SA 320

Materiality in Planning and Performing the Audit

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INDEPENDENT AUDITOR'S REPORT

To the Members [redacted]

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements [redacted] ("the Company"), which comprise the Balance Sheet as at March 31, 2023 and the Statement of Profit and Loss notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31, 2023, its profits for the year ended on that date.

Basis for Opinion

We conducted our audit in accordance with the Standards on Auditing (SAs) specified under section 143(10) of the Companies Act, 2013. Our responsibilities under those Standards are further described in the Auditors Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the Code of Ethics issued by the Institute of Chartered Accountants of India together with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013 and the Rules thereunder, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

The Company's Board of Directors is responsible for other information. The other information comprises the information included in the Board's Report including the Annexure to the Board's Report but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with the audit of the financial statements, our responsibility is to read the other information and in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appear to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report the fact. We have nothing to report in this regard.

Responsibility of Management for Financial Statements

The company's Board of Directors is responsible for the matters stated in Section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation of these financial statements that give a true and fair view of the financial position of the company in accordance with the accounting principles generally accepted in India, including the Accounting Standards specified under section 133 of the Act. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding the assets of the company and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgements and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statement that give a true and fair view and are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

The Board of Directors are also responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with SAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidences that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of integral control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances. But not for the purpose of expressing an opinion on whether the company has adequate internal financial controls with reference to financial statements in place and operating effectiveness of such controls.

Balance Sheet as at March 31, 2023

Amount in Rs ('000)

Particulars	Notes	As at March 31, 2023	As at March 31, 2022
I EQUITY AND LIABILITIES			
(1) Shareholders' funds			
(a) Share capital	3	100.00	100.00
(b) Reserves and surplus	4	19,822.46	6,949.57
		19,922.46	7,049.57
(2) Non-Current Liabilities			
(a) Long-term borrowings	5	15.00	15.00
(b) Deferred tax liabilities (net)		-	-
(c) Other Long Term Liabilities		-	-
(d) Long term provision		-	-
		15.00	15.00
(3) Current Liabilities			
(a) Short Term Borrowings		-	-
(b) Trade payables	6	-	-
- Micro & Small Enterprises		-	-
- Others		6,972.31	4,459.07
(c) Other current liabilities	7	1,106.91	2,359.85
(d) Short-term provisions			
		8,079.21	6,818.92
		28,016.67	13,883.49
II ASSETS			
(1) Non - current Assets			
(a) Property, Plant & Equipment and intangible assets	8		
(i) Property, Plant and Equipment		3,383.08	3,457.24
(ii) Intangible assets		-	-
(iii) Capital Work in progress		-	-
(iv) Intangible Assets under Development		-	-
(b) Non-current investments			-
(c) Deferred Tax Assets		16.71	-
(d) Long term loans and Advances	9	1,000.00	110.00
(e) Other Non Current Assets		-	-
		4,399.80	3,567.24
(2) Current Assets			
(a) Current Investments	10	5,491.21	
(b) Inventories		-	-
(c) Trade receivables	11	1,595.00	2,598.40
(d) Cash and cash equivalents	12	3,536.78	5,589.10
(e) Short-term loans and advances	13	2,860.06	396.06
(f) Other Current Assets	14	10,133.83	1,732.69
		23,616.88	10,316.25
		28,016.67	13,883.49

Statement of Profit and Loss for the year ended March 31, 2023

Amount in Rs ('000)

