

LESSON 9

AUDIT ENGAGEMENT

MEANING OF AUDIT ENGAGEMENT

- An audit engagement is an **arrangement wherein an auditor perform an audit of the transaction of the auditee** for which he has been engaged by the auditee.
- The audit engagement is a **contractual arrangement** by way of the Audit Engagement letter between the auditee and the auditor.
- ICSI issued CSAS-1 – Auditing Standard on Audit Engagement effective from 1st April, 2021, which defines:

“Audit Engagement” means **detailed terms of reference of appointment** including scope of audit, remuneration and limiting conditions, if any.”

Question: CSAS-1 is mandatory for audit engagements accepted on or after.....

Answer: April 01, 2021.

Question: What is the scope of CSAS-1 and what does it deal with?

Answer: CSAS-1 is applicable to the Auditor undertaking Audit Engagement under any statute. The Standard deals with the Auditor's role and responsibilities with respect to an Audit Engagement and the process of entering into an understanding/agreement with the Appointing Authority for the purpose of audit.

Offer and acceptance of the Audit Engagement

- The offer for the audit engagement may be initiated either by the Auditee or by the auditor.
- However, it is **necessary that the engagement is accepted by the auditors** and the auditor fulfils the various criteria for acting as an auditor prescribed in the various applicable laws.
- For example, in case of the statutory audit the auditor shall fulfil the eligibility criteria as prescribed under section 141 of the Companies Act, 2013.
- An auditor may be appointed either as a result of:
 - ✓ **one-to-one communication** between the auditor and the Management or
 - ✓ **through a tendering process** followed by the Management.

CASE STUDY**Offer:**

PQS Company, a trading company, is looking to engage an internal auditor for the financial year 2022- 2023. The company sends an email to ABC & Associates (Practicing Company Secretaries Firm), outlining the scope of the audit, the timeframe for completion, the audit fee, and any other terms and conditions that are relevant.

"We would like to engage your services to conduct an internal audit for the financial year 2022-2023. The audit should cover all aspects of our Internal control effectiveness; Statutory, procedures and control compliance; Implementation of recommendations; Corporate governance; Systems development; Process improvement; and Value for money and Best Value. The audit should be completed within four months of engagement. We are willing to pay a fee of INR 5,00,000 for this engagement. Please let us know if you are willing to accept this engagement, and if so, we can proceed with the necessary paperwork."

Acceptance:

ABC & Associates (Practicing Company Secretaries Firm) reviews the offer and responds with an acceptance that includes any additional terms or conditions they may have.

"Thank you for offering us this internal audit engagement. We are pleased to accept this engagement under the terms outlined in your email. In addition, we would like to include a clause that states that any findings from the audit will be presented before the audit committee. We will also require access to all financial records and documentation related to this engagement. If this is agreeable to you, we can proceed with the necessary paperwork."

Once both parties have agreed to the terms of the engagement, they can proceed with the necessary paperwork, such as an engagement letter.

In case the auditor is to be appointed by the management on one-to-one basis, following steps should be taken care by the auditor: (direct question can be asked)

Step 1

- Selection or screening of prospective auditee based on following risk / assessment:

- Client acceptance and engagement risk e.g. highly leveraged client, habitually litigant client, in the media for wrong reason, pledging of shares by the promoter group, PE involvement.
- Performance Risk – capacity, resources etc.
- Engagement Contract Risk
- Reputation Risk
- Commercials

Step 2

- Communicating his willingness to take up the audit assignment.

Step 3

- Conducting a pre-engagement meeting with the management.

The meeting may inter-alia include discussion about the:

- terms of engagement,
- prior year audit results,
- appropriateness of reporting framework,
- understanding business and environment including internal control system, design & operation,
- audit process,
- periodicity of audit,
- determining nature and conflict of interest,
- prior year audit findings and conclusions,
- appropriateness of reporting framework,
- understanding Auditee's business operations and environment including internal control system,
- commercial terms of the audit and the timelines and milestones, if any, for conducting the Audit and submission of the Audit Report.
- Auditor shall disclose in the pre-engagement meeting conflict of interest, if any, with the Auditee.
- The Auditor shall be under Confidentiality obligation with respect to the information obtained during the pre-engagement meeting.

Step 4

- Signing the engagement letter with the Management and issuance of certificate by auditor before accepting an audit.

In case where the appointment of auditor is through a tendering process by the management: (direct question can be asked)

Step 1	Pre-bid meeting with the management to discuss upon various aspects of the tender, scope of work terms of engagement, prior year audit results, appropriateness of reporting framework, understanding business and environment including internal control system, design & operation, audit process, periodicity of audit determining nature and conflict of interest etc.
Step 2	Submission of technical bid as per the requirements of the tender document of the management.
Step 3	Signing the engagement letter with the management.
Step 4	Certificate by auditor before accepting an audit.

The Auditor shall furnish a certificate to the Appointing Authority that: (direct question can be asked)

- The **number of audits are within the ceiling** prescribed by the ICSI as specified in para 2 of CSAS 1.
- No substantial conflict of interest** as defined in para 3 of CSAS-1 exists with the Auditee.
- There is **no restriction to render the professional services** under ICSI Guidelines.
- He is **not debarred to undertake such audit** under any law or under the disciplinary mechanism of the ICSI.

Preconditions of accepting/continuing any professional engagement (direct or indirect question can be asked)

Prior to acceptance of any Audit engagement, the auditor, in order to establish whether the preconditions for accepting professional assignment are present, the auditor should check that:

- Whether the **reporting framework** as required in the preparation, performance of audit, review of the secretarial/ non-financial statements **is acceptable** and

- (b) Whether the **management is in agreement to acknowledge and understands its responsibility** relating to:
- (i) **Preparation of the secretarial/ non-financial statements** in accordance with the applicable reporting framework, including their fair presentation
 - (ii) **Development of internal control/systems/procedure** to enable the preparation of secretarial/ non-financial statements which are free from material misstatement, whether due to fraud or error and
 - (iii) Providing:
 - (a) **Access to all information** of which management is aware that is relevant to the preparation/ audit/ review etc. of the secretarial/ non-financial statements such as records, documentation and other matters
 - (b) **Additional information** that the auditor may request from management for the relevant purpose and
 - (c) **Unrestricted access** to persons within the company from whom the auditor determines it necessary to obtain audit evidence.

Limitation on scope prior to Engagement Acceptance

If management or appointing authority imposes a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the **auditor believes the limitation will result in the auditor disclaiming an opinion** on the Secretarial records/non-financial statements, the **auditor shall not accept** such a limited engagement as an audit engagement, **unless required by law or regulation to do so**.

Other factors affecting Engagement Acceptance

- If the **preconditions** for an audit/professional assignment are **not present, the auditor should discuss the matter with management**.
- Unless required by law or regulation to do so, the auditor should not accept the proposed audit engagement:
 - (a) If the **auditor assesses that the reporting framework** to be applied in the preparation of the secretarial records/ non-financial statements **is unacceptable**, or
 - (b) If the **agreement has not been concluded**.
 - (c) **Reference to the expected form and content of any reports** and a statement that there may be circumstances in which a report may differ from its expected form and content.
- If any law or regulation prescribes sufficient detail of the terms of the engagement

referred to above, there is no need to record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities.

Criteria for declining and withdrawing from an Engagement

Based on the evaluation of client information and the following factors, the auditor should determine and document the conditions beyond which it would be prudent to decline, or withdraw from an engagement **(direct question can be asked)**:

- Client's status/information** that is **likely to impact adversely on the independence of the firm**.
- Ability of the firm to provide appropriate service** to the client, considering needs for technical skills, knowledge of the industry and personnel.
- Consider circumstances which would cause the firm to regard the **engagement as one requiring special attention or presenting unusual risks**.

APPOINTING AUTHORITY

- The appointing authority means the person who is appointing the Auditors of the company.
- The Auditee under the Statute could be a company or any other form of entity.
- Appointing Authority will depend upon the type of the Auditee.
- In case the Auditee is a company, the Appointing Authority would be the Board of company or members of the company, as the case may be, and
- in other cases, it would be the persons who have been entrusted with the responsibility of governance and compliances of the Auditee.
- Further, the Appointing Authority may also include Court, Tribunal or Regulator or any officer thereof.

CASE LAW

In the matter of *Kingston Cotton Mill Co.*, the case involved a dispute between the shareholders and the directors of a company over the appointment of an auditor. The shareholders had passed a resolution to appoint an auditor, but the directors refused to comply with the resolution.

The honorable court held that the shareholders of a company have the right to appoint an auditor, and that the directors of the company cannot interfere with this right.

- ICSI auditing standard CSAS-1 (Auditing Standard on Audit Engagement) effective from 1st April, 2021, defines: “Appointing Authority” means any person having authority to appoint the Auditor.
- “Auditee” means a person subject to audit.
- Under the provision of the Section 139 of the Companies Act, 2013, it has been specifically provided that the first statutory auditor **shall be appointed by the Board of Directors** of the company **within 30 days** of the incorporation of the company, however, subsequent auditors **shall be appointed upon the recommendation of the board or the audit committee of the company, if any, by the members at the general meeting** of the company.

For example, to conduct audit of the function and activities of the company in case of Secretarial Audit under Section 204 of Companies Act, 2013 or Clause 24A of the SEBI (LODR) Regulations, 2015 and Internal Audit under Section 138 of Companies Act, 2013, the Appointing Authority would be the Board of the Company.

It may be noted that the **internal auditor may or may not be the employee of the company.**

In case where the tribunal/ official liquidator by exercising his power, appointed the auditor, the tribunal/ official liquidator is considered as the appointing authority.

