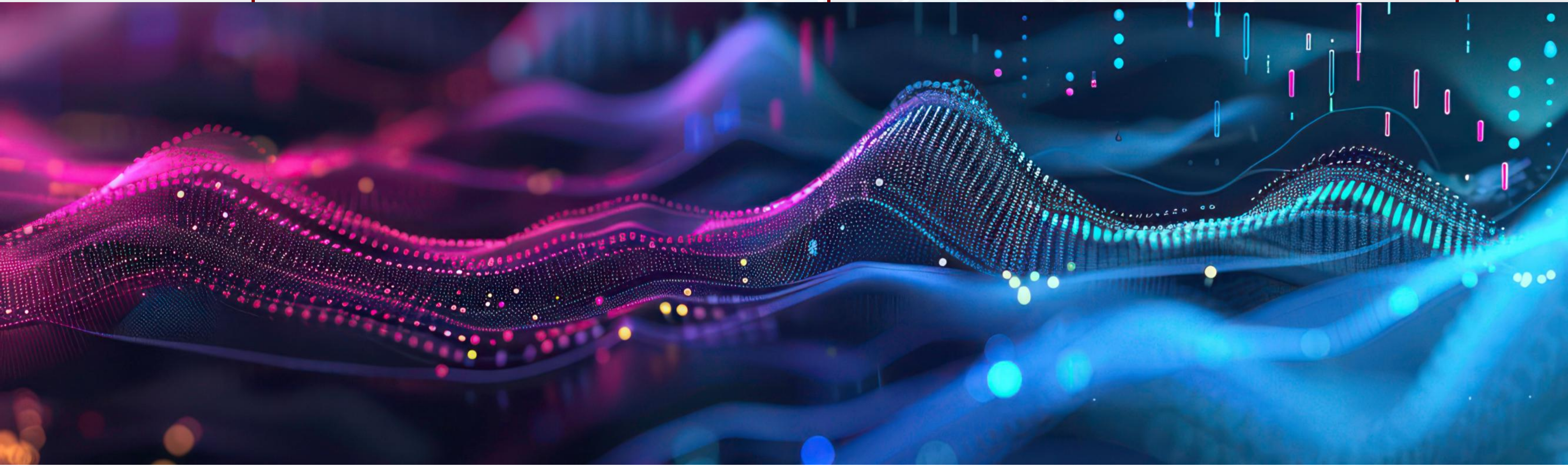
ASSURANCE GAZETTE

March, 2025

NANGIA & CO LLP
CHARTERED ACCOUNTANTS

Contents



Foreword

“Welcome to the Assurance Gazette for March 2025.

This edition highlights the importance of auditor communication with Audit Committees, focusing on Expected Credit Losses (ECL) under Ind AS 109. Emphasizing audit quality, financial integrity, and regulatory compliance, it addresses key audit considerations, management judgments, and best practices. Introduced by NFRA in Auditor-Audit Committee Interaction Series 1, this initiative aims to enhance transparency and strengthen the audit process.

This edition also highlights the second communication in the Auditor-Audit Committee Interactions Series, focusing on Deferred Tax Assets and Liabilities. Recognizing the complexities of deferred tax accounting, NFRA presents 27 key questions to support Audit Committees in strengthening oversight and ensuring compliance with accounting standards. This guidance promotes transparency, enhances audit effectiveness, and upholds financial integrity.”

NFRA's Auditor-Audit Committee Interaction Series on Expected Credit Losses

Introduction

Expected Credit Loss, under Ind AS 109, is crucial for timely credit risk recognition, ensuring accurate financial reporting and asset valuation. By considering past data, current conditions, and future forecasts, it enhances transparency, regulatory compliance, and investor confidence, aligning with the applicable financial reporting framework. NFRA's Auditor-Audit Committee Interaction Series 1 highlights key questions Audit Committees may raise with auditors on ECL.

Key Highlights

The table below summarises the key questions Audit Committees may raise with auditors on ECL.

Segment	Key Questions	Audit Approach
ECL Recognition and Measurement	Have opening and closing balances been reviewed properly? Are there any unusual movements in ECL reversals or charges to P&L?	Analyse trends in ECL balances, reversals, and charges, ensuring consistency with credit risk factors and economic conditions. Investigate unusual fluctuations.
	Has the auditor verified the ECL methodology used for different financial assets?	Ensure compliance with Ind AS 109, verifying that assumptions, past trends, and forward-looking factors are incorporated. Confirm correct application of the Provision Matrix and identify receivables requiring the General Approach for accurate ECL estimation.
Risk Assessment & Internal Controls	Has the auditor assessed the company's internal control system including credit risk management system?	Evaluate internal controls for effective credit risk identification and management. Review bad debts, disputes, and unsecured exposures to detect risk deterioration. Ensure risk assessments rely on objective data and analytics, minimizing reliance on subjective management estimates.

