

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

PART – I ACADEMIC UPDATE

RELEVANT AMENDMENTS FOR NOVEMBER 2022 EXAMINATION

**(Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by
Regulating Authority)**

I. Chapter 7 Audit Committee and Corporate Governance (SEBI (LODR) Regulations, 2015)

1. Insertion of word “**At least**” before two-thirds in point no. 1. The Audit Committee shall have minimum three directors as members. **At least** two-thirds of the members of audit committee shall be independent directors, however, in case of a listed entity having outstanding SR (Superior Rights) equity shares, the audit committee shall only comprise of independent directors. (Refer para 4.1 Qualified and Independent Audit Committee [Regulation 18(1)]– Page no.7.4).
2. Deletion of information on **Statement of significant related party transactions (as defined by the Audit Committee), submitted by management under** mandatorily review by Audit Committee as per Part C(B) OF Schedule II. (Refer para 7 Review of Information by Audit Committee on Page no.7.13)
3. Deletion of point no. (iv) The auditor shall ensure that the Chairperson of the board of the top 500 listed entities is - (a) a non-executive director; (b) not related to the Managing Director or the Chief Executive Officer as per the definition of the term “relative” defined under the Companies Act, 2013. It may be noted that this provision shall not be applicable to the listed entities which do not have any identifiable promoters as per the shareholding pattern filed with stock exchanges. It may also be noted that the top 500 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year. (Refer Para 8.5 Verification regarding Composition of Board [Regulation 17 & 17A on Page no. 7.16])
- 3.1. Insertion in Para 8.5 Verification regarding Composition of Board i.e., Regulations 17:
 - The listed entity shall ensure that approval of shareholders for appointment of a person on the Board of Directors [or as a manager] is taken at the next general meeting or within a time period of three months from the date of appointment, whichever is earlier.
 - Provided that the appointment or a re-appointment of a person, including as a managing director or a whole-time director or a manager, who was earlier rejected by the shareholders at a general meeting, shall be done only with the prior approval of the shareholders:
 - Provided further that the statement referred to under sub-section (1) of section 102 of the Companies Act, 2013, annexed to the notice to the shareholders, for considering the appointment or re-appointment of such a person earlier rejected by the shareholders shall contain a detailed explanation and justification by the Nomination and Remuneration

Committee and the Board of directors for recommending such a person for appointment or re-appointment. (Refer Para 8.5 Verification regarding Composition of Board [Regulation 17 & 17A on Page no. 7.17])

4. Meaning of Independent Director given on Page no. 7.18 to be read as: Independent director" means a non-executive director, other than a nominee director of the listed entity:
- (i) who, in the opinion of the board of directors, is a person of integrity and possesses relevant expertise and experience;
 - (ii) who is or was not a promoter of the listed entity or its holding, subsidiary or associate company [or member of the promoter group of the listed entity];
 - (iii) who is not related to promoters or directors in the listed entity, its holding, subsidiary or associate company;
 - (iv) who, apart from receiving director's remuneration, has or had no material pecuniary relationship with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, during the **three** immediately preceding financial years or during the current financial year;
 - (v) none of whose relatives— (A) is holding securities of or interest in the listed entity, its holding, subsidiary or associate company during the three immediately preceding financial years or during the current financial year of face value in excess of fifty lakh rupees or two percent of the paid-up capital of the listed entity, its holding, subsidiary or associate company, respectively, or such higher sum as may be specified; (B) is indebted to the listed entity, its holding, subsidiary or associate company or their promoters or directors, in excess of such amount as may be specified during the three immediately preceding financial years or during the current financial year; (C) has given a guarantee or provided any security in connection with the indebtedness of any third person to the listed entity, its holding, subsidiary or associate company or their promoters or directors, for such amount as may be specified during the three immediately preceding financial years or during the current financial year; or (D) has any other pecuniary transaction or relationship with the listed entity, its holding, subsidiary or associate company amounting to two percent or more of its gross turnover or total income: Provided that the pecuniary relationship or transaction with the listed entity, its holding, subsidiary or associate company or their promoters, or directors in relation to points (A) to (D) above shall not exceed two percent of its gross turnover or total income or fifty lakh rupees or such higher amount as may be specified from time to time, whichever is lower.]
 - (vi) who, neither himself /herself, nor whose relative(s) — (A) holds or has held the position of a key managerial personnel or is or has been an employee of the listed entity or its holding, subsidiary or associate company or any company belonging to the promoter group of the listed entity, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed: Provided that

in case of a relative, who is an employee other than key managerial personnel, the restriction under this clause shall not apply for his / her employment. (B) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of — (1) a firm of auditors or company secretaries in practice or cost auditors of the listed entity or its holding, subsidiary or associate company; or (2) any legal or a consulting firm that has or had any transaction with the listed entity, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm; (C) holds together with his relatives two per cent or more of the total voting power of the listed entity; or (D) is a chief executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent or more of its receipts or corpus from the listed entity, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the listed entity; (E) is a material supplier, service provider or customer or a lessor or lessee of the listed entity;

(vii) who is not less than 21 years of age.