- In case where the law specifically provides for the appointing authority and the appointing authority may authorize such person to sign the engagement letter, however instances where the law has not provided, the person who signs the engagement letter in official capacity can be considered as the appointing authority **(If the law explicitly names an individual or entity as the appointing authority, this specified authority can authorize another person to sign the engagement letter on their behalf and In situations where the law does not clearly designate an appointing authority, the person who signs the engagement letter in an official capacity is considered to be the appointing authority. This means their signature and role in the organization give them the authority to bind the organization to the terms of the engagement letter).**
- In case, the Auditee is under Corporate Insolvency Resolution Process, **the Appointing Authority shall be the Resolution Professional.**

In case of Audit of Depository Participants, the Appointing Authority may depend upon the type of Auditee,

e.g. if the Depository Participant is a company, then the Appointing Authority will be the Board or in case of an LLP it could be the designated partner or any other

partner as may be authorized to appoint the Auditor.

- Similarly, in case of Internal Audit of Stock Brokers, Internal Audit of Investment Advisors, Internal Audit of Portfolio Managers, Internal Audit of Credit Rating Agencies and Internal Audit of Research Analysts, the Appointing Authority would depend upon the type of Auditee.

Types of appointing authorities	
First statutory auditor of the Company	Board of Directors or members in EGM
Statutory Auditor	Members in AGM
Secretarial Auditor	Board of Directors
Internal Auditors	Board of Directors
Auditee is under Corporate Insolvency Resolution Process	Resolution Professional
Tribunal/ official liquidator by exercising his power	Tribunal/Official Liquidator
Audit of Depository Participants	Director /Designated etc. partner depends on nature of Organisation
Internal Audit of Stock Brokers	Depends upon the type of auditee

CASE STUDY

Sun Moon Limited is a listed company and operates in the manufacturing sector. In January 2023, the company received a notice from the Securities and Exchange Board of India (SEBI) stating that Sun Moon Limited had failed to comply with several provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

The SEBI notice also required the company to appoint a practicing company secretary to conduct a secretarial audit of its records and submit a report to SEBI.

The board of directors of Sun Moon Limited have decided to appoint a M/S RR & Associates (Practicing Company Secretaries Firm) to conduct the secretarial audit and passed the Board resolution in their meeting.

However, Mr. Abhinav (shareholder) of the company challenged the appointment of the secretarial auditor in court, stating that the board did not have the authority to appoint the auditor and that the appointment should have been made by SEBI. The matter was referred to court.

The court examined the provisions of the SEBI (Listing Obligations and Disclosure

Requirements) Regulations, 2015, and found that the regulations did not specify who had the authority to appoint a secretarial auditor.

However, **the court noted that the regulations required the secretarial auditor to be appointed by the company to conduct the audit.**

Based on these findings, **the court ruled that the board of directors of Sun Moon Limited had the authority to appoint the secretarial auditor**, and that the appointment was valid.

The secretarial audit was conducted, and the report was submitted to SEBI. Sun Moon Limited took corrective measures to rectify the non-compliances identified during the audit.

Terms and Conditions of Audit engagement (direct question can be asked)

- The **objective and scope of every audit is dependent on the four corners of the terms and conditions** which also include the scope of audit as agreed by and between the auditee and the auditors of the company.
- This **requires the specific attention of the auditors and auditee** on the following points (direct question can be asked):
 - ✓ The objective and purpose of the audit
 - ✓ The responsibilities of the auditor
 - ✓ The responsibilities of management/ Auditee
 - ✓ The audit risk
 - ✓ The audit limitation
 - ✓ The audit plan.
- This is **essential that the auditor as well as the auditee should agree upon the terms of audit engagement** and documented the same in the audit engagement letter or other suitable form of written agreement which can be referred on any conflict arising during the course of audit.
- In case of instances where due to change in the governing laws the amended law should be considered in the performance on the audit, however, **any request in the change of the terms of audit engagement should be considered by the auditor on its merit and shall be properly documented by the auditors.**

AUDIT FEE & EXPENSES

- Audit fee which is to be charge by the auditor depends on several factors, which includes:
(direct question can be asked)
 - ✓ **Size** of the organization;
 - ✓ **Nature** of business;
 - ✓ **Internal Controls** systems & Technology adopted;
 - ✓ **Scope** of audit;
 - ✓ **Frequency** of audit etc.
- Audit fees **should be a fair reflection of the value of the work performed** for the auditee, taking into account the above-mentioned factors.
- However, the Audit services **should not be offered or rendered under an arrangement whereby no fee will be charged unless specified findings or results are obtained**, or where the **fee is otherwise contingent upon the findings or results** of such services, and **fees SHOULD NOT BE REGARDED AS BEING CONTINGENT if fixed by a court or other public authority**.
- Also, the **charge or accept a fee for professional work on a percentage basis is not advisable EXCEPT** where that **course is authorized by statute or has been approved by a member body as generally accepted practice for certain work**.
- Auditors **should not accept a very low level of fee** as a result of competing for business.
- Also **not to enter in to price competition and deplored in the profession**, as it could impair the auditors' independence and deteriorate the quality of the auditing service.
- However, **charging a lower fee than has previously been charged** by another auditor for similar work is **not restricted** in any law.
- In case of Statutory Auditors, Section 142 of the Companies Act, 2013 provides that the remuneration to the Auditors **shall be fixed in the general meeting** of the company, also the **auditor can claim the expenses incurred by him in connection with the audit** of the company.
- Similarly, in case of the Secretarial Audit and the Internal Audit, the Audit fee **shall be decided by the Audit committee or by the board** of the company.

CASE STUDY

In *Re R. Swarup Reddy Vs. M.N Pratap Reddy*, in this matter CLB appointed independent auditors for auditing books of account the company. Auditors completed their work and claimed fees of Rs. 36.16 lakh.

The director company stated that fees claimed by auditors was on higher side and at best they were entitled for a fee of Rs. 8 lakhs.

The Court observed that said auditors had not only done audit but also did investigation, particularly with reference to related party transactions entered at instance of appellant with its two sister companies for period from 1-4-2007 to 31-3-2014.

Further, amount claimed by said auditors was supported by number of days spent and composition of people working on assignment.

It was also observed that appellant had paid nearly Rs. 62 lakhs for auditing of sister concerns for same period.

Therefore, fees claimed by auditors were reasonable.

Court was justified in directing the company to remit to said auditors the entire claimed amount.

The clause pertaining to Audit fees and expenses in the Audit Engagement Letter may be reflected as:

“V. Commercial Terms

Audit fees for the F.Y. 20XX-XX is fixed at Rs. XXXXXXXX plus applicable taxes. Fees will be billed as the work progresses.

Out-of-pocket expenses by the Auditor shall be reimbursed on actual basis”.

AUDITING STANDARD ON AUDIT ENGAGEMENT (CSAS-1)

ICSI Guidance Note on Audit Engagement

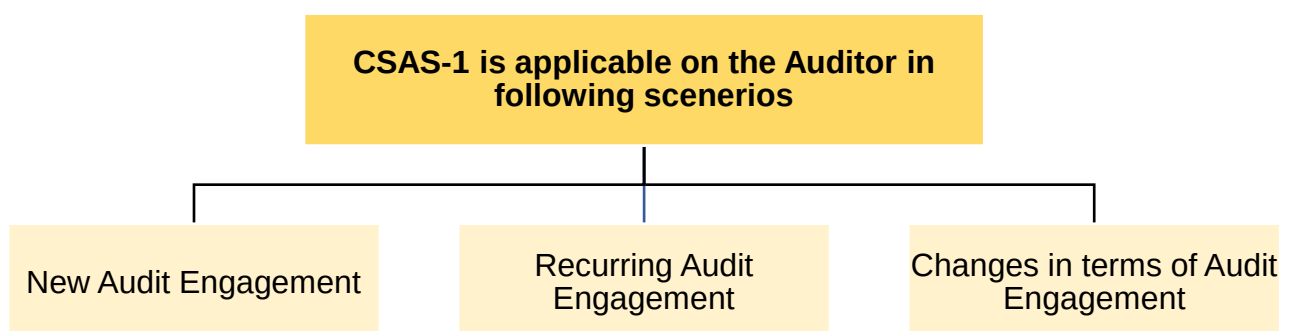
- The Auditing Standard on Audit Engagement (CSAS-1) is applicable to the Practicing Company Secretaries (PCS) as defined in the Company Secretaries Act, 1980, who undertake the audit assignment envisaged under the Companies Act, 2013 or Securities and Exchange Board of India Act, 1992 or any other law prevailing in India.
- CSAS-1 is **not applicable for Audits entrusted on a voluntary basis** by the Auditee to the Auditor. However, adherence to the Standard is recommended in respect of Audits entrusted on voluntary basis also.
- In case of appointment by Court, Tribunal or Regulatory Authority, CSAS-1 shall apply to the extent possible, since the manner of appointment and terms of engagement in such cases shall be as per the directions of the Court, Tribunal or Regulatory Authority.
- Following is an illustrative list of Audits which may be undertaken by a Company Secretary under various Statutes:

Type of Audit	Act/Regulation	Section/ Regulation	Auditee
Secretarial Audit	Companies Act, 2013	204	Company
Secretarial Audit	SEBI (LODR) Regulations, 2015	24A	Listed Entities
Internal Audit	Companies Act, 2013	138	Company
Audit of Depository Participants	SEBI (Depositories and Participants) Regulations 2018 read with SEBI circular no. SEBI/HO/MRD/ DOP2-DSA2/ CIR/P/2019/22 dated January 23, 2019	76	Sole Proprietorship, Partnership Firm, LLP, Company
Internal Audit of Stock Brokers	SEBI (Stock and sub- broker) Regulations, 1993	SEBI circular no. MIRSD/ DPSIII/ Cir-26/ 08	Sole Proprietorship, HUF, Partnership Firm, LLP, Company
Internal Audit of Investment Advisors	SEBI (Investment Advisors) Regulations, 2013	19(3)	Sole Proprietorship, Partnership Firm, LLP, Company
Internal Audit of Portfolio Managers	SEBI (Portfolio Managers) Regulations, 1993	SEBI circular no. IMD/ PMS/CIR/1/2172 7/ 03 dated	Body Corporate

		November 18, 2003	
Internal Audit of Credit Rating Agencies	SEBI (Credit Rating Agencies) Regulations 1999	SEBI circular no. MRD/ C R A / C I R - 0 1 / 2 0 1 0 dated January 06, 2010	Public Financial Institution, Scheduled Commercial Bank, Foreign Bank operating in India with RBI approval, Foreign Credit Rating Agency recognised by or under any law, Company, Body Corporate
Internal Audit of Research Analysts	SEBI (Research Analysts) Regulation, 2014	25(3)	Sole, Proprietorship, Partnership Firm, LLP, Company

- While auditing under any of the statutes, the Auditors are required to examine the Records, documents and information from the Auditee to express an independent opinion. Therefore, it becomes very important to understand the scope of audit.

