Recent Changes in Auditor's Report

MULUND CA CPE STUDY CIRCLE OF WIRC OF ICAI : Lecture meeting on 14.06.2014

CA BIPEEN G. MUNDADE

I have bifurcated Changes in audit report into 4 parts :

Changes in Audit Report as necessitated by:

1. Companies Act 2013
2. Companies (Audit & Auditors) Rules 2014
3. Auditing Standards (SA)
4. Audit Report Format including :

   Report on Consolidated Financial Statements (CFS) &
   Companies Auditors Report Order (CARO) 2015.

Companies Act 2013

Companies Act, 2013 was made effective from 12.09.2013.

Sec 139 to 148 deals with various matters related to Audit & Auditors. Most of them have been made effective from 1st April 2014:

Summary of all the relevant sections within the ambit of this Chapter Xdealing with Audit & Auditors along with the corresponding section form Companies Act, 1956:

Companies Act, 2013(New Act)	Companies Act, 1956(Old Act)	Section Title
139	224, 224A, 619	Appointment of Auditors
140	225	Removal, Resignation of auditor and giving of special notice.
141	226	Eligibility, qualifications and disqualifications of auditors.
142	224(8)	Remuneration of auditors.
143	227, 228, 619	Powers and duties of auditors and auditing standards.
144	Nil	Auditor not to render certain services.
145	229, 230	Auditors to sign audit reports, etc. (similar)
146	231	Auditors to attend general meeting.(similar)
147	232, 233, 233A	Punishment for contravention.
148	233B	Central Government to specify audit of items of cost in respect of certain companies. (Cost Audit)

Now the question arises on for reporting or Audit Report for the period beginning before 1st April 2014 and ending after 1st April 2014, (ex 30th June 2014 or 31st Dec 2014) which Act or provisions shall be applicable? Whether provisions of Companies Act 2013 or Companies Act, 1956. Even same question arose when we finalised Audit reports for year ended 31st March 2014 in August-September 2014.

To clear the confusion, ministry of corporate affair (mca) has issued ***Clarification on enforcement of certain provisions of the* Act vide Circular No.24/2014, dated 4-4-2014.**

It states that the financial statements, Auditor's report and Board's report in respect of financial years that commenced earlier than 1st April,2014 shall be governed by the relevant provisions/Schedules/rules of the Companies Act,1956 and that in respect of financial years commencing on or after 1st April,2014, the provisions of the new Act shall apply.

Of the above section, section 143 deals with the Powers & duties of the Auditors and changes as per the new section are as below:

COMPARISION OF Sec 143 of Companies Act, 2013 Relevant Sectionsof the Companies ACT,1956

SR.NO.	SUB-SECTION IN COMPANIES ACT,2015	MATTER	CORRESPONDING SUB-SECTION IN COMPANIES ACT,1956	REMARKS
1	143 (1)	Enquiries to be made by the Auditor	227(1) & 227(1A)	(a)The word "head office" replaced by "registered office" (b)Proviso allowing auditor to access subsidiary accounts.
2	143 (2)	Report to members on accounts examined & every financial statement.	227(2)	Specific mention of Accounting & Auditing Standards.
3	143 (3)	Details to be checked by auditor	227 (3)	Addition of 143(3)(f) & 143(3)(h)
4	143 (4)	Report shall state reasons for negative comment or qualifications.	227 (4)	Similar lines of 227 (4) of Co. Act, 1956.
5	143 (5) to 143 (7)	Rights & Duties of C&AG in respect of audit of Govt. Company	619	Similar lines of 619 of Co. Act, 1956.
6	143 (8)	Audit of Branch companies	228	Similar lines of 228 of Co. Act, 1956.
7	143 (9)	Compliance with Auditing Standards	NIL	New addition
8	143 (10)	CG may prescribe standards on auditing recommended by ICAI and its examination by NFRA	NIL	New addition
9	143 (11)	CG may in consultation with NFRA, to direct matters to be included in auditor's report.	227 (4A)	Similar lines of 227 (4A) of Co. Act, 1956, CG to now consult NFRA in place of ICAI
10	143 (12) &143 (13)	Reporting of fraud to CG	NIL	New addition

11	143 (14)	All provisions of Sec 143 made applicable to (a) Cost Accountant u/s 148 (b) Company Secretary u/s 204	NIL	New addition
12	143 (15)	Non-compliance with provisions of sub-section 12 (reporting of fraud) will result in fine not less than 1 lakhs which may extend to 25 lakhs.	NIL	New addition

Sec 143 **Powers & duties of auditors & auditing standards** corresponds to sec 227 of the Companies Act, 1956.

143 (1) requires auditors to make certain enquiries during the course of Audit and confer certain powers. It may be noted that the reply to these enquires **are to be reported only if answer is negative**. The words "head office" has been replaced by "registered office" for keeping books of accounts. Also a proviso is added as below:

Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries insofar as it relates to the consolidation of its financial statements with that of its subsidiaries .

