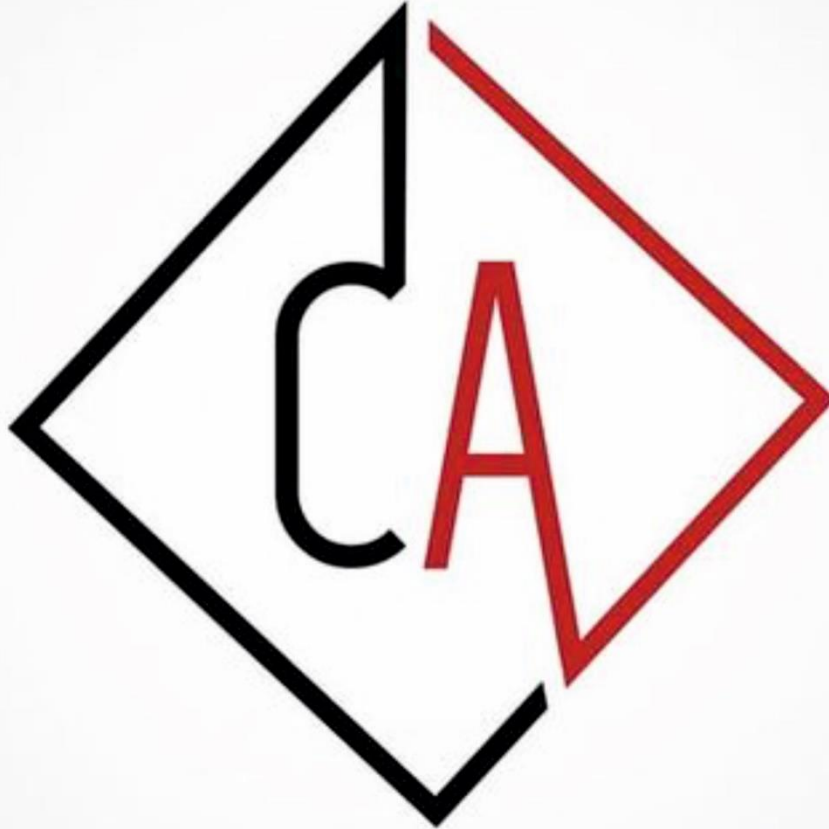


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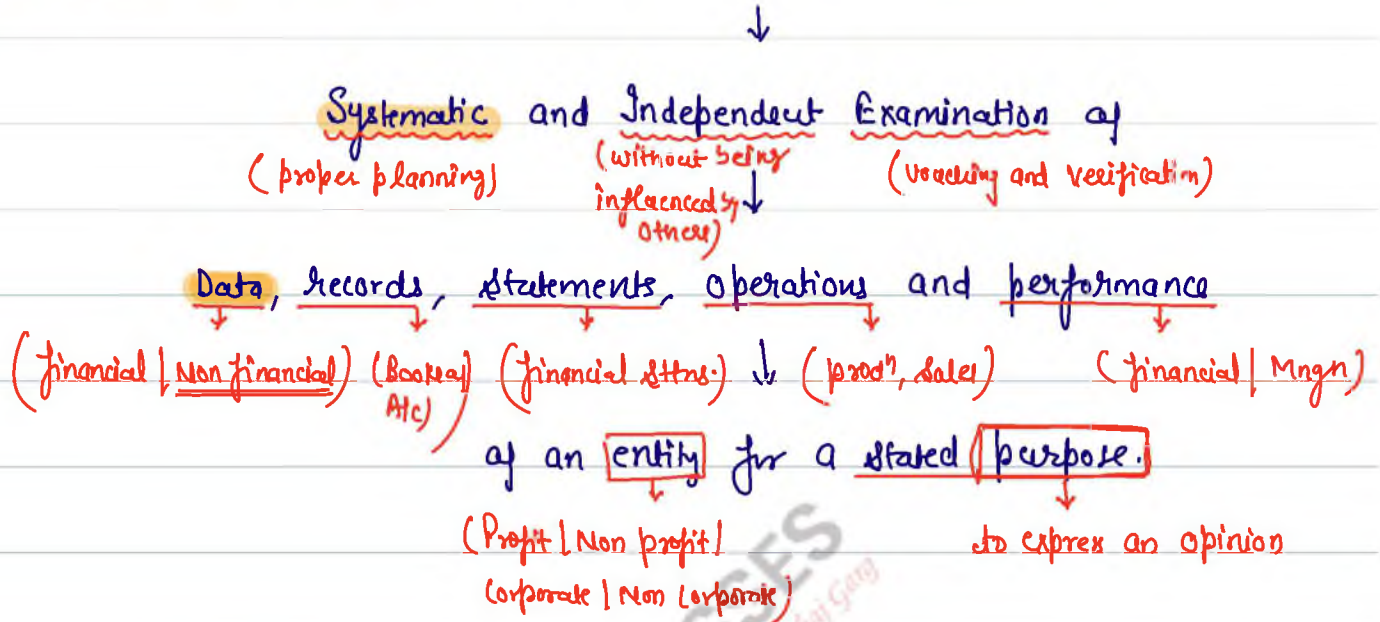
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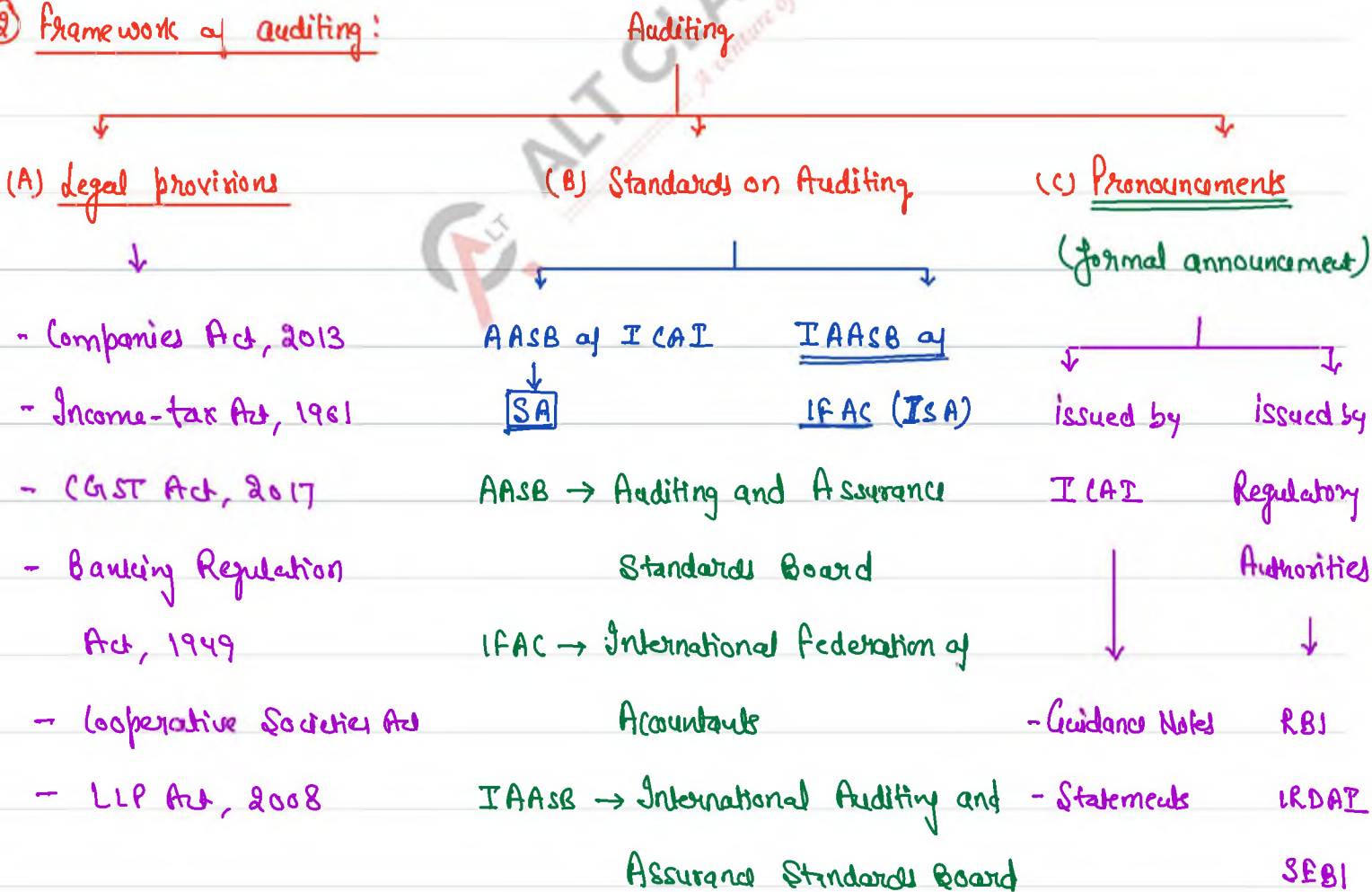


Introductory lecture

① Meaning of Auditing: Auditing may be defined as:



② Framework of auditing:



Note: As per requirements of Sec. 138 of Companies Act, 2013, certain companies are required to appoint internal auditor for internal audit function. Such audit cannot be considered as statutory audit as the objective of this audit is to facilitate / assist the management.

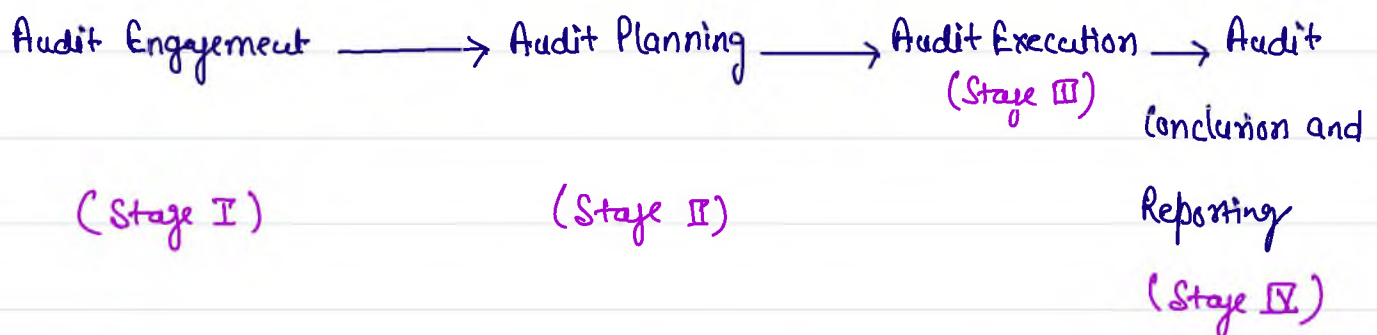
Note: A person, external to the organisation, if appointed by the entity for internal audit purposes, cannot be considered as external auditor.

Example: ABC Ltd. appoints M/s Ram Shyam and Associates (a CA firm) as its internal auditor on a remuneration of ₹ 1,00,000.

(a) whether M/s Ram Shyam and Associates can be considered as external auditor. → No

(b) As appointment was made as per requirements of Sec. 138 of Companies Act, 2013, whether such engagement can be considered as statutory audit. → No

⑤ Audit Process: Activities / stages through which audit is performed.



Stage I: Audit Engagement!

(SA-210)

- (i) offer and acceptance.
- (ii) letter of appointment issued by the Entity.
- (iii) Letter of Engagement issued by the Auditor.

Stage II: Audit Planning:

(i) Understanding of Entity, its environment and Internal Control. (SA 315)

(ii) Establish an Audit Strategy

(iii) Development of overall audit plan (SA-300)

(iv) Draft an audit programme.

Stage III: Audit Execution:

(a) Perform Audit procedures (SA-330)

(b) Collect Audit Evidences through these procedures. (SA-500-599)

(c) Evaluate the audit evidences so collected. (SA 500-599 and 700)

Stage IV: Audit Conclusion and Reporting:

(SA 700 - 799)

(i) Forming an audit opinion on financial statements.

(ii) Draft an audit report

(iii) Issue final audit report.

Introductory Lecture - 2

- Topics covered :
- (i) Meaning of Auditing
 - (ii) Framework of Audit
 - (iii) Types of Audit
 - (iv) Types of Auditor
 - (v) Audit Process

(vi) Types of Engagements:

2 types

↓

(A) Assurance Engagements

↓

An engagement in which a practitioner obtains assurance about the subject matter and express an opinion / conclusion on the basis of assurance obtained.

Examples:

- (i) Audit Engagements
- (ii) Review "

↓

(B) Non-Assurance Engagements

↓

An engagement in which a practitioner reports on facts findings without obtaining any assurance about the subject matter and without expressing any opinion / conclusion thereon.

Example:

Compilation Engagements

(vii) Types of Assurance:

3 types

(A) Absolute Assurance

- It requires 100% satisfaction over the accuracy of subject matter.
- To obtain absolute assurance, is generally not possible due to various limitations.
- Absolute assurance is expected in case of Certification work.

(B) Reasonable Assurance

- High, but not absolute.
- Reasonable assurance is possible with the proper planning and due diligence.
- Reasonable assurance is required in case of Audit Engagements.

(C) Limited Assurance

- Moderate assurance which is to be obtained through the performance of limited procedures.
- Limited assurance is required in case of Review engagements.

(viii) Types of Audit Reports:

2 types

(A) Unmodified Reports

Such reports are issued when auditor concludes that F.S. reflects a true and fair view.

(SA-700)

(B) Modified Reports

I. With unmodified opinion

- (a) With Emphasis of Matter Para (EOM Para)
- (b) With Other Matter Para (OM Para)

(SA-706)

II. With Modified opinion

- (a) Qualified opinion
- (b) Adverse opinion
- (c) Disclaimer of opinion.

(SA-705)

Ex. Financial statements of ABC Ltd. examined by Mr. P. (Auditor). Results of examinations are:

I. Auditor satisfied with the True and fair view of f.s. and concludes that there is nothing special to report in addition. → Unmodified report.

II. Auditor satisfied with the True and fair view of f.s., but at the same time is willing to highlight some matters of f.s. being considered as most significant. → Modified report
↓
Unmodified opinion
↓
EOM Para

III. Auditor is not satisfied with true and fair view of f.s. and is willing to report that. → Adverse Opinion

IV. Auditor is not able to conclude on the true and fair view of f.s. as necessary information required for the purposes of audit, not provided to him. → Disclaimer of opinion

V. Auditor is satisfied with true and fair view of f.s. subject to some matters which are either misstated in f.s. or info. (not provided) thereon. → Qualified Opinion

<u>Particulars-</u> ↓	(a) <u>Immaterial</u>	(b) <u>Material</u> but not <u>pervasive</u>	(c) <u>Material</u> as well as <u>pervasive</u>
<u>No Misstatement</u> identified + Necessary info. provided to auditor →	Unmodified opinion	Unmodified opinion	Unmodified opinion
✓ <u>Misstatements</u> identified by auditor	Unmodified opinion	Qualified opinion	Adverse opinion
✓ <u>Necessary info not</u> provided to auditor	Unmodified opinion	Qualified opinion	Disclaimer of opinion

Wordings of opinion Para:

(i) Unmodified opinion: F.S. reflects a true and fair view; or
F.S. are prepared in all material respects as per
applicable financial reporting framework.

(ii) Adverse opinion: Because of significance of matters stated in Basis for
Adverse section, F.S. do not reflect a true and fair view
~~or~~ F.S. are not prepared in all material respects as per
applicable financial reporting framework.

(iii) Disclaimer of opinion: We are not able to express any opinion on the
financial statements as necessary information required for
the purpose has not been provided for.

(iv) Qualified opinion: Subject to the exceptions as stated in Basis for
Qualified opinion section, F.S. reflect a true and fair
view of F.S. or F.S. are prepared in all material
respects as per applicable FRF.

(ix) Auditor's Objective:

As per SA-200 "Overall Objectives of an Independent Auditor and Conduct of an audit in accordance with standards on Auditing", the Overall objectives of the Independent auditor is:



To obtain reasonable assurance whether financial statements as a whole
(High, but not absolute) (BS | SPL | CFS | SOCE | Notes)

are free from material misstatements, whether caused due to error or fraud
(Significant) (Disturbance) Unintentional. Intentional

so as to express an Opinion whether the F.S. are prepared in all
(through the audit report) material respects as per applicable financial reporting framework (FRF).
(As | Ind AS | S-III | GAAP | IFRS | GFRS)

(x) Financial Reporting Framework (FRF):

Principles | Standards | Guidelines on the basis of which financial statements are prepared.

Various FRFs as used by different entities are

- (a) Indian GAAPs
- (b) AS | Ind-AS
- (c) IAS | IFRS | GFRS
- (d) US GAAP
- (e) Schedule III of Companies Act, 2013

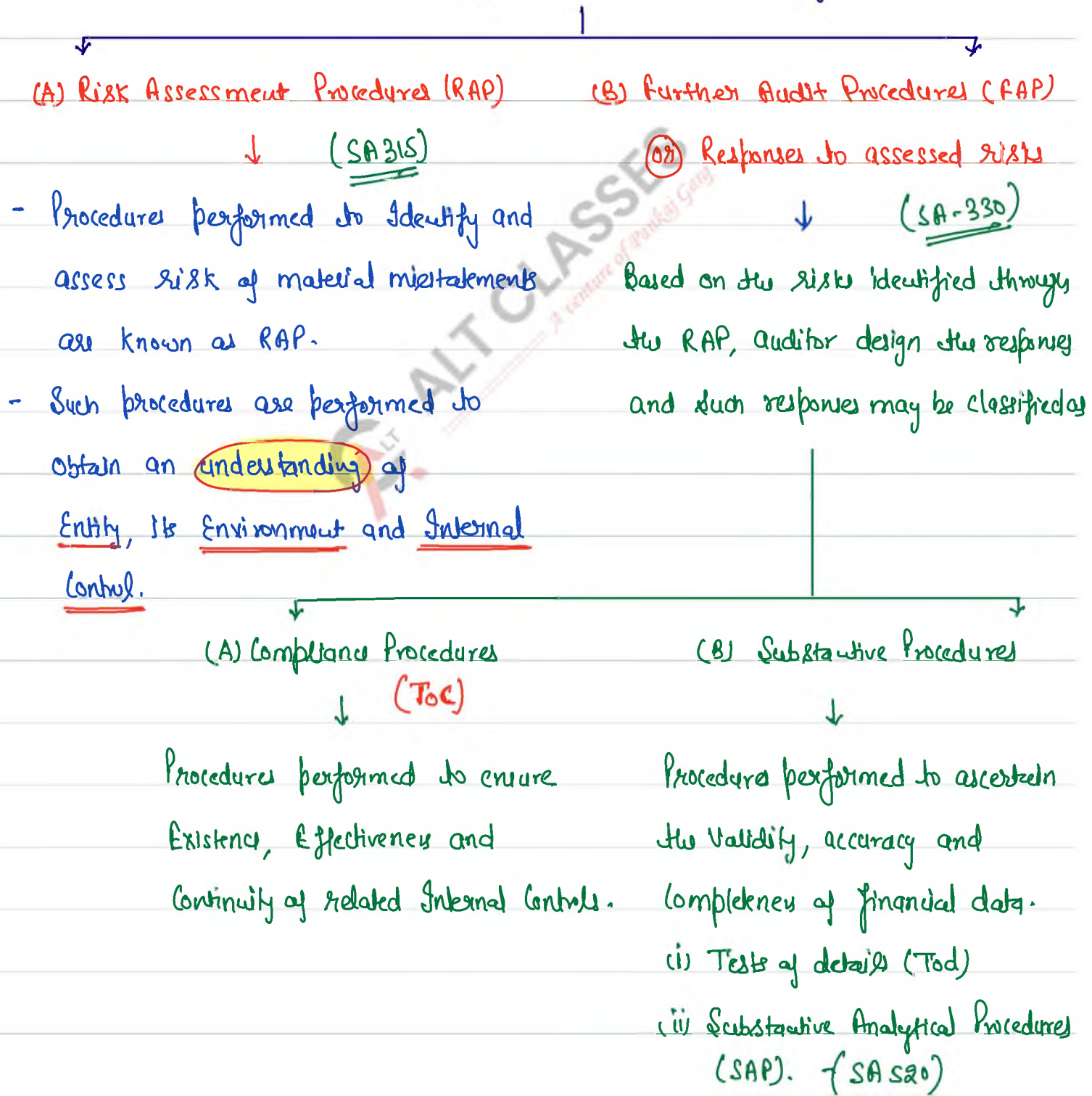
From auditing point of view, FRFs can be classified in 2 categories

(A) Compliance FRFs: Those FRFs, where management is not permitted to take any deviation-

(B) Fair Presentation FRA: Those FRFs, in which management is permitted to take deviation to ensure that financial statements reflects true and fair view.

(Xi) Audit Procedures: Procedures performed by auditor to collect and evaluate the audit evidences.

Procedures may be divided into two categories



Example:

ABC Ltd.



RAP - performed - Identified risk

- related party transactions
- Fraud
- Complex transactions.

Assessment of Risk

↓
High



Further audit procedures to be extended and more focused on the areas where risk appears to be high.

↓
Low



Auditor may design FAP to be comparatively less extensive.



ALT CLASSES
A venture of Gankol Group

Chapter - 1 "Nature, Objective and Scope of Audit"

(Lecture 1)

(i) Meaning, Objective and Scope of Audit:

(a) Meaning of Audit: Audit may be defined as :

"Systematic, Objective and detailed examination of financial information, of any entity,



whether profit making or not
irrespective of its size or legal

form



do as to express an opinion on true and fair view
of state of affairs (financial position of assets and liabilities) and financial results.

Points to be ensured that F.S. not misled anybody: - learned from main book -

(b) Objectives of Audit:

- Objective of audit of financial statements of an entity, is to express an opinion on the financial statements.
- Expression of opinion requires the auditor to issue an audit report, mentioning therein, whether the financial statements are being prepared in all material respects in accordance with financial reporting framework.
- Auditor's opinion helps the stakeholders in determining the true and fair aspects of financial statements.

Note: Auditor's opinion cannot be considered as an assurance as to future viability of the entity or the efficiency or the effectiveness with which the management has conducted the affairs of the entity.

(c) Objectives of Auditor: (SA200): - Already covered in introductory lecture -

(d) Scope of audit: Scope of audit of financial statements is to be determined by auditor, considering the following:

- (i) Terms of the engagement as agreed with client and specified in letter of engagement.
- (ii) Statutory provisions.
- (iii) Pronouncements of the ICAI and Regulatory authorities.

Points to be considered by auditor in determining scope of audit:

- to be learned from book -

(e) Aspects to be covered in an Audit:

- (i) Examination of accounting system and Internal Controls.
- (ii) Review of systems and procedures of business operations -
- (iii) Vouching of transactions occurred during the year.
- (iv) Verification of assets and liabilities.
- (v) Expression of opinion in the form of audit report.
- (vi) Compliances of statutory provisions.
- (vii) Reporting on other matters.

(ii) Types of audit: 2 types:

(a) Statutory audit

(b) Voluntary audit

Already covered in Introductory lec.

(iii) Advantages of audit of financial statements:

- (1) To protect the interest of fund providers.
- (2) To put a moral check on the employees.
- (3) Settlement of taxes with the government.
- (4) Settlement of trade disputes.
- (5) Detection of abnormal wastages in production.
- (6) Ensuring timely and proper maintenance of books of account.
- (7) Appraisal on effectiveness of controls.
- (8) Settlement at the time of admission / retirement of partners in partnership firm.
- (9) Grant of licences, subsidies etc. by the Government.

Homework: ✓ (i) Revision of topics covered - Main Book

- (ii) Learning of topics - Related with Questions covered in book

✓ (iii) Written practice of 2-3 Questions.

Chapter - 1 " Nature, Objective and Scope of Audit "

(Lecture 2)

(iv) Inherent limitations of Audit:

As per SA-200 " Overall objectives of an Independent Auditor and conduct of an audit in accordance with SAs", an audit suffers from certain inherent limitations, which are as follows:

(a) Nature of financial reporting: Financial statements are prepared on the basis of policies which are decided by the management.

Due to use of management judgements, financial statements are always subject to risk of material misstatements.

✓ (b) Nature of Audit Procedures: There are practical and legal limitations on auditor's ability to collect audit evidence, for example:

(i) Management and others do not provide complete information to auditor.

(ii) Audit procedures may be ineffective against certain situations like detection of fraud.

(iii) Audit is not an official investigation into alleged wrongdoings.

✓ (iii) Timeliness of financial reporting and Balance between benefit and cost:

- Delayed availability of financial statements may affect the performance of audit procedures.

- Management expects that audit is to be completed within a reasonable small time with lower cost, due to which auditor may not be able to perform the required procedures and collect sufficient appropriate audit evidences.

Note: Matter of difficulty, time or cost involved is not itself a valid basis to omit an audit procedure for which there is no alternative or to collect audit evidences which are less persuasive in nature.

✓ (iv) Other factors: For example:

- Frauds by senior management.
- Omission of recording of financial transactions.
- Transactions with related parties
- Changes in policies without justification.
- Non-compliance of laws and regulations.

Audit vs. Investigation:

(Noting - H.W.)

(v) Relationship of Auditing with other disciplines:

(a) with Accounting:

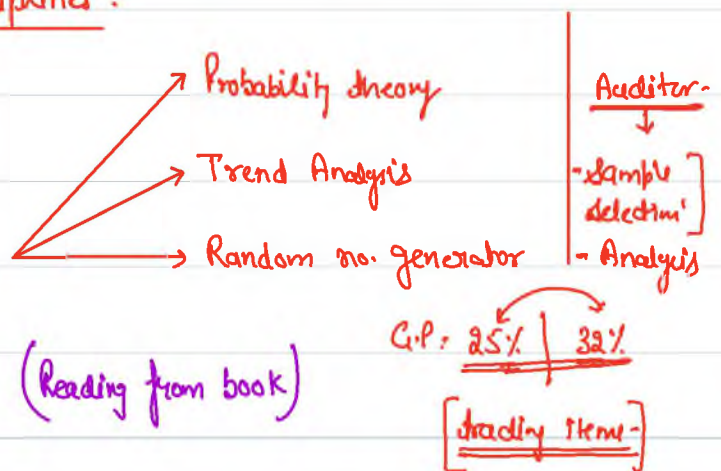
(b) with Law:

(c) with mathematics and statistics:

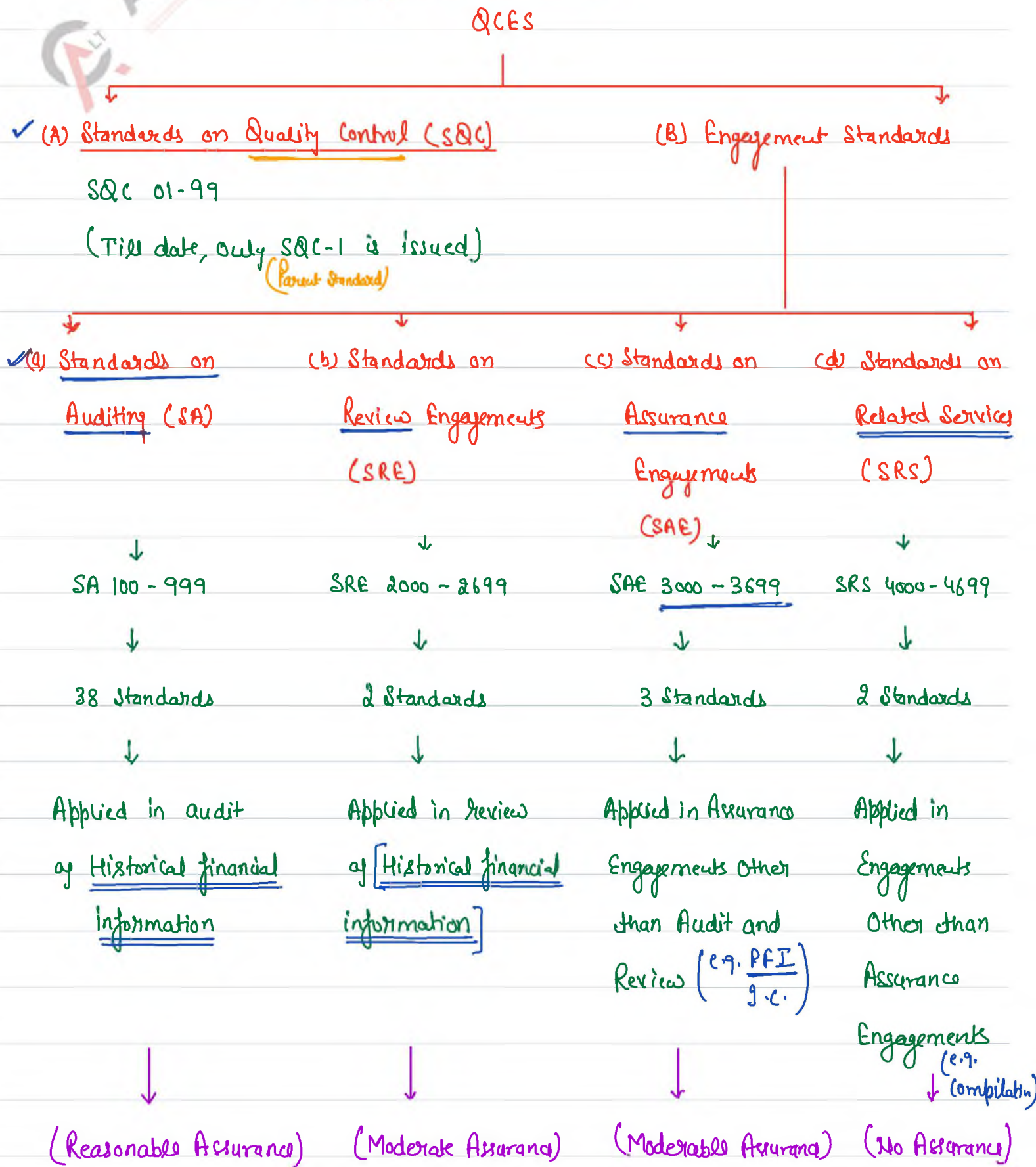
(d) with behavioural science:

(e) with data processing.

(f) with financial management



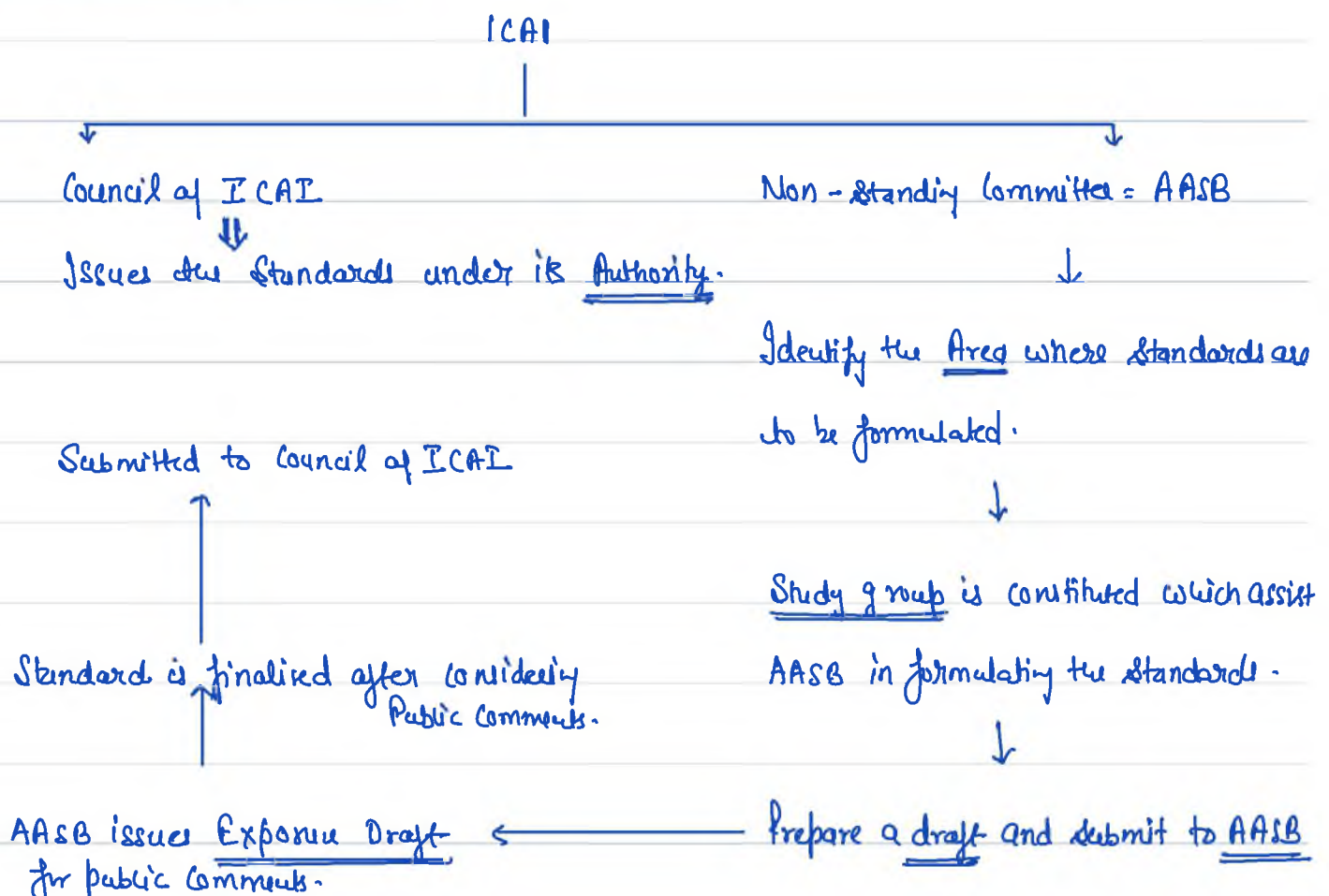
(vi) Quality Control and Engagement Standards:



Classification of SAs : (SA 100-999)

SA 100-199	- Introductory Matters	- No standard issued
200-299	- General Principles and Responsibilities	- <u>200, 210, 220, 230, 240, 250, 260, 265, 299</u>
300-499	- Risk Assessment and Responses	- <u>300, 315, 320, 330, 402, 450</u>
500-599	- Audit Evidences	- <u>500, 501, 505, 510, 520, 530, 540, 550, 560, 570, 580</u>
600-699	- Using Work of others	- <u>600, 610, 620</u>
700-799	- Audit Conclusions and Reporting	- <u>700, 701, 705, 706, 710, 720</u>
800-899	- Specialised Area	- <u>800, 805, 810</u>
900-999	- Miscellaneous	- No standard issued.

