

KEY TOPICS UPDATED FOR MAY 2021

- **CARO ,2020**
- **CODE OF ETHICS 2020 (OVERVIEW)**
- **PEER REVIEW**
- **QUALITY REVIEW (New Syllabus Only)**
- **MISCELLANEOUS Topics**

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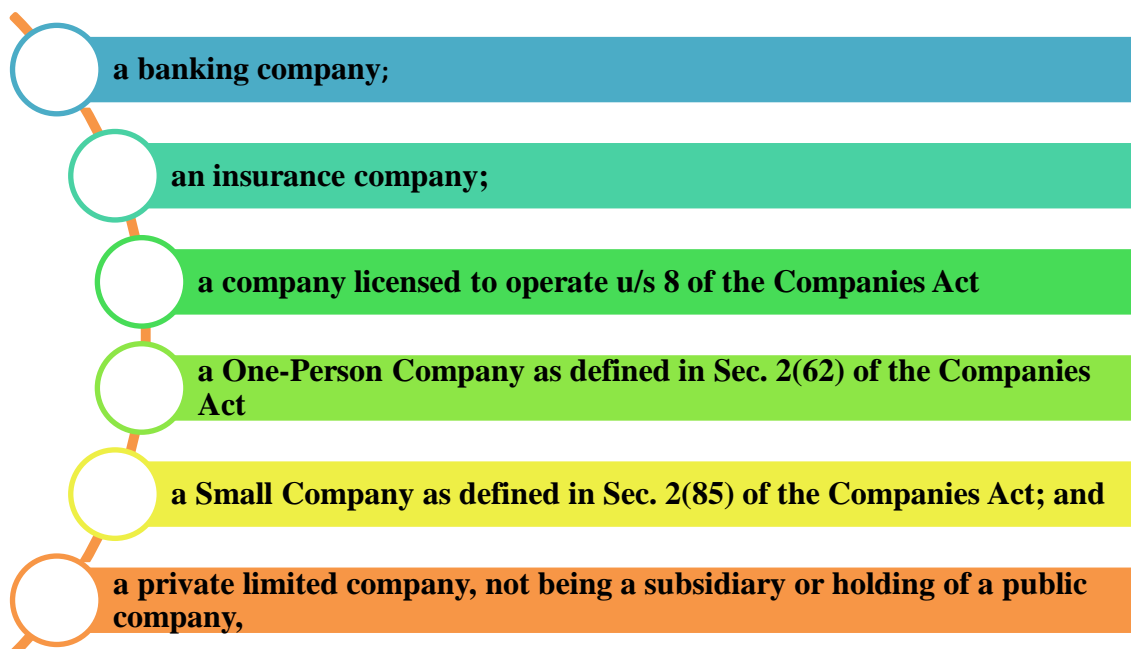
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1. Reporting Under CARO, 2020

In exercise of the powers conferred by section 143(11) of the Companies Act, 2013, the Central Government, after consultation with the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013, has issued the Companies (Auditor's Report) Order, 2020, (CARO, 20) dated 25th February 2020. Its applicability is from **FY 2020-21 onwards**.

1. Applicability of Companies (Auditor Report) Order, 2020

The CARO, 2020 is an additional reporting requirement. **The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013.** However, the Order specifically **exempts the following classes of companies:**



- having a Paid-up capital & Reserves & Surplus **not more than ₹1 Cr. as on the balance sheet date, and**
- which does not have total borrowings **exceeding ₹1 Cr.** from any bank or financial institution **at any point of time during the financial year, and**
- which does not have a **total revenue** as disclosed in Schedule III to the Companies Act, 2013 (including revenue from discontinuing operations) **exceeding ₹10 Cr. during the financial year** as per the financial statements.

Important points to be remembered while studying applicability of CARO 2016

1. This order is an order on the auditor's of the company.
2. CARO is not applicable to Audit Report of Consolidated Financial Statement.
3. CARO is applicable to Branch Auditor's.
4. NBFC's are not exempted from applicability of CARO.
5. Private Limited Companies are also not exempted from the purview of CARO.
6. While computing Paid up Share Capital for the applicability of CARO, the following points must be kept in mind:
 - To be exempt from applicability of CARO, a Private Limited Company should have Paid up Capital and Reserves & Surplus not more than 1 crore as on Balance Sheet Date.
 - Paid up share capital includes Equity Share Capital and Preference Share Capital.
 - Share application money is not considered part of capital.
 - While calculating Paid up Capital, amount of calls unpaid should be deducted therefrom, and amount originally Paid-up on Forfeited Shares should be added to the figure of Paid-Up Capital.

Definitions of PSC:

- a) **Sec.2(64): "Paid –Up Capital"** means aggregate amount of money credited as paid-up is equivalent to the amount received as paid up in respect of Shares issued. It also includes any amount credited as paid up in respect of shares of the Company.
 - b) **ICAI Guidance Note:** Paid –Up Share Capital means that part of the Subscribed Share Capital for which consideration in Cash or otherwise has been received. This includes Bonus Shares allotted by the Corporate Enterprises.
7. While computing **Borrowings** for the applicability of CARO , the following points must be kept in mind:
- To be exempt from applicability of CARO, a Private Limited Company should have Borrowings not more than 1 crore at any point of time during the Financial Year.
 - All types of Borrowings from Banks and Financial Institution are to be considered . (**Short Term, Long Term ,Overdraft facility, Cash Credit, Dues in respect of credit card etc.**)
 - The term "Banks" includes Private Banks and Foreign Banks also as per Banking Regulations Act, 1949.
 - The term "Financial Institution" used in CARO includes a Scheduled Bank and

NBFC's.

8. While computing Total Revenue for the applicability of CARO , the following points must be kept in mind:

- To be exempt from applicability of CARO, a Private Limited Company should have Revenue as per Schedule 3 not more than 10 crores at any time during the Financial Year.
- The term "Revenue" shall include not only Sale of goods and services but also include other incomes like sale of scrap, interest on investment etc.
- All sales returns are to be deducted from Sales for the purpose of CARO and Tax Audit.
- Indirect Taxes are to be included in Revenue as Sales if inclusive method of accounting are to be followed and not to be included if exclusive method of accounting is followed. {If question is silent, assume that exclusive method of accounting is followed.}

2. Auditor's report to contain matters specified in paragraphs 3 and 4 -

Every report made by the auditor u/s 143 of the Companies Act, 2013 on the accounts of every company examined by him to which this Order applies for the financial years commencing on or after 1st April 2020, shall contain the matters specified in paragraphs 3 and 4, as may be applicable.

The Order shall not apply to the auditor's report on consolidated financial statements except Para 3(xxi).