Consolidation and Audit of Consolidated Financial Statements is mandatory and therefore Auditors of the holding Company has been given the right to access to the records of the Subsidiary Companies insofar as it relates to consolidation

143 (2) requires auditors among other things to give report to the members on the accounts examined by him and every financial statement required by or under this Act to be laid down before the Company in General meeting and specifically mention that report shall take into account ."Auditing Standards". So it makes it statutorily binding on auditor to take into account Auditing Standards (SAs) alongwith Accounting Standards & other applicable provision while reporting on accounts & any Financial Statement (FS) under the Act.

Definition of Financial Statement (FS) given u/s 2(40) of the Companies Act now include Cash Flow and defines Financial statements in relation to Company includes :

i) Balance Sheet as at the end of Financial year
ii) Profit & Loss or Income & Expenditure Account for the Financial year
iii) Cash flow statement for the financial year
iv) Statement of changes in Equity , if applicable
v) Any explanatory notes annexed to or forming part of any of (i) to (iv) above

Auditors is required to report that :
to the best of his information and knowledge, the accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

143 (3) relates to Audit Report and few more clauses are added for reporting by the Auditors. These are the major changes and we shall discuss in detail as we move forward.

143 (4) requires auditors to state the reason if any matter required to be included in audit report under this section is answered in negative or with qualification. The reasons for such negative answer are to be stated in report itself.

It may be noted that requirement of giving qualification or negative remark in bold, thick or italics form as required under earlier 227 (4) is dispensed with and no more required.

143 (5), (6) & (7) deals with right, duties and power of CAG with respect to Companies owned or controlled by the State or Central Government.

143 (8) deals with audit of branches. It requires branch auditors appointed under this section to prepare the report on the accounts of the branch examined by him and send it to the Auditors of the Company. The Company auditors shall deal with the branch Auditors report in a manner he considers necessary. Auditor of the holding Company is required to follow the SA- 600 on using work f other Auditors.

143(9) This newly introduced section requires every auditor to comply with the auditing standards (SAs). So every auditor of the company is now statutorily require to comply with the Auditing Standards

143 (10) CG has assumed the power to prescribe SAs on recommendation of ICAI in consultation with and after the examination made by NFRA and further till the time CG prescribe such standards, SAs prescribed by ICAI shall be deemed to be SAs.

143 (11) CG has assumed the power to issue order in consultation with NFRA (earlier ICAI) the Company or class of the Companies directing the Auditors to include a statement on various matter prescribed in the order. CARO 2015 is prescribed on 10.04.2015 under this section.

143 (12) makes in mandatory for the auditor to report the fraud being or has been committed by officers or employees against the Company in the manner and within time prescribed.
Rule 13 of Companies (Audit & Auditors) Rule 2014 prescribe the details of time limit and procedure and Form to be filed for reporting frauds to CG. ICAI has recently issued Guidance Note on reporting of fraud.

143 (13) states that reporting of fraud by auditors as referred above under sec 143(12), shall not be treated as contravention of the duty if auditor reports the fraud in good faith.

143 (14) makes the provision of this section applicable to the extent relevant to Cost Accountant carrying on cost audit u/s 148 and Company Secretary carrying on Secretarial audit u/s 204 of the Companies Act 2013 respectively .

Last but not least 143 (15) prescribes penalty to Auditor, Cost Accountant or Company Secretary who donot comply with the provisions of reporting fraud to CG {143(12}. Minimum penalty prescribed is 1 lac and it may extend to 25 lacs.

We shall now move on to sub-section 143(3) which directly deals with Audit Report and there are certain additions made in reporting requirements under this sub section 143 (3). It is almost on same lines as 227 (3) of Companies Act 1956 with few additions given below.

143 (3)the auditors report shall also state –

(a) .....

(b).....

(c).....

(d) .....

(e) .....

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effects on the functioning of the company;

(g) .....

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(i) whether the company has adequate internal financial controls system in places and the operating effectiveness of such controls *** *Deferred to FY 2015-16*

(j) such other matters as may be prescribed.: *Companies (Audit & Auditors) Rules 2014 prescribed by the CG*

Reporting under clause f of sub-section 3 of section 143of the Act*143(3) (f)*

3. The relevant extracts of section143(3) (f) of the Act are reproduced below:

"(3). The Auditor's report shall also state-

.....

Clause (f) of sub-section 143(3) requires the auditor to report "the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company".

The Handbook of Auditing Pronouncement published by ICAI explain the word observation as it consist of looking at process or procedure being performed by other like counting of inventory by the client's staff. The Act does not specify the meaning of the phrase 'adverse effect on the functioning of the company'. The Guidance Note on Reporting under clause 143(f) & 134(3)(h) issued by ICAI states that expression adverse effect should not be interpreted to mean that any event affecting the functioning of the company, observed by the auditor, should be reported upon even though it does not affect the financial statements. Such an interpretation would not only be beyond the scope of the audit of the financial statements of the company but would also not be in accordance with objective and concept of the audit stipulated under the Act. This reporting requirement does not intend to change the basic objective and the concept of audit of financial statements of the company, which is to examine the financial statements with a view to express opinion thereon.

Auditors will need professional judgement in considering event or matters that may have an adverse effect on the functioning of the company.

