

WEBINAR ON PRACTICAL IMPLEMENTATION OF STANDARDS ON AUDITING

Session on
**Auditing execution – Special aspects including
related party and accounting estimates**

Organised
by
The Chambers of Tax Consultants

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Focus Area

- ❑ Accounting estimates and fair value disclosures – Standard on Auditing (SA) 540
- ❑ Auditing related party transactions – SA 550
- ❑ Communication with group auditors / auditors of component companies / entities - SA 600
- ❑ Group audit instructions

Auditing accounting estimates
including fair value accounting
estimates and related
disclosures

Scope

Auditor's responsibilities for accounting estimates, fair value of accounting estimates, and related disclosure

Application of SA 315* and SA 330** in relation to accounting estimates

Scope

Requirements and guidance on misstatement of individual accounting estimates, and indicators of possible management bias

*SA 315 - Identifying and Assessing The Risk of Material Misstatement Through Understanding the Entity and its Environment

**SA 330 – The Auditor's Responses to Assessed Risks

Nature of accounting estimates

- ❑ Some items of financial statements that cannot be measured precisely but can only be estimated

Example : Year end expenses, such as, electricity bills and similar other utility expenses

- ❑ Measurement objective for some accounting estimates - To forecast the outcome of one or more transactions, events or conditions

Example : Tax Demands – to consider based on estimated success rate thereof

- ❑ Measurement objective for fair value accounting estimates - Expressed in terms of the value of a current transaction or financial statements item based on conditions prevalent at measurement date

Example : Fair valuation of Investments. When applied

- ❑ Difference between outcome of an accounting estimates and amount originally disclosed in financial statements does not necessarily represent a misstatement of financial statements, particularly for fair value accounting estimates but affected by events or conditions subsequent to the date

Example : Marketing expenses of ₹ 10,000 recorded on estimate however the actual bill works out ₹ 9,700 say, may be discount availed; this does not result in material misstatement

Objective

□ Obtain sufficient appropriate audit evidence (SAAE) in context of applicable financial reporting framework:

- Accounting estimates including fair value accounting estimates in the financial statements are reasonable

Example : Fair Value of investment (where required under Ind AS), net realisable value of stock

- Emphasise the importance of professional skepticism, indicator of management bias and their audit implication

- Related disclosures in the financial statements are adequate

Example : Basis of accounting estimates / fair value accounting estimates

Accounting Estimates

- ❑ **Accounting Estimates** - Approximation of a monetary amount in the absence of a precise means of measurement – amount measured at fair value where there is estimate uncertainty
 - Estimates are based on **subjective** as well as **objective** factors and, as a result, judgement is required to estimate an amount at the date of the financial statements
 - A **change in accounting estimates** is an adjustment of the carrying amount of an asset or liability, or related expense, resulting from reassessing the expected future benefits and obligations associated with that asset or liability
 - **Management is responsible** for making the accounting estimates included in the financial statements
 - Accounting estimates having high degree of estimate uncertainty and a significant risk of material misstatement require more audit procedures and obtain more robust understanding of the entity's control, including control activities to that risk

- ❑ **Estimation uncertainty** - susceptibility of an accounting estimates and related disclosures to an inherent lack of precision in its measurement

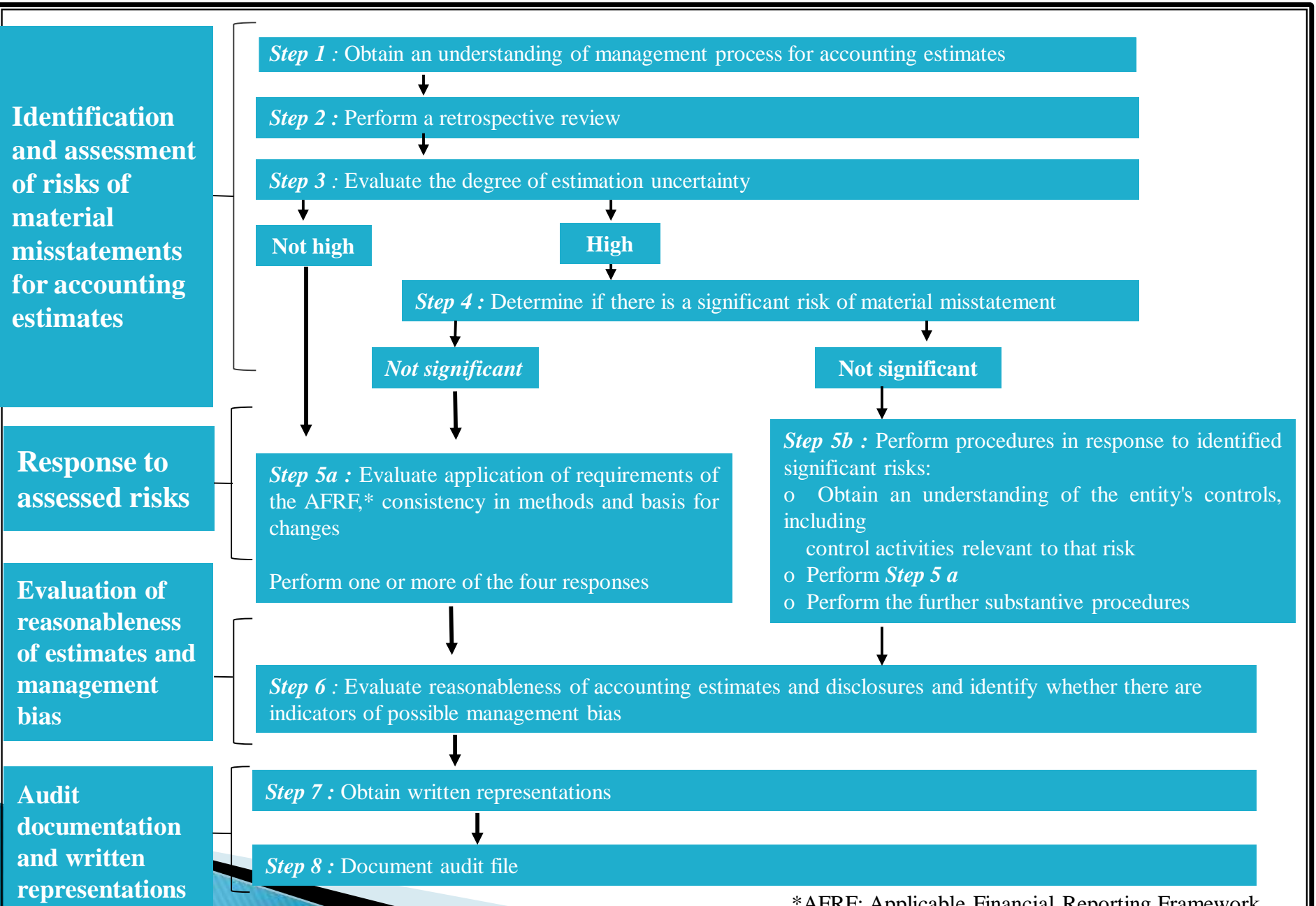
Examples...

