Professional Opportunities for Chartered Accountants in Risk Management

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Professional Development Committee
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Basic Draft of this publication was prepared by CA. (Dr.) Vishnu Kanhere

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Foreword

The growth of intricate commercial, economic, technological, social, political, and cultural frameworks has notably broadened the range, scale, size, and influence of risks. As businesses worldwide connect more, there is an increasing demand for experts who can handle complex risks like never before. With extensive financial expertise and ethical foundation, Chartered Accountants are strategically positioned to thrive in the field of risk management.

I am happy to share that the Professional Development Committee (PDC) of the Institute of Chartered Accountants of India (ICAI) is bringing out the publication **'Professional Opportunities for Chartered Accountants in Risk Management'**. This publication provides practical insights and real-world examples that showcase the tangible impacts that Chartered Accountants can have in safeguarding organizational value. It outlines the skills and competencies that are essential for success in risk management, emphasizing the importance of continuous learning and adaptability in an ever-changing environment. The publication serves as a guide to the various opportunities that await for chartered accountants in this specialized field, shedding light on the intersection of financial expertise, regulatory compliance, and strategic foresight.

I extend my appreciation to CA. Prasanna Kumar D., Chairman, PDC, CA. Mangesh P. Kinare, Vice-Chairman, PDC and other members of PDC for their dedications and efforts in bringing out this publication.

I hope this publication will be a great hand of support to our members and help them to further flourish their working horizon.

30th December 2023 | **CA. Aniket Sunil Talati**
New Delhi | **President, ICAI**

Preface

In today's dynamic business landscape, risk management has emerged as a critical function within organizations across various industries. The evolving complexities of global markets, technological advancements, regulatory changes, and economic uncertainties have amplified the importance of managing risks effectively.

The Professional Development Committee has felt that there is a tremendous potential for the members of the Institute in the field of Risk Management. Thus, the Committee has come out with a publication on Professional Opportunities for Chartered Accountants in Risk Management to delve into the realm of professional opportunities for Chartered Accountants in risk management, exploring the intersection of their expertise, competencies, and the growing demand for risk management professionals.

We would like to place on record our special thanks to CA. Aniket Sunil Talati, President ICAI and CA. Ranjeet Kumar Agarwal, Vice President of ICAI for their support and encouragement.

We would like to express our sincere gratitude to CA. (Dr.) Vishnu Kanhere, Senior Chartered Accountant from Mumbai for his valuable contribution for this publication which surely will be useful to its readers.

We would like to extend our gratitude to CA. Divya Gandhi and CA. Krishna Sai for shaping the publication.

We would like to thank all the members of the Professional Development Committee for their inputs and PDC Secretariat for all their support.

We hope the members and stakeholders concerned would find this Publication on Professional Opportunities for Chartered Accountants in Risk Management immensely useful and it would serve as a handy tool.

CA. Prasanna Kumar D
Chairman,
Professional Development Committee

CA. Mangesh P Kinare
Vice- Chairman,
Professional Development Committee

January 2024
New Delhi

Contents

Background

'Risk' is a word of many meanings. The concept of risk has been with us since times immemorial. All living beings have the instinct of self-preservation. In the process they try to protect themselves from natural calamities, predators, diseases and injury and many other events to preserve life and remain healthy and functional.

In this instinct lie the roots of understanding and managing risk - risk attitude, risk appetite, approach to risk, risk assessment, risk analysis, risk treatment and risk mitigation.

With the advent of human beings on this earth and evolution of human society into complex commercial, economic, technological structures and social, political and cultural structures, the scope, scale, size and impact of risks and the need for their management grew manifold to ultimately reach its present stage where it pervades and touches almost every pursuit and aspect of human life.

Objective, Scope and Coverage

The purpose and objective of this compact publication on Risk Management is to outline, highlight and focus on the role and scope of the profession of Chartered Accountancy in risk management. This is covered by introducing the concept of risk providing an overview of risk management, impact of risk primarily on CAs' practice and incidentally touching CAs in industry and other roles.

The idea is to present the important areas of their professional work which touch upon and deal with both risk management for CAs themselves and how in the process, CAs can contribute to risk management as a discipline.

This is followed by future dimensions, to give food for thought and future areas of work.

Case studies are given in the Chapter itself and some useful Tables in the Appendix to give better insight.

Strengths

This publication brings out the need, scope and importance of managing risk in practice and other areas for Chartered Accountants. It also provides a broad overview of the road map.

The case studies presented are from the practice domains and illustrate and bring home the aspects and issues and enable better understanding of dealing with risk.

Limitations and Weaknesses

This is a review publication and given the wide scope of the topic and limitation of size and coverage that we have, it concentrates on the key emerging risk areas and provides an overview of risk management and Chartered Accountants. An in-depth study of individual areas outlined in the successive Chapters, especially Chapter 4, needs to be carried out by future authors.

Balancing and Overcoming Challenges

The shortcoming identified above has been addressed in the publication by providing illustrative case studies covering some of the practice domains which provide a useful tool for the readers to go deeper into the subject and gain useful insights and knowledge.

Opportunities

Another useful effort would be to carry out original research to identify concepts and practices of risk management by Chartered Accountants in the Indian context. The study of this field as in most other fields is a continuing exercise.

These would be future directions to explore.

Chapter 1
Introduction to Risk

1.1 Introduction

1.1.1 Pervasive Risk

Over the years risk and its management have been the focus of human activity. Risk co-exists with change, and it has been a facet of human life whether it is culture, race, religion, personal life, political, economic or social activities, risk is an inseparable part of all human endeavour.

1.1.2 Changing Role of Risk

Depending on the prevailing attitudes and the ground situation, in terms of the environment, setting, context and background, risk has had a lesser or greater importance depending on the role it had to play. In times of prosperity, growth and wellbeing, risk was and still often is the farthest from human thought. That it applies equally to the modern world is evidenced by the severe turbulence and swings and the consequent losses witnessed in the stock market when risk was not on top of the mind for the players in the financial market and they let caution to the winds. Often it is observed in times of boom and euphoria that risk is lost sight of leading to mayhem on the markets.

1.1.3 Increased Uncertainty

The current heightened interest and importance of risk assessment is due to the unique situation that the world is in. Unlike in the past, in times of the industrial revolution, which had its fair share of risks, the modern world in the era of information and communication technology is a globalized and networked world where the forces of disintermediation, virtualization, convergence, knowledge management and empowerment are at play. The scope, scale and speed of operations in modern times are far beyond what was even thought of in the past. The shortened fuse wire of decisions and the world-wide impact of local actions and reactions are extremely difficult to predict.

In the post Covid world the digital transformation in India with financial digital initiatives like JAM (Jandhan Accounts, Aadhaar and Mobiles), Direct Benefit

Transfers (DBT) and digital payments like (NEFT, RTGS, IMPS, UPI) received a great fillip and boost with a high level of acceptability leading to an almost universal adoption of digital payments system at all levels of society across all age groups and genders.

1.1.4 Increased Volatility

This transformation has on one hand magnified rewards with penetration of banking, payment systems and financial literacy into the remotest rural regions of the country, but on the other hand, has also enhanced the risks. With increasing digital and information technology risks like cyber risks, cyber-crimes, online and other frauds, enhanced risk is the price we pay in this modern globalized, connected world.

1.2 Concept of Risk

1.2.1 Definition

The concept of risk has been attempted to be captured in many ways, but the basic definition still is relevant, and remains fairly simple.

Webster's Dictionary defines 'risk' as – *possibility of loss or injury (peril), someone or something that creates or suggests a hazard, the chance of loss or the perils to the subject matter of an insurance contract and the degree of probability of such loss, the chance that an investment will lose value.* The examples considered in the definition of risk given in Webster's Dictionary discuss more about transferable risk.

On the other hand, Oxford Dictionary defines risk as –

(noun) [Countable, uncountable] the possibility of something bad happening at some time in the future; a situation that could be dangerous or have bad results.

Some examples discussed are –

- *Health risks* are very low.
- *Risk of something a high risk* of failure
- A serious/ significant *risk of something*
- The study found a slightly *increased risk* of cancer in this group.
- Steps have been taken to *reduce the risk* of any trouble.

- Use filters or boiled water to *minimize the risk* of infection.
- *risk of doing something* Smoking can *increase the risk* of developing heart disease.
- *risk (that)…* There is still a risk that the whole deal will fall through.
- *risk to somebody/something* the chemicals *pose little risk* (= are not dangerous) to human health.
- a calculated risk (=one that you think is small compared with the possible benefits)
- Trying new things can be a gamble, but it's worth the risk.
- Patients should be made aware of the risks involved with this treatment.
- Make sure you understand the *risks and benefits.*
- Cigarette smoking is a *risk factor* for this disease.

Risk is contextual and has a varied character. Thus, some risks are avoidable, other risks can be controlled/optimized, some are transferable to other agencies/some can be insured against, and some have to be accepted.

The word 'risk' entered the English Language circa 1661 from the French word 'risqué' and the Italian word 'risco'.

1.2.2 Probability/Likelihood

Risk is imbedded when there is an event with more than one possible outcome that is, resulting in either desirable or undesirable consequences. Each outcome has a probability of occurrence depending on the circumstances. It is thus a potential event and not the loss itself.

Risk = Likelihood x Severity

Risk = Threat x Vulnerability

Risk = Probability x Harm

Thus, risk here refers to situations where the probabilities of future events can be estimated, and the loss/harm quantified. Loss in this definition refers to insurable loss or pecuniary loss. As against this in situations where there is no knowledge about future events with reasonable accuracy/confidence, it represents uncertainty.

1.2.3 Risk impact both ways

In fact, what may be perfectly normal and beneficial to one in a given set of circumstances may be fraught with danger and risk to another in the same or different setting. Thus, we have the probability of early bird catching the worm and the possibility of early worm getting caught, but the decision whether to be early or late depends on whether you are the ‘bird’ or the ‘worm’.

This was seen in health care related and ancillary sectors. During the period when Covid 19 pandemic had let to a near stoppage of business and economic activity and a curfew on movement of people across the country and even in other nations was imposed, certain services and businesses were working non-stop to meet the overwhelming demand. Thus, healthcare facilities, hospitals, clinics, nursing homes, chemist shops, pharma companies, vaccine manufacturers, suppliers of medicines, medical equipment suppliers, those making surgical and other masks and ancillary equipment, suppliers of oxygen and oxygen concentrators all had a phenomenal increase in demand and a very substantial business upturn. What was a disaster for other industries proved extremely beneficial for healthcare and these ancillary services/entities.

Risk is thus contextual and does not operate in isolation. The impact and outcome of adverse events does depend to a great extent on the circumstances prevailing at the time.

For example, a train accident and/or a road mishap occurring in peak hours will cause greater adverse impact, damage and harm to human beings than an incident of same magnitude occurring during off-peak hours.

1.3 Understanding Risk Perception

Risk, hence, is a word of many meanings. It means different things to different people. This perception of risk as a source of ‘threat or peril’, or as a ‘challenge and an opportunity’, depends on one’s attitude to life and risk – that of a ‘risk averter’ or a ‘risk taker’. Risk comes in all sizes and shapes from getting caught in rain without an umbrella and catching pneumonia, -sickness-facing life-threatening situations like natural calamities and of course normal and abnormal business risks involving loss of money and reputation.

1.4 Types of Risk

An organization faces many types of risks. These risks range from strategy and directional risks at the one end to risks in day-to-day operations at the other.

1.4.1. Strategic/Macro Risk

If one were to look at the enterprise as a whole, one is faced with *strategic* risks that cover strategic issues, business decisions and the business environment. Macro issues like political, economic, social situation and competitor activity often affect and influence these risks.

1.4.2 Operational/Micro Risk

Operational risks deal with operational issues including manufacturing and service provision, execution, people issues, administration, communication etc. These are faced in a micro-environment at the industry and firm level as against the micro level. (See Figures 1 & 2).

Fig.1: Macro Risks

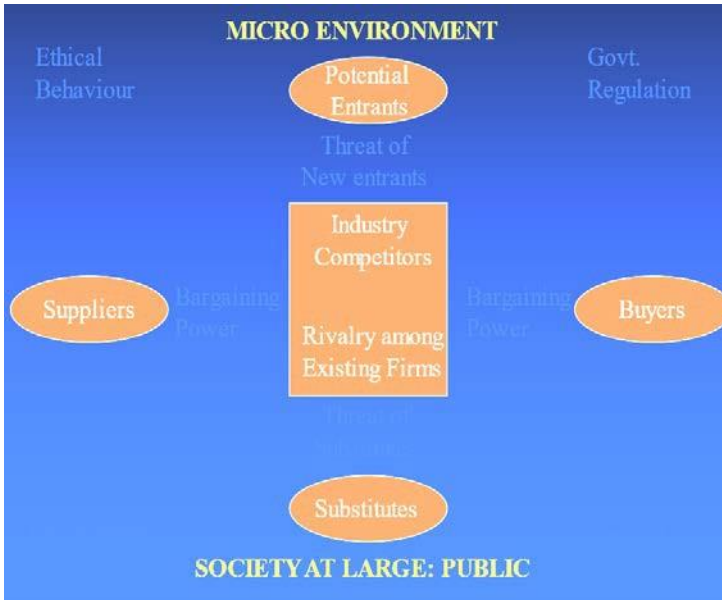


Fig.2: Micro/Industry/Firm Risks

At a different level there are other *external* risks that exist in the business environment that relate to markets, availability of finance and changing value of money – forex. A chart showing an overview of these risks is given in Appendix 1.

1.4.3 Risk Classification

There are thus many ways of classifying risks - according to their type or even as systematic risk and unsystematic risk.

Systematic risk covers interest rate, reinvestment rate, purchasing power, market exchange rate and political risk, whereas unsystematic risk covers business, financial, default, credit, liquidity and event risks.

Apart from this risk can be physical, psychological, social /economic, legal and even risk involving confidentiality.

1.5 Importance of Risk

Risk has been with us since the beginning of our life. Why is it that addressing, comprehending, analyzing and managing it has become so important today? The most important reason for the increased importance of risk is that we have started appreciating the fact that uncertainty and its resultant negative impact on business is increasing with globalization. Risk is becoming more important than ever before because changes are rapid and all pervasive that it requires preparedness and quick reflexes to launch pre-emptive moves to counter emerging, altered, scenarios. At the same time both stakes and expectations are increasing. A time has come when Gandhiji's words of wisdom, "there is enough for every man's need but not for every man's greed" are palpable today.

Contributing Factors – Some Examples

There are a number of factors and changes in recent times that have led to increasing importance of risk in society.

1.5.1 Legislation is becoming tougher

- Legislation is now more extensive – from compensation to environmental laws, third party liability to PILs, and laws granting compensation for corporate wrongs are becoming stricter.
- Legislation is more stringent – corporate governance – clause 49 of the listing agreement and SEBI rules are continuously reviewed and often amended. In U.S.A. it is the Sarbanes Oxley Act.
- Labour Laws: Risk assessment is necessary to avert legal liability – especially in areas of health and safety.