3. Matters to be included in the auditor's report

The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-

Sr.no.	Details	
[Para 3(i) Property, Plant and Equipment]	Adequacy of Records	(a) (A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment. (B) whether the company is maintaining proper records showing full particulars of intangible assets;
	Physical verification	(b) whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals ; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

	Title Deeds	(c) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format below:-												
	<table border="1"> <thead> <tr> <th><i>Description of property</i></th> <th><i>Gross carrying value</i></th> <th><i>Held in name of</i></th> <th><i>Whether promoter, director or their relative or employee</i></th> <th><i>Period held - indicate range, where appropriate</i></th> <th><i>Reason for not being held in name of company*</i></th> </tr> </thead> <tbody> <tr> <td>-</td> <td>-</td> <td>-</td> <td>-</td> <td>-</td> <td><i>*also indicate if in dispute</i></td> </tr> </tbody> </table>	<i>Description of property</i>	<i>Gross carrying value</i>	<i>Held in name of</i>	<i>Whether promoter, director or their relative or employee</i>	<i>Period held - indicate range, where appropriate</i>	<i>Reason for not being held in name of company*</i>	-	-	-	-	-	<i>*also indicate if in dispute</i>	
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-	-	-	-	-	<i>*also indicate if in dispute</i>									
	Revaluation of Property, Plant and Equipment	(d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;												
	Proceedings, if any against the company for holding Benami Property	(e) whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements;												
[Para 3(ii)] Inventories	Physical Verification	(a) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any												

		discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account.
	Working Capital Limit	(b) whether during any point of time of the year , the company has been sanctioned working capital limits in excess of ₹5 crore, in aggregate , from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details.
[Para 3(iii)] Investments, Guarantee / Security, Loans or Advances		(iii) whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so,-
		(a) whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans] , if so, indicate- (A) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates; (B) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates;
		(b) Whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest;

		(c) in respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;
		(d) if the amount is overdue, state the total amount overdue for more than ninety days , and whether reasonable steps have been taken by the company for recovery of the principal and interest.
		(e) whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, if so, specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];
		(f) whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013.
Para 3(iv) Compliance of provisions of Sec. 185 & 186		(iv) in respect of loans, investments, guarantees, and security, whether provisions of sections 185 and 186 of the Companies Act have been complied with, if not, provide the details thereof.
[Para 3(v)] Public Deposits		(v) in respect of deposits accepted by the company or amounts which are deemed to be deposits , whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules made thereunder, where applicable, have been complied with, if not, the nature of such contraventions be stated; if an order has been

		passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not;
[Para 3(vi)] Cost Records		Whether maintenance of cost records has been specified by the CG u/s 148(1) of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.
[Para 3(vii)] Statutory Dues		(a) Whether the company is regular in depositing undisputed statutory dues including Goods and Service Tax , provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than 6 months from the date they became payable, shall be indicated. (b) Where statutory dues referred above have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).
Para 3(viii) Unrecorded Income		(viii) whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year;
Para 3(ix) Repayment of Dues.		(ix) (a) whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below:-

<i>Nature of borrowing, including debt securities</i>	<i>Name of lender*</i>	<i>Amount not paid on due date</i>	<i>Whether principal or interest</i>	<i>No. of days delay or unpaid</i>	<i>Remarks, if any</i>
	<i>*lender-wise details to be provided in case of defaults to banks, financial institutions and Government.</i>				
		<p>(b) whether the company is a declared wilful defaulter by any bank or financial institution or other lender;</p> <p>(c) whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported;</p> <p>(d) whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated;</p> <p>(e) whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case;</p> <p>(f) whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised;</p>			
Para 3(x) Application of Money raised by public issue	Application of Money raised by public issue	(x)(a) whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the			

and preferential allotment		details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;
	Preferential allotment	(b) whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially, or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance.
[Para 3(xi)] Fraud		(xi)(a) whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated. (b) whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government. (c) whether the auditor has considered whistle-blower complaints , if any, received during the year by the company.
Para 3(xii) Nidhi Companies		(xii)(a) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability. (b) whether the Nidhi Company is maintaining ten per cent. unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability. (c) whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof.
Para 3(xiii) Transactions with related Parties		(xiii) whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act where applicable and the details have been disclosed in the financial statements, etc.,

		as required by the applicable accounting standards;
Para 3(xiv) Internal Audit System		(xiv) (a) whether the company has an internal audit system commensurate with the size and nature of its business. (b) whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor;
Para 3(xv) Non cash transactions with directors		(xv) whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with.
Para 3(xvi) Registration. with RBI		(xvi) (a) whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 (2 of 1934) and if so, whether the registration has been obtained. (b) whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934. (c) whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria. (d) whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group.
Para 3(xvii) Cash Losses		(xvii) whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses;
Para 3(xviii) Considerations of issues raised by outgoing auditor		(xviii) whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors;

<p>Para 3(xix) Existence of Material uncertainty as to company ability to meet its liabilities</p>		<p>(xix) on the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date;</p>
<p>Para 3(xx) Transfer of unspent CSR amount</p>		<p>(xx) (a) whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act. (b) whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of sub-section (6) of section 135 of the said Act.</p>
<p>Para 3(xxi) Qualifications or adverse remarks in CARO Reports of group companies</p>		<p>(xxi) whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements, if yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.</p>

4. Reasons to be stated for unfavourable or qualified answers-

(a) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is **unfavourable or qualified**, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.

(b) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

Questions on CARO 2020

1. Physical verification of only 30% (in value) of items of inventory has been conducted by the company. The balance 70% will be conducted in next year due to lack of time and resources.

Reporting for Physical Verification of Inventory: clause (ii) of Para 3 of CARO, 2020 requires the auditor to state in his report whether physical verification of inventory has been conducted at reasonable interval by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate. What constitutes “reasonable intervals” depends on circumstances of each case. The periodicity of the physical verification of inventories depends upon the nature of inventories, their location and the feasibility of conducting a physical verification. The management of a company normally determines the periodicity of the physical verification of inventories considering these factors. Normally, wherever practicable, all the items of inventories should be verified by the management of the company at least once in a year. The auditor in order to satisfy himself about verification at reasonable intervals and about coverage and procedures applied, should examine the adequacy of evidence and records of verification.

In the given case, the management conducted the physical verification of inventory only upon 30% (in value) of the total inventory for the reason of lack of time and resources. The above requirement of CARO, 2020 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedures of inventory verification are inadequate and unreasonable. He may also consider the impact on financial statements and report accordingly.

2. K Ltd. took a term loan from a nationalized bank in 2015 for ₹ 200 lakhs repayable in five equal instalments of ₹ 40 lakhs from 31st March 2016 onwards. It repaid the loans due in 2016 & 2017, but defaulted in 2018, 2019 & 2020. As the auditor of K Ltd, what is your responsibility assuming that company has sought reschedulement of loan?

Reporting for Default in Repayment of Dues: As per clause (ix) of Para 3 of CARO, 2020, the auditor of a company has to report whether the Company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, and if yes, the nature of borrowing, name of lender, period and amount of default to be reported. The Auditor is also required to report whether the company is a declared wilful defaulter by any bank or financial institution or other lender.

In this case, K Ltd. has defaulted in repayment of dues for three years. Application for rescheduling will not change the default position. Hence, the auditor shall report in his CARO report that the Company has defaulted in its repayment of dues to the bank to the extent of ₹ 120 lakhs and evaluate its consequential impact on the audit report as well.

3. LM Ltd. had obtained a term loan of ₹ 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in short term deposits.

Term loan invested in short term deposits: As per clause (ix) of Para 3 of CARO, 2020, an auditor needs to state in his report that whether the term loans were applied for the purpose for which the loans were obtained.

In the present case, the proceeds of the term loan obtained by LM Ltd. have not been put to use for construction activities and have been temporarily invested in short term deposit.

Here, the auditor should report the fact in his report that pending utilization of the term loan for construction of a factory, the funds were temporarily used for the purpose other than the purpose for which the loan was sanctioned, as per clause (ix) of Para 3 of CARO, 2020.

4. For the purpose of assessing applicability of CARO, what kind of loans need to be considered?

Borrowings from banks or financial institutions can be long term or short term and are normally in the form of term loans, demand loans, export credits, cash credits, overdraft facilities, bills purchased or discounted. Outstanding balances of such borrowings should be considered as borrowing outstanding for the purpose of computing the limit of rupees one crore. Non-fund based credit facilities, to the extent such facilities have devolved and have been converted into fund-based credit facilities, should also be considered as outstanding borrowings. The figures of outstanding borrowing would also include the amount of bank guarantees issued by the company where such guarantee(s) has (have) been invoked and encashed or where, say, a letter of credit has been devolved on the company. In case of term loans, interest accrued and due is considered as a borrowing whereas interest accrued but not due is not considered as a borrowing. Further, in case the company enjoys a facility, say, a cash credit facility, whose balance is fluctuating in nature, the Order would apply to the company in case on any day during the financial year concerned, the amount outstanding in the cash credit facility exceeds Rs. one crore as per books of the company along with other borrowings. The aggregate borrowings disclosed in the financial statements would need to be considered based on applicable generally accepted accounting principles in India (Ind AS/ AS).

