

भारत सरकार / Government of India

राष्ट्रीय वित्तीय ररपोर्टिंग प्राधिकरण /National Financial Reporting Authority

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NF- 25013/2/2023-O/o Secy-NFRA

Dated 3.10.2024

Circular under Section 132(2) (b), (c), and (d) read with Rule 4(1), 4(2)(e) and Rule 9 of NFRA Rules 2018

To

1. Auditors of the entities under the purview of Rule 3 of NFRA Rules 2018

Subject: Responsibilities of Principal Auditor and Other Auditors in Group Audits

The Statutory Audit of financial statements, both standalone financial statements (SFS) and consolidated financial statements (CFS) under Companies Act, 2013 (CA 2013 or Act), require the auditors to mandatorily comply with the Standards on Auditing (SAs), and related Standards and Codes, prescribed under section 143 of CA 2013. As of now, the auditors are required to ensure adherence to the following sets of Standards and Codes to remain compliant with the extant laws in India:

- a) Standard on Quality Control (SQC);
 - b) 35 SAs addressing various aspects during the entire life cycle of an audit; and
 - c) Code of Ethics including Independence standards.
2. Audit of SFS, where the company has branches, and the audit of CFS of companies with subsidiaries, associates etc, called as audit of Group Financial Statements (GFS), requires special considerations by the auditor (called Principal Auditor), who is ultimately responsible for issue of group audit opinion, and also by the auditors (called Other Auditor) engaged to undertake audit of components such as branches and subsidiaries etc. 'SA 600 - Using the Work of Another Auditor' deals with the requirements in the audit of GFS.
3. In the contemporary business and economic environment, there are audit areas of material and/or significant risk in almost all the audits of GFS due to the following features (this list is not exhaustive).
- a. Complex group structures including special purpose vehicles, auto pilot structures, cross holdings of interests across group entities and shared service centres in different geographies
 - b. Shell or dummy companies as a conduit to siphon off funds from Public Interest Entities (PIEs)
 - c. Regular/frequent formation or acquisition of new businesses and/or entities including schemes of merger and demerger
 - d. Significant transactions with related parties
 - e. Significant transactions outside the normal course of business
 - f. Unusual or abnormal variances in financial data
 - g. Rapid technological developments
4. However, in the course of performing its functions such as exercising oversight and monitoring and enforcing compliance, the National Financial Reporting Authority ('NFRA') has observed gross negligence and audit failure in audits of GFS (cases of Group Audits involving various companies).

Instances include Reliance Capital Limited, Reliance Home Finance Limited, Reliance Commercial Finance Limited (together accounting for alleged fraud of ₹ 29000 Crores), Coffee Day Enterprises Limited (alleged fraud of ₹ 3500 Crores), Dewan Housing and Finance Limited (alleged fraud of ₹ 34000 Crores), and audit quality review of IL&FS (which collapsed with a debt of ₹ 90000 Crores). In these cases, moneys were diverted through subsidiaries and associates. The Principal Auditors did not raise red flags at the right time despite indicators of fraud, going concern issues and diversion of funds, as they relied on fallacious interpretations of SA 600 to not go into these issues and instead completely relied upon the clean audit reports of the Component Auditors.

5. The combined effect of these have resulted in a loss of tens of thousands of crores in the financial and capital market, adversely impacting investors, including retail investors, and creditors, involving huge public interest. Therefore, in exercise of NFRA's powers under Section 132 (2) (b), (c), (d) read with Rule 4 (1), 4 (2) (e) and Rules 3, 4 and 9 of NFRA Rules 2018, the auditors' obligations, under CA 2013 and existing requirements in SA 600 and related standards, are hereby reiterated in the following paragraphs, so that interpretations of the provisions of SA 600 by the auditors remain consistent with their obligations under CA 2013, Standard on Quality Control (SQC) and other applicable Standards of Auditing.

