

NFRA STAFF SERIES
AUDIT STRATEGY MEMORANDUM-A SAMPLE DOCUMENT

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Objective of the Document:

This document prepared by NFRA Staff is intended purely towards promotion of awareness of auditing and accounting standards and audit quality as part of NFRA's education, training, seminar and advocacy initiatives, especially in support of the outreach activities being conducted, and in response to the feedback being obtained through such engagements.

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2) The facts, circumstances, data and figures and the names used in this document are hypothetical; any similarity or resemblance to the name, character, data and circumstances of any company or audit firm or entity is entirely coincidental.

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A. Background- Professional Standards' Requirements

For achieving audit objectives, auditors rely on two key stages at the beginning of the engagement i.e. audit strategy and audit planning. Though distinct, audit strategy and audit planning are closely connected. The strategy comes first and lays the foundation. Audit Strategy guides the development of the audit plan. The audit plan operationalizes the strategy—without a plan, the strategy remains theoretical. Strategy is the broad framework—the “what” and “why”—while planning is the detailed execution—the “how” and “when.”

SA 300, “*Planning an Audit of Financial Statements*,” (SA 300) makes a clear distinction between the two. SA 300 requires auditors to establish an overall audit strategy that sets the scope, timing, and direction of the audit, and then to develop a more detailed audit plan that describes the nature, timing, and extent of audit procedures. Based on the requirements of SA 300, the contents of Audit Strategy Document and Audit Planning Document for continuing engagements can be viewed as follows.

Audit Strategy Document (Refer para 6, 7, A9-A11 and Appendix of SA 300)	Audit Planning Document (Refer para 8 and A13 of SA 300)
❖ Introduction and scope of engagement	-
❖ Planning meetings with client and engagement team	-
❖ Overview of business and industry environment (including laws and regulations)	❖ Detailed risk assessment procedures at assertions, account balance or class of accounts level and disclosures as per SA 315, “ <i>Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment</i> ” (SA 315). ❖ Detailed analytical review of financial performance ❖ Development of audit programs etc. as per SA 330 “ <i>The Auditor’s Responses to Assessed Risks</i> ” (SA 330)
❖ Overall analytical review of financial performance	
❖ Overview of internal control systems including Information Technology (IT) platforms	
❖ Significant accounting and auditing matters	
❖ Involvement of internal auditor (IA), information systems auditor (IS auditor) & other experts	
❖ Materiality determination	-
❖ Audit of consolidated financial statements – Special Considerations	Refer Detailed risk assessment and audit program development as per above
❖ Engagement team planning and timetable	-

Following examples explain the difference between Audit Strategy and Audit Planning for Revenue:

	Example audit strategy for revenue: <i>Based on understanding industry environment and overall analysis of financial performance, revenue of Respective Division of automobile company has shown significant growth while the revenue growth of the industry has been flat. In this scenario, audit resources need to focus on revenue recognition and measurement aspects of Respective Division of the Entity.</i>
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	Example audit plan for revenue: ❖ <i>Perform detailed evaluation of internal control systems including IT Platforms and walkthrough of sales processing in Respective Division.</i> ❖ <i>Perform risk assessment procedures (SA 315) against various assertions e.g., Occurrence, Completeness, Accuracy, Cut-offs & Classification, etc.</i> ❖ <i>Develop audit programme for test controls, substantive tests, selection of sample sizes using statistical tables (e.g., Monetary Unit Sampling Method), confirm balances of sample customers selected as per the above sampling method and test system access logs with IT expert. Perform anti-fraud procedures i.e. duplicate invoices.</i>
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Auditors are also required by SA 300 to update both the strategy and the plan as the audit progresses. An audit strategy is not a static document. It is dynamic in nature and should be updated as the audit progresses, especially if new risks or events are identified. For example, if a significant fraud risk is discovered mid-audit, both the strategy and the plan must be revised accordingly. Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement.

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B. Audit Strategy Memorandum – ABC Limited

(Note: This sample audit strategy memorandum (ASM) has been developed for education and training purposes. It is designed for audit of standalone financial statements (SFS) as well as consolidated financial statements (CFS). In case an audit firm is engaged for an audit of SFS only, contents of this sample document need appropriate changes.)

	Name & Designation	Signature	Date
Prepared by	CA. Sahdev, Engagement Supervisor		5 th October 20XX
Reviewed by	CA. Bhim and CA. Arjun, Engagement Managers CA. Nakul, IS Audit Expert		10 th October 20XX
Approved by	CA. Dharmaraj, Engagement Partner		15 th October 20XX
Reviewed by	CA. Dronacharya, Engagement Quality Control Reviewer		16 th October 20XX

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I- Introduction and scope of engagement

We, M/s Dharmraj & Co., Chartered Accountants, have been appointed as statutory auditors of ABC Limited (ABC) under Section 139 of the Companies Act, 2013 (CA 2013) by the members in the Annual General Meeting held on _____. Our appointment is valid until the conclusion of the _____. This is third year of our audit engagement of this company. The Company operates primarily in passenger cars and commercial vehicles, with a manufacturing base in India/a European Country and export footprints in other overseas jurisdictions. ABC has six subsidiaries which form part of ABC's Consolidated financial statements. Two subsidiaries operate overseas- one in the European Country and other in the Middle East and the remaining four are domestic subsidiaries. ABC has two manufacturing plants in India at Gurugram and Halol. ABC does not use any service organisation.

The audit engagement is primarily governed by the provisions of CA 2013. ABC Limited's equity shares are listed on BSE, Mumbai, India and NSE, Mumbai, India, therefore, SEBI¹ (Listing Obligations and Disclosure Requirements) Regulations 2015 (SEBI Listing Regulations) are also applicable to the Company. The engagement covers the audit of the Standalone Financial Statements (SFS) and Consolidated Financial Statements (CFS) of the company for the year ended 31.03.20XY. Pursuant to section 129 of CA 2013, the financial statements shall give a true and fair view of the state of affairs of the company, comply with the Accounting Standards notified under section 133 read with the Companies (Indian Accounting Standards) Rules, 2015 and shall be in the form prescribed in Division II to Schedule III of CA 2013. There are separate auditors appointed for audit of financial statements of the subsidiaries, except in case of one Indian subsidiary where we are also auditors for SFS of that subsidiary and our audit strategy for audit of CFS is documented in the later part of this document.

In addition to expressing an audit opinion on the Financial Statements of ABC, we have the following additional reporting responsibilities:

A. Under CA 2013

1. Matters specified under Section 143(3) of the CA 2013, including commenting on:
 - Proper books of account including audit trail as per law being kept.
 - Financial statements agreement with books and returns.
 - Matter under CARO 2020² such as defaults in repayment of loans, payment of statutory dues, compliance with sections 177/188 of CA 2013, etc.
 - Adequacy and operating effectiveness of internal financial controls with reference to financial statements.
 - Other matters prescribed under Companies (Audit and Auditors) Rules, 2014.
2. Fraud reporting under Section 143(12) of the CA 2013.

B. SEBI Listing Regulations

We are also engaged for limited review of quarterly financial results disclosed as per SEBI Listing Regulations.

The audit of financial statements will be conducted in accordance with the standards on auditing (SAs) prescribed under section 143(10) of CA 2013 and the related standards and codes applicable in India.

¹ Securities and Exchange Board of India (SEBI), capital market regulator in India

² Companies (Auditor's Report) Order 2020

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In respect of audit opinion on the adequacy and operating effectiveness of internal control over financial reporting, our audit will be based on the prescriptions in the Guidance Note³ on ICFR issued by the ICAI.

ABC being an equity listed company is required to prepare its SFS and CFS based on the Indian Accounting Standards (Ind AS)⁴ prescribed under Companies (Indian Accounting Standards) Rules 2015 as amended from time to time. Europe based and Middle East based subsidiaries prepare their local financial statements as per IFRS Accounting Standards as adopted by the European Union and IFRS Accounting Standards issued by the International Accounting Standards Board, respectively. However, those subsidiaries will submit their Ind AS based F/S⁵ (Group Consolidation/Reporting Pack) in ₹ and audited as per Standards on Auditing and related standards and Code of Ethics applicable in India. As per the requirements of CA 2013 read with applicable Ind AS Framework, the financial statements consist of -

1. Balance Sheet;
2. Statement of Profit and Loss (including Other Comprehensive Income);
3. Statement of Changes in Equity;
4. Statement of Cash Flows; and
5. Notes to Accounts, including material accounting policy information.