Process of Issue of Standards!



Objectives and functions of AASB :

(Noting - H.w.)

Role of International AASB :

(Noting - H.w.)

Chapter - 1 "Nature, Objective and Scope of Audit"

(Lecture 3)

(vii) Statements and Guidance Notes:

BASIS	Guidance Notes	Statements
Meaning and Purpose	Guidance Notes are the documents issued by ICAI, so as to provide guidance to the members on matters on which members may require assistance.	Statements are the documents issued by ICAI, so as to ensure compliance by members on certain matters which appear to be critical.
✓ Compliance	Recommendatory	Mandatory
Duties of Members	To ensure that G/N on auditing, are being followed except when it appears that other procedures can be better applied.	To ensure that statements on auditing matters are being <u>followed</u> while performing audit work.
Examples	<ul style="list-style-type: none">- Guidance Note on CARO, 2020- Guidance Note on audit of <u>CFS</u>- " " " audit of 44 AB of Income-tax Act, 1961.- Guidance Note on audit of Banks	Statement of reporting of s 227(1A) of Companies Act, 1956. [Now covered of s 143(1) of Companies Act, 2013]

(viii) Qualities of Auditor:

(a) Personal Qualities

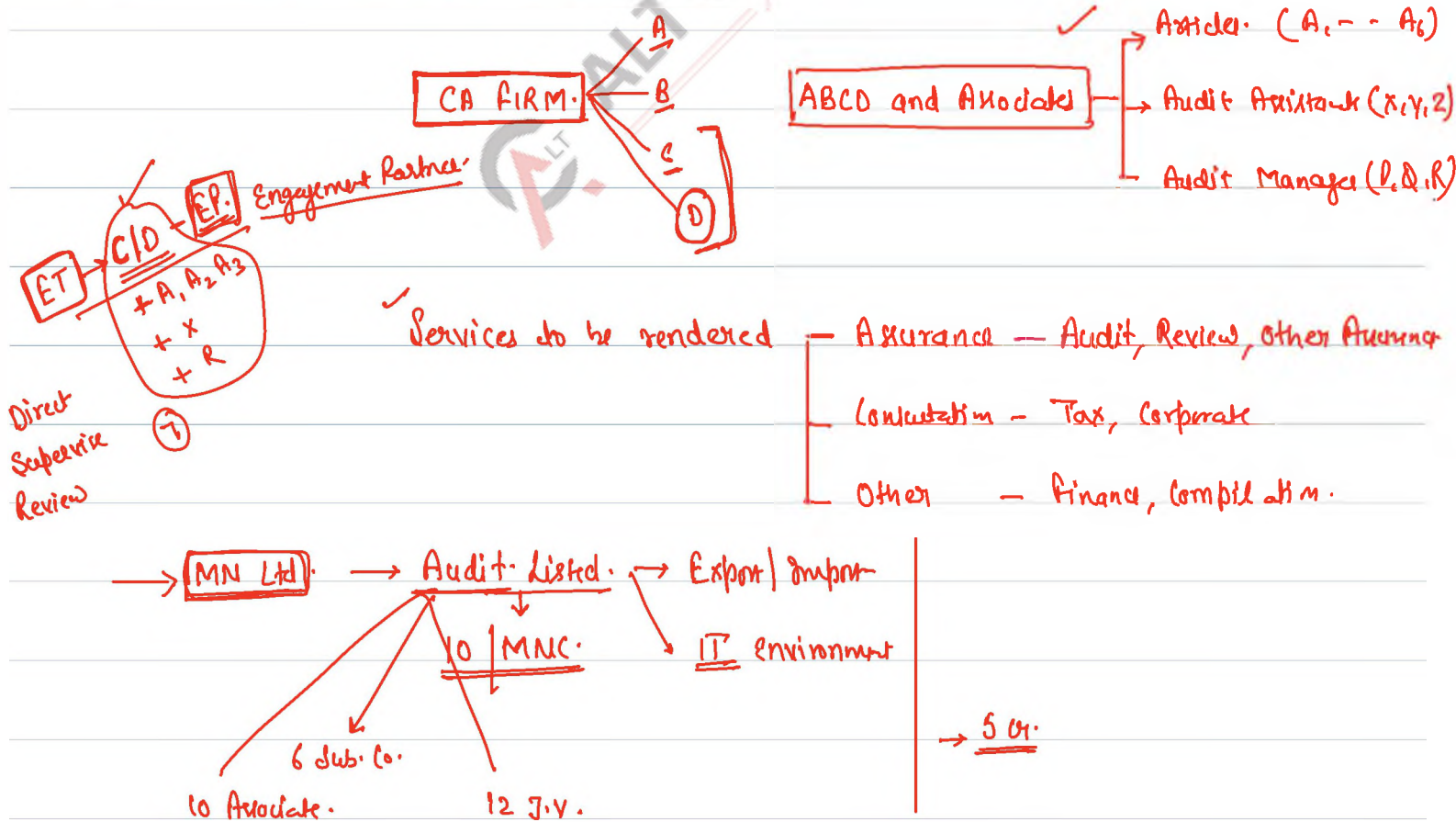
- Tactful approach
- Caution, firmness
- Good temper, patience
- Reliability, confidentiality
- Integrity, objectivity and Independence

(b) Technical Qualities

- updated knowledge of Business laws
- " " " " Corporate "
- " " " " Taxation "
- Knowledge of client's business
- Knowledge of Accounting aspects
- " " " Auditing "

— Details to be learned from book —

(ix) Elements of System of Quality Control:



(a) Objectives of Implementation of Quality Control Procedures:

- (i) To ensure compliance of professional standards, legal and regulatory requirements.
- (ii) To ensure that reports issued in the circumstances are appropriate.

(b) Levels of Quality Control:

- Quality Control procedures are required to be designed and implemented at
 - (i) FIRM Level; and
 - (ii) Engagement Level.
- Design and implementation of Q.C. Procedures at FIRM Level are covered by SQC-1.
- Design and implementation of Q.C. Policies and procedures at engagement level are covered by SA-220.

(c) Aspects of Q.C. Policies and procedures:

(i) FIRM Level: At FIRM level, Q.C. policies and procedures address the following aspects:

- (1) Leadership Responsibilities for Overall quality within the firm
- (2) Compliance of Ethical requirements.
- (3) " " Independence "
- (4) Acceptance and Continuance of Client Relationship.
- ✓ (5) Management of Human Resources
- ✓ (6) Engagement Performance
- ✓ (7) Monitoring.

(ii) Engagement level: At Engagement level, Q.C. Policies and Procedures addresses the following:

- ✓ (1) Leadership Responsibilities for Quality of an Audit
- ✓ (2) Compliance of Ethical requirements
- ✓ (3) " " Independence requirements
- ✓ (4) Acceptance and continuance of client relationship
- ✓ (5) Direction, Supervision and Review.

- Details to be covered from the book -

Ethical Requirements: Ethical requirements as comprised in code of Ethics issued by I AASB, are:

(a) Integrity: Principle of Integrity requires the auditor to be straight forward and honest. It implies fair dealings and transparency. Auditor should not associate with any information which may contain any false statement or misleading information or omit any material fact.

(b) Objectivity: Principle of objectivity requires that the professional judgement of auditor should not be compromised due to any biasness, conflict of interest etc.

(c) Professional Competence and due Care: Auditor must be competent enough to perform the audit in an effective and efficient manner. Due care is to be exercised while performing the audit.

(d) Confidentiality: Auditor should not disclose the information acquired during the course of audit with others unless required by law or

regulation.

(E) Professional behaviour: Auditor must update himself with all the applicable laws and regulations and should not disregard the profession.



Chapter - 1 "Nature, Objective and scope of Audit"

(Lecture - 4)

(18) Elements of system of Quality Control:

(A) At Engagement Level

- (1) Leadership Responsibilities
- (2) Ethical Requirements
- (3) Independence
- (4) Client acceptance / Continuance
- (5) Direction, Supervision and Review

(B) At FIRM LEVEL

- (1) Human Resources
- (2) Engagement Performance
- (3) Monitoring

(X) Independence:

(A) Meaning: Independence is a state of mind and personal character.

As per Guidance Note on "Independence of Auditors", the term "Independence" implies that



Judgement of a person should not be subordinate to the directions of the person who might have engaged him.

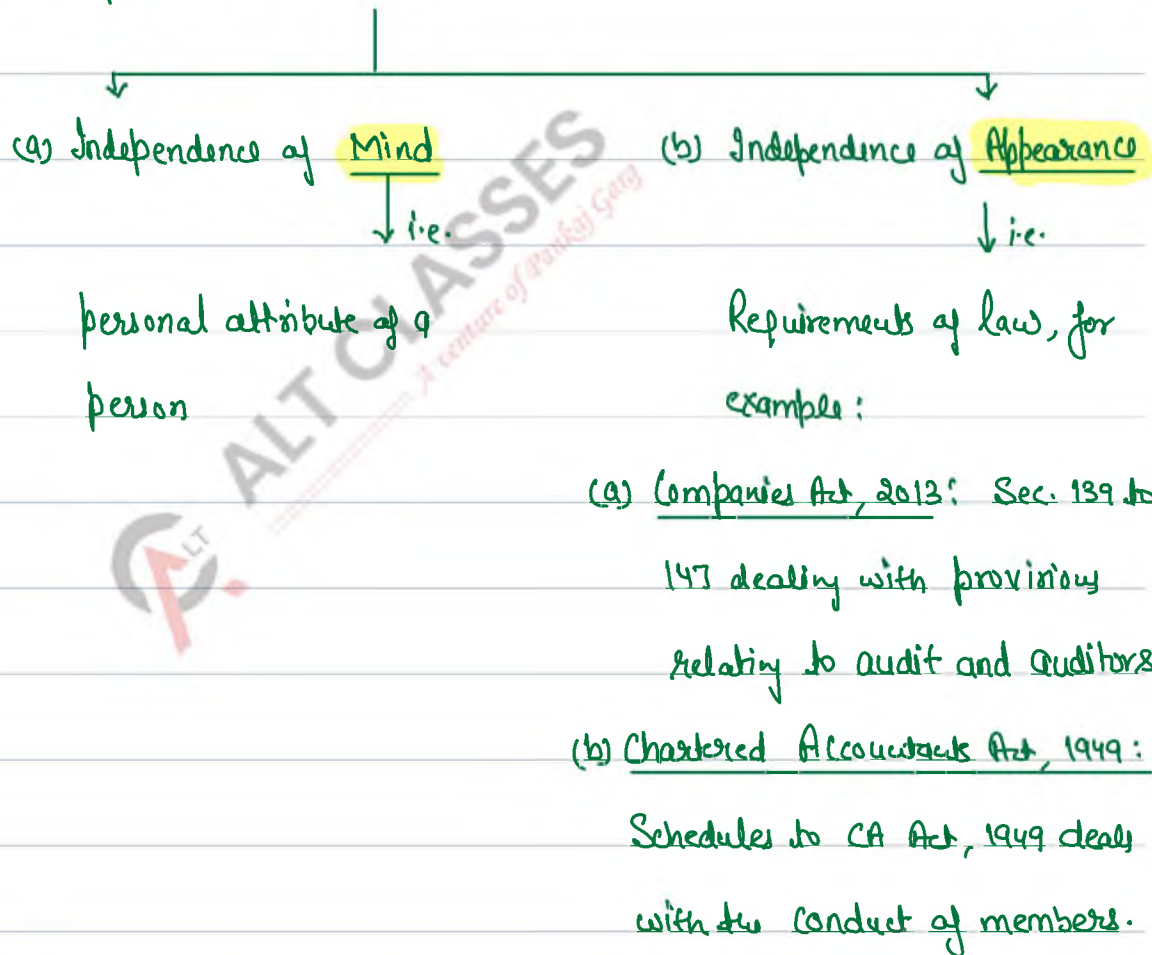
It means that auditor should perform his work in accordance with the manner as prescribed by:

- (a) Statutory provisions;
- (b) Pronouncements of ICAI; and
- (c) Regulatory bodies like RBI, NFRA, SEBI, etc.

(b) visibility: Independence of auditors must not exist in fact, but should also appear to exist to all reasonable persons like shareholders, Government, Regulatory bodies, lenders, etc.

As per SA-200 "Overall Objectives of the Independent Auditor and Conduct of an Audit in Accordance with SAs", the auditor shall comply with independence requirements.

Independence implies



Examples: Mr. X is appointed as auditor of ABC Ltd.

	<u>Mind</u>	<u>Appearance</u>
Situation - I Mr. X is a <u>shareholder</u> of ABC Ltd. and works under the direction of Managing Director of ABC Ltd.	X (as work under the directions of MD)	X (being a share holder)

Situation - II Mr. X, ^{is a} relative of MD and works ✓ X
 as per his own professional (as judgements are (being a relative
Judgement, not subordinated not subordinated of MD)
 by others to others)

Situation - III Mr. X, not related with any X ✓
 officer of ABC Ltd, performs (as works under (as does not
 his work as per directions of directions of BoD) having any
 Board of Directors. relationship)

Situation - IV Mr. X, not related with any ✓ ✓
 officer or with company in (as judgements (as does not have
 any manner and judgements are not any relationship)
 are not subordinate to subordinated)
 directions of others

Threats to Independence: Code of Ethics for professional accountants as prepared by IFAC identifies five types of threats

(a) Self-Interest threat: It may occur as a result of financial or other interest of a professional accountant or of a relative.
For Ex: - Direct or Indirect financial interest in a client.
 . Under dependence on client's fees.

(b) Self-Review threat: It may occur when a previous judgement to be re-evaluated by professional accountant responsible for that judgement.

for Ex: When auditor renders book-keeping and accounting services to same client.

(c) Familiarity threat: It may occur when, because of a relationship, a professional accountant becomes too sympathetic to the interests of others.

for Ex: Long association between specific auditor and their specific client.

(d) Advocacy threats: It may occur when a professional accountant promotes a position or opinion to the point that subsequent objectivity may be compromised.

for Ex: Auditor dealing with shares and securities of the client.

(e) Intimidation threat: It may occur when a professional accountant may be deterred from acting objectively by threats, actual or perceived.

Safeguards to Independence:

(Noting - H.W.)

Chapter - 1 " Nature, Objective and scope of Audit "

(Lecture - 5)

(xi) SA - 200 " Overall objectives of the Independent Auditor and Conduct of an Audit in accordance with the Standards on Auditing "

(1) Overall Objectives of the Independent Auditor:

- Refer Point no. (ix) of Introductory lecture -

(2) Requirements of SA-200: To achieve Overall Objectives as stated in

SA-200, Auditor is required to ensure

Compliance of following five requirements:

(A) Compliance of Ethical requirements:

Ethical requirements comprises of

(i) Code of Ethics

(ii) Independence

Comprises of five fundamental principles:

(a) Integrity

(b) Objectivity

(c) Professional Competence and due Care

(d) Confidentiality

(e) Professional behaviour

Independence comprises of:

(a) Independence of Mind

and

(b) Independence of

Appearance

(B) Professional Skepticism: An attitude of questioning mind, being alert to conditions that may indicate possible misstatements due to error or fraud and includes

Critical Assessment of audit Evidences.

- Auditor should plan and perform an audit with professional skepticism.
- Professional skepticism reduces risk of:
 - (a) Overlooking unusual circumstances.
 - (b) Over generalising.
 - (c) Using inappropriate assumptions in determining nature, timing and extent of audit procedures.

(C) Professional Judgement:

- Application of relevant training, knowledge and experience in the field of accountancy, auditing and ethical standards, in making informed decisions that are appropriate in the circumstances.
- Auditor shall exercise professional judgement in planning and performing an audit.
- Professional judgement is to be exercised throughout the audit and to be appropriately documented.
- Examples, where professional judgement to be used:
 - (a) Determining materiality and audit risk
 - (b) Determining nature, timing and extent of audit procedures.

(D) Sufficient appropriate audit Evidence and audit risk:

- To obtain reasonable assurance, auditor is required to obtain sufficient and appropriate audit evidence so as to reduce audit risk to an appropriate low level.
- 'Sufficiency' refers to quantity of audit evidences and 'Appropriateness' refers to 'quality' of audit evidences.
- "Audit Risk" - Risk that an auditor may express an inappropriate audit opinion when there exists a material misstatement.

Audit risk is a function of

Risk of Material Misstatement (RMM)

Detection Risk

Inherent Risk

Control Risk

Susceptibility of an account balance, transaction or disclosure to misstatement, when related Internal Controls do not exist.

(Non Existent Internal Control)

Susceptibility of an account balance, transaction or disclosure to misstatement, when related Internal Controls fails to prevent, detect and correct mis-

statements on a timely basis.

(Ineffective Internal Control)

Risk that procedures performed during the audit, will not be appropriate, so as to identify/detect misstatements.

(e) Conduct of an Audit in accordance with Standards on Auditing:

- Auditor shall comply with all standards that are relevant to audit.

For Ex: SA-510 "Initial Audit Engagements - opening balances"

is not applicable in case of recurring audit.

SA-299 "Total audit of financial statements" is not applicable in case sole auditor is appointed.

- Auditor must have an understanding of entire text of SA.
- Auditor shall comply with relevant requirements of a standard, if entire standard is not relevant.

For Ex: SA 210. "Agreeing the terms of Audit Engagement"

prescribes the requirements for initial audit engagement as well as for recurring audit.

In case of Initial Audit Engagement, requirements w.r.t. recurring audit will not be applicable and vice versa.

- To achieve overall objective, objectives stated in Individual standards are to be achieved.
- If Auditor fails to achieve overall objectives, auditor needs to modify the opinion, or withdraw from the engagement, as appropriate.

Chapter - 1 " Nature, Objective and Scope of Audit "

(Lecture 6)

(xii) Agreeing the terms of audit engagement (SA 210):

(A) Objectives of SA 210: To accept or continue an audit engagement when the basis upon which audit is to be performed has been agreed with the client through:

(a) establishing the existence of pre-conditions ^{*} for an audit; and

(b) common understanding of the terms between the client and the auditor.

Imp:

Pre-conditions for an audit: (a) Acceptable FRF

(b) Acknowledgement by management of their responsibilities as to:

(i) Preparation of financial statements as per applicable FRF.

(ii) Designing, implementation and maintenance of necessary internal controls.

(iii) Providing the auditor with:

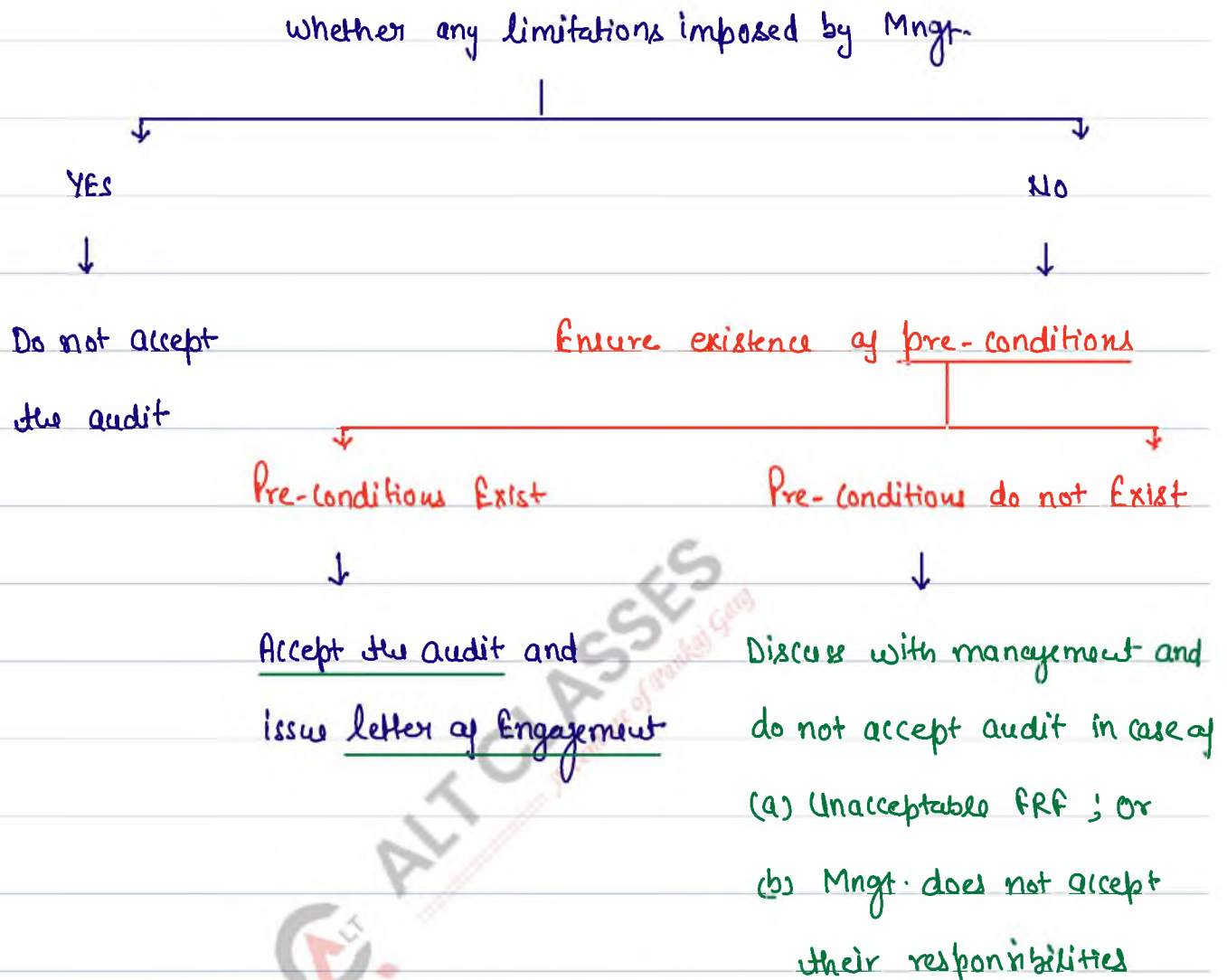
(a) Unrestricted access to the information required for purpose of audit.

(b) Unrestricted access to the persons within the entity.

(c) Additional information required for the purpose of audit.

(B) Requirements of SA 210:

(i) At beginning of audit in case of Initial audit Engagement:



Form and Content of Audit Engagement letter:

Audit Engagement letter shall be in written form and include:

- (i) Objective and scope of audit of financial statements
- (ii) Responsibilities of the auditor
- (iii) " " " Management
- (iv) Identification of two applicable FRF for preparation of financial statements.
- (v) Reference to expected form and content of audit report.

(ii) At beginning of audit in case of recurring audit:

Determine requirement as to (a) Revision of terms of audit Engagement.

or

(b) Reminding the existing terms.



Circumstances in which there exist requirement of issue of new letter of engagement in case of recurring audit: (Noting from H.W.)

(iii) During the course of audit, when mngrt. request for changes in terms of audit Engagement:

Management requested for changes in terms

↓

Auditor is required to determine its effect on level of assurance and Justification for change

↓
Auditor satisfied with the request of Management.

↓
Auditor not satisfied with the Management request

↓
Auditor should accept the request and record new terms / revised terms in letter of engagement

↓
Do not accept the change

↓
Management is not allowing the Auditor to continue with the existing terms

↓
Withdraw from the engagement and take appropriate action.

Circumstances in which management may request for change in terms of Audit Engagement: (Noting - H.W.)

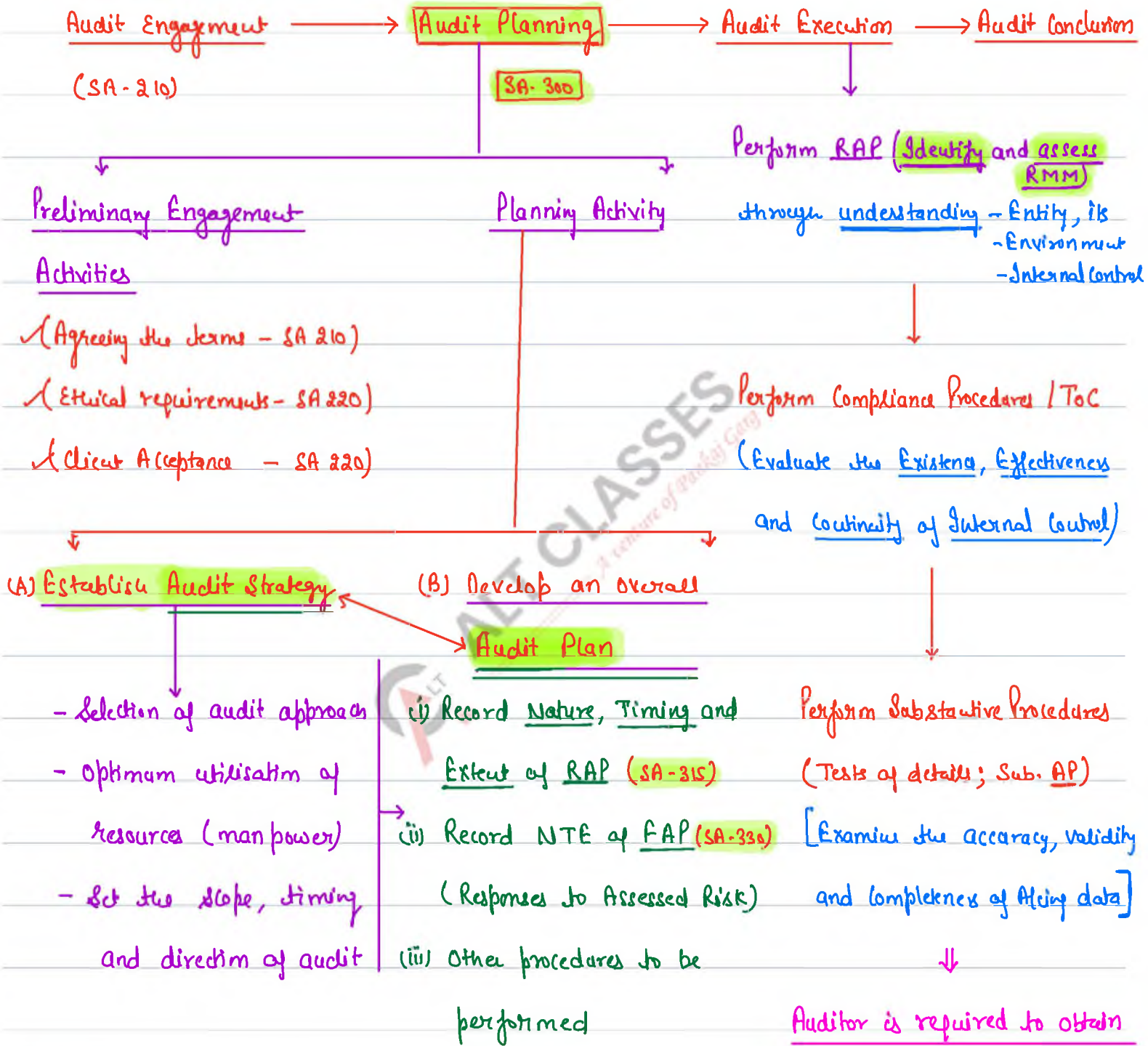
Prepⁿ strategy: i) Revision of Entire chapter

ii) Practice of Correct/Incorrect and MCQ

Chapter - 2 " Audit Strategy, Planning and Programme "

(Lecture - 1)

① Overview:



Note: With the performance of procedures and audit

evidence collected by the auditor, a need may

arise for change in audit strategy and audit plan.

Note: Documentation of audit strategy and audit

plan is known as **Audit Programme.**

sufficient appropriate audit evidence

↓

Draw conclusion on financial

statements and Express an

opinion.

② Audit Strategy:

(i) Meaning: Selection of audit approach so as to obtain necessary assurance at lower cost, with optimum utilisation of available resources



so as to set out the scope, timing and direction of audit.

(ii) Benefits of audit strategy:

- (a) Employment of Qualitative Resources
- (b) Allocation of appropriate Quantity of Resources -
- (c) Timing of deployment of resources -
- (d) Overall management of resources -

(iii) Factors affecting establishment of audit strategy:

SA-300 "Planning an audit of financial statements" requires the auditor to consider the below mentioned factors while establishing audit strategy:

- (a) Characteristics of the Engagement.
- (b) Reporting Objectives of the Engagement.
- (c) Factors that are significant in directing the Engagement team efforts.
- (d) Results of preliminary engagement activities
- (e) Nature, timing and extent of necessary resources required to perform the audit.

✓ Note: Considerations w.r.t. each factor all to be covered from book.

(iv) Relationship between audit strategy and audit plan:

- Audit strategy establishes the scope, timing and direction of the audit.
- Audit planning involves development of overall audit plan that covers the N, T, E of audit procedure.
- Audit strategy and audit plan are interrelated with each other, as changes in one may require changes in another.
- Generally, audit strategy is prepared before audit planning and audit plans contain more detail than the audit strategy.
- Audit strategy provides a basis for development of overall audit plan.

③ Audit Planning:

(a) Meaning of audit planning:

- SA-300 "Planning an audit of financial statements" deals with the auditor's responsibilities to plan an audit of financial statements.
- Audit planning may be defined as "developing an overall audit plan for the expected scope and conduct of audit", which comprises of Nature, Timing and Extent of audit procedures to be performed.
- Audit plan, besides other things, should also cover the following:
 - (a) Acquiring knowledge of client's business.
 - (b) Establish scope of reliance to be put on internal control.
 - (c) Direction, supervision and review of work performed by AT members.
 - (d) Coordination of work performed by AT members.

(b) Benefits of Audit Planning: (Noting - 11.00)

v. imp -

(c) Knowledge of Client's business:

- Audit plans, besides other things, includes the acquiring knowledge of client's business. While preparing plans, auditor must have knowledge about client's business. In the absence of this knowledge, a proper plan cannot be made.

- SA-315 "Identifying and Assessing Risk of Material Misstatement through understanding the Entity and its Environment", auditor should obtain understanding of the following:

(a) Relevant Industry, Regulatory and other factors including applicable financial reporting framework.

(b) Nature of Entity, including - its operations

- Ownership and Governing structure

- Types of investments

- Capital structure etc.

(c) Selection and application of accounting policies, including changes in accounting policies along with reasons.

(d) Objectives and strategies of client

(e) Business risks of client

(f) Measurement and review of financial performance.

Examples of above-mentioned topics: - to be read from book -

Knowledge of client's business.