Reporting under this clause requires that auditor's report should contain some observations or comments. The auditor's report may contain matters leading to modifications to the auditor's opinion or emphasis of matter in the auditor's report on the financial statements. If such matters are related to issues which may have an adverse effect on the functioning of the company then that need to be reported under this clause. In simple words the auditor should have made an "observation" or "comment" in the auditor's report at either of paragraphs in order to determine the need to report under clause (f) of section 143(3) and only such "observation " or "comments" of the auditors on financial transactions or matters that have been made by the auditor in the auditor's report which have an adverse effect on the functioning of the company are required to be reported under this clause.

?? Can we say generally unmodified opinion will not create requirement of reporting under this clause. ??

Reporting under clause f of sub-section 3 of section 143of the Act*143(3) (h)*

12. The relevant extracts of the section 143(3) (h) of the act are reproduced below:

"(3). the auditor's report shall also state –

.....

.....

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;"

Section 2(13) of the Act defines "books of account" to include records maintained in respect of-

(i) all sums of money received and expended by a company and matters in relation to which he receipts and expenditure take place;

(ii) all sales and purchases of goods and service by the company;

(iii) the asset and liabilities of the company; and

(iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section;

Section 128 of the Act, inter alia, states that every company shall prepare and keep it books of account and other relevant books and paper and financial statements that give true & fair view of the state of affairs of the company.

Further Clause (b) of section 143(3) itself requires the auditor to state whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books…… clause (d) requires Auditors to state that the balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and return.

The GN states that reporting under this clause is determined based on the FS prepared, but it does not mean that only FS will be considered as books of account. The FS are prepared based on books of account maintained, and therefore reporting under this clause is determined on that basis. Under 143(3)(d), the auditor is required to report whether FS are in agreement with the books of account. When read together, it means that, auditor needs to report if FS agree with books and whether there are any remarks on books itself. If there is adverse remark on books itself, and FS agree with such books, then it is likely to result in qualification.

In short, FS are only the basis to determine if books of account need to have any adverse comment though FS themselves are not books of account.

The auditor would need to report under clause (h) of section 143(3) any matter that causes a qualification, adverse remark or disclaimer of opinion on the financial statements since such matters will or possibly will have an effect on the books of account maintained by the company

Reporting any qualification, reservation or adverse remark under clause (h) of section 143(3) will be required if the auditor makes any observation under clause (b) of section 143(3) relating to whether proper books of accounts as required by law have been kept by the company or clause (d) dealing with whether FS are in agreement with books of accounts or if he gives modified Opinion.

Reporting under clause (f) & clause (h) can be illustrated by **example** below:

If the Company values its inventory at Cost instead of Lower of Cost or NRV as by AS-2, then the relevant paras in Audit report (Qualified opinion) and reporting under clause (f) & (h) needs to be stated as follows**:**

Basis for Qualified Opinion

The Company's inventories are carried in the Balance Sheet at Rs. XXX (Previous year *Rs. YYY*). The Management has not stated the inventories at the lower of cost and net realisable value but has stated them solely at cost, which constitutes a departure from the Accounting Standard – 2 "Valuation of Inventories". The Company's records indicate that had the Management stated the inventories at the lower of cost and net realisable value, an amount of Rs. XX (*P.Y Rs. YY*) would have been required to write the inventories down to their net realisable value. Accordingly, cost of sales would have been increased by Rs. XX (*Previous year Rs.YY*), and income tax, profit for the year and shareholders' funds would have been reduced by Rs. X, Rs. XX and Rs. XXX, respectively (*Previous year ended 31st March, 2014: Rs.Y, Rs.YY and Rs.YYY, respectively*).

This matter was also qualified in our report on the financial statements for the year ended 31st March 2014.

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, **except for the effects of the matter described in the Basis for Qualified Opinion paragraph above,** the aforesaid standalone 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, of the state of affairs of the Company as at 31st March, 2015, and its profit/loss and its cash flows for the year ended on that date.

……..

……

Report on Other Legal and Regulatory Requirements

As required by Section 143 (3) of the Act, we report that:

(a) We have sought and obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit;

…….

…….

(f) The matter described in the Basis for Qualified Opinion paragraph above, in our opinion, may have an adverse effect on the functioning of the Company.

……

(h) The qualification relating to the maintenance of accounts and other matters connected therewith are as stated in the Basis for Qualified Opinion paragraph above."

From the above discussion, Can we say that reporting under clause (h) of section 143(3) will not be required in case of unmodified report or there are no such observation under clause (b) or clause (d) of section 143 (3) regarding books of account kept by the company and its agreement with FS ???

Companies (Audit & Auditors) Rules 2014

In exercise of the power conferred by subsection 3 of sec 143, the CG has issued rules namely Companies Audit & Auditors) Rules 2014.