5. Whether CARO is Applicable to the auditor of consolidated financial statement?

Order shall not apply to the auditor's report on consolidated financial statements except clause (xxi) of paragraph 3.

6. What documents constitute title deed?

Following documents mainly constitute title deeds of the immovable property:-

- (i) Registered sale deed / transfer deed / conveyance deed, etc. of land, land & building together, etc. purchased, allotted, transferred by any person including any government, government authority / body / agency/ corporation, etc. to the company.
- (ii) In case of leasehold land and land & buildings together, covered under the head property,

plant and equipment (fixed assets), the lease agreement duly registered with the appropriate authority.

7. Should the auditor examine the cost record in detail while reporting under CARO?

CARO does not require a detailed examination of Cost Records. The Auditor should, therefore, conduct a general review of Cost Records to ensure that the records as prescribed are made and maintained. The word "made" applies in respect of Cost Accounts, and the word "maintained" applies in respect of Cost Records relating to Materials, Labour, Overheads, etc.

2. OVERVIEW OF THE CODE OF ETHICS

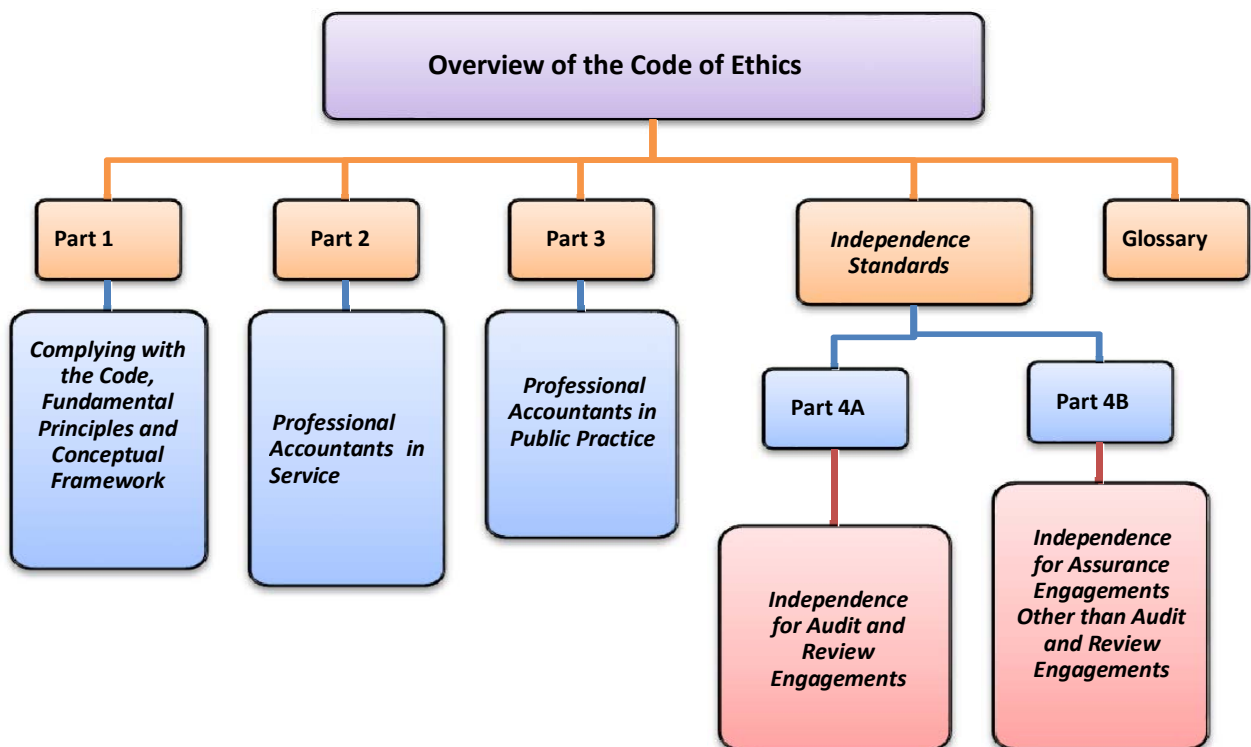
The revised Code of Ethics contains the following material:

- **Part 1 – Complying with the Code, Fundamental Principles and Conceptual Framework**, which includes the fundamental principles and the conceptual framework and is applicable to all professional accountants.
- **Part 2 – Professional Accountants in Service**, which sets out additional material that applies to professional accountants in service when performing professional activities. Professional accountants in service include professional accountants employed, engaged or contracted in an executive or non-executive capacity in, for example:
 - o Commerce, industry or service.
 - o The public sector.
 - o Education.
 - o The not-for-profit sector.
 - o Regulatory or professional bodies.

Part 2 is also applicable to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm as an employee.

- **Part 3 – Professional Accountants in Public Practice**, which sets out additional material that applies to professional accountants in public practice when providing professional services.
- **Independence Standards**, which sets out additional material that applies to professional accountants in public practice when providing assurance services, as follows:

- o **Part 4A – Independence for Audit and Review Engagements**, which applies when performing audit or review engagements.
- o **Part 4B – Independence for Assurance Engagements Other than Audit and Review Engagements**, which applies when performing assurance engagements that are not audit or review engagements.
- Glossary, which contains defined terms (together with additional explanations where appropriate) and described terms which have a specific meaning in certain parts of the Code. For example, as noted in the Glossary, in Part 4A, the term “audit engagement” applies equally to both audit and review engagements. The Glossary also includes lists of abbreviations that are used in the Code and other standards to which the Code refers.



The Code contains sections which address specific topics. Some sections contain subsections dealing with specific aspects of those topics.

Each section of the Code is structured, where appropriate, as follows:

- **Introduction** – sets out the subject matter addressed within the section, and introduces the requirements and application material in the context of the conceptual framework. Introductory material contains information,

including an explanation of terms used, which is important to the understanding and application of each Part and its sections.

- ▮ **Requirements** – establish general and specific obligations with respect to the subject matter addressed.
- ▮ **Application material** – provides context, explanations, suggestions for actions or matters to consider, illustrations and other guidance to assist in complying with the requirements.

A professional accountant shall comply with the Code. There might be circumstances where laws or regulations preclude an accountant from complying with certain parts of the Code. In such circumstances, those laws and regulations prevail, and the accountant shall comply with all other parts of the Code.

2.1 Fundamental Principles

In order to achieve the objectives of the Accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles. The fundamental principles as discussed in Code of Ethics of ICAI, to be complied, are given below:



(a) Integrity – Subsection 111

1.A professional accountant shall comply with the principle of integrity, **which requires an accountant to be straightforward and honest** in all professional and business relationships. Integrity implies fair dealing and truthfulness.

2.A professional accountant shall not knowingly be **associated with** reports, returns, communications or other information where the accountant believes that the information:

- (a) Contains a materially false or misleading statement.
- (b) Contains statements or information provided negligently; or
- (c) Omits or obscures required information where such omission or obscurity would be misleading.

However, a professional accountant will not be considered to be in breach of matters mentioned above in paragraph 2 if the professional accountant provides a modified report in respect of such above mentioned matter.