1.5.2 Insurance as a tool for Risk transfer

Insurance as an effective tool for risk transfer needs to be reviewed, especially in the light of modern-day developments as explained hereunder.

There are a number of insurance products available to cover risks.

Thus, there is loss of fixed assets policy, factory insurance policy, workmen's injury and compensation policy, insurance policy covering raw material and finished goods stock, equipment insurance and even loss of profit insurance are available for manufacturing industry.

Keyman insurance and other insurance including fire, marine and general insurance policies are available for service industry.

There are policies like cyber liability, Director's liability insurance, Directors and officers policy, crime liability, employee dishonesty insurance and other products available for senior management in a company.

There are however certain limitations in obtaining insurance cover like the following.

- Insurance is no longer available cheaply.
- Open ended cover is not widely available.
- All risks are not covered, and policies do have exclusions.
- Insurance companies do expect and require clients to manage risks as if they are uninsured and have to minimize loss as a prudent businessperson would (even though they are fully insured).
- Insurer does not compensate the entire loss even if the claim is accepted, by having average clause in the policy.
- Insurance payouts are slow and difficult to obtain.
- Many risks are not covered such as intangibles like loss of goodwill, reputation and brand equity.
- Insurance ultimately is reactive and not a proactive way of mitigating risks.

1.5.3 Customer Attitudes

- Clients want to pass on the risks to suppliers and service providers and want to de-risk their own business.
- Increased consumer awareness by business has led to claims and litigation.
- Shareholders are more aware of the risks affecting business value and therefore increased risk reflects in lower stock values.

1.5.4 Public Awareness

People and the society at large expect higher standards of governance, compliance and managing risks. Public at large now expect probity in public life and above-board corporate behavior, which means that companies have to manage ‘corruption risk’.

1.5.5 Technological Transformation

Introduction of digital technology in the day-to-day activities as well as in business dealings have ushered in a technological transformation based on online payments systems like NEFT, RTGS, IMPS, UPI, Net Banking, Direct

Benefit Transfer, Jandhan Account, Aadhar, Mobile Technology, social media, Artificial Intelligence (AI) and Cloud.

This has had a pervasive impact on the eco system with loss of paper trail increasing speed of execution, complexity of systems, cross border transactions leading to multiple jurisdictions being involved.

This technological transformation has brought about disintermediation enabling direct dealings but has also magnified the risk manifold to a high degree.

1.5.6 Changing Operating Environment

The operating environment of established businesses, startups, the markets in which they operate and those of players in industry as well as outside has undergone a change; the way business is transacted has changed and with the advent of digital and faceless era of business, risk has increased substantially.

1.5.7 Interdependence of decisions and actions

With growing complexity of business, trade, commerce and economic activity, globalization and increasing use of technology decisions and actions have a wider circle of impact which is not restricted just locally but is felt across borders/jurisdictions and this interdependence and impact have a cascading ripple effect on risk and its management.

1.5.8 Management Attitudes

- Professional and proactive managements promote risk management.
- Managements are wiser, from past incidents and want risk management practices in place.
- With the advent of Global Corporation, risk has become internationalized. Corporations face global concerns and short fuse wire of decisions have a greater impact on corporate bottom lines.
- Privatization – high-risk infrastructure sectors are also now in the private domain leading to greater understanding and provisioning for related business risks.

All the above factors have led to an increased need for understating, appreciating and managing risk.

1.6 Source of Risk

1.6.1 Imperfect Information

Risk arises due to imperfect knowledge stemming from lack of complete or perfect information about certain facts and events on the one hand and the uncertainty and unpredictability of results of specific inputs and actions, on the other. Risk is contextual and its impact varies depending on the underlying situation and ground realities obtaining in a given situation. It also increases if you are dealing with third party assets.

1.6.2 Threat Actor

Risk is also determined by actions and moves of the associate and/or adversary like in a zero sum or similar game. The well-known game Prisoner's Dilemma is an example.

1.6.3 Uncertain Outcomes

While risk arising from deficient information can be mitigated and reduced by gaining more information, *albeit* at a cost, the risk arising from uncertain outcomes can only be controlled to some extent either by developing better mechanism at predicting the outcomes or still better by controlling the outcomes as much as possible.

1.6.4 Vulnerabilities

Risk as we have seen, originates from vulnerabilities and threats and results in an adverse impact when it occurs. It is an outcome of threats, vulnerabilities and their impact. Vulnerabilities produce weaknesses that increase risk. Threats are external adverse factors that have a chance of occurrence. Greater the threat, greater the risk.

Fig.3: Genesis of Risk

1.6.5 Impact

The impact is adverse consequences and damages that can flow from materializing of the threat. The greater the impact, the higher the risk. Thus, minimizing the chance of threat materializing, reducing vulnerabilities and minimizing the damage or impact helps to mitigate risks.

If one addresses risk with preconceived notions about its probable causes it can lead to disastrous results as the real threat often lies elsewhere. What is required is clear perspective, correct approach and quick response.

Chapter 2

Overview of Risk Management

2.1 Risk Management

There is no consensus or general agreement on what the coverage and scope of risk management is. Since these boundaries between risk and risk management are hazy rather than attempting a definition, risk management is explained and understood by listing the steps and successive activities involved in risk management. The emphasis of risk management thus is on risk awareness, risk analysis, risk assessment and risk mitigation.

Thus, risk management consists of altering in a desirable manner the states a system may reach and their probabilities or manage their consequences.

2.2 Risk: Cost-Benefit/Risk Return Tradeoff

Both predictive and responsive courses of action have an associated cost. The manager has to develop a strategy that ensures that the returns always exceed the cost of risk mitigation. The right way to tackle, deal with and manage risk is to adopt strategic risk management. In the absence of satisfactory definition of risk management, for practical purposes, the emphasis of risk management tends to be on risk awareness, assessment and mitigation. However, strategic risk management involves:

- The process by which executive management, under Board supervision, identifies the risk arising from the business and establishes the priorities for control [*The Cadbury Report, 1992*
- Basically, altering in a desirable manner something missing in the system may cause a probable damage or manage its consequences.

2.3 Road Map to Risk Management

The road map to risk management can be summarized as under:

- Risk Awareness - management must be aware of the hazards and their impact on the business and how they could be avoided, prevented and reduced.
- Risk analysis and assessment

- Assessment – monitor threats, assess vulnerabilities, and estimate impact.
- Prioritization – analysis into acceptable, unacceptable and tolerable - middle of the road risks.
- Planning for the future.
- Prevention of occurrence.
- Strengthening the system against vulnerabilities.
- Minimizing the damage.

The road map of risk management process is depicted and explained in the following Figure:

Fig.4: Risk Management Process

2.4 Requirements for Successful Risk Management

- Availability of appropriate facilities and equipment.
- Availability of appropriate systems and procedures, including monitoring and auditing performance.

- Availability of appropriate organization, existence of sufficient level of competence, with suitable communication and training arrangements.
- Availability of appropriate arrangements for detecting and handling emergency situations.
- Availability of a system of active and continuous system of review of risk throughout the organization.

2.5 Tools, Used for Effective Risk Management

- Control
- Insurance
- Loss prevention
- Technological innovation
- Learning, Information, Distribution
- Robustness.

2.6 Risk Treatment/Mitigation

The Mantra for success in risk management thus seems to be to *bear, share and insure*. Bear what you can yourself, given your risk appetite. Share risk within the industry by creating risk sharing, using averting mechanisms and finally insure what cannot be controlled and pass on the risk to the insurers. Lastly, 'monitoring and planning' for the future involves a continuous process to adopt a *Plan, Do, Check and Act* cycle, in order to de-risk your business to the extent possible.

The risk assessment and risk management cycle is depicted in the following figure.

Fig.5: Risk Assessment and Management Cycle

2.7 Managing Risks

Managing risks, the proactive way thus involves:

- ***Having strategy that is,*** creating and putting in place proper ownership structure, carrying on your business on sound premises based on risk policies which minimize exposure to uncertainties.
- ***Managing people*** is another way of managing risk. This involves –
  - Setting standards from the top
  - Quick adaptation to change.
  - Balance and experience – multi tasking employees
  - Allocate responsibility for risk management.
- ***Manage processes -*** this is the nuts and bolts of risk management and involves developing and putting in place sound policies, best practices, adequate procedures, easy to implement guidelines, sufficient documentation, drills, safer solutions, isolation of threats and active protection of assets.

- ***Spreading the risk by*** out souring processes, sharing risk, using hedging option, swaps and derivatives. Risk can also be spread by insuring for loss of profit.
- Finally having a disaster recovery plan and business continuity plan to minimize the effects of the damage caused due to the adverse impact of threats materializing into reality – for example – strikes, lock-outs and natural calamities.

2.8 Continuous Risk Management

In short, continuous risk management (CRM) is a structured plan which provides a disciplined environment for proactive decision making to:

- Assess continually what could go wrong (risks)
- Determine which risks are most important to deal with
- Implement strategies to deal with those risks.
- Measure and assure effectiveness of the implemented strategies.

2.8.1 Continuous Risk Management formulation and implementation

CRM requires the following:

- Develop risk management plan.
- Perform risk assessment during systems analysis sub-process.
- Establish an initial set of risks (simplest technique is brainstorming)
- Risk management plan and risk profile evaluated and base-lined in evaluation sub-process.

2.8.2 Implementation of CRM plan

- Implement risk management process defined in the plan.
- Implement risk tracking system.
- Use risk management continuously to control and mitigate risks.
- Use risk assessment to identify and analyze risks.

The effective use and implementation of CRM results in a paradigm shift in the way businesses plan, implement and operate.

The paradigm shifts that results in the compliance function is depicted in the following

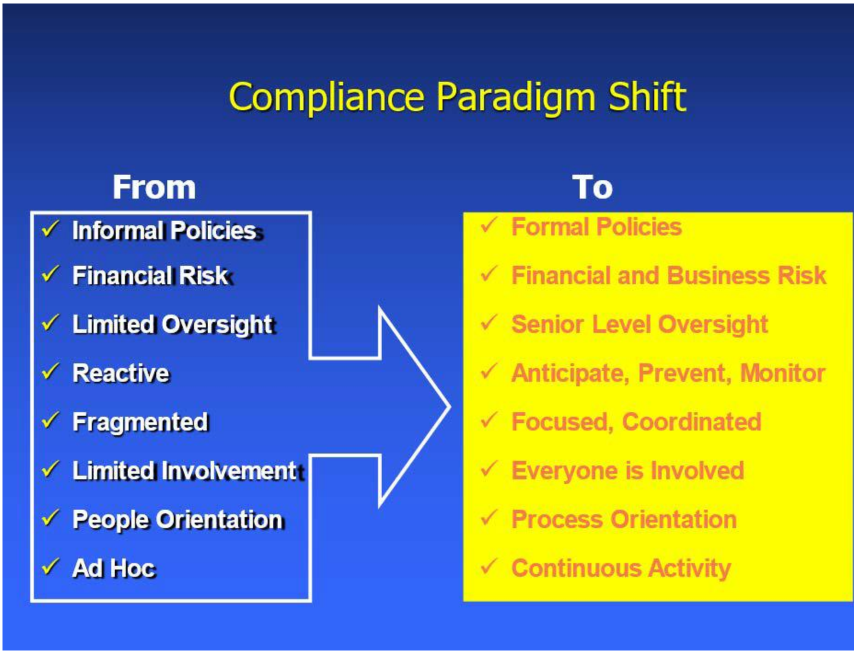


Fig.6: Paradigm Shifts in Compliance Functions

2.9 Enterprise Risk Management

The process of risk management traditionally was implemented in departments like Production & Distribution, Sales & Marketing, Finance, Human Resource, Legal & Compliance and so on.

This way a comprehensive organizational approach was not taken; risks were reviewed in silos, only from narrow departmental perspective, cumulative and cross functional impact was most often ignored/left out.

A comprehensive Enterprise Risk Management – Integrated Framework was developed by COSO (Committee of Sponsoring Organizations).

The ERM – Integrated Framework has four categories of objectives and eight components.

These are again considered at four levels: the business entity level, the division level, the business unit level below that and the subsidiary/related entities level, which are covered separately.

2.10 COSO Framework

The COSO framework advocates four categories of an entity's objectives which an effective ERM targets:

a) ***Strategic*** – These objectives are high level and are aligned with an entity's mission.

b) ***Operations*** – These objectives refer to the effective and efficient use of resource.

c) ***Reporting*** – These objectives surround an entity's need for reliable reporting.

d) ***Compliance*** – These objectives refer to an entity's need to comply with applicable laws and regulations.

Managing risks in these four categories within an entity's risk appetite will aid in creating and enhancing the stakeholder value.

The eight components, all of which are linked in an iterative process, are the following:

a) ***Internal Environment*** **–** This is the basis around which the risk is viewed and addressed by an entity. The risk management philosophy which is based on the risk appetite, integrity and ethical values of the entity and the environment in which they operate are aspects which design the internal environment.

b) ***Objective Setting*** – Objectives must be set before the management can identify potential events affecting their achievement. Effectively implemented ERM ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity's mission and are consistent with its risk appetite.

c) ***Event Identification*** **–** Events that affect accomplishment of an entity's objectives is identified either as risks or as opportunities. Opportunities, referred as upside aspects of risk, are to be adjusted against the management's strategy or objective-setting processes.

d) ***Risk Assessment*** – Risks are analyzed, considering the likelihood of occurrence and magnitude of impact. This is the basis and the determining factor of risk management.

e) ***Risk Response*** – Management has to select risk responses which are either avoiding, accepting, reducing, or sharing risk. For the purpose the organization has to develop a set of actions to align risks with the entity's risk tolerance.

f) ***Control Activities*** **–** Policies and procedures are established and implemented to help ensure that the risk responses are effectively carried out.

g) ***Information and Communication*** – Relevant information is identified, captured and communicated in a structured form and within a timeframe that enable people to carry out their responsibilities. An important aspect of this component is effective communication which transpires in a broader sense, flowing down, across, and up the entity.

h) ***Monitoring*** **–** The entirety of ERM is monitored and modifications made as necessary. Monitoring is accomplished through ongoing management activities.

2.11 Qualitative and Quantitative Methods

The risk analysis stage uses tools and techniques and methods such as the following:

Qualitative Methods – Brain storming, questionnaire, Delphi techniques

Quantitative Methods – Annual loss expectancy, simulation, Monte Carlo Method, etc., and

Semi- quantitative Methods – Risk Matrix, Heat Map, etc.

Generally, risk professionals prefer using quantitative methods, as they can help place a financial value on the risk and provide more comfort in terms of granularity and depth of the risk assessment process. They are also amenable to analyzing the changes/ reduction in risk, post treatment and mitigation.