Particulars	Examples
Receivables	<ul style="list-style-type: none">▪ Uncollectible receivables▪ Allowance for doubtful accounts▪ Uncollectible pledges
Revenues	<ul style="list-style-type: none">▪ Airline passenger revenue▪ Subscription income▪ Freight and cargo revenue
Contracts:	<ul style="list-style-type: none">▪ Revenue to be earned▪ Percent of completion
Inventories	<ul style="list-style-type: none">▪ Obsolescence▪ Estimate of Fair market value of Inventory
Financial instruments	<ul style="list-style-type: none">▪ Complex financial instruments, which are not traded in an active and open market▪ Valuation of securities
Litigation	<ul style="list-style-type: none">▪ Probability of loss▪ Amount of loss▪ Financial obligations / costs arising from litigation settlements and judgments

...Examples

Particulars	Examples
Accruals	<ul style="list-style-type: none">Property and casualty insurance company loss reservesRenegotiation refunds
Rates	<ul style="list-style-type: none">Annual effective tax rate in interim reportingGross profit rates under program method of accounting
Plant Property and Equipment	<ul style="list-style-type: none">Depreciation method or asset useful life and possible impairment of assetsProperty or equipment held for disposal
Others	<ul style="list-style-type: none">Losses and net realizable value on disposal of segment or restructuring of a businessShare-based paymentsCertain assets or liabilities acquired in a business combination, including goodwill and intangible assetsTransactions involving the exchange of assets or liabilities between independent parties without monetary considerationOutcome of long term contracts

Main steps in auditing accounting estimates when a risk of material misstatement exists



*AFRF: Applicable Financial Reporting Framework

...Risk Assessment Procedures and Related Activities...

Auditor is to obtain understanding of

Requirements for financial reporting framework relevant to accounting estimates, including related disclosures

Example : Financial Instrument disclosure as per Ind AS 109

How management identifies transaction, event and conditions giving rise to the need for accounting estimates to be recognised or disclosed in the financial statements

Example : DoT Demands, estimates for Non receipt of C-Forms

Makes accounting estimates and understanding of the data on which they are based

Example : Provision for bad and doubtful debts

Data to reviewed : Past trends and defaults

...Risk Assessment Procedures and Related Activities

❑ Manner of Making accounting estimates

- Method, including where applicable the use of model: Internally developed modules are riskier
- Relevant controls
- Whether management has used an expert
- Assumptions underlying the accounting estimates
- Change in the methods for making the accounting estimates and reasons therefor
Example : Change in useful life of property, plant and equipment
- Whether and, if so, how management has assessed the effect of estimation uncertainty

- ❑ Auditor is to review outcome of accounting estimates included in prior period financial statements, or, where applicable, their subsequent re-estimation for purpose of current period

Example : Calculation of Deferred tax which changes due to change in estimates and other factors

Risk of Material Misstatement (ROMM)...

❑ To Identify and assess the ROMM, auditor should

- evaluate the degree of estimation uncertainty associated with an accounting estimates
- determine whether any of those accounting estimates having high estimation uncertainty give rise to significant risks

Example : Provision for employee benefit for each quarter where actuarial valuation report is not available

❑ Response ROMM

Sr. No.	Four Responses to respond to assessed risk	Practical consideration for performing the steps
1	Determine whether subsequent events provide evidence about the accounting estimates	Appropriate when events up to auditor's report are expected to occur and provide audit evidence that confirms or contradicts the accounting estimates

...Risk of Material Misstatement (ROMM)...

Sr. No.	Four Responses to respond to assessed risk	Practical consideration for performing the steps
2	Test how management made the accounting estimates and the data thereof, and evaluate whether the method of measurement used is appropriate and the assumptions used are reasonable	<p>Appropriate when :</p> <ul style="list-style-type: none"> ▪ Accounting estimates are fair value estimates ▪ Derived from the routine process of data ▪ Based on large population of items nature that individually are not significant
3	Test the operating effectiveness of relevant controls over the accounting estimates, together with appropriate substantive procedures	<p>Appropriate when:</p> <ul style="list-style-type: none"> ▪ Controls exist for the review and approval of the accounting estimates by appropriate levels of management and, where appropriate, by Those Charged With Governance (TCWG); ▪ Accounting estimates is derived from the routine processing of data by the entity's accounting system

...Risk of Material Misstatement (ROMM)

Sr. No.	Four Responses to respond to assessed risk	Practical consideration for performing the steps
4	Develop a point estimate or a range to evaluate management's point estimate	Appropriate when: <ul style="list-style-type: none"><li data-bbox="919 432 1835 589">▪ Accounting estimates is not derived from the routine processing of data by the accounting system<li data-bbox="919 604 1835 868">▪ Review of similar accounting estimates made in the prior period financial statements suggests that management's current period process is unlikely to be effective

Substantive Procedures to Respond to Significant Risks

❑ **Estimation uncertainty – Auditor is to evaluate**

- How management has considered alternative assumptions or outcomes, and why rejected them
- How management has otherwise addressed estimation uncertainty in making the accounting estimates
- Whether the significant assumptions used by management are reasonable
- Management's intent to carry out specific courses of action and its ability to do so
- Development of a range with which to evaluate the reasonableness of the accounting estimates

❑ **Recognition and Measurement Criteria - Auditor is to obtain sufficient appropriate audit evidence on**

- Management's decision to recognise, or to not recognise, the accounting estimates in the financial statements; and
- Selected measurement basis for accounting estimates

Disclosures Related to accounting estimates

❑ **Obtain SAAE to ensure that:**

- Disclosures in the financial statements related to accounting estimates are in accordance with the requirements of the applicable financial reporting framework
- Evaluate adequacy of disclosure of estimation uncertainty
- Assumption
- Method of Estimation
- Basis for selection of method
- Effect of change
- Range of possible outcomes
- Fair Value accounting estimates
- Qualitative and Quantitative Disclosures
- Evaluate the adequacy of the disclosure in respect of accounting estimates giving rise to significant risk of their estimation uncertainty in the financial statements in the context of the applicable financial reporting framework

Other Requirements...