Observations by NFRA across various enforcement cases (illustrative)

6. Significant gaps have been noted by NFRA in audits, across various enforcement cases, relevant to audit of GFS. These include:

- a. Inadequate coordination/discussion with Component Auditors at most stages of audit
- b. Discrepancies in the number of components as per CFS and mandatory filings in MCA 21 which were not assessed by the auditors,
- c. Non-assessment of inclusion by Management of unaudited financial statements of some components in the CFS. In respect of the latter, the Principal Auditor stated that *"..... preparation of consolidated financial statements (CFS) is the responsibility of management and accordingly, use of component's unaudited financial statements, considering the nonavailability of audited financial statements, was also decision of management. As an auditor, we had no role to play in this regard. As a holding company auditor, it is not in our realm to insist on the management that all components financial statements should be audited"*. Such approach by the Principal Auditor went against the very objective of the audit of CFS as per the SAs i.e., to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
- d. SA 600 provides that Principal Auditor would normally be entitled to rely upon the work of Component Auditors unless there are special circumstances to make it essential for him to visit the component and/or examine the books of accounts and other records of the said component. While NFRA noted that the company had diverted large amounts to its promoter entity (upwards of Rs 3500 crores) and the auditor had himself identified the exposure of the group companies to the promoter company and recoverability of outstanding balances at year end as an important matter, the auditor stated that he relied upon the work of Component Auditors as 'no such special circumstances came to his attention to trigger the requirement of SA 600'.
- e. On non-reporting of fraud, a Principal Auditor stated that *'they had no obligation to evaluate the fraud risk in any of the group companies' and 'they had no access to the books of the subsidiaries audited by the other auditors'*.
- f. In another case both the Principal and Other Auditors failed to identify the false and erroneous under-statement of loans to entities controlled by promoters by way of book entries of cheques received as repayments but not encashed as of balance sheet date.
- g. In the case of audit of a non-banking finance company (NBFC) comprising 21 subsidiaries, one of the joint auditors and the auditor of 2 other subsidiaries had resigned reporting suspected fraudulent diversion of approximately ₹ 29,000 crores, some through group companies, and

others through undisclosed related parties and lending to companies which were not creditworthy, or had weak financials, or had no business activities; and used these loans for onward lending whose end use could not be verified. The Principal Auditor in the qualified audit report on the consolidated financial statements just referred to qualified opinion of the auditor of one of these 3 subsidiaries and also stated that the audit opinion was solely based on the reports of the auditors of 6 subsidiaries having 38.64% of the total assets of the group.

- h. In the case of another NBFC which operated through a network of around 250 branches across various states in India, the Principal Auditor did not ensure whether the appointment of the Branch Auditors appointment was legally valid, while the Principal Auditor's report stated that the branch audit reports had been considered and relied upon by the Principal Auditor. At the same time, the Principal Auditor, in their submissions to NFRA, denied that they relied on the Branch Auditors' Report and said that they did branch audits based on ERP System at HO. Neither the Principal Auditor nor the Branch Auditors verified group-wide internal control systems, in particular the controls relating to the appraisal and sanction of loans at the head office level and branch level. The Principal Auditor failed to properly evaluate nonconsolidation of a subsidiary resulting in material understatement of liability in the CFS.
- i. In the case of another company 100 % of the revenue of the company was being generated from its overseas branch (country A) and the auditor of this component was located in another overseas location (country B). The Principal Auditor was located in India where the entity had no business activities. The company had disclosed in its annual report that they were engaged in the Software business, whereas Revenue from operations reported in the financial statements was from construction business activities in overseas locations. The Principal Auditor did not evaluate the sufficiency of his participation in this audit which was replete with special circumstances nor did he evaluate the competence of the overseas auditor to undertake audit as per Indian statutory requirements.

Incorrect interpretation by some auditors in the application of existing provisions of SA 600

7. The above instances indicate an incorrect understanding by some auditors of their role in the audit of GFS. Because of the same, some auditors have incorrectly interpreted and selectively applied provisions of SA 600 in audits of GFS. This incorrect understanding is not in alignment with the Standards of Auditing and provisions in CA 2013.