3. When a professional accountant becomes aware of having been associated with information described in paragraph 2, **the accountant shall take steps to be disassociated from that information.**

(b) Objectivity- Subsection 112

A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.

A professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.

(c) Professional Competence and Due Care – Subsection 113

1. A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:
 - (a) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
 - (b) act diligently in accordance with applicable technical and professional standards.
2. Serving clients and employing organizations with professional competence requires **the exercise of sound judgment** in applying professional knowledge and **skill** when undertaking professional activities.
3. Maintaining professional competence requires a **continuing awareness** and an **understanding** of relevant **technical, professional and business developments.**

4. **Continuing professional development** enables a professional accountant to **develop** and **maintain** the **capabilities** to perform competently within the professional environment.
5. **Diligence** encompasses the **responsibility to act** in accordance with the **requirements** of an assignment, **carefully, thoroughly** and on a **timely** basis.
6. In **complying** with the **principle of professional competence and due care**, a professional accountant shall take reasonable steps to ensure that those working in a professional capacity under the accountant's authority have appropriate training and supervision.

Where appropriate, a professional accountant shall make clients, the employing organization, or other users of the accountant's professional services or activities, aware of the limitations inherent in the services or activities.

(d) Confidentiality- Subsection 114

1. A professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and employment relationships. An accountant shall:

Be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to a close business associate or an immediate or a close family member;

Maintain confidentiality of information within the firm or employing organization;

Maintain confidentiality of information disclosed by a prospective client or employing organization;

Not disclose confidential information acquired as a result of professional and employment relationships outside the firm or employing organization without proper and specific authority, unless there is a legal or professional duty or right to disclose;

Not use confidential information acquired as a result of professional and employment relationships for the personal advantage of the accountant or for the advantage of a third party;

Not use or disclose any confidential information, either acquired or received as a result of a professional or employment relationship, after that relationship has ended; and

Take reasonable steps to ensure that personnel under the accountant's control, and individuals from whom advice and assistance are obtained, respect the accountant's duty of confidentiality.

2. Confidentiality serves the public interest because it facilitates the free flow of

information from the professional accountant's client or employing organization to the accountant in the knowledge that the information will not be disclosed to a third party. Nevertheless, the following are circumstances where professional accountants are or might be required to disclose confidential information or when such disclosure might be appropriate:

- (a) **Disclosure is required by law, Example :**
- Production of documents or other provision of evidence in the course of legal proceedings.
 - Disclosure to the appropriate public authorities of infringements of the law that come to light
- (b) Disclosure is **permitted by law and is authorized by the client** or the employing organization;
- (c) There is a **professional duty or right to disclose**, when not prohibited by law:
- (i) To comply with the requirements of Peer Review or Quality Review of the Institute;
 - (ii) To **respond** to an inquiry or investigation by a professional or regulatory body;
 - (iii) To **protect** the professional interests of a professional accountant in legal proceedings; or
 - (iv) To **comply with technical and professional standards**, including ethics requirements.

3. In deciding whether to disclose confidential information, professional accountants should consider the following points:

a) **Whether the interests of any party, including third parties whose interests might be affected, could be harmed if the client or employing organization consents to the disclosure of information by the professional accountant;**

b) Whether all the relevant information is known and substantiated, to the extent it is practicable; and

c) The proposed type of communication, and to whom it is addressed;

d) Whether the parties to whom the communication is addressed are appropriate recipients.

4. **A professional accountant shall continue to comply with the principle of confidentiality even after the end of the relationship between the accountant and a client or employing organization. When changing employment or acquiring a new client, the accountant is entitled to use prior experience but shall not use or disclose any confidential information acquired or received as a result of a professional or employment relationship.**

(e) Professional Behaviour- Subsection 115

1. A professional accountant shall comply with the principle of professional behaviour, which requires an accountant to comply with relevant laws and regulations and avoid any **conduct** that accountant knows or should know might discredit the profession.

Conduct that might discredit the profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession.

A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

2. When promoting himself and his work, a professional accountant shall not bring the profession into disrepute. A professional Accountant is required to conduct his affairs in a manner that he remains outside the boundaries of professional and other misconduct. A professional accountant shall be honest and truthful and should not make:

(a) Exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained; or

(b) Disparaging references or unsubstantiated comparisons to the work of others.

(c) Any direct or indirect measures to advertise any professional/other facts which are in violation of Advertisement Guidelines issued by the Council of the Institute from time to time.

The professional accountant should ensure that the contents of an advertisement are true to the best of his knowledge and belief, and are in conformity with the Advertisement Guidelines, and be aware that the Institute does not own any responsibility, whatsoever, for such contents or claims by him. **However, if a professional accountant is in doubt about whether a form of proposed advertising is appropriate, the accountant is encouraged to consult with the Ethical Standards Board of ICAI.**

A professional accountant shall comply with each of the fundamental principles.

The fundamental principles of ethics establish the standard of behaviour expected of a professional accountant.

The conceptual framework establishes the approach which an accountant is required to apply to assist in complying with those fundamental principles.

A professional accountant might face a situation in which complying with one fundamental principle conflicts with complying with one or more other fundamental principles. In such a situation, the accountant might consider consulting, with:

- **Others within the firm or employing organization**
- **Those charged with Governance(TCWG)**
- **The Institute**
- **Legal Counsel**

However, such consultation does not relieve the accountant from the responsibility to exercise professional judgment to resolve the conflict or, if necessary, and unless prohibited by law or regulation, disassociate from the matter creating the conflict.

The professional accountant is encouraged to document the substance of the issue, the details of any discussions, the decisions made and the rationale for those decisions.

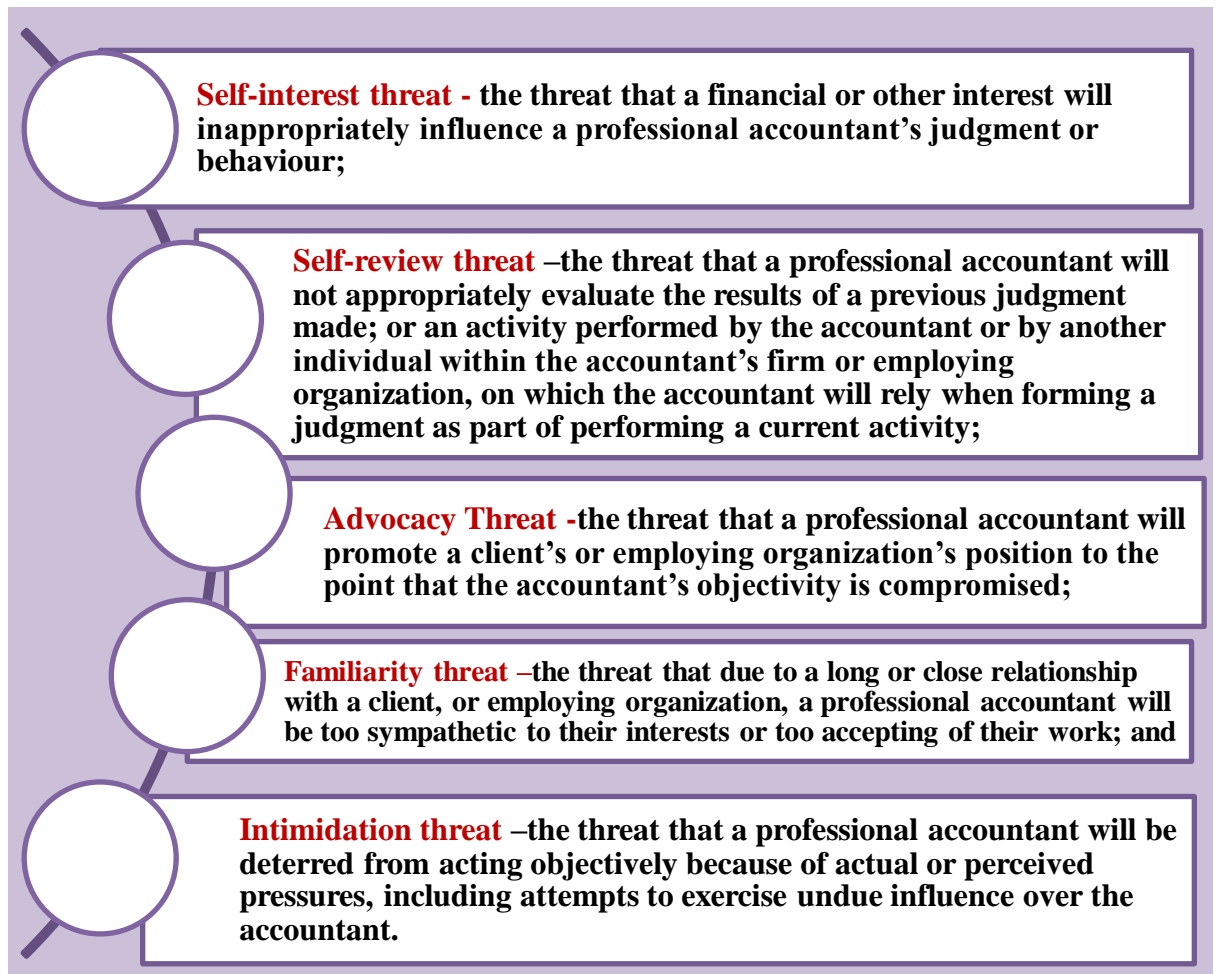
2.2 Threats, Evaluation of Threats and Safeguards