However, form and contents of Quarterly Financial Results subject to our limited review will be as per Regulation 33 of SEBI Listing Regulations and the circulars issued by SEBI.

The overall audit approach will be risk-based, focusing on areas where there is a higher risk of material misstatement, whether due to error or fraud. Our approach will combine tests of controls and substantive procedures and other audit procedures required under the SAs and related quality control/management standards and ethics code including independence standards. The remaining part of this Audit Strategy Memorandum covers the following aspects of audit strategy in accordance with SA 300.

1. Planning meetings with client and engagement team
2. Overview of business and industry environment (including laws and regulations)
3. Overall analysis review of financial performance
4. Overview of internal control systems including IT platforms
5. Significant accounting and auditing matters
6. Involvement of internal auditor, information systems auditor & other experts
7. Materiality determination
8. Audit of consolidated financial statements – Special considerations
9. Preliminary overall audit strategy
10. Engagement team planning and time- table

³Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India

⁴ Indian Accounting Standards are derived from and substantially converged with high-quality globally accepted IFRS Accounting Standards issued by the International Accounting Standards Board of IFRS Foundation.

⁵ Refer para B87 of Indian Accounting Standard 110, *Consolidated Financial Statements* read with first proviso to section 129(1) of CA 2013

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II- Planning meetings with client and engagement team

This section documents planning meetings with the engagement team and client to ensure a common understanding of the audit objectives, significant risks, and promote effective two-way communication with management and Engagement Team members.

I. Planning meeting with engagement team

1. Date of meeting: [Insert date]

2. Participants:

- Engagement Partner – CA. Dharmaraj
- Engagement Quality Control Reviewer– CA. Dronacharya
- Team members– CA. Bhim, CA. Arjun, CA. Abhimanyu & CA. Ghatotkacha
- Auditor's Experts – CA. Nakul, IS Audit Expert

3. Key matters discussed:

3.1 Sharing knowledge of the entity and the scope of the engagement with engagement team (ET) members

- CA. Bhim, Engagement Manager (EM1), who has been managing this audit during last two years, shared our understanding of the entity including the entity's organizational structure, ownership and governance, business model, industry, economic environment (including recent changes in macroeconomic and geopolitical events impacting the entity), operations and key staff, including significant changes since the prior year.
- CA. Arjun, Engagement Manager (EM2), informed the team about information obtained during the acceptance and continuance process and/or from other engagements that is of significance to either planning or performing the audit engagement.
- CA. Dharmaraj, Engagement Partner (EP) gave overview of
 - Scope: Audit of Standalone and Consolidated financial statements prepared in accordance with CA 2013 and the Indian Accounting Standards.
 - Reporting Responsibilities: Reporting on matters under CARO 2020, audit of Internal Financial Controls with reference to financial statements and other responsibilities prescribed under CA 2013.

3.2 Engagement team's collective responsibility for contributing to managing and achieving audit quality, and the importance of open and robust communication and raising concerns without fear of reprisal

- CA. Dharmaraj, Engagement Partner (EP) apprised the ET of the following critical aspects in this audit and our firm's Quality Control Policy Manual and Audit Methodology Manual.
 - The role each engagement team member plays and contributes to the management and achievement of quality at the engagement level through their personal conduct, communication and actions.
 - The importance of engagement team members understanding of the objectives of the work they perform, and encouraging engagement team members to think, analyse, question and

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be rigorous in their approach, while seeking supervision/coaching from more experienced team members as necessary.

- Quality messages communicated to/by the member firm (e.g., whether matters relating to recent inspection findings are relevant to the engagement and how those matters may impact the engagement).
- The importance of asking questions and raising concerns or possible threats to the achievement of quality to the engagement leader and/or team manager without fear of reprisal, and actions the engagement team can take to address such threats. We respect and encourage open dialogue, to create a climate for frank and honest discussions. Consistent with the firm's Code of Conduct, we protect against retaliation in any form.

3.3 Importance of professional ethics, values and attitudes to the engagement team

CA. Arjun, Engagement Manager (EM2) highlighted the following:

- The importance of complying with the Firm's Code of Conduct.
- The independence rules relevant to the engagement and the importance of compliance with them and maintaining personal independence.
- The Engagement Team's responsibility for maintaining confidentiality of client information and complying with any client specific data restrictions.
- The importance of each engagement team member completing all relevant compliance activities (e.g., mandatory ethics/independence training).
- The responsibilities of engagement team members when they become aware of an instance of non-compliance with laws and regulations by the entity.
- The importance of raising any concerns with respect to compliance with ethical requirements with the engagement leader, team manager, and/or Ethics Office without fear of reprisal.

3.4 Exercising professional skepticism throughout the engagement

CA. Dharmaraj, Engagement Partner (EP) and CA. Dronacharya, Engagement Quality Control Reviewer emphasised the following fundamental qualities of the independent auditors

- Maintaining a questioning mind and being aware of unconscious or conscious biases in exercising professional skepticism when gathering and evaluating audit evidence.
- Any potential impediments to the exercise of professional skepticism and actions to take should these arise.
- How and why fraud may occur (e.g., incentives/pressures, opportunities, attitude/rationalization)

3.5 Materiality

CA. Sahdev, Engagement Supervisor briefed about the following:

- Overall materiality, Performance materiality and Clearly trivial threshold
- Specific and component materiality, as applicable

3.6 Overall preliminary risk assessment and audit strategy

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Refer section X of this memorandum

3.7 Team responsibilities (Refer Section XI for more details)

- **Engagement Partner:** Overall direction and review.
- **Engagement Quality Control Reviewer:** Objective Evaluation of the Significant Judgments, Engagement Partner's involvement in the direction and supervision of work performed and Review of that work and Review of Financial Statements, Audit Report (including Key Audit Matters (KAM)) and Communication to be done with the TCWG/Audit Committee
- **Manager:** Supervision and Liaison with Client.
- **Experts**
 - a) IT System Testing.
 - b) Actuarial Valuation
 - c) Fair value and Value-in-Use

3.8 Timelines (Refer Section XI for more information)

- **Interim audit:** [15 October 20X(Y-1) to 30 November 20X(Y-1)].
- **Year-end audit:** [25 March 20XY to 30 April 20XY].

II Planning meeting with client management

1. Date of meeting: [Insert Date]

2. Participants:

- **From Auditor's side:** [Engagement Partner, Manager, Supervisor]
- **From Client's side:** [CFO, Head of Finance, Internal Audit Head, Company Secretary]

3. Key matters discussed:

3.1 Business environment update

▪ ***Significant changes in operations***

During the financial year, the company experienced several significant changes in operations, including the expansion of its manufacturing facilities and optimization of production lines to enhance efficiency. Company's manufacturing facility in the European Country has been expanded to produce electric vehicles to cater to increased customers' preference following environmental considerations. The company also launched new vehicle models across multiple segments, incorporating advanced technology. The company closely monitored regulatory developments in the automotive sector, including updates to emission norms, and taxation policies. These strategic and operational initiatives had a material impact on production volumes, revenue recognition, and the overall financial position of the company, and were carefully considered in the audit strategy and planning process.

▪ ***Extended producer responsibilities***

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The company is subject to Extended Producer Responsibility (EPR) norms, which require manufacturers to take accountability for the collection, recycling, and environmentally safe disposal of end-of-life vehicles and automotive components such as batteries and tyres. The company is obligated to collaborate with authorized recyclers. Auditors would need to consider adherence to EPR regulations when evaluating contingent liabilities, provisions, and disclosures related to environmental obligations under accounting standards (such as Ind AS 37⁶).

3.2 Reserve Bank of India inspection of NBFC subsidiary

Refer Section VII for more details on the remedial work of Risk management department of ABC Limited.

3.3 Internal audit system and Risk management system

Refer Section VII for our review of these functions

3.4 Updates on IT systems implementation/changes

During the financial year, the company undertook significant steps in the enhancement of its ERP system. Key updates included the migration of legacy data to new (hardware) mainframe system, automated interface between GL system and Sales and Inventory Management systems, and implementation of workflow approvals to reduce manual intervention and minimize errors.