✓ Strategy

STD of credit

Plan.

NTE of A.P.

performance

(A.P.) - RAP

Initial stage

RAP - limited Extent -

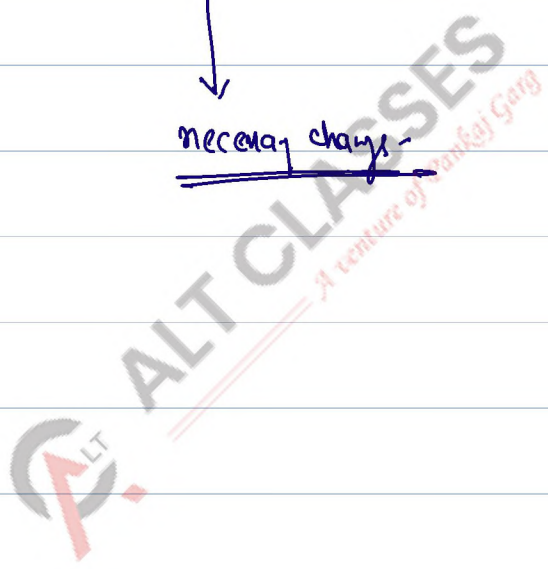
Understanding

St

Plan.

✓ (detailed understanding)

necessary changes



Chapter - 2 " Audit Strategy, Planning and Programme "

(Lecture 2)

③ Audit Planning:

(a) Meaning of audit planning

(b) Benefits " " "

(c) Knowledge of client's business

(d) Planning the direction, supervision and review of work of ET Members:

- As per SA-300 "Planning an audit of financial statements", auditor shall plan the nature, timing and extent of direction and supervision of work to be performed by ET members.
- Planning of NTE of direction, supervision and review depends upon following factors:
 - (a) Size and complexity of client's business.
 - (b) Areas of audit
 - (c) Risk of material misstatements
 - (d) Capability and competency of ET Members.

(e) Planning - a continuous process:

- Planning is not a discrete phase of audit, rather a continuous process which starts from end of prior period audit and continues till completion of current period engagement.

- Planning involves consideration of timing of certain activities and audit procedures which are to be performed even prior to execution of

Further audit procedures, for example:

- (a) Performing RAP to obtain understanding of entity and its environment
- (b) Determination of Materiality;
- (c) Decisions as to involvement of experts, etc.

Note: Based on this discussion, it can be concluded that planning is a continuous activity which requires changes with changes in circumstances.

(f) Changes in Planning:

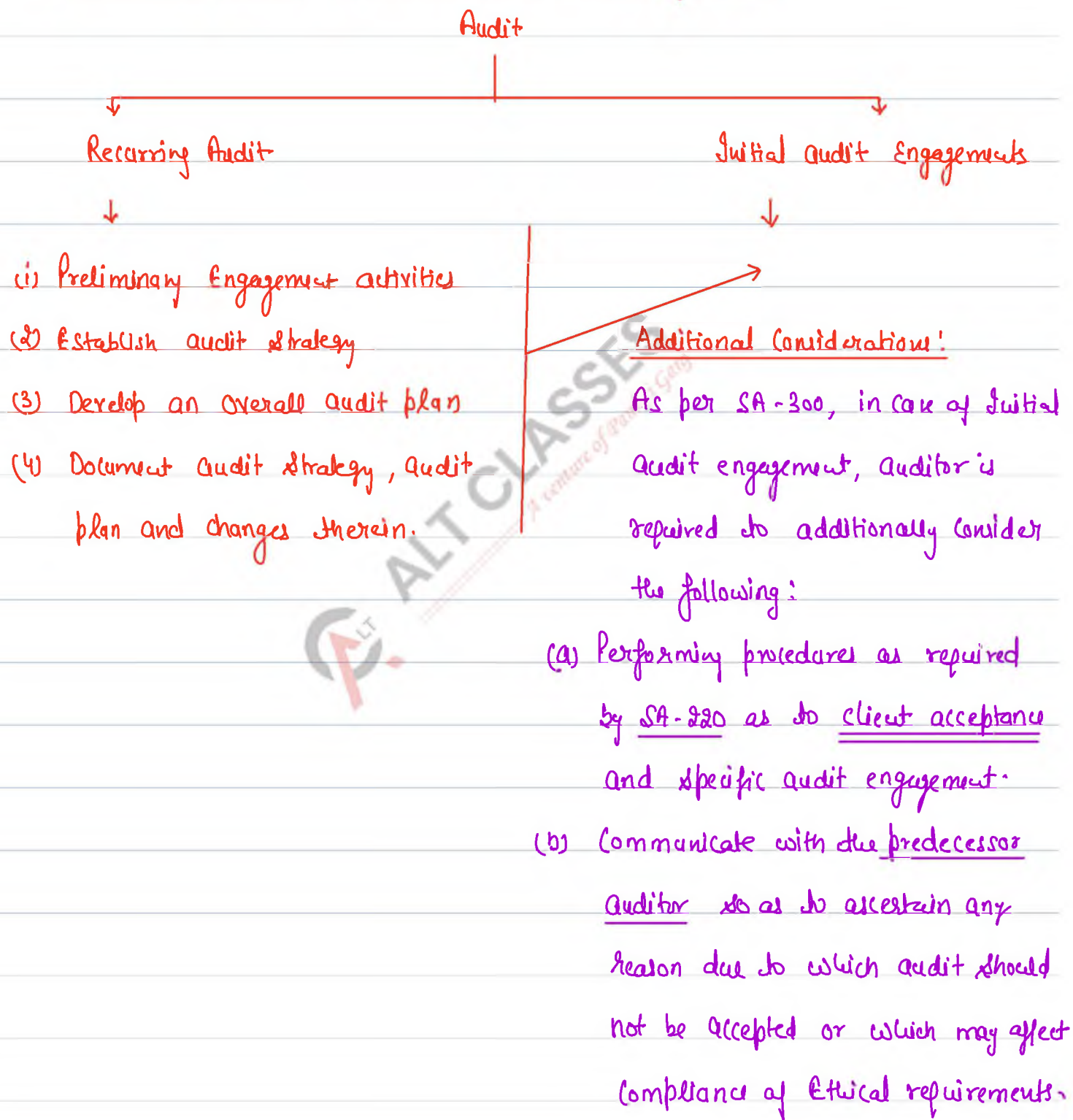
- Planning is a continuous process and auditor may be required to update its strategy and audit plan during the course of audit.
- Changes in strategy and plans may be required, based on new developments, like
 - Changes in circumstances
 - Changes in reporting requirements
 - Unexpected events
 - Collection of audit evidences that provide the auditor, information which was not available at initial stages.
- Auditor should document the following:
 - (a) Audit strategy
 - (b) Audit plan
 - (c) Changes in audit strategy and audit plan, along with reasons for changes.

(g) Documentation of audit plan:

Noting - H.W.

(h) Factors affecting development of audit plan:

(i) Additional consideration in Initial Audit Engagements:



④ Audit Programme!

- Audit Programme is a detailed plan of work, prepared by the Auditor, so as to ensure that audit is conducted in an effective and efficient manner.
- Audit programme, besides other things, provide the details of Nature, timing and extent of audit procedures planned to be performed.
- Audit programme also provides various methods and means by which audit procedures are performed

<u>Ex:</u>	<u>Audit Procedures</u>	→	<u>Methods and Means (Techniques)</u>
	(i) <u>RAP</u> (<u>Understanding of Entity, its Environment and I.C.</u>)		<u>Inquiry, Inspection, A.P.</u>
	(ii) <u>Tests of Control</u> (<u>Evaluate the I.C.</u>)		Re-performance
	(iii) <u>Tests of details</u> (<u>Examine the F.S.</u>)		- External Confirmation - Written Representation - Re-calculation - Observation

- while preparing audit programme, auditor should consider the following:

- (a) Audit programme should be drawn considering the scope and objectives of audit.
- (b) Audit programme must provide the procedures and techniques to be applied in audit.
- (c) Audit programme must ensure the coverage of Coordination aspects of work of ET members, other auditors and Experts.
- (d) Audit programme must specify the Audit Objective for each procedure to be carried out.

(e) Audit programme must satisfy the audit evidences to be collected for each financial item.

Note: Details of separate topics - to be covered/learned from book.



Chapter - 2 "Audit Strategy, Planning and Programme"

(Lecture No.3)

⑤ Materiality in planning and performing an audit (SA-320):

(i) Concept of Materiality:

- SA-320 "Materiality in planning and performing an audit" deals with the concept of materiality in planning and performing an audit.
- As per SA-320, a discussion present in the FRF provides a reference to the auditor to determine the materiality.

For Ex.: Schedule III of the Companies Act, 2013 requires separate disclosure of certain incomes and expenses, like:

- (a) Revenue items require separate disclosure, if the amount exceeds ₹ 1 lakh or 1% of Revenue from Operations, whichever is higher.
- (b) Separate disclosure of shareholding required in case any shareholder holds >5% of share Capital.

- However, in the absence of any such discussion in the FRF, following principles may be applied:

- (a) Any information which may affect the economic decisions of users of f.s. are considered material.
- (b) Materiality depends upon the facts and circumstances, nature and size of transactions, etc.
- (c) Judgement of materiality may differ from person to person and it is a subject of professional judgement.
- (d) Determination of materiality is to be considered on the basis of requirements of Common Users.

(ii) Auditor's assumptions about users of F.S. while determining materiality:

- (a) Users have reasonable knowledge of business, economic activities and accounting principles.
- (b) Users understand that financial statements are prepared, presented and audited to levels of materiality.
- (c) Users recognise the uncertainties inherent in the measurement of the estimates.
- (d) Users make reasonable economic decisions on the basis of information in the financial statements.

(iii) Auditor's considerations as to materiality:

- Concept of materiality to be applied by auditor while planning and performing an audit of F.S.
- While planning, auditor is required to consider the materiality for:
 - (a) determining NTE of RAP.
 - (b) Identifying and assessing RMM.
 - (c) determining NTE of FAP.
- While performing the audit, auditor is required to consider the materiality for:
 - (a) determining sufficiency and appropriateness of audit evidences.
 - (b) evaluation of audit evidences.
 - (c) drawing conclusions on the basis of audit evidences.

(iv) Concept of Performance materiality:

Performance materiality may be defined as:

" Amount, set by the auditor, at less than materiality for the financial statements, so as to reduce the risk that



aggregate of uncorrected and unidentified misstatements may exceed the materiality for the financial statements as a whole.

For Example:

- While planning the audit, auditor fix the materiality for the revenue items as ₹ 1 lakh.
- During vouching, auditor observed that some misstatements exist in the selected samples, in the range of ₹ 5,000 - ₹ 40,000.
- Auditor is of the view that, if ignored, aggregate of such uncorrected and undetected misstatements may exceed ₹ 1 lakh.
- Hence, a need arise to determine performance materiality which may be fixed at any amount on judgement of auditor, say, for example: ₹ 10,000.

(v) Determining materiality and Performance materiality:

(a) Auditor is required to determine the following:

- (i) Materiality for the financial statements as a whole.
- (ii) If required, on the basis of specific circumstances, materiality for the individual transactions, account balances and disclosures.
- (iii) Performance materiality, if circumstances required.

(b) Revision of materiality as audit progresses:

If auditor may become aware of any information during the audit that require the auditor to determine / revise the materiality that is different from the materiality initially determined, auditor may revise the materiality as below:

- (a) Revise the materiality for the financial statements as a whole;
- (b) Revise the materiality for individual transaction, account balances and disclosures.
- (c) Revise the performance materiality.

Note: Auditor shall also determine whether the Nature, Timing and Extent of Further Audit Procedures, remain appropriate or requires any change.

(vi) Documentation:

Auditor is required to document the following:

- ✓ (a) Materiality for the financial statements as a whole.
- ✓ (b) " " " Individual transaction, account balances and disclosure.
- ✓ (c) Performance Materiality
- ✓ (d) Circumstances requiring revision of materiality.
- ✓ (e) Revision of materiality levels.

Imp.

(vii) Benchmarks of Materiality:

- In General, Materiality may be determined as %age of Profit before tax;
Total Revenue;
Total Expenses;
Total Equity;
Gross Profit;
Net Asset Value, etc.
- Most Commonly used benchmark in case of profit oriented entities is profit before tax. In case of other entities, other benchmarks may be applied.

Factors affecting selection of benchmark:

- (1) Elements of the financial information
- (2) Items on which the attention of the users of financial statements tends to be focused
- (3) Nature of the Entity.
- (4) Industry and economic environment in which entity operates.
- (5) Entity Ownership structure and the way in which it is financed.
- (6) Relative volatility of the benchmark.

(viii) Audit Planning and Materiality

(ix) Materiality and Audit Risk.

(Noting - H.W.)

Chapter - 3 "Audit documentation and Audit Evidence"

(Lecture - 1)

(i) Audit documentation:

(i) Meaning: As per SA 230 "Audit Documentation", the term audit documentation is defined as to the record of:

- (a) Audit Procedures performed
- (b) Audit Evidences collected; and
- (c) Audit Conclusion reached.

Example -

Audit Plan / Audit Programme

Ext. Confirmation / WR / documents

Audit report

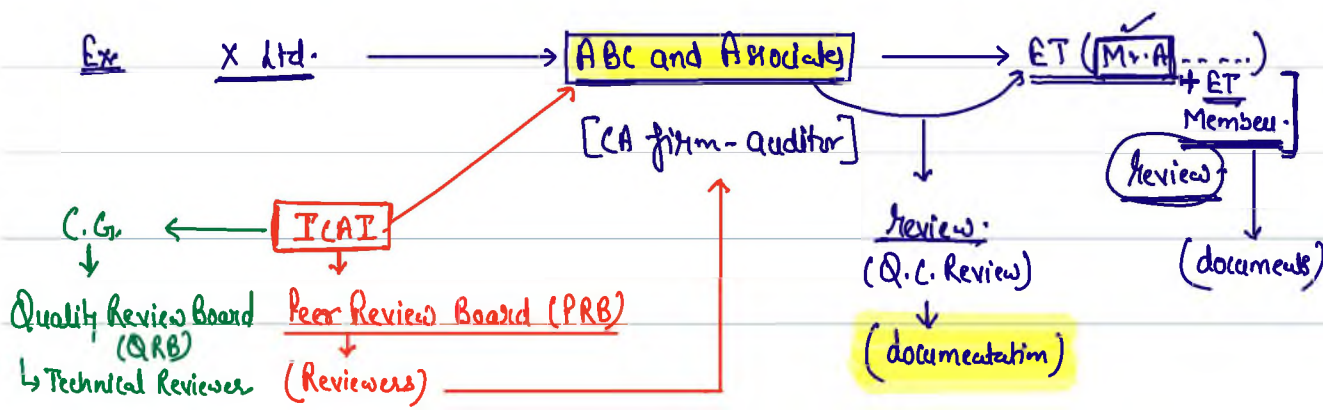
Audit documentation is commonly known as "Audit Working Papers"

(ii) Objectives of the auditor / Nature of audit documentation:

Auditor is required to prepare audit documentation that provides:

- (a) sufficient and appropriate record of the basis of audit report;
- (b) evidence that the overall objectives of the audit are achieved; and
- (c) evidence that audit was planned and performed in accordance with the standards on auditing and applicable legal and regulatory requirements.

(iii) Purposes of audit documentation: [Noting - Self]



(iv) Form, Content and Extent of Audit documentation:

The auditor shall prepare audit documentation that is sufficient to enable an "experienced auditor" to understand:

- (a) NTE of audit procedures;
- (b) Results of audit procedures performed and audit evidences collected;
- (c) Significant matters arising during the audit and conclusions reached thereon; and significant professional judgements made in reaching those conclusions.

Factors affecting form, content and extent of audit documentation:

- (i) Size and complexity of client's business
- (ii) Nature of audit procedures to be performed
- (iii) Identified RMM
- (iv) Significance of audit evidences obtained
- (v) Nature and extent of deviation identified
- (vi) Audit methodology and tools/techniques used.
- (vii) Need to document a conclusion

- Documentation of NTE of audit procedures
- " " " significant matters identified during the audit and related significant judgements
- Documentation of matters arising after the audit report

(v) Completion Memorandum:

- Completion memorandum is the audit documentation summary that describes:

(a) Significant matters identified during the audit; and

(b) how such matters are addressed.

eg. going concern.

- Completion memorandum facilitate effective and efficient reviews and inspections of audit documentation.

- Completion memorandum helps the auditor in identifying whether any individual objective of any SA is not met or auditor is unable to meet that objectives which prevents the auditor to achieve the overall objective of the audit.
(for ex. SA 570)

(vi) Examples of audit documentation: Self

(vii) Prepⁿ of audit documentation: Auditor shall prepare audit documentation on a timely basis.

It helps to enhance the quality of audit and facilitates the effective review and evaluation of audit evidences obtained and conclusions reached.

Note: Documentation prepared after the audit work has been performed is likely to be less accurate than the documentation prepared at the time such work is performed.

(viii) Assembly of final audit file:

Meaning of audit file: One or more folders or other storage media,



in physical or electronic form



Containing the records of audit documentation.

for a specific engagement.

Requirements: - Auditor shall assemble the ^{documentation in} final audit file and complete the administrative process within 60 days of date of auditor's report.

- After the assembly, auditor shall not delete the audit documentation before the end of its retention period.

(ix) Retention Period: 7 years from the date of audit report.

(x) Ownership: Unless otherwise specified by law or regulation, audit documentation is the property of the auditor.

However, auditor, may at its discretion, provide extracts from audit documentation to clients.

Chapter-3 "Audit Documentation and Audit Evidence"

(Lecture 2)

(2) Audit Evidence (SA-500):

(i) Meaning and Nature of audit evidence:

SA-500 "Audit Evidence" defines the term as: "Any information^{*} used by the auditor in arriving at the conclusions on which auditor's opinion is based."

* Information may be: (a) Internal; or (b) External.

(b) Oral; (b) documentary; or (c) Visual

(a) Financial; or (b) Non-financial

(a) Contained in accounting records; or (b) Other Info.
(Records)

Auditor is required to perform appropriate audit procedures for the purpose of obtaining audit evidences.

Audit Evidences to be collected by the auditor needs to be sufficient and appropriate.

Sufficiency: refers to quantity of audit evidences.

Appropriateness: refers to quality / relevancy of audit evidences.

Note: Higher is the relevancy / appropriateness of audit evidences, lower can be the sufficiency of audit evidences.

Note: Sufficiency of audit evidences are affected by certain factors, like:

(a) Materiality of subject matter.

(b) Risk of Material Misstatements.

(c) Size of Population

(ii) Auditor's duties when any information is to be used as audit evidence:

(a) Information prepared

Using the work of Expert (Mngt. Expert)

(i) Evaluate the competency, capability
and objectivity of Mngt. Expert.

(ii) Obtain an understanding of Mngt.
Expert work.

(iii) Evaluate the appropriateness of
Expert's work as audit evidence for
relevant assertion.

(b) Information produced by the

Entity.

(i) Obtain audit evidences as to
accuracy and completeness of
the information.

(ii) Evaluate whether information is
sufficiently precise and detailed
for audit purpose.

Note: If audit evidences obtained from one source is inconsistent with the
audit evidences obtained from another source

or

auditor has doubt over the reliability of information to be used
as audit evidences

✓ auditor shall determine modification / additions in audit
procedures to resolve the matter

and

✓ shall consider its effect on other aspects of audit.

* Sources of audit Evidences:

→ Reading from the book -

(iii) Audit Procedures for obtaining Audit evidences:

(a) Risk Assessment Procedures (RAP)

Procedures performed to identify and assess RMM, through understanding the Entity and its environment including Internal Control (SA 315)

(b) Further Audit Procedures (FAP)

Responses to assessed risks

(SA 330)

I. Tests of Controls (ToC) / Compliance Procedures

Procedures performed to Evaluate:

- (a) Existence
 - (b) Effectiveness
 - (c) Continuity
- of related internal controls

II. Substantive Procedures

Procedures performed to examine

- (a) Accuracy
 - (b) Validity
 - (c) Completeness
- of accounting data

(A) Tests of details (Tod)

- (a) Transactions occurred during the year (Vouching of transactions)
- (b) Balances exist at year end. (Verification of assets and liabilities)

(B) Substantive Analytical Procedures

- (SA-520)
- Involves consideration of
- (a) Comparisons
 - (b) Relationships.

(iv) Techniques to obtain audit Evidences:

- Methods and means through which audit procedures are performed so as to collect audit evidences.

- Various techniques that can be used by auditor are:

(a) Inspection

(e) Re-calculations

(b) Inquiry

(f) Re-performance

(c) Observation

(g) Analytical Procedures

(d) External confirmations

Examples:

Audit Technique.

I. Auditor ask the management as to details of suppliers from whom the raw material is procured.

Inquiry

II. Auditor examines the terms and conditions of loan granted by Bank from the loan documents.

Inspection

III. Auditor sends a letter to a debtors asking him to confirm the year end balance in his books of A/c.

External confirmation

IV. Auditor analyses trend of Gross profit and turnover of last three years to identify and assess RMM.

Analytical Procedures

V. Auditor evaluate the Internal control through performing the control activities.

Re-performance

VI. To examine accuracy of depreciation, auditor Re-calculation
calculate the amount with the information
given in accounting records.

VII. To ensure existence and condition of Inventory, Observation
auditor attend physical count procedures of
Inventory conducted by management

~~(V)~~ Imp
Reliability of audit evidences:

(a) External evidences are considered more reliable than internal evidences.

However, internal evidences may be considered more reliable if related internal controls are strong and effective.

(b) Audit evidences in documentary form are more reliable than evidences obtained orally.

(c) Audit evidences obtained by auditor ^{directly} are generally more reliable than the audit evidences collected through the management.

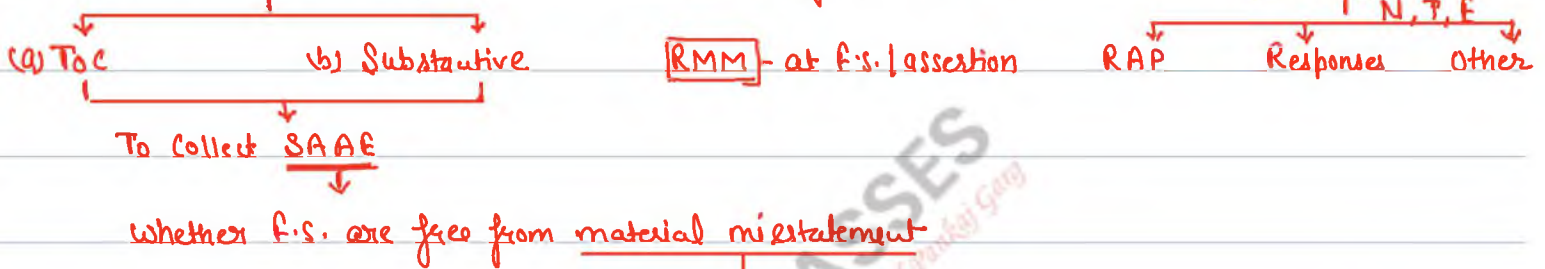
(d) Audit evidences in the form of original documents are considered more reliable than the evidences collected in the form of photocopies.

Chapter - 1 "Quality Control and Engagement Standards"

34) Responses to assessed risks (SA-330):

Audit Engagement (SA 210) → Preliminary Engagement Activities (SA 300) → Establishing Audit Strategy (SA-300)

Design and Perform Responses to assessed risk (SA-330) ← Perform RAP (SA-315) ← Developing audit Plan (SA-300)



No misstatement Exist

Draw conclusion and issue

Audit opinion [Unmodified opinion]

as per SA-700

Misstatements Exist

FRAUD

Apply procedures

as stated in SA-240

ERROR

Apply the procedure as

stated in SA-450

(i) Types of Responses:

- SA 330 requires the auditor to design and perform audit procedures which are appropriate to assessed risk (as assessed as per SA-315)

For the purpose of collection of sufficient and appropriate audit evidences-

- Responses are classified in two categories: (a) Compliance Procedures (ToC)

(b) Substantive Procedures (ToD + SAP)

(ii) Compliance Procedures / Tests of Control (TOC):

- Procedures designed to evaluate operating effectiveness of controls, in



preventing, detecting and correcting the material misstatements at assertion level for transactions, account balances and disclosure.

- Through the compliance procedures, audit collect evidences as to

(a) Application of Controls (Exist)

(b) Consistency of Controls (Continued)

(c) By whom and by what means such controls are applied.

(Responsible persons) (Manual / automated)

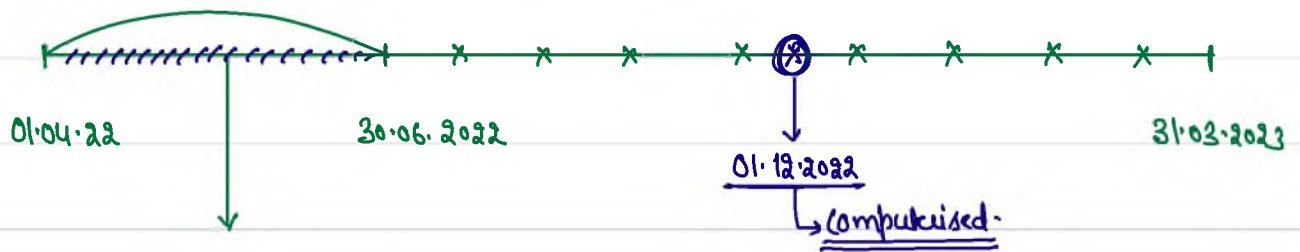
Note: Audit Evidences collected by Auditor indicates the existence and effectiveness of internal control.

- If I.C. Exist and effectively operated, auditor may design less substantive extensive procedures and vice versa.

- If case of Non-existent / deficient internal controls, Auditor should communicate the weaknesses, as identified to management / TCOG as per requirements of SA 260 and 265.

Special Consideration w.r.t. ToC:

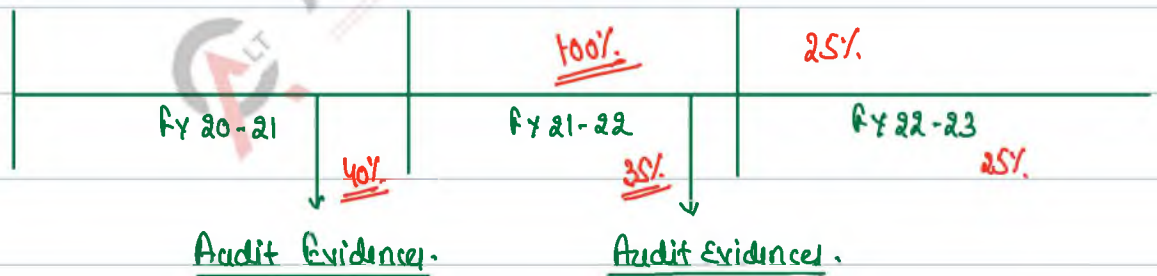
(A) Using audit Evidence obtained during Interim period:



Evaluate the I.C.

- (i) Auditor should obtain audit evidences as to significant changes subsequent to interim period.
- (ii) Determine the additional procedures to be performed and additional evidences to be collected for the remaining period.

(B) Using Audit Evidences obtained during prior period:



- (i) Establish continuing relevance of evidences obtained during audit of prior periods by determining significant changes subsequent to prior period.
- (ii) If no significant change occur, perform ToC once in three years with few tests every year.
- (iii) If significant change occurs, auditor should perform ToC in current period.

Factors warranting re-testing of controls: - Learning from bank -

(iii) Substantive Procedures: Procedures performed to detect material misstatements in the financial statements and accounting records.

Substantive procedures comprises of:

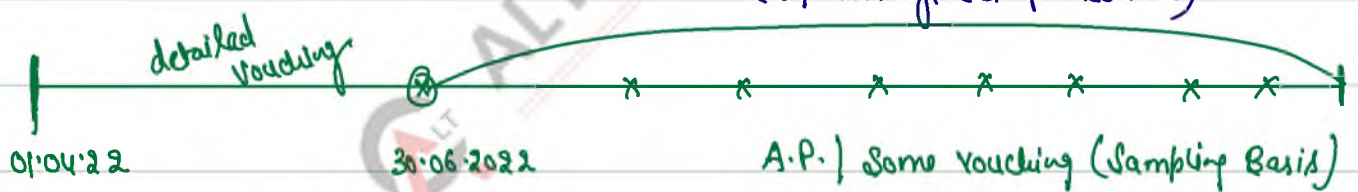
- (a) Tests of details (Vouching and Verification)
- (b) Substantive Analytical Procedures (Comparison and Relationships)

Timing of Sub. Procedures: If substantive procedures are performed for Interim period



Auditor is required to cover the remaining period by appropriate procedures.

(e.g. Analytical procedures)



Special Consideration:

(A) Using EC requests as substantive procedures:

Auditor may use EC requests as substantive procedures so as to obtain sufficient appropriate audit evidences w.r.t. assertions being examined.

While using EC requests, auditor should consider the following factors:

(a) Knowledge of the confirming party of the information to be confirmed.

(b) Ability or willingness of the confirming party to respond or to provide the requested info.

(c) Objectivity of the Confirming party.

(B) Substantive procedures w.r.t. Significant Risk:

Auditor should design and perform substantive procedures w.r.t. specific risks, that are responsive in nature.

For Example: Risk related to RP transactions. → perform procedures as prescribed by SA 550.

Risk related to fraud. → Perform procedures as prescribed by SA 240.

Risk related to subjectivity in measurement of estimates. → Perform procedures as prescribed by SA 540.

(C) Substantive procedures as to closing process:

- Reconcile the F.S. with underlying records.

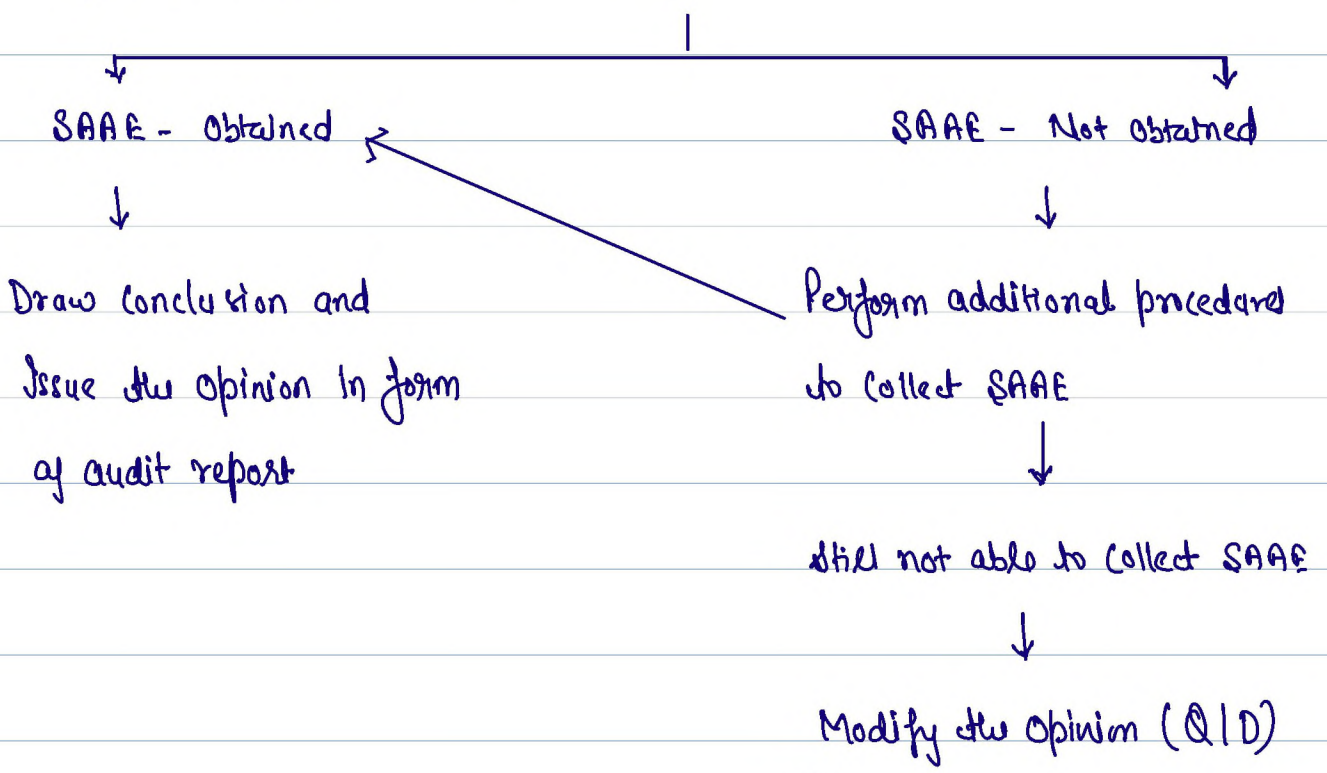
For Ex: Cash at Bank - to be reconciled with bank statement.