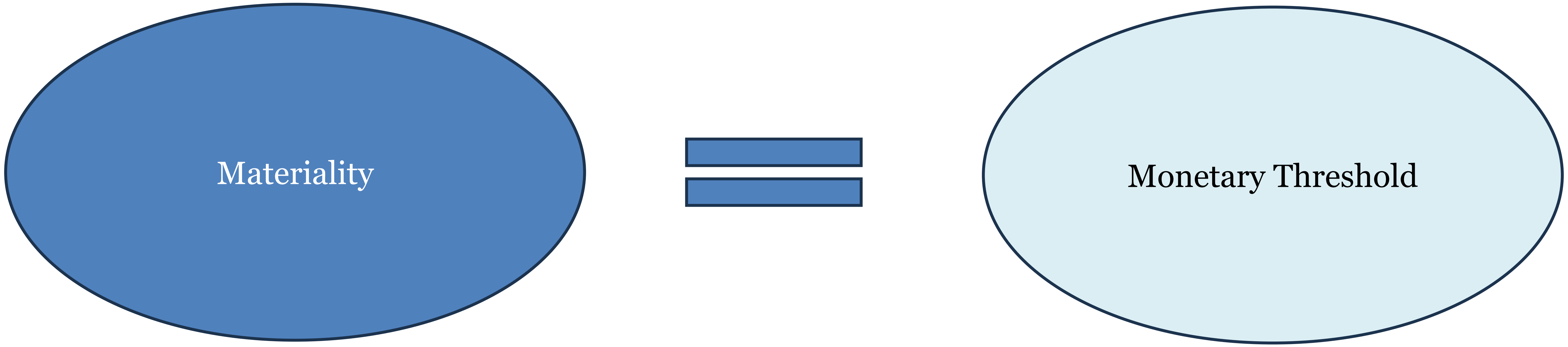
Particulars	Notes	Year ended March 31, 2023	Year ended March 31, 2022
I Revenue from Operation	15	67,798.48	32,033.52
II Other Income	16	195.15	2.38
III Total revenue (I + II)		67,993.63	32,035.90
IV EXPENSES			
Purchase of stock in trade		-	-
Changes in inventories of finished goods		-	-
Employee benefits expenses	17	8,716.21	5,198.01
Finance costs	18	27.25	9.13
Depreciation and amortisation expenses	8	1,584.30	564.55
Other expenses	19	42,462.64	17,304.64
Total expenses		52,790.40	23,076.33
V Profit before tax from continuing operations		15,203.23	8,959.57
VI Tax expense:			
- Provision for tax		-	-
- Tax of earlier years		2,347.05	-
- Deferred tax liabilities / (assets)		(16.71)	-
		2,330.34	-
VII Profit/(Loss) for the year from continuing operations		12,872.89	8,959.57
VIII Earnings per equity share of face value ` 10 each	20		
- Basic (Amount in INR)		1,287.29	895.96

Significant accounting policies 2

The notes referred to above form an integral part of the financial statements.

As per our report of even date.

Materiality



Materiality in auditing is defined as the ***magnitude of an omission or misstatement*** *of accounting information that, in the light of surrounding circumstances, makes it* ***probable*** *that the* ***judgment of a reasonable person*** *relying on the information would have been* ***changed or influenced by the omission or misstatement.***

Application of Materiality

Planning the audit

Performing the audit

Evaluating Effect of Uncorrected Misstatements on Auditor's Opinion

Notes

(a) Determining the nature, timing and extent of risk assessment procedures;
(b) Identifying and assessing the risks of material misstatement; and
(c) Determining the nature, timing and extent of audit procedures.

Types of Materiality

Overall Materiality

Performance Materiality

Specific Materiality (CTM/SUM/AMPT)

OM * X%

OM * 5%

For financial statements as a whole

Materiality at account level or class of transactions or disclosures

Transaction level materiality

Application by Types of Materiality

Overall Materiality	• Overall aggregation of misstatements at account level above CTM (including PM)
Performance Materiality	• Audit Scoping
	• Audit Sampling
	• Account Level aggregation of all misstatements above CTM.
CTM	• Correction of misstatements at transaction level