Rule 11 lays down **Other matters to be included in the auditor's report. These are to be reported under Other Legal and Regulatory Requirement.**

11. The auditor's report should also include their views & comments on the following matters namely-

(a) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;

(b) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;

(c) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

Sub-rule (a) requires auditors to give his view & comments on whether the Company has disclosed the impact of pending litigation on its financial position in FS.
So Auditor has to first confirm that all the pending litigation are brought to his notice and he has assessed impact on financial position.
Whether all litigation irrespective of the amount involved should be disclosed ? Any frivolous suit which company feels that will not stand in court or will not impact on financial position, should such litigation need to be taken into account ?Eg if someone has filed suit of 10 cr against Bank for non-sanction of Loan of 1 lac in time . Do auditor need to ensure that such litigations are also disclosed ?
In my opinion, Company and auditor also need to take professional judgement and materiality into account.

Sub-rule (b) require auditor to comment on whether provision are made for foreseeable losses on long term contract including derivative contracts.
Here derivative contracts are specifically included. Auditor has to study all long term contract and take professional judgement as to whether there are any foreseeable losses on such contract and if material in nature then whether provision is made by the Company.

Sub-rule (c) relates to transfer of amount to Investor Education & Protection Fund within stipulated time. As we are aware every Company has to transfer unpaid or unclaimed Dividend after 7 years to Investor Protection & Education Fund Established by CG under sub-section (1) of section 125 of the Companies Act 2013.

It is factual one and auditor has to comment on whether there is delay in such transfer.

Reporting under this rule is required even if the answer is negative or not applicable.

a. Company has disclosed the impact of pending litigation on its financial position in FS–Refer NoteX to the financial statements;[or the Company doesnot have any pending litigations which would impact its financial position]

Standards on Auditing (SA)

With view to enhance the credibility of Auditor's report and bring uniformity in reporting, ICAI has made mandatory for its members to follow SAs while performing the attest function including Audit.

SAs are grouped under various heading as given below:

Standards on Auditing No.	Title of Standards on Auditing
200-299	**General Principles & Responsibilities**
200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
210	Agreeing the Terms of Audit Engagements
220	Quality Control for an Audit of Financial Statements
230	Audit Documentation
240	The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
250	Consideration of Laws and Regulations in an Audit of Financial Statements
260	Communications with Those Charged with Governance
265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
299	Responsibility of Joint Auditors
300-499	**Risk Assessment and response to Assessed Risks**
300	Planning an Audit of Financial Statements
315	Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment
320	Materiality in Planning and Performing an Audit
330	The Auditor's Responses to Assessed Risks
402	Audit Considerations relating to an Entity Using a Service Organisation
450	Evaluation of Misstatements Identified During the Audit
500-599	**Audit Evidence**
500	Audit Evidence
501	Audit Evidence- Specific Considerations for Selected Items
505	External Confirmations
510	Initial Audit Engagements- Opening Balances
520	Analytical Procedures
530	Audit Sampling
540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
550	Related Parties
560	Subsequent Events
570	Going Concern
580	Written Representations
600-699	**Using Work of Other**
600	Using the Work of Another Auditor
610	Using the Work of Internal Auditor
620	Using the Work of an Auditor's Expert

700-799	Audit Conclusions and Reporting
700	Forming an Opinion and Reporting on Financial Statements
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
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 Statements
810	Engagements to report on Summary Financial Statements
2000-2699	**Standards on Review Engagements (SREs)**
2400	Engagements to Review Financial Statements
2410	Review of Interim Financial Information Performed by the Independent Auditor of the Entity

All the above SAs are mandatory and the members performing audit is required to follow all the Standards. These SAs are like guide for members while performing the attest function of Audit and are very useful for members in various situations mentioned therein.

Its not possible to give details of all SAs in given time. We shall discuss SA on Reporting, grouped under 700-705 and 706.

All other SAs are on Audit procedures ie audit planning, risk assessment, obtaining evidence, etc. But SA in this group particularly SA700, 705 and 706 are on reporting. These have been made mandatory from last year itself, but discussion on audit report would be incomplete without proper understanding of SA on reporting.

Detailing on

700-799	Audit Conclusions and Reporting
700	Forming an Opinion and Reporting on Financial Statements
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

SA 700- FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

1. This standard covers the following:

(i) Form and content of independent auditor's report
(ii) Unmodified opinion(as modified opinion is now covered in SA 705 whereas EOM & OM paragraphs are covered in SA 706)

2. It is framed in the context of general purpose financial statements prepared in accordance with General Purpose Framework

OBJECTIVES:

- Forming an opinion on the financial statements based on conclusions drawn from evidences obtained.
- Expressing clearly that opinion (including basis thereof) through written report.

GENERAL PURPOSE FRAMEWORK:

This Financial Reporting framework (FRF) is used by many users. It may be of two types:

FAIR PRESENTAION FRAMENWORK: FRF that requires compliance with the requirements of FRF acknowledges that

- Management may provide disclosures beyond those specifically required by the framework
- Management may depart from a requirements of framework to achieve fair presentation of financial statements(in a very rare case)

COMPLIANCE FRAMEWORK: FRF requiring compliance with requirements of the framework but does not contain acknowledgement as above.