The CSAS-1 deals with the Auditor's responsibilities while agreeing to the terms of Audit Engagement and entering into an agreement with the Management or those charged with governance. This includes principal contents of an Audit Engagement Letter and also the duties and responsibilities of the Auditor and the Auditee in case of a change in terms of engagement, if any.



(direct question can be asked)

New Audit Engagement

- Covers an **audit being conducted first time** and therefore the appointment of the Auditor is an initial appointment.
- It will also cover the situations where the **audit for the previous period was conducted by another Auditor**.

Recurring Audit Engagement

- Covers the **situation where the Auditor had conducted the audit for the previous period and is requested to conduct the audit for the subsequent period** as well.
- In such a case, **the Auditor should obtain fresh Audit Engagement Letter if the period of engagement has expired, including revised terms** if the circumstances so require Auditor shall adhere to the Standard even if the Audit Engagement is a continuing one.

Changes in terms of Audit Engagement

- Whenever there is a **change in the terms of Audit Engagement in the middle of an ongoing audit**, the Auditor shall adhere to the Standard and initiate a revised Engagement Letter in terms of this Standard.

Definitions

- “Auditor” means a member of the ICSI who holds a valid Certificate of Practice under Section 2(2) of the Company Secretaries Act, 1980. It includes a firm or Limited Liability Partnership (LLP) registered with ICSI and whose partners are members of the ICSI.
- The term “Management” includes Board of Directors and persons who have been entrusted with the responsibility of governance and compliances of the Auditee like in case of Companies.
- The term “persons who have been entrusted with the responsibility of governance and compliances of the Auditee” include the Key Managerial Personnel as defined under Section 2(51) of the Companies Act, 2013 and senior management.
- As per Section 2(51) of Companies Act, 2013: “Key Managerial Personnel”, in relation to a company, means –
 - (i) the Chief Executive Officer or the Managing Director or the Manager;
 - (ii) the Company Secretary;
 - (iii) the whole-time Director;
 - (iv) the Chief Financial Officer;

- (v) such other officer, not more than one level below the directors who is in whole-time employment, designated as Key Managerial Personnel by the Board; and
 - (vi) such other officer as may be prescribed.
- As per Regulation 16(1)(d) of SEBI (LODR) Regulations, 2015:
 “Senior Management” shall mean officers/ personnel of the listed entity who are members of its core management team **EXCLUDING** board of directors and normally this shall comprise all members of Management **one level below** the Chief Executive Officer/Managing Director/ whole time Director/ Manager (including Chief Executive Officer/Manager, in case they are not part of the board) and shall specifically include Company Secretary and Chief Financial Officer:
 - Explanation to Section 178 of the Companies Act, 2013, describes that “Senior Management” means personnel of the company who are members of its core Management team **EXCLUDING** Board of Directors comprising all members of Management **ONE LEVEL BELOW** the Executive Directors, including the functional heads.
 - In case of Auditee other than companies, the term “persons who have been entrusted with the responsibility of governance and compliances of the Auditee” shall include any person or employee of the Auditee as may be authorized. For example, in case of an LLP, Management includes the partners or designated partners or any officer of the LLP entrusted with such responsibility.
 - In case of a Proprietorship, Management means the proprietor or any officer authorised by him.

“Predecessor or Previous Auditor” means an Auditor:

- who has **conducted the most recent audit** assignment of the Auditee and submitted report thereon prior to the incumbent Auditor or
- was engaged **but did not complete the audit assignment** due to his resignation, termination or otherwise.

An Auditor who has completed the assignment and has not been reappointed or an Auditor who had been appointed but has not completed the assignment due to resignation, termination or otherwise, shall be deemed to be a “Predecessor or Previous Auditor” for the same assignment.

AUDIT ENGAGEMENT PROCESS

Pre-Engagement Meeting (direct question can be asked)

- Before accepting the Audit Engagement, the Auditor should have a pre-engagement meeting with the Auditee.
- The meeting may inter-alia include discussion about the
 - ✓ terms of engagement,
 - ✓ prior year audit findings and conclusions,
 - ✓ appropriateness of reporting framework,
 - ✓ understanding Auditee's business operations and environment including internal control system,
 - ✓ commercial terms of the audit and
 - ✓ the timelines and milestones, if any, for conducting the Audit and
 - ✓ submission of the Audit Report.
- Auditor shall disclose in the pre-engagement meeting conflict of interest, if any, with the Auditee.
- The Auditor shall be under Confidentiality obligation with respect to the information obtained during the pre-engagement meeting.

Appointment

- The appointment of Auditor shall be made in the manner prescribed in the applicable laws, act, rules, regulations, standards and guidelines and
- In case no such manner has been prescribed, such appointment shall be made in the manner determined by the Appointing Authority.
- Before accepting an audit, the **Auditor shall furnish a certificate** to the Appointing Authority that (direct question can be asked):
 - a) The **number of audits are within the ceiling** prescribed by the ICSI as specified in para 2 of CSAS 1.
 - b) **No substantial conflict of interest** as defined in para 3 of CSAS-1 exists with the Auditee.
 - c) There is **no restriction to render the professional services** under ICSI Guidelines.
 - d) He is **not debarred to undertake such audit** under any law or under the disciplinary mechanism of the ICSI.
- A Specimen Eligibility Certificate is placed at Annexure A.

- The **Auditor shall obtain an Audit Engagement Letter along with a copy of the resolution, if any, passed by the Appointing Authority** and shall provide acceptance to the Appointing Authority.
- The Auditor may give his acceptance to undertake the audit either on the copy of the Audit Engagement letter or through a separate letter.
- The acceptance may also be communicated through an **email**.

Illustration:

Section 179(3)(k) of Companies Act, 2013 read with Rule 8(4) of Companies (Meeting of Board and its Powers) Rules, 2014 requires that the Internal Auditor and Secretarial Auditor of the company shall be appointed by passing a resolution at a duly convened meeting of the Board.

Therefore, the appointment of Internal Auditor/Secretarial Auditor cannot be made by passing a resolution by circulation.

Further, the said appointment cannot be made by Key Managerial Personnel or Senior Management, even if authorised by the Board in this regard.

Audit engagement letter (direct question can be asked)

- The engagement letter **provides the opportunity to detail the scope of the Audit Engagement** and to define the responsibilities between the Auditor and the Auditee.
- It is in interest of both the management and the auditor that the **auditor should get an audit engagement letter before the commencement of the audit to help avoid misunderstandings** with respect to the terms of engagement.
- In some entities, however, the objective and scope of an audit and the responsibilities of management and of the auditor may be sufficiently established by law, in that case, the engagement letter may **give a reference to the fact that relevant law or regulation applies and that management acknowledges and understands its responsibilities for preparation and maintenance of records and for devising proper systems to ensure compliance with the provisions of applicable laws and regulations**.
- It **should be reviewed every year** to ensure that it is up to date **but does not need to be reissued every year UNLESS there are changes to the terms** of the engagement.
- The auditor **shall obtain a new engagement letter if the scope or context of the assignment changes** after initial appointment.

- It documents the terms of Audit Engagement agreed between the Auditor and the Appointing Authority with reference to scope of audit, responsibilities of Auditor and Auditee, remuneration and limiting conditions, if any.

- **Audit Engagement Letter shall *inter alia* include:** (direct question can be asked)
 - a. The **objective and scope** of the audit;
 - b. The **responsibilities** of the Auditor and the Auditee;
 - c. **Written representations** provided and/or to be provided by the Management to the Auditor, including particulars of the Predecessor or Previous Auditor;
 - d. The **period within which the audit report shall be submitted** by the Auditor, along with milestones, if any;
 - e. The **commercial terms regarding audit fees and reimbursement of out-of-pocket expenses** in connection with the audit; and
 - f. **Limitations** of audit, if any.
- Where the **objective and scope of the audit and responsibilities of the Management and of the Auditor have been established by law, the Audit Engagement Letter shall give a reference to the provisions of the relevant law** along with a statement that the Management acknowledges and understands its responsibilities for preparation and maintenance of records and for devising proper systems to ensure compliance with the provisions of applicable laws, act, rules, regulations and standards for the time being in force.
- The **Auditor shall agree upon the terms of Audit Engagement with the Appointing Authority** which shall be documented in an Audit Engagement letter.
- **Responsibilities of Auditor inter alia include the following:** (direct question can be asked)
 - ✓ To **take up the audit as per the terms** of the engagement.
 - ✓ To **depute personnel who have the knowledge of the laws** under which the audit is being carried out, subject to his overall supervision.
 - ✓ To **observe and ensure observance of highest standards of ethics** and maintain utmost professionalism at all times by the employees, staff and other team members involved in the Audit and persons engaged by him to provide advice or assistance for the conduct of audit.
 - ✓ To **maintain and ensure confidentiality** by the employees, staff and other team members involved in the audit and persons engaged by him to provide advice or assistance for the conduct of audit.
 - ✓ To **not trade in securities** relating to which unpublished price sensitive information has come to his/ her knowledge during the course of audit, **which responsibility shall extend to the employees, staff and other team members involved in the audit and persons engaged by him to provide advice or assistance for the conduct of audit also.**

- **Responsibilities of Auditee inter alia include: (direct question can be asked)**
 - ✓ To **provide access to premises** of the Auditee and timely access to Records, documents, legal opinions, show cause notices, inspection reports and other information, explanations and reports as may be necessary in connection with the audit.
 - ✓ To **identify and depute a responsible official** to timely provide relevant documents, information and explanations required by the Auditor.
 - ✓ To **provide written Management representations**, if any, to the Auditor during the course of audit, which shall provide the Auditor a substantive evidence of important assertions and the Management's primary responsibility for the assertions and its accuracy.
 - ✓ To **provide details of the Predecessor or Previous Auditor**, so as to enable proposed Auditor to communicate with the Predecessor or Previous Auditor.
- **Audit remuneration and expenses may depend on several factors including: (direct question can be asked)**
 - ✓ **Size** of the organisation
 - ✓ **Location** of business and its branches
 - ✓ **Type** of company (Listed/Unlisted)
 - ✓ **Sector** to which company belongs
 - ✓ **Nature** of business
 - ✓ **Internal control mechanism**
 - ✓ **Scope** of Audit Engagement
 - ✓ **Frequency of audit**, whether monthly, quarterly, yearly
 - ✓ **Type of audit**, whether sole, joint or concurrent audit
 - ✓ The **experience of the Auditor** in conducting audits
 - ✓ **Estimated man-hours** required to complete the assignment
 - ✓ **Guidance/Advisory** issued by the ICSI, if any
 - ✓ **Any other term or a combination** of any of the above.
- Audit fees **should be a fair reflection of the value of the work performed** for the Auditee, considering the above factors.
- Quantum of fees, billing arrangement and terms of payment shall be mentioned in the Audit Engagement letter.

