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REQUIREMENT TO CONDUCT A LIMITED REVIEW OF THE AUDIT OF ALL ENTITIES WHOSE ACCOUNTS ARE CONSOLIDATED WITH THAT OF A LISTED ENTITY AND CONSEQUENT NECESSARY PROCEDURES

4 April 2019

Introduction

The Kotak Committee Report on Corporate Governance had recommended certain changes to the regulatory regime for group audit. Consequently, the Securities and Exchange Board of India (SEBI) had amended regulation 33 of the SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015 (LODR) by including the following sub-regulation: *"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 AS 21 in accordance with guidelines issued by the Board on this matter"*. The amendment was notified by SEBI through a notification dated May 9, 2018 and has been made effective from April 1, 2019 (the SEBI Notification). The purpose of the SEBI Notification was to ensure that there is uniformity while conducting an audit/ review of all consolidated entities in a group with that of the listed company – and consequently, that the statutory auditor of the listed entity conduct an independent and a minimum review of the audited financial statements/ results of those entities whose financial statements/ results are consolidated with that of the listed entity's.

Subsequent to the SEBI Notification, SEBI has issued a circular dated March 29, 2019 (SEBI Circular), through which SEBI has codified the guidelines and procedures to be followed by listed entities, entities that are consolidated with such listed entities and their respective statutory auditors to give effect to the amendment referred to above. This newsletter details such amendments and explains the rationale behind such introduction.

The SEBI Circular in detail

Objective

A listed company is required to publish financial information periodically, in order to allow shareholders, stakeholders and the public at large to view its business and financial performance and take consequent and necessary decisions based on such review. Financial information is required to be published quarterly, year to end of each quarter and annually. SEBI prescribes formats for the presentation of such financial information by listed entities and formats for limited review reports and audit reports to be issued along with such financial information. In order to align such formats with the amendment introduced by the SEBI Notification, as mentioned above, and in order to prescribe procedures to be undertaken in order to conduct such limited review, SEBI has issued the SEBI Circular. It is clarified that the new formats introduced by the SEBI

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Circular replaces the earlier formats for limited review reports and audit reports issued in relation to the presentation of financial information by listed companies.

The procedure to be followed while conducting a limited review consolidated financial statements/ results of listed companies:

In order to ensure that there is uniformity while conducting an audit/ review of all consolidated entities in a group with that of the listed company – and for that purpose, the statutory auditor of the listed entity conduct an independent and a minimum review of the audited financial statements/ results of those entities whose financial statements/ results are consolidated with that of the listed entity's – SEBI has laid down certain procedures to be conducted by the statutory auditor of the listed company. A few important procedures to be conducted are as follows:

- Obtain an understanding of the consolidation process followed by the listed entity, including instructions issued by the management of the listed entity to its consolidated entities,
- Discuss with the auditors and management of the consolidated entities the business activities that are significant to the group or is likely to be significant,
- Design and perform audit/ review procedures on the consolidated financial statements/ results arising from special considerations relating to the consolidation process,
- When considered necessary, require the subsidiary's auditor to answer a detailed questionnaire,
- The auditor of the listed company may decide that supplemental tests of the records or the financial statements of the subsidiary is necessary, which it may conduct itself or through the auditor of the subsidiary.

Further, the auditor of the listed company shall communicate to the auditors of the consolidated entities instructions, in order to aid the review process and maintain consistency in group audit – some of the material instructions are as follows:

- Identify a threshold above which misstatements in the financial statement of the subsidiary cannot be regarded as immaterial,
- Identify significant misstatements in the consolidated financials due to fraud or error caused by the work of a consolidated entity's auditor,
- A description of the accounting policies, to ensure consistent application of accounting policies across the group,
- Description of identified deficiencies in internal controls in the consolidated entities,
- Indicators of possible management bias in making accounting estimates at the subsidiary level.

The above list is not exhaustive and may include other matters, as decided by the statutory auditor of the listed company. However, if the statutory auditor of the listed company does not include any of the matters mentioned above in the procedure adopted by it while conducting a review, he should record reasons in writing.

It is pertinent to note that the procedure prescribed by the SEBI Circular does not alter the requirements of limited review or audit of the standalone/consolidated financial statements/results of the listed company and/or the standalone financial

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statements/results of the consolidated entities. The requirement for review/audit of the financial statements / results as required by the LODR continues to exist.

Revised formats of limited review reports and audit reports issued in relation to the presentation of financial statements - as per the SEBI Circular

The SEBI Notification and the SEBI Circular has necessitated amendments to the formats of auditor's reports on financial statements/results. Such formats are divided into two categories, (i) for listed entities other than banks and insurance companies and (ii) for banks. Insurance companies are required to follow the formats prescribed by the Insurance Regulatory and Development Authority.

The following formats for auditor's reports on financial statements/results have been included in the SEBI Circular- amended to the extent of the changes instituted by the substantive terms of the SEBI Notification and SEBI Circular:

- Format for the limited review report on quarterly and year to date results;
- Format of an unmodified opinion is expressed on the quarterly and year to date financial results;
- Format of an independent auditor's review report on review of consolidated unaudited quarterly and year to date financial results;
- Format of an unmodified opinion is expressed on consolidated audited quarterly and year to date financial results; and
- Format of an unmodified opinion is expressed on consolidated audited annual financial results.

The procedure prescribed by the SEBI Circular is applicable for listed entities in case the financials of the parent company or listed entity are prepared in accordance with Indian Accounting Standards or Accounting Standards.

Comments

The SEBI Circular merely lays down the procedure to be adopted by the statutory auditor of the listed company while ensuring a review of the audited and reviewed financials of the consolidated entities. The procedures assist in ensuring that the standards of audit and limited review adopted by different auditors for different entities in the same group are alike - as a result of which, the consolidated financial statements/results present a true and fair picture of the financial conditions and results of operations of the group as a whole.

- Subhayu Sen (Partner) and Richa Yadav (Associate)

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