- ❑ **Evaluating the Reasonableness of Accounting Estimates and Determining Misstatements**
 - Determine difference between management's estimate and auditor's estimate
 - Arbitrary change of accounting estimates by management
 - Misstatements may be caused by selection of accounting policies or on account of sampling or factual misstatements

- ❑ **Management Bias**
 - **Definition** –
A lack of neutrality by management in the preparation and presentation of information
 - **Indicators**
 - Review the judgments and decisions made by management in making of accounting estimates to identify whether there are indicators of possible management bias
 - Indicators of possible management bias do not themselves constitute misstatements for purposes of drawing conclusions on reasonableness of individual accounting estimates

...Other Requirements

❑ **Written Representations**

- Obtain written representations from management and, where appropriate, TCWG whether they believe significant assumptions used in making accounting estimates are reasonable
- Appropriateness of measurement process
- Assumption reflect management's intent
- Disclosures are complete and appropriate
- No subsequent events require adjustment

❑ **Documentation**

- Basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risks; and
- Indicators of possible management bias, if any

Some Issues...

❑ **Example : Provision for doubtful receivables**

- Entity has provided ₹ 10 Lakhs as provision for doubtful receivables
- Auditor challenged because as per his estimate provision should be of ₹ 60 lakhs
- Both the parties agreed for a provision for ₹ 40 lakhs
- Auditor says that once he was satisfied about the adequacy of provision, he is not required to keep any record on his file

View :

- **One documents/ records what one does.** The regulators/ the new law enforces, *prima facie* drew an analogy that what has not been documented done. Therefore, the auditor must bring on record the basis of agreement for the amount of provision

❑ **Example : Assumption - Liability for Gratuity**

- Actuary's Report assumes 10% as rate of return on gratuity trust investments
- Auditor knows that the current return on it is no more than 6%

View :

- Auditor should challenge the actuary's report

... Some Issues

❑ **Example : Difference in Opinion**

- Many material Account Receivables from related parties are outstanding since 5 years
- These parties do not respond to the balance confirmation request
- Management assures the auditor that all these parties are sound and solvent by providing audited financial statements of those parties
- Taking this under record, the auditor agrees that no provision for doubtful debts need to be made

View :

- Since the management are assuring that these parties are sound and solvent provision need not be created

❑ **Example : Audit report**

- In the pervious year, the Auditor's report was qualified with regard to short-provision for Receivables
- In the current year, the provision is adequate
- Therefore, the auditor has dropped the qualification from Auditor report of the current year

Auditor's Reporting

Sr. No	Particulars	Auditor's Duty to provide
1	The accounting estimates made by management are reasonable	Clean or unmodified opinion
2	Management has unreasonably changed the method of estimation without appropriate audit evidence Or Auditor is unable to conclude reasonably whether there is misstatement or not	Modified opinion in accordance with SA 705 on "Modifications to the Opinion in the Independent Auditor's Report"
3	Misstatement or a series of misstatements in accounting estimates that the auditor evaluates as material and pervasive	Adverse opinion

Related Parties

Scope

- ❑ Deals deals with Auditor's responsibilities:
 - Regarding Related Parties relationships and transactions, when performing audit of financial statements

- ❑ Provides application guidance:
 - With respect to risk of material misstatements (ROMM) associated with Related Party relationships and transactions, *vis-à-vis* SA 315, SA 330 and SA 240

SA 315- Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment

SA 330- Auditor's Responses to Assessed Risk

SA 240- The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

Responsibilities and Objectives of the Auditor

□ Responsibilities of the Auditor

- Perform procedures to identify, assess and respond to ROMM on account of failure to account for or disclose Related Party relationships, transactions and balances as laid down by financial reporting framework
- Evaluate presence of fraud risk factors as per SA 240
- Even if financial reporting framework establishes minimal or no requirements:
 - Conclude whether financial statements achieve a true and fair view; and
 - Are not misleading

□ Auditor's objectives

- Obtain an understanding of Related Party relationships and transactions (irrespective of whether financial reporting framework establishes Related Party requirements) sufficient to be able to:
 - Recognise fraud risk factors
 - Conclude whether financial statements:
 - Achieve a true and fair presentation; and
 - Are not misleading
- Where financial reporting framework establishes Related Party requirements:
 - Obtain sufficient appropriate audit evidence (SAAE) whether Related Party relationships and transactions have been appropriately identified, accounted for and disclosed in financial statements in accordance with financial reporting framework

Related Party...

- ❑ A related party as defined in applicable financial reporting framework; or
- ❑ Where applicable financial reporting framework establishes minimal or no Related Party requirements:
 - A person/entity having control/significant influence, directly or indirectly, over reporting entity;
 - Entity over which reporting entity has control/significant influence, directly or indirectly; and
 - Entity under common control with reporting entity through having:
 - Common controlling ownership;
 - Owners who are close family members; or
 - Common key management

...Related Party...

❑ **Example:**

When defined under a framework, the auditor needs to evaluate whether the definition and the requirements under different framework are aligned?

View:

- The Companies Act, 2013 requires disclosure at the time of entering into contract or arrangement
- Accounting Standard (AS) / Indian Accounting Standard (Ind AS) requires disclosure at the time of entering into a transaction
- Even the definition under the Companies Act, 2013, AS / Ind AS and SEBI norms are not aligned
- Clause 49 adds new class of Related Parties to the definition thereof given under the Act and includes close family members, fellow group entities, joint ventures of same third party and combinations thereof, which are not in AS/ Ind AS or the Companies Act, 2013
- Revised Clause 49 requires shareholders' approval for all material Related Party transactions with no exception for transactions in ordinary course of business or at arms-length
- Definition of material transactions differs

...Related Party...

□ Example:

Whether two entities under the same Group can be called as Related Parties?

View:

It will depend on whether the entities fall under the definition of Related Parties as given in Companies Act, 2013, Ind AS/AS and/or SEBI norms

□ Example:

- X Ltd. has one subsidiary Y Pty Ltd. in South Africa and another subsidiary Z Pte Ltd. in Mauritius
- When a transaction takes place between Y Pty Ltd. And Z Pte Ltd., the amount gets consolidated in the accounts of X Ltd
- One may ask whether the provisions of Indian law for such transactions between Y Pty Ltd. and Z Pte Ltd. will be applicable?