FORMING AN OPINION:

1. Auditor shall form an opinion as to whether the financial statements are prepared in accordance with applicable FRF.
2. To form such an opinion, he shall obtain reasonable assurance as to whether financial statements as a whole are free from material misstatements.
3. In forming such opinion he shall consider the following:

- Sufficiency and appropriateness of audit evidences
- Materiality of uncorrected misstatements
- Adequacy of disclosures in financial statements
- Consistency of Accounting policies with applicable FRF
- Reasonableness of Accounting Estimate
- Reliability & relevance of financial information
- Adequacy of disclosure of material transactions & events
- Appropriateness of terminology used in financial statements.

4. In case of fair presentation framework, he shall also consider :

- Overall presentation, structure and content of financial statements.
- Whether financial statements (including notes), represent the underlying transactions & events so as to achieve fair presentation.

EXPRESSION OF OPINION:

UNMODIFIED OPINION: When he concludes that financial statements are prepared, in all material respects, in accordance with applicable FRF and are free from any material mis-statement.

MODIFIED OPINION : When the auditor

(i) Concludes that financial statements as a whole are not free from material misstatements, or
(ii) Is unable to obtain sufficient & appropriate evidence to conclude that the financial statements as a whole are free from material misstatement. (Modified Opinion explained in detail in SA 705)

AUDITOR'S REPORT:

1. **TITLE :**
   - Clearly indicating that it is an "Independent Auditor's report".
   - So that it can be distinguished from the reports issued by others.
2. **ADDRESSEE:**
   - As per the circumstances applicable
   - For eg. In case of a company, it is addressed to the shareholders or members.

➢ **BIFURCATION OF PARAGRAPHS:**
- Introductory Paragraph
- Management's Responsibility For The Financial Statements
- Auditor's Responsibility
- Auditor's Opinion
- Report on other legal and Regulatory Requirements

3. **INTRODUCTORY PARAGRAPH:**
   - It includes the following:
     (i) Entity(client)
     (ii) Title of each component of financial statement
     (iii)Summary of Accounting Policies & explanatory information
     (iv)Date & period covered by each financial statement
     (v) Fact that financial statements have been audited.

4. MANAGEMENTS'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS:

- It describes the responsibility of management or persons who are responsible for preparation of financial statements.
- It states that management is responsible for:
  (i) Preparation of financial statement as per applicable FRF
  (ii) Design, implementation & maintenance of internal controls &
  (iii)Fair presentation of financial statement (in case, financial statements are prepared as per fair presentation framework)

5. AUDITOR'S RESPONSIBILITY:

This paragraph states that:

(i) Responsibility of auditor is to express an opinion on the financial statements;
(ii) Audit was conducted in accordance with SA issued by ICAI;
(iii) Auditor complied with ethical requirements;
(iv) Auditor obtained reasonable assurance as to whether financials statements are free from material misstatements;
(v) Audit involves procedures to obtain evidences about amounts & disclosures in financial statements;
(vi) Procedures depend on the auditor's judgement including Risk Assessment Procedure ;
(vii) Auditor considers internal controls but do not express opinion thereon.(If he is supposed to express opinion thereon, he shall omit this phrase)
(viii) Audit incudes evaluation of accounting policies, accounting estimates & overall presentation of financials statements; and
(ix) Auditor believes that audit evidences are sufficient & appropriate to provide the basis for auditor's report.

6. AUDITOR'S OPINION

While expressing unmodified opinion he shall use following:

(i) In case of fair presentation framework
- Financial statements present fairly in all material respects in accordance with [Applicable FRF]
- Financial statements give true & fair view in accordance with [Applicable FRF]

(ii) In case of compliance framework
- Financial statements are prepared in all material respects in accordance with [Applicable FRF]

7. OTHER REPORTING RESPONSIBILITIES:

- If there is any requirement, there shall be a separate heading "Report on other legal and Regulatory Requirements".
- For eg. CARO in case of audit of a company.

8. DATE OF AUDITOR'S REPORT:

It can't be earlier than the date on which:

(i) All components of financial statements have been prepared, &
(ii) Management have asserted that they have taken the responsibility for those financial statements.

9. PLACE OF SIGNATURE:

Specific location (The city where the audit report is signed)