Inventory ——— to be reconciled with stock sheet prepared at the time of physical verification near the year-end.

- Examine significant journal entries and adjustments made during the course of preparation of financial statements. (for example - Accruals, Outstanding, prepaid, etc.)

(iv) Results of Responses to Assessed Risks:

- Auditor is required to ascertain whether on the basis of procedures performed, sufficient appropriate evidences obtained or not.



Chapter - 3 "Audit documentation and Audit Evidence"

(Lecture - 3)

- (1) Audit documentation - SA 230
- (2) Audit Evidence - SA 500
- (3) Responses to assessed risks - SA 330
- (4) Written Representation - SA 580

(i) Meaning and Nature of WR:

• SA 580 "Written Representations" defines the term WR, as a "written statement provided by management to auditor:

(a) to confirm certain matters;

or

(b) to supplement other evidences.

- WR are recognised as audit evidences being a response to the inquiry.
- However, WR do not provide sufficient and appropriate audit evidences on their own w.r.t. the matters to which they relate to.
- Hence, forming conclusion solely on the basis of WR cannot be considered as a right approach.
- Auditor shall request WR from the mgmt./TCWG having responsibilities for preparation of financial statements and have knowledge of concerned matters.

(ii) Objectives of auditor: (Noting - H.W.)

(iii) Matters on which WR is required:

(a) w.r.t. Management responsibilities

(b) w.r.t. requirements of other SA

↓
Regarding: Prepⁿ and presentation of f.s.

Information provided to auditor

↑
For Example: WR required by

SA 550, 560, 570

Circumstances where auditor can ask the management to reconfirm its
acknowledgement and understanding of responsibilities in WR: (Noting - H.W)

(iv) Date of WR | Period covered by WR | Form of WR:

- Date of WR shall be as near as practicable to the date of audit report.
- In no case, it should be after the date of audit report.
- **WR** must covered the period for which the audit was conducted and reported in audit report.

(I) SA-710 (II)

B/s as at 31.03.2021 And 31.03.2022 B/s as at 31.03.2022

	31.03.2021	31.03.2022
<u>Comparative f.s.</u>	(X)	

	31.03.2021	31.03.2022
<u>Corresponding figures</u>		

- WR shall be in the form of a representation letter addressed to auditor.

(v) Auditor's duties when WR is not provided or WR provided is doubtful!

Auditor requested WR from management

(A) WR not provided

(B) WR Provided by Mngt.

- Discuss with management
- Reevaluate the reliability and Integrity of Mngt.
- Issue disclaimer of opinion

(a) WR Reliable

(ii) WR Not reliable

(iii) WR doubtful

Consider WR as
audit evidence.

- take appropriate action
- determine its effect on possible audit opinion.
- Issue disclaimer, if sufficient doubt exist on Integrity of management.

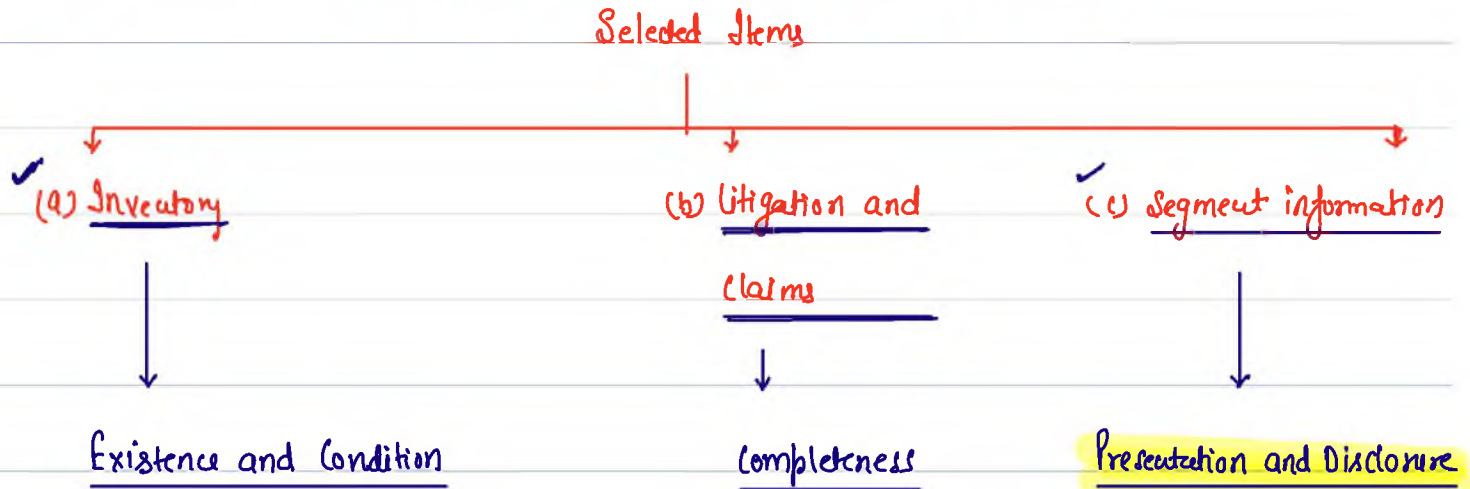
Perform additional
procedures to resolve
doubts

Doubt resolved

Doubt not resolved

Take appropriate decision as
per circumstances

(5) Audit Evidence - Specific considerations for Selected Items (SA 501):



(A) Audit procedure w.r.t. Inventory:

i) Auditor is required to obtain sufficient appropriate audit evidence w.r.t. Existence and Condition of Inventory.

For, this purpose, auditor is required to perform following procedure:

(a) attend ^{physical} inventory count unless impractical do as:

- Evaluate management instructions and procedures for recording the result of inventory count.
- Observe the performance of management count procedures.
- Perform test - count.
- Inspect the Inventory.

(b) Perform procedures over the Entity records to determine whether the records accurately reflects the results of inventory count.

* Vouching, Reconciliation

Attendance at Inventory Counting:

Matters relevant in planning the attendance at physical inventory counting:

- from book -

(Noting - How)

Special Circumstances:

(a) To attend Inventory Count is impractical:

In such situations, auditor is required to perform alternate audit procedures* to collect sufficient appropriate audit evidences w.r.t. existence and condition of inventory.

* Inspection of documentary records (Purchase and Sales Invoice)

External confirmations of suppliers

written representations.

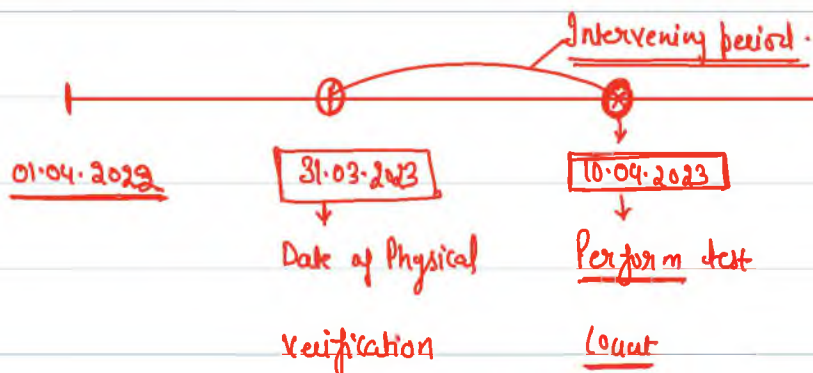
However, if auditor is not able to collect audit evidences from alternate audit procedures, auditor need to modify audit opinion.
(Qualified) (Disclaimer)
↓ ↓
Material Mat+P

(b) Auditor not able to attend inventory count due to any reason (other than impractical):

Make some physical count on an alternate day

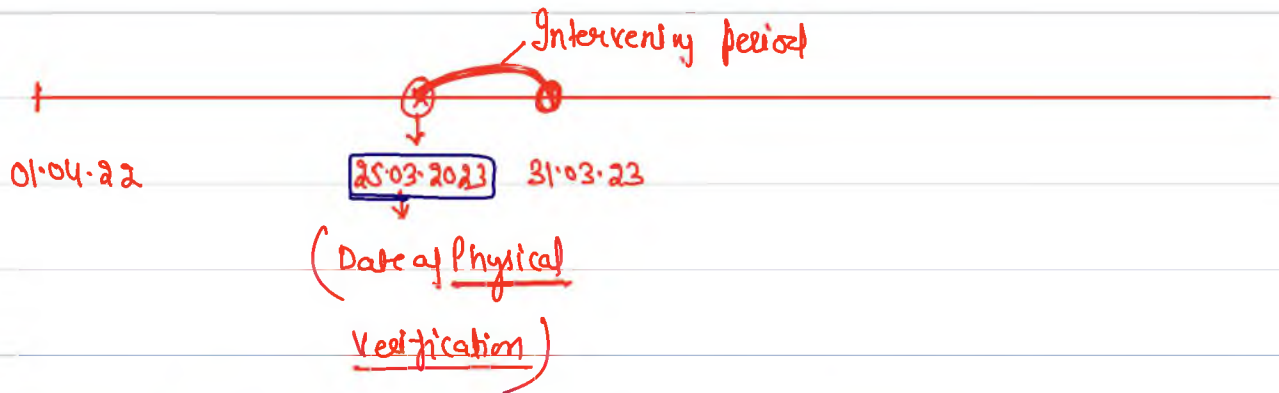
and

* perform procedures on transactions that occurred during the intervening period to ensure their appropriate recording.



* Vouching, Reconciliation etc.

(c) Inventory Count on a date other than B/S date:



Perform audit procedures to obtain audit evidence whether the transactions occurred during the intervening period are recorded appropriately.

(d) Inventory lying with third parties (for ex: consignee, agent, job workers)

- Obtain External Confirmation from third parties.
- ✓ Visit the premises of third party, if permissible.
- Inspect the records.

(B) Audit procedures w.r.t. litigation and claims: - Completeness

To ensure completeness of litigation and claims, auditor is required to design and perform audit procedures, including:

- Inquiry of management and others within the entity, including in-house legal counsel.
- Review legal expenses Account.
- Review the minutes of meetings of TCoGr and correspondence between the entity and external legal counsel.

Special Circumstances: - to be covered from book -

Circumstances requiring meeting with External legal Counsel: (Noting - H.co.)

(C) Audit procedures w.r.t. segment information - (presentation and disclosure)

Auditor is required to obtain sufficient appropriate audit evidences regarding presentation and disclosure of segment info in accordance with applicable FRF (Schedule III / AS-17) by :

- (a) Obtaining an understanding of methods used by management in determining segment information
- (b) Evaluate whether such methods are likely to result in disclosure as per applicable FRF.
- (c) testing the application of such method.
- (d) Performing analytical procedures or other procedures as appropriate.

Examples of Matters that are relevant when obtaining an understanding of the methods used by management in determining segment information:

(Noting -H.W.)

Chapter - 3 " Audit Documentation and Audit Evidence "

(Lecture - 4)

- (1) Audit Documentation - SA 230
- (2) Audit Evidence - SA 500
- (3) Responses to Assessed Risk - SA 330
- (4) Written Representations - SA 580
- (5) Audit Evidence - Specific Consideration for Selected Items - SA 501
- (6) External Confirmations - SA 505

(i) Meaning and types of confirmation requests:

- External confirmations are audit evidences obtained as a direct written response from a third party in paper form or Electronic form.
- Confirmations are of two types:

(a) Positive (+ve) Confirmation request

Request that the confirming party respond directly to the auditor indicating whether the confirming party agree or disagree

OR

provide the requested information.

(b) Negative (-ve) Confirmation

Request that the confirming party respond to auditor only when it disagrees with the information.

(ii) Areas where External Confirmations may be used: (Noting - H.W.)

(iii) Effects of +ve and -ve requests:

- Response to a +ve request may be considered as sufficient appropriate audit evidence on which auditor may draw the conclusion unless the doubt arises.
- Negative requests provides a less persuasive audit evidence as compared to +ve requests. Hence, limited use of -ve requests is recommended and should be used only when the following conditions are satisfied:
 - (a) Lower risk of material misstatements.
 - (b) Population comprises of large no. of transactions of homogenous nature of small amounts.
 - (c) Expected deviation rate is low.
 - (d) Auditor is not aware of the circumstances that 3rd party may disregard the request.

(iv) Steps to be followed:

Step-1: Determine the information to be confirmed.

Step-2: Selection of appropriate party from whom information is to be confirmed. (i.e. confirming party)

(Knowledgeable, Ability, willingness, Objectivity)

Step-3: Designing of Confirmation request. [-ve request, +ve request } with info.
without info.]

Factors to be considered in designing the request: (Noting - H.W.)

Step-4: Sending the confirmation request.

Step-5: Evaluate the responses, if received.

If response not received, re-send the request or perform alternate audit procedure, as appropriate.

(V) Special situations:

Auditor ask management for external confirmations

(a) Management Refuses

↓
Inquire the reasons and
seek the evidence as to the
Validity and reasonableness

↓
Satisfactory

reasons



Perform Alternate
audit procedures

Reasons are not

satisfactory



- Communicate to TCWG
- Evaluate its impact on other
audit procedures and audit opinion

(b) Management agrees and co-operate

(A) Reply not received

↓
Perform alternate audit
procedures



SAAE not obtained



Modify the opinion

(B) Reply Received

↓
Third party

agree



Consider it as
SAAE
(unless doubt arises)

↓
Third party

disagree (Exception)



Inquire further to
identify instances
of misstatement (if any)

↓
Doubtful reply.



Perform additional
procedures to
resolve doubts

↓
Non-reliable reply



Evaluate its effect
on audit procedures
and audit opinion

(7) Initial Audit Engagements - Opening Balances (SA 510):

	<u>Fy 21-22</u>	<u>Fy 22-23</u>	<u>SA 510 - applicability</u>
<u>X Ltd.</u>	Audit - <u>Mr. A.</u>	Audit - <u>Mr. A.</u>	<u>No</u> (Recurring audit)
<u>Y Ltd.</u>	Audit - <u>Mr. B.</u>	Audit - <u>Mr. C.</u>	YES
<u>Z Ltd.</u> (Newly Inc. Co.)	<u>NA.</u>	Audit - <u>Mr. D.</u>	<u>No</u> (No op. Balance)
<u>ABC and Associates:</u>	<u>Not done</u> (as not required)	Audit - <u>Mr. E.</u>	YES

(i) Meaning of Initial audit engagements and opening balances:

(a) Initial audit engagements: An audit engagement in which financial statements for the prior period are either:

- Not audited; or
- were audited by predecessor auditor.

(b) Opening Balances: Those account balances that exist at the beginning of the period.

- These are based upon the closing balances of the prior period and reflects the effects of transactions and events of prior periods and accounting policies applied in the prior period.
- They also include the matters requiring disclosures that existed at the beginning of the period, such as contingencies and commitments.

(ii) Objectives of the auditor:

Auditor's Objective in relation to examination of opening balances in case of Initial audit engagements is to obtain sufficient appropriate audit Evidences as to

- ↓
- (a) whether opening balances contain any misstatement that materially (and) affect current period financial statements
- (b) whether accounting policies are applied consistently and changes, if any are appropriately - accounted for; and - disclosed.

(iii) Auditor's procedures w.r.t. opening balances:

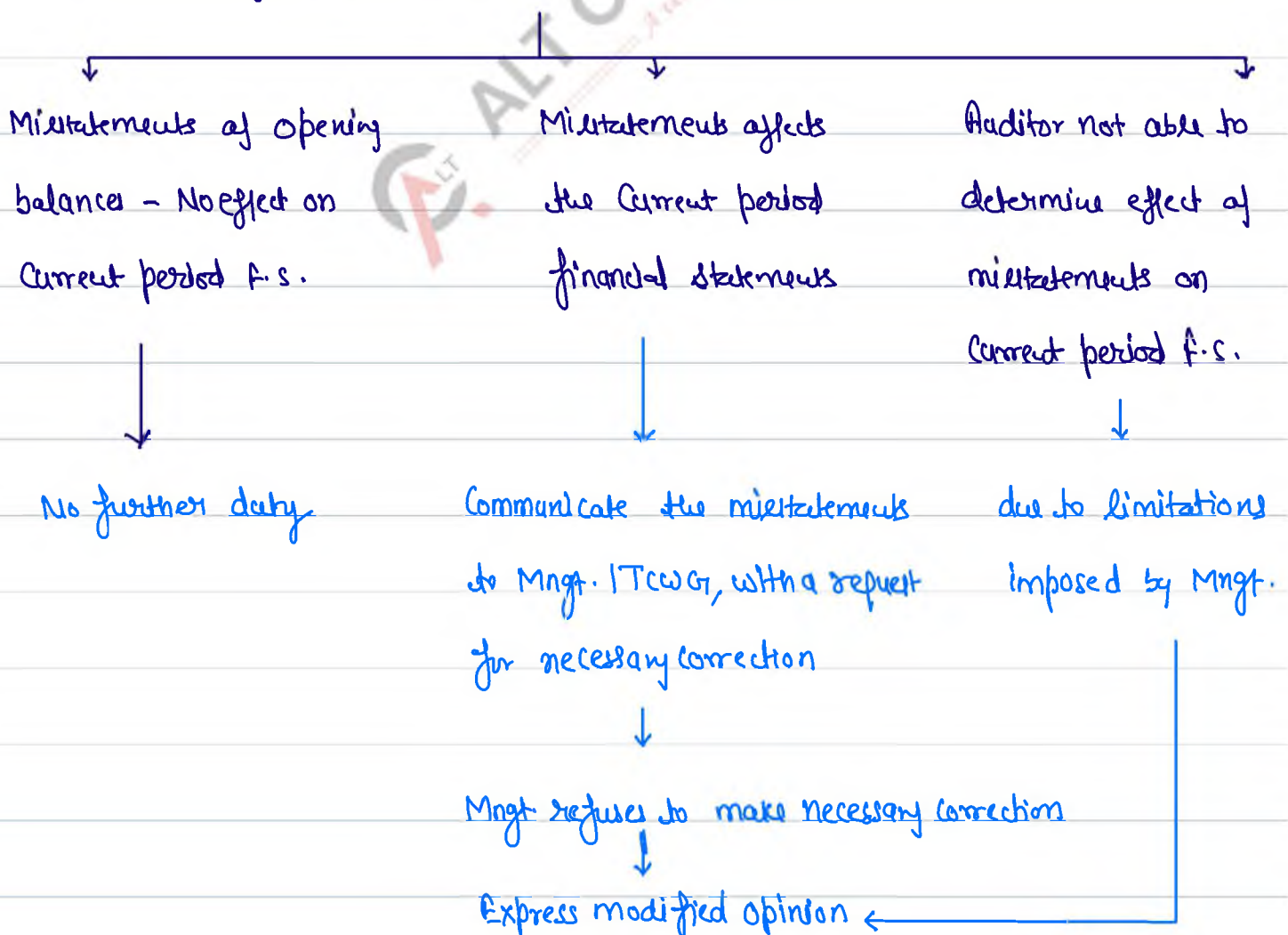
- (a) Auditor should read the prior period financial statement and auditor's report thereon, if any, to obtain information w.r.t. opening balances of prior period and related disclosures.
- (b) Auditor should examine whether the closing balances of prior period are correctly brought forward to current period as opening balances.
- (c) In case of any difference in opening balance, ensure that appropriate adjustment as per relevant accounting standard has been made in the books of account. (AS-5)
- (d) Auditor should perform specific procedures in relation to significant opening balances, if he has any doubt over the reliability of prior period financial statements or if the financial statements of prior period were not audited.

* Specific procedures that may be applied includes:

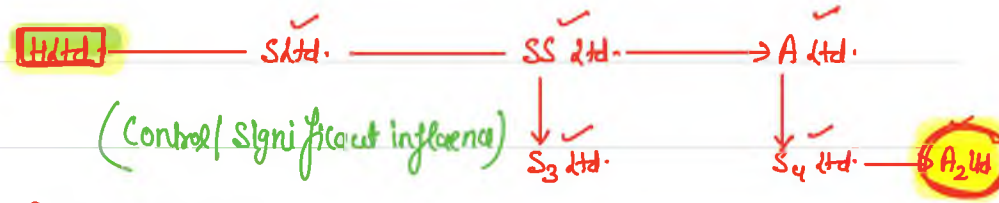
- (i) External confirmations for significantly large trade receivables and trade payables.
- (ii) Inspection of Certificate of Investments.
- (iii) Verification of fixed asset registers.
- (iv) Examination of bank statement and bank reconciliation statement.

(e) Auditor should collect evidences w.r.t. consistent application of accounting policies.

(f) If auditor identifies any material misstatement in opening balances, auditor should evaluate its effect on current period financial statements.



(8) Related Parties (SA-550):



Related parties.

- Related party relationships (Holding/Sub)
- " " Transactions (Sales/purchases)
- Balances at the end.

Mngt. → To identify the RP, RP relationships,

Sec. 177/188 → Approval of RP transactions → Audit Committee / BoD

FRF: (AS/Ind-As/Sch-III) → Accounting requirement and disclosure requirements.

Auditor: → Understanding of RP relationships / transactions

→ Ensure that RP transactions are appropriately accounted for and disclosed as per FRF. (AS-18)

(i) Meaning of Related party: - Reading from the book -

(ii) Nature of RP relationships and transactions: (Noting - H.w.)

(iii) Responsibilities of Auditor: (Noting - H.w.)

(A) Risk Assessment Procedures:

(1) To understand related party relationships and related party transactions.

(2) To obtain an understanding of management controls as to:

(a) Authorisation / approval of related party transactions.

(b) Identification of RP and determination of RP relationship.

(c) Accounting and disclosure requirements of applicable FRF.

For this purpose, auditor may inquire the management as to:

(a) Related Parties;

(b) Changes in related parties from prior period;

(c) Relationship with related parties,

(d) Nature and purpose of transactions with related parties.

✓ (3) While obtaining information and performing procedures, auditor should remain alert for situations, which signifies that some related party may exist or related party transactions may occur, which are not disclosed in the financial statements.

✓ (4) Auditor should also remain alert as to occurrence of transactions that occurs outside the ordinary course of business.

(B) Auditor's Responses:

Imp (i) If auditor identify a related party that is not previously identified by management:

(a) Communicate to other members of engagement team.

(b) Inquire from the management reasons for failure to identify the related party.

(c) Request the management to identify the transactions with the related party identified by the auditor.

(d) Re-consider the risk that other related parties may exist.

(e) If non-disclosure of related party and related party relationship appears to be intentional, evaluate its impact on audit and audit opinion.

civ) If auditor identifies the transaction that occur outside the normal

Course of business:

- (a) Inquire the business rationale of the transaction.
- (b) Examine the terms on which the transaction occurs.
- (c) Collect evidences as to approval / authorisation of transaction.
- (d) Collect evidences as to appropriate accounting and disclosure.

(iv) Records / documents to be inspected to obtain information about RP

relationships or transactions:

(Noting H.W.)

(9) Concept of true and fair view:

Auditor is required to report whether books of account and financial statements reflects true and fair view of state of affairs and financial results.

For this purpose, auditor is required to ensure the following:

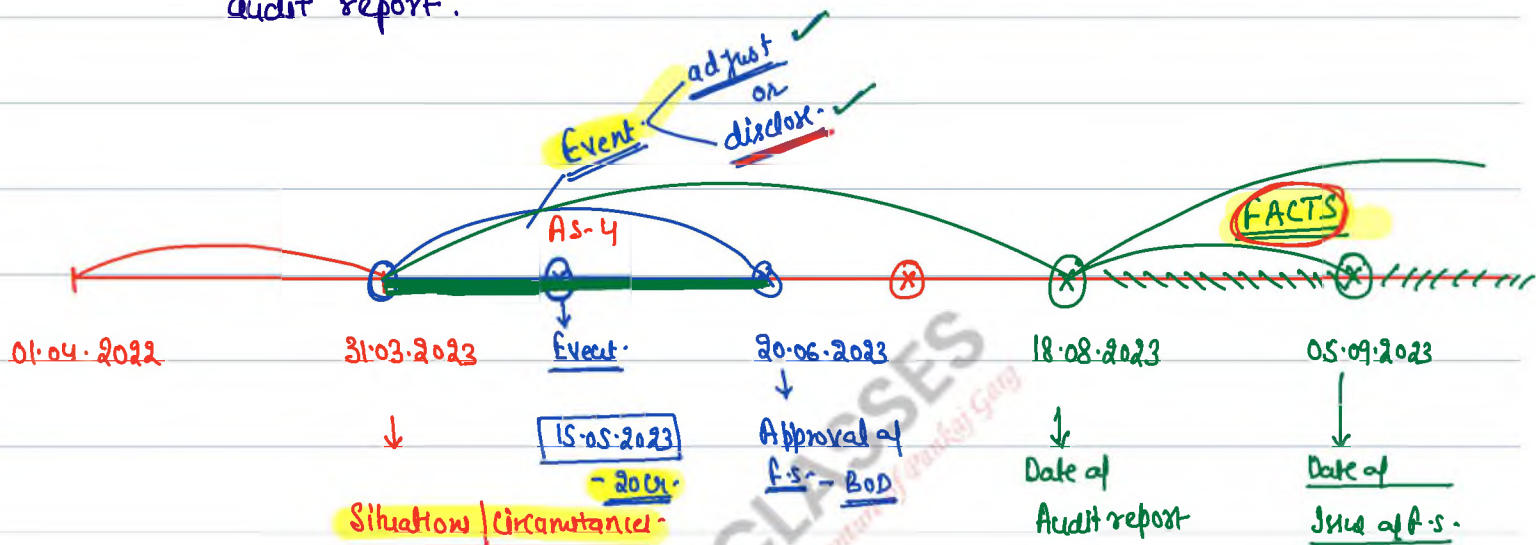
- (i) that assets are not undervalued or overvalued
- (ii) that no material asset is omitted
- (iii) that no " liability is " .
- (iv) that charge, if any on the assets is properly disclosed.
- (v) that accounting policies have been consistently followed.
- (vi) that P&L A/c and B/S shows all necessary disclosures.
- (vii) that all unusual, exceptional and non-recurring transactions are separately disclosed.

(10) Subsequent Events:

(A) Meaning of Subsequent Events:

✓ Events that occurred between (B/s date) and date of auditor's report
and included

the facts that have become known to the auditor after the date of audit report.



(a) Court's Case - Litigation

Liability - Contingent (adjusting Event)

(b) Fire - on 20.05.2023

destroys - factory bldg - loss - scr.

(Non-adjusting Event / disclosure required)

(B) Audit Procedures in case of Subsequent Events:

(i.e. Events upto date of audit report)

(i) Perform procedures to obtain evidences that all events requiring adjustments or disclosures have been identified.

(ii) For this purpose, auditor may:

(a) Obtain an understanding of the procedures followed by management

- to identify the events.

- (b) Inquire [★] the management as to occurrence of significant events that may affect the financial statements.
- (c) Read the minutes of meeting, if any, held after B/S date.
- (d) Study the Interim financial statements, if any prepared by the entity, subsequent to B/S date.
- (iii) If auditor identify any event which requires any adjustment or disclosure, auditor should ensure its appropriate treatment in the books of account as per requirements of applicable FRF (AS-4).
- (iv) Obtain a WR from mgmt. that all known events that require adjustments / disclosures as per FRF have been appropriately adjusted / disclosed.

Matters to be Inquired: - To be learned from book -

(c) Audit procedure for facts known to auditor after the date of audit report:

- Auditor has no obligation to perform any audit procedure regarding such financial statements for the facts known to him after date of audit report.
- However, if a fact becomes known to auditor that had he aware of this fact before date of AR, a modified opinion was caused to be issued, the auditor shall:
 - (a) Discuss the matter with management
 - (b) Determine whether the f.s. needs amendment and, if so
 - (c) Inquire how management intends to address this matter in f.s.

Chapter - 3 "Audit Documentation and Audit Evidence"

- ① SA-230 - Audit Documentation
- ② SA-500 - Audit Evidence
- ③ SA-330 - Responses to Assessed Risks
- ④ SA-580 - Written Representation
- ⑤ SA-501 - Audit Evidence - Specific Considerations for selected items
- ⑥ SA-505 - External Confirmations
- ⑦ SA-510 - Initial Audit Engagements - Opening Balances
- ⑧ SA-550 - Related Parties
- ⑨ True and fair view
- ⑩ SA-560 - Subsequent Events
- ⑪ Going Concern (SA 570) :

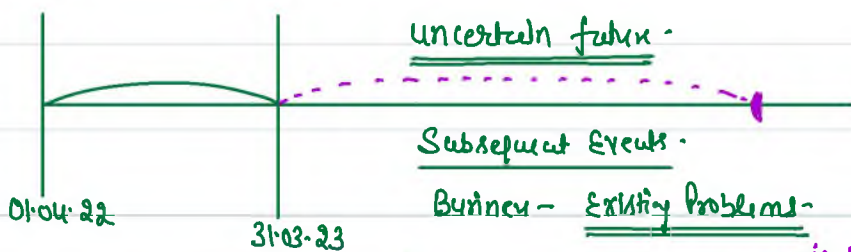
AS-1 "Disclosure of Accounting Policies" → fundamental accounting assumptions

(a) Going concern (b) Consistency (c) Accrual

Mngt. Responsibilities:

(1) To Evaluate appropriateness of Going concern basis of Accounting.

FY 2022-23



[01.04.2023 - 31.03.2024]

- (i) 30.09.2023 - debⁿ - repayment due. ✓
- (ii) Raw material - shortage → change - alternate ✓
- (iii) licence - 31.12.2023 - renewal ✓

- Entity → able to realize its assets and pay its liabilities

- Mngt - No intention - to liquidate

- foreseeable future

If Going concern - not exist

- Books of A/c + A.S. → liquidated.

- Separate disclosure - required

Auditor's Responsibilities:

- (i) Auditor is required to obtain sufficient appropriate audit evidence w.r.t. appropriateness of management use of "Going Concern Basis of Accounting"
- (ii) For this purpose, auditor is required to perform appropriate procedures and ensure that the period selected by the management for evaluating the appropriateness of Going Concern basis of Accounting, should not be less than 12 months.
- (iii) Auditor is required to evaluate the appropriateness of going concern by Identifying the factors that may cause any issue / concern w.r.t. going concern.

Factors Indicating Concerns Over use of Going Concern Basis:

- | | |
|---|-----------------------------|
| (a) Financial factors / indicators / Events | - to be learned from book - |
| (b) Operating factors / " / " | |
| (c) Other factors | |

- (iv) If auditor identify any financial, operating or other indicator, that may affect the appropriateness of Going Concern Basis, auditor is required to perform additional procedures so as to ensure ^{appropriateness of} going concern basis.