3.5 Financial performance

3.5.1 Standalone financial statements: No material change in revenue but decline in Cost of materials consumed, and substantial increase in warranty provisions.

3.5.2 Consolidated financial statements: Significant investments in intangible assets, Status of projects on product development/intangible assets, revenue recognised in the current year, decline in Cost of materials consumed, substantial increase in warranty provisions and business restructuring initiative plans.

3.5.3 Actual Performance versus Budgets/Forecasts

4. Actions Agreed

- Time plans for interim audit and communication of significant audit findings during interim audit
- Client to advise timelines for draft financial statements, Audit Committee meetings and Board meetings [Date].
- CFO/HOF to facilitate meetings with Business Heads and CEO.
- CFO/Company Secretary to facilitate meetings with Audit Committee and Board of Directors.
- Regular status meetings to be held weekly during audit fieldwork.

⁶ Indian Accounting Standard 37, *Provisions, Contingent Liabilities and Contingent Assets*

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III- Overview of business and industry environment (including laws and regulations)

This section documents the industry conditions, volatility, competitive dynamics, technological and regulatory developments and entity-specific positioning, all of which may influence the audit approach of ABC Limited ('Company').

Based on review of journals and publications of automobile industry, ABC's investors' calls and our preliminary meeting with the client, we have observed and noted the following matters which we consider relevant for our audit:

1. Market or industry in which the entity operates

The Company operates primarily in passenger cars and commercial vehicles, with a manufacturing base in India/EU and an export footprint in overseas jurisdictions. The industry is capital-intensive, heavily dependent on supply chains for steel, aluminium, batteries, and semiconductors, and influenced by consumer sentiment, financing availability, fuel prices, and government policies. ABC limited has six subsidiaries in India and Overseas. One of the Indian subsidiaries is engaged in granting vehicle loans and registered as Non-Banking Finance Company (NBFC) with the Reserve Bank of India.

The global automobile industry is a multi-trillion-dollar sector that serves as a barometer for economic activity. The Indian automobile market, one of the top five in the world, is characterized by a mix of domestic players, global joint ventures, and multinational corporations. It comprises several segments: passenger cars, two-wheelers, three-wheelers, commercial vehicles, and electric vehicles (EVs).

2. Significant market changes/ volatility

The Company has reported fluctuating revenues in the last three years, with sharp declines, followed by partial recovery, but margins remain under pressure from rising input costs and also due to the following reasons:

- *Raw material inflation:* Prices of steel, aluminium, plastics, and lithium have increased sharply, impacting margins.
- *Geopolitical risks:* Trade wars and geopolitical tensions affect supply chains and export markets.
- *Policy shifts:* Introduction of new emission standards, mandatory safety features, and EV subsidies.

3. Macro-economic conditions

The Company operates in a dynamic economic environment. Automobile sales are closely correlated with GDP growth and consumer sentiment. A slowdown in economic growth results in muted demand.

Automobile sales rely heavily on consumer financing through Banks and NBFCs. High interest rates increase borrowing costs for customers and reduce affordability, depressing sales. Credit availability from NBFCs is critical; recent prudential regulatory interventions caused liquidity crunches in the NBFCs directly impacting volume of vehicle sales.

4. Competition

The automobile sector is fiercely competitive. ABC competes with domestic leaders such as DEF, GHI as well as with international brands like JKL, MNO, PQR, and newer EV entrants such as STU and VWX. Key competitive pressures include price wars and aggressive discounts - particularly in small car segments and technology race in EVs, hybrids, and autonomous features.

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5. Technological developments

The Company has invested in a new EV line, collaborating with a foreign technology partner. It has been investing heavily in the research and development of EV prototypes and other niche brands. The company is witnessing transformation driven by:

- *Electric Vehicles:* Shift towards lithium-ion battery-powered vehicles.
- *Autonomous Driving Features:* Though nascent in India, global trends are moving rapidly.

6. Peer comparison

Compared with peers, the Company reported:

- Higher-than-average margins due to substantial decrease in cost of material.
- Lower export revenue due to weaker overseas dealer networks.

7. Market position of the entity

The Company holds a mid-tier market share in passenger vehicles and ranks among the top five in commercial vehicles. Its EV segment is emerging, but competition is intensifying. Market position analysis suggests that while the Company has strong brand recognition in the domestic market, its export competitiveness and premium positioning lag behind peers.

8. Compliance with laws and regulations

The industry is regulated in various areas ranging from taxation to environmental obligations which have a direct material effect on the financial statements. Following are the key laws and regulations:

- Apart from general corporate law requirements, ABC being a listed entity is subject to comprehensive and robust regulations of capital market regulator i.e., SEBI Listing Regulations. The regulations that have high relevance and impact to ABC, pertain to Related Party Disclosures (including assessment of arm's length and appropriate approvals) and timely disclosure of material events to the stock exchange.
- The Company is subject to the Income-tax Act, 1961 including provisions relating to corporate taxation and transfer pricing.
- Goods and Services Tax (GST) apply to the sale of vehicles, spare parts, and accessories. For automobiles, the applicable GST rate was amongst the highest (typically 28%), with additional compensation cess on luxury vehicles and SUVs. Recently, the government has announced substantial reduction in GST rates, and it is expected to boost the passenger vehicles sales in the last quarter of the financial year.

(The Company has disclosed ongoing tax litigation amounting to ₹ ____ crore, primarily relating to transfer pricing adjustments)

- The Company faces intense scrutiny due to its environmental footprint. Laws include Environment Protection Act, 1986 and related rules particularly the Extended Producer Responsibilities Rules such as obligations for recycling batteries and vehicle parts.
- The increasingly connected vehicles of the Company store vast amounts of consumer data. Compliance obligations include Information Technology Act, 2000 and Rules on Data Protection,

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The Digital Personal Data Protection Act, 2023 (Rules pending notification) and Global frameworks like GDPR for export markets.

- ABC limited has a subsidiary engaged in car financing business and is subject to prudential regulations of Reserve Bank of India (RBI). The RBI has introduced strict norms on lending by the Banking sector to Non-Banking Finance Companies (NBFC).

9. Other industry specific industry risks

Key risks relevant to the industry and entity include:

- *Supply chain risks*: Dependence on global suppliers for semiconductors and batteries.
- *Foreign exchange risks*: Exposure from exports and imported components.

(The Company has substantial exposure to Euro and AED due to investments and export sales. Last few years, ₹ has experienced depreciation against Euro and AED and resulting in positive impact on the company's financials. Any reversal of this trend in the remaining part of the year could have a significant impact on the financial statements for the year and future years.

- *ESG and climate risks*: Increasing investor and regulator focus on carbon footprint and sustainability reporting.

10. Communication with Those Charged with Governance (TCWG) and Audit Committee

CA. Dharmaraj, Engagement Partner advised the CFO about requirement of SA 260 (Revised)⁷ and SA 265⁸, for the auditors to identify appropriate persons within the ABC Limited's governance structure with whom to communicate. Considering the legal and governance structure of ABC Limited under CA 2013, it was noted that the Board of Directors are the appropriate persons falling within the definition of TCWG. It was also agreed to discuss and agree with the Board and its subgroup viz. Audit Committee to establish a suitable two-way communication between our firm and ABC Limited's TCWG.

⁷ SA 260 (Revised), *Communication with Those Charged with Governance*

⁸ SA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

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IV- Overall analysis review of financial performance

(This section documents the overall analytical review of the financial performance – which is important because it helps to identify high-risk areas, detect anomalies, and assess trends before fieldwork. Detailed analysis needs to be undertaken during the comprehensive risk assessment procedures performed as part of detailed audit planning.)

We have reviewed annual reports, quarterly financial results and the internal MIS system and noted the following scenario. Following is the summary of important financial performance indicators as per internal MIS of the company. A detailed analysis of all financial statement line items (FSLI) above the overall materiality thresholds will be performed as part of detailed audit planning phase.