10. SIGNATURE OF THE AUDITOR:

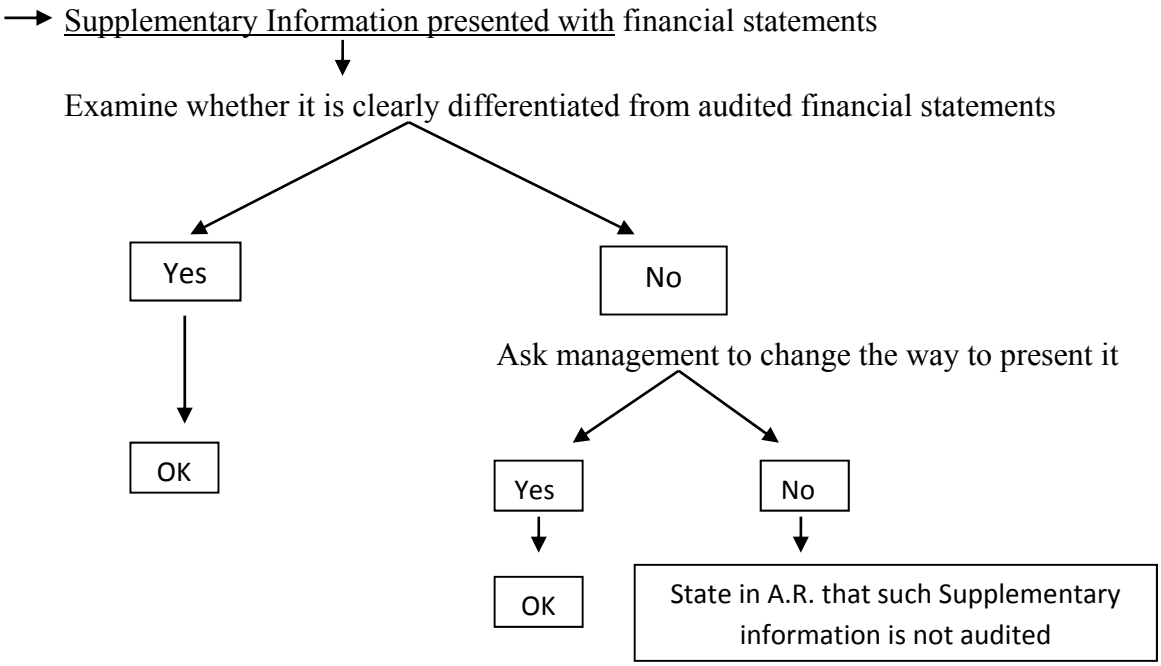
- In case of individual practitioner, it is signed in the personal name of auditor.
- Mention membership number of member in ICAI as well
- In case of firm, it is signed in personal name of Proprietor/Partner as well as in the name of the firm.
- Firm's registration number is also mentioned in this case.
-

- **AUDITOR'S REPORT UNDER SA/ISA:**

- If auditor's report is prescribed by law or regulation, then he shall refer to SA only if his report includes aforesaid elements.
- In case of audit conducted in accordance with both SA's and ISA's, then auditor's report may refer to ISA in addition to SA only if there is no conflict between requirements of both leading to different opinion or not to include EOM paragraph.

- **SUPPLEMENTARY INFORMATION PRESENTED WITH FINANCIAL STATEMENTS:**

- The auditor shall evaluate whether it is clearly differentiated from the audited financial statements.
- If not then he shall ask the management to change the way it is presented.
- If management refuses to do so, the auditor shall mention in the audit report that such supplementary information has not been audited.



SA 705 MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

SA 705 deals with the auditor's responsibility to issue appropriate report when auditor concludes that modification in Auditor's opinion on financial statements are necessary.

OBJECTIVES OF THE AUDITOR

To express clearly an appropriately modified opinion on the financial statements when the auditor
(a) Concludes, based on the evidences obtained that the financial statements as a whole are not free from material misstatements, or
(b) Is unable to obtain sufficient and appropriate evidences to conclude that financial statement s as a whole are free from material misstatements.

TYPES OF MODIFIED OPINION

(i) A Qualified opinion
(ii) An Adverse opinion
(iii) A Disclaimer of opinion

MEANING OF PERVASIVE

Pervasive is a term used in context off misstatements, to describe the effects or possible effects on the Financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient & appropriate audit evidence.

Pervasive effects on the financial statements are those that in the Auditor's judgments:

- Are not confined to specific elements, accounts or items of the financial statements,
- If so confined, represents or could represent a substantial proportion of the financial statements or,
- In relation to disclosures, are fundamental to users understanding o the financial statements

For eg. Misstatement w.r.t. sales will have effect throughout the financial statement & is pervasive. But in case of a particular debtor or creditor it will not be pervasive.

DETERMINING THE TYPE OF MODIFICATION:

Auditor's Judgment about the Pervasiveness of the effects or Possible effects on the Financial Statements will determine the type of modification i.e. qualified opinion, adverse opinion or disclaimer of opinion.

The above has been represented in the table below:

Nature of Matter giving Rise to the Modification	**Material but Not Pervasive**	**Material & Pervasive**
Financial Statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

FORM & CONTENT OF AUDITOS'S REPORT IN CASE OF MODIFIED OPINION:

"Basis for Modification" Para

- He shall in addition to SA 700, place this Para immediately before the opinion Para.
- Its heading is " Basis for _____ opinion" as appropriate.
- Here, he shall describe the matter giving rise to modification.
- It includes quantification of financial effects of matter under impracticable
- If not practicable to quantify, state this fact.

Wordings of Qualified opinion

Except for the **effects** of matter described in the "Basis for qualified opinion" Para,

(a) The financial statements present fairly, in all material respect (or give a true & fair view) in accordance with fair presentation framework , or
(b) The financial statements have been prepared in all material respect in accordance with compliance framework.
(Note: in case of Qualified opinion due to inability to obtain evidence the word "effects" shall be substituted by "possible effects")

Wordings of adverse opinion

"In the auditor's opinion because of significance of matters described the basis for adverse opinion Para,

(a) The financial statements do not present fairly (or give a true & fair view) in accordance with the fair presentation framework; or
(b) The financial statements have not been prepared, in accordance with compliance framework."