View:

- In accordance with the provisions of Ind AS, the provisions of Related Party transactions are applicable even to transactions between two foreign subsidiaries situated out of India
- However, this applicability of Ind AS will only be for disclosure and not for obtaining approvals as per Companies Act, 2013
- No approval of the Audit Committee or Board of X Ltd. will be required for transaction between the two foreign subsidiaries

Arm's length transaction...

❑ **Arm's length transaction:**

- Transaction conducted on such terms and conditions;
- As between a willing buyer and willing seller;
- Who are unrelated; and
- Acting independently and pursuing their own best interests

❑ **Management's Assertion on Arm's length**

- When management has made an assertion in the financial statements that Related Party transaction was conducted on terms equivalent to those prevailing in arm's length transaction
 - Auditor to obtain SAAE about the assertion
- Management support for assertion may include:
 - Comparing terms to those of identical/ similar transaction or to known market terms;
 - Engaging an external expert to determine market value and to confirm market terms and conditions

...Arm's length transaction

□ Example:

How to assess whether the transactions with Related Parties is at arm's length price?

View:

- It is often difficult to determine whether transactions are conducted at arm's length
- Auditors to consider the bargaining power of each party and use their judgement, by considering similar transactions or the market price of similar goods or services
- Most commonly used guidance in this regard under income tax provisions is given in international and domestic tax laws in context of transfer pricing regime
- One may even refer to Rules for Registered Valuers wherein valuation methodologies are prescribed for Registered Valuers
- It should be noted that these guidelines are not conclusive and have only persuasive value
- One may consider various qualitative and quantitative assessments to determine arm's length

Indicators of existence of Related Party and potential problem areas...

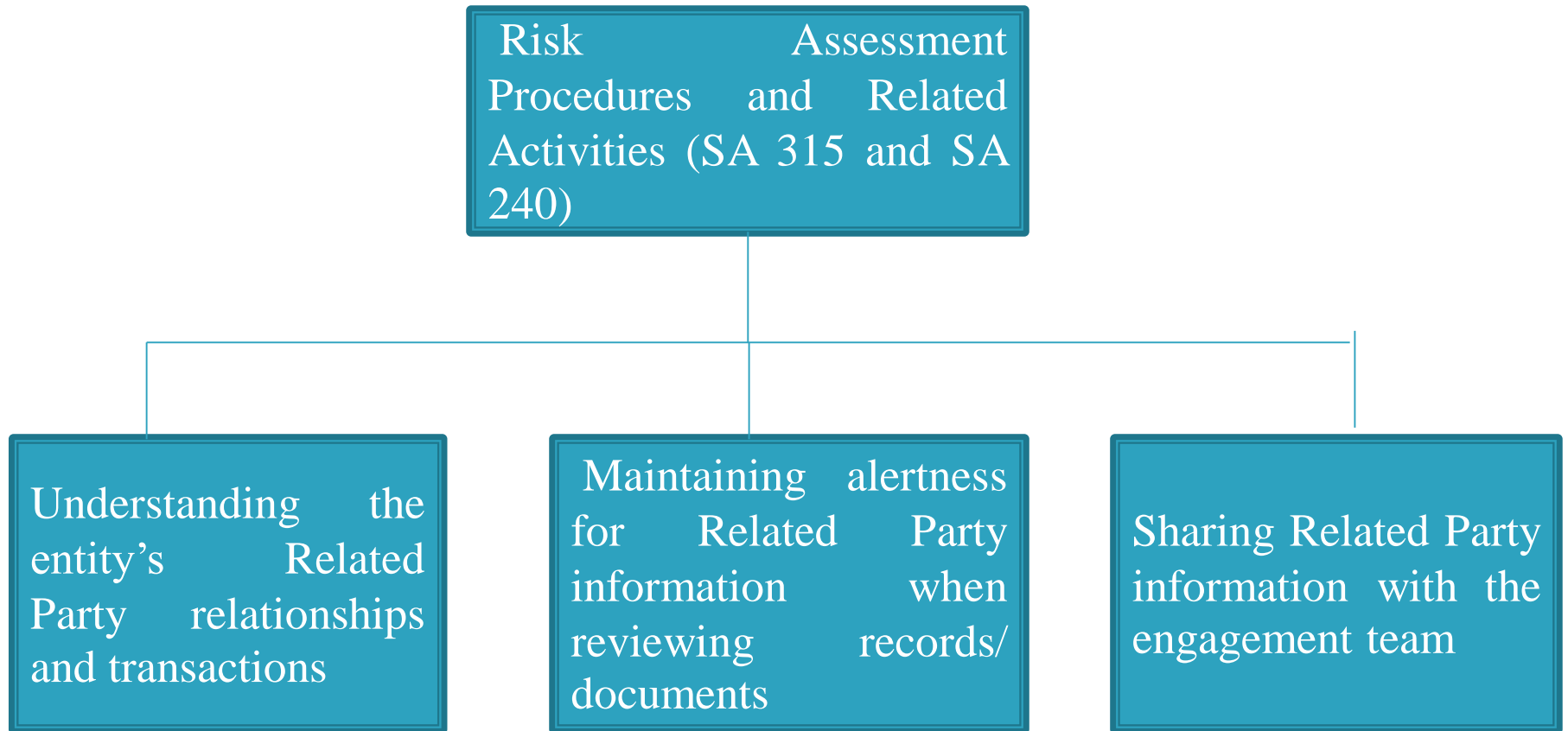
❑ **Small and/ or owner-managed :**

- Significant involvement of family members where the members may not be identified due to change in surname, etc.
- Transaction with trustees or beneficiaries may not be identified
- Sensitivity to the disclosure of loans by or to the company on favourable terms
- Free gifts or services to related parties
- Owner rents or buys property below / above market rate
- Loans (at no or lower interest rate), commitments and contingencies
- Drawings by directors, as if the company were a partnership

...Indicators of existence of Related Party and potential problem areas

- ❑ **Large or more complex private companies, public companies :**
 - Unusual loan arrangements with directors or their families
Example- Continual roll-over of loans with no repayment
 - Complex equity transactions and restructuring without a clear business rationale
 - Collusive relationships with business contacts
Example - Change of suppliers without a tendering process, or to less favourable terms and conditions
 - Unusually high levels of entertaining expense for the nature of the business in which the client is involved
 - Limited documentation supporting lease arrangements

Risk Assessment Procedures and Related Activities



- ❑ Auditor's inability to detect material misstatements is greater in case of Related Party relationship/transactions