Key Financial Data – Standalone financial statements

₹ Crores

Particulars	31.03.20X(Y-2)	31.03.20X(Y-1)	31.12.20X(Y-1) (9 Months)	31.03.20XY
	Actuals			Forecast#
Revenue!	65,700	73,300	49, 000	70,000
Cost of materials	42,000	45,000	30,00	40,000
Depreciation	1,700	2,000	1,400	2,000
Other expenses	7,800	8,800	6,700	9,500
Amount transferred to capital and other account	(1,000)	(1,100)	(900)	(1,200)
Profit before Tax	1,500	5,000	5,800	7, 600
Exceptional items	300	(2,800) *	95	325
Operating margin	7.79%	11.02%	10.6%	13.28%
Operating cash flows	4,900	8,500	-	8,600
Net worth	22,000	30,000	31,800	33,500
Intangible assets under development	500	600	-	1,100
Property, Plant & Equipment	11,700	11,500	-	11,500
Inventory	3,000	3,400	3,100	3,200
Investments in subsidiaries, joint ventures and associates	27,900	28,700	-	29,700
Trade receivables	2,300	2,700	2,300	2,300
Borrowings (Current & Non-Current)	18,800	13,300	-	8,600
Trade payables	13,000	13,300	-	13,200
Provisions	1,900	3,000	4,300	4,300
Debt-equity ratio	0.84	0.46	0.35	0.26
Inventory turnover ratio	14.61	16.06	8.71^	14.35
Debtor turnover ratio	29.76	28.90	15.35^	27.52

! Product- wise revenue analysis will be performed during detailed audit planning phase.

#ABC has a robust budgeting and management information system (MIS)

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* In FY 20XY, ABC had disposed of a Subsidiary resulting in one-time gain of ₹ 3,700 Crores partly offset by one-time additional expenditure for surrender of Employee Provident Fund Scheme.

^ Not annualised

Key Findings from Analytical Review

Account/Area	Observation
Revenue	Projected Decline of 4.51% vs Actual growth of 11.47% last year is not significant. Our preliminary discussion with ABC's Senior Management indicates that the trend is in line with Indian automobile industry which has reportedly entered consolidation phase following years of high growth. Revenue forecast indicates a decline, but it is not significant. However, revenue trend had been fluctuating over last couple of years and needs our attention during detailed risk assessment phase.
Cost of material consumed	There is significant decrease c. 11.16% in the cost of materials consumed which has led to substantial increase in PBT. Reportedly, ABC had initiated a special drive of operational efficiency to improve operating margin. This area needs particular focus during audit.
Warranty Provision	Warranty Provision reported as part of 'Provisions' and there is significant increase in the provision from ₹ crores to ₹ crores. Rationale for this significant increase of c. X% needs review.
Net worth & Debt -Equity Ratio	There is continuing trend of augmentation of net worth by plough back of profits by the company. This has also helped company in reducing its debt burden in the form of intercorporate deposits from subsidiaries.

Key Financial Data- Consolidated financial statements

₹ Crores

Particulars	31.03.20X(Y-2)	31.03.20X(Y-1)	31.12.20X(Y-1) (9 Months)	31.03.20XY
	Actuals			Forecast
Revenue	345,900	437,900	323,000	440,000
Cost of materials	208,000	249,000	177,000	241,000
Depreciation	24,000	27,000	17,900	27,000
Other expenses	61,700	78,800	65,000	85,500
Expenses transferred to Capital and Other Account	(18,400)	(26,700)	(23,600)	(31,000)
Profit before Tax	1,400	28,200	22,000	34,000
Exceptional item	(1,600)	500	-	900
Operating margin	9.21%	14.01%	12.64%	13.28%
Operating cash flows	35,400	67,900	-	63,000
Net worth	45,000	85,000	96,000	116,000

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Particulars	31.03.20X(Y-2)	31.03.20X(Y-1)	31.12.20X(Y-1) (9 Months)	31.03.20XY
	Actuals			Forecast
Intangible assets under development	9,000	24,800	-	48,000
Property, Plant and Equipment	76,600	73,100	-	72,500
Inventory	40,800	48,000	-	47,500
Trade receivables	15,700	16,900	-	13,200
Investment in Associates	4,700	5,300	-	5,500
Borrowings (Current & Non-Current)	1,26,000	98,500	-	62,500
Trade payables	92,700	1,08,800	-	97,400
Provisions	25,000	28,900	-	36,800
Debt-equity ratio	2.77	1.16	0.95	0.54
Inventory turnover ratio	6.16	5.89	4.05	5.72
Debtors' turnover ratio	24.25	26.55	21.49	29.12
Revenue Segment-wise Breakup!	3,46,000	4,34,000	3,23,000	4,40,000
I) Automotive & related activity	3,46,500	4,34,703	3,22,000	4,38,000
Indian Brands	1,23,500	1,31,700	92,900	1,28,000
International Brands	2,22,800	3,02,800	2,29,100	3,10,000
II) Others – Financing etc.	4,800	5,900	4,500	6,000
III) Intra & inter-segment	(5,300)	(6,500)	(3,500)	(4,000)

! Based on MIS data which is considered for presenting Operating Segments as per Ind AS 108, *Operating Segments*

Key findings from analytical review

Account/Area	Observation
Share of Subsidiaries	As can be seen from the tables above, substantial portion of revenue being more than 80% of revenue arises from subsidiaries.
Revenue	Revenue Growth has been flat for the year under audit as against significant growth of x% during previous year. Our revenue across different segments also does not indicate significant variation for the year under audit; International brands indicate growth of 2.4% whereas Indian brands indicate 2.9% decline. Reportedly, the automobile industry is in a consolidation phase following years of high growth.
Cost of Materials	The overall number is expected to decline by c. y % due to cost efficiency project undertaken by ABC.
Expenses transferred to capital and other accounts	ABC has been investing substantial amount in product development/engineering expenses and other intangible assets. During last two years total amount capitalised has increased from ₹ 18,000 crores to ₹ 31,000 crores, an increase of c.65%. This accounting area will be reviewed in the light of requirements of Ind AS 38, <i>Intangible Assets</i> and other applicable Ind ASs.
Intangible Assets under development	ABC has substantial amount classified under non-current assets, c. ₹ 48,000 crores; together with other intangible assets (₹ 33,800 crores) these account for c.38-40% of total b/s size. Timing of Capitalisation, Amortisation and need for

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Account/Area	Observation
	impairment under Ind AS 36, <i>Impairment of Assets</i> , if any, will be focus area during the audit.
Warranty Provision	ABC limited carries substantial amount of Product Warranty Provision of ₹ 28,000 crores; during the year this amount has increased by c. z%. This increase is despite sales remaining flat.
Net worth & Debt - Equity Ratio	There is a continuing trend of augmentation of net worth by plough back of profits by the company. This has also helped company in reducing its debt burden in the form of intercorporate deposits from subsidiaries.

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V-Overview of internal control systems including IT platforms

(This section documents the understanding an entity's internal control systems to determine the extent of control risk and audit strategy for reliance on controls. Risk assessment matrix given below in this model document is an example only and the audit firms may adopt other models used in practice.)

As part of our audit of financial statements of ABC limited, we are also required to audit the ABC's adequacy and operating effectiveness of internal controls with reference to financial statements. We will be adopting dual approach for both these audits as prescribed in the Guidance Note of Audit of Internal Controls over Financial Reporting (ICFR). For the purpose of reporting/communicating to Management and Those Charged with Governance, we will evaluate the severity of each control deficiency that comes to our attention to determine whether the deficiencies, individually or in combination, are significant deficiencies or material weaknesses as of the balance sheet date. For the purpose of expressing an audit opinion on ICFR, severity of deficiencies, if any, identified will be classified as 'Significant' or 'Material' based on qualitative and quantitative analysis. The latter will be evaluated based on the approach suggested in the Guidance Note and AICPA Audit Guide– Audit Sampling⁹, to the extent applicable.

This is our third-year audit and during our previous audits we have evaluated and obtained information about ABC's internal control systems and processes and found to be adequate and satisfactory. However, based on our discussion with CFO and Head Internal Audit, there have been significant changes including in the IT platforms of ABC during the year. Therefore, we will not be placing reliance on documentation in our previous work papers but performing a comprehensive evaluation of control environment and control risk assessment for the current year audit and documentation of the same.