- The Audit fee **shall not be contingent upon findings or results** of the audit.
- However, **fees shall not be regarded as being contingent if fixed by a court or other public authority**.
- The Auditor is **not permitted to pay a commission to obtain an audit nor shall he accept a commission** for referral of an Auditee to a third party.
- He **shall not accept a commission** for the referral of the products or services of others.

- **As per Clause 2 of Schedule I of the Company Secretaries Act, 1980:** A Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional work to any person, other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner.
- **As per Clause 9 of Schedule I of the Company Secretaries Act, 1980:** A Company Secretary in Practice shall be deemed to be guilty of professional misconduct, if he charges or offers to charge, accepts or offers to accept, in respect of any professional employment, fees which are based on a percentage of profits or which are contingent upon the findings, or result of such employment, except as permitted under any regulation made under this Act.

- Auditor should include a statement in the Audit Engagement Letter that because of
 - ✓ inherent limitations of an audit,
 - ✓ inherent limitations of internal control,**an unavoidable risk exists that some material non-compliance may not be detected,**
even though the audit is properly planned and performed in accordance with the applicable Auditing Standards.
- Audit Engagement Letter should also **specify that arrangements concerning the involvement of third party and experts** in some aspects of the Audit.
- If the **Appointing Authority has imposed a limitation** on the scope of the Auditor's work in the terms of engagement and the **Auditor believes that such limitation will result in lower level of assurance** than what is required under law, the **Auditor shall not accept such an engagement, UNLESS REQUIRED BY LAW OR REGULATION TO DO SO**.
- Specimen Audit Engagement Letter is placed at Annexure B.

Communication to Previous Auditor (direct question can be asked)

- As a measure of the professional etiquettes, while taking up any audit engagement, the auditors **shall give intimation to the previous auditor**, intimating his engagement as auditor of the company.
- The term predecessor or previous auditor can be defined as an auditor who has **conducted the most recent audit** assignment of the Auditee of the **same nature and submitted report** thereon prior to the incumbent auditor or **was engaged but did not complete the audit assignment due to his resignation, termination or OTHERWISE (means for any other reason)**.

CASE LAW

In *Re, Ssay & Associates v. Institute of Chartered Accountants of India*, it was held that there is **no requirement for an auditor to secure a no objection certificate from previous auditor** as only requirement is that auditor, who accepts position as an auditor, must communicate with previous auditor about same.

- In case whenever **a practicing company secretary is appointed as secretarial auditor in place of the existing secretarial auditor**, he should communicate the appointment to the earlier incumbent in writing.

Illustration

Mr. P was appointed as the Secretarial Auditor of ABC Ltd. for the F.Y. 2019-20. However, during the course of audit, he intimated the Appointing Authority his inability to complete the audit of ABC Ltd. and therefore cannot give audit report thereon. ABC Ltd. accepted the request of Mr. P and approached Mr. Q to become the secretarial Auditor for F.Y. 2019-20.

In such case, Mr. Q has to first communicate to the Predecessor Auditor i.e. Mr. P of his intention to accept the secretarial audit assignment of ABC Ltd. and wait for 7 days from the date of intimation to Mr. P, before accepting the secretarial audit of ABC Ltd. for F.Y. 2019-20.

- There should be an effective communication with the Predecessor or Previous Auditor, if any.
- Auditor **should communicate with the Predecessor or Previous Auditor** in such manner as to **retain positive evidence of the delivery of the communication**.
- Communication by a **letter sent by Registered Acknowledgement Due or by courier or by hand against the written Acknowledgement or through an email** would be in

the normal course provide such evidence.

- The Auditor **shall wait for a period of 7 days** from the date of communication before accepting the audit.
- In case **any information is provided by the Predecessor Auditor, the Successor Auditor shall take cognizance** of the same.
- The information obtained from the Predecessor may be useful in undertaking the audit. Such **information shall remain confidential**.

CASE STUDY

XYZ Limited is a listed company and recently hired a new secretarial auditor firm (M/s AA & Associates) to replace the previous auditor firm (M/s BB & Associates), who had been serving the company for two years. The M/s AA & Associates was made responsible for ensuring compliance with various regulations and guidelines and preparing audit report.

Challenge:

- The primary challenge faced by XYZ Limited was to smoothly execute the transition of responsibilities between new and old auditors to communicate effectively with the M/s BB & Associates.
- This was crucial, as the new auditor would need access to all previous records, reports, and other information related to the company's secretarial audit.

Solution:

- To address this challenge, the company's management decided to set up a meeting between the M/s AA & Associates and the M/s BB & Associates.
- During the meeting, the new auditor would have the opportunity to ask any questions, clarify any doubts, and obtain access to all relevant records and reports.

Results:

- The communication between the previous secretarial auditor and the new auditor was successful as a written communication in form of email has been made by M/s AA & Associates to previous auditor, and the M/s AA & Associates was able to obtain all necessary information to perform their duties effectively.
- The information provided by the previous auditor was extremely useful, as it helped the new auditor to identify any areas of concern and address them promptly.

- The Council of the Institute of Company Secretaries of India has resolved that it shall be mandatory for every Company Secretary in Practice, before accepting any of the following assignments, to communicate to the previous incumbent, in terms of terms of clause (8) of part I of the First Schedule to the Company Secretaries Act, 1980:
 - (i) Signing of Annual Return in Form MGT-7 under Section 92(1) of the Companies Act, 2013 and rule 11(1) of the Companies (Management and Administration) Rules, 2014.
 - (ii) Certification of Annual Return in Form MGT-8 under Section 92(2) of the Companies Act, 2013 and rule 11(2) of the Companies (Management and Administration) Rules, 2014.
 - (iii) Issuance of Secretarial Audit Report in terms of Section 204 of the Companies Act, 2013.
 - (iv) Issue of Secretarial Audit Report to material unlisted subsidiaries of Listed entities (whose equity shares are listed) under Regulation 24A of SEBI (LODR) Regulations, 2015.
 - (v) Issue of Annual Secretarial Compliance Report to Listed entities (whose equity shares are listed) under Regulations 24A of SEBI (LODR) Regulations, 2015.
 - (vi) Certification under SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015 that none of the directors on the board of the company have been debarred or disqualified from being appointed or continuing as directors of companies by the Board/ Ministry of Corporate Affairs or any such statutory authority under Schedule V, Part C, Clause (10)(i).
 - (vii) Certification under Regulation 40(9) of SEBI (LODR) Regulations, 2015 certifying that all certificates have been issued within thirty days of the date of lodgement for transfer, subdivision, consolidation, renewal, exchange or endorsement of calls/ allotment monies.
 - (viii) Conduct of Internal Audit of Operations of the Depository Participants registered with NSDL & CDSL under the provisions of the Depositories Act, 1996 read with SEBI (Depositories and Participants) Regulations, 1996.
 - (ix) Certificate of Reconciliation of Share Capital Audit Vide Circular No. D & CC/FITTC/CIR-16/2002 Dated December 31st 2002 (Amended Vide Circular No. CIR/ MRD/DP/30/2010 Dated 06-09-2010) Issued By SEBI.
 - (x) Acting as Compliance Auditor under Third Party Certification/ Audit Scheme (Amendment), 2018 in the State of Haryana.
 - (xi) Issuance of Audit Report as provided under Regulation 76 the SEBI (Depositories and Participants) Regulations, 2018, by the unlisted public companies, to be submitted on a half-yearly basis to the

ROC, under whose jurisdiction the registered office of the company is situated, under the provisions of the Rule 9A(8) of the Companies (Prospectus & Allotment of Securities) Rules, 2014.
 - (xii) Diligence Reporting for Banks in case of multiple banking/consortium lending

arrangements in terms of the circular issued by RBI.

(xiii) Conduct of Internal Audit of Depository Participants.

(xiv) Conduct of Internal Audit of stock brokers/sub brokers under SCRA, 1956 and Rules and Regulations made thereunder.

Question: Is communication to previous auditor required?

Answer: Yes, the Auditor shall communicate in writing to the predecessor or previous auditor, if any before accepting the audit engagement.

Further, Council of ICSI has prescribed the following format to be issued by Company Secretaries under Clause 8 of the First Schedule of the Company Secretaries Act, 1980:

CS.....

Address Dear Sir / Madam,

Sub.: Intimation in terms of Clause 8 of the First Schedule to the Company Secretaries Act, 1980.