8. Such interpretations appear to have partly arisen due to the selective reading of the requirements in SA 600 and treating them as being independent by themselves, unconnected with the overall responsibilities of auditors under CA 2013 and other SAs, including SA 200, which is fallacious. Below are a few examples of interrelated requirements that seem to have been disregarded by auditors in performing statutory audits of GFS (paragraphs 9-15 below).

9. The authority of all SAs, including SA 600, is set out in SA 200- Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing. **It is very important to note the overall objectives of an auditor in conducting an audit of financial statements, which are provided in Paragraph 11 of SA 200.**

“The overall objectives of the auditor in conducting an audit of financial statements are:

- (i) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

- (ii) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

Note: In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the SAs require that the auditor disclaim an opinion or withdraw from the engagement, where withdrawal is legally permitted."

10. **The overall objectives of audit of financial statements are the same for a Principal Auditor or a Component/Other auditor. Thus, Principal Auditors cannot contend that they did not perform adequate procedures in audits of GFS if in their opinion a particular SA, by itself, did not require them to do so.**

11. Paragraphs 18-23 of SA 200 state that *the auditor shall comply with all SAs relevant to the audit*. SA 200 further states that *the auditor shall not represent compliance with SAs in the auditor's report unless the auditor has complied with the requirements of this SA and all other SAs relevant to the audit*. An SA is relevant to the audit when the SA is in effect, and the circumstances addressed by the SA exist. **The auditor shall have an understanding of the entire text of an SA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.**

12. SA 200 further states that "The SAs contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The SAs require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit and, among other things:

- Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
- Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
- Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained.

These requirements are universal to audit of financial statements, whether standalone or consolidated.

13. Paragraph 21 of SA 200 states that to achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit, having regard to the interrelationships among the SAs, to:

- (a) Determine whether any audit procedures **in addition** to those required by the SAs are necessary in pursuance of the objectives stated in the SAs.
- (b) Evaluate whether sufficient appropriate audit evidence has been obtained.

As seen above, the requirement of performing audit procedures is not limited to those just mentioned in an SA. SA 200 states that because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in the SAs, the auditor is responsible for determining the audit procedures necessary to fulfil the requirements of the SAs and to achieve the objectives. In the circumstances of an engagement, there may be particular matters that **require the auditor to perform audit procedures in addition** to those required by the SAs to meet the objectives specified in the SAs (Para A70 of SA 200).

An opposite situation may also arise where an auditor is not able to perform additional procedures to meet the overall objectives of the SAs and the overall objectives of the auditor. The Note below paragraph 11 of SA 200 (quoted in paragraph 9 above) states that in all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the SAs require that the auditor disclaim an opinion or withdraw from the engagement, where withdrawal is legally permitted. A similar requirement is there in paragraph 22 of SA 600 which requires that when the principal auditor concludes, *based on his procedures*, that the work of the Other Auditor cannot be used **and he has not been able to perform sufficient additional procedures** regarding the financial information of the component audited by the Other Auditor, he should express a qualified opinion or a disclaimer.