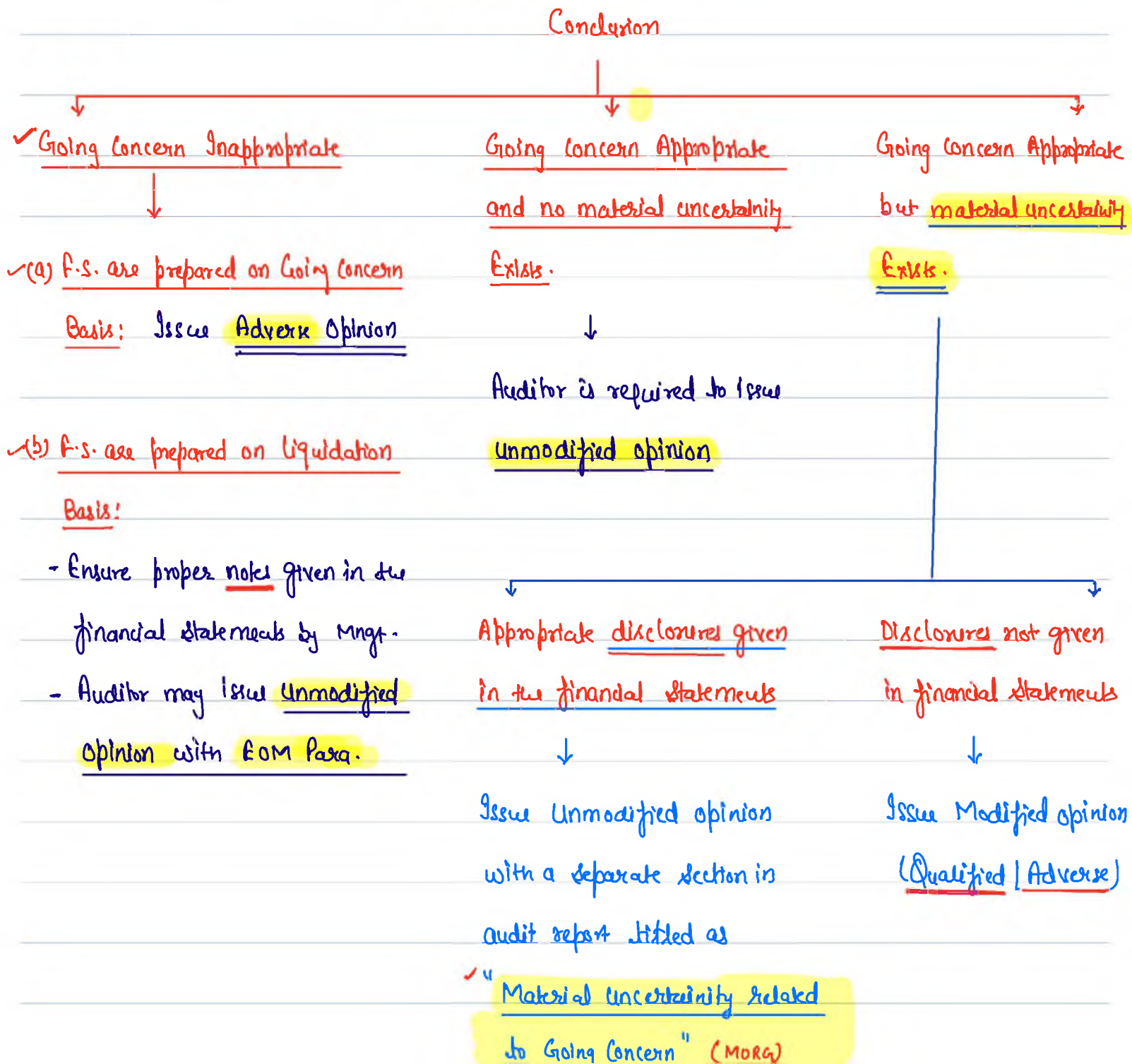
Examples of additional procedures:

- (a) Evaluate management plan for future.
- (b) Evaluate feasibility of management plan.
- (c) Obtain WR from the mgmt / TCGs w.r.t. their plans and feasibility.
- (d) Evaluate the reliability of cash flow forecast.

(e) Analyse the Entity Interim financial statements.

(v) Based on the audit evidences collected, auditor should draw the conclusion as to appropriateness of management use of Going Concern basis of accounting and Issue the report accordingly.

(vi) Conclusion and reporting requirements:



Chapter - 4 " Risk Assessment and Internal Control " (Lecture - 1)

(1) Audit Risk:

(a) Meaning and Consideration:

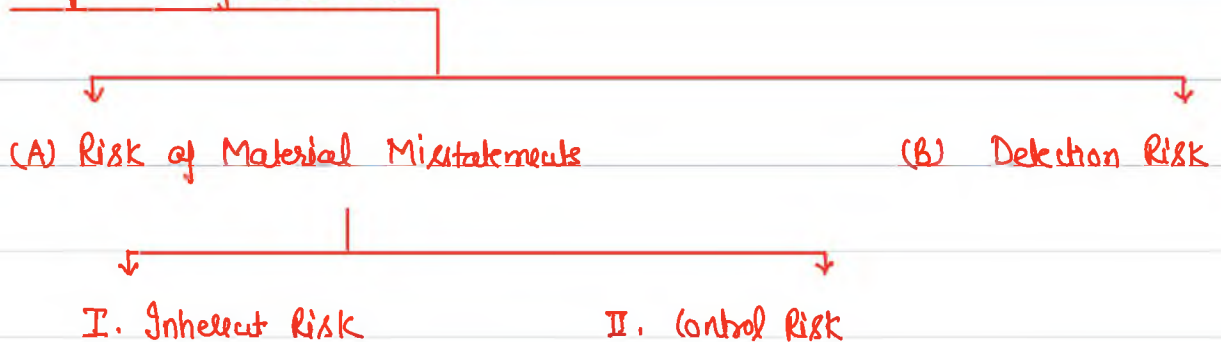
- Audit risk may be defined as risk of expressing inappropriate opinion when financial statements are materially misstated.

Note: Expressing modified opinion when financial statements do not contain material misstatements will not be considered as audit risk.

- SA 315 " Identifying and assessing RMM through understanding the entity and its environment " deals with the auditor's responsibilities as to identifying and assessing RMM at financial statement and assertion levels. [Details to be covered in next topic]

- RMM at assertion level consists of two components: Inherent risk and Detection risk

(b) Components of Audit Risk:



I. Inherent Risk: Susceptibility of an assertion about a class of transactions, account balances or disclosures,



to a misstatement that could be material either

individually or in aggregate with other misstatements



assuming that related internal controls do not exist.

Factors causing Inherent risk: (Noting H.W.)

Factors to be considered while assessing Inherent risk:

- (a) Experience of the Entity from previous audit engagements.
- (b) Controls established by management to compensate for a high level of inherent risk.
- (c) Knowledge of any significant changes which might have taken place since last assessment.

II. Control Risk: Susceptibility of an assertion about a class of transactions, account balances or disclosures



do a misstatement that could be material either individually or in aggregate with other misstatements



if related internal controls fails to prevent, detect and correct material misstatements on a timely basis.

Factors causing Control Risk: Inherent limitations of Internal Control

Factors to be considered to assess control Risk - whether to rely or not to rely on I.C.: (Noting - H.W.)

Note: Separate assessment of IR and CR is not advisable as both risks are related to Internal Control. Hence a Combined assessment as RMM is recommended.

III. Detection Risk: Risk that the audit procedures performed by the auditor will not detect the material misstatements is known as detection risk.

This risk generally arises due to the test checking nature of audit procedure, use of sampling and persuasive nature of audit evidences.

(c) Relationship between RMM and DR:

- RMM and DR are inversely related to each other.
- Higher is the RMM, lower should be detection risk so that overall audit risk can be reduced to an appropriate low level.
- However, if RMM is on lower side, auditor may accept detection risk to a reasonable extent so as to reduce the audit risk to an appropriate low level.

$$\begin{aligned}\text{Audit Risk} &= \text{RMM} \times \text{DR} \\ &= (\text{IR} \times \text{CR}) \times \text{DR}\end{aligned}$$

Example: Compute overall audit risk assuming the following:

- Chances that 40% of services provided by the client would be defalcated.
- Management assures the auditor that I.C. can prevent such defalcation by 75%.
- Audit procedures performed by auditor gives satisfaction as to detection of fraud and error to the extent of 60%.

Sol: (a) Inherent Risk = 40% (b) Control Risk = 25%

$$\text{Risk of Material Misstatement} = 40\% \times 25\% = 10\%$$

(C) Detection Risk = 40%

$$\begin{aligned} \text{Overall Audit Risk} &= 10\% \times 40\% \\ &= 4\% \end{aligned}$$

CR ↓ \ IR →	HIGH	Medium	Low
HIGH	RMM Highest DR Lowest	RMM Higher DR Lower	RMM Medium DR Medium
MEDIUM	RMM Higher DR Lower	RMM Medium DR Medium	RMM Lower DR Higher
LOW	RMM Medium DR Medium	RMM Lower DR Higher	RMM Lowest DR Highest

(d) Materiality and Audit Risk: - Already covered in chapter-2 (SA 320) -
(Revision - H.W.)

(e) Conditions which increase risk of fraud or error: (Noting - H.W.)

(a) Identifying and Assessing Risk of Material Misstatement:

SA-315 deals with the auditor's responsibilities for identifying and assessing risk of Material misstatement.

(A) Risk Assessment Procedures:

SA-315 defines the term "Risk Assessment Procedures" as

↓
"Audit procedures ^{*} performed to obtain an understanding of the entity and its environment, including internal control,

↓
to identify and assess risk of material misstatements, whether caused due to fraud or error, at the financial statement (Overall level) and Assertion level. (Transaction level)

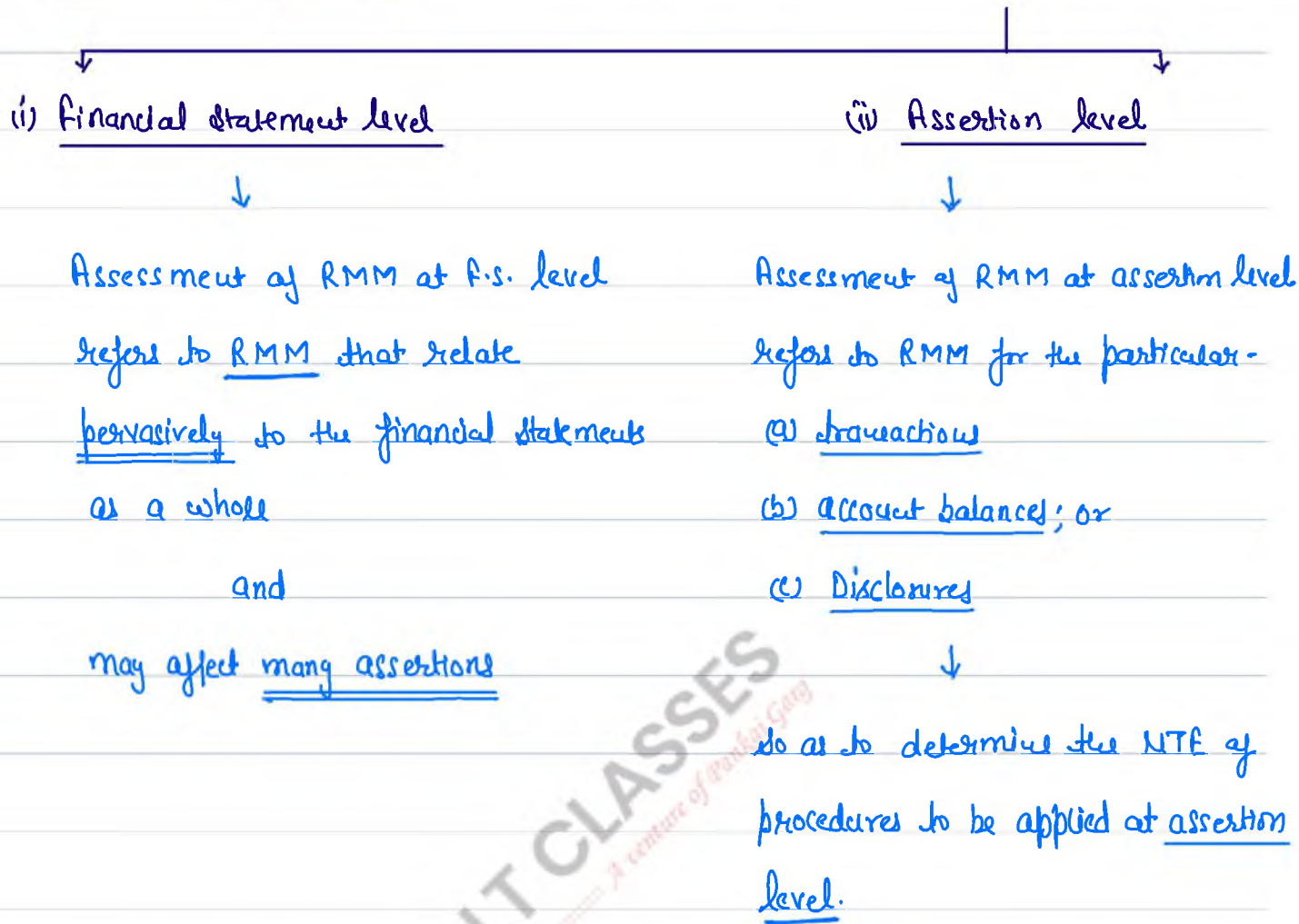
* Risk assessment procedures may be performed through:

- ✓ (a) Inquiries of management and others within the entity.
- (b) Analytical procedures at initial stages.
- (c) Inspection of records
- (d) Observation of business operations.

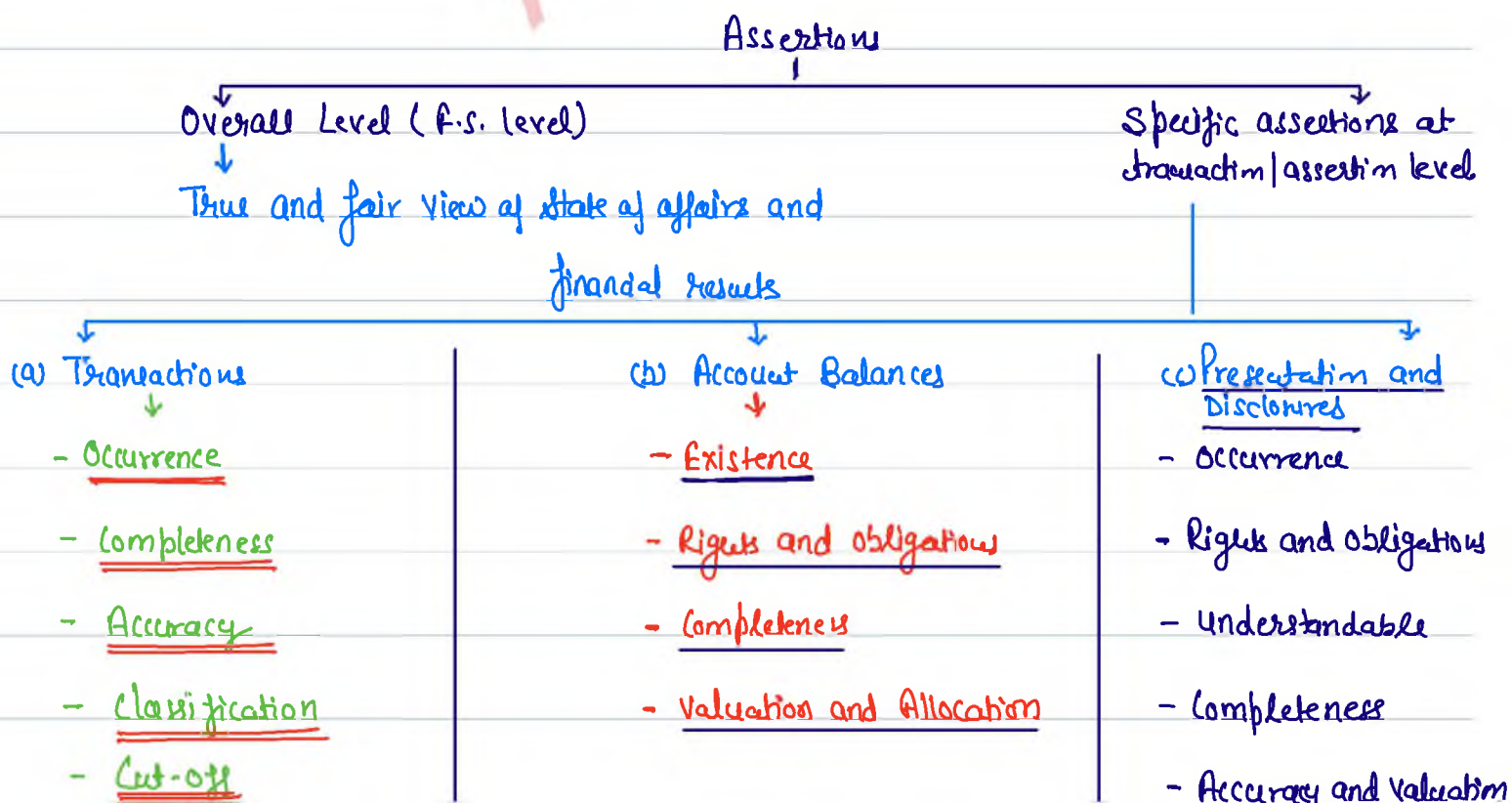
Examples - to be learned from the book

Imp:
(B) Matter of which auditor is required to obtain understanding: - Already covered.

(C) Assessment of RMM: Auditor is required to assess RMM at



(D) Assertion: Representations used by management while preparing and presenting the financial statements.



Chapter - 4 " Risk Assessment and Internal Control "

(Lecture - 2)

(a) Identifying and Assessing RMM (SA-315):

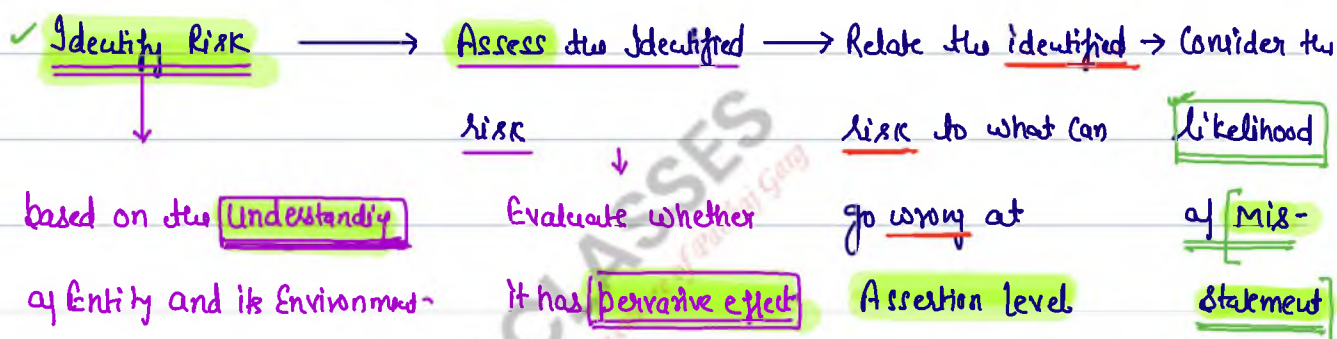
(A) Risk Assessment Procedure

(B) Matters of which understanding is required

(C) Assessment of RMM @ F.S. level and @ Assertion level

(D) Assertions to be evaluated.

(E) Risk Assessment Process:



Ex:

Related party transactions

ols - Ordinary course of business

→ Limited No. of small amount → understated ✓
→ wrong measurement ✓
(No Pervasive effect) → wrong valuation at year end

→ Significant amount ✓

(Approx. 50% of total sales) ✓

(Pervasive effect)

(Learning from book - Noting H.W.)

(F) Risks that require special considerations: (Noting - H.W.)

(i) Risk of fraud

(ii) Risk of significant economic, accounting and other developments

(iii) Complexity of transactions

(iv) Risk of significant transactions with related parties.

(v) Degree of subjectivity in the measurement of financial information.

(vi) Risk of significant unusual transactions.

Matters related with non-routine transactions having significant risk:

(i) Greater management intervention to specify accounting treatment.

(ii) " manual intervention for data collection and processing.

(iii) Complex calculations or accounting principles.

(iv) nature of non-routine transactions which makes it difficult for the entity to implement effective controls over the risks.

Matters related with significant judgement having significant risk:

(1)

(2)

(3) Internal Control:

(A) Meaning of Internal Control:

SA-315 defines the term "Internal Control" as the processes designed, implemented and maintained by Top-level Management / others within the Entity to provide reasonable assurance as to the achievement of Entity's Objectives as to:

- (a) Effective and efficient business operations.
- (b) Safeguarding of assets.
- (c) Prevention and detection of fraud and error.
- (d) Compliance of applicable laws and regulations.
- (e) Timely availability and reliability of financial reports.

(B) Objectives of Internal Control:

- (i) Only authorized transactions should enter into accounting system.
Authorisation may be general or specific.
- (ii) Ensure appropriate recording of transactions i.e. transactions should be recorded with correct amount, recorded in correct account and in correct accounting period.
- (iii) Ensure that assets are being used only for authorized purposes i.e. for business use. Assets are safeguarded from unauthorized use.
- (iv) To ensure the existence of assets recorded in the books of account. i.e. recorded assets are compared with the actual assets at reasonable intervals and in case of any difference, appropriate action is taken.

(c) Limitations of Internal Control:

- (i) Cost constraints
- (ii) Abuse of authority by management personnel.
- (iii) Manipulation by management
- (iv) Collusion by employees and others.
- (v) Potential for human error.
- (vi) Manual interventions in case of automated environment.
- (vii) Focus of Internal Control only towards usual transactions, therefore, policy may not exist for exceptional/non-routine transactions.

————— Details to be covered from book —————

- (i) Internal control can only provide reasonable assurance as to achieving the objectives of financial reporting.
- (ii) Involvement of human judgements in decision-making.
- (iii) Lack of understanding the purpose of Internal Control.
- (iv) Collusion among employees.
- (v) Judgements by management.
- (vi) Limitations in case of smaller entities.

MCQ: Which of the following ^{audit} risk arises due to inherent limitations of Internal Control:

- (a) Inherent Risk
- (b) Control Risk ✓
- (c) Detection Risk
- (d) Sampling Risk

(C) Components of Internal Control System : 5 components

- ↳ Control Environment
- ↳ Information System
- ↳ Entity Risk Assessment Process
- ↳ Control Activities Relevant to Audit
- ↳ Monitoring of Controls

(i) Control Environment:

- Control Environment includes governance and management functions and attitude, awareness and actions of Mngt and TCWG as to Internal Control and its importance.

- Control Environment includes the following:

- (1) Communication and Enforcement of Integrity and Ethical Values.
- (2) Commitment to Competence:
- (3) Participation by TCWG:
- (4) Management Philosophy and Operating Style:
- (5) Organisational Structure:
- (6) Assignment of authority and responsibility.
- (7) HR Policies and Procedures.

(ii) Entity Risk Assessment Process:

Circumstances where risk can arise or change: (Noting - H.W.)



Chapter - 4 "Risk Assessment and Internal Control"

(Lecture - 3)

(1) Audit Risk

(2) Identifying and assessing RMM

✓ (3) Internal Control

(a) Meaning of Internal Control

(b) Objectives of Internal Control

(c) Limitations of Internal Control

(d) Components of Internal Control : 5 Components

(i) Control Environment

(ii) Entity Risk Assessment Process

(iii) Information System

(iv) Control Activities

(v) Monitoring

↓
Procedures and records designed and established to :

(a) Initiate, record, process and report the transactions.

(b) Resolve inaccurate processing of transactions;

(c) transfer the information from transaction processing system to general ledger.

(d) capture information relevant to financial reporting

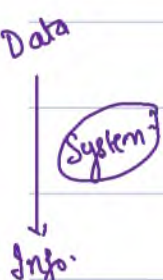
(e) ensure information required to be disclosed in the financial statements as per requirements of applicable FRF is accumulated, processed, summarised and reported in the financial statements.

Auditor's Consideration while obtaining understanding of Info-system:

(Noting - H.W.)

Auditor's Consideration as to understanding of communicating financial roles

and responsibilities: (Noting - H.W.)



(iv) Control Activities :

Policies and Procedures that help ensure that management directives are carried out. Control activities includes the following:

- (a) Authorisation .
- (b) Segregation of duties
- (c) Physical Controls.
- (d) Performance Reviews.
- (e) Information Processing.

(v) Monitoring of Controls :

- Monitoring of controls is a process to assess the effectiveness of internal control performance over time.
- Monitoring ensures the assessment of effectiveness of controls and at the same time helps in taking correction action timely.
- Management may monitor the effectiveness of controls by obtaining information from the external parties such as customer complaints and regulator comments that may indicate problems in current system and highlight areas of improvement.
- Auditor shall obtain an understanding of the major activities used by the entity to monitor the internal controls over financial reporting.

Monitoring of Controls : If Entity has an Internal audit System: (to be covered later)

(4) Evaluation of Internal Control by auditor:

Internal Control is reviewed/evaluated by the auditor so as to:

- (a) determine the extent of reliance to be put on Internal Controls and
- (b) determine the Nature, Timing and Extent of Sub. Procedures.

	<u>Auditor's Reliance</u>	<u>NTE of Sub-Procedures</u>
Effective I.C.	Auditor generally rely on I.C.	less extensive sub. Pro. may be applied
Ineffective I.C.	Auditor not rely on I.C.	More extensive sub. Procedures to be designed

Q.1. Procedures through which auditor obtains understanding of I.C.: RAP

Q.2. Procedures through which auditor Evaluates Existence, Effectiveness and Continuity of I.C.: ToC/Compliance

Q.3: Objectives of understanding and Evaluation of I.C.:

- (a) because of statutory requirements
- (b) to report to shareholders as part of audit report.
- (c) to determine N, T, E of sub. audit procedures.
- (d) to determine the integrity of Mngt. and TCWG.

Steps involved in Evaluation of Internal Control:

Step-1: Obtaining information w.r.t. Internal Control: (RAP as per SA 315)

Auditor should obtain necessary information for the purpose of evaluation of Internal Control.

Information required, includes the following:

- (a) Important aspects of business
- (b) Nature of business activities
- (c) Size of business
- (d) Systems followed in manufacturing, trading and other activities
- (e) Basis of various controls and procedures.

Various methods that can be used to collect the information mentioned above are :

- ✓ (a) Narrative Records
- ✓ (b) Check list
- ✓ (c) Internal Control Questionnaire
- ✓ (d) Flow charts

Step-2: Evaluate Existence, Effectiveness and Continuity of Internal Controls (ToC as per SA 330)

Based on the information collected by the auditor, Internal controls are to be evaluated by performing Tests of Controls (also known as Compliance Procedures).

Tests of Controls comprises of the following :

- (a) Inspection of Records
- (b) Inquiry and observation
- (c) Re-performance
- (d) Specific testing of computerised applications through use of Computer Assisted audit Techniques (CAATs).

✓ Based on the results of the Tests of Controls, auditor should evaluate whether the Internal controls are designed and implemented as contemplated in preliminary assessment of Control Risk.

Step-3: Communicating deficiencies in Internal Control (as per SA 265) :

Deficiencies in the Internal controls are to be communicated by the auditor to TCoG and Mngt. through the letter of weakness (LoW).

Impact of satisfactory Control Environment: To be covered from book

(Noting - H.W.)

Benefits of Evaluation of Internal Control by auditor: To be covered from book

(Noting - H.W.)

⑤ Internal Control and IT Environment: - Self Study -

Risk to Internal Control imposed by IT:

IT poses specific risks to an Entity Internal Control. Such risks are listed as below:

- (i) Reliance on systems or programs that process inaccurate data or data is processed inaccurately or both. [i.e. Inaccurate data or Inaccurate processing]
- (ii) Unauthorised access to data may cause → destruction of data
→ Improper changes to data
→ recording of unauthorised transactions
→ inaccurate recording of transactions.
- (iii) Unauthorised changes to data in Master files
- (iv) " " do systems or programs
- (v) Inappropriate manual intervention
- (vi) Inability to access data as required or potential loss of data.
- (vii) Failure to make necessary changes to systems or programs
- (viii) Possibility of IT Personnel gaining access beyond those necessary to perform assigned job, thereby breaking down segregation of duties.



Chapter - 4 " Risk Assessment and Internal Control "

(Lecture No. 4)

- (1) Audit Risks
- (2) Identifying and Assessing RMM
- (3) Internal Control
- (4) Evaluation of Internal Control by Auditor
- (5) Internal Control and IT Environment
- (6) Internal Audit:

(i) Meaning of Internal Audit Function:

SA-610 "Using the Work of Internal Auditors" defines the term "Internal Audit Function" as a function of an entity that performs

↓
Assurance and Consulting activities

↓
designed to evaluate and improve effectiveness of activities relating to

↓
1. Governance

↓ as to

- ✓ - accomplishment of Objectives of Ethics and Values

✓ - Accountability

✓ - Transparency

✓ - Corporate Fairness

↓
2. Risk Management

↓ as to

- identifying and evaluating significant risks

- Management of Identified risks.

- Effectiveness of financial reporting.

↓
3. Internal Control

↓ as to

- Evaluation of Internal Control

✓ Examination of financial info.

✓ Review of operating activities

✓ Compliance of laws and regulations.

(ii) Statutory requirements w.r.t. Internal audit (Sec. 138 of Companies Act, 2013):

(A) Companies requiring to have Internal audit system:

(i) Every listed company

(ii) Unlisted public companies which satisfy any of below mentioned criteria:

O/S deposits $< 25 Cr.$

(a) O/S deposits at any point of time during preceding FY $\geq 25 Cr.$

OR

Pusc $< 50 Cr.$

(b) Pusc during the preceding FY $\geq 50 Cr.$

OR

Loan = $\boxed{100 Cr. (one day)}$
 $< 100 Cr. (remaining days)$

(c) O/S loans or borrowings from banks or PFI at any point of time during preceding FY $> 100 Cr.$ or more

OR

Exceeding

T/O $< 200 Cr.$

(d) T/O during preceding FY $\geq 200 Cr.$

(iii) Private companies, which satisfy any of the below mentioned criteria:

(a) O/S loans or borrowings from banks or PFI at any point of time during preceding FY $> 100 Cr.$ or more

OR

(b) T/O during preceding FY $\geq 200 Cr.$

(B) Who can be Internal Auditor: [#] Internal auditor shall either be a

- Chartered Accountant; OR

- Cost Accountant; OR

- Such other Professional as decided by Board.

* May be practicing or non-practicing.

Internal Auditor may or may not be an employee of a company.

(7) Internal Financial Control:

(i) Sec. 134(5)(e) - Director's Responsibility Statement

(Existence and operating effectiveness)

(ii) Sec. 143(3)(c) - Auditor's Report

(Existence and operating effectiveness of

Internal Controls w.r.t. financial statement)

Meaning of IFC: As defined in 134(5)(e) of Companies Act, 2013, Internal financial controls may be defined as policies and procedures, adopted by the Company for:

(a) Orderly and smooth functioning of Company business;

(b) Safeguarding of assets;

(c) Prevention and detection of fraud and error;

(d) Accuracy and completeness of accounting records;

(e) Timely preparation of reliable financial information.

Reporting requirements of 143(3): - to be covered from book -

IFC and IFC w.r.t. F.S. (ICFR)

IFC [Directors are responsible for all IFC]

I. ICFR: (Internal Controls over

financial reporting)

II. Other IFC

[Auditor reports on adequacy and op. effectiveness of ICFR]

Ex: - All transactions recorded in books of Ac must have supporting document.

- Year end adjustments to be approved by responsible person.

Ex: Payments > 20000 - through cheques. Payments for purchases > 50000

to be approved by Manager finance.

Chapter - 5 "Fraud and Responsibilities of Auditor"

(i) Meaning and Characteristics of Fraud:

- SA 240 "The auditor's responsibilities relating to fraud in an audit of financial statements" defines the term 'fraud' as



an **intentional act** by one or more individuals among management, TCGs, employees or third parties, using **deceptive means** to obtain **unfair or unjust advantage**.

- Auditor is concerned with fraud that causes a material misstatement in the financial statements. Such frauds may be classified as
(a) Fraudulent financial reporting (b) **Misappropriation of assets**.

- ✓ Fraudulent financial reporting involves intentional misstatements including omission of amounts or disclosures in the financial statements so as to deceive the users of financial statements.

- ✓ **Misappropriation of assets** involves embezzling receipts, stealing of assets, using entity assets for personal use etc.

- Fraudulent financial reporting or misappropriation of assets, generally involves three fraud risk factors: (a) Incentive or pressure to commit fraud;
(b) Perceived opportunity to do so;
(c) Rationalisation of the Act.

(ii) Responsibilities for prevention and detection of fraud:

(a) Primary responsibility for prevention and detection of fraud is of management and TCWG.

For this purpose, management must create a culture of honesty and ethical behaviour in the organisation.

(b) Auditor is responsible to obtain reasonable assurance that financial statements as a whole are free from material misstatements, whether caused due to error or fraud.