ABC's internal control environment includes the following:

- Comprehensive internal control and risk management system with well documented policies and process manual.
- ABC control policies and processes are periodically revalidated through well-established control & risk assessment framework by the Internal Audit Division and Risk Management Division.
- Budget and MIS to monitor the financial and non-financial targets.
- Internal Audit Division comprising professionals with domain knowledge in Financial, IT and Production & Sales Management. This division functionally reports to the Audit Committee with administration reporting to the Chief Executive Officer (CEO).
- Risk Management Division which is a recent addition in the Company and reports to the Risk Management Committee of the Board.
- Audit Committee comprises 5 members, 2/3 are Independent Directors with proven expertise in financial reporting, internal controls and risk management.

ABC's information technology platforms comprise the following key systems:

- Finacle software is used for General Ledger (GL) and Financial Reporting across the Group entities including all subsidiaries.
- PeopleSoft application is being used for HR and Payroll Management, which has automated interface with GL system.

⁹ Refer Para 3.91 to 3.94 of AICPA Audit Guide – Audit Sampling 2017

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- Enterprise Asset Management Software for Property, Plant & Equipment, which is material category of assets of ABC.
- In-house developed packages for Sales, Production and Inventory Management

During the year, ABC has upgraded its Sales and Inventory Management platforms and built in automated interface to Finacle software. Further, various IT applications have been migrated to new mainframe called xyz. We understand the Risk Management division was actively involved in managing these changes. We have been informed by Head of Internal Audit that they will be undertaking post-implementation review during 3rd quarter and reports are expected before 31st March of current financial year. This will be a major focus area for our audit during this year and our IS Engagement Team will be performing a detailed review of IT platforms, including data migration process and functioning of automated controls as many of the important reports such as Receivables Ageing and Inventory Valuation reports, which we are planning to use are impacted by these changes.

We will be assessing the Financial Statement Line Item (FSLI) wise preliminary Risk of Material Misstatement (ROMM) against various assertions using our firm's standard risk assessment matrix depicted below.

Inherent Risk	Control Risk	Risk of Material Misstatement
High	High	High
High	Medium	High
High	Low	Moderate
Medium	High	High
Medium	Medium	Moderate
Medium	Low	Low
Low	High	Moderate
Low	Medium	Low
Low	Low	Low

Inherent risk and Control risk assessment matrix (3x3) is as depicted below.

Likelihood (Probability)		Severity (Magnitude)		
				
		Low	Medium	High
		High	High	High
		Medium	Medium	High
		Low	Low	Medium

Additionally, we may be classifying certain accounts or class of accounts as 'Significant Risk' or 'Fraud Risk' based on the criteria given in SA 315 or SA 240¹⁰.

(Engagement teams will have to elaborate this, depending on facts and circumstances of the client engagement as part of detailed Audit Planning phase).

¹⁰ Standard on Auditing (SA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

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VI-Significant accounting and auditing matters

(This section documents the rationale for identifying certain accounting/ auditing matters.)

Based on our review of financial performance, material information disclosed to stock exchanges and preliminary discussion with management, we have noted the following areas of significance to us during current year audit.

Standalone financial statements

Employee benefits

During previous year, ABC has surrendered its exempted provident fund to Employee Provident Fund Organisation, Govt of India. However, subsequently this exemption automatically lapsed due to non-fulfilment of certain conditions. As a result, certain additional employee benefit obligations came on to the company and substantial amount additional provision based on actuarial valuation were made. We need to review the adequacy of these provisions in the light of developments during the year. We will be reviewing the adequacy of these provisions in consultation with an external actuarial expert to be engaged by us.

Business restructuring: Demerger of passenger vehicle division

During Q2 of this year, ABC has informed the BSE & NSE as a material event about its proposed plan to demerge its passenger vehicle division into a separate legal entity. This restructuring transaction is subject to approval by National Company Law Tribunal (NCLT), application for which is pending before NCLT. Head Legal has informed that this is expected in future and require substantial accounting process for identification and derecognition of assets and liabilities relating of that division.

Consolidated Financial Statements

Intangible assets under development

Our preliminary review of financial statements and past experience indicates continued substantial increase in the amounts invested as the product development & accounted as intangible assets under development. In view of the rapid changes in the business environment and technological advancement in the automobile sector, we will be focussing on the group's policy to carry-forward this amount and the controls over review of impairment of these assets as Ind AS 36. We will also be reviewing whether the asset recognition criteria of Ind AS 38 is met or not. Large portion of these intangible asset balances are in the books of overseas subsidiary, and we will be closely liaising with Engagement Team of that overseas subsidiary.

Business combination: Planned Acquisition of Component Manufacturing Entity in Middle East.

ABC intends to expand its footprint in the Middle East market and identified potential automobile component manufacturing entity. It is expected to be finalised in Q2 and will be incorporated into the existing entity in Middle East. Initial evaluation as per CFO is that this requires acquisition method of accounting as per Ind AS 103, *Business Combinations*. It will also involve engagement of fair value measurement expert, and we will be using an external expert for this purpose.

Warranty provisions

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Our review of quarterly financials and the management forecast indicate substantial increase in the warranty provisions. The increase is primarily due to change in the ABC's marketing policy of offering extended period warranties in line with market trends and also due to change in the method of accruing for these provisions based on subject matter experts including actuaries.

Expected credit loss for Vehicle Loans

During last year, RBI in its Annual Inspection report had identified a number of weaknesses in the credit risk management system of NBFC subsidiary. Further, the IAD had performed asset quality review of vehicle loan portfolio and noted significant deterioration in the credit quality and potential risk on collectability. We will be working with the auditor of this NBFC subsidiary to ensure that the ECL provision is adequate in accordance with the requirements of Ind AS 109, *Financial Instruments*.

Significant areas due to inherent risk in the Automobile industry:

The automobile sector is highly complex and presents several significant accounting and auditing matters, particularly because of the interplay between manufacturing operations, technological advancements, regulatory requirements, and consumer-driven market dynamics. The most significant areas relate to:

- *Revenue recognition:* Since the Company typically sell through multiple channels including dealerships, distributors, direct customers, and export markets, and each of these arrangements may involve different performance obligations under Indian Accounting Standard 115, *Revenue from Contracts with Customers*. Revenue may also involve bundled arrangements such as extended warranties, free servicing, or promotional discounts, which require auditors to evaluate whether such elements represent separate performance obligations that need to be recognized over time rather than at a point in time.
- *Inventory valuation* since they typically hold large volumes of raw materials, work-in-progress, and finished goods, and valuation is influenced by multiple factors including standard costing, overhead absorption, allocation of fixed and variable production costs, obsolescence of spare parts, and slow-moving inventory due to changes in consumer preferences or new product launches.
- *Impairment testing* of PPE, intangible assets, goodwill arising from acquisitions is a critical area, particularly because the automotive industry is cyclical and sensitive to market demand, regulatory pressures, and global economic conditions. Appropriate forecasting of prospective financial information is particularly relevant given the cyclical nature of the automobile industry, intense competition, and technological disruption with the shift toward electric vehicles. Thus, there is a need to critically assess key assumptions relating to management's cash flow forecasts, like growth rate, discount rate and terminal value.
- Another critical area is *environmental, social, and governance (ESG) related obligations*, particularly compliance with emission norms, and climate change (net-zero) commitments, which may give rise to provisions or contingent liabilities. The impact of extended producer responsibility norms for automobile waste recycling and disposal must also be evaluated in financial statements, as these represent material future obligations.

New accounting developments

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We have reviewed the website of Ministry of Corporate Affairs (MCA) for amendments to Companies (Indian Accounting Standards) Rules 2015 and the circulars or press releases of National Financial Reporting Authority (NFRA) and noted the following notifications of amendments to Ind ASs that may affect the ABC's financial statements.

- ***International Tax Reform- Pillar 2, Amendment to Indian Accounting Standard 12, Income Taxes***

This amendment prohibits the entities from accounting for any deferred tax asset or liability due to Pillar 2 Tax Reform until the global uncertainty around this reform is settled. Since the ABC has substantial overseas operations, we will review the deferred tax balances in consultation with our tax Experts.