The conceptual framework specifies an approach for a professional accountant to:

- (i) Identify threats to compliance with the fundamental principles;**
- (ii) Evaluate the threats identified; and**
- (iii) Address the threats by eliminating or reducing them to an acceptable level.**

A. Threats

Threats to compliance with the fundamental principles fall into one or more of the following categories:



Circumstances that may create self-interest threats

- Having a direct **financial interest** in a client
- **Undue dependence** on total fees from a client.
- Having a **close business relationship** with a client.
- Concern about the **possibility of losing** a client.
- **Potential employment** with a client.
- Having access to confidential information of the client that **might be used for personal gain.**

Examples of Circumstances that may create Self Review Threat

- A loan to or from an assurance client or any of its directors or officers
- A professional accountant holding a financial interest in, or receiving a loan or guarantee from, the employing organization.
- A professional accountant participating in incentive compensation arrangements offered by the employing organization.
- A professional accountant having access to corporate assets for personal use.
- A professional accountant being offered a gift or special treatment from a supplier of the employing organization.

Examples of circumstances that may create advocacy threats:

- Promoting shares in an **entity** when that entity is a financial statement audit client.
- Acting as an advocate on behalf of an assurance client in **litigation or disputes** with third parties.
- Lobbying in favor of legislation on behalf of a client.

Examples of circumstances that may create familiarity threats

1. A member of the engagement team having a **close or immediate family relationship** with a director or officer of the client.
2. A member of the engagement team having a close or immediate family relationship with an employee of the client who is in a position to exert direct and significant influence over the subject matter of the engagement.
3. A former partner of the firm being a director or officer of the client or an employee in a position to exert direct and significant influence over the subject matter of the engagement.
4. Long association of an audit team member with the audit client.

Examples of circumstances that may create intimidation threats

- Being threatened with dismissal or replacement in relation to a client engagement because of a disagreement about a professional matter.
- Being feeling pressured to agree with the judgment of a client because the client has more expertise on the matter in question.
- Being informed that a planned promotion will not occur unless the accountant agrees with an inappropriate accounting treatment.

Specific circumstances give rise to unique threats to compliance with one or more of the fundamental principles. Such unique threats cannot be categorized. In either professional or business relationships, a professional accountant in public practice should always be on the alert for such circumstances and threats.

B. Evaluation of Threats:

The conditions, policies and procedures described above might impact the evaluation of whether a threat to compliance with the fundamental principles is at an acceptable level.

- (i) **Acceptable level** : An acceptable level is a level at which a professional accountant using the reasonable and informed third party test would likely conclude that the accountant complies with the fundamental principles.
- (ii) **Reasonable and Informed Third Party** : The reasonable and informed third party test is a consideration by the professional accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time the conclusions are made. The reasonable and informed third party does not need to be an accountant but would possess the relevant knowledge and experience to understand and evaluate the appropriateness of the accountant's conclusions in an impartial manner.

C. Addressing Threats

If the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the accountant shall address the threats by eliminating them or reducing them to an acceptable level. The accountant shall do so by:

- (i) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (ii) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- (iii) Declining or ending the specific professional activity.

Actions to Eliminate Threats : Depending on the facts and circumstances, a threat might be addressed by eliminating the circumstance creating the threat. However, there are some situations in which threats can only be addressed by declining or ending the specific professional activity. This is because the circumstances that created the threats cannot be eliminated and safeguards are not capable of being applied to reduce the threat to an acceptable level.

D. Safeguards :

Safeguards are actions individually or in combination that the accountant takes that effectively reduce threats to an acceptable level. Safeguards vary depending on the facts and circumstances. **Examples of actions that in certain**

circumstances might be safeguards to address threats include:

- Assigning additional time and qualified personnel to required tasks when an engagement has been accepted might address a **self-interest threat**.
- Having an appropriate reviewer, who was not a member of the team, review the work performed or advise as necessary might address a **self-review threat**.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client might address **self-review, advocacy or familiarity threats**.
- Involving another firm to perform or re-perform part of the engagement might address **self-interest, self-review, advocacy, familiarity or intimidation threats**.
- Separating teams when dealing with matters of a confidential nature might address a **self-interest threat**.

3. PEER REVIEW

Key points of Peer Review updated for May,2021

- **"Peer Review"** means an examination and review of the systems and procedures to determine whether the same have been put in place by the Practice Unit for ensuring the quality of assurance services as envisaged by the **Technical, Professional and Ethical Standards** as applicable including other regulatory requirements thereto and whether the same were consistently applied during the period under review."
- **"Reviewer"** means a member duly approved and empaneled by the Board on fulfilling the qualifications prescribed for a Reviewer.
- **"Practice Unit"** means a firm of Chartered Accountants or a member in Practice, practicing whether in an individual name or a trade name or such other entity as recognized by the Institute of Chartered Accountants of India from time to time.
- **Peer Review Board** means the Board constituted by the Council in terms of this Statement from time to time. The expression "Peer Review Board" is hereinafter referred to as "Board". **The Peer Review Board (the Board) was established in March 2002 and the Statement on Peer Review has been revised in April'2020.**

The Statement on Peer Review shall be deemed to be a guideline of the Council under **clause (1) of Part II of Second Schedule** to the Act and it is obligatory for the Practice Unit to comply with the provisions contained in this Statement.

PEER REVIEW OF AUDITORS

Peer review of attest function has a special significance.

- First of all the nature of work is such that it can be easily subjected to peer review. It is possible to review the work subsequent to its completion; which

means that one does not get disturbed while doing the work because of the peer review.

- Secondly, the business environment is changing so fast that it is necessary for an auditor to keep improving his audit techniques and seek a stamp of approval about his competence.
- And thirdly, the question of whether an auditor has performed his function satisfactorily or not is arising more frequently now. There is a considerable gap between what the society as a whole expects the auditors to do and what the auditors are actually required perform; by law and as per the terms of their engagement. Therefore, if the work of any auditor is questioned, the auditor's **first line of defense** would be that the work has happened as per auditing practices which have been peer reviewed.