However, these quantitative methods suffer from a number of limitations such as the following:

1. The difficulty of identifying all significant sources of risk

2. The difficulty of presenting the logic correctly (and clearly)

3. The difficulty (or impossibility) of managing in a mathematically and logically rigorous manner, and the massive effect of poor management or "culture."

4. The difficulty of obtaining appropriate data for the specific facility being studied.

5. The difficulty of defining clear cut acceptance criteria

6. The difficulty of overcoming lay suspicions with numerical results

7. The danger of managers with an inadequate understanding of those limitations using the value of a so assessed risk as the main basis for making a decision

8. Thus, the apparent sophistication of full quantitative risk assessment can conceal critical and dubious assumptions, and seriously impair or invalidate the assessed magnitude of the risk.

9. Hence, any quantitative assessment of risk should be accompanied by a non-quantitative descriptive assessment.

2.11.1 Special Risks

There are certain risks that are special because of their magnitude, because of their consequences and sometimes because of their complex nature or pervasive impact. These special risks are generally – information technology risks (IT Risks like zero-day virus attacks), financial risks like the global meltdown, business and people risks that can range from environmental risks, health and safety, security of the nation to mega frauds.

Often these are difficult to assess, evaluate, predict and deal with as these border on the realm of Uncertainty.

2.11.2 Uncertainty

Let us look into the concept of uncertainty as against that of risk. To put it simply, when all potential outcomes, or that of the probability of each outcome occurring or even the cost of the negative outcomes is not known or understood, these result into uncertainty.

Events arising out of these occur once in a very long period and traditional methods and even quantitative sophisticated systems including business intelligence models/systems are not able to predict these with a degree of accuracy.

Events arising out of these are called “Black Swan Events” like the global meltdown.

2.11.3 VUCA World

The current world environment with rapid changes and increasing conflicts, turbulence and danger has become less and less predictable.

The sense of stability, reassurance of an orderly life and economic well-being are not evident in the society.

The current environment is marked by rapid and unpredictable changes, uncertain nature of climate, business environment, social and cultural thoughts, political system and lifestyle.

Added to this is the complexity caused by the world becoming a global village leading to interrelated impacts on events, incidents, actions and their outcomes.

The relationship between cause and effect being less clear, less certain and less predictable outcome of decisions and actions implemented also remains ambiguous.

The VUCA world accelerates change and change has a more unpredictable impact due to complex inter-dependencies but what it gives rise to is risks nevertheless, though more unpredictable, of greater magnitude, more volatile and with a wider spread.

(a) ***Managing risk in a VUCA World*** –

These risks can and are addressed by analyzing them, assessing them and managing them with appropriate mitigating and other controls and treatments.

(b) ***Unified Vision Road Map and Team***

However, given these characteristics, risks arising in a VUCA environment need an organization that acts cohesively, has a greater degree of affiliation and bonding and has a better and clearer and well spelt out vision and path.

(c) ***Better Knowledge and Understanding***

Develop better understanding by tracking the business, social, cultural, political and technology environment and review and evaluate business plan and risk controls, mitigation strategy.

(d) ***Agility***

Given that the environment is rapidly changing, organizations need to build a team response and effort and be more agile and proactive in dealing with developing situations and changing environment.

2.11.4 Challenges and Future Directions

The challenge in risk management is understanding the risks, making sense of the risk and having clear cut risk objectives.

The future direction is to increase the awareness of risks, their consequences and treatment/mitigation, to provide learning to increase the understanding of risks over time, to encourage proactive planning and participation, assess organization as an integrated effort to deal with risks and not in silos; and to evolve best practices leading to establishment of standards and a framework for risk management.

Chapter 3

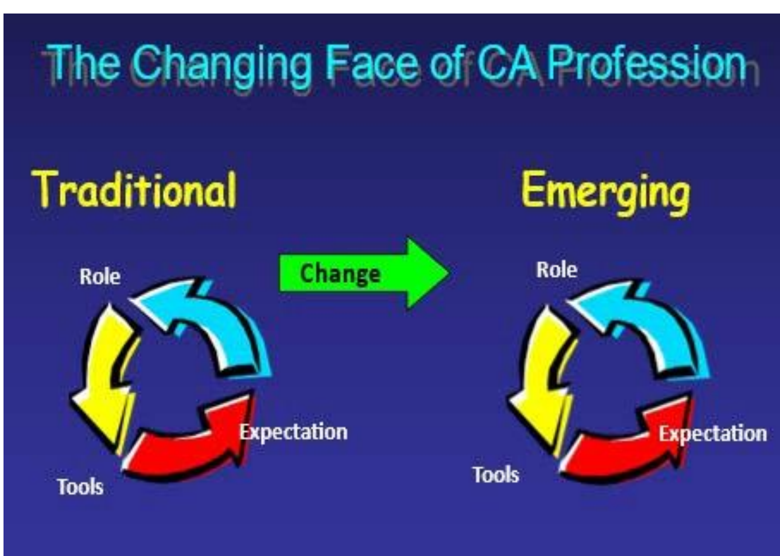
Risk and the Chartered Accountant

3.1 Changing Face of CA Profession

We have considered the growing need for and importance of risk and its management in Chapter 1, and we looked at factors that have contributed to the growing importance of risk in general in Chapter 2. In this Chapter we will look at the factors and causes leading to increase in importance of consideration of risk and risk management by Chartered Accountants in practice and also to an extent of those CAs who work in industry.

The CA profession has undergone a sea change in the last twenty years, and it has so changed on the one hand in terms of the role of CAs, the tools and technologies used by them and the expectation of stakeholders from practicing CAs.

On the other hand, the traditional areas of audit/assurance, taxation and consultancy have given way to emerging areas like system audit, forensic audit, sustainability reporting, IT enabled services (ITES) and ERP/ automation, remote working, artificial intelligence.



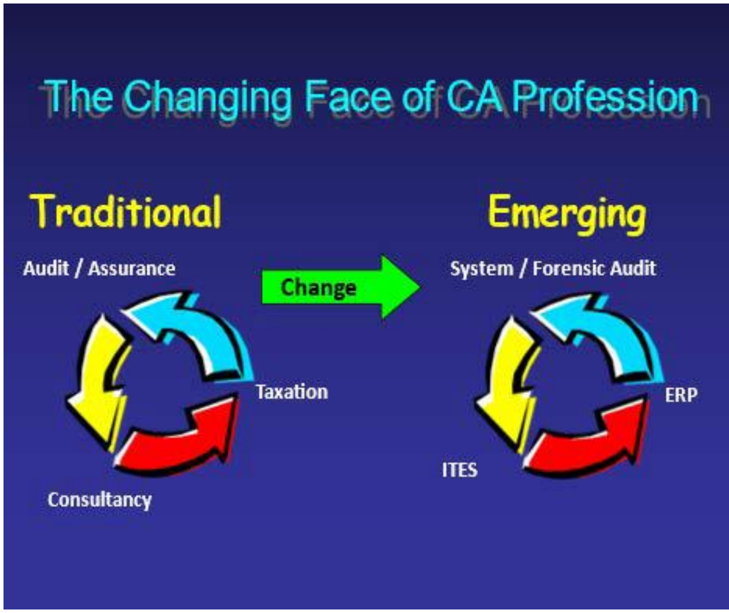


Figure 7: Changing Face of CA Profession.

3.2 Changing Relationship of CA Firms

The relationship of Chartered Accountants which was once held as fiduciary and only between the Chartered Accountant and the shareholders/ management to whom the CA as a statutory auditor reported, is no longer limited as one-to-one relationship as in the past.

Now Chartered Accountants have a responsibility to the stakeholders who rely on their report which includes multiple/ diverse entities like the Government, regulatory authorities, management and staff, owners/ shareholders, public, trading partners, customers, workers, bankers, and other external agencies and so on.

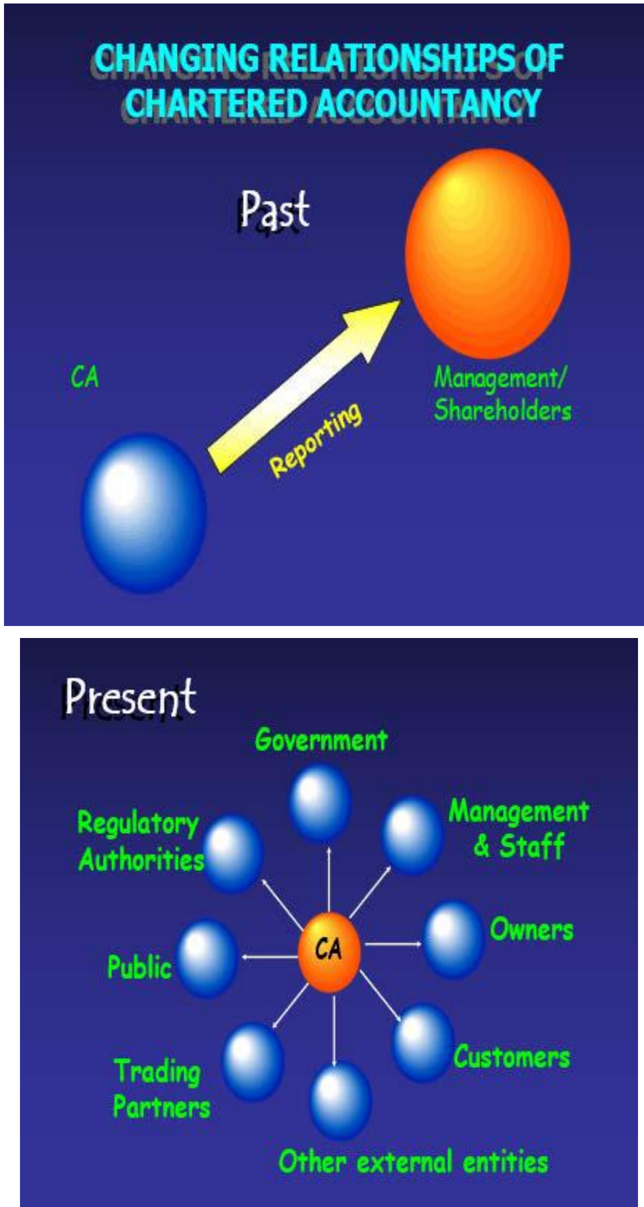


Fig. 8: The Changing Relationships of CA Firms

3.3 Changing Business Environment

Somewhere during the Eighties the western world and in the Nineties India was transformed by the powerful forces of deregulation, securitization and globalization. This transformation has continued till today with the advent of the new world of technology and its revolutionary and fundamental impact leading to change in marketing, commerce and economic policies.

Traditional professions gradually changed, and the era of multi-disciplinary businesses, consulting and practices emerged. Somewhere the concept of public interest and public policy gave way to profitability, commercial concept of return on equity (ROE) and return on investment (ROI).

The influence of these economic forces, economic rationalism and liberalism was so pervasive that professional designations now took on the characteristics of brands and were permitted to be used as such, our profession of Chartered Accountants (CA) being no exception.

Further, in the process and program of transforming businesses, professions and governance from the physical platform to a digital one, efficiency, effectiveness, response time and result was at a premium and trust, propriety, due care and diligence took a back seat.

Response of the Professional

The need today is to equip oneself in the changed world order to adapt to the new priorities of profitability and return on investment, in order to not be left behind; yet at the same time both individually and as a profession we should renew our pledge to uphold the fundamental basis and principles of the CA profession of maintaining trust, integrity, objectivity, avoidance of conflict of interest, technical competence, professional skepticism, due care, confidentiality, professional behavior and upholding of public interest over self-interest that our founding fathers had stood for and that the nation and public today expect and demand of our profession and look up to it.

3.4 Legislative Changes

The colossal frauds internationally across the world like Enron and in India like Satyam have led to an increased focus on the profession of Chartered Accountants and the role of Statutory Auditors the world over and India is not an exception.

a) Legislation in India including the Chartered Accountants Act, 1949, Companies Act, 2013 and other economic legislations have, over the years, been made more strict with tighter regulations and greater external oversight, monitoring control and replacing/reducing the earlier self-regulatory mechanism of the Institute, especially in the area of disciplinary proceedings and in matters of maintenance of ethics, and adherence to code of conduct in respect of the Chartered Accountants and other professionals.

These changes are due to push as well as pull factors of public pressure, social intent and voice of the people as well as regulatory demand and pull for more stringent and better measures by the regulators.

b) Apart from this Consumer Protection Act, 2019, Right to Information Act and changes in other legislations like Income Tax Act, 1961 have enhanced the accountability, responsibilities and obligations of the practicing Chartered Accountant towards clients, stakeholders and society at large.

IKYC Norms -Recognizing another emerging area of concern, the ICAI has already mandated know your client norms recognizing that with the digital revolution and remote working after the Covid 2019 pandemic, online services, faceless interaction and dealings have become the order of the day, which need an even better knowledge and understanding and verification of credentials of the client.

Businesses, Government and even professionals like CAs now have to accept, on board and deal with clients remotely in a faceless manner where the communication is through emails or messages or such other digital or other remote interaction.

In such situations physical identification and identity and in-person credential verification is neither possible nor practicable. The need for specific verification and identification of the client who is being represented as well as to whom and on whose behalf taxation, consultancy, certification and such other professional services are being rendered, have been increasingly felt.

Know your client already mandated by ICAI has been raised to the next level especially after the recent amendment to the Prevention of Money Laundering Act, 2002.

The recent amendments to the Prevention of Money Laundering Act, 2002 (PMLA), have brought practicing professionals including Chartered Accountants under its ambit.

These professionals are now required to comply with the provisions of the Act, including maintaining records of the client's identity and transactions, verifying the identity of their clients and reporting any suspicious transactions to the authorities. Professionals (including practicing Chartered Accountants) have now been defined as Reporting Entities under the Act.

With the expansion of the scope of PMLA it now covers activities and transactions such as buying and selling of immovable property, managing client money, security or other assets, managing bank, savings or securities accounts, organizing contributions for creation, operation or management of companies, trusts, etc., and buying and selling of business entities. By bringing practicing CAs within the ambit of the Prevention of Money Laundering Act, 2002, the Government intends to enhance the compliance and reporting standards of these professionals, who are involved in critical financial transactions on behalf of their clients.

Response by Professionals

The practicing professionals have to rise to the occasion and the need of the hour and enhance and improve their due diligence, ensure compliance with the various laws and the new forms of regulation and comply and meet the reporting standards and requirements. Considering the multiplicity of laws and regulations, the wide scope and volume of transactions and activities and the limitations of staff, time and cost, it has become necessary to follow a risk-based approach by the practicing Chartered Accountants to meet the responsibility cast on them.

3.5 Evolving Smart Digital Technology

Emergence of and evolution of new age increasingly sophisticated technology including machine learning, artificial intelligence, cloud computing, big data analytics, mobiles, social media, and internet of things has resulted in rapid changes leading to a challenge to traditional ways of working and even in the next two or three years we would see a number of traditional practice areas becoming fully automated with greater outsourcing and greater use of and collaboration with social media. These are the very tools that the profession has traditionally remained away from, and which will have to be proactively adopted. The emphasis and the work area of Chartered Accountants will move from repetitive jobs to those requiring application of mind and decision making.