14. Under SA 600 the principal auditor continues to remain responsible for forming and expressing his opinion on the group financial statements. A combined reading of the provisions of SA 600 such as paragraph 5, which states that 'When the principal auditor uses the work of another auditor, the principal auditor should determine how the work of the other auditor will affect the audit', and paragraph 12, which states that "The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment', show that under SA 600 as well, the auditor is required to obtain sufficient appropriate audit evidence to provide a basis for his overall opinion. In doing so, the auditor must comply with the requirement under paragraph 17 of SA 200, namely, 'to obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.'
15. As per paragraph 9 of SA 600 in considering whether the auditor's own participation is sufficient to be able to act as the Principal Auditor, the Principal Auditor has to consider the risk of material misstatements in the financial information of the components audited by the Other Auditor. In doing so, the auditor is expected to apply the requirements in SA 315- Identifying and assessing risks of material misstatement through understanding the entity and its environment (e.g. paragraph 11 read with application paragraph A29) and not rely blindly on the work done by the Component Auditor. Paragraph 10 of SA 600 does not envisage a mechanical adoption/ reliance on the work of the Component Auditor, but a professional assessment of the decision regarding such reliance which needs to be documented by the auditor.
16. **Therefore, the responsibility of the auditor under SA 600 is required to be read with the auditor's concomitant responsibilities in CA 2013, and in related SAs such as SA 200, SA 220 (Revised), SA 230, SA 240, SA 300, SA 315 (Revised 2019), SA 320, SA 330, SA 450 and SA 701 towards obtaining sufficient and appropriate evidence in support of the auditor's opinion on the group financial statements.**
17. Additionally, the interpretation apparently being applied by some auditors in respect of obligations or requirements which use words other than 'shall' in the text of SA 600, is also not correct. The word 'should', it appears, is being interpreted by some auditors to claim that the provisions are directory and not mandatory. A few such provisions in SA 600 which use the word 'should' are illustrated below. For instance,
 - a. Paragraph 5 of SA 600 states that 'When the principal auditor uses the work of another auditor, the Principal Auditor should determine how the work of the other auditor will affect the audit.'

- b. Paragraph 9 of SA 600 states that the auditor should consider whether the auditor's own participation is sufficient to be able to act as a Principal Auditor.
 - c. Paragraph 12 of SA 600 states that "The Principal Auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment."
 - d. Paragraph 15 of SA 600 states that "The Principal Auditor should consider the significant findings of the other auditor".
18. The word 'should' has been used on over twenty occasions in the substantive text of the SA 600 and the word 'shall' has not been used even once. Considering these provisions as directory and not performing the required procedures frustrates the basic purpose of the audit and the objectives of this Standard and results in non-compliance of the Section 143(2), Section 143(3), Section 143(9) of CA 2013 and the Standards of Auditing.
19. The Hon'ble Supreme Court of India in a case¹ has held:
- "...The mere use of the word "should" does not mean necessarily that the compliance with the rule is discretionary. It is well-settled that whether a provision is directory or mandatory depends on its object and purpose, not merely on the use of any particular word or phrase."
20. In another decision², the Hon'ble Supreme Court held
- "Equally, it is settled in law that when a statute is passed for the purpose of enabling the doing of something and prescribes the formalities which are to be attended for the purpose, those prescribed formalities which are essential to the validity of such thing, would be mandatory"
21. In a recent decision,³ the High Court of Bombay laid down a clear test to determine whether a provision is mandatory or directory in nature:
- "36. Some of the well-known tests to determine whether a provision is *mandatory* or *directory* are as follows:
- (i) The use of expressions like "*shall*" or "*may*" are not conclusive and regard must be had to the true intent of the legislation. However, use of expressions like "*shall*" or "*should*" or "*must*" by the legislature at least *prima facie*, indicates *mandatory* nature. Similarly, the use of expressions like "*may*" or "*as nearly as may be*" by the legislature, at least *prima facie* indicates *directory* nature. *State of U.P. v. B.R. Upadhyaya*, AIR 1961 SC 751;
 - (ii) The circumstance that the statute itself provides consequences of breach or noncompliance, normally suggests a *mandatory* nature; *Maqbool Ahmad v. Onkar Pratap Narain Singh*, AIR 1935 PC 85, p. 88, *Manilal Shah v. Sardar Mahmud*, AIR 1954 SC 349;
 - (iii) A provision couched in negative form, generally suggests *mandatory* nature; Affirmative words, simpliciter, generally suggest *directory* nature; *M. Pentiah v. Muddla*, AIR 1961 SC 1107; *Dharamdeo Raiv. Ramnagina Rai*, (1972) 1 SCC 460;

¹ *Juthika Bhattacharya v. State of M.P.*, (1976) 4 SCC 96: 1976 SCC (L&S) 561

² *State of Haryana v. Raghubir Dayal* (1995) 1 SCC 133

³ WP No 10478 of 2014 Anant H. Ulahalkar and Ors Vs Chief Election Commissioner and Ors decided on 09.12.2016

