

First Notes



SEBI issued procedure and formats for limited review and audit reports

9 April 2019

First Notes on
Financial reporting
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Disclosures
Sector
All
Banking and insurance
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Relevant to
All
Audit committee
CFO
Others
Transition
Immediately
Within the next three months
Post three months but within six months
Post six months
Forthcoming requirement

Background

The Securities and Exchange Board of India (SEBI) had constituted a Committee on Corporate Governance under the chairmanship of Uday Kotak (the Kotak Committee). This Kotak Committee deliberated on various aspects of corporate governance in India including the procedures involved in group audits i.e. the responsibility of the principal auditor¹ and component auditor² in the audit of a listed entity and its components.

Currently, in a situation of a group with various components³, in India the Institute of Chartered Accountants of India's (ICAI) Standards on Auditing permit the principal auditor to place reliance on the audit performed by the auditor of the components and provide an audit opinion on the Consolidated Financial Statements (CFS) based on the audit report provided by the component auditor. While, internationally, International Standards on Auditing do not permit a division of responsibility between the principal auditor and component auditor. Therefore, the auditor of the holding company (parent entity) is responsible for the direction, supervision and performance of the group audit engagement.

The Kotak Committee recommended to SEBI to discuss the regulatory framework for conducting a group audit with ICAI to introduce amendments to the relevant auditing standards in India.

Accordingly, on 9 May 2018 SEBI amended its Listing Regulations and specified that the statutory auditor (principal auditor) of the listed entities would be required to undertake a limited review of the audit of all the entities/companies whose accounts are to be consolidated with the listed entity as per Accounting Standard (AS) 21, *Consolidated Financial Statements*. This provision is applicable from 1 April 2019.

However, the term 'limited review of the audit' has been a subject of multiple interpretations as there was lack of clarity on the level of procedures to be performed by the principal auditor in the case of a group audit. Additionally, it was unclear on how this requirement was aligned to the existing guidance for auditors included in SA 600, *Using the work of Another Auditor* and the principles set out in the *Guidance Note on Audit of Consolidated Financial Statements* (Revised 2016) issued by the ICAI.

¹Principal auditor means the auditor with responsibility for reporting on the financial information of an entity when the financial information includes the financial information of one or more components audited by another auditor.

²Component auditor means an auditor, other than the principal auditor, with responsibility for reporting on the financial information of a component which is included in the financial information audited by the principal auditor.

³Component means a division, branch, subsidiary, joint venture, associated enterprises or other entity whose financial information is included in the financial information auditor by the principal auditor.

New development

The SEBI through its circular dated 29 March 2019 prescribed the procedure and formats for limited review report and audit report of the listed entity and its components. The revised procedure and formats would be required to be followed by the statutory auditors of such entities. These procedures are applicable from 1 April 2019.

This issue of First Notes provides an overview of the recent SEBI circular.

Overview of the circular

Scope: The circular is applicable to the following:

- All listed entities whose equity shares and convertible securities are listed on a recognised stock exchanges and their statutory auditors (principal auditors)
- All entities whose accounts are to be consolidated with the listed entity (subsidiaries, associates and joint ventures) and their statutory auditors (component auditors).

Financial reporting framework: The procedure highlighted in the circular is applicable for the audit/limited review of Consolidated Financial Statements (CFS) or consolidated financial results of the parent company. Such procedures should be in accordance with the requirements of the following financial reporting framework:

- Ind AS: Under Ind AS CFS/consolidated financial results would be prepared based on Ind AS 110, *Consolidated Financial Statements*, Ind AS 28, *Investments in Associates and Joint Ventures* and Ind AS 111, *Joint Arrangements*
- Accounting Standards: Under Accounting Standards CFS/consolidated financial results would be prepared based on AS 21, *Consolidated Financial Statements*, AS 23, *Accounting for Investments in Associates in Consolidated Financial Statements* and AS 27, *Financial Reporting of Interests in Joint Ventures*.

Compliance with auditing framework in India: The statutory auditor (principal auditor) undertaking the audit or review of the CFS or consolidated financial results of the parent has ensured compliance with the following:


- SA 600, *Using the Work of Another Auditor*
- Standards on Review Engagements (SRE) i.e., SRE 2400, *Engagements to Review Financial Statements* or SRE 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*
- Guidance Note on Audit of Consolidated Financial Statements (Revised 2016) issued by ICAI.

The circular reiterates that the audit and limited review of the respective components that are being consolidated with the parent company would continue to be undertaken by the respective auditors of such components.

Procedure: The parent company management is responsible to ensure that there is co-ordination between principal and component auditor to comply with SA 600. The circular provides detailed procedure for principal auditor to consider while performing audit/review of the components of the listed entity. However, the procedures given in the circular should not be construed as complete and comprehensive i.e. procedures are not exhaustive and should be considered along with the auditing framework of India. The steps that the principal auditor should follow are:

- Understand the consolidation process followed by the parent company management.
- Discuss with the component auditor/component management significant business activities and identify significant and non-significant components. Significant components should cover at least 80 per cent of each of the consolidated revenue, assets and profits.