(viii) who is not a non-independent director of another company on the board of which any non-independent director of the listed entity is an independent director.

(Refer Page no.7.18)

5. Deletion of word “the immediate next Board meeting or” and “whichever is later” in Regulation 25(6) i.e., sub-point no (ix) An independent director who resigns or is removed from the Board of Directors of the listed entity shall be replaced by a new independent director at the earliest but not later than three months from the date of such vacancy. **(Refer para 10 Obligations With respect to employees including Senior management, key managerial persons, directors and promoters on Page no. 7.22)**
6. The Board of Directors of every listed public company shall constitute the Nomination and Remuneration Committee which shall comprise of at least three directors, all of whom shall be non-executive directors and at least **two-thirds** shall be independent directors. Deletion of condition i.e., in case of a listed entity having outstanding SR equity shares, two thirds of the committee shall comprise of independent directors. Chairperson of the committee shall be an independent director. **(Refer Para 14 Nomination and Remuneration Committee- Regulation 19 and Part D of Schedule II, on Page No. 7.26)**
- 6.1 Insertion in the role of the Nomination and Remuneration Committee :(1A). For every appointment of an independent director, the Nomination and Remuneration Committee shall evaluate the balance of skills, knowledge and experience on the Board and on the basis of such evaluation, prepare a description of the role and capabilities required of an independent director. The person recommended to the Board for appointment as an independent director shall have the capabilities identified in such description. For the purpose of identifying suitable candidates, the Committee may: a. use the services of an external agencies, if required; b. consider candidates from a wide range of backgrounds,

having due regard to diversity; and c. consider the time commitments of the candidates. **(Refer Para 14 Nomination and Remuneration Committee- Regulation 19 and Part D of Schedule II, on Page No. 7.27)**

7. The provisions of regulation 21 shall be applicable to:(i). the top 1000 listed entities, determined on the basis of market capitalization as at the end of the immediate preceding financial year; and, (ii). a 'high value debt listed entity'.
- 7.1 The role of the Risk Management Committee committee shall, inter alia, include the following:
 - (1) To formulate a detailed risk management policy which shall include: (a) A framework for identification of internal and external risks specifically faced by the listed entity, in particular including financial, operational, sectoral, sustainability (particularly, ESG related risks), information, cyber security risks or any other risk as may be determined by the Committee. (b) Measures for risk mitigation including systems and processes for internal control of identified risks. (c) Business continuity plan.
 - (2) To ensure that appropriate methodology, processes and systems are in place to monitor and evaluate risks associated with the business of the Company;
 - (3) To monitor and oversee implementation of the risk management policy, including evaluating the adequacy of risk management systems;
 - (4) To periodically review the risk management policy, at least once in two years, including by considering the changing industry dynamics and evolving complexity;
 - (5) To keep the board of directors informed about the nature and content of its discussions, recommendations and actions to be taken;
 - (6) The appointment, removal and terms of remuneration of the Chief Risk Officer (if any) shall be subject to review by the Risk Management Committee. The Risk Management Committee shall coordinate its activities with other committees, in instances where there is any overlap with activities of such committees, as per the framework laid down by the board of directors.]

(Refer Para 16 Risk Management Committee- Regulation 21 and Part D of Schedule II, on Page No. 7.29)

8. **Para 18 Information to Shareholders [Regulation 36] to be read as:** (1) The listed entity shall send the annual report in the following manner to the shareholders: (a) Soft copies of full annual report to all those shareholder(s) who have registered their email address(es) either with the listed entity or with any depository; (b) Hard copy of statement containing the salient features of all the documents, as prescribed in Section 136 of Companies Act, 2013 or rules made thereunder to those shareholder(s) who have not so registered; (c) Hard copies of full annual reports to those shareholders, who request for the same.

- (2) The listed entity shall send annual report referred to in sub-regulation (1), to the holders of securities, not less than twenty-one days before the annual general meeting.
- (3) In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information: (a) a brief resume of the director; (b) nature of expertise in specific functional areas; (c) disclosure of relationships between directors inter-se; (d) names of listed entities in which the person also holds the directorship and the membership of Committees of the board along with listed entities from which the person has resigned in the past three years; and (e) shareholding of non-executive directors in the listed entity, including shareholding as a beneficial owner; (f) In case of independent directors, the skills and capabilities required for the role and the manner in which the proposed person meets such requirements.