Group Activity 1

Scoping at FS level and at account level

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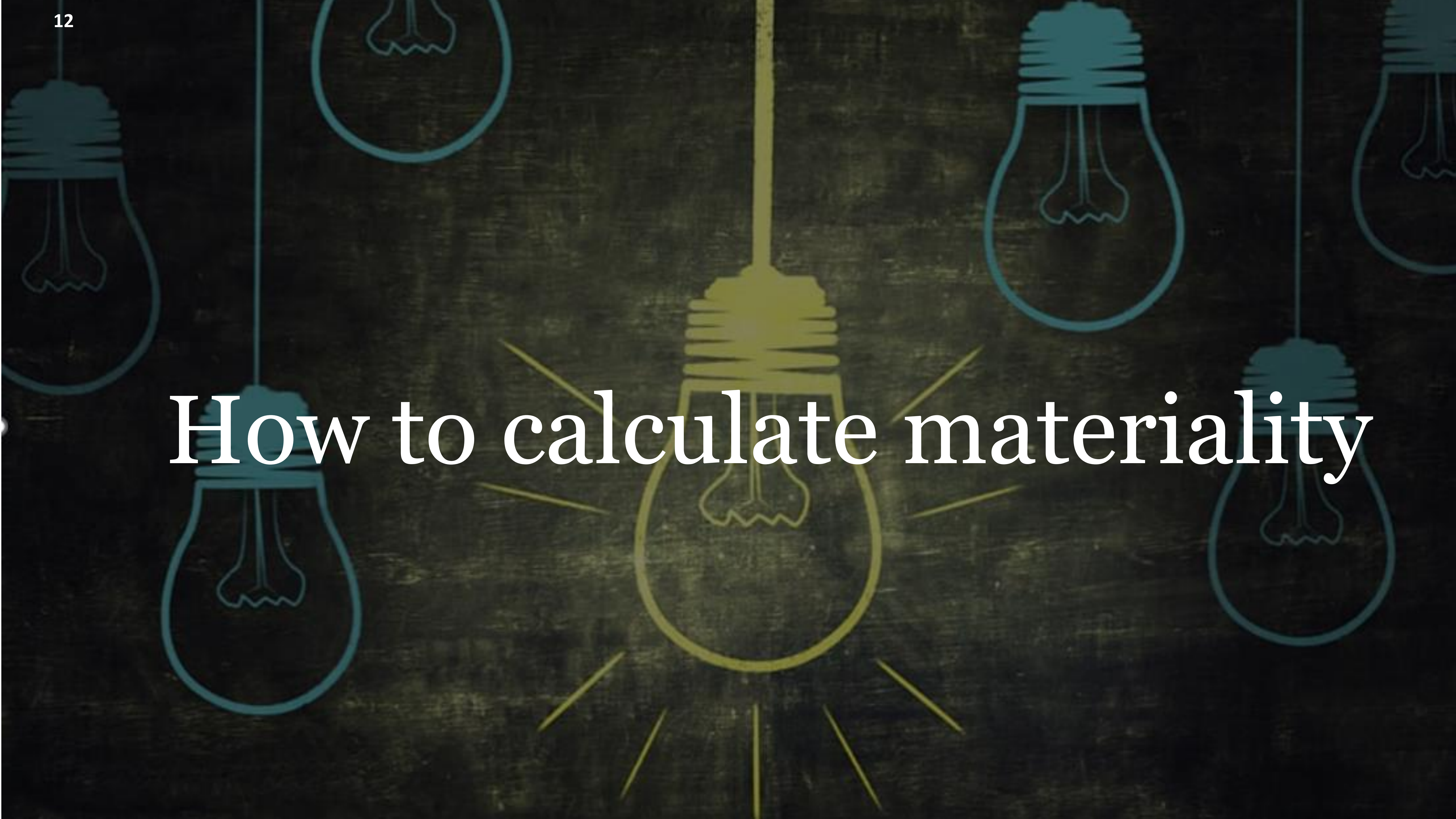
As per our report of even date.