Wordings of disclaimer of opinion

"Because of significance of matter described in the basis for disclaimer" Para, the auditor has not been able to obtain sufficient appropriate evidence& thus, the auditor does not express an opinion or the financial statements."

Communication

- In case he expects to modify his opinion,

  He shall communicate the circumstances & proposed wordings to Those Charged With Governance(TCWG).

FORMAT OF A QUALIFIED OPINION

SITUATION: Inventories are misstated. Covered in the example regarding inventories u/s 143(3)

FORMAT OF AN ADVERSE OPINION

SITUATION: The financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. The effects of the mis-statement on the financial statements have not been determined because it was not practicable to do so. An adverse audit opinion isgiven under the circumstances.

INDEPENDENT AUDITORS' REPORT

TO.
THE MEMBERS OF XYZ LIMITED

Report on the Financial Statements

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

Adverse Opinion
In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India:
(a) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
(b) in the case of the consolidated Profit and Loss Account, of the profit/ loss for the year ended on that date; and
(c) in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date.

FORMAT OF A DISCLAIMER OF OPINION

SITUATION: The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was unable to obtain audit evidence about the entity's inventories and accounts receivable. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. A disclaimer of audit opinion is given in the circumstances.

INDEPENDENT AUDITORS' REPORT

TO.
THE MEMBERS OF XYZ LIMITED

Report on the Financial Statements
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Management's Responsibility for the Financial Statements

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Auditor's Responsibility

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Basis for Disclaimer of Opinion

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

In addition, the introduction of a new computerised accounts receivable system in September 20X0 resulted in numerous errors in accounts receivable. As of the date of our audit report, Management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of Rs. XXX as at March 31, 20X1.

As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable in the Balance Sheet, and the corresponding elements making up the Statement of Profit and Loss and Cash Flow Statement.

Opinion

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

SA 706 EMPHASIS OF MATTER PARAGRAPHS & OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

Objective

To draw user's attention by way of additional communication in the auditors report, to

- Matter appropriately incorporated in the financial statements, that is of such importance that it is fundamental to user's understanding of financial statements; or
- Any other matter (other than those in financial statements) relevant to users or auditor's responsibility or his report

Emphasis of Matter Para

Meaning

- Para which refers to a matter appropriately incorporated in the financial statements,
- That is of such importance that it is fundamental to user's understanding of financial statements

In audit report

Place it immediately after the opinion paragraph in auditor's report

Heading

"Emphasis of matter"

It includes

- Clear reference to the matter being emphasized; and
- Where exactly it can be found in the financial statements.
- **Clarification by auditor: Indicate** that the auditor's opinion is not modified in respect of the matter emphasised. (The report is not modified or qualified).

Examples where EOM may be necessary

(i) Substantial doubt about going concern properly disclosed in financial statements.
(ii) Material change in the accounting policy
(iii) Early application of a new accounting standard.
(iv) Uncertainty relating to a pending litigation, properly disclosed in the financial statements by the management.

"Other Matter" Para

Meaning

- Para relating to matter
- Other than those in financial statements
- Which is relevant to
- User's understanding or auditor's responsibility or his report.

In Audit report

After "opinion "Para & any " Emphasis of matter " Para

Heading

"Other Matter"

Examples where it is necessary

In case of consolidation, Valuation of investment in subsidiary where investment is substantial but auditor has neither audited not received audit report for the same.

Communication with TCWG

If auditor expects to include an EOM or OM paragraph, he shall communicate the same to those with governance (TCWG).

Example of AUDIT REPORT CONTAINING EMPHASIS OF MATTER PARAGRAPH:

Situation/ Circumstance as follows:

Audit of a complete set of separate general purpose financialstatements of a company prepared under the Companies Act, 1956financial reporting framework.

There is uncertainty relating to a pending exceptional litigationmatter. The Auditor has decided to highlight this in the auditor's report by an Emphasis ofMatter paragraph.

Inventories are misstated. The misstatement is deemed to be materialbut not pervasive to the financial statements. The audit opinion isqualified for the misstatement.

In addition to the audit of financial statements, the auditor has otherreporting responsibilities required under the Companies Act, 1956and/or other regulatory requirements.

INDEPENDENT AUDITORS' REPORT
TO.
THE MEMBERS OF XYZ LIMITED

Report on the Financial Statements

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Management's Responsibility for the Financial Statements

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Auditor's Responsibility

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Basis for Qualified Opinion

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

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Act in the manner so required and give a true and fairview in conformity with the accounting principles generally accepted in India:
(a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
(b) in the case of the Profit and Loss Account, of the profit/ loss for the year ended on that date; and
(c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Emphasis of Matter

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

Report on Other Legal and Regulatory Requirements

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Example of Other matters Para in Auditor's Report

Situation/ Circumstance as follows:

Audit of a complete set of consolidated general purpose financial statements of a parent company prepared under accounting principles generally accepted in India, as required for compliance with SEBI'sregulatory requirement, which is a fair presentation framework.

