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The Institute of Chartered Accountants of India

Audit Qualifications, Emphasis of Matter & its Impact on Tax Audit Report



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- Some real life scenarios

Examples of circumstances in which dept approached to Disciplinary Committee

- ✓ Not reporting in 40 A (2) (b) for group company transactions
- ✓ Deemed dividend
- ✓ Arms length price
- ✓ Books of account not maintained –
- ✓ Inadmissible expenditure – personal expenditure
- ✓ Payment of interest to MSME
- ✓ Fair valuation 56(2) (Viib) issue of shares exceeding fair market value
- ✓ Particulars of loan accepted U/s 269SS and payments made U/s 269T
- ✓ Quantitative details



Framework for Drafting Audit Report

For statutory audit

- ✓ Drafting audit report under SA 700, 705 and 706

For income tax

- ✓ Certifying all the figures influencing the computation
- ✓ Model qualifications are provided
- ✓ Significance of Remarks in 3 CD
- ✓ ICDS disclosures and accounting standards Reported in para 3 of 3 CA and para 5 of 3 CB.



True and Correct

- ✓ Particulars given in form 3 CD and annexure thereto are true and correct
- ✓ As per Guidance Note, we are not only expected to verify the books of account but also documents
- ✓ Document includes - Defined in section 2(22AA) of the Act – definition is inclusive
 - Electronic records - data generated, image or sound stored received or sent in an electronic form or micro film or computer generated micro fiche.
- ✓ ICAI's view on true and correct
 - To be interpreted in light of the concept of 'reasonable assurance' as per SA 200 Frame work of Assurance defined
 - Reasonable **assurance is less than absolute assurance** due to following factors
 - Selective **testing** and use of **judgement** for selecting sample
 - Inherent **limitation** of interna control
 - **Persuasive evidences** are relied more than conclusive



Power to perform audit

- ✓ U/s 143 of the Companies Act, 2013 powers are given to the statutory auditors to call for BOA, information, documents etc. and to have access to all books & record.
- ✓ Under Income tax Act, no such powers are given.
- ✓ The Tax auditor is appointed by the assessee and is required to conduct tax audit by applying the generally accepted auditing procedure, professional judgement and SA as issued by ICAI, GN on Audit Report and Certificate for special purpose.



SA 700- Modified indicates Responsibilities

ICAI's view on modified SA

- ✓ SA 700 forming an Opinion and Reporting on Financial Statements
- ✓ Scope of SA 700 for various types of audits
- ✓ Guidance note on tax audit specifically requires to mention / report on the responsibilities of management/ assessee and the auditor.
- ✓ Reference of note no does not suffice



Disclosure of SA 700 on responsibility in Tax audit report

Sample note as per GN for responsibility

Assesses responsibility for financial statements

The assessee is responsible for the preparation of the aforesaid financial statements that give a true and fair view of the balance sheet and profit and loss in accordance with the applicable Accounting Standards issued by the Institute of Chartered Accountants of India. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Tax auditors responsibility

My/ Our responsibility is to express an opinion on these financial statements based on my/our audit. I/We have conducted this audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

I/We believe that the audit evidence I/we have obtained is sufficient and appropriate to provide a basis for my/our audit opinion.



Structure of the Reports & where to write Disclaimer, Qualification and Adverse – Structure is formal Q9

Opinion and reporting on financial statements – SA 700

1. **Opinion**
2. Basis of opinion
3. Key audit matters
4. **Management's Responsibility** for the Standalone Financial Statements
5. **Auditor's Responsibilities** for the Audit of the Financial Statements
6. Other Matter
7. Report on Other Legal and Regulatory Requirements

Modified opinion - 705

1. Qualified opinion/ Adverse opinion
2. Basis of Qualified Opinion
3. Key audit matters
4. Responsibilities of Management and Those Charged with Governance for the Financial Statements
5. Auditor's Responsibilities for the Audit of the Financial Statements
6. Other Matter
7. Report on Other Legal and Regulatory Requirements

Report with EOM -706

1. Opinion
2. Basis for Opinion
3. Emphasis of Matter
4. Key Audit Matters
5. Other Matter
6. Responsibilities of Management and Those Charged with Governance for the Financial Statements
7. Auditor's Responsibilities for the Audit of the Financial Statements
8. Report on Other Legal and Regulatory Requirements

When modification to auditors opinion required

Nature of modification and giving raise to modification	Auditors judgement about the pervasiveness of the effects or possible effects on the financial statements	
	Material and not Pervasive	Material and Pervasive
Have sufficient information - Financial statements are materially misstated	Qualified Opinion	Adverse Opinion
Inability to obtain sufficient and appropriate audit evidence	Qualified Opinion	Disclaimer of Opinion