No doubt, with the growing complexity of business, adoption of information technology tools like digital signatures and transforming technology with tools like Chat GPT, AI etc. have become the order of the day.

On the other hand, a blind adoption of the technology and a reliance on these digital smart tools and adopting a black box approach can expose the practicing Chartered Accountant to risk of committing professional misconduct and negligence.

Response by Professionals

Response to new technology and change cannot be of shock, refusal to accept, anger or ignoring or resisting the same. An approach of proactive understanding based on awareness, education, adoption and assimilation of the technology, understanding how and what it can be used for, its limitations, the use cases involved and how to deal with and mitigate them is the correct approach and it is this that the practicing Chartered Accountants need to adopt to stay relevant.

3.6 Emergence of Uniform Global Reporting and Disclosure Standards:

Over the years with the push from member countries including India, global accounting bodies like IFAC and SAFA have actively pushed for and driven development of GAAP for uniform globalized reporting and disclosure. The process has already taken momentum and reached fruition and we are likely to see it completed in the next few years.

The adoption of these Standards would help to enhance financial reporting, disclosure and compliance and promote greater international business with smoother movement of capital, business, trade and services.

This also poses a challenge in terms of greater competition, cross border services and the issues arising therefrom, the need to adopt global best practices and standards and to change the traditional mindset by all concerned, Chartered Accountants being no exception to it. This specifically poses a challenge to the multitude of small and medium practices that would find it increasingly difficult to adapt to these changes and face global competition.

3.7 Diverse Factors

The causes of the sea change brought about in the CA profession by way of these diverse factors are brought out in the figure given below.

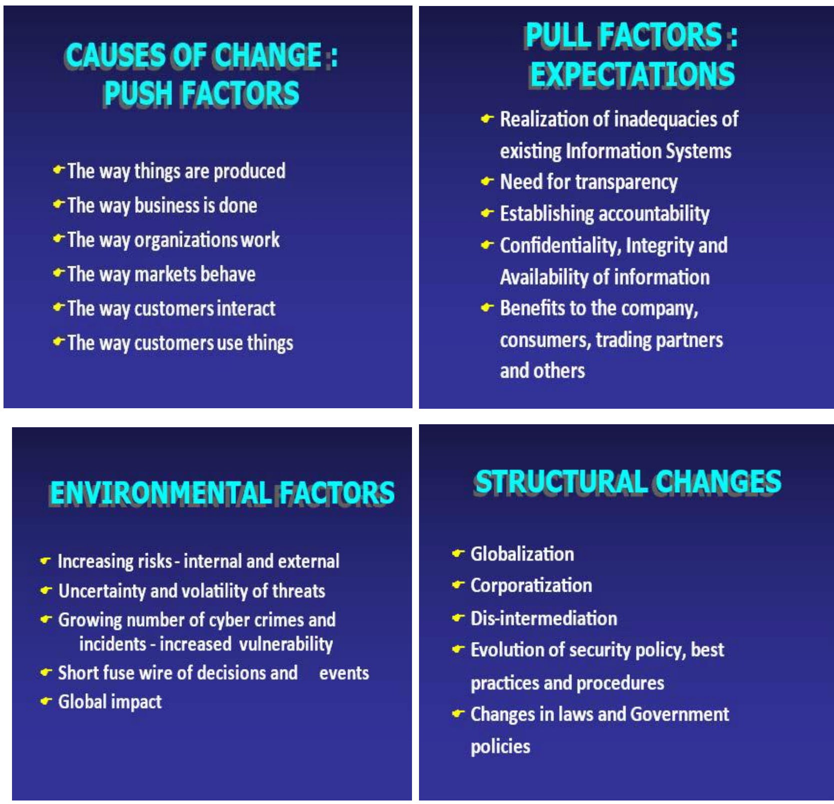


Fig. 9: Causes and Factors of Change in CA Practice/ Work Environment Leading to Enhanced/Altered Risk.

3.8 Political and Economic Thought

Unlike in the late Eighties and early Nineties when globalization and liberalization held total sway on the economic and political level, the policies and approach in recent years has been to be global and liberal in reach but at the same time have economic self-interest/patriotism and nationalism at heart to see that the interests of the country are protected and promoted keeping the global context, commitment, reach and presence of the profession in mind.

This requires that Chartered Accountants as professionals act as a pillar of the economy and shoulder the responsibility of taking care of the economic health of the country. Chartered Accountants need to be partners in nation building.

Hon. Prime Minister Narendra Modi said – “You (C.A.s) take care of the economic health of the country, and you are famous world over for your knowledge and financial skills.” The said remarks continued with the need for introspection of their working for the nation.

The words of Dr. APJ Abdul Kalam our revered Honorable Former President of India are very relevant to note here –

“Chartered Accountancy is not only about debit and credit and accounts. Scope of Chartered Accountancy has grown at a gigantic level. Chartered Accountants are the backbone of the nation’s economy, and due to their financial expertise, they can guide the nation by suggesting various economic and financial measures to uplift the deteriorating Indian economy and boost up the economic as well as industrial growth exclaimed. A rational person can see the participation of Chartered Accountants in every field whether it is related to budget forecasting, tax planning, preparation of books of accounts, capital budgeting, financing or any other activity, need of Chartered Accountants are in every field.

Their expertise knowledge is required in every area. As we know that the trending topic of the current scenario is the implementation of GST and Chartered Accountants are playing a vital role in its implementation. Starting from drafting rules and provisions for GST Act till the implementation of GST, knowledge of Chartered Accountants is a prerequisite. Chartered Accountants play an essential role in various fields. The knowledgeable advice of Chartered Accountants is prerequisite in the formation of any law relating to commerce, taxation or legal fields. While forming a law or any Act, Chartered Accountants is one of the most critical committee members. They have comprehensive knowledge of various essential aspects which is essential in the formation of any law.”

3.9 Emerging Concepts and Practices Based on SDGs

The global goals adopted by Member nations of the United Nations are seventeen sustainable development goals which have given rise to key concepts and practices adopted by corporates and the business world. These are:

Goal 1: No poverty

Goal 2: Zero hunger (No hunger)

Goal 3: Good health and well-being

Goal 4: Quality education

Goal 5: Gender equality

Goal 6: Clean water and sanitation

Goal 7: Affordable and clean energy

Goal 8: Decent work and economic growth

Goal 9: Industry, Innovation and Infrastructure

Goal 10: Reduced inequality

Goal 11: Sustainable cities and communities

Goal 12: Responsible consumption and production

Goal 13: Climate action

Goal 14: Life below water

Goal 15: Life on land

Goal 16: Peace, justice and strong institutions

Goal 17: Partnership for the goals

These involve understanding, measuring and reporting on a number of qualitative intangible factors including approach, attitude, perception, feelings, feedback etc. which belie quantification. The CA profession has to gear up to these newer initiatives which pose a challenge.

3.10 CSR, Social Stock Exchanges, Social Audit and Social Impact Assessment

The mandatory expenditure on corporate social responsibility, an obligation cast by the Companies Act,2013, has to be spent in appropriate beneficial projects, schemes and avenues. Corporates find it difficult to find good/ genuine charitable projects by eligible entities. This is where the concept of social stock exchanges as a platform to connect intending donors and supporters with non-profit/ for profit Non-Government Organization who are engaged in executing socially relevant projects to achieve social upliftment and attainment of goals comes into play. Both the donors and such entities are connected and brought together to resolve their issues.

It is essential that the projects and their social impact is assessed by competent professionals who also conduct social audit of such entities. This provides assurance to the corporates and donors. Chartered Accountants have now to measure up to these newer expectations of society and stakeholders, as social auditors.

Response of professionals

CAs as professionals need to acquire the knowledge and skills to be able to conduct social impact assessment and social audits and cover areas like diversity reporting and so on, as Social Auditors.

3.11 Emerging Practice Areas

A number of new avenues of practice like intellectual property, trademarks, patents, copyrights, brands, intangibles, are emerging that the CA professionals have to equip for and be in a position to serve the business, corporate community and society. These emerging practice areas away from traditional conservative practice of auditing and assurance of normal financial results, requires the Chartered Accountants to be proficient by acquiring necessary training, knowledge and skills and also understanding the enhanced risks and be able to manage them to meet the expectations of the stakeholders.

Some of the emerging practice areas are highlighted in the figure given below:

Fig. 10: New Practice Areas for CAs.

All these factors have led to a transformation in the environment, context, nature, scope and responsibilities of the Chartered Accountants.

Chapter 4

CAs in Practice and Risk

4.1 Risk and The Chartered Accountant in Practice

We have examined the risks and risk management as applicable to business and industry in general in Chapters 1 and 2.

In Chapter 3, we reviewed and elaborated some of the important factors that have resulted in a significant increase in risk and the need for addressing this risk by Chartered Accountants in the course of their practice and work areas in industry and in other emerging roles as well.

In this Chapter we shall deal with and cover in detail risk and the Chartered Accountancy practice.

4.2 Initiatives by ICAI and CAs in Responding to Risk

CA Curriculum, Studies, Trainings, Article ship

The ICAI and its curriculum, courses, as well as the robust system of articleship training/industrial training have ,over the years, evolved and kept pace with changes in the business, economic, legislative, social and technology environment to help the practicing and working qualified Chartered Accountants to deal with changes and the resultant risks and manage them in the course of their profession and providing their professional services in the areas of audit and assurance, certification, taxation direct, indirect and international, consulting and transaction advisory, business support services, valuation, management consultancy and other services.

Introduction of digital technology

The ICAI and the accounting profession as such are facing significant changes and challenges in the current times and in times to come the responsibilities, obligation and need for risk response would also be on the rise.

The accounting profession, professional organizations, Institute its Board of Studies and Members have responded to this by trying to fill the skill gap of practicing CAs in the use of digital technologies including cloud computing, bigdata analytics and artificial intelligence.

Now let us look at risk and its management in the various practice areas of Chartered Accountants with an emphasis on emerging and newer risks apart from the known traditional risks, which we all are aware of and have effectively dealt with overtime.

Let us now consider the risks that accountants face at the professional, strategic, operational as well as at micro level. Risk has been with the profession since its advent because accountants certify either 'correctness' or 'true and fair' state of affairs.

4.3 Risk and Financial Reporting, Audit and Assurance Certification Practice

This primarily covers statutory audits under the Companies Act, 2013 and audits under other laws where the practicing Chartered Accountant acts as an independent auditor. Audits of LLPs, trusts, cooperative societies, banks, insurance companies, electricity companies, tax audits under income tax law, GST Act, and other audits are covered in this area of practice.

The performance of an audit engagement by a statutory auditor under the Companies Act, 2013 and Rules made thereunder involves certain risks in accepting, conducting and reporting on the audit.

Similarly other audits mentioned above involve similar reporting by the auditor, by and large, on the true and fair view presented in the reporting by the entity being audited.

4.3.1 Audit and Assurance Function

The audit and assurance function covers audit of financial accounts, documents and records maintained by an organization as per applicable Accounting Standards with proper internal controls on transaction execution, recording as well as on financial reporting in accordance with Auditing Standards of the Institute/ prescribed under the applicable law.

Most of the audits conducted are statutory audits under the company law although there are audits of financial accounts and reporting under other laws the like Maharashtra Cooperative Societies Act, Mumbai/ Maharashtra

Public Trust Act, Banking Regulation Act, Electricity Act, Insurance Act and so on.

Audits are also conducted under other specific laws like tax audit under Income Tax Act, 1961 GST Audit, etc.

There are certain other audits and certifications required under Banking Regulation Act and other laws.

4.3.2 Audit Risk Model

Generally, auditors use the audit risk model to understand, capture and manage the risks arising from performance of an audit engagement. It helps the auditor to assess in the planning stage of audit, the types of evidence and the extent of audit procedure and how much evidence is needed for each assertion in the financial reporting.

The risk elements considered are inherent risk, control risk, detection risk and (acceptable) audit risk.

Their relationship is best captured in the equation.

Audit Risk = Inherent Risk * Control Risk * Detection Risk

Thus, where by the nature of the business/ activity/ businesses model of the auditee or by the past track record and antecedents and/or the current business and organizational environment, the inherent risk of the auditee is considered high, the extent of audit procedure will have to expanded/increased to reduce the detection risk thereby bringing the total audit risk down to acceptable level.

Further, for example, where controls are not designed well or where implementation of controls is found to have weaknesses, the control risk becomes high whereupon audit procedures have to be enhanced to bring down the detection risk thereby reducing overall audit risk to acceptable level.

Despite these protocols and a system of peer review and technical review along with continuing professional education and post qualification certifications being in place to ensure and enhance the skills and abilities of Chartered Accountants and improving audit quality to meet public expectations, a gap does exist between what is expected and what is delivered.

4.3.3 Growing scams and the response thereto

The accounting profession in the last few years, has passed through turbulent times post Enron and WorldCom abroad and our own GTBs and cooperative banking scams and Satyam Scam in India, and has reached a stage of crossroads. The message is loud and clear that the profession has to improve if the financial system and trust and faith in the profession are to survive. All concerned stakeholders – the Government, the key players, the profession itself have moved with alacrity to rectify the situation. New accounting and audit standards have been adopted; the world is moving towards one set of global uniform financial reporting standards. Initiatives have been taken under companies Act, 2013 to improve the quality of corporate reporting in India. ICAI also monitors and enforces the compliance with Accounting and Auditing Standards and oversees the quality of service of the professionals and suggests measures for improvement in the quality of reporting and audit services. A lot has been done; a lot more needs to be done. It is in this context that we need to look at the risk from the perspective of accountants and auditors.

4.3.4 Dual role of score keeping and reporting

Accountants play the role of score keeping and reporting. The reporting involves providing information to managements for decision making and to other stakeholders for investment, rewards, taxes etc. From an accountant's perspective risk is closely associated with governance, compliance and performance. Every organization in its attempt to achieve its business objectives needs governance, compliance with laws and measurement of performance – that is profit.

4.3.5 Responsibility, Risk and the Accountant

The issue we will examine is what is the role and relevance of accounting and the accounting professional, whether as an accountant or as an auditor, in the context of risk and what are the risks an accountant faces.

The accounting professional's role in risk is on one side as the person in charge of the accounting and reporting process- the chief financial officer (CFO), and on the other side as a professional, independent auditor or internal auditor who expresses opinion on the financial statements and internal controls etc. respectively.