The auditor should ascertain from the communications sent, whether in the case of appointment of a new director or re-appointment of a director, the shareholders have been provided with the information stipulated above. **(Refer Para 18 Information to Shareholders [Regulation 36] on Page no. 7.30)**

9. The listed entity shall submit a quarterly compliance report on corporate governance in the format as specified by the Board from time to time to the recognised stock exchange(s) within twenty-one (21) days from the end of each quarter.

The listed entity is also required to formulate a policy on materiality of related party transactions and on dealing with related party transactions. This policy should also include clear threshold limits duly approved by the board of directors. Further, such policy shall be reviewed by the board of directors at least once every three years and updated accordingly. A related party transaction shall be considered material, if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds rupees one thousand crore or ten per cent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity, whichever is lower. **[Regulation 23(1)]**

All related party transactions and subsequent material modifications shall require prior approval of the independent directors in audit committee of the listed entity **[Regulation 23(2)]**

Audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity subject certain conditions **[Regulation 23(3)]**.

The listed entity shall submit to the stock exchanges disclosures of related party transactions in the format as specified by the Board from time to time and publish the same on its website **[Regulation 23(8)]**.

Provided that a 'high value debt listed entity' shall submit such disclosures along with its standalone financial results for the half year.

Provided further that the listed entity shall make such disclosures every six months within fifteen days from the date of publication of its standalone and consolidated financial results.

Provided further that the listed entity shall make such disclosures every six months on the date of publication of its standalone and consolidated financial results with effect from April 1, 2023. **(Refer Para 22.3 Related Party Disclosures given on Page no. 7.35)**

9.1 As per Schedule V - Annual Report, the annual report shall contain the following additional disclosures relating to Related Party:

1. The listed entity which has listed its non-convertible securities] shall make disclosures in compliance with the Accounting Standard on “Related Party Disclosures”.
2. The disclosure requirements shall be as follows:

Sr. no.	In the accounts of	Disclosures of amounts at the year end and the maximum amount of loans/ advances/ Investments outstanding during the year.
1.	Holding Company	<ul style="list-style-type: none"> • Loans and advances in the nature of loans to subsidiaries by name and amount. • Loans and advances in the nature of loans to associates by name and amount. • Loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount.
2.	Subsidiary	Same disclosures as applicable to the parent company in the accounts of subsidiary company.
3.	Holding Company	Investments by the loanee in the shares of parent company and subsidiary company, when the company has made a loan or advance in the nature of loan.

For the purpose of above disclosures directors' interest shall have the same meaning as given in Section 184 of Companies Act, 2013.

(2A) Disclosures of transactions of the listed entity with any person or entity belonging to the promoter/promoter group which hold(s) 10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results.

3. The above disclosures shall not be applicable to listed banks.

(Refer Para 22.3 Related Party Disclosures given on Page no. 7.35)

- II. In Chapter 9 Audit of Banks, on page no. 9.20, for Verification of Balance with Reserve Bank of India part, responded word to be read as “unresponded”.
- III. In Chapter 12, Audit under Fiscal Laws,
- (i) In illustration 1 on page no. 12.9, 8.13 should be read as “10.13”.
- (ii) In question no. 1 on page no. 12.105, 1124 crore should be read as 1124 lac.
- IV. In Chapter 18 on Professional Ethics, Illustration 16 to be read as:

Mr. X is a Chartered Accountant accepted the appointment as Statutory Auditor of the Company ABC Ltd. without communicating with the previous auditor before accepting the audit. He also failed to ascertain the compliance of requirement of Section 139 and 140 of the Companies Act, 2013 in respect of the appointments have been duly complied with.

Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 requires communication by the incoming auditor with the previous auditor before accepting a position by him.

Clause (9) of Part I of the First Schedule to the Chartered Accountants Act, 1949, provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956 (now Section 139 and 140 of the Companies Act, 2013), in respect of such appointment have been duly complied with.

Under this clause it is obligatory on the incoming auditor to communicate with previous auditor and ascertain from the Company that the appropriate procedure in the matter of his appointment has been duly complied with so that no shareholder or retiring auditor may, at a later date, challenge the validity of such appointment.

In this case Mr. X accepted the appointment as Statutory Auditor of the Company ABC Ltd. without communicating with the previous auditor. Further, he accepted the appointment without first ascertaining whether the requirement of Section 139 and 140 of the Companies Act, 2013 in respect of the appointments have been duly complied with.

Conclusion: Therefore, Mr. X is liable for misconduct under clause 8 and Clause 9 since he accepted the appointment without communicating with previous auditor as well as for not verifying the compliance of statutory requirements.

Note: Students are also advised to refer RTP of Paper 1 Financial Reporting (for AS, Ind AS and other updates) and Paper 4 Part A - Corporate Laws (for academic updates relating to Company Law).