Understanding Related Party relationships and transactions

- ❑ SA 315 and SA 240 require discussion with the engagement team:
 - Nature and extent of entity's relationship
 - Importance of professional skepticism
 - Records and documents indicating relationship
 - How related party may be involved in fraud
 - Disclosure of undisclosed related parties or transactions

- ❑ Auditor to inquire with the management:
 - Identity of entity's related party
 - Nature of relationship
 - Transactions with the related parties, if any
 - Internal controls
 - Transactions in normal course and other than normal course of business

- ❑ Understanding of control environment:
 - Internal ethical codes
 - Policies and procedures for disclosures
 - Timely discussion between the management and TCWG
 - Internal auditor's review
 - Whistle-blowing policies
 - Transaction approval method

Factors- Professional Skepticism and Related Party transactions

❑ **Factors that the auditor should be aware of that may motivate transactions with Related Parties:**

- Is there a lack of sufficient working capital or credit to continue the business?
- Does management have an urgent desire for a continued favourable earnings record to support the price of the entity's stock?
- Is the earnings forecast overly optimistic?
- Does the entity depend on one or a few products, customers, or transactions for continued success?
- Is the entity in a declining industry with many business failures?
- Is the entity involved in significant litigation, especially between stockholders and management?
- Are there significant dangers of obsolescence because the entity is in a high technology industry?
- Does the entity book profit by sale/ purchase to related party at arm's length price?
- Does the entity take any loans internally?

Maintaining alertness for Related Party information when reviewing records/ documents

- ❑ Auditor to remain alert when inspecting records/documents:
 - With respect to arrangements/information indicating existence of Related Party relationships or transactions
 - Not previously identified or disclosed to auditor

- ❑ If auditor identifies significant transactions outside entity's normal course of business, inquire of management about:
 - Nature of these transactions, and
 - Whether Related Party could be involved

- ❑ Auditor to inspect the following for existence of related party relationships and transactions:
 - Bank, legal and third party confirmations
 - Minutes of the meeting of shareholders and TCWG
 - Records of investments
 - Register required to be maintained under Section 189 of the Companies Act, 2013
 - Internal audit reports
 - Shareholder's register

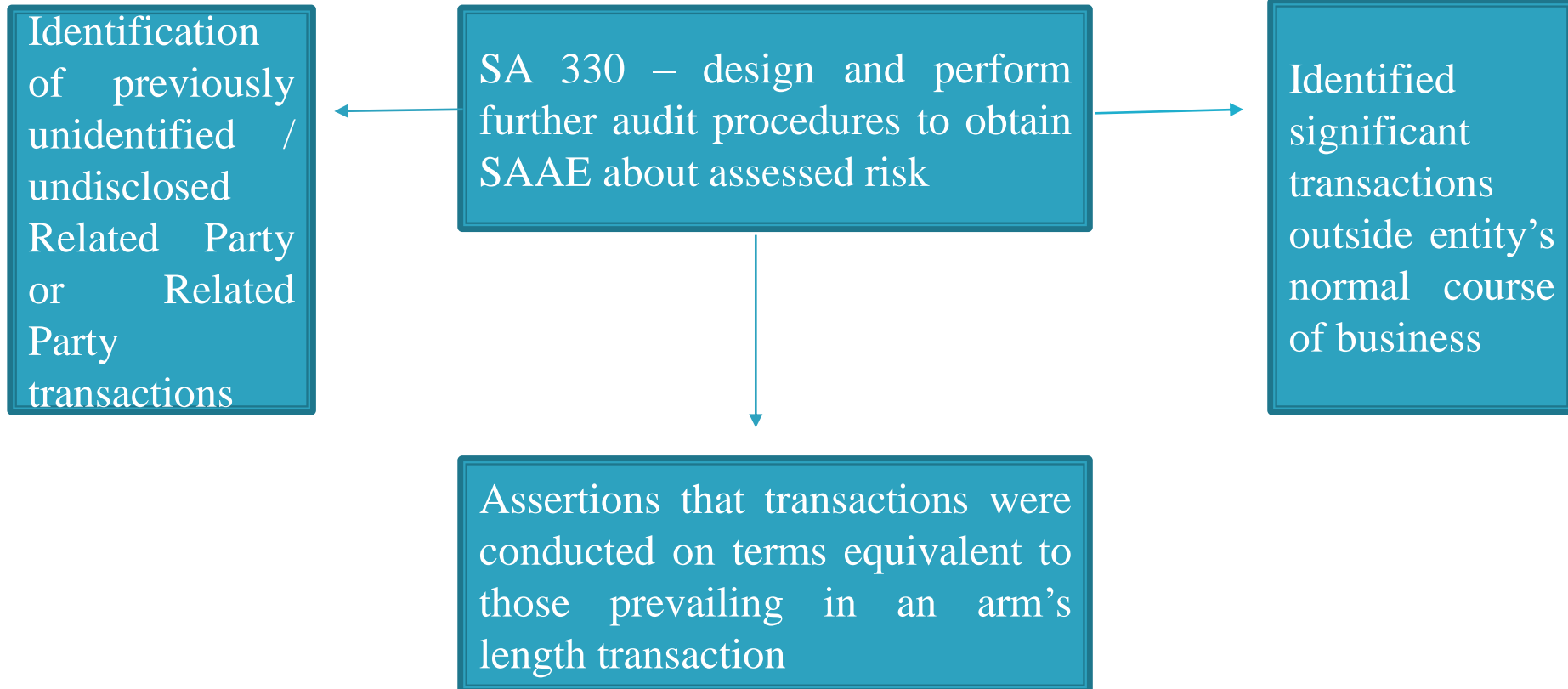
Identification/Assessment of ROMM associated with Related Party relationships and transactions

- ❑ Auditor to identify and assess ROMM associated with Related Party relationships and transactions:
 - Determine whether risks are significant;
 - Identified significant Related Party transactions outside normal course of business – giving rise to significant risk

- ❑ If fraud risk factors identified:
 - Consider such information when identifying and assessing ROMM due to fraud in accordance with SA 240

- ❑ Fraud Risk Factors associated with Related Party with Dominant influence:
 - Domination of management by a single person or small group of persons without compensating controls is a fraud risk factor
 - Indicators of dominant influence:
 - Related Party has vetoed significant business decisions taken by management or TCWG
 - Significant transactions are referred to Related Party for final approval
 - No/ little debate among management or TCWG regarding business proposal initiated by Related party
 - Transactions involving the Related Party (or a close family member) are rarely independently reviewed/approved