I, CS /We, M/s....., Company Secretary in Practice / Firm of Company Secretaries have been

approached by the Management of M/s..... Limited to.....(list of professional services) for the FY

..... vide their letter No. dated We understand that earlier the abovementioned professional

services were being rendered by your goodself/ firm to M/s. Limited during the Financial Year

I / We request you to kindly take this communication as an intimation to be given to the previous incumbent in terms of Clause 8 of the First Schedule to the Company Secretaries Act, 1980.

Regards, CS

Membership No. ACS / FCS CoP No.....

For & Co./ & Associates, Company Secretaries Firm Unique Code

Date:

Place:

Limits on Audit Engagements (direct question can be asked)

- An auditor **shall not accept audit engagement beyond the limits of number of audits**, if any, as may be specified under applicable laws or any other body governing such profession.
- Violation of the limits by the auditor may attract disciplinary actions** against the auditor.
- The fact that **because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements or material non-compliances may not be detected**, even though the audit is properly planned and performed in accordance with the applicable auditing standard.
- To uphold the quality of services rendered by members of the Institute, the Institute has issued the following guidelines:

Guidelines	Guidelines Issued at
Limits for the issue of Secretarial Audit Reports: 10 Secretarial Audits per partner/ PCS, and - an additional limit of 5 Secretarial Audits per partner/PCS in case the unit is peer reviewed. The limits will be applicable for the Secretarial Audit Reports issued for the FY2016-17 onwards)	235th meeting of the Council held on 11th February, 2016
Number of Annual Secretarial Compliance Reports to be issued by PCS are 5 (five) reports individually / per partner in each financial year w.e.f. 1st April, 2020 and an additional limit of 5 (five) ASCR individually/ per partner in case the unit has been Peer Reviewed.	260th meeting of the Council held on 4-5 May, 2019
In case of the following, Secretarial Audit/ Secretarial Compliance Report to be done by Peer Reviewed Units only: - Top 100 companies as per market capitalization w.e.f. April 1, 2020 - Top 500 companies as per market capitalization w.e.f. April 1, 2021 - All listed companies w.e.f. April 1, 2022 - All companies w.e.f. April 1, 2023	259th meeting of the Council held on 16th March, 2019

Test Yourself

Question: Can an Auditor accept any number of audits?

Answer: The Auditors shall accept audit engagements within the limits of number of audits, if any, as may be under any law or by ICSI from time to time.

CONFLICT OF INTEREST (case-study question can be asked)

- CSAS-1 (Auditing Standard on Audit Engagement) effective from 1st April, 2021, defines "Conflict of Interest" as
 - ✓ The Auditor **shall not have any substantial conflict of interest** with the Auditee.
 - ✓ Any **conflict of interest, other than substantial conflict of interest, must be disclosed by the Auditor before accepting the Audit Engagement** or as soon as the Auditor becomes aware of the same, as the case may be.

The term conflict of interest is defined below. It is expected that the Auditor shall not have any conflict of interest with the Auditee. If the **Auditor has any such interest, it is the duty of the Auditor to disclose such interest/ conflict of interest to the Auditee** before accepting the Audit Engagement.

- The conflict of interest with the Auditee explained below **SHALL NOT BE** construed as a substantial conflict of interest:
- Auditor holding **not more than 2%** paid up share capital or shares of **nominal value of Rs. 50,000**, whichever is **LOWER** or **MORE THAN 2% voting power**.
- Auditor indebted to the Auditee for an amount **NOT EXCEEDING Rs. 5,00,000**.
- Auditor was in employment of the Auditee **MORE THAN 2 YEAR AGO**

In above cases, the Auditor shall be eligible for undertaking the Audit Engagement **only if he discloses such fact in WRITING** before accepting the Audit Engagement or as soon as he becomes aware of the same, as the case may be.

- In following cases, it shall be construed that the Auditor has a substantial conflict of interest with that of the Auditee and he **shall not accept** any Audit Engagement from the Auditee.
 - ✓ Auditor holding **more than 2%** paid up share capital or shares of **nominal value of Rs. 50,000** or holding **more than 2% voting power**.
 - ✓ Auditor indebted to the Auditee for an amount **EXCEEDING Rs. 5,00,000** indebtedness that may seriously impair the independence of the Auditor, irrespective of the amount.
 - ✓ Auditor was in employment of the Auditee **not more than 2 years ago**.

In above mentioned cases, the Auditor is **debarred** from accepting such Audit Engagement.

Test Yourself

Question: Can an auditor accept Audit engagement even if there is conflict of interest?

Answer: Yes. The Auditor can accept audit engagement where there is conflict of interest with the Auditee by making disclosure before accepting audit engagement or on becoming aware of such conflict. However, in **case of substantial conflict of interest Auditor cannot accept Audit engagement.**

Explanation

Substantial Conflict of Interest means:

Holding of more than 2% in the paid-up share capital or shares of nominal value of rupees fifty thousand, whichever is lower or more than 2% voting power, as the case may be, by the Auditor **singly or along with partners, spouse, parent, sibling, and child of such person or of the spouse, ANY OF WHOM IS DEPENDENT FINANCIALLY on such person.**

Before accepting the audit, the **Auditor shall disclose that there is no conflict of interest of ownership** as specified in this Standard or prescribed in any law, act, rules and regulations under which the audit is being carried on.

Where there exists a substantial conflict of interest in the Auditee organisation, the Auditor cannot accept the Audit Engagement.

The limit of holding of more than 2% in the paid-up share capital or shares of nominal value of rupees fifty thousand, whichever is lower or more than 2% voting power **shall be applied based on combined holding** of the Auditor along with partners, spouse, parent, sibling, and child of such person or of the spouse, any of whom is dependent financially on such person.

Illustration 1

Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. B holds 1% paid- up share capital in a company XYZ Ltd. Wife and

daughter of Mr. A, who are financially dependent on him hold 1% paid-up share capital in XYZ Ltd. each.

Mr. A has been offered the Secretarial Audit of XYZ Ltd.

In this case, Mr. A is not directly holding any interest in XYZ Ltd. However, according to para 3.1 of CSAS-1, Mr. A is having a substantial conflict of interest in XYZ Ltd. as the aggregate value of paid-up share capital held by his wife, daughter and partner in XYZ Ltd. is 3%. Hence, he is not eligible to become Secretarial Auditor of XYZ Ltd.

Illustration 2

Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. A holds 1% paid-up share capital in a company XYZ Ltd. and Mr. B holds shares of nominal value of Rs. 60,000 in XYZ Ltd.

Mr. A has been offered the Secretarial Audit of XYZ Ltd.

In this case, though Mr. A hold only 1% of the paid up share capital in XYZ Ltd. But according to para 3.1 of CSAS-1, he is having a substantial conflict of interest in XYZ Ltd. as his partner Mr. B is having a share capital of nominal value of more than Rs.50,000 in XYZ Ltd. and therefore Mr. A is not eligible to become Secretarial Auditor of XYZ Ltd

Illustration 3

Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. A & Mr. B each holds 0.5% paid-up share capital in a company XYZ Ltd. Nominal value of such shares held by each of them is Rs. 20,000. Mr. A has been offered the Secretarial Audit of XYZ Ltd.

In this case, though Mr. A is having a conflict of interest in XYZ Ltd. The same will not be considered as a substantial conflict of interest. Therefore, Mr. A can accept the Secretarial Audit of XYZ Ltd. In this case he shall disclose to the Appointing Authority the fact that he has a conflict of interest with the company, but the same is not substantial conflict of interest in accordance with CSAS-1.

Illustration 4

Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. A holds 1% of the paid-up share capital in company XYZ Ltd. Nominal value of such shares is Rs. 60,000. The market value of the shares held by Mr. A is Rs. 40,000. Mr. A has been offered the Secretarial Audit of XYZ Ltd.

In this case, there will be a substantial conflict of interest between Mr. A and the company XYZ Ltd. as the nominal value of shares held by Mr. A is more than Rs. 50,000, therefore he cannot accept the Secretarial Audit of XYZ Ltd. The market value of the shares is irrelevant while deciding the conflict of interest based on ownership in accordance with CSAS-1.

Illustration 5

Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. A holds 1% of the paid-up share capital in company XYZ Ltd. Nominal value of such shares is Rs. 60,000. XYZ Ltd. wants to give its Internal Audit assignment to ABC, LLP.

In this case, there exists a substantial conflict of interest of ABC, LLP with the company XYZ Ltd. due to the fact that one of the partners of the LLP is holding shares of a nominal value of more than Rs. 50,000 in XYZ Ltd. Therefore, it will not be eligible to undertake the internal audit assignment of XYZ Ltd. as per CSAS-1.

- Indebtedness of the Auditor for an amount exceeding rupees five lakh **OTHER THAN THAT ARISING OUT OF ORDINARY COURSE OF BUSINESS OF THE AUDITEE.**
- Provided that any **indebtedness that may seriously impair his independence** shall also be considered as substantial conflict of interest.
- Before accepting the audit, **the Auditor shall disclose that there is no conflict of financial interest as specified in this standard or prescribed law** under which the audit is carried on.
- The limit of rupees five lakh as specified **shall be applicable to the combined indebtedness** of the audit firm including indebtedness by the partners in their individual capacity.
- The term “ordinary course of business” has not been defined.
- An assessment of whether a transaction is in “ordinary course of business” can be subjective and may vary on case-to-case basis.

- For example, a banking company which in ordinary course of business provides loan or gives guarantees/ securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the prevailing lending rate, may extend loan to its Auditor as per the terms and conditions of the company and such loan shall not be treated as conflict of financial interest.

Illustration 1

Mr. A is a Practicing Company Secretary. He has taken a personal loan of Rs. 5,00,000 from a XYZ LLP wherein Mr. B, who is the designated partner is friend of Mr. A. The payment of such loan is still outstanding in full. Mr. A has been offered to undertake the Internal Audit of XYZ, LLP.

In the given case, Mr. A has a conflict of interest in XYZ LLP, but it doesn't debar Mr. A from undertaking the Internal Audit of XYZ LLP. Mr. A shall disclose the fact to the Appointing Authority before accepting such Audit.