(iv) A procedural rule, should ordinarily, not be construed as *mandatory*. If a provision relates to performance of any public duty and the invalidation of any act done in disregard of that provision causes serious prejudice to those for whose benefit it is enacted and at the same time, who have no control over the performance of the duty, such provision should be treated as *directory*; *Dattatraya Moreshwar* (supra);

(v) If a statute confers a concession or privilege and prescribes a mode of acquiring it, the mode so prescribed must be adopted as even affirmative words in such cases are construed imperative; *Edward Ramia Ltd. v. African Woods Ltd.*, 1960 (1) ALL ER 627;

(vi) Where a provision prescribes that a certain act has to be done in a particular manner by a person in order to acquire a right and it is coupled with another provision which confers an immunity on another when such act is not done in that manner, the former has to be regarded as *mandatory* one;

(vii) Provisions which impose private duties or obligations upon private parties are ordinarily to be regarded as *mandatory*; *Kedamath Jute Mfg, Co. Ltd. v. Commercial Tax Officer*, AIR 1966 SC 12;

(viii) If exceptions, exemptions or concessions are granted by a statute subject to fulfilment of certain conditions, then such conditions must be mandatorily fulfilled. Subject to fulfilment of conditions, the provision may be liberally construed;

(ix) The nature, design and consequences which would follow from construing the provision as “*mandatory*” or “*directory*”. Where construction of a provision as *directory* will render the provision or significant parts otiose, redundant or a surplusage. The principle is that the legislature does not use words in vain; and

(x) Where the construction of a provision as *mandatory* would result in absurdity, which could never have been intended by the legislature, the provision can be construed as *directory*.”

Preliminarily, it may be noted that on a *prima facie* basis, unlike the word ‘may’, the use of the word ‘should’ indicates that the provision is mandatory and not directory. Further, the interpretation of ‘should’ depends on several factors like legislative intent, the purpose of the law, and the consequences of non-compliance (especially for public interest).

22. Accordingly, auditors shall note that the use of the word ‘should’ at various occasions in SA 600 does not confer an arbitrary choice to the auditors to selectively apply the determinations or procedures required in the SA. The auditors are required to comply with SA 600 and related provisions on audit of GFS across SAs, unless the auditor records reasons for not doing so and provides reasons in his or her audit file and documentation that he or she undertook alternative actions that were sufficient to achieve the objective of the specific audit engagement.

23. It is useful to note that similar considerations of the use of specific terms to denote auditor obligations under Standards of Auditing apply globally. The Public Company Accounting Oversight Board (PCAOB), USA, has issued Rule 3101, Certain Terms Used in Auditing and Related Professional Practice Standards, in which it is stated that while the word ‘shall’ implies

‘unconditional responsibility’, the word "should" indicates responsibilities that are ‘presumptively mandatory’.

Rule 3101 states that *‘the auditor must comply with requirements of this type specified in the Board's standards unless the auditor demonstrates that alternative actions he or she followed in the circumstances were sufficient to achieve the objectives of the standard. Failure to discharge a presumptively mandatory responsibility is a violation of the relevant standard and Rule 3100 unless the auditor demonstrates that, in the circumstances, compliance with the specified responsibility was not necessary to achieve the objectives of the standard’*”.

In the note issued under the rule, the PCOAB stated that *“in the rare circumstances in which the auditor believes the objectives of the standard can be met by alternative means, the auditor, as part of documenting the planning and performance of the work, must document the information that demonstrates that the objectives were achieved.”*

24. Importance of the Principal Auditor’s obligations towards Group financial statements is further underscored in the Master circular for compliance with the provisions of the Securities and Exchange Board of India (Listing Obligations and Disclosure requirements) Regulations 2015, issued 11 July 2023 by SEBI. The circular provides⁴ that **the statutory auditor of a listed entity shall undertake a limited review of the audit of all the entities/companies whose accounts are to be consolidated with the listed entity** as per the relevant accounting standard (AS 21/Ind-AS 110) in accordance with guidelines issued by the Board on this matter. The audit procedures, which extensively reference SA 600 in addition to other obligations of auditors in respect of audit/review of CFS, are provided in Annexure 10 of SEBI’s above-mentioned circular.