Responses to ROMM associated with Related Party relationships and transactions



Identification of unidentified / undisclosed Related Party or Related Party transactions

- ❑ Determine whether underlying circumstances confirm existence of relationship/transaction
- ❑ If auditor identifies, unidentified/ undisclosed Related Party or Related Party transactions:
 - Promptly communicate relevant info to other members of engagement team;
 - Where financial reporting framework establishes Related Party requirements:
 - Request management to identify all transactions with newly identified Related Party for further evaluation
 - Inquire reason for failure of entity's controls to identify/disclose Related Party relationships and transactions
 - Perform appropriate substantive audit procedures relating to newly identified Related Party or significant Related Party transactions;
 - Re - consider risk that other Related Party or significant Related Party transactions may exist that management has not previously identified/disclosed;
 - If non-disclosure by management appears intentional, evaluate implications for audit

Identified Significant Related Party transactions outside normal course of business

- ❑ Inspect underlying contracts/agreements and evaluate whether:
 - Business rationale (or lack thereof) suggests that transactions entered to engage in fraudulent financial reporting or to conceal misappropriation of assets
 - Terms of transactions consistent with management's explanations
 - Transactions appropriately accounted for/disclosed in accordance with financial reporting framework
- ❑ Obtain evidence that transactions appropriately authorised and approved

Other Requirements...

❑ **Written Representations**

- Approval of specific transaction-
 - Materially effecting the financial statement
 - Involving management
- Oral representations by management
- Financial or other interest in related parties
- Management's assertion about arm's length transaction

❑ **Communication with TCWG**

- Non-disclosure by the management to the auditor
- Inappropriately authorised and approved transactions
- Disagreement with the management
- Non-compliance with applicable laws
- Difficulties in identifying the party that ultimately controls the entity

❑ **Documentation**

The auditor to document the following:

- The names of related parties
- The nature of related parties relationships
- Matters communicated to TCWG in regards to related parties
- Result of audit procedures

Summary- Five Point Action Plan...

- ❑ **Plan your work on the audit of related party relationships and transactions thoroughly :**
 - Plan the audit of related party relationships and transactions by updating existing information, and, where possible, obtain a list of related parties from clients or compile a list based on discussions with clients
 - Ask management about changes from the prior period, the nature of the relationships, whether any transactions have been entered into and the type and purpose of the transactions
 - Ensure that the client understands who or what related parties are and why the relevant disclosure requirements are necessary
 - Speak to the right person ‘in authority’ at the client who can answer questions.
 - Plan for concerns raised by audit team members and others to be considered and reviewed by suitably experienced staff
 - Brief all audit team members on related party relationships and transactions and the risks of material misstatement due to fraud or error that could arise from such transactions
 - Ensure that all staff are informed about any changes to related party relationships throughout the engagement and are aware of the need to bring such changes to the attention of the rest of the team

...Summary- Five Point Action Plan...

- ❑ **Focus on the risk of material misstatement that might arise from related party transactions :**
 - Understand the nature, size and complexity of the businesses and use family trees or document group structures to help identify related parties and relationships between the client and related parties
 - Follow up indicators of the existence of undisclosed related parties or related party transactions
 - Consider the impact of undisclosed related party relationships and transactions as a potential fraud risk
 - Consider the qualitative aspects of materiality
 - Emphasise the importance of the audit team remaining alert for related party relationships and transactions as the audit proceeds
 - Discuss related party relationships with others within the firm who provide services to the client, such as staff in the tax, accounting or corporate finance departments

...Summary- Five Point Action Plan...

- ❑ **Understand the internal controls at the company to identify related parties and to record related party transactions :**
 - Understand the controls, if any, that management has put in place to identify, account for and disclose related party transactions and to approve significant transactions with related parties, and significant transactions outside the normal course of business
 - If few or no processes are in place for dealing with related party relationships and transactions, seek to obtain an understanding of those relationships and transactions by inquiry of management

...Summary- Five Point Action Plan...

❑ **Design procedures to respond to risks identified...**

- Perform procedures to confirm identified related party relationships and transactions and identify others including:
 - inspecting bank and legal confirmations obtained as part of other audit procedures;
 - inspecting minutes of shareholder and management meetings and any other records or documents considered necessary, such as regulatory returns, tax returns and records of investments
- Where the existence of related party relationships or transactions that management has not previously identified or disclosed is indicated, communicate the information to team members promptly and;
 - request management to identify all such transactions;
 - ask why controls failed to identify or disclose the related parties or transactions;
 - perform appropriate substantive procedures;
 - reconsider the risk that further unidentified or undisclosed relationships or transactions may exist and evaluate the implications for the audit

...Summary- Five Point Action Plan...

□ **Design procedures to respond to risks identified...**

- Consider any fraud risk factors in the context of the requirements of SA 240
- Establish the nature of significant transactions outside the company's normal course of business and whether related parties could be involved, by asking management
- Consider any arm's-length assertions and obtain supporting evidence from third parties
- Treat significant related party transactions outside the normal course of business as significant risks and inspect relevant documentation to evaluate the business rationale of the transactions, whether they have been appropriately authorised and approved, whether the terms are consistent with management's explanations and whether they have been appropriately accounted for
- Document the identity of related parties and the nature of related party relationships

...Summary- Five Point Action Plan

❑ **Perform completion procedures :**

- Obtain a representation that management has disclosed the identity of related parties, relationships and transactions of which they are aware and that related parties and transactions have been appropriately accounted for and disclosed
- Communicate significant related party matters arising during the audit to those charged with governance unless all of those charged with governance are involved in its management
- Ensure that the accounting for and disclosure of related parties and related party transactions are appropriate
- Consider the implications of the findings from work performed on related parties and related party transactions for the audit opinion

Auditor's Reporting...