It is important to note that in spite of the advantages of peer review, not many professional bodies have implemented the concept effectively. In this background, **it is very creditable that ICAI has, over a period, made peer review compulsory for all auditors.**

SCOPE OF PEER REVIEW (IMP)

The Statement of Peer Review aims to confine the scope of review **to preceding three years** since this would establish the consistency or deviations, **if any**, in respect of procedures followed by the practice unit.

Revised Scope of Technical, Professional and Ethical Standards

As per the Statement, Technical, Professional and Ethical Standards – means

- (i) Accounting Standards issued by ICAI that are applicable for entities other than companies under the Companies Act, 2013;
- (ii) Accounting Standards prescribed under **section 133** of the Companies Act; 2013 by the Central Government based on the recommendation of ICAI and in consultation with the National Financial Reporting Authority (NFRA) and notified as Accounting Standards Rules 2006, as amended from time to time;
- (iii) Indian Accounting Standards prescribed under section 133 of the Companies Act 2013 by the Central Government based on the recommendation of ICAI and in consultation with NFRA and notified as Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time;
- (iv) Standards :

Standards issued by the Institute of Chartered Accountants of India including-

- | | |
|--------------------------|--|
| (a) Engagement standards | (d) Standards on Internal Audit. |
| (b) Statements | (e) <i>Guidelines/ Notifications / Directions / Announcements / Pronouncements / Professional Standards issued from time to time by the Council or any of its Committees.</i> |
| (c) Guidance notes | |

- (v) **Framework for the preparation and presentation of financial statements, Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services and Framework for Assurance engagements;**
- (vi) **Provisions of the relevant statutes and / or rules or regulations which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.**

APPLICABILITY OF PEER REVIEW (IMP)

Practice Units subject to Review

1. Every Practice Unit including its branches, based on their category as determined below will be subject to Peer Review in accordance with this Statement.

Level I: A Practice Unit which has undertaken any of the under-mentioned assurance services in the period under review **shall be treated a Level I entity:**

- (i) Central Statutory Audit of Public Sector Banks, Private Sector Banks, Foreign Banks, Cooperative Banks and Public Financial Institutions;
- (ii) Central Statutory Audit of Central or State Public Sector Undertakings and Central Cooperative Societies based on criteria such as turnover or paid up capital etc. as may be decided by the Board;
- (iii) Central Statutory Audit of Insurance Companies;
- (iv) Statutory Audit of asset management companies or mutual funds;
- (v) Statutory Audit of enterprises whose equity or debt securities are listed in India or abroad;
- (vi) Statutory audit of any body corporate including trusts which are covered under public interest entities.**
- (vii) Statutory Audit of Entities which have raised funds from public or banks or financial institutions of over **Rupees Fifty Crores** during the period

under Review;

(viii) Statutory Audit of Entities which have **raised donations and / or contributions over Rupees Fifty Crores during the period under Review;**

(ix) Statutory Audit of entities having net worth of more than two Hundred and Fifty Crores rupees (>₹250 CR) at any time during the period under Review.

(x) Statutory Audit of entities which have been funded by Central and / or State Government(s) schemes of over Rupees Fifty Cores during the period under Review.

(xi) Statutory Audit of Non – Banking Financial Companies (NBFCs) as may be defined by the Board.

(xii) Central Statutory Audit of Regional Rural Banks.

(xiii) Statutory Audit of parent, subsidiary, associate, and joint venture of the above entities.

Level II: A Practice Unit which has undertaken any of the under-mentioned assurance services in the period under review **shall be treated as Level II entity:**

(i) Statutory / Internal / Concurrent / Systems / Tax audit and / or Departmental Review of Branches / Offices of -

(a) Public Sector undertaking

(b) Public Sector or Private Sector and / or Foreign Banks

(c) Insurance Companies

(d). Co-operative Banks

(e). Regional Rural Banks

(ii) Statutory Audit of Non – Banking Financial Companies (NBFCs) as may be defined by the Board.

(iii) Statutory Audit of entities having Net Worth of over Five Crores rupees or an annual turnover of more than Fifty Crores rupees during the period under Review.

(iv) UDIN's generated by the Practice Units more than the specified number determined by the Board from time to time.

(v) Statutory Audit of entities which have raised funds from public or banks or financial institutions of more than Twenty Five Crores rupees but less than Fifty Crores rupees during the period under review.

(vi) Any other Practice Unit providing assurance or other services not

covered under (i) (ii), (iii), (iv) and (v) hereinabove.

- 2 **Special case review :** The Board, based on specific information received from Secretary, ICAI or any other Committee of the Institute including Disciplinary directorate or any other Regulator , which in the opinion of the Board requires a special review of the Practice Unit, may conduct a special review of the Practice Unit.
- 3 Any Practice Unit not selected for Peer Review, may suo moto apply to the Board for the conduct of its Peer Review. The Board shall act upon the same **within 30 days** from the date of receipt of such request.
- 4 An auditee (Client) may request the Board for the conduct of Peer Review of its auditor (Practice Unit). The Board shall act upon the same within 30 days from the date of receipt of such request.
- 5 **The Board may, with the approval of the Council, modify any of the above criteria.**

Periodicity of Peer Review

The Periodicity of Peer Review will be:

- | | |
|-----|---|
| (a) | Level - I Practice Units – Once in 3 years. |
| (b) | Level - II Practice Units – Once in 4 years |

However, if the Board so decides or otherwise at the request of the Practice Unit, the Peer Review for a Practice Unit can be conducted at shorter intervals.

PEER REVIEW BOARD (IMP)

The Board shall be constituted by the Council. The Board shall consist of a maximum of **twelve members** to be appointed by the Council, of whom not less than 50% shall be from amongst the members of the Council as defined in Section 9 of the Chartered Accountants Act, 1949.

- 1) **Term of the members - The term of two third members shall be for **three years or end of the term of the member in the Council whichever is earlier**, or such other period as may be prescribed by the Council from time to time. The Chairman and the Vice-Chairman of the Board may be **rotated every year** by the Council of the Institute.**
- 2) Casual vacancies on the Board shall be filled by the Council. A Member of the Disciplinary Committee or the Disciplinary Board of the Institute of Chartered Accountants of India shall not be a member of the Board.
- 3) **Meeting (Quorum) Requirement : No business shall be transacted at any meeting of the Board unless there are present **at least one third members of the Board** but not **less than three members**, including the Chairman or, in his**

absence, the Vice-Chairman. In the absence of quorum within half an hour of the time fixed for the meeting, the meeting shall stand adjourned to a date, time and place fixed by the Chairman or, in this absence, the Vice-Chairman. The Board shall meet as and when required for transaction of the business before it. However, **at least one meeting shall be held in every three months.**

- 4) **Reporting:** The Board shall submit a report to the Council prior to the date of every meeting of the Council.

ELIGIBILITY TO BE A REVIEWER (IMP)

A Peer Reviewer shall: -

- (a) Shall be a member in practice with at least 10 years of experience for Level I entities and 7 years of experience for Level II entities.
 - (b) In case a member has moved from industry to practice and is currently in practice he should have at least 15 years of experience in industry and at least 5 years' experience in practice for Level I entities and an experience of at least 10 years in industry and at least 3 years' experience in practice, for Level II entities.
 - (c) Should have undergone the requisite training and cleared the requisite test for Peer Review as prescribed by the Board.
 - (d) Should have conducted audit of Level I Entities for at least 7 years or got his entity audited for at least 7 years which should be a Level I entity to be eligible for conducting Peer Review of Level I Entities.
- 2 A member on being appointed as a Reviewer shall be required to -
- (a) furnish a declaration as prescribed by the Board, at the time of acceptance of Peer Review appointment.
 - (b) sign a Declaration of Confidentiality as per Annexure A to this Statement .
- 3 **A member shall not be eligible for being appointed as a Reviewer, if -**
- (i) any disciplinary action / proceeding is pending against him
 - (ii) he has been found guilty of professional or other misconduct by the Council or the Board of Discipline or the Disciplinary Committee at any time
 - (iii) he has been convicted by a competent court whether within or outside India, of an offence involving moral turpitude and punishable with imprisonment
 - (iv) he or his partners or personnel has any obligation or conflict of interest in the Practice Unit.
4. A Reviewer shall not accept any professional assignment from the Practice Unit for a period **two years from the date of appointment.** Further, he should not have accepted any professional assignment from the Practice Unit **for a period of two years before the date of appointment as reviewer** of that Practice Unit.