4.3.6 Initiatives to Improve Reporting and Compliance

The CFO post SOX in the US and clause 49 of the Listing Agreement and other Corporate Governance initiatives in India and the recent measures under Section 132 of the Companies Act, 2013 all have a common aim of putting in place Standards that will ensure and improve financial reporting and compliance. Ultimately it is the CFO who is responsible for maintaining proper records and accounting for transactions, selection and application of proper Accounting Standards, computation and extraction of financial statements, true and fair reporting of the profit / loss and the state of affairs and also ensuring safeguarding of assets, control over operations and vouching for the verification and veracity of records. This of course is under the guidance and authority of the Board of Directors and the Audit Committee who ultimately steer the organization. The CFO has thus become 'owner' responsible for accounting and reporting function. His liability is thus now two-fold. One of due care to the best of his skill and ability to his employer, and the second of proper service (that is *not* deficient) to the stakeholders. Failure to do his job using due care, diligence and professional expertise would attract action and liability. With the introduction of Companies Act, 2013 this responsibility together with that of CA professionals who are independent directors of companies including Chairman of Audit Committees have increased manifold.

4.3.7 Risk as Score Keeper

The accountant as a score keeper maintains records of financial transactions. Books of accounts and accounting and financial records provide the basis for all decision making within the organization. It is an analysis of this data using various tools and techniques that help organizations take decisions. Decisions that are strategic like export on not, expand or shut down, diversify or continue, decisions that are operational like working in the second shift, increasing the work force, double the productions, hold stocks, as well as day to day decisions like accept an order, increase the price in the local market, etc.

The information provided by the CFO has to be correct, accurate, timely and relevant. In this role as a management accountant providing inputs, he is part of the decision-making team.

4.3.8 Risk as reporter

The financial statements provide key information to stake holders. It is the business scorecard that gives vital information about the net worth, assets and liabilities, profitability, growth, stability, liquidity, solvency, gearing and turnover.

The information provided by the accountant – CFO – who is a critical member of the management team is expected to be independent (unbiased), transparent, true and fair – that fairly represents the position of the business from the stakeholders' perspective. In this role, the accountant faces the *risk* of application of wrong principles and standards, wrong accounting estimates, errors, mistakes and frauds, inaccurate particulars, window dressing and creative accounting – that is - unfair presentation, off balance sheet items, unaccounted transactions, unprovided liabilities, watered capital, issues of capital versus revenue, deferment of revenue expenses, under provisioning or over provisioning for expenses and liabilities, the list is endless.

The risk is also faced by CAs who act as Director/Independent or Executive and Chairs of Audit committees.

Any lapse in the discharge of this responsibility can involve civil/criminal liability and professional action.

4.3.9 Risk in Audit and Assurance

The risk in this role is two-fold. The first as an internal auditor having organizational independence and the other as the independent external/statutory auditor.

(a) ***Internal Auditor***

As an internal auditor the professional accountant, deals with reporting on the existence and effectiveness of controls, adherence to policies and procedures, safeguarding of assets, compliance with laws and regulations, existence of appropriate and adequate documentation and MIS, fraud and error, deviations from established and prescribed procedures and at times on proper utilization of physical and human resources, including propriety of expenditure and commercial decisions and economic actions.

The risks faced by the accounting professional as internal auditor arise from the sheer volume and complexity of transactions and are:

- failure to detect lapses and weakness in procedures.
- failure to identify areas of fraud.
- failure to detect frauds.
- maintaining his independence whilst being an employee/ retainer of the company.

(b) *External Auditor*

As an external auditor the professional accountant deals with financial statement reporting, the fair presentation of the position of its assets and liabilities and true and fair reporting of its profit and loss for the period. This involves verifying the books of accounts, with supporting evidence, proper application of accounting principles and standards, verifying existence and efficacy of controls and following the set of professional audit and assurance standards developed over the years. All these enable him to express an opinion on the financial statements prepared and submitted by the management.

The external auditor can do precious little to address risks inherent in a business activity. He is not an insurer of results, but what he can and must do to the best of his professional ability is to address the risk of detection of misreporting. He needs to display independence and professional competence, use the concepts of materiality, prudence and professional skepticism, whilst dealing with error and fraud to provide sufficient assurance to the users of financial statements that the financial statements are 'true and fair'. He needs to plan and perform the audit as well as report as per Auditing Standards. It is his duty to maintain audit quality so that public interest is always upheld.

Kingston Cotton Mills' Case

The days of the *Kingston Cotton Mills'* case where the auditor was held not responsible for reporting frauds and other delinquent acts of managements and was "only a watchdog and not a bloodhound", are gone.

A professional accountant owes a duty of care to the person who has engaged him for the work of auditing and reporting, arising out of the contract and terms of engagement and the governing laws and regulation.

Practicing CAs are well advised to take professional indemnity or Errors and Omission Insurance. They may also consider cyber liability and other allied policies. In cases where they work as independent directors purchasing a Director's and Officer's liability policy will also be advisable.

The liabilities of professionals especially 'auditors' who do not discharge their responsibilities are broadly divided into the following four types:

- Civil liability for negligence
- Statutory liabilities under the Compares Act, 1956 and other statutes
- Liability under the Indian Penal Code
- Liability for professional misconduct under the Chartered Accountants Act 1949, including as mandated by the companies Act, 2013.

Candler v. Crane

Auditors were not considered to owe a duty of care to third parties or individuals belonging to a group in the absence of a direct contractual relationship even if these third parties had relied on his report. The decision in the cases of *De Savory v. Holden Howard & Co,* (TLR) 11-1-60 and *Candler v, Crane Christmas & Co*, 1951 Z. K. B. 164 (Court of Appeal) absolved the auditor from such responsibility. However, the dissenting judgment of Lord Denning in *Candler v. Crane Christmas & Co* is worth perusing. He observed:

"The accountant, who certifies the accounts of his client, is always called upon to express his personal opinion whether the accounts exhibit true and correct view of his client's affairs, and he is required to do this not so much for the satisfaction of his own client but more for the guidance of shareholders, investors, revenue authorities and others who may have to rely on the accounts in serious matters of business. If we should decide this case in favour of the accountants there will be no reason why accountants should ever verify the word of the one man in a one –man company because there will be no one to complain about it. The one man who gives them wrong information will not complain if they do not verify it. He wants their backing for the misleading information he gives them and he can only get it if they accept his word without verification. It is just what he wants so as to gain his own ends. And the persons who are misled cannot complain because the accountants owe no duty to them. If such be the law, I think it is to be regretted for it means that the accountants' certificate, which should be a safeguard, becomes a snare for those who rely on it. I do not myself think that it is the law. In my opinion, accountants owe a duty of care not only to their clients, but also to all those whom they know will rely on their accounts in the transactions for which these accounts are prepared".

This liability of owing a duty to third parties was established by the decision of *Hedley Byrne and Co Ltd v. Heller and Partners*. (1964) AC 465.

Trisure's Case

I would refer to two Indian cases:

1. The decision of the Bombay High Court In Trisure's decision (Case No. 1377 of 1978) the Bombay High Court vide order dated 21/24 October 1985 re-emphasized that an auditor need not proceed with suspicions unless the circumstances are such as to arouse suspicions in a professional man of reasonable competence. The judgment also upholds the use of sampling for testing internal controls and use of sampling to complete the audit where controls are found satisfactory.

Palai Central Bank case

2. The following observations of Justice P.T. Raman Nair in the decision in the case of *The Official Liquidator, Palai Central Bank Ltd v. Joseph and others*, (App. No. 247 of 1963 in BCP No 11 of 1960) are relevant:

"So far as the 8th respondent, the auditor for 1946 onwards is concerned, very lengthy arguments have been addressed regarding the duties of a familiar bloodhound as opposed to watchdog lines. But this much, I suppose on one, would deny and Counsel for the 8th respondent has not been disposed to deny it namely, that even the tamest of watchdog has duty no to connive with the thief.

There are of course numerous subsequent and more recent decisions of the disciplinary committee of ICAI, as well which have been upheld by High Courts which are available on the ICAI website and journal, and the same are not listed/reproduced here.

Introduction of Audit Quality Maturity Model

The Audit Quality Maturity Model was launched by the Institute as a self-evaluation recommendatory model for evaluating the current level of Audit Maturity of the firms.

AQMM v 1.0 is an evaluation model, an amalgamation of a well- researched set of Audit Quality Indicators (AQIs), which not only help firms to arrive at their current maturity level but will also provide a mechanism to help and guide to improvise their audit quality.

It is a cross-functional evaluation model covering key areas of not only audit engagements but also audit practice at the firm level. It includes operations of the firm include revenue budgeting and pricing, audit practice manual, budgeting of engagements, time sheet, use of technology adoption, quality control for engagements, Human Resource Management including resource planning and monitoring, performance evaluation and compensation, physical and IT infrastructure.

4.3.10 Chartered Accountants as Service Providers

Let us consider the present situation in which Chartered Accountants and auditors are viewed by the public and stakeholders as *service providers.* Service provided includes accounting, audit & assurance, taxation, consultancy, investment advisory, valuation and/ many other services including at times opinions and management consultancy. The issue is: Is there any exposure under the consumer protection laws like other similarly placed professional service providers – for example- doctors and lawyers who have been recently exposed. The National Consumer Disputes Redressal Commission and later the Supreme Court of India in the case of *Indian Medical Association v. V.P. Shantha*, (AIR 1996 SC 550) have held that the services rendered by the medical practitioner is included and covered under the definition of 'services' in section 2(1) (o) of the Consumer Protection Act, 1986. This covers not only the treating doctors but also the consultants. This reflects the view that the watchdog bodies of the profession are not perceived to be adequate to provide justice to consumers. In its judgment dated August 6, 2007, in the case of *D.K. Gandhi v. M. Mathias*, the National Consumer Redressal Commission made it clear that all professionals, including lawyers, should come under the ambit of the Consumer Protection Act. If doctors can come under the fold of the Act, lawyers and all other providers of services like chartered accountants, architects and property dealers will also come under the Consumer Protection Act. This case marks a departure from established law that professionals can be penalized only by the established disciplinary procedures under the law governing the profession. Thus, in the changed environment claims for deficient services will not be restricted to be dealt with by the Disciplinary Committee or an in-house forum of the Institute or even under Companies Act, 2013 but could be agitated before and decided upon in other fora like the consumer forum and civil and criminal courts.

4.3.11 Move towards Uniform Globalized Standards

A quick look at the Accounting Standards in India shows that right upto 1994 there were only a handful of Standards, less that ten in number. The years 1993, 1994 and 1995 saw a spurt in Standards which reached upto 15 in number. Thereafter from 2000 – 2001 onwards came another slew of Standards which saw them going past 30 by 2005-2006. For a profession which has seen hardly any changes, this was a quantum change – a paradigm shift. Today the Ind AS go upto Ind AS 41, and the Indian AS have also reached AS 32. There are 32 standards for non-corporate and 41 Ind AS notified and as amended by the MCA upto 31st March 2023. The shift is truly remarkable because the newer Standards, covering - Accounting for investments, Amalgamations, Retirement benefits, Governments grants, Borrowing costs, Segment reporting, Related party disclosures, Leases, Earnings per share, Consolidated financial statements, Accounting for taxes on income, Interim financial reporting, Intangible assets, Joint ventures, Impairments of assets, Contingent liabilities and provisions even Agriculture and so on, all make for a more balanced, transparent, uniform and meaningful reporting that helps investors and stakeholders get a better insight into the financials of the organizations and enable a better comparison of performance across board.

Over the past few years there has been a sea change in the accounting profession. The factors that have caused it are many. The movement that begun due to the external forces of globalization and disintermediation became stronger when the need for better and more meaningful accounting and the reporting role of accountants was internalized and understood by the accountants in the after math of the huge scams and financial irregularities of the recent past, when their very integrity, need and existence was questioned the world over. This happened due to two primary drivers. The first was the realization that the postmortem accounts at historical costs seldom reflect the true picture for any sort of decision making, be it strategic or operational decisions by the management, or investment decisions by the shareholders, investors and the stock market.

The other was the realization that the exiting Standards and formats were not able to cope with the complexities of commercial transactions involving mergers and acquisitions, joint ventures and emergence of the importance of intangible assets. Business became more complex with transactions and activities covering multiple segments and multiple currencies across the seven continents. Accounting Standards therefore had to keep pace with global investors and stockholders demanding international standards in India.

Accounting is changing and facing challenges like fair value accounting, inflation, intangibles, growing dependence on information systems, ERP and last but not the least convergence with International Financial Reporting Standards – IFRS. All these challenges are areas of risk.

Having seen the drivers on the accounting side for the changes in financial reporting, let us now look at the auditing aspect.

4.3.12 Changing Landscape of Auditing

Auditing too has changed from the post mortem, check box, tick box, check list – based approach to a proactive discipline that encompasses such emerging disciplines / areas like forensic audit and auditing in a digital environment. Auditing today is not only a continuous process but also a proactive one where it has become predictive and preventive in dealing with financial irregularities and frauds by focusing on auditing and improving controls.

Auditing today also needs to be fast and quick enough to provide comfort to financial reports that are now issued every quarter and even at the end of the year in a matter of days and not weeks and months after the year end. These changes in auditing have had a substantial impact on financial reporting today. There was a time when auditors restricted themselves to the books of accounts and financial statements drawn out therefrom. The emphasis was on “true and correct” which later shifted to “true and fair”. Today the accounting process itself is more transparent with the auditor clearly stating in his report the scope, role and nature of audit activities and what management’s responsibility is and what the auditors do.

Today apart from financial statements, which now cover cash flows and other statements too, auditors also audit quarterly accounts, conduct a limited review of reports, even audit projections containing prospective statements and audit compliance to corporate governance.

The role of the auditors which according to them (the auditors) was perceived as that of a watch dog, has also changed with stakeholders expecting them to be more proactive in actively looking for frauds, irregularities and errors at least like a more aggressive and alert watch dog, if not an outright bloodhound.

Another very important change that has come over the profession and has a direct impact on financial reporting is the quality of the audit profession. Mechanisms have been put in place to ensure that independence norms are followed, accounting and Auditing standards are compiled and the quality of audits is maintained through capacity building measures like continuing professional education (CPE) and peer review of audit firms, technical review of audits measures under Companies Act, 2013 With standards improving, auditing, getting e-enabled and the quality of auditors getting better financial reporting is bound to improve.

4.3.13 Risk based approach to Auditing

Risk management is becoming a way of life in today's world. Risk is ever present – you have business risk, commercial risk, financial risk, exchange risk, inherent risk, risk of disaster, political risk, the list is endless. The financial reporting process and all its components are no exception to this. You have risks in accounting by way of incorrect capturing of financial information pertaining to transactions, audit risk being control risk (risk of failure of controls) and detection risk (risk of failure to detect errors and misstatements) risks in communication of financial results – reporting risk and eventually the ever-present risk of fraud, errors and misrepresentation / mistakes inherent in the business itself. Risk based approach is being adopted in internal accounting of business operations, in auditing the results and in financial reporting so as to make reporting efficient and effective.