Illustration 2

Mr. A is a Practicing Company Secretary. He had taken a personal loan of Rs. 5,00,000 from XYZ Ltd. wherein his uncle is Managing Director. Mr. A has been offered to undertake the Secretarial Audit of XYZ Ltd.

In the given case, Mr. A has conflict of interest with the Auditee, as the amount of indebtedness is Rs. 5,00,000, but the same is not considered as substantial conflict of interest. In this case, he is required to make disclosure of the fact to Appointing Authority.

Illustration 3

Mr. P is a Practicing Company Secretary and is offered to conduct the Secretarial Audit of ABC Ltd. Mr. P is indebted to the Director of the company for an amount Rs. 6,00,000. Whether he can accept the Secretarial Audit Engagement of ABC Ltd.

In the given case, Mr. P has a substantial conflict of interest in ABC Ltd. And therefore he can't accept the secretarial audit assignment.

Illustration 4

Mr. A is a Practicing Company Secretary. He had taken a personal loan of Rs. 25,00,000 from XYZ Ltd.. He has used such loan towards purchase of his house which has been mortgaged with XYZ Ltd. Due to some financial crisis, Mr. A has not been able to repay any amount towards the loan since past 2 years. Mr. A has been offered to undertake the Secretarial Audit of XYZ Ltd.

The circumstances of the case suggest that indebtedness of Mr. A towards XYZ Ltd. is such that , if he accepts the Audit of XYZ Ltd., it may substantially impair the independence of Mr. A while forming an opinion on the basis of his audit findings and therefore considered as substantial conflict of interest

Therefore, in this case, Mr. A shall be debarred from accepting the Secretarial Audit assignment of XYZ Ltd.

- Where an Auditor was in employment of the **Auditee, its holding or subsidiary company** and **2 years have not lapsed from the date of cessation** of employment, the same shall be considered as substantial conflict of interest.
- A PCS or member/partner of a PCS firm cannot undertake the audit of that undertaking **where the member was in employment prior to holding the Certificate of Practice, unless two years have lapsed from the date of cessation of employment.**
- The PCS shall disclose the fact that two years have not lapsed from the date of cessation of his employment to the Auditee.
- Holding and Subsidiary company shall have the same meaning as defined under section 2 (46) and 2(87) of the Companies Act, 2013.

Illustration 1

Mr. A was the Company Secretary of PQR Ltd. from 1st October, 2015 till 31st May, 2018. He left the job w.e.f. 31st May, 2018 and joined in ABC and Associates (CS Firm) as a partner. On 1st January 2020, ABC and Associates has been offered to conduct Secretarial Audit of ST Ltd. for the F.Y. 2020-21. ST Ltd. is the wholly owned subsidiary of PQR Ltd.

According to para 3 of CSAS-1, Mr. A or ABC and Associates, in which he is a partner cannot undertake any audit assignment in PQR Ltd. and/or its holding or subsidiary companies till 31st may, 2020, i.e. two years from the date of cessation of his employment in PQR Ltd. Therefore, ABC and associates cannot undertake the Secretarial Audit assignment of ST Ltd. for the F.Y. 2020-21.

Illustration 2

Mr. A was the Company Secretary of PQR Ltd. from 1st October, 2015 till 31st May, 2018. He left the job w.e.f. 31st May, 2018 and joined ABC and Associates (CS Firm) as an employee. On 1st January 2020, ABC and Associates has been offered to conduct Secretarial Audit of ST Ltd. for the F.Y. 2020 -21. ST Ltd. is the wholly owned subsidiary of PQR Ltd.

Since Mr. A has joined ABC and Associates in the capacity of an employee, ABC and associates can undertake the Secretarial Audit assignment of ST. Ltd. for the F.Y. 2020-21.

Effect of Substantial Interest (direct question can be asked)

- The Company Secretaries Act, 1980 (the Second Schedule, Part I, paragraph 4) makes it an act of misconduct for a Company Secretary to express an opinion on any report or statement of a business or enterprise in which he or his firm or a partner of his firm has a substantial interest, **unless he discloses the interest also in his report.**
- Such **restriction will put the stakeholders on guard against any possibility of an impairment of the independence** of the professional signing the report.
- The Companies Act, 2013 does not define the phrase “substantial interest”. This **should be left to the judgment and discretion of the professional** to determine the extent of interest which would affect his independence.
- He **would be well advised to satisfy himself that the decision in this regard is such as would be taken as reasonable by an objective third party** in the circumstances

of the case.

- The **professional must take care to see that he does not get into situations** where there could be a conflict of interest and duty.
- A **practicing professional in practice may face a conflict of interest situation** while performing a professional service.
- A conflict of interest **creates a threat to objectivity and may create threats to the other fundamental principles**.
- Such threats may be created when:
 - ✓ The professional provides a professional service related to a particular matter for two or more clients whose interests with respect to that matter are in conflict or
 - ✓ The interests of the professional with respect to a particular matter and the interests of the client for whom the professional provides a professional service related to that matter are in conflict.
- An auditor **shall not allow a conflict of interest to compromise professional judgment**.
- Examples of situations in which conflicts of interest may arise include:
- When an auditor identifies and evaluates interests and relationships that might cause a conflict of interest, they **must implement safeguards to eliminate or reduce any threat to compliance with fundamental principles to an acceptable level**.
- The **auditor should use professional judgment and consider whether a reasonable and informed third party, knowing all the specific facts and circumstances**, would likely conclude that the fundamental principles are not compromised.
- When **addressing conflicts of interest**, including making disclosures or sharing information within the firm or network and seeking guidance of third parties, **the auditor shall remain alert to the fundamental principle of confidentiality**.
- If the **threat** created by a conflict of interest is **not at an acceptable level**, the **auditor shall apply safeguards to eliminate the threat or reduce it to an acceptable level**.
- If **safeguards cannot reduce the threat to an acceptable level**, the **auditor shall decline to perform the audit; or shall terminate relevant relationships or dispose of relevant interests** to eliminate the threat or reduce it to an acceptable level.
- Before accepting a new client relationship, engagement, or business relationship, an auditor shall take **reasonable steps to identify circumstances that might create a conflict of interest**, including identification of:
 1. The **nature of the relevant interests and relationships** between the parties involved; and

2. The **nature of the service and its implication** for relevant parties.
- It is **expected that the Auditor shall not have any conflict of interest with the Auditee**. If the Auditor has any such interest, **it is the duty of the Auditor to disclose such interest/ conflict of interest to the Auditee** before accepting the Audit Engagement.

CONFIDENTIALITY

- The **Auditors of a company while performing the audit assignment access the various confidential information** of the company and it is most required for the auditors to maintain the confidentiality of the auditee information.
- The principle of confidentiality imposes an obligation on the auditor to refrain from: **(direct question can be asked)**

Disclosing information	• Disclosing information acquired as a result of professional relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and
Using information for personal advantage	• Using information acquired as a result of professional relationships to their personal advantage or the advantage of third parties.
Inadvertent disclosures	• An auditor should maintain confidentiality even in a social environment. The auditor should be alert to the possibility of inadvertent disclosure, particularly in circumstances involving long association with a business associate or a relative.
Information disclosed by a Prospective client	• An auditor should also maintain confidentiality of information disclosed by a prospective client or employer.
Confidentiality within the firm	• An auditor should also consider the need to maintain confidentiality of information within the firm or employing organization.
Control of Staff	• An auditor should take all reasonable steps to ensure that staff under the auditor's control and persons from whom advice and assistance is obtained respect the auditor's duty of confidentiality.

Clause (1) of Part I of the Second Schedule to the Company Secretaries Act, 1980:

- A Company Secretary in practice is guilty of professional misconduct if they disclose information acquired during professional engagement without the Auditee's consent, unless required by law.

Definition of Information:

- Information implies any data not available in the public domain.

Confidentiality during Audit:

- Auditors receive, verify, and inspect various confidential and privileged documents, evidence, and representations.
- These should not be disclosed without the Auditee's express authority.

Proper and Specific Authority:

- Refers to the Appointing Authority or a person/committee entrusted by the Appointing Authority to oversee the audit.
- Auditors must maintain confidentiality of any information about the Auditee or their business.
- Disclosure is allowed only if explicitly permitted by the Auditee.
- Different Auditees may have different authorities to grant permission for disclosure (e.g., Board of Directors in a company, designated partner in an LLP).

Confidentiality in Social Environments:

- Auditors must maintain confidentiality even in social settings and avoid inadvertent disclosure, especially with long-term associates, relatives, or friends.

Audit Report References:

- References to audit evidence or documents in the audit report are deemed disclosure under legal obligation or performance of duty.
- Using decisions of judicial authority in forming an opinion is not considered sharing confidential information.

Educating and Safeguarding:

- Auditors should **educate employees**, staff, and team members **about confidentiality**.
- **Implement reasonable procedures** to maintain and safeguard confidentiality.
- **Take signed Non-Disclosure Agreements** (NDAs) from personnel with access to

confidential information.

- Ensure **procedures and safeguards to prevent unauthorized access** to confidential information.

CHANGES IN TERMS OF ENGAGEMENT (direct question can be asked)

- The Auditor **shall not agree to a change in the terms** of the Audit Engagement **without reasonable justification**.
- Changes to the terms of the Audit Engagement **must be agreed upon in writing** between the Auditor and the Appointing Authority, typically through a supplementary/revised engagement letter.
- **Requests to change** the terms of Audit Engagement **may result from changes in circumstances or restrictions** on the audit's scope.
- The Auditor **must consider the justification for the change**, especially if it involves a restriction on the scope of the Audit Engagement.
- Changes in circumstances affecting the Auditee's requirements may be a reasonable basis for changing the Audit Engagement **(In simple terms, this statement means that if something important about the auditee's situation changes, it might make sense to adjust the terms or scope of the audit engagement. The original audit plan may no longer be suitable because of new developments or unforeseen circumstances. For example: Imagine a company hires an auditor to conduct a statutory audit of its financial statements. Halfway through the year, the company decides to sell one of its major divisions, which significantly alters its financial reporting structure. Because of this change, the company and the auditor might agree to revise the audit engagement to focus on the remaining business operations instead of the original broader scope. This adjustment ensures the audit remains relevant and addresses the auditee's current needs and priorities).**
- Changes may not be reasonable if they relate to incorrect, incomplete, or otherwise unsatisfactory information. Example: If the Auditor cannot obtain sufficient evidence for labour law compliance and the Appointing Authority requests changing the Audit Engagement to avoid a modified or disclaimer of opinion.
- Changes to the terms of the Audit Engagement **require mutual consent**, a **supplementary/revised engagement letter**, and a **justification for the change**, signed by the Appointing Authority.
- The **impact of such changes on the level of assurance must be assessed before acceptance**.
- If the change results in a lower level of assurance, the Auditor may accept the change only

if it can be adequately covered by a modified report.