Sr. No.	Particulars	Auditor's Duty
1	Previously unidentified or undisclosed related parties or transactions	<ul style="list-style-type: none"> - To communicate the same to Management and TCWG - Ask the management to disclose the same*
*	<p>If the management agrees to disclose</p> <p>If the management refuses to disclose</p>	<ul style="list-style-type: none"> - Unqualified report - ask the reason for such refusal - modify the report in accordance with SA 705 on "Modifications to the opinion in the Independent Auditor's Report"
2	Where the contract is of abnormally high amount with related parties	<ul style="list-style-type: none"> - Apply additional audit procedures in regards to contract terms, pricing , relationship, approval and disclosure - If found unreasonable, modify the report in accordance with SA 705

...Auditor's Reporting

Sr. No.	Particulars	Auditor's Duty
3	Identified transactions have been accounted for/ disclosed appropriately	- Unqualified report

Communication with group
auditors / auditors of component
companies / entities

Introduction

- ❑ Establishes standards for application in situations where an auditor reporting on the financial information of an entity uses the work of other auditor
- ❑ Work of the other auditor may relate to financial information of one or more components included in the financial information of the entity
- ❑ Not applicable if principal auditor concludes that financial information of the component is immaterial
- ❑ However, applicable when several components, immaterial in themselves, are together material in relation to the financial information of the entity as a whole
- ❑ When the principal auditor uses the work of another auditor, the principal auditor should determine how the work of the other auditor will affect the audit
- ❑ The auditor to exercise adequate skill and care and may not be aware of any reason to believe that he should not have so relied on the work of other auditor

Definitions

- ❑ **Principal Auditor** : Auditor responsible for financial information of an entity when it includes financial information of one or more components audited by another auditor
- ❑ **Other Auditor** : Auditor, other than Principal Auditor, responsible for reporting on financial information of a component which is included in financial information audited by the Principal Auditor
- ❑ **Component** : Division, branch, subsidiary, joint venture, associated enterprise or any other entity whose financial information is included in financial information audited by the Principal Auditor

Principal Auditor's Procedures

- ❑ Consider the professional competence of the other auditor, if the other auditor is not a member of the Institute of the Chartered Accountants of India (ICAI):
 - where a component is situated in foreign country:
 - Procedures herein assume added importance
 - Visit component and examine books of account, if essential
- ❑ Obtain sufficient appropriate audit evidence (SAAE) that the work of other auditor is adequate for Principal Auditor's purposes
- ❑ Discuss audit procedures applied by the other auditor
- ❑ Review a written summary of other auditor's procedures and findings through questionnaires/checklist
- ❑ Consider significant findings of other auditor :
 - discuss audit findings with other auditor and management of the component
 - perform supplemental tests, if necessary

Documentation

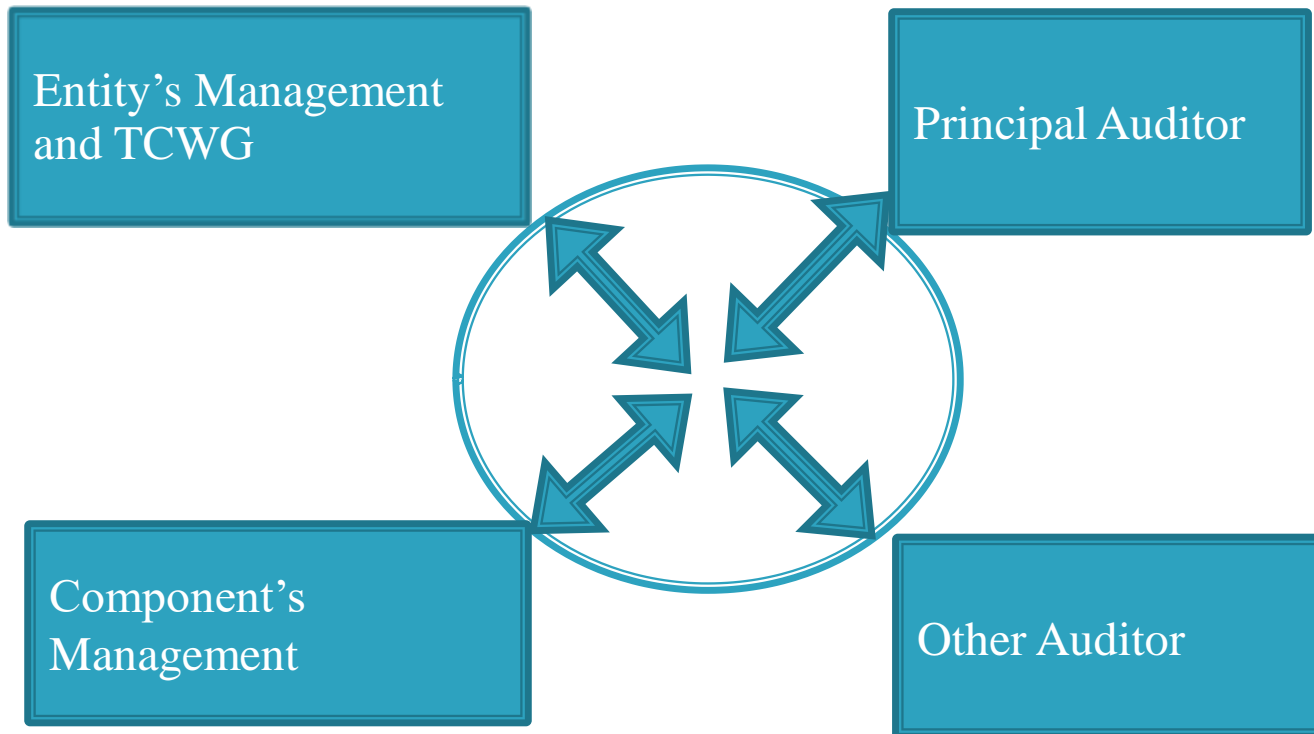
- ❑ List of the components whose financial statements are audited by the other auditor and their significance to the financial information of the entity as a whole
- ❑ Names of the other auditors
- ❑ Any conclusion reached that individual components are not material
- ❑ Procedures performed regarding components
- ❑ Conclusions reached
 - Example- the results of discussion with the other auditor; and review of the written summary of the other auditor's procedures*
- ❑ Manner of dealing with Modified Report of the other auditor while finalising Principal Auditor's Report

Co-ordination Between Auditors...