Segment	Key Questions	Audit Approach
	Has the auditor evaluated the design and effectiveness of controls in the company's three-stage ECL classification, ensuring accurate recognition and measurement of allowances?	The auditor should verify Ind AS 109 compliance, assess internal controls, test sample transactions, evaluate PD, LGD, and EAD assumptions, validate forward-looking estimates, and review governance and documentation for accurate ECL recognition.
Loans, Advances & Related Party Transactions	Has the auditor reviewed loans, advances, or receivables from related parties (including promoters)?	
	-> Has the auditor verified the business rationale and creditworthiness of such transactions?	Assess the commercial justification and financial strength of counterparties to determine the risk of default.
	-> Are there any changes in business terms that could significantly impact ECL provisioning?	Review any modifications in loan terms that may reduce ECL artificially or alter credit risk assessment.
	-> How has the auditor verified the accuracy of balances and genuineness of repayments?	Examine supporting documents, repayment records, and bank statements to ensure reported collections are authentic and not structured to understate ECL.
	-> Has the auditor assessed the recoverability of outstanding balances and adequacy of ECL allowances?	Perform ageing analysis, assess default risks, and ensure ECL provisions adequately reflect potential credit losses.
	-> Has the auditor considered appropriate stratification of financial assets for ECL determination?	Verify whether ECL techniques are customized based on industry, geography, business lifecycle, and asset class risk profile.
	If recoverability is based on management expert reports, has the auditor verified their competence and objectivity?	Evaluate the independence, expertise, and methodology of external experts used for valuation, ensuring reliable and unbiased assessments.

Segment	Key Questions	Audit Approach
Regulatory Compliance & Economic Considerations	Does the company's approach meet the fundamental principles of Ind AS 109, including unbiased estimation, time value of money, and historical + forward-looking data?	Validate that ECL estimates incorporate objective, probability-weighted scenarios without management bias.
	Has the auditor considered the guidance notes of relevant regulators or standard-setters or relevant prudential regulators e.g. Reserve Bank of India in this area?	The auditor should review guidance from regulators and standard-setters, ensure ECL models align with regulatory expectations, assess compliance with prudential norms, and verify that industry best practices are incorporated into risk assessment and financial reporting.
	Has the auditor considered the impact of Regulatory developments and policy directions?	The auditor should review regulatory updates and policy changes from regulators, and other authorities, assess their impact on ECL estimation, verify compliance with revised guidelines, and ensure necessary adjustments in risk assessment and financial reporting.
Use of Experts & Model Validation	Does the company have adequate subject matter experts (credit risk specialists, data analysts) for ECL estimation?	Ensure qualified credit risk specialists and data analysts are involved in ECL assessments.
Group Audits & Subsidiaries	Has the Principal Auditor evaluated the work done by auditors of subsidiaries and associates?	Assess whether the subsidiary auditors' work meets group audit requirements and aligns with ECL methodologies.

Nangia's Take

National Financial Reporting Authority (NFRA) has introduced the Auditor-Audit Committee Interaction Series, emphasizing the critical role of auditor communication with Audit Committees, particularly regarding Expected Credit Losses (ECL) under Ind AS 109. This initiative presents key questions to enhance understanding of compliance, transparency, and accountability in ECL financial reporting. By strengthening Auditor-Audit Committee interaction and offering greater clarity on the measurement and recognition of ECL allowances, it ensures proper reporting to the Audit Committee, strengthening oversight of a company's credit risk management and financial health.

NFRA: Second communication of Auditor-Audit Committee Interactions Series, focusing on Deferred Tax Assets, Liabilities

The National Financial Reporting Authority (NFRA) has released the second installment of its “Auditor-Audit Committee Interactions Series,” focusing on the audit of income taxes, particularly Deferred Tax Assets (DTAs) and Deferred Tax Liabilities (DTLs) as outlined in Ind AS 12. This follows the initial communication, which covered the assessment of Expected Credit Losses.

In this latest communication, NFRA emphasizes that as per the detailed guidance in Ind AS 12, DTAs or DTLs arise from temporary differences between the book value of assets or liabilities in the financial statements and their corresponding tax bases. The measurement of deferred taxes involves applying the appropriate income tax rates and regulations enacted or substantively enacted as of the reporting date. NFRA underscores that consistent measurement is crucial for ensuring reliable financial reporting. It also draws attention to the specific criteria in Ind AS 12 regarding the recognition of tax effects arising from ownership interests in subsidiaries, associates, and joint ventures, as well as the treatment of goodwill from business acquisitions.

To aid Audit Committees in their oversight responsibilities, NFRA has compiled a set of 27 potential questions that committees may pose to auditors to evaluate the accuracy of estimates and judgments under Ind AS 12. Some key questions include:

1) Has the auditor identified all relevant income tax laws that were enacted or substantively enacted at the reporting date? How was the determination of 'substantively enacted' laws made, and were experienced tax professionals involved?
2) Were there any significant amendments to tax laws or judicial rulings that could impact the calculation of DTAs and DTLs? How were these changes factored into the analysis?
3) What tax rate was applied for the measurement of current and deferred taxes? Was the rate chosen based on the expected reversal of temporary differences?
4) How has the company calculated and measured DTAs and DTLs? Did the company implement effective internal controls over this process, and how has the auditor evaluated these controls?
5) Have any revalued non-depreciable assets carried at fair value been identified? How were the resulting tax implications addressed?
6) How has the auditor ensured the completeness and accuracy of temporary differences identified by the company?
7) Has the company recognised DTAs for unused tax losses or tax credits? How has the auditor assessed the probability of future taxable income sufficient to realise these DTAs?
8) In cases of business combinations, were deferred taxes recognised on acquired assets and liabilities? Was this properly adjusted against goodwill or bargain purchase gains?

In addition to these questions, NFRA also references the applicable Standards on Auditing (SAs). Specifically, SA 540 governs the auditor's responsibilities concerning accounting estimates, SA 701 deals with the communication of key audit matters (KAM) in the audit report, and SA 260 (Revised) mandates communication with those charged with governance on significant qualitative aspects of accounting practices.

The illustrative list of 27 questions serves as a robust guide for Audit Committees and Management to enhance their understanding and oversight of the company's income tax-related judgments and disclosures under Ind AS 12. By fostering transparent discussions and ensuring rigorous evaluations, NFRA aims to strengthen the overall quality of financial reporting.

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