- ***Classification of liabilities as Current and Non-current, Amendments to Indian Accounting Standard 1, Presentation of Financial Statements.***

Recently, the MCA has notified certain amendments clarifying the provisions regarding classification of liabilities as current and non-current. One of the amendments relates to alignment of Ind AS 1 provision with corresponding IFRS Accounting Standard viz. IAS 1, from next accounting year i.e., 1st April 20XX to 31st March 20XY.

- ***NFRA circular on accounting policy disclosures re-measurement of revenue and trade receivables***

We have reviewed the website of NFRA and noted an important circular advising companies about erroneous disclosure of accounting policy as fair value instead of transaction price. We will review the ABCs disclosures to ensure that the disclosure is as per the applicable Ind AS principles.

New Auditing Developments

- ***Standard on Auditing 315, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment***

SA 315 has been in operation for past many years. However, the understanding of the SA has undergone significant refinements in light of various developments and one of the key refinements is that risk assessment procedures have to explicitly consider 'Inherent Risk', apart from other such as 'Control Risk', while evaluating risk of material misstatement. Our firm's audit methodology has been amended to reflect these important refinements to support a risk- based audit.

- ***NFRA circulars on fraud reporting u/s 143(12) of CA 2013 and Group Audit***

NFRA has issued important clarificatory circulars in two critical areas of auditor's responsibility while performing their public interest function. In view of the fact that the ABC has overseas subsidiaries which contribute nearly 85% of the revenue and significant portion of net worth of the Group, NFRA clarificatory circular on Group Audit is very relevant to this audit engagement.

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VII- Involvement of internal auditor, IS auditor and other specialists

(This section of the ASM summarizes the nature, scope, and outcome of work performed by internal auditors, IS auditors, and auditors' experts in the audit of ABC Company. It documents the extent of reliance placed on their work and how their involvement influenced the audit approach.)

Internal audit department (IAD)

Internal audit department (IAD) of the Company has evolved into a critical component of its internal control and risk management architecture. In recent years, IAD has undergone significant capacity building programme and is staffed with professionals across finance and non-finance domains. Moreover, its scope and responsibility has been extended and well recognised across all the group entities including overseas operations. It satisfies the requirements of SA 610(R), *Using the Work of Internal Auditors*.

Although there is no specific restriction in CA 2013 regarding use of Internal Auditors as direct assistance by statutory auditors, keeping in view of the provisions of section 144 of CA 2013 prohibiting external auditors from rendering internal audit services and our responsibility under CARO 2020 to evaluate the adequacy of internal audit system, we will not be availing direct assistance of the IAD of the company. However, we will be considering the findings of the IAD in relation to critical internal control activities and also assess whether the Internal Audit System is commensurate with the size of its business for the purpose of reporting under CARO 2020. In particular, we will be reviewing the reports of IAD on their post-implementation review of IT system enhancements, expected to be issued in Q4 of this year. We will also be reviewing their work on controls over management of critical projects on product development (intangible assets) and operational efficiency project.

Risk management department (RMD)

We will be evaluating the involvement of RMD in two important areas which will have bearing on the financial statements. One is in relation to RMD's involvement in the Company's recent major IT system overhaul project. Second one is in respect of RMDs review and remedial measures introduced in the NBFC's credit risk management following significant findings by the NBFCs Prudential Regulator viz. RBI.

Information system auditors (IS Auditors)

Considering the highly automated operating environment in the Company, the involvement of our IS auditor is critical in this audit. During the current year, our IS Auditors special focus would be on testing whether data migration from legacy systems to the ERP was complete and accurate, whether user roles and access privileges were aligned to segregation of duties, and whether automated interfaces are working smoothly and effectively. Overall work to be performed by IS Auditor would be as follows:

- Evaluate design and operating General IT Controls including access management, change management, backup/recovery, audit trail and cybersecurity.
- Review application controls within the newly implemented ERP system, focusing on:
 - User access rights and segregation of duties.
 - Automated workflows for procurement, production, and sales.
 - Data migration from legacy systems to ERP.
 - Reliability of system-generated reports used in audit testing.

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Other specialists

Actuaries

In the audit of SFS of Parent, we will be involving an external Actuary to evaluate the ABC's liability and accruals in respect of the ABCs Employee Provident Fund plans which has devolved back due to non-compliance with certain conditions that were to be fulfilled upon surrender of ABCs EPF Trust to EPFO, Govt of India.

In respect of European subsidiary, which employs large number of workers, it is subject to rigorous labour laws and employee benefit obligations under relevant legislation. Therefore, ensuring adequacy of provisions for employee benefits under Indian Accounting Standard 19, *Employee Benefits* is very important. We plan to engage a local Actuary in consultation with the auditors of European subsidiary to independently validate compliance with Ind AS 19 requirements by the European Subsidiary's HR department in this regard.

Valuation experts

Considering substantial investment in the research and development areas by the Group entities, there is a need to focus on ABCs Group controls and processes over accounting for these costs and evaluating the need for impairment of capitalised intangibles and those intangible assets not yet available for use. We will be using external valuation experts to validate the ABC's computation of value-in-use for these intangibles.

Further, we will be utilising the services of valuation experts for evaluating fair value measurements of various assets, liabilities and intangibles etc. to be acquired by Middle East subsidiary in the planned acquisition project.

Income Tax – Transfer Pricing Experts

ABC has substantial amount of Intra-group transactions with its European subsidiary which are subject to stringent Indian tax laws and European Tax laws. Further, we need to evaluate the status of International Tax Reforms – Pillar 2 minimum tax in the Europe. Therefore, we will be engaging our in-house International Tax experts to look into these areas closely.

Environmental Law Experts

The Group including overseas subsidiaries are subject to fast moving and rigorous Environment and Climate Risk Laws and Regulations (EPR obligations). We need to engage a suitable expert in this area, and we will be closely coordinating with the auditors of subsidiaries in Europe and Middle East.

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VIII- Materiality determination

(This section of the ASM summarizes the steps considered in determination of Materiality for the purpose of audit ABC Limited. SA 320, *Materiality in Planning and Performing an Audit*, requires the auditor to set materiality levels for the financial statements as a whole and for performance materiality, ensuring that audit procedures are appropriately focused on areas that could influence the economic decisions of users. There are number of approaches to determine materiality depending on facts and circumstances of each audit. One of the primary considerations is identifying the benchmark most important to users of financial statements of the auditee entity. In the absence of limited guidance in SA 320¹¹, it may be useful to refer to thematic reviews of various regulators to understand some of the methods followed in practice. We reiterate that determination of materiality requires exercise of professional judgement).

Overall materiality and performance materiality

Basis of determination of benchmarks

ABC is a listed entity with its equity shares listed on BSE and NSE. During the year ABC has become debt-free company, and the key stakeholders are mainly the equity shareholders. Keeping in mind the profitable operating performance, which has stabilised during last two years, and based on review of investor presentation, we understand that the users focus on two operating performance benchmarks, we have used forecast Revenue and Profit before Tax (PBT) for the current year 20XY.

Standalone financial statements – Overall materiality (OM)

Benchmark	Amount (₹ Crores)	Acceptable %age	Materiality Estimate (₹ Crores)
Revenue	70,000	0.5- 1%	350
PBT	7,600	5%-8%	380

Based on the above and large number of shareholders using the financial statements of ABC, range of materiality is ₹ 350 – 380 crores (determined basis the lower end of the above ranges). Accordingly, OM has been set at ₹ 365 crores.

Performance materiality (PM)

Generally, performance materiality is set at 50 to 75% of Overall materiality. Considering the recent stability in the Automobile Industry business, ABC's recent turnaround as a profitable entity and rapid technological advancements, Performance materiality is set with lower range of acceptable global benchmark i.e., it is set at 50% of Overall materiality amounting to ₹ 183 crores.

Clearly trivial threshold (CTT)

Global best practices indicate 0-5% of OM as a benchmark for CTT. Accordingly, CTT of ₹ 18 crores is considered appropriate.

Review of materiality limits determined at audit planning stage

Materiality limits determined as part of Planning Stage will have a significant impact on the extent of audit tests and sample sizes, therefor, need a review as the audit progresses and revisions if necessary.

¹¹ SA 320, *Materiality in Planning and Performing an Audit*

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As required by para 10 of SA 450¹², we will review the materiality thresholds prior to evaluating the effect of uncorrected misstatements and shall reassess materiality thresholds determined at planning stage in accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results.