↓

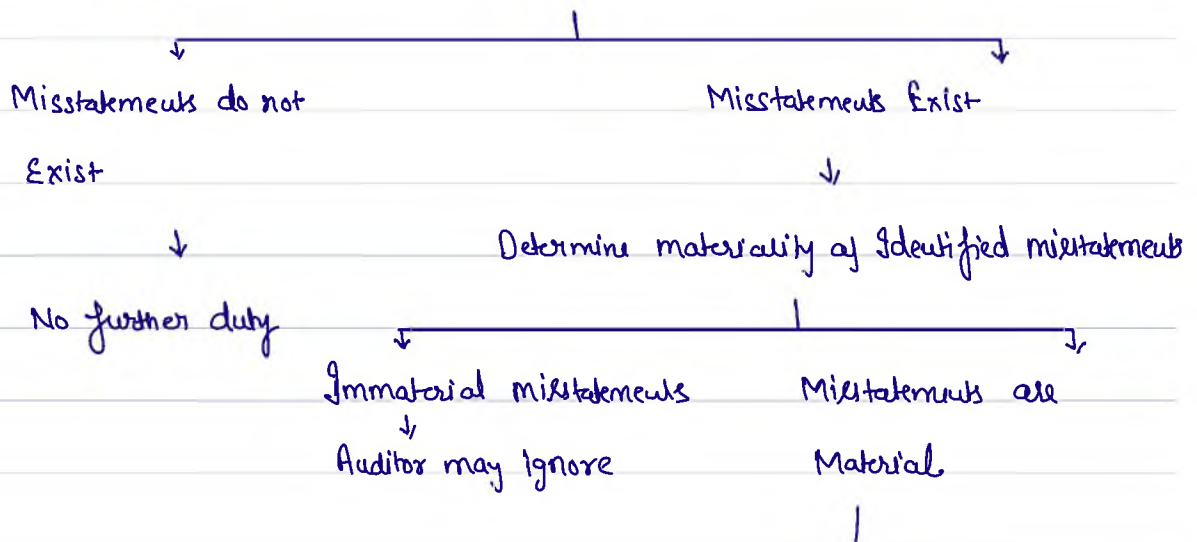
For this purpose, SA-200 requires that the auditor should maintain an attitude of professional skepticism.

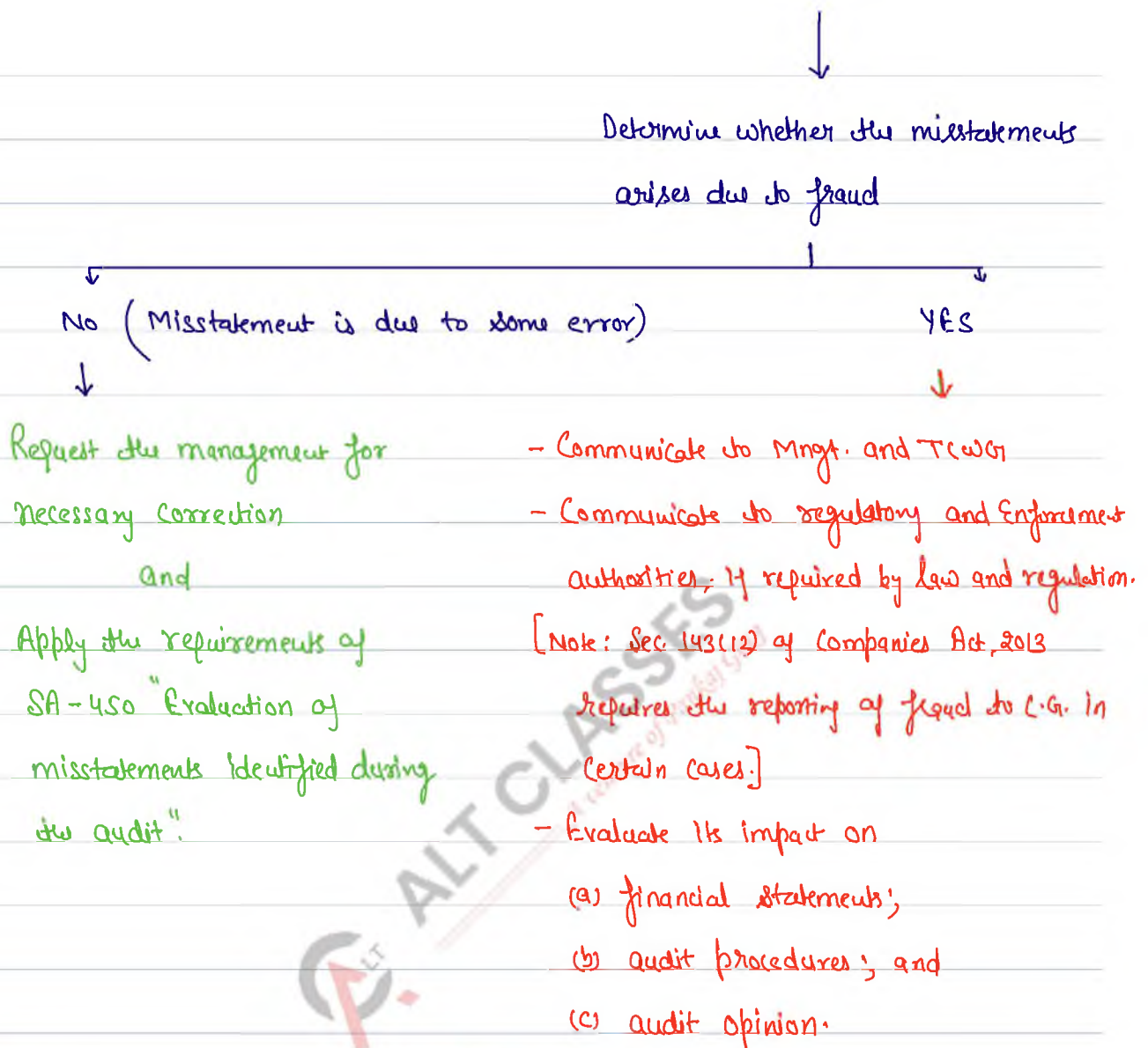
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Auditor may identify the circumstances or events that create doubt as to possibility of some misstatements.

↓

Auditor should perform appropriate procedures to conclude whether misstatements in financial statements exist.





(iii) Auditor unable to complete the Engagement:

- If auditor concludes that it is not possible to continue performing the audit due to fraud or suspected fraud, he should
 - ✓ (a) Consider the professional and legal responsibilities in such circumstances.
 - ✓ (b) Consider whether there is a requirement to report to person who made the appointment or to the regulatory authorities.
 - ✓ (c) Consider the possibility of withdrawing.

- If auditor withdraws, he should discuss it with the appropriate level of management and TCWG and consider whether there is any legal requirement to report the withdrawal to any person.

Note: Refer Sec. 140(2) of the Companies Act, 2013.

Imp:

(iv) Auditor's responsibility for failure to detect fraud:

- to be learned from book -

H.W: Revise from main book.

Learn Q1A from Q1B.

Written practice of 3-4 Questions.

(v) Fraud Risk factors:

SA 240 defines the term fraud risk factors as "Events or Conditions that are Indicative of (a) Incentive or pressures to

Commit frauds

(b) an opportunity to

Commit fraud.

Examples of fraud risk factors: - to be learned from book -

(H.W.)

Fraud risk factors



(a) Incentives / Pressures

(b) Opportunity to

Commit frauds

(c) Rationalisation to

Commit frauds

Fraudulent financial reporting

Misappropriation of assets.

(i)

(ii)

(iii)

(iv)

(i)

(ii)

(iii)

(iv)

(i)

(ii)

(iii)

(iv)

(i)

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(i')

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(i)

(ii)

(iii)

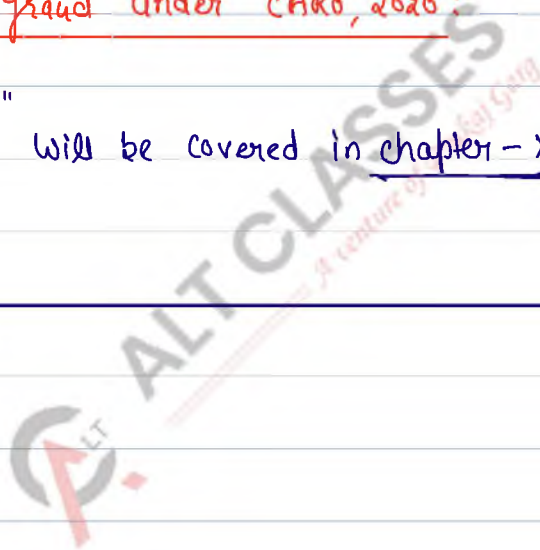
(iv)

(vi) Conditions or Events that increase risk of fraud or Error:

- (a) Discrepancy in Accounting records
- (b) Conflicting or missing Evidences
- (c) Unusual relationships between Auditor and mgmt.
- (d) Others

(vii) Reporting of fraud to (C.G. U/s 143(12) of Companies Act, 2013 and Reporting of fraud under CARO, 2020:

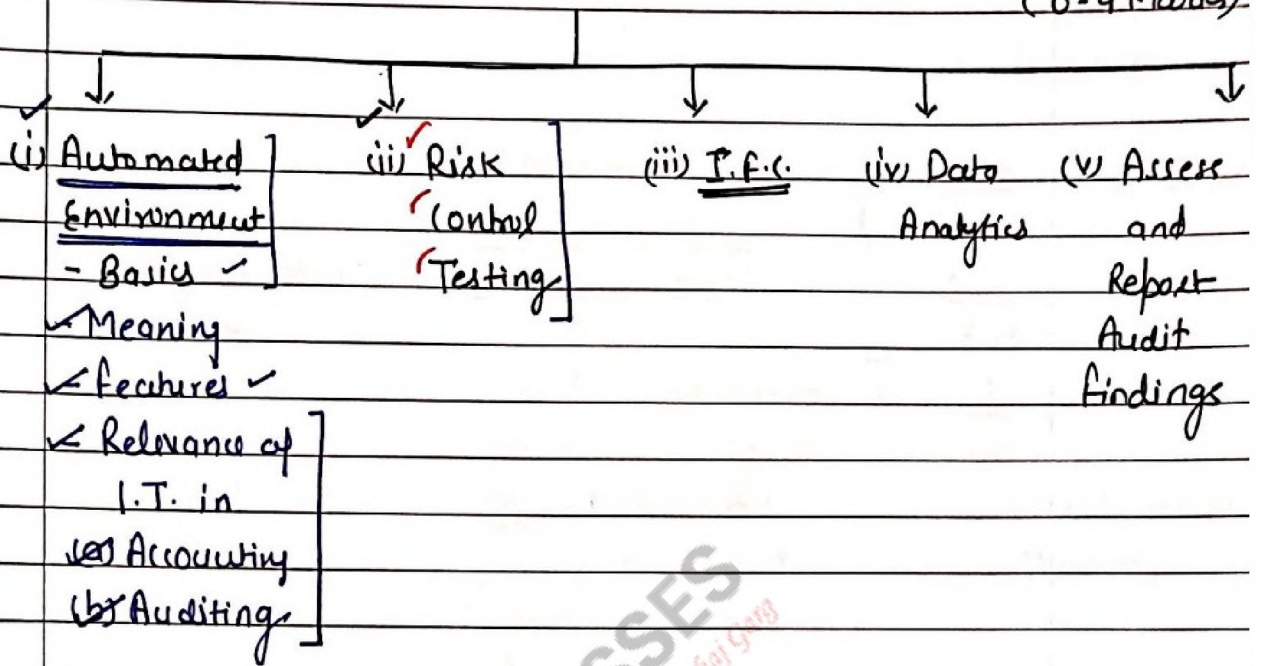
" Will be covered in chapter - X "



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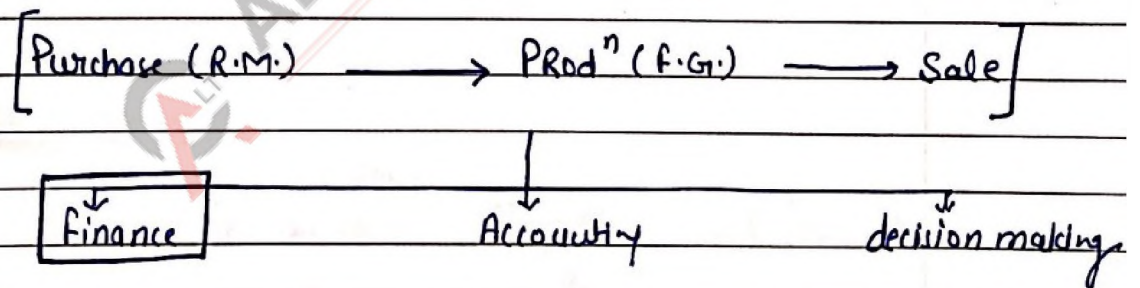
Chapter - 6 " Audit in an Automated Environment "

(0-4 Marks)



Automated Environment

Business Entity - ERP (Enterprise Resource Planning) Software



Risk → SA 315

↳ Identity + Assess + Respond

Whether risk exist

Understanding of Entity, Environment + I.C.

documented

RAP

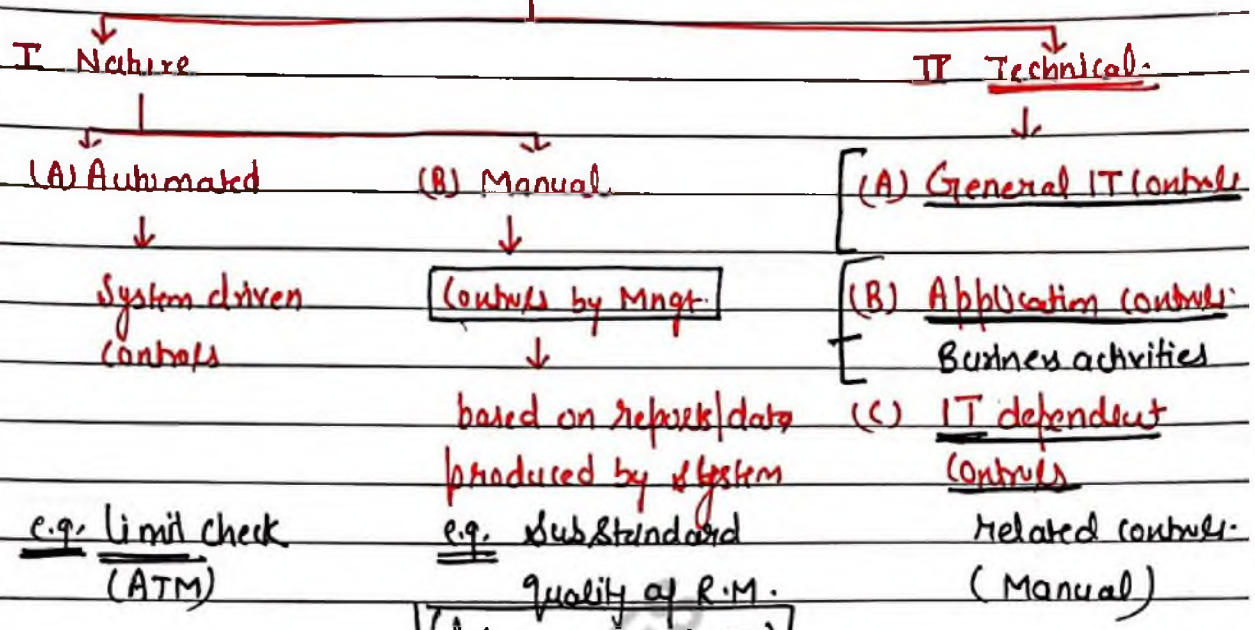
Assessment of Risk

- High
- Moderate
- Low

Responses

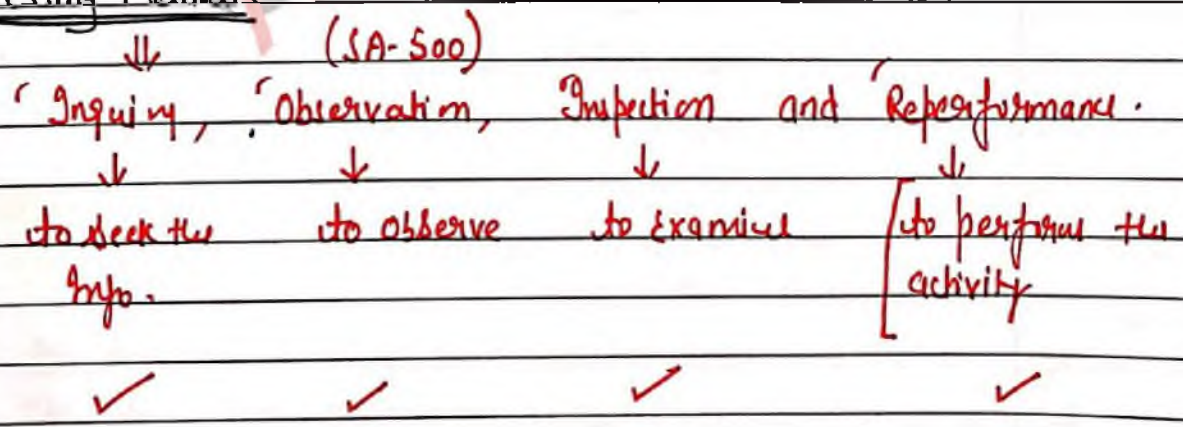
- Substantive Testing
- Compliance Procedures
- Reporting

Controls



	Supplier (X)	Supplier (Y)
	(Input-Output Ratio)	
	Q-1 = 90%	Q-2 = 90.5%
	Q-3 = 89.9%	Q-4 = 84.1%
	89.8%	

Testing Methods:



Lecture No. 2 of Chapter No. 6

(iii)

I.F.C.

(iv) Data Analytics

(v) Assess and Report
Audit findings

Meaning → Sec. 134(5) - Director's Responsibility Statement

Internal financial control → Existence
→ Operating Effectiveness

I.F.C. → Policies and Procedures → adopted by company for

- orderly and smooth functioning of company business
- safeguarding of assets
- prevention and detection of fraud and errors
- Accuracy and completeness of accounting records
- Timely preparation of reliable financial information

IFC reporting requirements → Directors → Sec. 134(5)
→ Rule 8(5)]

→ Auditor - Sec. 143(3) (i)

→ Sch. IV - Independent directors

→ Sec. 177 - Audit Committee → g.c.

- ① Sec. 134(5) → Director's Report → IFC → Existence and Effectiveness
- ② Sec. 143(3)(i) → Auditor's Report → IFC w.r.t. → Existence and Effectiveness
F.S.
- ③ Rule 8(5) → Director's Report → IFC w.r.t. → Adequacy (Existence) financial reporting
- ④ Sch. IV → Independent directors → Integrity of financial info.
financial controls and Risk Mngt.
- ⑤ Sec. 177 → Audit Committee → comments - g.c. - Statutory auditor / J.A.
(Robustness and Defensibility)

DATA ANALYTICS

Analytical process

Meaningful information is being extracted

from raw data

Using tools, processes and techniques

↳ Excel / Audit software / CAATS

Weakness identified in I.C.

whether it constitute deficiency in I.C. (Non-existent I.C. / ineffective I.C.)

YES

NO

Significant deficiency - YES

NO

Communicate to TCWG and

Impact - audit opinion / Audit report

Conclusion.

Report to Mngt.

Assess impact -

- Compensatory Controls
- Mitigating Factors
- Impact on I.T. Controls.

Chapter - 7 "Audit Sampling"

① Introduction to Sampling: [Traditional Approach vs Risk Based Approach]

- to be covered / learned from book -

② Meaning and types of Sampling:

SA 530 "Audit Sampling" defines the term sampling as -

"Application of audit procedures to less than 100% of items within a population, in a manner that all sampling units have equal chances of selection, so as to provide the auditor, a reasonable basis to draw a conclusion on the entire population."

Population: Entire set of data from which samples are selected.

Sampling Unit: Individual transactions forming the population.

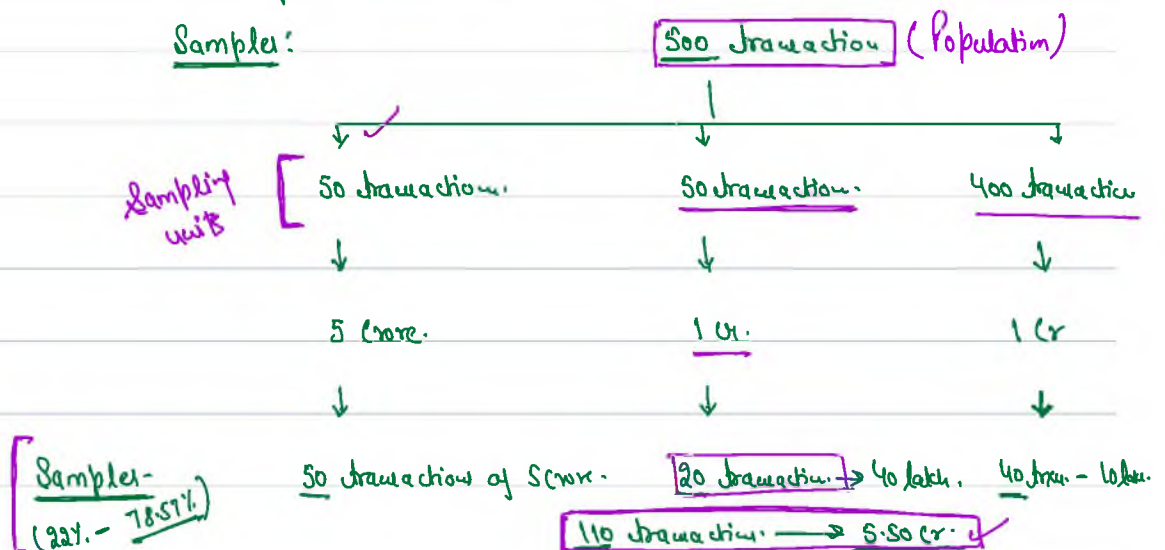
Samples: Sampling Units selected for audit purpose.

Example: Sales of X Ltd. for FY 2022-23 consists of 500 transactions for ₹ 7 Crores.

Population: 500 transactions of ₹ 7 Crores ✓

Sampling Unit: Each sale transaction

Sample:



Audit Sampling is primarily classified in two categories

(A) Statistical Sampling

(B) Non Statistical Sampling

Sampling approach, which has the following features:

- Random selection
- Use of Probability theory
- Ensures equal chances of selection
- Determination of Sampling Risk

(e.g. Systematic Sampling, Random Sampling)

An approach that do not have features of:

- Random selection; and
- use of Probability theory.

(e.g. Haphazard selection)

③ Advantages of Statistical Sampling:

- ✓ (i) Defensible and objective selection.
- ✓ (ii) Determination of calculated risk for a particular sample size.
- ✓ (iii) Determination of Minimum sample size for a specific risk
- ✓ (iv) Better presentation of Entire population, more particular in case of heterogeneous population (through use of stratification).
- ✓ (v) Consistency in sample size, irrespective of sampling units in population.

✓ (500 transaction example.)
Sample size

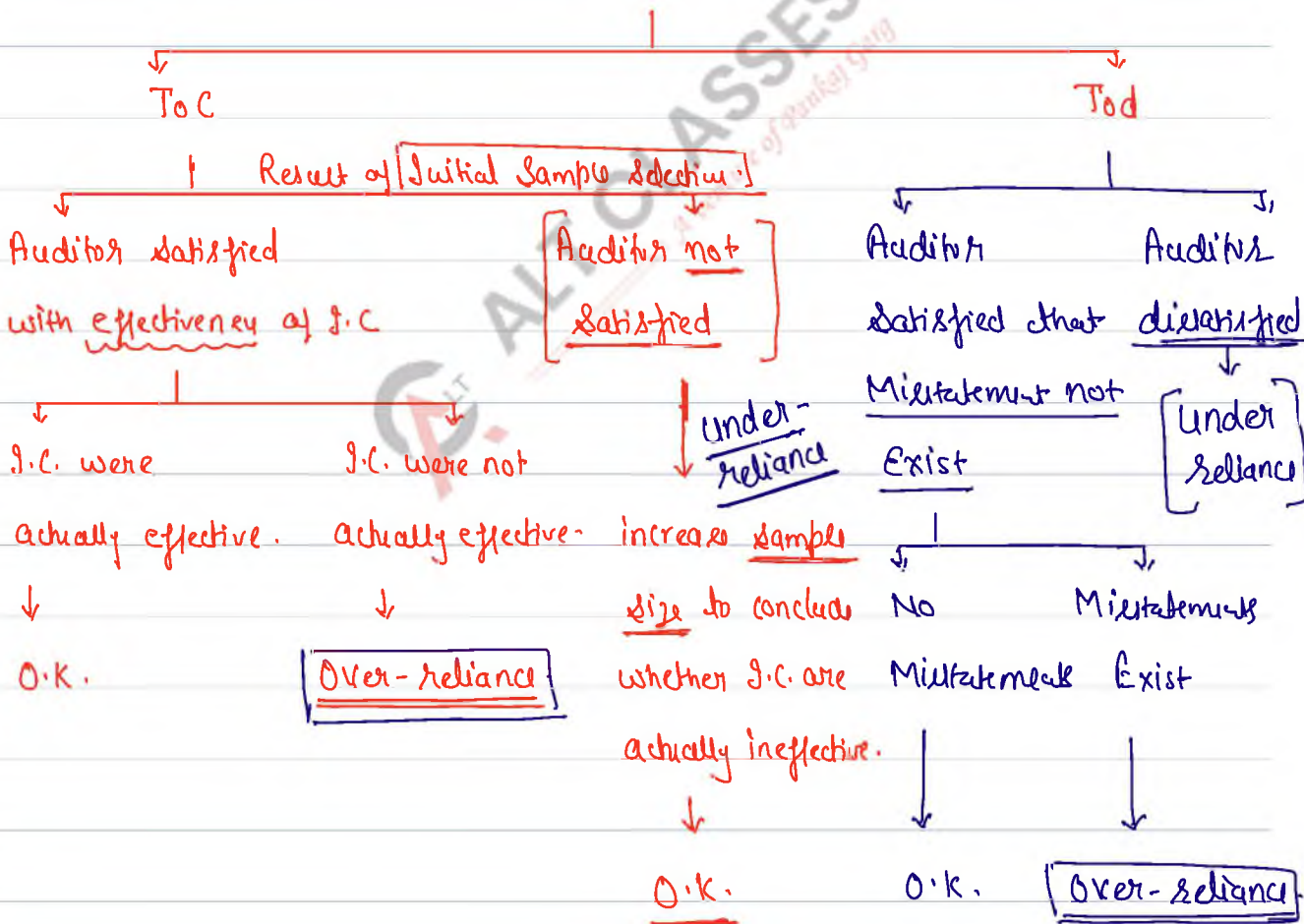
Population	5000 txn.	$\frac{5000}{500}$	= Every 10th txn.
"	10000 "	$\frac{10000}{500}$	= Every 20th "
"	20000 "	$\frac{20000}{500}$	= Every 40th "

Population: 1000 txu. - Acceptable Risk 5% - Sample Size -> ?
 10% -> " " -> ?
 20% -> " " -> ?

Population: 1000 txu. - Sample Size -> [100 txu. -> Sampling Risk - ?
 200 txu. -> " " - ?
 400 " -> " " - ?]

④ Sampling Risk:

Procedure



④ Sampling Risk: Risk that the auditor's conclusion based on a sample may be different from the conclusion, if the entire population was subjected to same audit procedure.

Sampling risk can be classified as :

Risk of over-reliance

Risk of Under-reliance

(a) w.r.t. ToC → Auditor may consider that S.C.

are more effective when actually they are not.

Auditor may consider that S.C.

are less effective when actually they are more effective.

(b) w.r.t. ToM → Auditor may consider that material misstatements does not exist, when actually they exist.

Auditor may consider that material misstatements exist, when actually they does not exist.

Impact → It leads to erroneous conclusion which affects audit effectiveness (Inappropriate opinion)

It leads to affect audit efficiency that requires more efforts to conclude that initial conclusions were wrong.

Non-Sampling Risk: Risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. (e.g. wrong procedures selected)

⑤ Sample design, size and selection:

(a) Sample designing: Auditor should design the population so as to ensure that samples represent the entire population. While designing the population, auditor need to consider the following:

- purpose of audit procedures; and
- Characteristics of the population from where samples are to be drawn.

For designing purposes, auditor may use the concept of (a) Stratification or (b) Value weighted selection.



Conversion of heterogeneous population into homogenous groups.



designing / selection of items based upon high monetary values.

(b) Sample Size: Auditor should determine the sample size in a rational manner so as to reduce the sampling risk to an appropriate low level.

Factors affecting determination of sample size:

- Risk of Material Misstatement.
- Auditor's tolerable range of deviation (T.C.) or misstatements (Allowance for error).
- Expected rate of deviation.
- Designing of population (i.e. stratification)
- Desired level of Assurance.

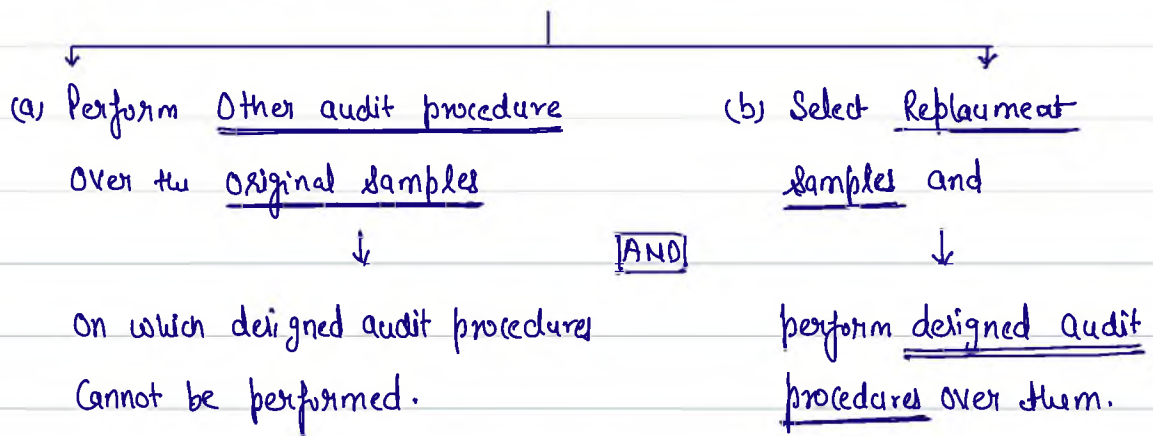
(c) Sample selection: Auditor should select the samples from the population in such a manner that no biasness enter into selection and every transaction has equal chances of selection.

Methods for sample selection: Following methods can be used for selection of samples:

- (a) Random No. selection.
- (b) Systematic selection
- (c) Monetary Unit selection
- (d) Block selection
- (e) Haphazard selection.

⑥ Performing audit procedures and evaluating results of audit sampling:

- Auditor should perform designed audit procedures over the selected items.
- If designed audit procedures cannot be performed over the selected items, auditor shall consider the following:



- ↓
- If auditor is not able to collect audit evidence by performing other audit procedures over the original samples, auditor shall treat it as deviation w.r.t. Internal control; misstatement w.r.t. accounting data.
 - Auditor shall investigate the nature and cause of deviations and misstatements identified and evaluate their possible effect on audit opinion.
 - Auditor shall project misstatements found in the samples to the population so as to obtain a broad view of scale of misstatements.
 - If a misstatement has been established as an anomaly, it may be excluded while projecting misstatements to the population. However, effect of any such misstatement, if uncorrected, still need to be considered in addition to the projection of the non-anomalous misstatements.

Evaluating results of audit sampling:

- Auditor shall evaluate the results of the samples and determine whether the use of audit sampling has provided a reasonable basis for conclusion for the entire population that has been tested.
- If auditor conclude that audit sampling has not provided a reasonable basis for the conclusions about the population, auditor may request the management to investigate the misstatements identified.

- while analysing deviations (ToC) and misstatements (TOD), auditor is also required to consider the qualitative aspects of misstatements identified by him. (e.g. type of a deviation, timing of occurrence of a deviation, processing of a deviation by a person).

H.w. [Reading | Revision of Entire Chapter from main book
- learning of Q/A.
- written practice of 4-5 Questions.



Chapter - 8 " Analytical Procedures "

① Meaning and Nature of Analytical Procedures :

SA- 520 " Analytical Procedures " defines the term " analytical procedures " as follow:

(items of f.s.)
" Evaluation of financial information through analysis of relationship among financial and non financial data and

also includes necessary investigation of identified fluctuations or relationships that differ from relevant information .

Example: Evaluation of Hotel Room Rent Revenue . by using a predictive model \rightarrow $\left(\frac{\text{Avg. Room Rent}}{\text{Per day}} \right) \times \text{No. of Rooms} \times \frac{\text{Occupancy}}{\text{Ratio}} \times 365$ days

Measurement .

$$\rightarrow 10000 \times 50 \times 90\% \times 365$$

$$= \boxed{16,42,50,000}$$

$$\text{Actual Room Rent Revenue} = 20,00,50,450$$

$$\text{Fluctuation} = 3,58,00,450 \text{ (21\% more than prediction)}$$

$$\text{Tolerable range (Acceptable level)} = \pm 5\%$$

Auditor need to investigate the fluctuation . For this purpose, auditor may inquire the management and perform other procedures like Vouching .