However, the Auditor should take the following precautions while accepting the change:
(direct question can be asked)

- (1) The Auditor **should not agree to a change in the terms of the Audit Engagement which restricts the scope of audit** provided under any statutes.
- (2) If the **term of the Audit Engagement is changed when it is expected that Auditor may have to issue a modified report, such type of changes should be resisted.**
- (3) Any **request to change to avoid or circumvent unfavourable Auditor's report is also unjustified** and should not be accepted.
- (4) If the **terms of the Audit Engagement are changed before the completion of the audit, the Auditor should not disregard the evidences obtained prior to the change** in scope of audit.

Test Yourself

Question: Can terms of audit engagement be changed?

Answer: As per Para 5.1 of CSAS-1, unless there is reasonable justification for doing so, the auditor shall not agree to change the terms of Audit Engagement. Further, if before completion of the assignment, the Auditor is requested by the Appointing Authority to change the scope of engagement, resulting in a lower level of assurance, the Auditor shall consider the appropriateness of carrying out the same.

Annexure A

Specimen Certificate of Eligibility as Secretarial Auditor

Date

To

The Board of Directors, Dear Sir,

Sub: Proposed Appointment as Secretarial Auditor

I/We thank you for your communication dated.....2019 seeking my/our consent to act as the

Secretarial Auditor of your company for the financial year I/We give my/ our consent for being appointed as Secretarial Auditor of the company. I/we hereby confirm that:

1. I am/we are eligible for appointment and not disqualified for appointment as per the Companies Secretaries Act, 1980 and rules and regulations made thereunder and ICSI Auditing Standards;
2. The proposed appointment is within the limits, if any laid down by ICSI;
3. I/We do not have any substantial conflict of interest in terms of ICSI Auditing Standard on Audit Engagement (CSAS 1);
4. I/We do not have any conflict of interest in terms of ICSI Auditing Standard on Audit Engagement (CSAS 1) Or
I/We do have conflict of interest other than substantial conflict of interest which are as below :

Thanking you,

Yours sincerely,

Annexure B

Specimen Audit Engagement Letter

To,

ABC & Associates (name of Audit
firm) Company Secretaries

(Address)

Dear Sir,

This engagement letter is provided in connection with (type of audit) of XYZ Ltd.

I. Scope of work

The scope of the Audit shall include(For example, in case of Secretarial Audit , the scope of audit shall be as specified in Section 204 of the Companies Act, 2013)

II. Responsibilities of Auditor

The Auditor shall carry out the audit with utmost integrity in terms of this Audit Engagement Letter adhering to the highest level of ethics and standards. The Audit shall be conducted in accordance of the requirements of the Act.

III. Duties of Auditee

Auditee acknowledges its responsibility for maintenance of Records and compliances under the applicable laws, acts, rules and regulations.

Auditee acknowledges its responsibility to provide the Auditor access to Records and documents of the Auditee, reports of third party and information as may be sought by the Auditor. The Auditee shall be responsible for the correctness and appropriateness of the Records, documents and information of the Auditee.

IV. Timeline

The Auditor shall submit the Audit Report for the F.Y. 20XX-XX within days of the end of the financial year.

Auditor may also submit a quarterly/half-yearly review report in which the audit observations of the Auditor made during the quarter for timely redressal.

V. Commercial Terms

Audit fees for the F.Y. 20XX-XX is fixed at Rs. XXXXXXXX plus applicable taxes. Fees will be billed as the work progresses.

Out-of-pocket expenses by the Auditor shall be reimbursed on actual basis.

VI. Confidentiality

The Auditor shall not disclose the information obtained during the course of Audit without proper and specific authority or unless there is a legal obligation or duty to disclose.

VII. Indemnity

During and after the term of this Engagement, both Parties agree to protect, indemnify, defend and hold harmless other Party, and to extent required from time to time non defaulting party, its officers, agents, and employees, from and against any and all expenses, damages, claims , suits, losses, actions, judgments, liabilities, and costs whatsoever (including legal fees on a full indemnity basis) arising out of, connected with, or resulting from, defaulting Party's negligence, misrepresentation or the breach of any obligations to be performed by the other party and/or its representatives under this Engagement. In no event will either party's liability towards other party arising from the terms of this Engagement exceed the total sum of fees paid under this Engagement.

VIII. Any other term as may be agreed between the Auditor and the Auditee, if any

For XYZ

Limited

Date

Place

Director

Director

7 Pager Revision Chart of Chapter 9

MEANING OF AUDIT ENGAGEMENT

Meaning: An audit engagement is an arrangement where an auditor is hired to audit the auditee's transactions. It is a contractual relationship formalized through an *Audit Engagement Letter*.

ICSI Standard: Defined by CSAS-1, effective from April 1, 2021, as terms of reference for the appointment, including audit scope, remuneration, and limiting conditions.

Offer and Acceptance:

- Initiated by either the auditor or auditee.
- Must meet eligibility criteria (e.g., Section 141 of the Companies Act, 2013).
- Appointment can be through direct communication or tendering process.

In case the auditor is to be appointed by the management on one-to-one basis, following steps should be taken care by the auditor (4 steps):

- **Step 1:** Selection or screening of prospective auditee based on following risk / assessment (5 points)

- **Step 2:** Communicating his willingness to take up the audit assignment.
- **Step 3:** Conducting a pre-engagement meeting with the management (13 points).
- **Step 4:** Signing the engagement letter with the Management and issuance of certificate by auditor before accepting an audit.

In case where the appointment of auditor is through a tendering process by the management:

- **Step 1:** Pre-bid meeting
- **Step 2:** Submission of technical bid
- **Step 3:** Signing the engagement letter
- **Step 4:** Certificate by auditor

The Auditor shall furnish a certificate to the Appointing Authority that:

- Number of audits are within the ceiling.
- No substantial conflict of interest.
- No restriction to render the professional services.
- Not debarred to undertake such audit

Preconditions of accepting/continuing any professional engagement

Acceptable Reporting Framework
Ensure the reporting framework (for audit, review, or secretarial/non-financial statements) is acceptable.

Management's Acknowledgment of Responsibilities

- Preparation of secretarial/non-financial statements in accordance with the applicable reporting framework.
- Internal Control development to prevent material misstatements due to fraud or error.
- Providing Access to:
 - Relevant information, records, and documentation.
 - Additional information requested by the auditor.
 - Unrestricted access to relevant personnel.

Limitation on Scope Prior to Engagement Acceptance - Refusal of Engagement: If management limits the auditor's scope in a way that would lead to a disclaimer of opinion, the auditor should not accept the engagement unless legally required.

Other Factors Affecting Engagement Acceptance

- **Declining Engagement:** If preconditions are not met:
 - Unacceptable reporting framework.
 - Agreement not concluded.
 - Reference to expected reports and possible variations.
- **Legal Exemptions:** If laws cover the engagement terms, no need to document them, but management must still acknowledge responsibilities.

Criteria for Declining or Withdrawing from Engagement

- **Client's Impact on Independence:** Evaluate any factors affecting the firm's independence.
- **Firm's Ability to Serve:** Assess if the firm has the necessary skills and resources.
- **Special Risks:** Consider any special risks or unusual circumstances related to the engagement.

APPOINTING AUTHORITY

Definition: The appointing authority is the person or entity responsible for appointing the auditor.

Dependence on Auditee Type:

- For **companies**, it's the Board of Directors or members of the company.
- For **other entities**, it's the person(s) responsible for governance and compliance.

Other Authorities: Can also include the Court, Tribunal, Regulator, or their officers.

Kingston Cotton Mill Co. - the shareholders of a company have the right to appoint an auditor, and that the directors of the company cannot interfere with this right.

ICSI Auditing Standard (CSAS-1):

Defines appointing authority as anyone with the power to appoint an auditor.

Companies Act, 2013 (Section 139):

- First statutory auditor:
Appointed by the Board within 30 days of incorporation.
- Subsequent auditors:
Appointed by members at the general meeting upon the board or audit committee's recommendation.

Corporate Insolvency: The Resolution Professional is the appointing authority.

Other Audits: For entities like stock brokers, investment advisors, and credit rating agencies, the appointing authority varies based on the auditee.

Table of Types of Appointing Authorities

Sun Moon Limited case study - court ruled that the board of directors of Sun Moon Limited had the authority to appoint the secretarial auditor, and that the appointment was valid.

Terms and Conditions of Audit engagement

Objective & Scope:

- Defined within the terms and conditions agreed upon by the auditor and auditee.
- Includes scope of audit.

Key Considerations:

- Objective & Purpose of Audit
- Auditor's Responsibilities
- Management/Auditee's Responsibilities
- Audit Risk
- Audit Limitations
- Audit Plan

Agreement Documentation: The audit engagement terms must be agreed upon and documented in an engagement letter or other written form to prevent conflicts during the audit.

Changes in Law or Terms:

- Amendments in law must be followed during the audit.
- Any changes in audit engagement terms must be assessed and documented by the auditor.

AUDIT FEE & EXPENSES

Factors Influencing Audit Fees:

- Size of the organization
- Nature of business
- Internal control systems & technology used
- Scope and frequency of audit

Fairness of Audit Fees:

- Fees should fairly reflect the work performed, considering the above factors.