OBLIGATIONS OF THE PRACTICE UNIT

Any Practice Unit, in addition to the prescribed information to be furnished including the questionnaire, statements and such other particulars as the Board may deem fit, shall comply with the following.

- (i) Produce to the Reviewer or allow access to, any record, document or prescribed register maintained by the Practice Unit .
- (ii) Provide to the Reviewer such explanation or further particulars/ information if asked.
- (iii) Provide to the Reviewer all assistance in connection with Peer Review;
- (iv) Where any information or matter relevant to a Practice Unit is recorded otherwise than in a legible form, the Practice Unit shall provide and present to the Reviewer a reproduction of any such information or matter, or of the relevant part of it in a legible form, with a translation in English or Hindi, if the matter is in any other language, and if such translation is requested for by the Reviewer. The Practice Unit shall be responsible and accountable for the accuracy and truthfulness of the translation so provided.

Obligations of the Peer Reviewer

- (i) The Reviewer shall not take any extracts of the Practice Units clients' file or records examined by him while conducting Peer Review, as a part of his working papers.
- (ii) The Reviewer shall complete the Review within the prescribed time frame.

Certain additional changes in Peer Review

- **Selection of Practice Unit & appointment of Reviewer**-A declaration in the form approved by the Board shall be submitted by the Practice Unit within **seven days** from the date the Practice Unit (PU) has been notified by the Board so that Reviewer to be allotted from the Panel of three reviewers can be identified by the Board as per Level submitted by Practice Unit, in the declaration form.
 - **Peer Review Visits**: Peer Review visits will be conducted at the Practice Unit's head office or /and branch(es) or any other locations. This on-site Review should **not extend beyond seven to fifteen working days** based on the size of the Practice Unit.
 - **Illustrative Qualifications in Reporting by the Reviewer (2 examples added)**
- 1) It was observed during examination of engagement files that **the staff deployed lacked industry expertise and was, in general, inexperienced**. The PU does not have a system of supporting and encouraging its resources to undergo relevant professional education necessary to execute audits of entities in specialised industries. Moreover, there was no evidence in the working papers prepared by articled assistants of any review performed by a senior resource.

- 2) No evaluation of the control environment of the entities audited was seen to have been done to identify risks due to deficiencies or weaknesses in the audited entities internal control in accordance with SA 315, Identifying and Assessing the Risk of Material Misstatement through Understanding of the Entity and its Environment.

Moreover, no attempt was made to test internal control over financial reporting in order to determine if the controls are implemented and operating effectively in accordance with SA 330, The Auditor's Response to Assessed Risks.

➤ **Peer Review Certificate**

On receipt of the Peer Review Report, the Board shall **within three months:**

- (a) Issue a Peer Review Certificate to the Practice Unit mentioning the next due date for Review.
- (b) Inform the Practice Unit that a Peer Review certificate cannot be issued along with the reasons therefor as well inform the Practice Unit about the due date for conducting a **follow- on review.**

➤ **Validity of Peer Review Certificate**

A Practice Unit cannot continue with the existing certificate, whose validity has expired. **All documents signed by the Practice Unit during the intervening period (i.e. expiry of previous certificate and issuance of new certificate) will be invalid.** Therefore, it is the responsibility of the Practice Unit to complete the Peer Review of the firm and submit all necessary documents **at least one month before the date of expiry of the previous certificate.**

DIFFERENCE BETWEEN PEER REVIEW AND QUALITY REVIEW

Peer review is a review of the systems and procedures of an audit firm. Although sample audit files are inspected by the peer reviewer, **it is done for the purpose of testing the effectiveness of the systems and procedures. The intention is to not to find faults but to help the firm develop effective systems.** It is a kind of mentoring process. Peer review is a part of the activities of ICAI aimed at improving the quality of service.

In contrast, a quality review is supposed to act as a deterrent. **Quality Review Board (QRB) is constituted by the Central Government and is independent of ICAI.** As per Section 28A of the Chartered Accountant's Act, the Central Government has the authority to constitute a Quality Review Board. QRB carries out **supervisory and disciplinary functions.** A quality review normally **pertains to one particular audit conducted by an audit firm.** The main objective quality review is to find errors or inadequacies, if any, committed by the auditor while conducting the audit. Serious errors detected in quality review lead to disciplinary action against the member.

4. QUALITY REVIEW

1. INTRODUCTION

‘Quality means doing it right when no one is looking.’ Henry Ford

The quality control policies and procedures should be documented and communicated to the firm’s personnel. Such communication describes the quality control policies and procedures and the objectives. In addition, the firm recognizes the importance of **obtaining feedback on its quality control system from its personnel.**

Therefore, the firm encourages its personnel to communicate their views or concerns on quality control matters. (Para 8 of Standard on Quality Control (SQC) 1 Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements).

EXAMPLES ARE IMPORTANT

Example of important areas as per Quality Review Report 2018-19 in accordance with Standard on Quality Control -1 are

- 1) Whether the audit firm **establishes and implements policies** and procedure on all the element of system of quality control
- 2) Whether the **engagement quality control reviewer review at an appropriate time** for the planning of an audit, significant audit judgement, and expressions of an audit opinion.
- 3) Whether the audit firm assigns as the person responsible for the monitoring of the system of quality control a person with **appropriate experience** for the role, vest the assigned person with sufficient and appropriate authority.
- 4) Whether the audit firm obtain, **at least annually, a confirmation letter** concerning compliance with policies and procedure for the maintenance of independence .
- 5) Whether the audit firm perform the **independence confirmation procedure** set forth in its internal rules before acceptance and continuance of an audit engagement, and when issuing the auditor’s report appropriately confirms that there was no change in the status of independence.
- 6) Whether the audit firm **develop and provides education/ training program** that fully take into account the knowledge, experience, competence and capabilities of the professional staff.

2. Constitution and Composition of Quality Review Board

- ✓ The Board comprises of a Chairperson and 10 other members.
- ✓ Central Government nominates the Chairperson and 5 members.
- ✓ Remaining 5 members are nominated by the **Council of the ICAI**.
- ✓ 6 out of 11 Members of the Board, including Chairperson, are nominated by the Central Government.
- ✓ Members are nominated from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy.