✓ Analytical Procedures Comprise of

↓
Consideration of
Relationships

- Among financial items
- among financial and non-financial items.

and

↓
Consideration of
Comparison

- with prior period information
- with anticipated results
(Budgeted data or auditor's prediction / expectation)
- with Industry information.

② Application of Analytical Procedures:

Analytical procedures may be applied during different phases of audit:

↓
(a) Initial (Planning) Phase

- to understand client's business
- to determine NTE of procedures to be performed
- to identify and assess Risk of Material Misstatement.

↓
(b) Execution Phase

- to collect audit Evidences for specific assertions
- to obtain reasonable assurance as to financial items.

↓
(c) Conclusion Phase

- for overall review
- to determine whether f.s. are consistent with auditor's understanding.

[use of Analytical Procedures during Initial phase is dealt by SA- 300 and 315]

[SA- 520 provides the requirements related to use of AP as SAP - Substantive Analytical Procedures]

③ Steps while performing substantive analytical procedures (SAP):

Step-1: To determine suitability of substantive analytical procedures:

- Auditor is required to determine nature of audit procedures to be performed over the accounting data, based on the circumstances.
- Auditor should determine the appropriateness of tests of details and analytical procedures to be performed.
- While determining use of analytical procedures, auditor should consider certain factors like -
 - (a) Availability of data.
 - (b) Disaggregation (classification) of data.
 - (c) Type of accounting information.
 - (d) Source of information.
 - (e) Comparability of information.
 - (f) Predictability of information.
 - (g) Nature of assertion to be evaluation.

Step-2: Evaluate reliability of data:

- Auditor should determine the reliability of data over which SAP are to be performed.
- Reliability of data is effected by following factors:
 - (a) Source of information available.
 - (b) Comparability of information available.
 - (c) Nature and relevance of information.
 - (d) Internal controls exercised over the preparation of information.

Step-3: Develop an Expectation of recorded amount or ratio and evaluate whether the expectation is sufficiently precise to identify the material misstatement:

Auditor is required to develop the expectation of recorded amount or ratio. While developing the expectation and evaluating the expectation, auditor should consider the following factors:

- (a) Accuracy with which the expected results can be predicted;
- (b) Extent to which the data can be disaggregated.
- (c) Availability of the information.

Example: Employees wages

	$(\text{No. of workers}) \times (\text{Avg. wages}) \times (\text{No. of days})$	
(a) skilled labour	$= 100 \times 1000 \times 300$	$= 3 \text{ cr.}$
(b) semi-skilled labour	$= 500 \times 800 \times 300$	$= 12 \text{ cr.}$
(c) unskilled labour	$= 1000 \times 600 \times 300$	$= 18$
	$\left[\begin{array}{l} \text{Actual wages as} \\ \text{Recorded in books of ABC} \end{array} \right]$	$= 35 \text{ cr.}$

Step-4: Determine the tolerable range of differences that can be accepted without further investigation.

Tolerable range: based on professional judgement of auditor and related circumstances

$= 1\%$

Expected recorded amt. = ₹ 33 cr.

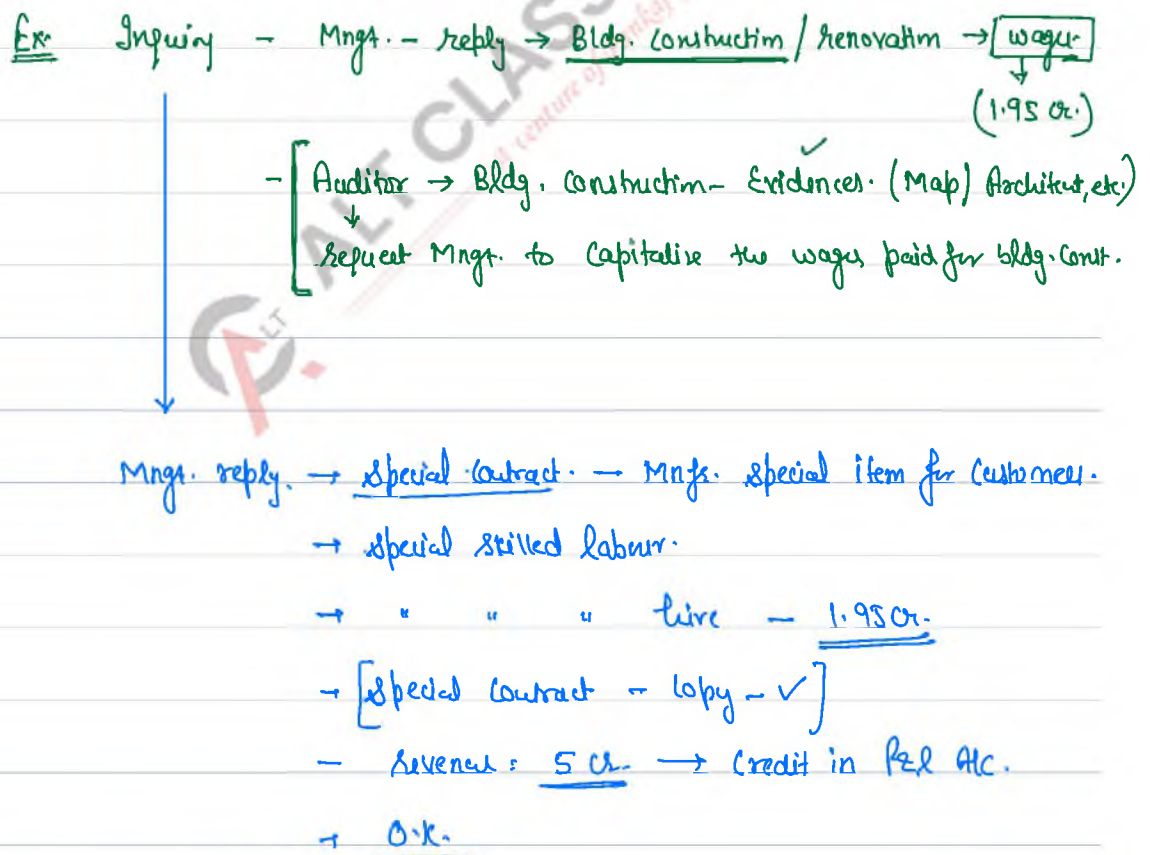
Actual " " = ₹ 35 cr.

difference = ₹ 2 cr. $\left[\textcircled{6\%} \text{ over the expected amt.} \right]$

Step-5: Investigating the differences beyond tolerable range:

If as a result of analytical procedures, auditor identify any fluctuation or relationship that is inconsistent with the relevant information by a significant amount, auditor shall investigate the difference by:

- Inquiring the management; and
- performing other audit procedures as seems appropriate in the circumstances.



H.w. - Quick Revision - from Main Book

- learning - QIA.
- written practice - 4-5 Questions.

④ Techniques while using SAP:

(i) Trend Analysis: Comparison of data of current period with data of one or more prior period.

	2022-23	2021-22	2020-21	2019-20
Sales:	39 Cr.	32 Cr.	31 Cr.	40 Cr.
(Sales)	56 Cr.	49.5 Cr.	44 Cr.	40 Cr.

Arrows indicate trends: Sales for 2021-22 and 2020-21 are circled, and arrows point from 2022-23 to 2021-22 and 2020-21. For (Sales), arrows point from 2022-23 to 2021-22 and 2020-21, and from 2021-22 to 2020-21.

(ii) Ratio Analysis: To establish relationship among financial and non-financial items.

It also involves comparison of significant ratios of current period with that of prior periods or anticipated ratio or industry averages.

(iii) Reasonable Tests: Such tests are applicable over income statement items, through which financial items are tested using non-financial data.

For Ex: Cost of goods produced may be tested using non-financial data like quantity of raw material used, labour hr. worked etc.

(iv) Structural Modelling: A modelling tool that constructs a statistical

2019-20	-	X ₁	Y	Z	model from financial and/or non-financial data of prior periods so as to predict the current period balances.
20-21	-	X ₁	Y	Z ₂	
21-22	-	X ₂	Y	Z ₄	
22-23	-	(P)	Y	?	

- Home work:
- (i) Quick Revision of Entire Chapter
 - (ii) Learning of Q/A
 - (iii) Written practice of few Questions -



Chapter - 9 "Audit of Items of F.S." (Lecture - 1)



(iii) Audit of Income Statement Items

- (a) Audit of Sale of Products and Services
- (b) Audit of other Incomes (Interest, dividend, Profit on sale of Investments, etc.)

- (a) Audit of Purchases
- (b) Audit of Employee Benefit Expense
- (c) Audit of Depreciation and Amortisation
- (d) Audit of other Expenses (Power and Fuel, Rent, Repairs, Insurance Travelling Exp. etc.)

- ### (iv) Other Misc. Provisions
- (a) Disclosure of CSR Activities
 - (b) Rounding off
 - (c) Details of Benami Properties
 - (d) Ratios
 - (e) Details of Cryptocurrency and virtual currency.

(i) Assertions: As per SA 315, assertions can be defined as "Representations by the management that are embodied in the F.S., as used by auditor to consider the potential misstatements that may occur.

Assertions used in the F.S.:

↓
Items of Income Statement

↓ (Income and Expenses)

(a) Occurrence

(b) Completeness

(c) Cut-off

(d) Measurement

(e) Presentation and Disclosure

↓
Items of Balance Sheet

↓ (Assets and liabilities)

(a) Existence

(b) Completeness

(c) Cut-off

(d) Valuation

(e) Rights and obligation

(f) Presentation and disclosure

(ii) Audit of Share Capital:

(A) Assertions: (i) Existence (ii) Completeness (iii) valuation and (iv) Presentation and Disclosure

(B) Audit Procedures: (i) General

(ii) Special Cases: (a) Issue of shares at Premium

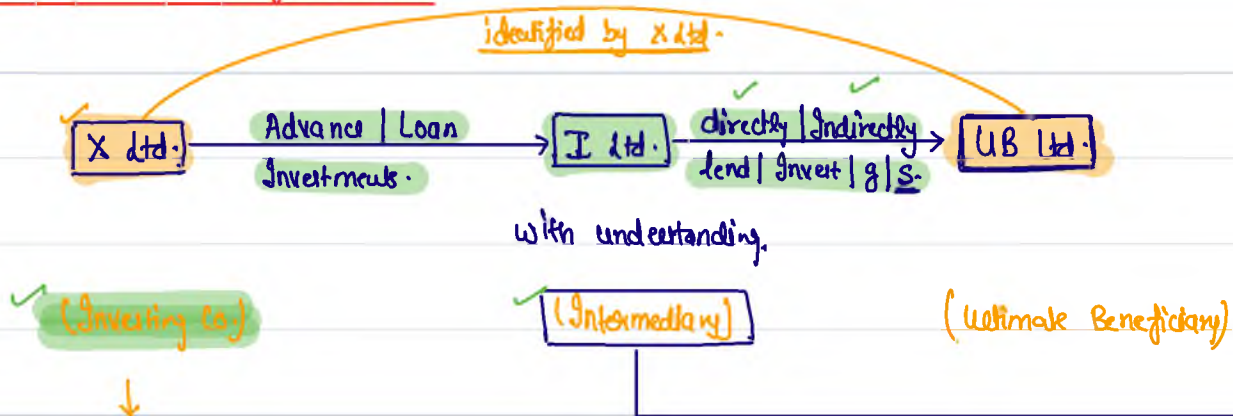
(b) " " " at discount

(c) " " Sweat Equity shares

(d) Reduction of share capital

(C) Disclosure requirements as per Sch-III:

(D) Addl. Disclosure requirements:



- date and amount of funds advanced / loaned or invested in Intermediaries with complete detail of each intermediary.
- date and amount of fund further advanced or loaned or invested by such intermediaries along with complete details of ultimate beneficiaries
- date and amount of guarantee or security provided to or on behalf of ultimate beneficiaries.
- declaration that relevant provisions of FEMA, 1999 and Companies Act, 2013 has been complied with and transactions are not violative of PMCA, 2002.

(Prevention of Money Laundering Act, 2002)

- date and amount of fund received from funding parties with complete details of each funding party.
- date and amount of funds further advanced / loaned / invested with other intermediaries along with complete details of other intermediaries or ultimate beneficiaries.
- date and amount of guarantee, security provided to or on behalf of the ultimate beneficiaries.
- declaration that relevant provisions of FEMA, 1999 and Companies Act, 2013 has been complied with and transactions are not violative of PMCA, 2002.

(iii) Audit of Reserves and Surplus:

(a) Meaning of Reserves and Provisions:

(b) Reserves vs. Provisions:

(c) Types of Reserves: Capital and Revenue

(d) Assertions to be Examined: (i) Existence

Self-Study -

(ii) valuation

(iii) Completeness

(iv) Presentation and Disclosure

(e) Audit Procedures: - from book -

(f) Disclosure Requirements:

(A) Sch-III:

(Noting - H.W.)

(B) Ind AS Compliant Sch-III:

Chapter - 9 "Audit of Items of F.S." (Lecture - 2)

- ① Assertions
- ② Audit of Share Capital
- ③ Audit of Reserves and Surplus
- ④ Audit of Borrowings:

Q.1: While verifying the borrowings of X Ltd, auditor plans to perform external confirmation procedures to ensure existence of borrowings from all banks and financial institutions.

In relation to this activity, guide the auditor as to specific aspects to be taken care of. (3 Marks)

Q.2: Mention the specific procedures to be performed by an auditor to verify that all borrowings have been accounted for in the books of the company on a timely basis. (i.e. Assertion of completeness) (3 Marks)

- ⑤ Audit of Trade payables and Current liabilities:

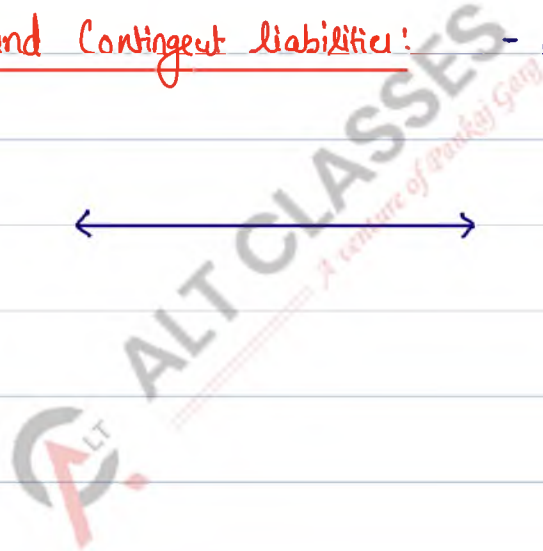
Q.1: Write a short note on the criteria for classification of liabilities into Current and Non-current liabilities. (4 Marks)

Q.2: What are the disclosure requirements of Sch-III w.r.t. the trade payables in relation to Micro and Small Enterprises (5 Marks)

Q.3: Auditor is required to examine various assertions like Existence, Completeness, Valuation and presentation etc. in relation to financial statements items. For this purpose, auditor perform various procedures, like direct confirmation, inspection of records, written representations, inquiry with mgmt. etc. In addition to these procedures, auditor may apply analytical procedures to examine various assertions.

[State the various analytical procedures to be performed to examine various assertions relating to trade payables. (5 Marks)]

⑥ Audit of Provisions and Contingent liabilities: - Self Study -



Chapter - 10 "Audit and Auditors" [Inter-law + Audit]

Coverage: Law and Audit → Chapter X of Companies Act, 2013 (Secs 139 to 148)
→ Companies (Audit and Auditor's) Rules, 2014 - CAAR
→ Companies (Cost Records and Audit) Rules, 2014

Audit → Companies (Auditor's Report) Order, 2020 - CARO
→ SA-299 - Joint Audit of financial statements
→ SA-600 - Using Work of another auditor

① Appointment of Auditors: (Sec. 139)

(A) First Auditor:

(i) Non-Govt. Co. - Sec. 139(6)
↓
BOD Members
(30 + 90)

First auditor shall be appointed by Board of Directors within 30 days of registration of company.

↓
If BOD fails, BOD shall inform the members and members shall appoint the first auditor in General Meeting (EGM) within 90 days.

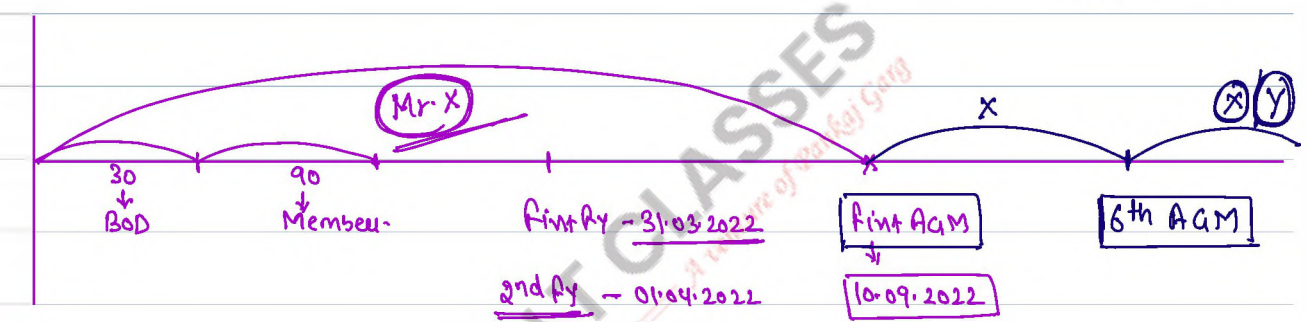
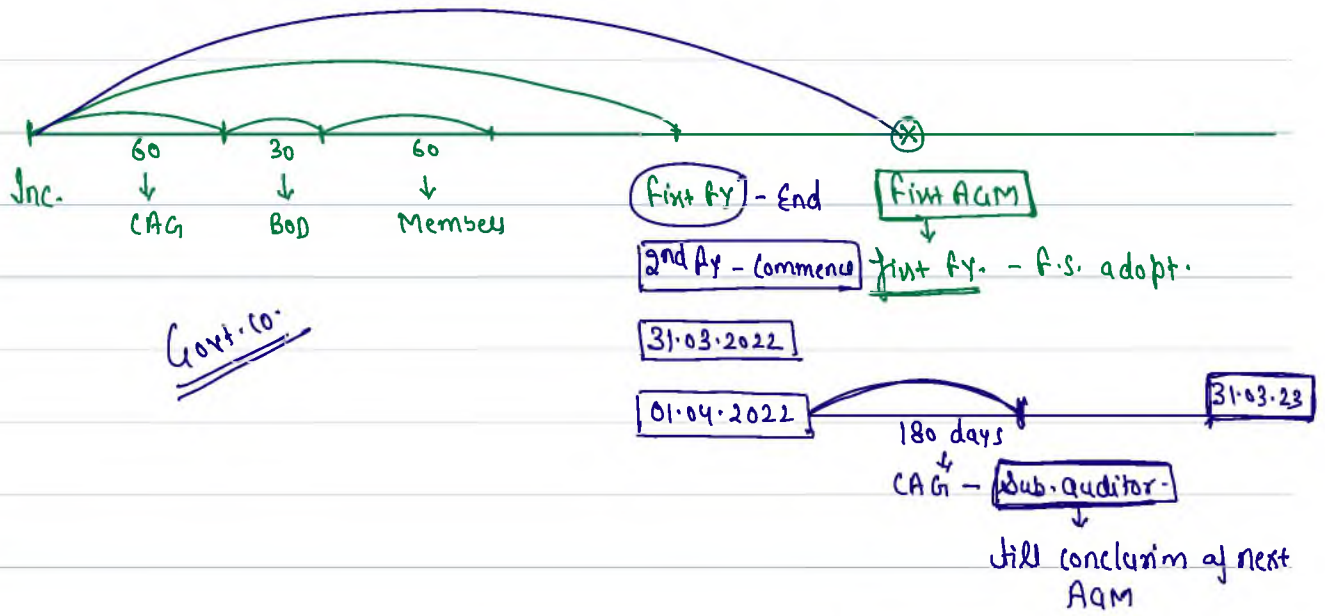
Tenure: till conclusion of first AGM

(ii) Government Company - Sec. 139(7)
↓
CAG BOD Members
(60 + 30 + 60)

First auditor shall be appointed by CAG within 60 days of regn. of company.

↓
If appointment not made by CAG within 60 days, BOD will appoint first auditor within next 30 days.

↓
If BOD fails, BOD shall inform the members and members shall appoint the first auditor in General meeting within 60 days.



- Inc.
- Written consent.
 - Certificate.
 - Submission - auditor + ROC

1. Adoption of f.s. of first year.
 2. Completion of tenure of first auditor
 3. Appointment of Sub-auditor.
- First auditor re-appointed as sub-auditor.
- Willing | Not disqualified |
 - No special notice | sp. resolution.

(B) Subsequent Auditor:

Non-Government Co. - Sec. 139(1)

Subsequent auditor of a non-govt. Co. shall be appointed at first AGM and thereafter at Every 6th AGM.

Tenure: till conclusion of 6th AGM.

Govt. Co. - Sec. 139(5)

Subsequent auditor of a Govt. Co. shall be appointed by CAG for every financial year

Within 180 days of commencement of each financial year.

Tenure: till conclusion of next AGM.

Appointment of subsequent auditor in non-govt. Co. shall be made in prescribed manner (Rule 3 of CAAR, 2014) and shall be subject to following conditions:

(i) Written Consent

Before appointment, a written consent of the auditor and a certificate that appointment, if made shall be in accordance with the provisions of the Act, shall be obtained.

(ii) Certificate

Certificate shall indicate that criteria as specified U/s 141 has been fulfilled.

✓ Sec. 141 - Eligibility, Qualification and Disqualifications of Auditor

(iii) Intimation

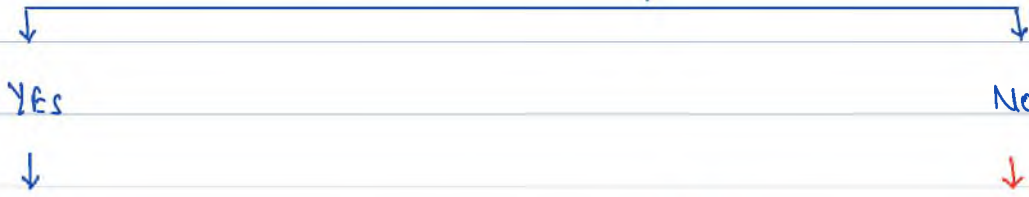
Company shall inform the Auditor of his appointment and file a notice of appointment in form ADT-1 with ROC within 15 days of appointment.

Note: Contents of the certificate to be

given by the auditor to the company are prescribed in Rule 4.

Rule 3: Manner of selection and appointment of auditor!

Company is required to constitute audit committee U/s 177



Audit Committee → shall consider the qualification and experience of the person proposed to be appointed as auditor

BOD shall consider the qualification and experience of the person proposed to be appointed as auditor.

shall forward the recommendation to the Board of Directors

→ BOD Agree →

BOD shall recommend the name of proposed auditor to members

↓
BOD disagree

↓
Members will appoint the auditor in AGM*

↓
BOD will request audit committee for reconsideration

↓
Audit committee agree

↓
Audit committee disagree

↓
Audit committee shall propose another name as auditor.

↓
BOD will record the reasons for disagreement and make its own recommendation to members

↓
Members will appoint the auditor in AGM*

* Note: If no auditor is appointed at AGM, existing auditor shall continue. [Sec. 139(10)].

Note: Companies required to have audit committee (Sec. 177):

Every listed public company and [other unlisted public companies] which satisfied any of the following conditions are required to constitute an audit committee:

✓ (a) Paid up Capital \geq 10 Cr.

OR

✓ (b) Turnover \geq 100 Cr.

OR

✓ (c) Outstanding loan, borrowings, debentures and public deposits \geq 50 Cr.

as on last day of latest audited F.S.

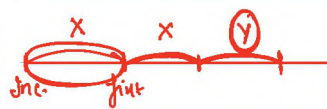
Rule 4 of Companies (Audit and Auditor's) Rules, 2014:

Contents of Certificate: - (Noting - H.W.)

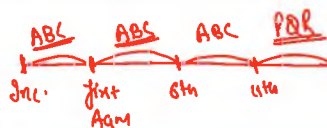
↓ Revision from Main Book.

② Rotation of Auditors:

(i) Sec. 139(2): Listed Companies and Other prescribed Companies (Rule 5) shall not appoint:



(i) an Individual - as auditor for more than one term of five consecutive years.



(ii) an Audit firm - as auditor for more than 2 terms of five consecutive years each.

Rule 5 of CAAR, 2014: Companies (other than small companies and OPC) covered below:

- ✓ (a) Public Unlisted Companies having PUC \geq 10 crores;
- (b) Private Companies having PUC $>$ 50 crores;
- ✓ (c) Companies not covered in (a) and (b) above, having borrowings from banks, financial institutions or public deposits \geq 50 crores.

Examples:

		<u>PUC</u>	<u>T/O</u>	<u>Borrowings</u>	<u>Rotation applicable or not</u>
A Ltd.	- <u>Listed</u>	5 cr.	-	42 cr.	Applicable (Listed)
B Ltd.	- <u>Listed</u>	15 cr.	-	90 cr.	" (")
C Ltd.	- <u>Unlisted</u>	<u>20 cr.</u>	-	25 cr.	" (PUC \geq 10 cr)
D Ltd.	"	6 cr.	-	46 cr.	Not applicable
E (P) Ltd.	"	10 cr.	-	46 cr.	" "
F (P) Ltd.	"	22 cr.	-	<u>51 cr.</u>	Applicable (Borrowing \geq 50)
G (P) Ltd.	"	<u>54 cr.</u>	-	42 cr.	Applicable (PUC \geq 50 cr)
H (P) Ltd.	"	<u>1.50 cr.</u>	<u>18 cr.</u>	<u>52 cr.</u>	Not applicable being a small company.

Provisions relating to rotation covered u/s 139(2):

(i) cooling off period: Individual auditor or firm auditor shall not be eligible for re-appointment for a period of 5 years in same company after completion of their respective tenures.

(ii) Disability of other firms having common partners:

Audit firms having common partners as on [date of appointment] with the firm whose tenure has just expired, shall not be eligible for appointment for a period of 5 years.

Example: XYZ Ltd. (listed company) is willing to appoint M/s ABC and Co. as their auditor. Its AGM to be held on 15.09.2022, in (PQR & Co.) which tenure of existing auditor expires.

Existing auditor (PQR and Co.) is having 3 Partners - P, Q and R

M/s ABC and Co. (Proposed auditor) is having 4 Partners - A, B, C and R

Q.1: whether ABC and Co. can be appointed as auditor in XYZ Ltd.

Ans: No, as Mr. R is a common partner as on date of appointment.

Q.2: Will your answer change, if ABC and Co. is having only three partners A, B and C.

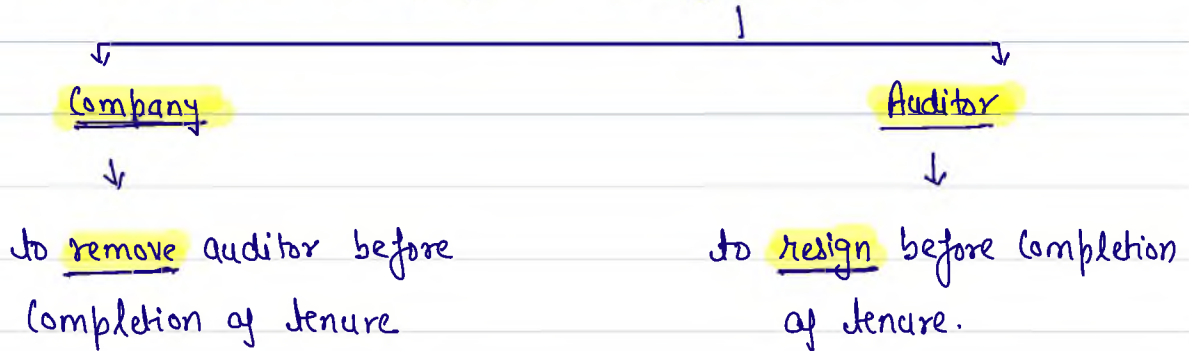
Ans: ABC and Co. can be appointed as auditor.

Q.3: Assuming that ABC and Co. is having 3 Partners A, B and C, and after their appointment as auditor in XYZ Ltd., Mr. R joins ABC and Co as a partner. whether ABC and Co. need to vacate the office.

Ans: ABC and Co. is not required to vacate the office.

(iii) Implications of Sec 139(2):

Sec. 139(2) shall not prejudice the rights of



(iv) Sec. 139(3): Rotation among auditing partner and Joint Audit:

Members of the company may resolve the following:

- A, B, C
- a) Rotation of auditing partner and his team at prescribed interval. (as decided by members)
 - b) That the audit may be carried out by more than one auditor (i.e. Joint Auditor).

Sy → $\begin{bmatrix} 1-A \\ 2-A \\ 3-B \\ 4-B \\ 5-C \end{bmatrix}$

Note: If more than one auditors are appointed then provisions of SA-299 "Joint Audit of financial statements" shall apply.

(iii) Sec. 139(4): Powers of C.G.:

C.G. may prescribe the manner of rotation for the purposes of Sec. 139(2).

Note: Rule 6 prescribes the manner of rotation for the purposes of Sec. 139(2).

(iv) Rule 6 : Manner of Rotation :

(a) Audit Committee shall recommend to Board the name of auditor who replaces the existing auditor.

BoD shall consider the recommendations of audit committee and forward to members.

Members shall consider the recommendations in AGM.

(b) For the purpose of rotation, individual auditor or audit firm shall not be eligible for a period of 5 years, if it belongs to same network to which retiring auditor belongs to.

Example: A Ltd. (Listed Company) is willing to appoint M/s XYZ and Associates as its auditor on completion of two tenures of M/s ABC and Associates.

Q.1 Whether XYZ and Associates can be appointed as auditor, if XYZ and Associates and ABC and Associates are part of Network of KPMG.

Ans.: No, as both firms belong to same network. [Rule 6]

Q.2. Whether XYZ and Associates can be appointed as auditor, if Mr. Z is a partner in XYZ and Associates as well as ABC and Associates.

Ans.: No, as Mr. Z is a common partner as on date of appointment. [Sec. 139(2)]

Q.3. Whether XYZ and Associates can be appointed as Auditor, if there is no common partner and no common network.

Ans: Yes, as Sec. 139(2) and Rule 6 do not prohibit/restrict such appointment.

Q.4 What will be the consequences if in Q.3, after appointment of XYZ and Associates as auditor,

(a) a partner of ABC and Associates join XYZ and Associates as partner.

(b) XYZ and Associates becomes part of Network MN considering that ABC and Associates is already a part of Network MN.

Ans: (a) No consequences, XYZ and Associates need not to vacate the office. [Sec. 139(2)]

(b) XYZ and Associates disqualified and need to vacate the office. [Rule 6]

(c) Break in the term should be for a continuous period of 5 years.

(d) A partner in charge of audit firm, who certifies the financial statements of the company, if retires from the firm and joins another firm of Chartered Accountants, that other firm shall also be disqualified to be appointed as auditor of that company for a period of 5 years.

Example: M/s ABC and Associates, having partners A, B and C is auditor of PQR (P) Ltd, having PUC of ₹ 80 Crores.

Tenure of ABC and Associates is expiring in upcoming AGM to be held on 20.08.2022.

FY FY 2021-22, audit report and financial statements were signed/certified by Mr. A.

Mr. A resigns from ABC and Associates on 10.08.2022 and joins MN and Associates.