- ❑ Sufficient liaison/co-ordination between Principal Auditor and other auditor
- ❑ Principal Auditor may require other auditor to answer a detailed questionnaire
- ❑ Other auditor should co-ordinate with Principal Auditor :
 - adhering to time-table
 - bringing to the attention of Principal Auditor any significant finding
 - compliance with relevant statutory requirements
 - respond to detailed questionnaire

...Co-ordination Between Auditors

- An efficient and effective group audit requires channels of two-way communication between



Restriction on Communication

- ❑ **Factors affecting the line of permissible communication:**
 - Statutory obligation for the other auditor and components' management to co-operate with the Principal Auditor (where the component is subject to statutory audit)
 - Contractual obligation between component's management and other auditors in the engagement letter
 - Contractual obligation between entity and other auditor, and/or other auditor and whoever is paying for their work (where an audit is only performed for entity's purposes)
- ❑ Any necessary communication outside these parameters to be facilitated by means of written permissions

Content of Communication

Group audit instructions

Independence confirmation/
understanding
other
auditor

Consolidation
Questionnaires
and memoranda
of work
performed

Other
Auditor's report
on work
performed

- ❑ Nature, extent and content of communication depends on:
 - significance of the component to the entity (including financial significance)
 - what work the Principal Auditor have decided
 - also depends whether Principal Auditor and other auditor operate :
 - as part of the same firm or networks or
 - in the same country or under the same regulatory regime

Principal Auditor's Reporting

Sr. No.	Particulars	Principal Auditor's Duty
1	Principal Auditor concludes that he cannot use the work of the other auditor	Express a qualified / disclaimer of opinion because of scope limitation
2	Principal Auditor unable to perform sufficient additional procedures regarding financial information of the component audited by the other auditor	Express a qualified / disclaimer of opinion because of scope limitation

- ❑ Report to state clearly the division of responsibility between the Principal Auditor and the other auditor
 - The division of responsibility to be stated by indicating extent to which financial information of the component audited by other auditor have been included in financial information of the entity

Purpose and Objectives

❑ Purpose :

- Communicate the aspects of entity's strategy and entity's plan that relate to the other auditor, including the work to be performed by the other auditor

❑ Objectives :

- Issue of Independent Auditor's Report in accordance with the Standards on Auditing (SA) including report on internal financial controls over financial reporting
- Fulfil professional and, where applicable, statutory obligation
- Define the respective responsibilities and reporting requirements, and the related deadlines
- Report all significant findings related to accounting / tax / legal or other issues
- Fulfill communication requirements, and provide independent, insightful and timely feedback to the board of directors/the audit committee and management of the entity

Group Audit Instructions...

□ The first part of group audit instructions includes:

- A request for the other auditors to confirm that they will cooperate with Principal Auditor
- Relevant ethical requirements
- Component materiality, the ‘clearly trivial’ threshold for reporting uncorrected misstatements for group purposes and, if applicable, materiality for transactions, balances or disclosures
- Significant risks of material misstatement in the entity’s financial statements relevant to the component, including fraud risks, with a request for the other auditor to communicate any other significant risks to the entity’s financial statements, together with the other auditors’ response to those risks and
- A list of related parties prepared by the entity’s management together with any other parties of which Principal Auditor is aware, with a request that the other auditor communicate the identity of any further related parties that come to their attention

...Group Audit Instructions

- ❑ **Other matters that are commonly communicated at this stage include:**
 - a timetable, including meetings between entity and component's management and other auditor, and key contacts
 - work to be performed on intra-group transactions, balances and unrealised profits
 - subsequent events work to be performed where there is a gap between the entity and component period-end or auditor reporting date
 - matters to be documented by other auditors for the purposes of the group audit
 - Principal Auditor and internal audit findings from work on group-wide controls
 - a request for timely/early communication of any evidence that appears to contradict the original group risk assessment and of significant or unusual events
 - a request for timely confirmation of matters relating to going concern, litigation and claims, significant deficiencies in internal control, issues related to fraud and other significant accounting and auditing matters

Understanding the other auditor and Knowledge Sharing

□ Understanding the other auditor

- Responsibility to comply with ethical requirement, including independence requirements (i.e. Standard of Quality Control 1 and Code of Ethics issued by ICAI)
- Assessing professional competence to fulfill the scope and complexity of engagement
- Regulatory environment in which the component auditor operates

□ Knowledge Sharing

- Understanding the entity, it's components and their environment
- Risk Assessment Procedures performed
- Communicating significant risks of material misstatement, on a timely basis, due to error or fraud, in the component and responses to such risks
- Communicating suspected or identified frauds along with summaries of communication with management / those charged with governance by the component auditor

Scope of Work and Additional Procedures...

❑ **Work description and Materiality**

- In accordance with SAs, perform an audit of the component's financials
- Use the component materiality and performance materiality
- Preparation of component's financials in accordance with Entity's accounting policy and reporting instructions
- Issue of Audit Report which includes reporting on internal financial controls over financial reporting

❑ **Laws and Regulations**

- Communicating non-compliance of laws and regulations including illegal acts at a component level

❑ **Litigation claims and assessment**

- Communicating all identified litigations and claims with a potential impact along with management's assessment

...Scope of Work and Additional Procedures

❑ **Related Parties Transaction**

- Nature of the relationships and transactions between the component and the related parties
- The extent of involvement in significant transactions by the component's management and TCWG

❑ **Inter-company balances**

- Gain an understanding of the nature of the inter-company transactions
- Verify the classification of inter-company balances/transactions and supporting schedules
- Verify the year-end reconciliation procedures of the each components

❑ **Subsequent Events**

- Performing subsequent event procedures designed to identify events
- Adjustment to, or a disclosure in the entity's financial statement

Involvement in the Work of the Other Auditor

- ❑ Discussion with component management of the component's business activities significant to the entity
- ❑ Discussing susceptibility of material misstatement of the component due to fraud or error
- ❑ Review of documentation of identified significant risks of material misstatement along with conclusion of the other auditor and
- ❑ Evaluating the appropriateness of the further audit procedures, if required

Others

- ❑ Issuance of Other Auditor's Report including Key Audit Matters (KAM)
- ❑ Report on corrected and uncorrected misstatements that individually exceed the respective Audit Misstatement Posting Threshold
- ❑ Obtain written representation from the component's management as an evidence to support KAM
- ❑ Retention of all audit documentation in accordance with SA 230, "Audit Documentation" and International Standard on Quality Control 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements"

Issues on communication with other auditors and group audit instructions...

- ❑ Failure on part of management to provide certified financial statements of the components to the Principal Auditor
- ❑ Access to working papers of the other auditor to the Principal Auditor
- ❑ Appropriateness of the Component Materiality and procedures followed for computing the same
- ❑ Concerns about the competence, independence or diligence of the other auditor
- ❑ Failure on the part of other auditor to deliver report and other deliverables on timely basis
- ❑ The group has a significant component which is exempt from audit

...Issues on communication with other auditors and group audit instructions

- Failure on part of the Principal Auditor to involve in the work of other auditor
- Determining coverage of components needed overall
- Where the entity has earlier filing deadline than the components
- Non-conterminous year ends
- Aligning inconsistent accounting policies
- Failure to maintain proper documentation by the other auditor



“Having audited your accounts, we can’t find anything at all suspicious. Which makes us very suspicious.”

Thank you!
Jimmy

