit.**” (emphasis supplied)

Practical issues in Financial Reporting and Auditing in respect of CARO ‘ 2003

Issue 7:

➤ **Main Audit Report**

- As required by the Companies (Auditors’ Report) Order, 2003 (as amended by the Companies (Auditors’ Report) (Amendment) Order, 2004), issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Companies Act, 1956, we enclose in the Annexure hereto a statement on the matters specified in paragraphs 4 & 5 of the said Order
- “Further to our comments in the Annexure, we state that.....”

Practical issues in Financial Reporting and Auditing in respect of CARO ‘ 2003

Other Practical Issues:

➤ ***CARO Report***

- For statement of facts, use the following as preface to the reporting para:
- “In terms of the information and explanations sought by us and given by the company 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.....”
- For expression of opinion, use the following preface to the reporting para:
- In our opinion” or “In our opinion and according to the information and explanations given to us during the course of the audit...”

➤ ***Period of compliance***

- Order should be judged with reference to the whole accounting year and not merely with reference to the position existing at the balance sheet date or the date at which he makes his report.
- The auditor might consider, the state of affairs existing at the balance sheet date or at the date when he makes his report to give a more complete picture.

Practical issues in Financial Reporting and Auditing in respect of CARO ‘ 2003

Other Practical Issues:

➤ *Qualification in CARO and 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 Companies Act.

➤ Audit reports mentions that CARO provision with respect to “(i) Loans to/from related parties” and “(ii) transactions that need to be entered into the register maintained under the Companies Act” are not applicable; however, in Financial Statements, it has been explicitly mentioned for Loans to Subsidiaries / Advances to Subsidiaries / Deposits from relatives of KMP. (under Related Party Disclosure) – *Contrary Reporting.*

➤ The Company has not defaulted in repayment of dues to banks. *No mention of repayment to debenture-holders & financial institutions. In case not applicable, should be mentioned separately.*

➤ While reporting on ‘statutory dues – disputed / undisputed’, auditor should report on all the dues mention in respective paragraph. *In case not applicable, should be mentioned separately.*

The Companies Accounting Standards Rules, 2006

Practical issues in Financial Reporting and Auditing in respect of Accounting Standards

Issue : 1

It was noted from the accounting policy of Foreign Currency Transactions:

“...Transactions in foreign currencies are recognised at rate of overseas currency ruling on the date of transactions. Gain / Loss arising on account of rise or fall in overseas currencies vis-à-vis reporting currency between the date of transaction and that of payment is charged to profit and loss account.”

Practical issues in Financial Reporting and Auditing in respect of Accounting Standards

Issue : 2

Accounting policy of borrowing cost states as follows:

“Fixed assets are recorded at cost and cost includes appropriate direct and allocated expenses including interest on specified borrowings for acquisition of assets up to the date of commencement of commercial production.....”

Practical issues in Financial Reporting and Auditing in respect of Accounting Standards

Issue : 3

- It was noted from the financial statements that segment assets and segment liabilities disclosed as per the requirement of AS 17 does not tally with the Balance Sheet

Practical issues in Financial Reporting and Auditing in respect of Accounting Standards

Issue 4 :

- The break-up of opening balance of DTA and DTL was not disclosed

Issue 5:

- In the absence of information, in respect of certain items of fixed assets capitalised, it could not be established whether assets capitalised were on account of replacement of existing asset or addition or extension to an existing asset and hence the impact of the same on the classification/value of the assets and depreciation/ expenses is currently not ascertainable.

Issue 6:

- The Company capitalises the assets either on yearly or quarterly basis rather than the actual ready-to-use date.

Practical issues in Financial Reporting and Auditing in respect of Accounting Standards

Issue 7:

- The Company charges overheads on estimated/fixed percentage/proportionate/ payment basis to the Capital work-in-progress rather than the actual usage basis.

Issue 8:

- Disclosure regarding Land, whether freehold or leasehold.

Issue 9:

- Lease, whether cancellable or a non-cancellable lease
 - Disclosures for non-cancellable lease
 - Straight lining of lease rent

Practical issues in Financial Reporting and Auditing in respect of Accounting Standards

Issue 10:

- The Annual Report of a Company it was noted that the cash flow statement has classified all cash flows into four categories viz.,
 - operating activities,
 - investing activities,
 - financing activities and
 - others

Issue 11:

- Capital investment subsidy, which is in the nature of promoter's contribution, has been credited to Statement of Profit & Loss, instead of Capital Reserves.

Issue 12:

- Revenue
 - Sales are accounted for on dispatch of goods.
 - Advertisement income is recognised when advertisement and net realisation are confirmed
 - 'Dividend income is considered on receipt basis'

Practical issues in Financial Reporting and Auditing in respect of Accounting Standards

Issue 13:

- 'Short term Provisions' includes an item – Provision towards old inventories

Issue 14:

- Inventories are measured at COST. Cost is determined on LIFO Basis.

Issue 15:

- "Import of materials is accounted on receipt thereof at the factory.

Practical issues in Financial Reporting and Auditing in respect of Accounting Standards

Issue 16:

- Long term investments are carried at cost.
 - (Supplement-1): No supplementary disclosure.
 - (Supplement-2): No provision for diminution in value is made as they are long term investments.
 - (Supplement-3): Provision for diminution in value has been made wherever applicable.