Contingent Fee Prohibition:

- Audit services should not be based on contingent fees tied to specific findings or results, except if fixed by a court or authority.

Percentage-Based Fees:

- Charging a fee on a percentage basis is generally discouraged unless authorized by statute or accepted as a standard practice.

Price Competition:

- Accepting very low fees to compete is discouraged as it could impair the auditor's independence and audit quality.
- However, charging a lower fee than a previous auditor for similar work is not restricted by law.

Remuneration of Statutory Auditors (Section 142, Companies Act, 2013):

- Audit remuneration is fixed in the company's general meeting.
- Auditors can claim expenses incurred during the audit.

Remuneration for Secretarial and Internal Audit:

- Audit fees are decided by the audit committee or the board.

R. Swarup Reddy Vs. M.N Pratap Reddy

CLB Appointment: The Company Law Board (CLB) appointed independent auditors to audit the company's books of account.

Fee Dispute: Auditors claimed fees of ₹36.16 lakhs, while the company director argued that the fee should be capped at ₹8 lakhs.

Court's Observations:

- Auditors performed both an audit and an investigation, especially regarding related party transactions from 2007-2014.
- The fee claimed was supported by the number of days spent and the team composition.
- The company had previously paid ₹62 lakhs for auditing sister concerns for the same period.

Verdict: The court found the auditor's fees reasonable and directed the company to pay the full amount claimed.

AUDITING STANDARD ON AUDIT ENGAGEMENT (CSAS-1)

Applicability

- CSAS-1 applies to Practicing Company Secretaries (PCS) under the Company Secretaries Act, 1980, for audits under the Companies Act, 2013, SEBI Act, 1992, or other Indian laws.
- It does not apply to voluntary audits but is recommended for them.
- For audits appointed by Court, Tribunal, or Regulatory Authorities, CSAS-1 applies as far as possible.

Types of Audits Covered

- Illustrative list of audits may be conducted under various statutes, requiring the auditor to examine records and express an independent opinion.

Audit Engagement Process

- The auditor must agree on the terms of engagement with management or governance bodies.
- Key components include the Audit Engagement Letter and procedures for changing terms of engagement.

New vs. Recurring Audit Engagement

- **New Audit Engagement:** First-time audit or a new auditor replacing the previous one.
- **Recurring Audit Engagement:** Previous auditor conducting audit for subsequent periods, requiring a fresh engagement letter if the term has expired.

Changes in Terms of Engagement

- If terms change during an ongoing audit, a revised engagement letter must be issued.

Definitions

- **Auditor:** A member of ICSI holding a valid Certificate of Practice, including firms or LLPs registered with ICSI.
- **Management:** Includes Board of Directors, Key Managerial Personnel (KMP), and senior management as per Companies Act, 2013 and SEBI (LODR) Regulations, 2015.
- **Predecessor Auditor:** Previous auditor who completed or was engaged but didn't finish the audit assignment due to resignation, termination, etc.

AUDIT ENGAGEMENT PROCESS

Pre-Engagement Meeting

- **Objective:** Before accepting the audit, the Auditor meets with the Auditee to discuss key aspects such as the terms of the engagement, prior audit findings, reporting framework, understanding of the Auditee's business, internal controls, audit timelines, and commercial terms.
- **Conflict of Interest:** The Auditor must disclose any conflict of interest and maintain confidentiality regarding the information obtained during the meeting.

2. Appointment of Auditor

- **Manner of Appointment:** The appointment must follow the laws, rules, and guidelines. If no specific process is prescribed, the Appointing Authority determines the procedure.
- **Eligibility Certificate:** The Auditor must certify that the number of audits is within the ICSI limits, no substantial conflict of interest exists, and the Auditor is not restricted by law or debarred by ICSI from providing the service.
- **Audit Engagement Letter:** The Auditor must obtain an engagement letter and, if required, a copy of the resolution passed by the Appointing Authority. The Auditor's acceptance can be conveyed in writing or via email.

Audit Engagement Letter

- **Purpose:** This document outlines the audit's scope, responsibilities of both the Auditor and the Auditee, remuneration, and limitations. It prevents misunderstandings about the terms of the engagement.
- **Contents:** It includes the objective and scope of the audit, responsibilities, written representations from management, audit report timelines, audit fees, and any audit limitations.
- **Updates:** The letter should be reviewed yearly but only needs to be reissued if there are changes in the engagement terms.
- **Confidentiality and Ethics:** The Auditor must maintain confidentiality and ensure ethical standards throughout the audit.

Responsibilities of the Auditor

- **Conduct the Audit:** As per the terms of engagement, the Auditor should deploy personnel knowledgeable in the relevant laws and maintain high ethical standards.

CONFLICT OF INTEREST

Confidentiality and Insider

Trading: The Auditor and team members must maintain confidentiality and avoid trading in securities related to information gained during the audit.

Responsibilities of the Auditee

- **Provide Access:** The Auditee must give access to premises, records, and necessary information, including written management representations.
- **Facilitate Audit:** They must appoint a responsible official to assist the Auditor and provide details about the predecessor auditor.

Audit Remuneration

- **Factors Affecting Fees:** These include the organization's size, location, type (listed/unlisted), nature of business, internal controls, scope, and frequency of audit. Fees should reflect the value of work done.
- **Billing and Payment Terms:** Audit fees should not be contingent upon audit results. The Auditor cannot accept commissions for referrals or professional work sharing, as per the Company Secretaries Act.

Communication with Previous Auditor

- **Professional Etiquette:** When taking up a new audit, the Auditor should communicate with the predecessor Auditor to retain positive evidence of the transition and ensure no conflicts.
- **Mandatory Communication:** Certain audits, such as Secretarial Audits or certification under SEBI regulations, require mandatory communication with the previous Auditor.
- **Ssay & Associates v. Institute of Chartered Accountants of India** no requirement for an auditor to secure a no objection certificate from previous auditor

Limits on Audit Engagements

- **Compliance with Limits:** The Auditor must not exceed the number of audits allowed under applicable laws or guidelines. Failure to comply may lead to disciplinary action.

Definition:

- The Auditor must not have a substantial conflict of interest with the Auditee.
- Any non-substantial conflict must be disclosed before accepting the engagement or as soon as discovered.

Non-Substantial Conflict (Disclosure Required):

- Holding up to 2% of paid-up capital or shares worth Rs. 50,000 or less.
- Indebtedness to the Auditee not exceeding Rs. 5,00,000.
- Employment with the Auditee over 2 years ago.

Substantial Conflict (Prohibited):

- Holding over 2% paid-up capital or more than Rs. 50,000 in shares or voting power.
- Indebtedness exceeding Rs. 5,00,000, impairing independence.
- Employment with the Auditee within the last 2 years.

Key Provisions:

- Substantial interest includes combined holdings of the auditor, their family, or dependents.
- Indebtedness beyond Rs. 5,00,000 (outside the ordinary course of business) leads to conflict.
- Auditors must ensure no conflict of ownership or financial interest exists.
- Holding and subsidiary companies as defined under the Companies Act, 2013 apply.

Safeguards:

- Implement safeguards to mitigate conflict or decline/terminate the engagement if the conflict cannot be resolved.
- Disclosures must be made if a conflict is identified.

Professional Ethics:

- The Auditor must avoid conflicts that compromise objectivity or independence.
- The Companies Act and Company Secretaries Act highlight the importance of disclosing substantial interests to protect stakeholders.

CONFIDENTIALITY

Required for the auditors to maintain the confidentiality of the auditee information.

Principle of confidentiality imposes an obligation on the auditor to refrain from:

- Disclosing information
- Using information for personal advantage
- Inadvertent disclosures
- Information disclosed by a Prospective client
- Confidentiality within the firm
- Control of Staff

Clause (1) of Part I of the Second Schedule to the Company Secretaries Act, 1980: A Company Secretary in practice is guilty of professional misconduct if they disclose information obtained during an engagement without the auditee's consent, except when required by law.

Definition of Information:

- Information refers to data not publicly available.

Confidentiality During Audit:

- Auditors handle confidential documents and evidence, which should not be disclosed without explicit consent from the auditee.

Proper and Specific Authority:

- Authority refers to the appointing entity or a designated person who can approve disclosures.
- Disclosure is only permitted with auditee's authorization, which varies based on the type of auditee (e.g., Board of Directors for a company).

Confidentiality in Social Settings:

- Auditors must avoid disclosing confidential information, even inadvertently, in casual or social environments.

Audit Report References:

- Including audit evidence in reports is allowed under legal or duty obligations.
- Referring to judicial decisions in forming opinions is not considered disclosing confidential information.

Educating and Safeguarding:

- Auditors should train staff on confidentiality and implement safeguards, including NDAs, to prevent unauthorized access to confidential data.

CHANGES IN TERMS OF ENGAGEMENT

No Change Without

Justification:

- Auditor should not agree to change the audit terms without reasonable justification.

Written Agreement:

- Changes must be documented in writing through a supplementary or revised engagement letter, mutually agreed upon by the Auditor and the Appointing Authority.

Circumstances for Change:

- Requests for changes may arise due to new circumstances or scope restrictions.
- Auditor should assess the justification, especially if it limits the audit scope.

Valid vs. Invalid Changes:

- **Valid:** Changes due to genuine circumstances affecting the audit (e.g., new requirements).
- **Invalid:** Changes based on incorrect or incomplete information, or to avoid an unfavourable opinion.

Example:

- If sufficient evidence for compliance cannot be obtained, changing terms to avoid a modified opinion is unjustified.

Precautions for Auditors:

- Avoid changes restricting the statutory audit scope.
- Resist changes aimed at avoiding a modified report.
- Reject changes meant to circumvent an unfavourable audit report.
- Do not ignore evidence obtained before the change in terms.

Impact Assessment:

- Assess how the change affects the assurance level before accepting. A lower level of assurance should only be accepted if covered by a modified report.

Please do specimen's given at the end of the chapters properly.