Sufficiency of audit procedure towards evaluation of the work of the Other Auditor by the Principal Auditor

25. In the course of NFRA’s functions relating to oversight over the quality of service of the profession and monitoring and enforcing compliance with auditing and accounting standards, some auditors have contended to NFRA that in their understanding there is a bar on review of work papers of the Component Auditor, and this perceived bar has been stated by some Principal Auditors to be a reason to place sole reliance on the work of the Component Auditors. In their understanding the bar arises due to Clause (1) of the Second schedule of the Chartered Accountants Act, 1949, PART I, Professional misconduct in relation to Chartered Accountants in Practice which states that a Chartered Accountant in Practice shall be deemed to be guilty of professional misconduct, *“if he discloses confidential information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client or otherwise than as required by any law for the time being in force”*.
26. It is clear that the above-mentioned clause does not constitute a bar on sharing of work papers between the Principal Auditor and the Component/Other auditor, nor is there such a bar in any other law in the country. Sharing of work papers by a Component Auditor with the Principal Auditor will be permissible because it is required by the Principal Auditor for discharging his duties under Section 143 of CA 2013 and, therefore, it meets the requirement of ‘as required by any law for the time being in force’ mentioned in Clause (1) of the Second schedule of the Chartered Accountants Act, 1949, PART I. This is further explained in the following paragraphs.

⁴ Chapter III Financial Disclosures, Section III A, part (C), paragraph 12

27. Sharing of work papers by auditors, or review of work papers of the Component Auditor by the Principal Auditor, **which is required in course of his professional duties**, is inherent to the obligations of the Principal Auditor in s.143 of CA 2013 and SAs (SAs have a statutory status in CA 2013). Section 143 of CA 2013 (s.227 and s.228 of CA 1956 also) requires that the company auditor or the Principal Auditor has to consider the report of the branch auditor and report how (CA 1956)/in what manner (CA 2013) he considered it in respect of his overall reporting obligations. Relevant provisions in CA 2013 are discussed below in paragraphs 28-30.
28. Further, S. 143 of CA 2013 grants auditors a **right of access** to all books and vouchers of the company including **right of access** to the records of all the subsidiaries of the companies in so far as it relates to the consolidation of its financial statements with that of its subsidiaries. Auditors are entitled, under the provisions of this section, ‘to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor...’.
29. The obligation of the auditor under the Companies Act lies towards ‘every financial statement’ which includes the CFS. Section 143 (2) of CA 2013 states that ‘The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall

after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under sub-section (11) and to the best of his information and knowledge, the said accounts, financial statements **give a true and fair view** of the state of the company’s affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

30. Section 143 (3) of CA 2013 states that the auditor’s report shall also state—
- (a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;
 - (b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
 - (c) whether the report on the accounts of any branch office of the company audited under subsection (8) by a person other than the company’s auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
 - (d) whether the company’s balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
 - (e) whether, in his opinion, the financial statements comply with the accounting standards; (f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
 - (g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;
 - (h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
 - (i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls; (j) such other matters as may be prescribed.

Section 143 (4) states that 'Where any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons therefor'.