Issue 17:

- PF Trust managed by the company - whether 'Defined Benefit Plan' or 'Defined Contribution Plan'

Issue 18:

- Disclosure as per Paragraph-120(n) of AS-15, relating to the experience adjustments not given in the financial statements.

Practical issues in Financial Reporting and Auditing in respect of Accounting Standards

Issue 19:

- The expenses, incomes, assets and liabilities are not properly segregated as required in the Segment reporting disclosure as per Accounting Standard 17 on Segment Reporting notified by Companies Accounting Standards Rules, 2006. In our opinion, the same does not give true and fair view of the segment-wise operations of the Company.

Issue 20:

- The Company has not carried out Technoeconomic assessment as on 31 March 20XX and hence identification of impairment loss and provision thereof, if any, has not been made. The same is not in accordance with Accounting Standard 28 on Impairment of asset notified by Companies Accounting Standards Rules, 2006. The consequential impact of adjustment, if any, on the financial statements is currently not ascertainable. This was also a subject matter of qualification in previous auditor's report on the financial statements for the year ended 31 March 20XX.

Practical issues in Financial Reporting and Auditing in respect of Accounting Standards

Issue 21:

- Details in respect of items comprising prior period expenses and prior period income are not given.

Issue 22:

- Disclosure of EPS excluding extraordinary items (net of taxes)

Practical issues in Financial Reporting and Auditing in respect of Accounting Standards

Issue 23:

➤ **Disclosure in Notes to Account**

- As a matter of prudent accounting policy, the Company during the period, has not accounted for deferred tax asset.
- “Minimum Alternate Tax (MAT)” Since the Company is covered by the provisions of Section 115 JB of the Income Tax Act, 1961 and credit entitlement would be available in the subsequent years no provision has been made for tax expenses.

➤ **Comments:**

- The company has recognised the credit available in respect of minimum alternate tax paid upon the assumption that credit entitlement would be available in the subsequent years. However, the company has not disclosed the nature of convincing evidence available with it for the purpose of recognizing MAT credit.
- It is seen that deferred tax asset is not recognised. It is not clear how the MAT credit has been recognised.



Standard on Auditing (SA) 701

“Communicating Key Audit Matters in the Independent Auditor’s Report”



Key Audit Matters –Global Scenario

- ❖ Already embraced by 110+ countries
- ❖ Earlier adoption in Australia, Netherlands, South Africa and UK
- ❖ Position in the United States
 - ❖ Shifting towards a Critical Audit Matters model
 - ❖ Large filers by 30 June 2019
 - ❖ Other entities by 15 December 2020
- ❖ Challenges identified
 - ❖ Disclosure of sensitive information
 - ❖ Deliberations and arguments with TCWG

Need for ISA 701

- ❖ Based on the indications of Academic Researches and Public Outreach programs, IAASB issued ISA 701, considering:
 - ❖ Increasing Expectation of User's of FS to have insight of an audit.
 - ❖ Need to enhance Quality of Audit & Relevance of Audit
 - ❖ Increasing Complexities in Financial Reporting Framework

Key Audit Matters –Intended Benefits

- ❖ Increased communication between auditors, investors and those charged with corporate governance
- ❖ Enhanced user confidence in audit reports and financial statements
- ❖ Higher attention by management and preparers of financial statements to disclosures referencing the auditor's report
- ❖ Enhanced audit quality, transparency and increased information value
- ❖ Effective financial reporting in the public interest
- ❖ Auditor focus on matters to be reported which results in an increase in professional skepticism

What are Key Audit Matters

- ❖ Those matters which in the auditor's Professional Judgement , were of most significance in the audit of FS of the current period
- ❖ KAMs are selected from the matters communicated with TCWG
- ❖ Areas of higher RMM assessed or significant risks identified as per SA 315
- ❖ Effect of significant events/ transactions on audit
- ❖ Significant auditor judgments relating to areas that involved significant management judgments

Most Significance in Audit –Factors to consider

- ❖ Nature & extent of communication of the matter with TCWG.
- ❖ Importance of the matter to users' understanding of FS.
- ❖ Nature of underlying accounting policy–its complexity / subjectivity.
- ❖ Nature and materiality of corrected and accumulated uncorrected misstatements due to fraud / error related to the matter.
- ❖ Nature & extent of audit effort needed to address the matter
- ❖ Nature & severity of difficulties faced by auditor in applying audit procedures, evaluating results of those procedures, and obtaining relevant and reliable evidence
- ❖ Severity of any control deficiency identified relevant to the matter
- ❖ Whether matter involved number of separate but related audit considerations

Applicability of SA 701

- ❖ Applicable in case of audits of complete sets of general purpose FS. w.e.f. 1st April, 2018 .The FS should be:
 - general purpose FS and
 - complete set of FS.
- ❖ Standard mandatorily applicable in case of audits of listed entities.
- ❖ Standard also applicable in case of audits of unlisted entities in following situations:
 - Where auditor decides to communicate KAM voluntarily or at the request of TCWG / Mgt.
 - Where auditor is required by law or regulation to communicate KAM

ICAI has issued “Implementation Guide to Standard on Auditing (SA) 701” on 18-02-2018

<https://resource.cdn.icai.org/48820aasb-icai-igsa701.pdf>