Consolidated financial statements – Overall materiality (OM)

ABC Group's financial performance trend is same as that of Parent entity. Keeping in mind the profitable operating performance, which has stabilised during last two years, and based on review of investor presentation, we understand that the users focus on two operating performance benchmarks, we have used forecast Revenue and PBT for the current year 20XX.

Benchmark	Amount (₹ Crores)	Acceptable %age	Materiality Estimate (₹ Crores)
Revenue	440,000	0.5- 1%	2,200
PBT	34,000	5%-8%	1,700

Based on the above and large number of shareholders, the range of materiality is ₹ 1,700 to 2,200 crores, we consider the mid-range of ₹ 2,000 crores is appropriate.

Consolidated financial statements – Performance materiality (PM)

As mentioned above, generally, performance materiality is set at 50 to 75% of Overall materiality. Considering a few unusual variations in certain class of account balances and the substantial increase in intangible assets under development at overseas subsidiary coupled with rapid technological advancements in the Automobile Industry business, Performance materiality at group level is set with lower range of acceptable global benchmark of 50% of Overall materiality i.e., ₹ 1,000 crores.

Consolidated financial statements – Clearly trivial threshold (CTT)

Global best practices indicate 0-5% of OM as a benchmark for CTT. However, as explained for haircut for Group Performance Materiality, CTT is set at mid-range of accepted global practices i.e. ₹ 50 crores is considered appropriate.

We being the Principal Auditor responsible for audit of CFS, we would establish overall group materiality, performance materiality, and clearly trivial thresholds at the consolidated level and would also consider them in assessing misstatements, if any, at group level. Based on group materiality, materiality is determined for each subsidiary or business unit, considering its relative size, risk profile, and contribution to the consolidated financial statements. However, in some cases subsidiary company auditors perform audit tests based on materiality level for subsidiaries' separate financial statements. In such cases, for CFS audit purposes, they will consider lower of the two i.e., materiality thresholds advised by us or the ones determined by them for their SFS audits.

¹² SA 450, *Evaluation of Misstatements Identified during the Audit*

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IX- Audit of Consolidated financial statements -Special considerations

(This section of the ASM sets out the considerations relevant for the group Audit Strategy, in line with the requirements of SA 600¹³, and NFRA Circular on the Responsibilities of Principal Auditor and Other Auditors in Group Audits).

Overview of the components of the group

ABC has following subsidiaries which form part of ABC's Consolidated financial statements (contributing 85% of consolidated revenue). There are separate auditors appointed for audit of standalone financial statements of the subsidiaries, except in case of one Indian subsidiary where we are also auditors for SFS of that subsidiary:

- Three Indian subsidiaries are engaged in manufacturing of auto-components, spare parts and related items.
- One of the Indian subsidiaries is engaged in granting vehicle loans and registered as Non-Banking Finance Company (NBFC) with the Reserve Bank of India (RBI).
- One subsidiary in the European Country engaged in manufacturing of vehicles, auto-components, spare parts and related items and One subsidiary in the Middle East is engaged sale of vehicles and cars and spare parts and related items

Scoping of components

We, being the Principal Auditor and responsible for expressing opinion on CFS of ABC Limited, have considered the requirements of SEBI Listing Regulations¹⁴ and the requirements of SA 600 read with NFRA circular dated 4th October 20XX, for determining the scope and coverage of components that should be audited. We have also exercised professional judgement to determine the degree of involvement and oversight to be exercised over the Other Auditors who are auditing the components included in the CFS of ABC.

As noted earlier, ABC Group's revenue substantially (approx. 85%) arises from subsidiaries. Therefore, we consider it very critical for us to establish a mutually beneficial effective 'two-way' communication and coordination with the Other Auditors and involvement in their audit work in all significant areas. Accordingly, our preliminary audit strategy on Other Auditors' work is as follows:

Component information	Other auditor information	Whether scoped in for full scope review?
Indian Subsidiary 1: ▪ Represents 10% of the group's revenue. ▪ Significant risk relevant to the group financial statements (i.e. presumed fraud risk in revenue recognition and significant risk relating to inventory)	▪ Our Firm is the auditor for SFS but Engagement Team is different. ▪ Audit methodology and practices are same as those used for Parent entity audit.	Yes

¹³ SA 600, *Using the Work of Another Auditor*

¹⁴ Regulation 33(3)(h) of SEBI Listing Regulations require that for the purposes of consolidated financial results to be submitted with Stock Exchanges, at least eighty percent of each of the consolidated revenue, assets and profits, respectively, shall have been subject to audit.

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Component information	Other auditor information	Whether scoped in for full scope review?
Indian Subsidiary 2: - Represents 20% of the group's revenue. - A number of late adjustments were made by component management in the prior year. - Presumed fraud risk in revenue recognition (as per para 26 of SA 240, auditor has to presume risk of fraud in revenue recognition unless rebutted as per para 47 of SA 240).	- Other Indian Audit Firm (not our Network firm). - Prior year experience with the Other auditor was satisfactory. - Other Auditors are well trained on sector specific matters - Documentation of work performed, and conclusions reached by the Other Auditor were satisfactory.	Yes
Indian Subsidiary 3: Represents 2 % of the group's assets and 1 % of group revenue.	Not a network firm.	No because the component is not material to the group CFS.
Indian NBFC Subsidiary: - Unique business processes and IT systems. Contributes around 10% of group's revenue. - RBI Annual Inspection and Internal Audit Division has identified a number of weaknesses in the credit risk management system including adequacy of ECL provision – a significant risk. - Division III to Schedule III to the CA 2013 provides a different format for presentation of balance sheet to NBFCs. - Presumed fraud risk in revenue recognition (as per para 26 of SA 240, auditor has to presume risk of fraud in revenue recognition unless rebutted as per para 47 of SA 240).	- Other Indian Audit Firm (not member of our Network). - Prior year experience with the component auditor was not satisfactory. - Other Auditors needed more guidance due to lack of adequate domain knowledge of NBFCs. - Responsiveness to our requests at times has been poor. - Documentation of work performed, and conclusions reached by the Other Auditor required a considerable amount of follow-up and clarifications. - To address the issues noted in prior year, we will perform the following this year: - We will be providing them the detailed audit programmes in all significant audit areas; - We will be regularly coordinating with the Engagement Team to ensure audit work and the results are properly documented.	Yes
European Subsidiary: - Represents 35% of group revenue and 25% of group assets - Large amount of intangible assets	Europe based audit firm is eligible to undertake company audits in that country. But we will be evaluating the competency and	Yes

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Component information	Other auditor information	Whether scoped in for full scope review?
▪ Significant increase in warranty provisions ▪ Presumed fraud risk in revenue recognition (as per para 26 of SA 240, auditor has to presume risk of fraud in revenue recognition unless rebutted as per para 47 of SA 240).	other eligibility criteria as per India's Audit and Statutory Framework. ▪ Similar to India, European Country auditing standards & ethical codes are based on ISAs & IESBA code respectively, but there are some differences with those applicable in India. ▪ Prior years' experience with the Other Auditor was satisfactory.	
Middle East Subsidiary: ▪ Primarily engaged in import of vehicles and auto components from India & Europe based fellow subsidiary. ▪ Represents 10% of group revenue and 5% of group assets ▪ Planning a potential acquisition of an automobile component manufacturing entity. ▪ Presumed fraud risk in revenue recognition (as per para 26 of SA 240, auditor has to presume risk of fraud in revenue recognition unless rebutted as per para 47 of SA 240).	▪ Middle East based audit firm registered with Financial Audit Authority of relevant jurisdiction, but we will be evaluating the competency and other eligibility criteria as per India's Audit and Statutory Framework. ▪ Similar to India, Middle East Jurisdiction auditing standards & codes are based on ISAs & IESBA code respectively, there are some differences with those applicable in India.	Yes

Planned extent of involvement in the work of the Other Auditor (Component Auditors)

Based on the information gathered by us, the Principal Auditors, and our past experience on working with the Other Auditors, we have decided to use the work of the Other Auditors in respect of financial information of the components for the purpose of our audit opinion on the ABC's CFS. Accordingly, we would perform the following procedures to comply with SA 600 and the NFRA Circular:

- We will establish a mutually beneficial 'two-way' communication protocols with the Other Auditors and the management of subsidiaries.
- We will require Other Auditors to confirm their independence in accordance with applicable code of ethics to audits in India.
- We will be communicating with the Other Auditors' regarding the use of their audit work for the purpose of our audit of CFS. We would be specifically seeking their opinion on their audit of financial information reported in the Group Consolidation/Reporting Package, which includes two important aspects i.e., elimination of intra-group transactions, the information reported therein is based on the Indian Accounting Standards applicable to ABC's CFS in India and they have performed the audit in accordance with the Standards on Auditing, Quality Control and Ethics Code applicable to the auditors of companies in India. We will also advise them to provide written confirmation to share their audit work papers/related information with us.