31. Therefore, the law specifies unequivocal right of access of the Principal Auditor to records of holding company, subsidiaries, associates, JVs, branches, and to information and explanation from company officers (including subsidiaries, associates, JVs, branches), his obligations to report on all information and explanations which to the best of his knowledge and belief were necessary for purpose of audit, his obligations to report if any of the matters that are required to be reported in the audit report could not reported or are answered in negative or a qualification.
32. SA 600 also requires, in paragraph 12, that "The Principal Auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the Other Auditor is adequate for the Principal Auditor's purposes, in the context of the specific assignment." SA 600 further requires under paragraph 5 that 'When the Principal Auditor uses the work of another auditor, the Principal Auditor should determine how the work of the other auditor will affect the audit.'
33. **Above provisions in law and SA read together and read with auditor's overall objectives in the SAs demonstrate that while SA 600 does not mention specifically a review of audit work papers of the Component Auditor or Other Auditor by the Principal Auditor, such a review may need to be applied by an auditor in appropriate cases, in exercise of his professional duties, professional skepticism and professional judgement, for evaluating whether the work of the Component Auditor is adequate for his purposes (the purpose being evaluating the work done by the Component Auditor towards gathering sufficient and appropriate evidence that his overall opinion on the group financial statements is appropriate in the circumstances as per his obligations in CA 2013 and the SAs). Such a review of audit work papers of the Component Auditor or Other Auditor by the Principal Auditor would also be consistent with the obligations of the Principal Auditor in SEBI's LODR, as mentioned above. Sharing of work papers by the Component Auditors with the Principal Auditor will be permissible in such cases and the above provision of the Chartered Accountants Act, 1949 will not come in the way because such sharing is required for the lawful discharge of duties of the Principal Auditor.**

Professional competence

34. Paragraph 11 of SA 600 provides that when planning to use the work of another auditor, the Principal Auditor should consider the professional competence of the Other auditor in the context of the specific assignment if the Other Auditor is not a member of the ICAI. This provision does not say that the Principal Auditor should not or cannot consider the professional competence of the Other Auditor in the context of the specific assignment even if the Other Auditor is a member of the ICAI.

Paragraph 13 of SA 600 requires that **the nature, timing, and extent of procedures (performed by the Principal Auditor)** will depend on the circumstances of the engagement **and the Principal Auditor's knowledge of the professional competence of the Other Auditor**. The paragraph further states that this knowledge may have been enhanced from the **review of the previous audit work** of the Other Auditor.

35. Form the above, it is abundantly clear that the reference to 'knowledge of professional competence' in this provision cannot by any interpretation be understood to mean the process

of merely confirming whether the Other Auditor is a CA or not. There is no parallel of any such provisions in any other profession where acquiring a professional degree is taken to be synonymous with professional competence. Professional competence goes beyond acquiring a professional degree/certification and takes into account the experience of the auditor, in terms of years of experience, relevant skills, sectors audited, complexity of audit assignments handled, and availability of adequate resources to undertake the specific engagement etc., to name a few. As provided in the SA, this assessment of professional competence of the Component or the Other Auditor is meant to help the Principal Auditor in his evaluation of the work of the Other Auditor and to determine to what extent he has sufficient appropriate audit evidence that provides a sufficient basis for his opinion on the GFS.

36. To conclude, as explained above, a selective reading and interpretation of existing provisions in SA 600 by some auditors without keeping in view the overall purpose and objectives of the audit and the provisions of the Act is not in alignment with the Standards of Audit and provisions of the Companies Act, 2013 and also not in public interest.

Responsibility for Consolidated Financial Statements lies with the Management and Board of Directors of the Holding Company and the Principal Auditors

37. Attention of the auditors is also invited to the provisions related to Consolidated Financial Statements in CA 2013 as some members of the auditing profession have shown a wrong understanding that the **responsibility for Consolidated Financial Statements does not lie with the Management and Board of Directors (BOD) of the Holding Company and concomitantly the group auditor should also not have responsibility for the same.**

The provisions of CA 2013 are very clear as far as the responsibility for financial reporting of both Separate Financial Statements and CFS of the parent company are concerned.

- (a) Section 134 (1) of CA 2013 dealing with approval of Financial Statements and Board's Report says that 'the financial statements, **including consolidated financial statements**, if any, shall be approved by the BOD before they are signed on behalf of the Board by the Chairperson of the company where he is authorized by the Board and by the two directors and CEO and CFO and Company Secretary'. Read with Section 129 (3) and 129 (7) of CA 2013, the provisions provide for the responsibility of the CFS to be that of the holding or parent company.
- (b) Further, as mentioned above also, under Section 129 (4) of CA 2013 states that 'the provisions of this Act applicable to the preparation, adoption **and audit** of the financial statements of a holding company shall, mutatis mutandis, apply to the consolidated financial statements.' Hence the responsibilities of the management and the auditors of the holding entity are unambiguous in law.