4.3.14 Changes in Financial Reporting towards greater disclosure

Reporting in the present day is not limited to the financial statements alone but carries a lot of other information which has numerous details. The normal reporting formats and presentation techniques used in the annual report differ from company to company and country to country making it non-comparable. Despite the advances in computing and information technology this information is not always searchable. The use of hypermedia, especially XBRL that is fast emerging as the global standard makes this information more meaningful and searchable.

4.3.15 XBRL: (Extended Business Reporting Language) & Knowledge graphs in the context of financial reporting for professional accountants

(a) Extensible Business Language is based on XML (Extendable markup language) – based format. It was developed to cover electronic communication and analysis of data. XBRL tags each data cell and each line of content and therefore enables fast query and analysis. XBRL, if introduced and accepted world over as the reporting standard will enable more than good governance, as standards-based analysis will let corporate strategists quickly review internal results and performance comparison of likes with likes vis-a-vis competitors. Corporate reporting will also improve as more and more countries are preparing to adopt it as the reporting standard of choice.

(b) Knowledge graphs are a tool of the information age in which we all now find ourself. As we transition from an industrial economy into a digital economy, the tools we use need to change to be updated for the current times.

What exactly is a knowledge graph? At the core of every machine-readable knowledge graph is a machine-readable knowledge model.

A knowledge model is a collection of interlinked logical statements that describe the terms, structures, associations, rules, and facts that make up that knowledge graph. A financial report is a knowledge graph.

Knowledge graphs put information into context via linking and logical oriented metadata and this way provide a framework for data integration, solving problems, information analysis and sharing of that machine-readable information.

4.3.16 Financial Accounting, Management and Reporting in Government, semi- Government and Public Bodies

The Government system of accounting has all along been based on a single-entry system with its drawbacks, such as lack of information on income due for collection, outstanding liabilities in respect of expenses, and the value of assets created and held.

Over the last two three years, a number of municipal and public bodies have started the process for adopting the double entry system used by corporates, which is widely used by Government bodies in the developed world as a measure of self–sustenance of institutions/ organizations. This is a sea change and reflects a quantum jump over the past.

4.3.17 Global Crisis

The last major financial crisis in the markets, the global meltdown of 2008, beginning with the sub prime crises in US, followed by economic meltdown, reckless investment and products, leading to string of bankruptcies, near collapse situation in the United States and the last minute bailout brought to fore immense risks in the world of finance.

What has caused this crisis? Is it bad economics? Bad mathematics? Bad logic? Poor judgment? Is it a failure of rating agencies, failure of merchant bankers, investment analysts and consultants, failure of banks and financial institution in their due diligence and homework and failure of auditors in expressing their opinion? Failure of monitoring and regulatory bodies and government agencies failure of Boards in their oversight? Failure in record keeping and reporting probably it is all of this in some measure. All have probably failed.

What would be the fallout and impact of the ongoing crises like the Ukraine war, or the destabilization in US -China relations, the interest rate uncertainty, the global attrition between international currencies. The outcome would be more risk.

4.3.18 Challenge for CAs

A person can always be wiser in hindsight. But one fact that comes out glaringly out of this is that every situation, every strategy, every move, every operation, every action, every transaction, every receipt and payment, every contract, every assurance, every deal, every agreement, every statement, every acceptance has a financial footprint that the accountant captures, records and reports and the auditor verifies, vets, vouches, audits, comments and expresses an opinion on. Does that mean that all this is too onerous and that accountants should hide behind disclaimers, subject tos, not withstanding, ifs and buts, and the law as it stands? Professional accountants, be they CFOs, accountants or auditors need to understand the situation and the task before them and equip themselves to go forth and discharge their role. To quote William Shedd

“A ship in harbor is safe, but that is not what ships are built for”.

This is the challenge.

4.3.19 Continual Professional Development – The right response

The way forward for accountants to counter this risk is to equip themselves with knowledge through continuing professional education, improve assurance function supported by peer review and above all maintain independence coupled with professional skepticism and adherence to ethical standards. The need of the hour then is to convert vulnerabilities and weakness into strengths and threats into opportunities to manage change. Let us accept the challenges of change.

4.4 Tax Practice – Direct and Indirect Taxes

Chartered Accountants have been providing tax related services to clients essentially covering tax planning, tax management and tax compliance.

4.4.1 Tax Management

Tax management and compliance involves the routine activity of meeting the tax obligation in a timely and proper manner starting from registration of entity, obtaining and registering PAN and TAN, compliance of TDS and TCS provisions, timely estimations and payment of advance tax, timely compilation, computation and filing of tax returns, attending to notices of demand, scrutiny and other notices for enquiry/assessment and others, as well as attending assessments, penalty and various appellate proceedings both in faceless mode as well as in person on behalf of the client.

These are always for and on behalf of the client and on his due instructions.

With the shifting of all tax related work including registration, filing of returns payment of tax and assessment and appeals to an online digital format in a faceless manner, the speed has increased and timelines have now reduced substantially requiring the assessee/client and the Chartered Accountant to be even more alert and abreast of the latest amendments and changes.

Being able to deal with information systems and being system savvy is a new skill set now required to be acquired.

4.4.2 Tax Planning

As regards tax planning part of the practice it has always been the golden rule that the practicing Chartered Accountant has to advice the client and base the tax planning on the legitimate use of deductions, exemptions, and benefits provided under the tax laws.

Thus, there is no scope for tax avoidance, use of doubtful or colourable devices, or artificially contrived transactions or a claim thereof only to minimize tax liability and to no other useful, justifiable commercial purpose. There is of course no place for outright tax evasion either, which is a criminal act.

4.2.3 Tax Compliance

The liability of the practicing Chartered Accountant and his exposure in case of misstatement in tax returns and/or statements filed on the instructions of as supplied by and as duly authorized by his client was always considered to be limited to being due diligent in compiling the information and in making a claim on the basis of interpretation of law. Beyond that it has always been the duty and responsibility of the assessee to provide the information in tax returns and which therefore was the liability and responsibility of the assessee and not of the Chartered Accountant in case any misstatements were discovered/found.

4.2.4 Penalty Provisions under Income Tax Act, 1961

The penalty provisions under the income-tax law have been now expanded to cover Chartered Accountants by introduction of section 271J of Income Tax Act, 1961.

Prior to introduction of this section penal consequences were only on the assessee, in case of negligence by the Chartered Accountant, the only option for the Commissioner of Income Tax was to lodge a complaint with the ICAI against the CA who would then face disciplinary proceedings.

Now, with the introduction of section 271J the CA is directly liable to penalty.

Section 271J is reproduced below:

"**Section-271J: Penalty for furnishing incorrect information in reports or certificates**.

Without prejudice to the provisions of this Act, where the Assessing Officer or the Commissioner (Appeals), in the course of any proceedings under this Act, finds that an accountant or a merchant banker or a registered valuer has furnished incorrect information in any report or certificate furnished under any provision of this Act or the rules made thereunder, the Assessing Officer or the Commissioner (Appeals) may direct that such accountant or merchant banker or registered valuer, as the case may be, shall pay, by way of penalty, a sum of ten thousand rupees for each such report or certificate.

Explanation: For the purposes of this section, —

a) "accountant" means an accountant referred to in the Explanation below sub-section (2) of section 288.

b) "Merchant banker" means Category I merchant banker registered with the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);

c) "Registered valuer" means a person defined in clause (oaa) of section 2 of the Wealth-tax Act,1957(27of1957)". **Penalty for failure to furnish statements, etc.**

The penalty is ` 10,000 for each such report or certificate where the professional Chartered Accountant has provided incorrect information (whether with mala fide intention or not in any of the report or certificate.)

Section 273B further provides that in case the defaulter proves the reasonable cause of failure then no penalty under section 271J of the Income Tax Act would be levied.

This is an indication of the future path and the thought process in the revenue department and tax authorities regarding the liability and responsibility of Chartered Accountants providing services to assesses and tax payers and representing them before the tax authorities.

4.5 Indirect Tax Laws and Practice

Given the subsuming of multifarious indirect tax laws into GST, GST as an indirect tax which is a completely new piece of legislation which has provided a new avenue of practice with a level playing field.

The professional services in indirect taxes being similar to that of direct taxes, the risks and issues faced by professionals are similar.

4.6 Business Management Consultancy, Transaction Advisory and Consultancy and Other Services

The various other services including business and management consultancy for clients, valuation and transaction advisory for mergers and acquisition, raising finance and capital, succession planning, information system security and other types of emerging services all have similar features and characteristics.

Professional Chartered Accountant has to ensure that at all times he maintains professional competence, independence, avoids all conflict of interest, maintains integrity, probity, confidentiality, exercises due diligence, expertise, inspires trust and displays adherence to code of conduct and ethics.

The primary risk in such assignments is that of professional negligence, complicity and knowingly or unknowingly being party to an unlawful act that is against the provisions of any statute, carrying out work and providing services based on incorrect information, mistake or fraudulent errors deliberate or inadvertent /misstatement etc.

The liability of the CA that arises could be potentially to the client, or to aggrieved third parties, who use the work, or to the Government and/or regulatory agencies and under the laws, regulations and procedures concerning/governing Chartered Accountants.

4.7 General and Specific Risks

Having seen the specific risks and issues relating to the areas of practice of Chartered Accountants let us come to the common administration areas and operating of a Chartered Accountant's practice where risk management is called for and which relate to conduct of practice, accepting clients, staffing the firm, areas of expertise and conduct of operations.

4.8 Practice and Office Management

In the following practice and office management areas a judicious risk management has to be employed by the practicing CAs.

The areas of office management and managing practice are well captured in the Office Management Manual brought out by ICAI in 2020.

Essentially these cover

1. *Client Relationship Management* – Onboarding and acceptance of a client, relationship management and termination
2. *Human Resource Management* – Starting from recruitment, selection, introduction, workforce lifecycle management, learning and development, training, compliance with laws, code of conduct and discipline, ensuring independence, exit management.
3. *Technology and Infrastructure Management* covering \infrastructure, hardware, software, data and information security, client confidentiality and privacy of personally identifiable information (PII), software licensing and backups, networking and remote access working.
4. *Project/Engagement/Work Management* – Project management to ensure efficiency, effectiveness and minimize cost overruns, scope creep, and time creep and complete successful assignments.
5. *Finance Management* – Cost estimation and estimates, quotes, time sheets, logs, billing management, collection follow up, expense contract.
6. *Knowledge Management* – Books, seminars, study circle, materials, CPE
7. *Communication* – Telephone, net, social media.
8. *Archiving* – Physical storage digitization, backups, off site storage, retrievability,

4.9 Controls in CA Practice for Risk Prevention, Reduction, Mitigation and Treatment

Practice risk arises in the specific areas of practice as well as in routine operations and office management that we discussed due to known existing risks as well as the emerging risks arising from changing business, economic, technological and social environment, and the rising expectations of the stakeholders.

The comprehensive enterprise risk management approach that we discussed in Chapter 2, has an important key activity of control of risk in the end-to-end process. Institution of appropriate controls and modifying and improving them based on successive risk assessments and analysis help reduce and manage the risks to an acceptable level given the attitude, approach and appetite for risk.

The appropriate solution for the CAs in practice is therefore to adopt a proactive approach and put in place controls to treat, mitigate and control risks keeping them at an acceptable level.

The general and specific controls and documentation maintained by Chartered Accountants in practice, individually and as a firm for maintaining quality of audit, assurance and certification practice is the first line of defense for managing risk in the various practice areas of a Chartered Accountant identified and discussed above including tax practice, direct and indirect, business and management consultancy, transaction advisory, valuation and other emerging practice areas with appropriate adjustments and modifications.

4.9.1 COSO framework and CA Practice

Before listing and considering the controls, let us refresh the steps in risk management well-articulated and captured in COSO framework outlined in the earlier Chapter.

Risk assessment, risk treatment – control activities, information, communication, monitoring and back to risk assessment is the cycle of risk management and the framework developed in COSO.

These controls are divided into the following two parts:

- Quality controls that are general controls at the firm level that deal with competencies, skills, professional standards and code of ethics.
- Specific controls designed for engagement level for operations to ensure compliance with standards, and legal regulatory requirements.

4.9.2 General Controls in CA Practice

1. ***Leadership responsibilities in the firm*** – Documentation policies and procedure to establish quality control of professional practice and assignments, communicated to employees and implemented in the organization. These are achieved through tone at the top, appraisal linked to quality, commercial considerations not to overrule quality and public interest. Adequate authority resources and authority for those in charge.

2. ***Ethical Requirements*** – Cost of ethics – Integrity, objectivity, professional competence and due care, confidentiality and professional behavior

Independence to be maintained to ensure no conflict of interest based on threats and safeguards approach.

Controls to neutralize self-interest, self-review, advocacy, familiarity and intimidation – like involving reviewing partners/managers, frank discussion on independence, confirmation and removing those that are a threat from the assignment. Ensure no financial interest, no employment interest and no business relationship into clients, safeguard from long association by rotation of staff, avoiding and /or having clearcut policy on gifts and hospitality and professional fees to be less than 20 per cent of total fees of individual client or group. Conflicting services not to be accepted as would affect independence. It should be ensured that compliance is understood, confirmed and complied with.

3. ***Acceptance and continuance of client relationship and specific engagements*** – Evaluating client for reputation and integrity, background of promoters, related parties / KMPs and ensure no criminal background. Conflicts of interest to be checked and resolved, ensure competence and resources communicate with previous CA, decide whether association with the client is appropriate and acceptable.

4. ***Human resources*** – Background checks, on boarding orientation, required qualifications, experience, capabilities, competences of staff- best fit, continuing training, professional education, upskilling, technical competency, professional maturity, staff discipline controls are working, operations, exit.

5. ***Engagement Performance*** – Practice aids are used for background check, review of risk, risk assessment and risk responses – engagement planning memorandum is populated.

The engagement performance is as planned in line with the quality documentation, duly documented appropriately reported with file archival and retention.

6. ***Monitoring*** – There is mechanism for internal quality control and monitoring for compliance and quality for all controls including complaints and unresolved issues.

4.9.3 Specific Controls for managing risks in CA practices

These are designed to be implemented to teams/resources/CAs/Partners at the engagement level of the practice.

During the discharge of/ execution of an engagement/ professional service for areas of practice the following controls are monitored:

(a) Compliance with applicable laws and regulations – e.g., Income tax, GST, Companies Act, 2013 laws applicable to cooperative societies, laws applicable to trusts, etc.

(b) Compliance with applicable standards prescribed by the regulator, authority, legislation, by ICAI or as per industry benchmark, norm, practice.

4.9.4 Effectiveness of Controls

(a) The test of design, implementation and operating effectiveness of these controls as per the relevant applicable practice area/work coverage will have to be discussed and finalized by the CA firm.

(b) The materiality planning and how significant risks are identified and dealt with has to be evaluated periodically by the firm.

(c) Errors, issues, mistakes spotted in internal review, whether these are appropriately dealt with, rectified, closed and communicated to users of reports and are discussed and closed.