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- We will be advising them the levels of materiality, performance materiality and CTT for their respective components. Other Auditors may use different quantitative thresholds determined for their audit of SFS provided those thresholds are lower as compared to those computed by us and allocated to their components and advised to them.
- We will be issuing our firm's standard Group Audit instructions to Other Auditors (being other audit firms) and in particular highlighting the following significant matters identified by us in this audit strategy document.
 - Substantial increase in the carrying amounts intangible assets under development and intangible assets, and the resultant concerns on amortisation or impairment requirements.
 - Substantial increase in warranty provisions although the revenue numbers are flat.
 - Related parties and related party transactions including intra-group transactions.
 - Planned acquisition of a manufacturing unit by the Middle East based subsidiary and consequential work on acquisition accounting as per Ind AS 103.
 - Critical evaluation of deferred tax items in the context of developments in UK Tax legislation re-Pillar 2 Minimum Tax regime.
- We will be participating in the Other Auditor's work on risk identification and assessment procedures including understanding of system of internal control, IT environment in relation to significant audit areas and development of audit procedures responsive to those risks. We plan to have on-line meetings to discuss significant audit aspects such as fraud risk and amortisation period/impairment of intangible assets capitalised and those under development).
- We will be making on-site visits to Europe based and Middle East subsidiary once the interim audit work is complete.
- We will perform reviews of working papers of Other Auditor's in all significant areas. If need arises, we will request such Other Auditor to perform additional procedures or provide more detailed explanations.
- Participate in closing and other key meetings between Other Auditors and component management or those charged with governance of the component, wherever necessary.

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X- Preliminary overall audit strategy

(This section of the ASM sets out the engagement team's preliminary overall risk assessment and audit strategy)

Based on preliminary results of our overall risk assessment analytical procedures, review of industry environment and initial meetings with client management and client personnel, following are identified as the key focus areas for audit. During detailed audit planning phase, these initial assessments will be reviewed further.

Standalone financial statements (SFS)

- Significant decrease in Cost of Materials though there is no material change in Revenue numbers.
- Substantial increase in Warranty Provisions
- Restructuring of Employee Benefit Plans

Consolidated financial statements (CFS)

- Significant increase in carrying amount of intangible assets under development in a subsidiary company.
- Substantial increase in Warranty Provisions in subsidiaries
- Accounting for domestic business restructuring initiatives
- Business combination accounting for planned acquisition of auto-component production entity in Middle East by a subsidiary company.

Both SFS and CFS

- ***Revenue recognition and cut-off***

Revenue recognition is one of the most critical areas in financial reporting because it directly impacts profitability, investor perception, and management incentives. Revenue in automobile entities is often: high volume and high value, carried out through multiple channels (e.g. direct sales, dealerships, financing schemes) and is linked to sales targets, bonuses, and dealer incentives that can create pressure to recognize revenue prematurely or inflate numbers.

- ***Warranty provisions.***

There is substantial increase in warranty provisions although revenue numbers are generally flat. The estimation of warranty provisions involves management judgment, including assumptions about product failure rates, historical claims, cost per claim, and expected repair or replacement expenses. These estimates are inherently uncertain, making them susceptible to error or manipulation. Management may intentionally understate provisions to inflate profits or meet market expectations, particularly at year-end.

- ***IT General Controls and Internal Control Environment***

As mentioned in section V, the ABC Limited has undertaken significant overhaul of its IT platforms and related controls and processes. Therefore, we will be reviewing in detail the changes made, suitability of systems design and operating effectiveness of the internal controls.

- ***Inventory obsolescence – Spare parts***
- ***Impairment loss on vehicle loans granted by NBFC subsidiary***
- ***Management override of controls***

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XI- Engagement team planning and timetable

1. Engagement overview

- **Client Name:** ABC Limited
- **Audit Period:** 1st April 20X(Y-1)-31st March 20XY
- **Engagement Partner:** CA. Dharmaraj
- **Engagement Quality Control Reviewer:** CA. Dronacharya
- **Industry:** Automobile
- **Reporting Framework:** Ind ASs notified under Companies (Indian Accounting Standards) Rules 2015 and amended from time to time.
- **Group Audit Engagement/Involvement:** Yes

2. Location-wise Estimated Hours

	Current year Estimate (Hours)	Last year Actual (Hours)
SFS of ABC[^]		
Corporate office	400	300
Manufacturing Plant 1	200	150
Manufacturing Plant 2	250	200
Sales & Marketing Division at Corporate Office*	300	250
Total	1,200	1,000
CFS of ABC[^]		
Corporate Office	500	500
Other Auditors – From Corporate Office	400	300
Other Auditors – On-site	600	400
Total	1,500^{&}	1,200

[^]Detailed audit area-wise time budgets will be prepared in conjunction with the preparation of Risk assessment and Audit Programme development phase, including to evaluation of the reasonableness of the accounting estimates made by management and plan for confirmation.

*ABC has number of branches called showrooms and distribution centres across India. However, all documents and information required for our audit is available centrally at Sales & Marketing Office. Also, these branches do not have material amount of physical assets. Hence, on-site visits to these showrooms and distribution centres are not planned.

[&] Substantial increase in estimated time is due to higher number of significant risk areas identified during this year such as substantial increase in Intangible Assets under development and warranty provisions.

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3. Engagement team structure

Role	Name	Responsibilities
Engagement Partner	CA. Dharmaraj	Overall responsibility, final sign-off, liaison with TCWG
Engagement Quality Control Reviewer	CA. Dronacharya	Independent review of significant judgments, audit quality
Engagement Managers	CA. Bhim & CA Arjun	Day-to-day supervision, review of audit work, managing timelines
Audit Supervisor	CA. Sahdev	Planning execution, supervising team, coordinating with client
Audit Staff	CA. Abhimanyu and CA Ghatotkacha & Other 10 staff members	Performing fieldwork, testing, documentation
IT/IS Specialist	CA. Nakul	Review of ERP controls, ITGCs, automated controls
Tax Specialist	CA. Krishna	Review of tax provisions, transfer pricing, deferred tax
Valuation/Actuarial Expert	CA. Vidhur	Support in provision for employee benefits and impairment computation

4. Key planning activities and timeline

Phase	Activity	Responsible	Target Date
Pre-Engagement	Engagement acceptance, independence confirmation, client onboarding, including Engagement letter	Engagement Partner / Managers	
Planning Phase	Understanding business, risk assessment, materiality determination	Engagement Partner / Managers / Audit Supervisor	
	Issue Group Audit Instructions	Managers	

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Phase	Activity	Responsible	Target Date
	Internal control walkthroughs, ITGC testing	Audit Supervisor/ IS Auditor	
	Audit strategy memorandum (ASM) preparation	Managers / Partner	
	Communication with and Audit Committee	Engagement Partner	
Interim Audit	Testing controls, walkthroughs, interim substantive testing	Engagement Team	
Year-End Audit	Substantive testing of balances & disclosures	Engagement Team	
	Expert involvement (Tax, Valuation, IS audit)	Respective Expert	
	Review of component auditors' work (Group Audit)	Engagement Partner / Managers	
Completion & Reporting	Evaluation of misstatements, going concern, subsequent events	Engagement Partner / Managers	
	Completion of EQCR	EQCR Reviewer/Partner	
	Draft Audit Report discussion with Management	Engagement Partner	
	Final Audit Report discussion with Audit Committee/TCWG	Engagement Partner	
	Communication with Audit Committee	Engagement Partner	