- Develop an overall CFS/consolidated financial results audit/review plan.
- Design and perform audit/review procedures on the CFS/consolidated financial results arising from the special considerations relating to the consolidation process.
- Principal auditor to consider if the component auditor should answer a detailed questionnaire regarding matters where the principal auditor requires information.
- Principal auditor to consider the significant findings of the component auditor and may consider to discuss such findings with the component auditor and management of the component. He may also require certain supplemental tests to be performed on the records or the financial statements of the component.
- Determine if a component is immaterial and hence, SA 600 is not applicable to it. However, the principal auditor should exercise caution and evaluate that several components may be immaterial in themselves but together they may be material.
- Obtain management representations.
- Evaluate and consider all reporting considerations including those communicated by the component auditors.
- Determination of significant components should be based upon the understanding of the risks associated with the consolidated financial statements, materiality and exercise of professional judgement.




Audit and review instructions: The circular requires principal auditor to communicate the requirements to the component auditor on a timely basis. The communication should set out the work to be performed, the use of that work, and the form and content of the component auditor communication with the principal auditor.

Additionally, the circular requires principal auditors to include key matters in the audit and review instructions to be considered by the component auditors. Some of the important key matters to be considered by the principal auditors are:

- Threshold for material misstatements in the component's financial results
- List of related parties and work to be performed on intra-group transactions/account balances
- Significant risks of material misstatement due to error or fraud
- A description of the accounting policies
- Areas requiring special consideration
- Significant deficiencies in internal control at the component level
- Subsequent events review requirements, etc.



Responsibility of the component auditor: The component auditor should provide an acknowledgement to the principal auditor for the receipt of instructions and also provide a confirmation to the principal auditor regarding compliance with the instructions received, together with the applicable audit/review report.



Revised formats for financial results: The circular provides revised formats for limited review reports and audit reports to be submitted by the statutory auditors. These formats would be applicable to listed entities including banks. Insurance companies are required to follow formats as prescribed by insurance sector regulator, Insurance Regulatory and Development Authority of India (IRDA).

The updated formats require principal auditor to assess that the audit/review of the components has been performed by the component auditor, and the principal auditor has performed the procedures as per the SEBI circular while relying on the work of the component auditor.

Our comments

The SEBI's circular detailing the procedure to be followed by the principal auditor and component auditor is a welcome step. It reinforces the requirements of SA 600 and the Guidance Note on Audit of Consolidated Financial Statements. In the past, there could be situations of inconsistency with regard to the extent of diligence exercised by the principal auditor. Therefore, the procedure highlighted in the circular is likely to result in change in practice and enhance focus on the substance of the responsibilities for principal auditors and component auditors.

The principal auditor would be able to obtain sufficient audit/review information that would help the principal auditor to rely on the work performed by component auditors. The circular clearly highlights that the principal auditor should follow certain steps i.e.

- Determine the scope of work in the context of the audit/review of the CFS/consolidated financial results
- Perform procedures to obtain sufficient appropriate audit evidence to ensure that work of the component auditor is adequate (including supplemental tests)
- Determine key matters and timelines for reporting
- Assess and address the significant findings of the component auditor
- Evaluate and consider all reporting considerations including those communicated by the component auditor e.g. subsequent events, uncorrected misstatements of the financial information, indicators of possible management bias in making accounting estimates, deficiencies in internal control at the component level, etc.

The robust process explained in the circular along with SA 600 and the Guidance Note on Audit of Consolidated Financial Statements is likely to improve the overall audit quality and governance environment in India. Companies and auditors would need to consider the impact of the circular on the audit/review, and plan for any changes in the approach that may be required.

Next steps

ICAI is expected to issue guidance with regard to procedure to be followed by the principal auditor to ensure compliance with this circular.



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The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.



RBI defers implementation of Ind AS for banks till further notice

26 March 2019

Scheduled Commercial Banks (SCBs) excluding Regional Rural Banks (RRBs) were initially required to implement Indian Accounting Standards (Ind AS) from 1 April 2018. However, RBI vide a press release dated 5 April 2018, deferred the implementation of Ind AS by one year i.e. 2019-20 would have been the first year of Ind AS with 2018-19 as the comparative year.

The RBI through a notification dated 22 March 2019, has further deferred the Ind AS implementation till further notice.

Missed an issue of Accounting and Auditing Update or First Notes



Issue no. 32 – March 2019

The topics covered in this issue are:

- Not for Profit Organisations - accounting, tax and regulatory requirements
- Accounting for transfer of debtors to franchisee
- Accounting for investments in an associate and joint venture
- Regulatory updates.



New standard on leases notified

2 April 2019

On 30 March 2019, the Ministry of Corporate Affairs (MCA) notified Indian Accounting Standards (Ind AS) 116, Leases as part of the Companies (Ind AS) Amendment Rules, 2019. Ind AS 116 replaces existing standard on leases i.e. Ind AS 17, *Leases* with effect from accounting periods beginning on or after 1 April 2019.

Ind AS 116 is largely converged with International Financial Reporting Standard (IFRS) 16, *Leases*.

In this issue of First Notes, we aim to provide an overview of the key requirements of Ind AS 116.



Voices on Reporting

KPMG in India is pleased to present Voices on Reporting – a series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

In our recent Voices on Reporting webinar on 4 April 2019, we discussed the key financial reporting and regulatory matters that are expected to be relevant for the stakeholders for the quarter ended 31 March 2019.

Click here to access the [audio recording \(mp3\)](#) and [presentation \(pdf\)](#).

Feedback/queries can be sent to aaupdate@kpmg.com

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