(d) Appropriate documentation, confirmations, external validation, work of other experts used/reviewed, and evidence used need to be covered and adequately provided for.

(e) The report /output whether adequately reviewed and vetted before finalization of the professional service by the person who verified and confirmed.

(f) Work done, evidence obtained, conclusions arrived at, and reports/ output issued to client need to be adequately documented /recorded as working paper and reviewed before final report is prepared.

(g) Client authorization, communication approval and sign off in the work at all stages to be recorded.

(h) Review of work by independent professional within the firm, to ensure quality and compliance.

(i) Archiving, retention of records and retrieval.

4.9.5 Sizing of Controls

Risk management controls and their implementation, general and specific for various assignments and professional work/ practice need to be deployed based on size, complexity, methodology, type of data/evidence available, risks inherent in the activity, execution and the methodology followed. Legal, regulatory, contractual requirements (if any) and industry benchmarks and client expectations would also be seen.

4.9.6 Risk Transfer

Specific tools available to deal with risks other than mitigation of risk, risk control and risk treatment are those of risk transfer.

Insurance as an effective tool for risk transfer needs to be reviewed and considered for use by the CAs especially in the light of modern-day developments. There are products like Errors and Omission Insurance for practicing CAs to derisk their practice. CAs can also take professional indemnity insurance to transfer risk in practice.

There is Cyber Liability, Director's liability, Crime liability, Employee Dishonesty and host of other products available in the market which can also be used by CAs in appropriate situations, whether in practice or in service or in business and other activities.

There are a number of insurance products available to cover risk.

Thus, there is loss of fixed assets policy, factory insurance policy, workmen's injury and compensation policy, insurance policy covering raw material and finished goods stock, equipment insurance and even loss of profit insurance is available for manufacturing industry.

Keyman insurance, and other insurance including fire, marine and general insurance policies are available for the service industry.

There are policies like Cyber Liability, Director's liability Insurance, Director's and Officers policy, Crime liability, Employee Dishonesty insurance and other products available for the senior management personnel in a company.

4.9.7 Reciprocal Arrangements

Apart from insurance, CAs in practice and firms can consider reciprocal agreements with one or a group of CA firms within their vicinity / circle.

Thus, CAs who are in the vicinity/circle and know each other, may come together and decide that in case of any disruption of CAs practice, temporary or permanent, due to mishap, illness and/ or disability or death the other CAs in the group, may take over and complete unfinished services and remunerate/compensate the affected CA/legal heir to the extent appropriate. This way client service does not suffer and the affected CA does not attract any liability for not completing professional assignment/obligation.

In case of events like death, permanent or temporary disability of the CA which will affect the service to clients, cause significant disruption of taxation, audit and such pending assignments and affect continuance of employment of staff and also affect the dependents of the CA, a colleague from the circle or a group of CA practitioners/firms may be identified out of whom one or more can be selected/chosen by the clients for ensuring continuity. This can be formalized by entering into a Practice Continuation Agreement (PCA) amongst the group/circle of CA practitioners which is like a reciprocal arrangement. This may minimize the disruption caused to the continued client service.

This may help minimize potential professional liability claims arising from missed filing/audit report deadlines, giving peace of mind to the CA practitioner.

Chapter 5

Summary and Future Directions

5.1 Summary

In the first two Chapters we covered both risk and risk management framework, systems and practices. In the third and fourth Chapters we dealt with the increasing significance of risk and the need for addressing risk by CAs followed by risks specific to Chartered Accountants in practice in some details.

We shall now summarize and have an overview of the risks and the Chartered Accountant in practice followed by some directions for the future.

5.2 Practice Areas

The brief of a practicing Chartered Accountant today encompasses a wide scope covering diverse areas of professional practice and services. In the early days of the profession the focus was on accounting, audit and assurance and taxation mostly direct taxes. Today the scope has spread and the depth of these professional services has grown in terms of disciplines, sectors, industries, and complexity over the last seventy five years beginning from the advent of Chartered Accountants Act in India..

The areas of professional practice of Chartered Accountants are given in the following Table.

PRIMARY AREAS OF CHARTERED ACCOUNTANTS PRACTICE

Practice Area	Spread	Depth
1. Accounting	Internal Accounting External Reporting	Financial, Management Accounting, External Reporting under various statutes Companies Act, Co-op. Societies Acts, Banking Regulation Act, etc.
2. Audit and	Audit Reports	Financial, Statutory,

Practice Area	**Spread**	**Depth**
Assurance	Limited Review Reports Certifications	Internal, Tax, GST, Excise (discontinued), Management Audit, Information System Audit, Treasury Audit, Bank Statutory, Branch and Internal Concurrent Audit, Forensic Audit, Social Audit, Software Audit, Data Migration Audit, Environmental Audit, Information Security Audit, Various Assurance Services including limited review reports and certification.
3. Taxation	Direct Taxes – Income Tax Indirect Taxes – GST, Customs International Taxation	Tax Compliances, Tax Management, Tax Representation, Opinions, Tax Planning
4. Management and Business Consultancy and Transaction Advisory Services	Business Process Reengineering, Mergers and Acquisitions, Take Overs, Strategic Decisions Advisory	Planning and Setting up organizations and Entities, Organic and Inorganic Expansion, Supply Chain Management, Financial Planning, Fund raising, Treasury Management, Public Listing, Private Placements, Project Financing and Execution, Investment

Practice Area	Spread	Depth
		Consulting.
5. Valuation	Shares, Financial Assets and Instruments Intangibles - goodwill	Share Valuations, Valuation of Bonds, Valuation of Brands, Valuation of Intangibles.
6. Corporate Training and Advisory	Finance, Taxation, Other laws	In house training, Certification training and coaching, consultancy Skill developmental in finance and accounting, financial literacy.
7. Information System and Digital Services	Implementation of systems, System Advisory Domain Specific Design Inputs, Digital Solutions	ERP System Implementation, Data migration and cleaning, Information Security Services, Digital Transactions and Record Management.
8. Other Services	Insurance Survey or Risk Management	Calculating and verifying claims, advise on policies / insurance risk management consultancy.
9. Other Laws	Consultancy, Representation	FCRA, Customs, FEMA, PMLA. Trust Legislation co-operative Societies Legislation MSME related services.

Practice Area	Spread	Depth
		Stamp duty and Legislations on Succession and wills.
10. Emerging Areas	Environmental, Social, Governance (ESG)	Corporate Social Responsibility, Sustainability Reporting, Social Audit, Triple Bottom Line Reporting, Environmental Reporting, Impact Assessment and Audit.

5.3 Sectors Covered

The sectors which a practicing Chartered Accountant primarily served were those of business consisting of manufacturing and trading. Eventually with the advent and growth in service sector in terms of volume, value, type of services, spread and complexity this sector was added to the practice area. Finally, with agro processing industries, seed corporations, organic farming, corporates entering farming the primary sector is also now well covered.

Then came the Information and communication technology revolution and knowledge services sector was added to become the fourth sector.

SECTORS COVERED IN CA PRACTICE

Sector	Type of Economic Activity
1. Primary	Agriculture, Farming, Fishing, Animal Husbandry, Dairy Farming Extraction Industries, Ores, Minerals, Wood, Timber, etc.
2. Secondary	Manufacturing, Production, Refining, Utilities – Electricity, Gas Hydro, Wind, Solar Power, Construction, Infrastructure.

Sector	Type of Economic Activity
3. Tertiary	Trade – Wholesale Retail Financial services – BFSI, Communication, Business Services, Hospitality, Travel, Leisure, Tourism, Real Estate, Personal Services, Transportation, Information Technology, Media and Entertainment, Online and Remote Services.
4. Quaternary	Knowledge Industries Education Research and Development Public Sector Social Sector

5.4 Stakeholders

Chartered Accountant in practice in olden times owed a duty of care to the management, those that engaged him and to whom he reported to; thus, there was a one-to-one unitary relationship of stakeholders for the CA.

With the formation of joint stock companies, separation of ownership and management, the various laws that came including those relating to companies, taxes, banking, labour and so on, and with the complexity of business and that of the CA practice, the stakeholders kept growing and increasing.

In today's time the practicing CA owes a duty of care to a much wider spread of stakeholders, those who rely on his reports, the output of his services and even to the public, the nation, the people at large and humanity.

Some of the important stakeholders for CA in practice are outlined in the following Table.

IMPORTANT STAKEHOLDERS FOR CA IN PRACTICE

Stakeholder	Spread / Coverage
1. Enterprises	Owner, Shareholders, Trustees, Promoters, Directors. Management, KMP, Professional Managers, Compliance Officers.

Stakeholder	Spread / Coverage
2. Lenders	Banks, Financial Institutions, Entities, Funds in BESI segments
3. Input Providers / Third Parties	Labour, Work force, Suppliers, Vendors, Associates, Business Partners, Service Providers, Infrastructure Providers, Utilities, Logistics Provider, Middlemen, Agents, Brokers, Dealers, Consultants, Transport and Communication.
4. Government – Legislature and Regulating Bodies	Regulators – RBI, MCA, SEBI, DOEA, Taxation Authorities, Registration Authorities, Municipalities, Local Bodies, Ministry.
5. Users	Consumers, Consumers Organizations
6. Public	NGO, Welfare bodies, Women bodies, Trade, Industry Bodies, Professionals, People, Entities representing the Population and Society.
7. Environment	Business responsibility and Sustainability Reporting towards a better future

5.5 Rapid Changes

As we have seen the core areas of CA practice are undergoing rapid changes.

The advancements in the core areas of audit and assurance, certifications, taxation and financial and management corporate consultancy, and transaction advisory services have been widespread and deep.

There has been a marked change in Legislations, rules and regulations, change in the profession itself and a globalized world which has led to constant and rapid changes in a world marked by volatility, uncertainty, complexity and ambiguity.

Thus the current political, economic, social and technological environment, together with the push factors of globalization, liberalization, disintermediation and ICT revolution, on the one hand and the pull factors of peoples' expectations, industry and business needs, changing / evolving legislation, strict laws, rules and regulations on the other have transformed the CA practice making it more complex, competitive, demanding, challenging and at the same time providing greater opportunities to emerging professionals.

The environment and business / industry systems within which a Chartered Accountant conducts practice are complex, shaped by diverse factors we discussed / summarized above and has interdependencies of high degree. The changing political, economic, social and technology transformation has given rise to a volatile, uncertain, complex, ambiguous environment that organizations and practicing Chartered Accountants find difficult to keep pace with and adapt to and change their functioning to meet this challenge.

5.6 Risks in CA Practice

Given the wide spectrum of CA practice and with changing laws, a practicing CA now has to cover diverse set of sectors, diverse set of stakeholders and a broad spectrum of specialized practice areas and services that we have seen above.

These give rise to risks and the primary among them are explained below followed by the appropriate response.

5.6.1 Strategic Risks

With a plethora of practice areas and the choices of advancement in practice and with growing competition and complexity of CA practice the risk of lack of proper vision, mission, goals objectives and strategics can expose the firm to strategic risk which will make it difficult to sustain and grow the practice in long term.

5.6.2 Operational Risk

This is especially significant for individual practicing Chartered Accountants and small and medium sized CA firms. With the economic challenges the larger firms too face this risk too. CA firms find it difficult to employ qualified and professional staff who are responsible, dedicated, have the skill sets and competencies, have the drive and initiative and willing accept the remuneration offered. Lack of high-quality resources is the major operational risk. Rapid change in Government policies, legislations, increasing competition from other professions, from digital initiatives and from within the profession, erosion of base earlier contributed by Government and regulatory mandates and empanelment of CAs, all these hinder and affect the working of the practice.

5.6.3 Financial Risk

The practicing CAs often lack proper financial management though they are themselves good at and advice their clients about it. It is seen that many CA practitioners lack proper financial budgeting and financial management, billing management, timely collections and follow up, time sheets, logs, costing, quotes and ABC Analysis of clients etc. In their absence or inadequacy, practicing CAs find that their dues are always in substantial arrears leading to a resource crunch and incurring even the cost of bridge finance. This affects resource availability of the firm.

5.6.4 Technology Risks

Almost every area of modern CA practice from audits, tax to consulting need extensive use and dependence on digital tools and technology. More often CA firms' staff are not sufficiently trained in the use of digital tools and there is reticence to adopt them as well as to digital practices. Software used is often not upgraded and sometimes may not be licensed; safe digital practices are ignored or not put in place due to complexity or sheer neglect.

This has given rise to technology risks including virus attacks, loss of data, technical issues resulting in delay in critical work and compliances, compromise of confidentiality and integrity and even failure or non-availability of systems at critical times.

5.6.5 Regulatory/Legal Risks

Legislations relating to CAs including Companies Act, 2013, Chartered Accountants Act, 1949, PMLA Act, regulatory bodies, rules and regulations are continuously evolving and these changes often in the middle of a year affect the CA practice substantially.

5.6.6 Societal, Environmental Risks

The changing expectations of the society, the changing political, economic social and technological environment, black swan events like the global meltdown of 2008 and the Covid 2019 pandemic all these external factors expose the CA practice to severe risks that pose a challenge.

These along with specific risks relating to individual practice areas like audit risks, risk of tax penalties, risk of financial claim, disciplinary proceedings have been considered at length in Chapter 4.

5.6.7 Risk Response

The risk response for a CA firm is to follow a robust risk management process along the lines outlined in the COSO framework. This consists of risk awareness, identification, assessment, analysis, developing strategies for risk management, mitigation and treatment of risk.

5.6.8 Leadership

Strategic risks are best responded to be establishing proper leadership with responsibility and authority with an emphasis on quality and ethical values which are fundamental to the profession. These also enable addressing societal risk, environmental risk and make the CA practice a long term and sustainable one.

5.6.9 Managing Engagement Performance

Managing client relationships, ethical requirements, human resources, engagement performance and monitoring help address key risks including operational risk, financial risk, technology risks, regulatory risks, and legal risks.

5.6.10 General & Specific Controls

The general controls in CA Practice (para 4.8.2) together with specific controls covering practice areas (para4.8.3) of compliance of applicable laws and regulations and compliance of applicable standards together make a robust risk management strategy for CAs in practice enabling growth and sustainability in the long term in this uncertain and complex world.

5.6.11 Future Directions

The future path lies in covering the above in greater depth, considering best practices, and to develop a framework for risk management specific to CAs in practice, in industry as well as in other emerging areas.