Note 19

Other Expenses

Administrative Expenses	7,030.30	2,634.84
Audit Fees	30.00	-
Business Promotion Expenses	-	1,469.55
Commission and Brokerage	360.00	125.00
Designing Fees	6.00	240.00
Foreign Fluctuation Account	0.39	
Insurance	3,806.52	547.57
Marketing Expenses	8,476.47	179.25
Office Expenses	688.07	425.56
Other Expenses	13.44	3.28
Postage and Telegram Expenses	32.54	13.61
Power and Fuel	102.00	3.76
Printing & Stationery	6.73	24.95
Professional and Technical Fees	15,224.49	9,323.88
Rent, Rates and Taxes	3,934.60	1,526.00
Share and Mutual Fund Transaction Charges	14.65	
Software Expenses	320.77	375.00
Telephone Expenses	19.96	9.51
Travelling expenses	1,419.78	402.88
Video Making and Production Charges	975.95	
	42,462.64	17,304.64

How to calculate materiality



Overall Materiality

Overall Materiality = Benchmark × Benchmark Percentage

Common Benchmarks	General Range
PBTCO	3%-8%
Net Assets/ Equity	1.0%-3.0%
Total Revenues	0.5%-2.0%
Total Assets	0.5%-2.0%
Total Expenses	0.5%-2.0%

Factors Affecting Identification of Benchmark

- Elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
- The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
- The relative volatility of the benchmark.

The Benchmark

Consideration	What is important to the users?	Example of a metric that may be relevant	Industry Example	Listed engagements/ High Risk Engagements	Non-High Risk engagements/ Non-listed entities
Profit-seeking entity	The entity's profitability and prospects for future net cash inflows.	PBTCO	Any manufacturing company or service company	3%-5%	3%-8%
A highly leveraged entity	The entity's ability to service its debt, including the ability to satisfy obligations and comply with debt covenants and continue as a going concern.	Net Assets/ Equity	Airline Industry, Telecom	1%-2%	1.0%–3.0%
An entity in an industry where margins can fluctuate significantly (e.g. a start-up enterprise) or a Revenue focused entity	The sales base that would drive future profitability and cash flows.	Total Revenues	Service Industry (Current Case), AI, Media Industry	0.5%-1.5%	0.5%–2.0%
An entity primarily generating profit from lending activities (e.g. a Bank or FI) or a newly incorporated company	The asset base that drives lending activities - i.e. the primary profit generating activities.	Total Assets	New Manufacturing Company or Capital Intensive or Banks	0.5%-1.5%	0.5%–2.0%
An entity operating on cost plus markup (Captive subsidiaries)	Profitability depends on Total expenses of the company.	Total Expenses	Cost Plus	0.5%-1.5%	0.5%–2.0%

Performance Materiality

Performance Materiality = Overall Materiality × Performance Materiality %

Factors to consider while determining an appropriate haircut

- Whether this is the first year of the audit – use lower performance materiality
- Deficiencies in entity-level controls,
- Number and severity of deficiencies in control activities including pervasiveness of internal control deficiencies,
- History of misstatements that were accumulated in the audit of the financial statements of prior periods (both corrected and uncorrected),
- Level of turnover of senior management or key financial reporting personnel,
- Management's preparedness/willingness to correct misstatements, etc.

The Percentage

When Aggregation Risk is assessed as:	Performance materiality is determined as:
Normal	75% of Overall Materiality
Increased	65% of Overall Materiality
High	50% of Overall Materiality

Specific Materiality/ CTM/ AMPT

Specific Materiality = Overall Materiality × CTM %

Notes

- Up to 5 percent of materiality is often considered as clearly trivial.
- The auditor may determine, based on the facts and circumstance of the entity and the audit engagement, that a lower level is appropriate.

Test Your Understanding

Question 1:

A Retail Chain operates numerous stores across the country, selling a wide variety of consumer goods. The company has stable and predictable revenue streams and maintains a consistent operating profit margin each year. Recently, the company has seen an increase in its profit before tax due to improved operational efficiencies. What should be the benchmark for calculating materiality?

A: Total Expenses
B: Total Revenues
C: PBTCO
D: Net Assets

Answer : C

Test Your Understanding

Question 2:

Entity D is a listed entity that leases high value machinery to the construction industry.
The entity has been an audit client for a number of years and the engagement risk has been determined as normal.
The entity has significant debt and has financed its investments through external debt.
Due to Covid 19, the company's revenue has reduced by 50% leading to a loss during the year.
What shall be benchmark to be considered for calculating materiality??