 The report includes an Other Matter paragraph in respect of the auditor's responsibility in respect of subsidiaries not audited by him but which form part of the consolidated financial statements under the report.

Opinion

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

(a) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at Mar 31, 20XX;
(b) in the case of the Profit and Loss Account, of the profit/ loss for the year ended on that date; and
(c) in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date.

Other Matter

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

Report on Other Legal and Regulatory Requirements

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4. Audit Report Format including

Standalone : Unmodified

Modified: Qualified Opinion, Adverse Opinion, Disclaimer Opinion (Examples already discussed under SA 705)

Report on Consolidated Financial Statements (CFS)

CARO 2015.: To be dealt in next Presentation

Suggested AUDIT REPORT FORMAT:
Unmodified Report (on Standalone FS)

INDEPENDENT AUDITORS' REPORT

TO.
THE MEMBERS OF XYZ LIMITED

Report on the Financial Statements

We have audited the accompanying financial statements of XYZ LIMITED ("the company"), which comprise the Balance Sheet as at 31 March 2015, the Statement of Profit and Loss, the Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

The Company's Board of Directors is responsible for the matters in section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014. This responsibility also includes the maintenance of adequate accounting records in accordance with the provision of the Act for safeguarding of the assets of the Company and for preventing and detecting the frauds and other irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of internal financial control, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these standalone financial statements based on our audit.

We have taken into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of the Act and the Rules made thereunder.

We conducted our audit in accordance with the Standards on Auditing specified under section 143(10) of the Act. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal financial control relevant to the Company's preparation of the financial statements that give true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on whether the Company has in place an adequate internal financial controls system over financial reporting and the operating effectiveness of such controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by Company's Directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid standalone financial statements, give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India;

a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 2015;
b) in the case of the Statement of Profit and Loss, of the profit for the year ended on that date; and
c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Report on other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2015 ("the Order) issued by the Central Government in terms of Section 143 (11) of the Act, we give in the Annexure a statement on the matters specified in paragraphs 3 and 4 of the Order.

2. As required by section 143(3) of the Act, we report that:

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

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

c) The reports on the accounts of the branch offices of the Company audited under sub-section (8) by a person other than Company's Auditor has been sent to him under the provision to that sub-section and have been properly dealt with us in preparing our report.

d) the Balance Sheet, the Statement of Profit and Loss, and Cash Flow Statement dealt with by this Report are in agreement with the books of account **and returns**

e) In our opinion, the aforesaid standalone financial statements comply with the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014.

f) On the basis of written representations received from the directors as on 31 March, 20XX, taken on record by the Board of Directors, none of the directors is disqualified as on 31 March, 20XX, from being appointed as a director in terms of Section 164(2) of the Act.

g) With respect to the other matters to be included Auditor's report in accordance with Rule 11 of the Companies (Audit & Auditors) Rule 2014 in our opinion & to the best of our information and according to the explanations given to us :

i. The Company does not have any pending litigations which would impact its financial position.

ii. The company did not have any long term contracts including derivative contracts for which there were any material foreseeable losses.

iii. There were no amounts which were required to be transferred to the Investor Education and Protection Fund by the Company.

FOR ABC & ASSOCIATES
Chartered Accountants
Firm Reg. No. XXXXXXX

PARTNER
Membership No. XXXXX
Place:
Dated:

Report on Modified opinion (that is qualified opinion, adverse opinion or Disclaimer of opinion) **already discussed in SA 705.**

Suggested AUDIT REPORT FORMAT: CFS

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF ABC COMPANY LIMITED

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of ABC Company Limited which comprise the consolidated Balance sheet as at 31st March, 20XX, the consolidated Statement of profit & loss and consolidated Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements & plan & perform

the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and the disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal financial control relevant to the Holding Company's preparation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on whether the Holding Company has an adequate internal financial controls system over financial reporting in place and the operating effectiveness of such controls. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of the accounting estimates made by the Holding Company's Board of Directors, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion and to the best of our information and according to the explanations given to us, the consolidated financial statements give a true and fair view in conformity with the accounting principles generally accepted in India,
(a) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
(b) in the case of the consolidated Profit and Loss Account, of the profit/ loss for the year ended on that date; and
(c) in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

(i) As required by the Companies (Auditor's Report) Order, 2015 ("the Order"), issued by the Central Government of India in terms of sub-section (11) of Section 143 of the Act, based on the comments in the auditors' reports of the Holding company, subsidiary companies, associate companies and jointly controlled companies incorporated in India, we give in the Annexure a statement on the matters specified in paragraphs 3 and 4 of the Order, to the extent applicable.

Place of Signature:
Date:

For XYZ & Company
Chartered Accountants
(Firm's Registration No.)

Signature
(Name of the Member Signing the Audit Report)
(Designation5)
(Membership No. XXXXX)

NOTES/ QUESTIONS

Recent Changes in Auditor's Report

MULUND CA CPE STUDY CIRCLE OF WIRC OF ICAI : Lecture meeting on 14.06.2014

CA BIPEEN G. MUNDADE

CEL-9223290561, eMail: bipeen@bgmca.com

THANK YOU