Appendix 1

Overview of Different Types of Risks faced by an Enterprise

(A) Strategic Risks

- Strategy and business environment risk
- Event risk, Group risk, Legal risk
- Regulatory risk, Competition risk
- Management risk, Organization risk
- Human Resources Management risk
- Capital inadequacy risk.
- Disaster risk/Force majeure
- External credit rating

(B) Operational Risks

Manufacturing/Service Risks

- Manufacturing failure
- Service failure
- Project management risk
- Compliance risk
- Accounting/Taxation risk

Risks in Operations

- Audit compliance risk
- Booking error
- Business process design
- Customer relationship management
- Counter party failure

- Confidentiality risk
- Distribution Channel
- Documentation risk
- Execution risk
- Information Communication risk
- Information Security risk
- Methodology error
- Model error
- Money laundering
- Product complexity
- Settlement error
- Security risks
- Training gaps
- Volume risks

Risks in Human Resources

- Fraud
- Keyman
- Human error
- Training gaps
- Negligence

Risks in Communications

- Communication interface risk
- Connectivity failure
- System customization risk
- Telecom failure
- Third party/vendor failure for non-IT outsourcing

(C) Market Risks

- Commodity risk
- Country risk
- Equity position risk
- Limits risk
- Price volatility

(D) Credit Risks

- Counter party risk
- Credit appraisal
- Credit investigation
- Exposure risk
- Monitoring gaps
- Recovery risk
- Sector downturns
- Security realization risk

(E) Finance Risks

Liquidity Risk

- Funding risk
- Market conditions
- Time risk

Interest Rate Risk

- Basis risk
- Prepayment risk
- Re-pricing risk
- Yield curve risk

Forex Risk

- FX rate
- Gap risk
- Settlement risk

Appendix 2

Tax Representation Case Study

Overview of tax representation

Chartered Accountants represent clients in direct tax cases, indirect tax cases, as well as under certain other laws where they are permitted to appear before the authorities to represent the client and put forth submissions and arguments as well as produce documents on their behalf.

The statements and submissions made by them are on the basis of due authorization which is contained in a letter of authority or power of attorney with the payment of requisite duty by way of non- judicial stamp paper on which the same is issued.

The primary authorizing document binds the client as to the statements filed, documents produced, and submissions and arguments made on behalf of the client before the authorities in the course of proceedings.

The nature of proceedings which are conducted by these authorities viz. Assessing Officer, Appellate Commissioner or the Appellate Tribunal are quasi – judicial in nature. In fact, after the advent of the faceless mode of assessments and appeals now they are in faceless mode with submission being electronic and hearings though video conferencing mode.

Inherent in the practice area of tax representation is the risk of errors and misstatements in the course of such hearings/proceedings.

The significant risk areas in the service of representation are:

1. Risk of errors and misstatement in facts of the case.
2. Risk of errors / mistakes in the arguments made on behalf of the client, on point of law, on applicability / interpretation of the law.
3. Errors in invoking / referring to commentaries, interpretations and case laws with citations.

In the case of Income Tax Act, 1961 section 288 provides the powers and procedures and who can act as authorized representatives.

Thus, these authorized representatives (A. R) (Chartered Accountants are eligible to be A. R) are considered as representatives of and representing the assess / client and therefore an extension of the client.

Lawyers arguing before a judicial forum on behalf of a client are on the other hand considered as “Officers of the Court” and hence enjoy certain immunity and powers.

The case study on Tax representation is therefore of a Chartered Accountant who appears in a hearing before the Income Tax Appellate Tribunal and submits arguments and attends the hearing on behalf of his client.

Case:

The client assessee is an individual carrying on business of dealing in wooden and steel furniture and is regularly assessed to tax.

The client had filed a return of income, the case was selected for scrutiny, after faceless hearings scrutiny assessment order was passed. Being aggrieved, the assessee had gone in first appeal to the Appellate Commissioner who had granted partial relief.

The assessee had filed an appeal before the ITAT and the tax department had filed cross objections in the matter.

The issue was regarding estimation of gross profit margin of the trader and involved an addition. The Appellate Commissioner had reduced the addition by fifty per cent.

The assessee / appellant duly appointed Mr. X, a CA as authorized representative to appear before the Tribunal and argue the matter.

Being the first hearing Mr. X, the A.R. on behalf of the appellant client filed written submissions in the form of a paper book. The compilation consisting of an index, the documents and pages of the paper book were duly signed by the appellant, the submissions having been prepared by Mr. X.

It contained details of accounts, details of sales, purchases and expenses claimed and the loss.

The submissions relied upon certain case laws of the. jurisdictional High Court and other authorities including ITAT with proper references.

A copy of the paper book was served on the Departmental representative (DR) and copies submitted to the ITAT.

At the next hearing it was discovered that the submissions were erroneous and misleading in as much as the case laws mentioned and facts of these cases as well as the citations given could not be found either by the DR or by the members of the. ITAT hearing the matter. Upon detailed search these case laws so referred were found to be not in existence and hence not genuine.

In the circumstances Mr. X, the AR when asked to explain the errors and discrepancies admitted that he had used Chat GPT a recently introduced and developed free ware that was based on Artificial Intelligence to research the case and the A.R. prepared the brief and submitted it as generated by the Chat GPT verbatim. He was unaware that the submissions and the case laws, judgments and references presented by Chat GPT were erroneous and did not not-exist as he had not done any verification of his own. The ITAT asked Mr. X, the AR to show cause as to why action should not be taken against the AR/ the client for submitting fake case laws, claims and misleading the Tribunal which would have resulted in miscarriage of justice, at the time of next hearing. As a professional colleague you are approached

1. As to what stand Mr, X, CA should take in the matter
2. Whether the use of Chat GPT for preparing the brief/paper book/submissions before ITAT was appropriate?
3. What are the risks involved in using Chat GPT for such cases and what safeguards/precaution should be taken for the same.

Suggested course of Action of Mr. CA. AR of the client.

The proceeding before the Income Tax Appellate Tribunal being quasi-judicial proceedings the provisions of Chapter XI of the Indian Penal Code, 1860 (IPC) of false evidence and offences against public justice could be invoked especially of section 209 – Dishonestly Making false claim in Court.

Ans. 1. The first course of action in the matter would be to file a written apology before the ITAT explaining that the use of Chat GPT was in good faith, there was no intention of any dishonesty on part of appellant and AR and that the AR generally believed the submissions and case laws cited and provided by the Chat GPT to be true and that non-verification of the same was an error of judgment being a genuine mistake that will not be repeated in future and considering the track record the first time default be condoned.

Ans. 2. For the future certain do's and don'ts regarding use of Chat GPT and /or any other automated AI based tool for tax representation work/tax work/ legal work need to be followed.

Chat GPT is essentially a language processing model developed by Open AI. It has been trained on Google data of 2021 vintage and is enabled to answering questions and responding by writing reports, notes and carrying out research from its knowledge data base and providing summarized reports.

Thus, Chat GPT can surely be used by CAs for assistance in areas like conducting research, reviewing information trends in statements, identifying risks, preparing design outline for reports, and for writing draft reports.

Ans. 3. Risks: The primary risk involved in use of Chat GPT is that of assuming that the output of Chat GPT is proper and correct/ and/ or the last word on the subject. Thus, the risk is of over reliance on an as yet untested technology.

In fact, it is now known that

(1) Chat GPT may occasionally generate incorrect information that suits the answer it chooses to provide for the question/task assigned.

(2) Chat GPT may at times generate harmful or wrong or biased output that is not free and fair.

(3) Chat GPT has only limited knowledge of events and hence of case laws after 2021.

Safeguards

Hence it is important for Mr. X as Authorized Representative of his client (and for all CAs)

(a) To exercise due caution

(b) Apply professional skepticism and make use of their expert professional judgment before relying on any work/output of Chat GPT or any AI based software.

(c) The AI based software being only a tool, it is necessary to validate the output for example verifying the references and case laws from authentic tax reference books or tax/ judicial date bases or websites of Tribunals and Courts.

Case Study on Tax Return Compilation and Filing

Overview of Tax Filing

The filing of returns under the direct as well as indirect tax laws is the responsibility of the assessed or dealer and a person duly authorized under the Act for the same (e.g., Director, Partner, Trustee)

An authorized representative or tax consultant's job is limited to obtaining information and details duly authenticated from the client, compiling the information and populating the tax return. Thereupon it is the responsibility and best practice to get the tax return approved by the client by way of written/email informed consent/confirmation.

Subsequent to this the file may be sent to the client to be uploaded by the client using his digital signature.

Risks in the area of tax filing are –

1. Risk of errors, misstatements and inconsistencies in the information, documents and the compiled and filed returns.
2. Errors, mistakes in application of law in terms of claiming and computing exemptions, deductions, gross taxable income, net income tax, interest, credit for payments and balance payments.
3. Errors can arise in selection of status of assessee, forms filed or in any information/data fields.
4. Errors in interpretation and relying on provisions of the law, texts, case laws, commentaries etc.
5. Errors, mistakes or gaps in the process of obtaining authorization, approval, informed consent of the client and in ensuring correct uploading of return by the client/authorized persons.

Case

The client approached the tax consultant Mr.CA for advice and assistance in uploading his tax return. He provided him some details for which Mr.CA obtained his conformation. Later the client who was intending to obtain a bank loan on the basis of his tax filings requested Mr.CA to prepare the return disclosing such income such that he will get the loan from the bank.

For this he neither had any evidence nor details and he made this request to Mr.CA on a personal visit to his office.

Thereafter the CA prepared and compiled the return and the return was uploaded using digital signature of the client.

Subsequently additions were made by Assessing Officer estimating the income resulting in substantial tax demand which was confirmed by the Appellate Commissioner.

The client appointed another tax consultant and an appeal was filed before ITAT wherein the assessee/appellant claimed that the data in the return was entirely prepared by Mr.CA to help him obtain a bank loan and hence although he had no issue with the earlier Mr.CA, he said that what was shown in the return was inflated by Mr.CA and not his real income. He argued that the addition being not on real income, the demand be dropped which the ITAT accepted.

The ITAT is considering to refer the matter for action against the CA.

How can Mr. CA control the materializing of the risks of filing erroneous tax return as well as breaching the code of conduct of the profession.

Suggested Course of Action:

Mr. CA and all practicing CA professionals need to understand and follow the following steps –

(1) Ethics, fair play and adherence to code of conduct are the primary and most important aspects than earning of professional fees or losing a client

(2) Mr. CA should have advised the client to ensure that only factually correct and real data of income be provided to him, and return be compiled and filed on that basis.

(3) The client could be advised to make proper submission to the bankers providing sound projections of future income, supported by way of adequate security and sureties to obtain the desired bank loan but not to fudge/falsify the income.

(4) In case the client does not agree and insists on having his way, Mr. CA should withdraw from such assignment.

Safeguards

Apart from the above the basic precautions of ensuring on record the due appointment, authorization, consent, confirmation and actual signing and uploading of the returns to be always taken. These have been described earlier under the heading Overview of Tax Filing given in the case study.

Case Study on Risk in Statutory Audit

Statutory Auditors' Responsibilities in Relation to Fraud in a Company

Unlike in the past in *Kingston Cotton Mills* case where an auditor was expected to be a watchdog and not a bloodhound, today under Auditing Standards as well as under applicable statutes, the auditor has certain responsibilities relating to disclosure in case of frauds.

(1) Standard of Auditing SA -240. The Auditor's Responsibilities relating to fraud in an Audit of financial statements expects the auditor to maintain professional skepticism and also communicate to Management, those changed with Governance (TCWG), and Regulatory and Enforcement Authorities regarding reporting of frauds/suspected frauds.

Clause (xi) of Companies (Auditors Report) Order, 2020 also requires the auditor to make a statement relating to reporting of frauds in the report.

Case: Mr.CA, the Statutory Auditor of the company while reviewing the stock records finds some suspicious recurring entries of weeding out of damaged stock. Further irregularities and mismatch is found in the balance as per records and physical balances which are regularly written off. He suspects that there is some fraud in the stores department of substantial nature.

He communicates with the management which assures him that all the shortage were found and the weeding outs are routine and regular and there is no defalcation or fraud as per internal enquiry.

Being concerned and as management is not cooperating, he simply withdraws from the assignment and resigns as auditor citing personal reasons.

As a professional college Mr.CA approaches you to enquire whether on resigning he is no longer responsible for reporting on the state of affairs of the company and suspected fraud and what should be done?

Advice

It is wrong to assume that resigning from an audit engagement absolves the auditor from reporting obligations to fraud and consequences under Companies Act, 2013.

In fact, the Supreme Court in *Union of India and Another v. Deloitte Haskins and Sells, LLP and Another* (C.A. No 2305-2307 of 2022 dated 3-5-23) held that consequences of section 140(5) of Companies Act, 2013 will be applicable also on those auditors who resign without reporting fraud/suspected frauds.

Suggested Course of Action

(1) Mr.CA and all practicing CAs should maintain professional skepticism throughout the audit.

(2) Understand and follow the Standards on Auditing especially SA 240 where fraud is suspected.

(3) The provisions of Companies Act, 2013, Companies (Audit and Auditors) Rules 2014 and CARO, 2020 and obligations cast thereunder be carried out professionally and in correct spirit, especially timely reporting of fraud/suspected fraud.

(4) Situations like these have to be handled adhering to the code of conduct and maintaining independence and not be affected by bias or other considerations or by escaping responsibilities by resigning.

(5) Circular No. NF-250 13/02/2023 dated 26.06.2023 by National Financial Reporting Authority, gives detailed guidance regarding similar issue that may be followed.

Note: As per the latest amendments Auditors are bound by several restrictions even in case of resignation of listed entities.

Extracts of Deloitte and Haskins & Sells LLP resignation as auditor of Adani Ports and Special Economic Zone Limited provides an example of the type of disclosure of concerns which have prompted the auditor to resign.

“Deloitte had stated that the Adani Group did not consider it necessary to have an independent external examination of these allegations because of their evaluation and the ongoing investigation by the Securities and Exchange Board of India (SEBI).

"The evaluation performed by the Group does not constitute sufficient appropriate audit evidence for the purposes of our audit," Deloitte had said in notes to APSEZ's financial statement.

In the absence of the independent external examination and the pending completion of investigation by SEBI, the auditor had said it cannot comment if the company was fully compliant with the law and if the transactions flagged may result in possible adjustments and/or disclosures in the financial statement in respect of related parties."

(The above disclosure is part of the resignation available on NSE website)

Another example is, PWC has quit as auditors of Reliance Capital and Reliance Home Finance due to lack of Corporate Governance.

Auditing firm Price Waterhouse and Co. Chartered Accountants (PWC) has resigned as one of the statutory auditors of Reliance Capital and Reliance Home Finance, citing an inability by the firms to satisfactorily resolve "certain observations/transactions" which could be significant or material to the financial statements of both companies.

According to PWC, during its audit for the financial year of 2018-2019, it came across certain transactions that were highlighted to Reliance Capital in a letter dated April 24, 2019 under relevant provisions of the Companies Act.

While Reliance Capital disputed the same, the auditor sent another letter on May 14, 2019 to reiterate its concerns.

"According to PWC, these actions by the Company have prevented it from performing its duties as statutory auditors and exercising independent judgment in making a report to the members of the Company, and impaired its independence, and hence, it is no longer in a position to complete the audit and instead feels compelled to withdraw from the audit engagement and resign,"

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