A. Total Expenses
B. Total Revenues
C. PBTCO
D. Net Assets

Answer: D

Test Your Understanding

Question 3:

Voltin India Limited is engaged in the manufacturing of semiconductors in India.
The company is listed on stock exchange.
The company has been earning consistent profits and has a high growth rate.
Company has obtained borrowings from Banks, however, the company has maintained a stable debt equity ratio.
Please determine Overall Materiality, Performance Materiality and CTM.

Major Heads	Major Items	Amount
Assets	PPE	80 Lakhs
	Cash and Cash Equivalents	100 Lakhs
	Trade Receivables	50 Lakhs
Liabilities	Borrowings	20 Lakhs
	Trade Payables	94 Lakhs
	Share Capital	50 Lakhs
	Retained earnings	100 Lakhs
Revenue	Domestic Sales	200 Lakhs
Expense	Direct and Indirect expenses, cost of goods sold, employee expenses, other expenses	150 lakhs
Net Profit		50 Lakhs

Answer

Benchmark	PBTCO
Benchmark %	4%
Overall Materiality	2 Lakhs (50*4%)
Performance Materiality %	75%
Performance Materiality	1.5 Lakhs
CTM	0.1 Lakhs or Rs. 10,000

Test Your Understanding

Question 4:

MG Vehicles is engaged in the manufacturing of passenger vehicles and commercial vehicles in India.
Until the previous year, ABC limited used to import raw materials from Belgium.
Following the Make-in- India concept and to reduce costs, MG Vehicles incorporated a new subsidiary which is engaged in-house production of parts and assembly. During the year, the company imported production line and assembly line from Belgium which will enable the company to manufacture and assemble the parts in next year. Currently, the installation of both the lines in progress and production has not started. The production will start from second half of next year.
Besides, This is the first year of audit for the firm of both the parent company and the subsidiary. In the previous year, it was audited by another CA firm.
Following is the extract of major heads of financial statements.
Please determine Overall Materiality, Performance Materiality and CTM.

Major Heads	Major Items	Amount
Assets	Capital work in Progress	300 Lakhs
	Cash & Cash Equivalents	50 Lakhs
Liabilities	Loans from related party	250 Lakhs
	Trade Payables	94 Lakhs
	Share Capital	10 Lakhs
	Retained earnings	-4 Lakhs
Revenue	Nil	Nil
Expense	Incorporation expenses, freight expenses, professional services	4 Lakhs
Net Loss		- 4 Lakhs

Answer

Benchmark	Total Assets
Benchmark %	2%
Overall Materiality	7 Lakhs (350*2%)
Performance Materiality %	65%
Performance Materiality	4.55 Lakhs
CTM	0.35 Lakhs or Rs. 35,000

Test Your Understanding

Question 5:

Softin Limited is a private limited company engaged in providing design and engineering services to its parent company in Russia.
The company is located in a SEZ.
The company's major expenses are salaries and wages, transportation and rent expenses.
Only source of Revenue is billings to its related party Softin Inc. in Russia. The company has entered into an agreement with the parent to add a mark up of 5% on all its expenses. The billing is done on monthly basis.

During the previous year audit, we did not identify any mis-statements and the company has strong internal controls. The board of directors are based in USA and India.
Following is the extract of major heads of financial statements.
Please determine Overall Materiality, Performance Materiality and CTM.

Major Heads	Major Items	Amount
Assets	PPE (Computers & laptops) Cash & Cash Equivalents	150Lakhs 250 Lakhs
Liabilities	Loans from related party Trade Payables Share Capital Retained earnings	Nil 10 Lakhs 10 Lakhs 350 Lakhs
Revenue	Export of Services	525 Lakhs
Expense	Employee benefit expense, transportation, building lease	500 Lakhs
Net Profit		25 Lakhs

Answer

Benchmark	Total Expenses
Benchmark %	1%
Overall Materiality	5 Lakhs (500*1%)
Performance Materiality %	75%
Performance Materiality	3.75 Lakhs
CTM	0.25 Lakhs or Rs. 25,000

Questions?

THANK YOU

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