38. In view of the above background including the judgements of the Hon'ble Supreme Court and High Court, as cited above, and the critical public interest function performed by the auditors of public interest entities, NFRA reiterates that auditors shall understand their **responsibility under CA 2013 and SA 600 with their concomitant responsibilities in related SAs such as SA 200, SA 220 (Revised), SA 230, SA 240, SA 300, SA 315 (Revised 2019), SA 320, SA 330, SA 450 and SA 701 towards obtaining sufficient and appropriate evidence in support of the auditor's opinion on the group financial statements and carry out audit procedures accordingly.**

39. While doing so, use of the word 'should' in the various paras of SA 600 shall not be treated as directory, giving an arbitrary choice to the Principal Auditor to perform or not to perform the

procedures as specified in the SA 600. The word "should" in SA 600 casts responsibilities that are presumptively mandatory. Every Principal Auditor is, therefore, mandatorily required to perform all the procedures specified in SA 600 (regardless of the word 'should' in SA 600) and related SAs in fulfilment of his obligations under CA 2013 read with the overall objectives provided under SA 200, unless he has valid reasons to say that he has carried out alternate procedures to achieve these objectives and the absence of performance of such procedure would not materially impact his opinion of the accounts being true and fair. In circumstances in which the Principal Auditor believes the objectives of the SAs relevant to audit of GFS can be met by alternative means, the Principal Auditor, as part of documenting the planning and performance of the work, shall document the information that demonstrates how the objectives were achieved through the alternate means.

40. Section 132 (2) (b) & (c) of CA 2013 and the rules made thereunder enjoin upon NFRA to ensure compliance with accounting and auditing standards as prescribed. Rule 4 (1) of NFRA Rules 2018 requires the Authority to protect the public interest and the interest of investors, creditors and others associated with the companies governed under Rule 3 by establishing high quality standards of accounting and auditing and exercising effective oversight of auditing functions performed by the auditors. Clauses (c), (d) and (e) of Rule 4 (2) *inter alia* require monitoring and enforcing compliance with Auditing Standards, suggesting measures for improvement in the quality of service and promoting awareness in relation to the compliance of auditing standards. The present circular is issued to implement the aforesaid objectives for the protection of public interest. It seeks to promote awareness for ensuring effective compliance with the existing auditing standards.
41. It may be noted that this circular reiterates, in public interest, the existing obligations on statutory auditors which, as NFRA has observed, are not being interpreted correctly by a section of auditors of the Public Interest Entities under NFRA's purview. This circular is applicable to the auditors of all entities covered under Rule 3 of NFRA rules 2018 with immediate effect to prevent recurrence of audit failures and loss of confidence in audit of Public Interest Entities (PIEs). The auditors of the entities under Rule 3 of NFRA Rules 2018 are hereby required to scrupulously adhere to this circular in carrying out their audits of the PIEs.

Authorised for issue by the Executive Body, NFRA.



(Vidhu Sood)
Secretary, NFRA

Copy to:

1. Secretary, Ministry of Corporate Affairs, Government of India
2. Governor, Reserve Bank of India
3. Chairperson, Securities and Exchange Board of India
4. Chairperson, Insurance Regulatory and Development Authority of India
5. Chairperson, Pension Fund Regulatory Development Authority
6. Director General of Corporate Affairs, Ministry of Corporate Affairs, Government of India
7. Director General (Commercial-II), O/o CAG of India
8. Chairman, BSE
9. MD&CEO, National Stock Exchange
10. President, The Institute of Chartered Accountants of India

11. President, The Institute of Company Secretaries of India
12. Director General, Confederation of Indian Industry (CII)
13. Director General, Federation of Indian Chamber of Commerce and Industry (FICCI)
14. Secretary General, The Associated Chambers of Commerce and Industry of India (ASSOCHAM)
15. Secretary General, PHD Chamber of Commerce and Industry (PHDCCI)
16. Director, The CFO Board