Impact of disclaimer on other part of the report

In case if accurate estimation is not possible, auditor has used estimate or judgement to determine the figure, same should be stated

Mis-statement and qualifications

If unable to obtain Sufficient Information

Para 13 of SA 705

- Qualify - Auditor is able to conclude possible effect on the financials undetected misstatement (if any) which could be material but not pervasive
- misstatements are material and pervasive (*qualification of the would be inadequate to communicate gravity of situation*)
 - Withdraw from the audit as per the law
 - if withdrawal is not possible, practicable or before the issue of the auditors report – Disclaim the opinion on the financial statement.

Example of Qualified Opinion

The Company's inventories are carried in the Balance Sheet at Rs. XXX.

- Management has not stated the inventories at the lower of cost and net realizable value but has stated them solely at cost,
- which constitutes a departure from the Accounting Standards prescribed under section 133 of the Companies Act, 2013.
- The Company's records indicate that, had management stated the inventories at the lower of cost and net realizable value, an amount of Rs. xxx would have been required to write the inventories down to their net realizable value.
- Accordingly, cost of sales would have been increased by Rs. xxx, and income tax, net income and shareholders' funds would have been reduced by Rs. xxx, Rs. xxx and Rs. xxx, respectively.

Emphasis Of Matter (EOM) SA 706

EOM Vs KAM

What is EOM

- Matters in EOM are already appropriately disclosed or treated in the financial statements.
- EOM does not indicate qualification
- Giving EOM in place of qualification – is non compliance of EOM Q4 of SA706

Already dealt appropriately, why EOM?

Circumstance when it is necessary

- Uncertainties relating to future outcomes of litigations
- Significant post balance sheet event
- Early adoption of accounting standards having material impact on financials
- Framework given by law , Accounting standards is not acceptable to the company
- Alert user that the financials are prepared with certain purpose e.g. going concern
- Covid -19 note

Real Life Situations

- ✓ Statutory audit report has qualification influencing the profitability however same is not in 3 CA/ CB whether it amounts to concealment
- ✓ Emphasis of matter and 3 CA/ CB
- ✓ Judgement of statutory auditor and tax auditor differs
- ✓ Difference of opinion between the tax auditor and assessee
- ✓ Previous year audit not performed by us
- ✓ Statutory auditor and Tax auditor is different
 - Post balance sheet events
 - Opinion may differ
- ✓ Reliance on the work performed by third party for example internal auditor , branch auditor



Examples of challenges

- ✓ Undisclosed income reporting
- ✓ inventory reported to bank Vs statement
- ✓ Creditors ageing indicating above 3 years outstanding – **clause 25 of 3 CD section 41**
- ✓ Interest paid on MSME creditors disclosed in financial statements.
- ✓ Advances to directors / KMP / related parties transactions
- ✓ Relationship with struck off companies
- ✓ Willful defaulter
- ✓ Ratio
- ✓ Reporting on crypto currency



Clause 3 of Form 3CA/ 3 CB : Qualification and Observations Provided in Form

- ✓ Proper books of account to enable reporting in form 3CD have not been maintained by the assessee
- ✓ All the information and explanations which to the best of my/our knowledge and belief were necessary for the purpose of my/our audit has not been provided by the assessee
- ✓ Transactions necessary to verify the reportable transactions were not available
- ✓ Proper stock records are not maintained by the assessee
- ✓ Valuation of closing stock is not possible
- ✓ Yield/ percentage of wastage is not ascertainable
- ✓ Records necessary to verify personal nature of expenses not maintained by the assessee
- ✓ TDS returns could not be verified in the books of account



Clause 3 of Form 3CA/ 3 CB : Qualification and Observations Provided in Form

- ✓ Records produced for verification of payments through account payee cheque were not sufficient
- ✓ Amount of expense related to exempt income u/s 14A of Income Tax Act, 1961 could not be ascertained
- ✓ Creditors under MSE Development Act, 2006 are not ascertainable
- ✓ Prior period expenses are not ascertainable from books of account
- ✓ Fair Market Value of Shares U/s 56(2) (vii a) (vii b) is not ascertainable
- ✓ Reports of audit carried out by Excise/ service tax department were not made available
- ✓ GP ratio is not ascertainable from the financial statements prepared by the assessee
- ✓ Information regarding demand raised or refund issued during the previous year under Income tax laws other than Income Tax act 1961 and Wealth Act, 1957 was not made available
- ✓ Others





Thank You