3. QUALITY REVIEW IF REFERENCE MADE BY NFRA ONLY (IMP)

The Ministry of Corporate Affairs vide letter F.No.7/1/2019-CL-1 dated 30th January, 2019, has clarified to **the Quality Review Board** that in view of Sec.132 (2) of the Companies Act, 2013 r/w Rule 9(4) of NFRA Rules, 2018, **the issue of ORB reviewing audits of the companies/bodies corporate specified under Rule 3 of the NFRA Rules, 2018 will only arise in case a reference is so made to ORB by NFRA, and not otherwise.**

Rule 3 (1) of NFRA Rules 2018, as notified by Central Government on 13 November, 2018, inter alia, provides that the Authority (read NFRA) shall have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the following class of companies and bodies corporate, namely:-

- (a) companies whose securities are **listed** on any stock exchange in India or outside India;
- (b) **unlisted public companies** having
 - ✓ **paid-up capital** of not less than **₹ 500 crores** or
 - ✓ having **annual turnover** of not less than **₹ 1000 crores** or
 - ✓ having, in aggregate, **outstanding loans, debentures and deposits** of not less than **₹ 500 crores** as on the 31st March of immediately preceding financial year;
- (c) insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force or bodies corporate incorporated by an Act in accordance with clauses (b), (c), (d), (e) and (f) of sub-section (4) of section 1 of the Act;
- (d) any body corporate or company or person, or any class of bodies corporate or

companies or persons, on a reference made to the Authority by the Central Government in public interest; and

(e) a body corporate incorporated or registered outside India, which is a subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d), **if the income or net-worth of such subsidiary or associate company exceeds twenty percent of the consolidated income or consolidated net-worth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d).**

Rule 9(4) of NFRA Rules, 2018 provides that the Authority (read NFRA) may refer cases with regard to overseeing the quality of service of auditors of companies or bodies corporate referred to in rule 3 to **the Quality Review Board constituted under the Chartered Accountants Act, 1949 (38 of 1949)** or call for any report or information in respect of such auditors or companies or bodies corporate from such Board as it may deem appropriate.

Accordingly, QRB would now be able to initiate reviews of quality of audit services provided by members of the Institute **only in respect of entities other than those specified under Rule 3(1) of NFRA Rules, 2018, namely,**

- ✓ private limited companies,
- ✓ unlisted public companies below the thresholds specified under Rule 3(1) of NFRA Rules, 2018 and
- ✓ other entities not specified under Rule 3(1) of NFRA Rules, 2018; and
- ✓ **those referred to QRB by NFRA under Rule 9(4) of NFRA Rules, 2018.**

However, in the meanwhile, QRB has also been completing its on-going reviews of top listed and other public interest entities which were in process.

4. Coverage of Services for Quality Review

The Quality Review would involve assessment of the **work of statutory auditors** while carrying out statutory audit so that the Board is able to assess:-

- (a) Quality of statutory audit and reporting by statutory auditors; and
- (b) Quality control framework adopted by the AFUR (Audit Firm under Review) in conducting statutory audit.

Exclusions: This Procedure would not extend to:

- (i) Review of **internal audit, tax audit, GST audit and other such special purpose audits** conducted by the members of the Institute which may be covered by the Board at a later stage or unless otherwise specified; and
- (ii) **Review of services provided by the members of the Institute in employment.**

5. SELECTION OF AUDIT FIRMS

The Board may decide the audit firms to be included in the selection during each stage. Such selection of audit firms for review may be made on the basis of one or more of the following criteria:-

(a) Criteria based on Entities Audited:

- (i) The entities other than those specified under Rule 3(1) of NFRA Rules, 2018 may be selected on the basis of one or more of the following:-
 - ✓ **risk based selection** including regulatory concerns pointing towards stakeholder risks.
 - ✓ on account of being part of a sector otherwise identified as being susceptible to risk on the basis of market intelligence reports.
 - ✓ reported **fraud** or likelihood of fraud.
 - ✓ **serious accounting irregularities** in the financial statements highlighted by the media and other reports.
 - ✓ **major non-compliances** under relevant statutes highlighted in past reviews.
- (ii) In case of joint audits, if required, **all joint auditors may be reviewed**, as may be decided by the Board on case-to-case basis.
- (iii) The Board may also review the quality of the statutory audit services of AFUR with a view to assessing the quality of statutory audit and reporting by the statutory auditors and their quality control framework on a reference made to it by any regulatory body like Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, Ministry of Corporate Affairs, National Financial Reporting Authority (NFRA) under Rule 9(4) of NFRA Rules, 2018 etc.
- (iv) The Board shall not consider cases of complaints received from individuals, firms, companies, other entities and their partners, directors and other officers etc. which shall be continued to be dealt with in accordance with the mechanism available under the Chartered Accountants Act, 1949. Cases of complaints from only regulatory bodies and other media reports involving serious accounting irregularities shall be considered by the Board for the purpose of initiating the review.
- (v) The selection for suo moto quality reviews may, however, be done using methods such as random sampling, selection of particular class or classes of entities/audit firms, in the manner as specified at (i) above.
- (vi) The QRB secretariat should place the details of the entities and audit firms, which may be selected for quality review before the Board for its consideration. The Board, at this stage, may consider whether the case warrants a quality review by a TR and may refer the cases selected for quality

review to the relevant TRs.

The Board will obtain the Annual Report of the entity concerned in terms of the 'Chartered Accountants Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board Rules, 2006'.

(b) Criteria based on Audit Firms:

Selection of audit firms should also be made for quality review of their statutory audit work **on random basis**, the volume of work handled by them represented by the number and nature of clients, sectors that may be identified as facing high risk, or on account of fraud or likelihood of fraud.

(c) Quality Review Cycle:

- (i) The following quality review cycle of Audit firms may be followed generally or as may be decided by the Board:
- Once in **3 years** for Audit firms having **20 or more Partners**
 - Once in **4 years** for Audit firms having **10 or more but less than 20 Partners**
 - Once in **5 years** for Audit firms having **less than 10 Partners**.
- (ii) Up to **3 audit engagements** of an AFUR may be selected by the Board, as may be considered appropriate, during a particular quality review cycle covering entities of varied industries, size, geographical spread and regulatory concerns. However, **in the absence of any adverse finding in a past review, not more than one audit engagement of the same engagement partner/ proprietor of an AFUR may be selected** for quality review by the Board during a particular quality review cycle
- (iii) However, in case of **any adverse findings in past review/s** or in any other situation, QRB may conduct quality review of any particular audit firm or of a particular engagement partner at **more frequent interval and/or select more than 3 audit engagements**.

6. Composition of the Review Team

- ✓ It depends on the size of the AFUR/entity/(ies) under review.
- ✓ The composition of the team, mandatorily headed by a TR empaneled with the Quality Review Board, may also include up to 5 Assistants engaged by the TR, as may be fixed by the Board in each case on need basis.
- ✓ However, **no firm of Chartered Accountants may be included as a member of the review team.**

7. Independence of Assistant (Qualified Assistance)

4 additional points have been added to ensure assistant is independent.

- (f) He should not have been associated with the AFUR and the concerned entity, whose audit is being reviewed, during **last three financial years and/or thereafter.**
- (g) He should not have any disciplinary proceeding under the Chartered Accountants Act, 1949 pending against him or any disciplinary action under the Chartered Accountants Act, 1949 / penal action under any other law taken/pending against him during **last three financial years and/or thereafter;**
- (h) He should not be a member of current QRB/ICAI's Central Council/Regional Council/Branch level Management Committee; and
- (i) He should not himself be empanelled as a TR with the Quality Review Board.

The Board may also obtain services of relevant industry experts, if needed, on such criteria as may be specified by the Board.

5. MISCELLANEOUS

1. Dividend Note Added regarding AS 4/IND-AS 10

As per Accounting Standards (AS) 4 (amended)- Contingencies and Events Occurring After the Balance Sheet Date and Ind AS 10- Events after the Reporting Period, **if dividends are declared after the balance sheet date but before the financial statements are approved for issue, the dividends are not recognised as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes.**

2. Audit Procedure to check compliance of AS 4 /IND-AS 10

If dividends are declared after the balance sheet date but before the financial statements are approved for issue, check that the dividends have not been recognized as a liability as per Accounting Standard (AS) 4 (amended)- Contingencies and Events Occurring After the Balance Sheet Date and Ind AS 10- Events after the Reporting Period, but **whether a disclosure of the same has been made in the notes.**