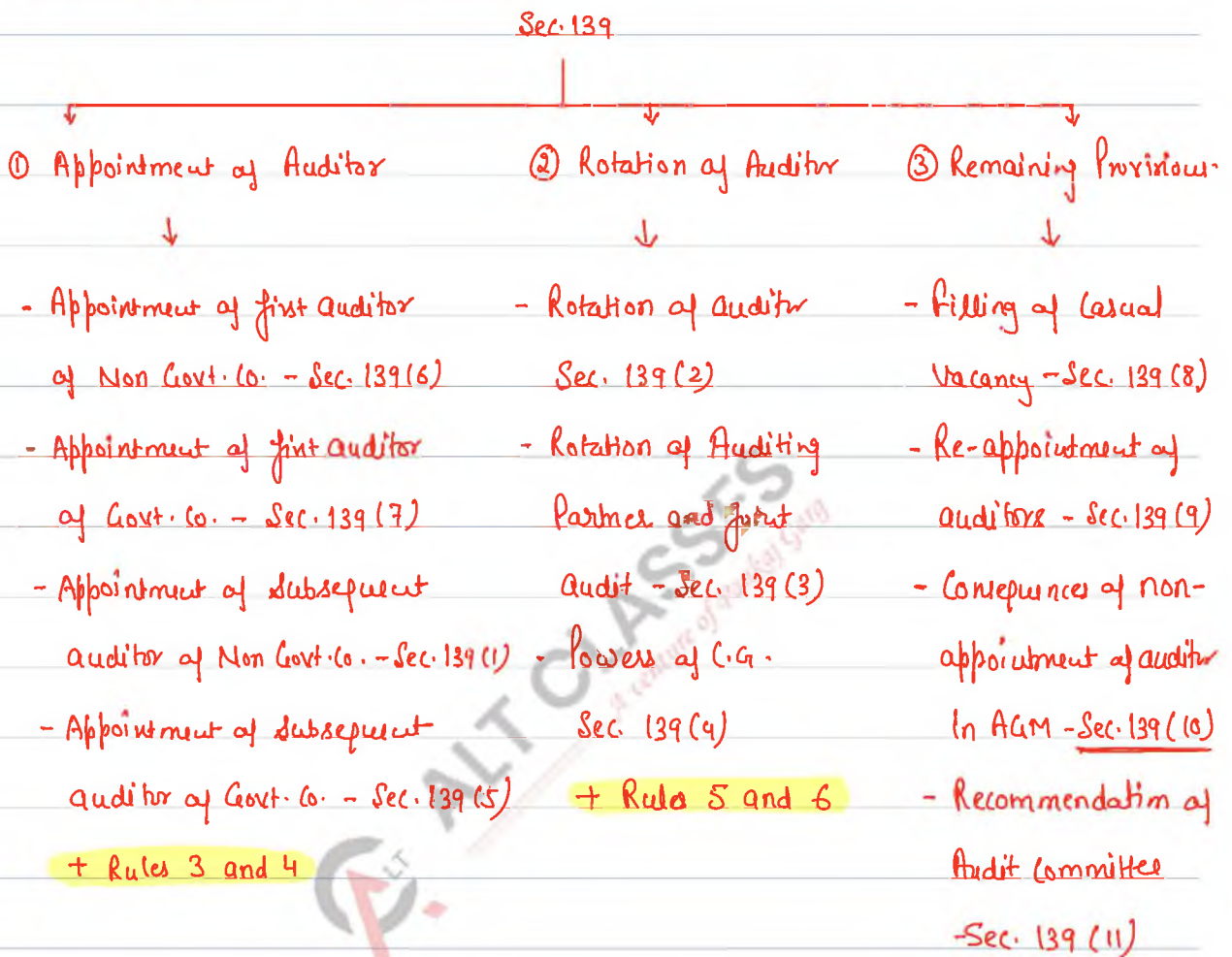
Q. Whether MN and Associates can be appointed as auditor in AGM of PQR (P) Ltd. on 20.08.2022.

A. No. as Mr. A, certifying partner of retiring firm, resigns from retiring firm and joins MN and Associates as auditor.

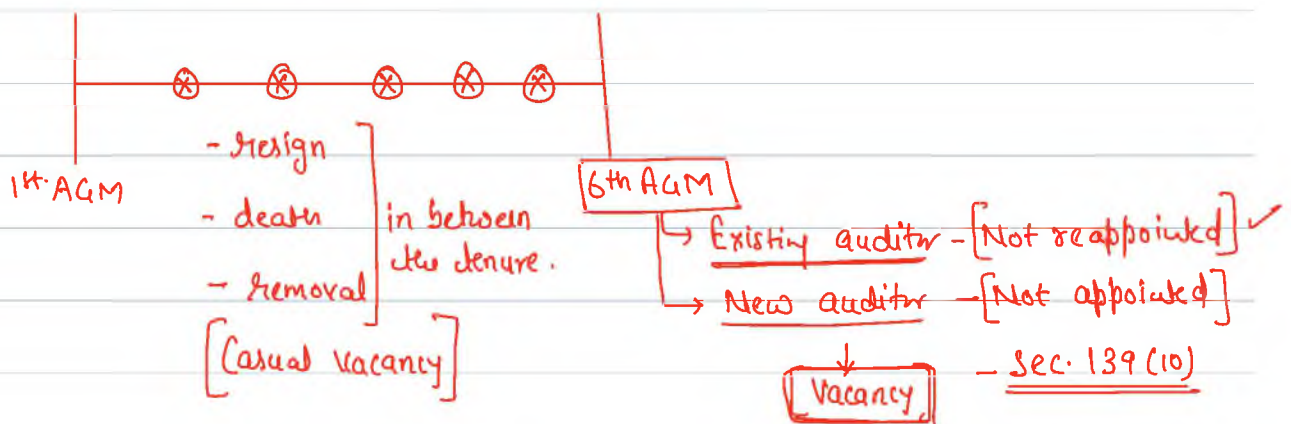
Q. What will be answer if Mr. A joins MN and Associates on 15.09.2022.

A. MN and Associates can be appointed as auditor in AGM to be held on 20.08.2022, but need to vacate the office on 15.09.2022, after being disqualified due to joining of Mr. A as partner.

③ Remaining provisions of Sec. 139:

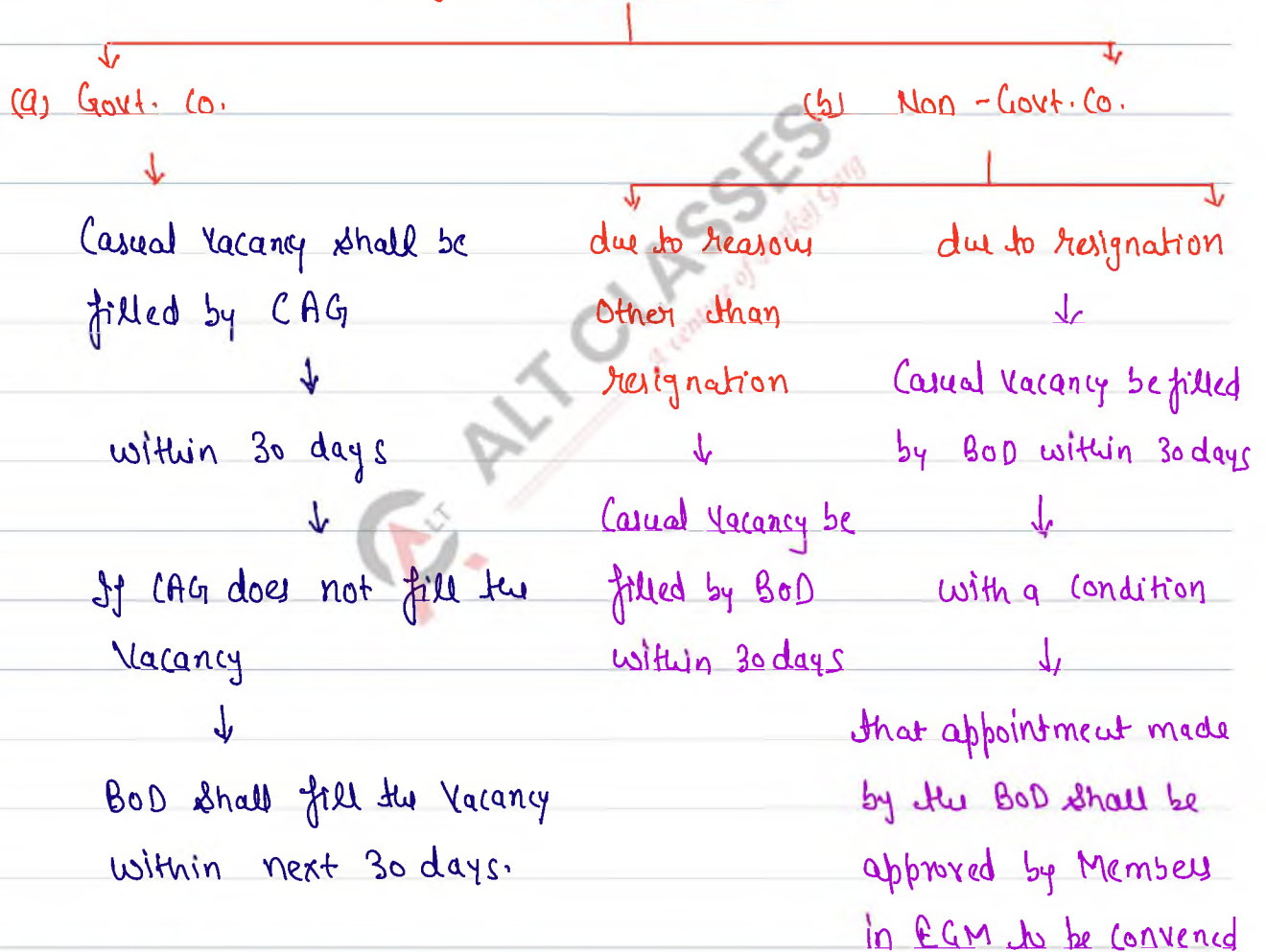


① Filling of Casual Vacancy - Sec. 139(8):

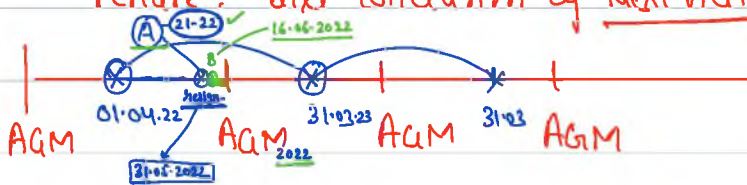


- Casual vacancy not defined anywhere in company law.
- Any vacancy created after valid appointment, but before completion of tenure, can be termed as casual vacancy
- Casual vacancy may arise due to death, resignation or removal etc. of the auditor.

Filling of Casual Vacancy - Sec. 139(8)



Tenure: till conclusion of Next AGM.



Tenure: till conclusion of Next AGM

(ii) Re-appointment of Auditor : Sec. 139(9)

As per Sec. 139(9), retiring auditor may be re-appointed, if:

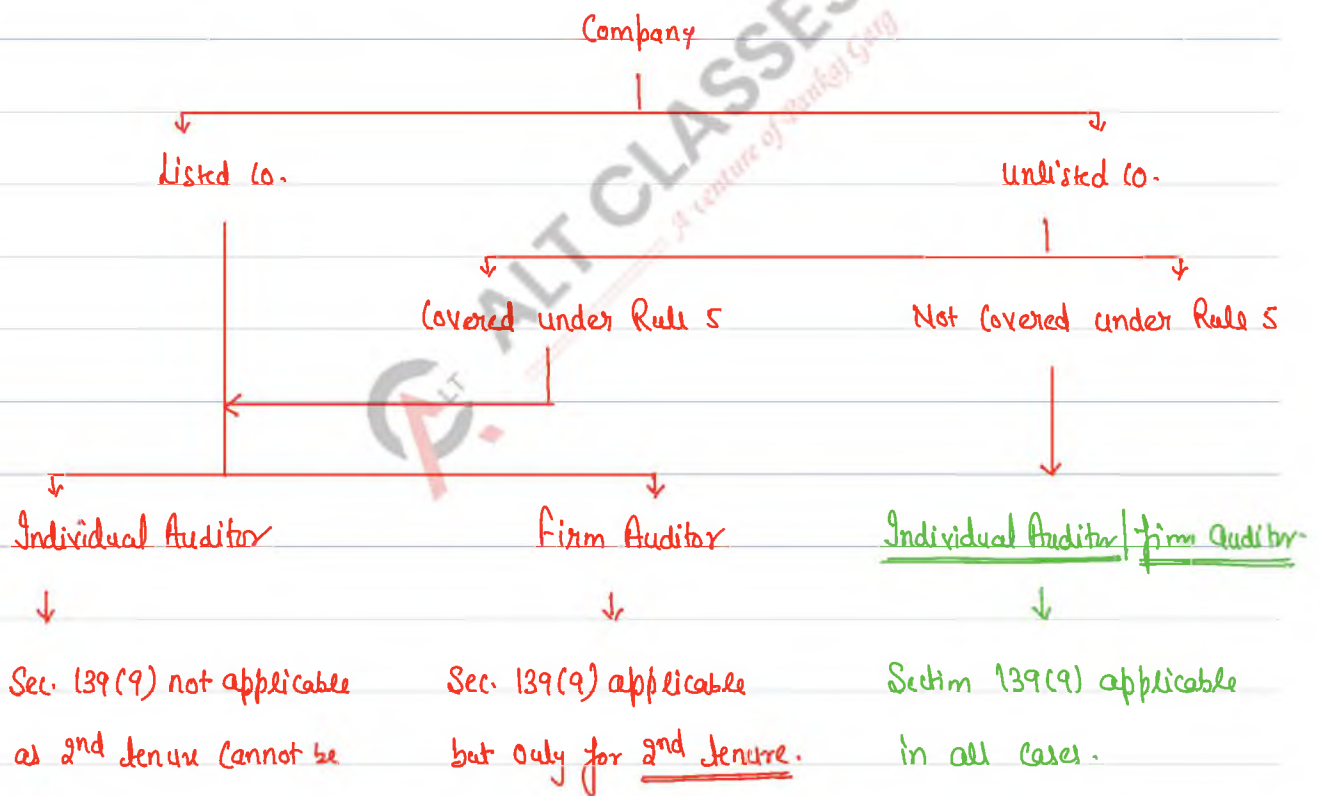
(a) he is not disqualified (i.e. qualified)

(b) he is not unwilling (i.e. willing)

(c) No special resolution was passed by the Company w.r.t.

(i) Appointing someone else as auditor; or

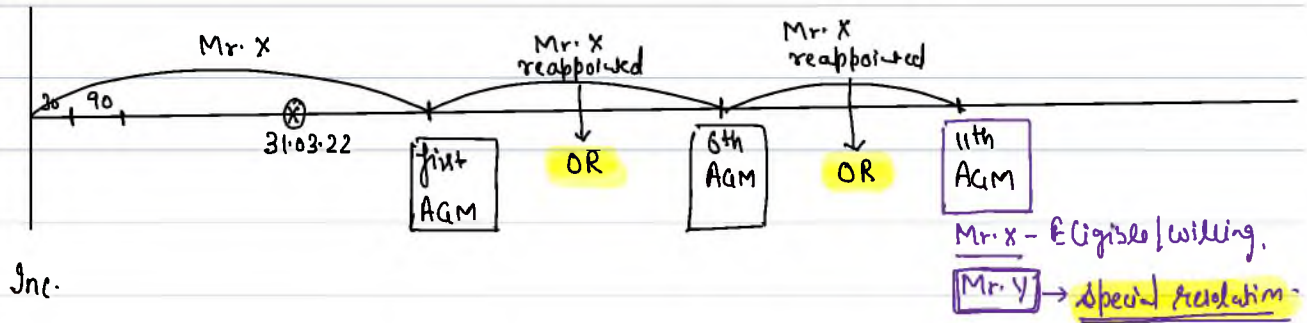
(ii) providing expressly that retiring auditor shall not be re-appointed.



given.

Note: To reappoint retiring auditor, Ordinary resolution is required. However, to appoint auditor in place of retiring auditor (who was eligible as well as willing to reappoint), special resolution will be required.

Non Govt. Co.: (Statutory provisions not applicable)



(iii) No appointment / Reappointment in AGM - Sec. 139(10)

If no auditor appointed / reappointed in AGM, existing auditor shall continue.

Note! Sec. 139(10) can be applied, provided:

- (a) Existing auditor not disqualified u/s 141.
- (b) Existing auditor is willing to continue.
- (c) Existing auditor is not under cooling period.

Note! If above mentioned conditions not met, then existing auditor cannot continue and there arises a vacancy in office of auditor.

(iv) Recommendations of Audit Committee : Sec. 139(11)

If a company is required to constitute Audit Committee u/s 177 of Companies Act, 2013, all appointments of auditor including filling of casual vacancies, shall be made after considering the recommendation of audit committee.

④ Removal, Resignation and Requirement of Special Notice : Sec. 140

(a) Removal before expiry of tenure : Sec. 140(1)

Auditor may be removed before expiry of tenure by:

(i) passing [Special resolution] in general meeting

and

(ii) obtaining [prior approval] of C.G. in prescribed manner. (Rule 7)

However, before taking any action, concerned auditor shall be given an [opportunity of being heard].

Rule 7: Application to C.G. shall be made within 30 days of passing Board Resolution, in form ADT-2.

within 60 days of approval of C.G. Special resolution is to be passed in general meeting.

Step-1 Opportunity of being heard

↓

Step-2 Board Resolution to be passed

↓ 30 days

Step-3 Application to be made to C.G. (ADT-02)

↓

C.G. Approval.

↓ 60 days

Step-4 Convene General Meeting to pass Special Resolution

(b) Resignation of Auditor:

Sec. 140(2): Auditor who has resigned shall file a statement of resignation in prescribed form to Company
(Rule 8 - AIT03) }
ROC and also to
CAG (in case of Govt. Co.)

↓
within 30 days of resignation

↓
stating the reasons and other facts relating to resignation.

Sec. 140(3): Penalty for contravention of Sec. 140(2):

Minimum = lower of ₹ 50000 or audit fees

Additional = ₹ 500 per day after the first for the period for which default continues.

Maximum = ₹ 2,00,000

Ex: Auditor resigns on 15.06.2022; statement of resignation filed on 25.08.2022.

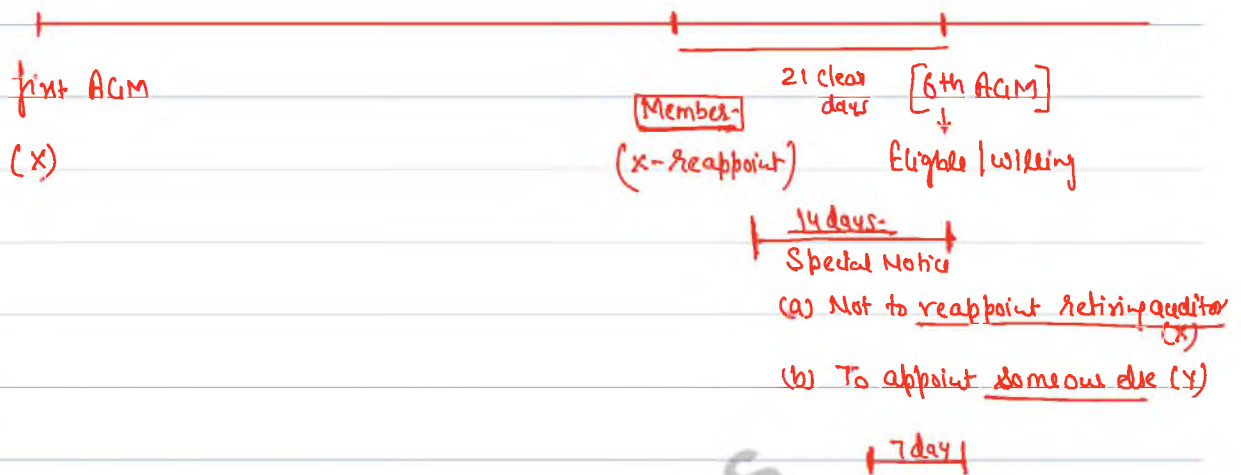
Audit fees was ₹ 60,000. State the Penalty u/s 140(3).

$$\text{Penalty} = \text{₹ } 50,000 + [(\text{₹ } 500) \times (41-1)]$$
$$= \text{₹ } 70,000$$

Delay: 16.07 - 25.08

$$= (16 + 25)$$
$$= 41 \text{ days}$$

(c) Requirement of Special Notice - Sec. 140(4)



- Special Notice is required to pass special resolution for
 - (a) appointing someone else as auditor; or
 - (b) not to reappoint the retiring auditor

↓

- Special notice shall be received by the company at least 14 days before AGM.

↓

- Company shall forward the notice immediately to retiring auditor.

↓

- Auditor has a right to give representation (reasonable length)

↓

- Representation received should be sent to members along with a copy of special notice received from the member

↓

- However, if the representation is received late, auditor may request the company to read out the representation in general meeting.
(In this case, ^{copy of} representation shall also be filed with ROC).

Note: If company or other person is of the opinion that auditor is abusing his right to secure needless publicity, a request may be made to Tribunal to pass an order for not sending the representation and not to read out the representation in general meeting.

M. Imp.
(D) Tribunal's direction for change of auditors : Sec. 140(5)

Tribunal may either suo moto or on application of C.G. or other concerned person, by order, direct the company to change its auditors

↓
If Tribunal is of the opinion that auditor of the company is directly or indirectly acted in a fraudulent manner.

Appointment of auditor by C.G.:

If on an application of C.G., Tribunal is of the opinion that change of auditor is required, Tribunal shall within 15 days of application direct that (a) he or it shall not function as auditor; and
(b) C.G. may appoint the auditor.

Note: Any individual or audit firm against whom any order has been passed by Tribunal u/s 140(5), will be disqualified to be appointed as auditor of any company for a period of 5 years and
- liable to be punished u/s 447 of Companies Act, 2013.

⑤ Eligibility, Qualification and disqualifications of auditor (Sec. 141):

(a) Sec. 141(1): A person shall be appointed as auditor only if he is a Chartered accountant having CoP (Individual Auditor).

A firm whereof majority partners are Chartered accountants practising in India, can be appointed as auditor in firm's name (Firm Auditor).

(b) Sec. 141(2): A firm (including LLP), if appointed as auditor, only the partners, who are Chartered Accountants, are authorised to act and sign on behalf of the firm.

(c) Sec. 141(3): Following persons shall not be eligible to be appointed as auditor of the company:

(a) Body Corporate (other than LLP):

Ex.: Mr. Ram (Practising CA) incorporates A (P) Ltd.

Whether A (P) Ltd. can be appointed as auditor of

any other company. No

(b) Officers / Employees of the company.

Ex.: Mr. Ram (Practising CA) is also a director of

A (P) Ltd.

Whether Mr. Ram can be appointed as auditor

of A (P) Ltd. → No

(c) Partner | Employee of Officer | Employee of Company.

Ex: Mr. Ram (Practising CA) is a director of ABC Ltd. Mr. Ram is also a partner of Ram Shyam and Associates (CA firm) having two partners Ram and Shyam.

Q. Whether Mr. Shyam can be appointed as auditor of ABC Ltd. → No

Q. Whether Mr. Hanuman [Employee of Ram Shyam and Associates] and also a practising CA, can be appointed as auditor of ABC Ltd. → No.

(d) a person, who himself or his partner or relative

- | | | |
|---|---|--|
| (i) is holding <u>any security</u> or <u>interest</u> in <u>Cs</u> [Company, its holding, subsidiary, associates, or another subsidiary of its holding co.] | (ii) is <u>indebted</u> to <u>Cs</u> for an amount <u>exceeding prescribed limit</u> [Rule 10 - ₹ 5 lakh] | (iii) has given any <u>guarantee</u> to <u>Cs</u> for <u>any loan</u> granted to third person for an amount exceeding prescribed limit |
|---|---|--|

Note: Relative may hold securities

in the [Company] for an

amount not exceeding prescribed

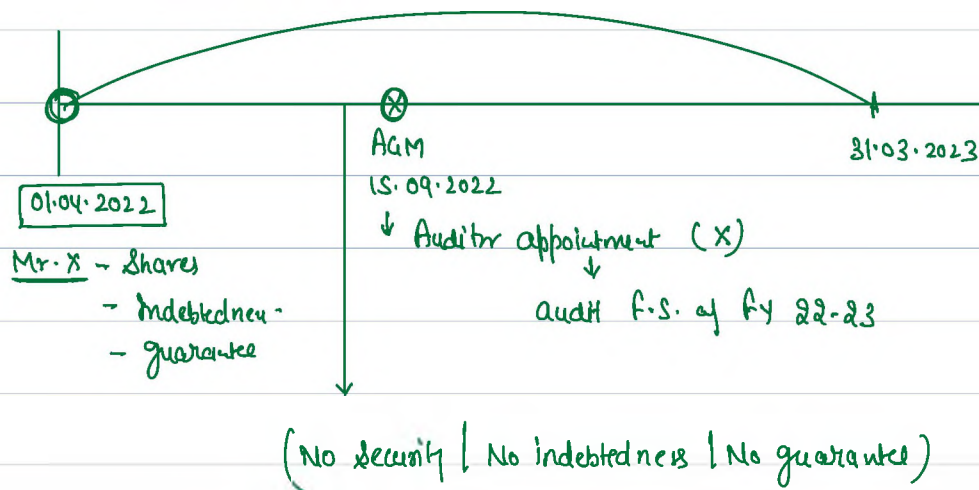
limit. [Rule 10 - F.V. upto 1 lakh]

Note: In the event of acquisition of share

> 1 lakh, after appointment, auditor is required to take corrective action within 60 days of acquisition.

[Rule 10 - ₹ 1 lakh]

Note. These provisions need to be examined at the time of appointment.



Ex. Mr. Ram is appointed as auditor of ABC Ltd. in AGM held on 20.09.2022.

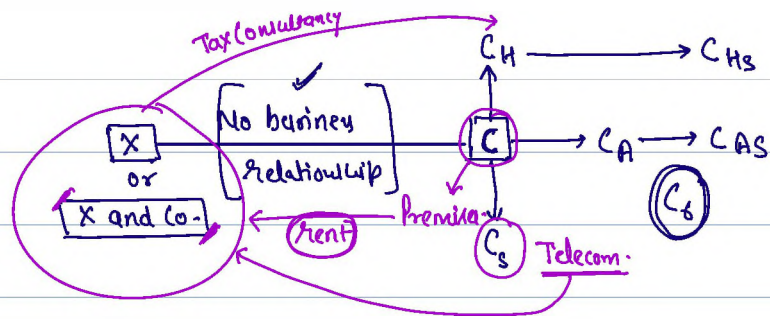
On 25.09.2022, Ms. Sita (wife of Ram) acquires shares of ABC Ltd. having f.v. 1.10 lakh (M.v. - 90,000)

State the consequences.

Mr. Ram is required to take corrective action within 60 days from 25.09.2022, so as to ensure that the shareholding of Ms. Sita in ABC Ltd. does not exceed ₹ 1 lakh.

However, if corrective action is not taken, Mr. Ram is required to vacate the office on expiry of 60 days from date of acquisition.

(e) a person, or a firm, who directly or indirectly is having any business relationship with the Company, its holding, subsidiary, associate or subsidiary of its holding or associate Co.



Business Relationship: - to be covered from book -

(f) A person whose relative is a director of the company or is in the employment of the company as a director or KMP.

Ex: Mr. X, brother of Mr. Y (Practicing CA) is a director of ABC Ltd. whether Mr. Y. can be appointed as auditor of ABC Ltd. - No.

Imp
(g)

A person who is in full time employment elsewhere
or

a person who is auditor of > 20 companies excluding
 (a) OPC

(b) Small Company

(c) Dormant Company

(d) Pvt. Ltd. Co. having

PUC < 100 Cr.

Ex: Mr. X having 40 audits - OPC - 5
 Small - 4

$$40 - 21 = 19$$

Dormant - X

Pvt. Co. PUC < 100 Cr - 12] (No default in filing

F.S. or annual return)

Note: As per Council General Guidelines, 2008, a member of ICAI, in practice can accept 30 audit assignments excluding OPC and dormant companies.

Ex. ABC and Associates is having 3 partners, A, B and C. C is also in full time employment with XYZ Ltd.

ABC and Associates is having 50 audits which comprises of audit of OPC - 5 ✓

" " dormant - 6 ✓

" " Pvt. Ltd. Companies PUC < 100 Cr. (no default in filing A.s) - 10 ✓

Public Companies - 29 ✓

Q.1 Maximum No. of audits which ABC and Associates can accept

(a) Under Company Law

(b) Under Council General Guidelines, 2008

Ans! (a) $20 \times 2 = 40$ audits excluding OPC, dormant, small co. and Pvt. Ltd. PUC < 100 Cr. (no default)

(b) $30 \times 2 = 60$ audits excluding OPC and dormant companies

Q.2. Compute the No. of audits which ABC and Associates can accept further within the ceiling limit.

Ans. (a) Company Law : $40 - 29 = 11$ audit

(b) Council Guidelines = $60 - 29 - 10 = 21$ audit.

Example: firm of ABC and Associates (3 Partners - A, B, C) = $\frac{C.Law - 60}{(20 \times 3)}$ | $\frac{Guideline - 90}{(30 \times 3)}$

Total Audits.	OPC + domestic	Small Co.	Pvt. PUC < 100 cr. No default.	Pvt. PUC < 100 cr. default.	Pvt. PUC > 100 cr.	Public	C.Law	C.G.G. 2008	
1.	100	10	20	5	5	10	50	65	90
2.	190	15	10	40	15	25	85	125	175
3.	150	10	-	50	10	5	75	90	140
4.	120	10	15	40	5	8	42	55	110
5.	100	20	10	-	2	4	64	70	80
6.	80	5	5	5	10	5	50	65	75
7.	100	20	10	12	8	10	40	58	80
8.	140	55	25	15	5	5	85	45	85

(h) a person who is convicted by a court, of any offence, involving fraud and a period of 10 years not elapsed since date of conviction.

(i) a person who directly or indirectly, renders any service referred U/s 144 to its company, or its subsidiary or its holding co.

(d) Sec. 141(4): Where a person attracts any disqualification referred to in 141(3), after appointment as auditor,

Subsequent disqualification.

↓

he shall vacate the office and such vacancy shall be treated as casual vacancy.

Ex. Mr. X (Practising CA) appointed as auditor of ABC Ltd in AGM held on 20.09.2022.

Mr. X purchases shares of H Ltd. (Holding of ABC Ltd.)

for ₹ 10,000 on 10.12.2022. Whether any consequence arise.
(F.V. = M.V.)

- Mr. X becomes disqualified and need to vacate the office immediately.

⑥ Remuneration of Auditor: (Sec. 142) - to be covered from book -

⑦ Auditor not to render certain services (Sec. 144): - to be covered from book -

Home work: Sec. 141, 142, 144, telling on no. of audits

✓ Revision / Reading from Main Book

- Learning of answers

- Written practice of few questions.

⑧ Rights of auditor:

(i) Right of access: Sec. 143(1)

Every auditor of the company shall have a right of access to the books of account and Vouchers, at all times, whether kept at the head. office or at any other place.

(ii) Right to obtain information and Explanation: Sec. 143(1)

Auditor has a right to obtain the necessary information and explanation for the purpose of audit, from the officers or employees of the company.

Note: If auditor is denied access to books of account or vouchers or necessary information or explanation has not been provided to him, auditor shall:

(a) Evaluate its effect on audit opinion (i.e. to determine the requirement of issuing modified opinion) - Qualified / Disclaimer and

(b) Report u/s 143(3) that all information and explanation required for the purpose of audit has not been provided.

(iii) Right of access to records of subsidiaries - Sec. 143(1)

Auditor of holding company has a right of access to records of subsidiaries and associate companies in relation to audit of Consolidated financial statements.

(iv) Right to resign before completion of tenure: Sec. 139(2)

(v) Right of opportunity of being heard: Sec. 140(1)

in relation to his removal before completion of tenure.

(vi) Right of representation - Sec. 140(4):

If special notice is received by the company from its members to pass special resolution w.r.t.

(a) appointing someone else as auditor

or

(b) providing expressly that retiring auditor shall not be re-appointed.

(vii) Rights in relation to general meetings: Sec. 146

(a) Right to receive notice of general meetings; and

(b) Right to be heard in general meetings.

Note: Auditor is required to attend general meetings (unless exempted by the company) either personally or through qualified representative.

(viii) Right to receive remuneration:

It is a contractual right established through letter of appointment and letter of engagement.

(ix) Right of lien:

It is a contractual right to retain the records, documents, books, etc. of client, in case of non-payment of audit fees.

Right of lien can be exercised subject to following conditions:

- (1) Lawful possession of records;
- (2) Non payment of fees; and
- (3) auditor has worked on these records, documents, etc.

Note: Due to legal requirements of sec. 128 of Companies Act, 2013, to exercise right of lien is practically, not feasible.

Further, Ethical Standard Board of ICAI recently decided that a practicing CA cannot exercise right of lien.



⑨ Auditor's duties and other incidental provisions: Sec. 143

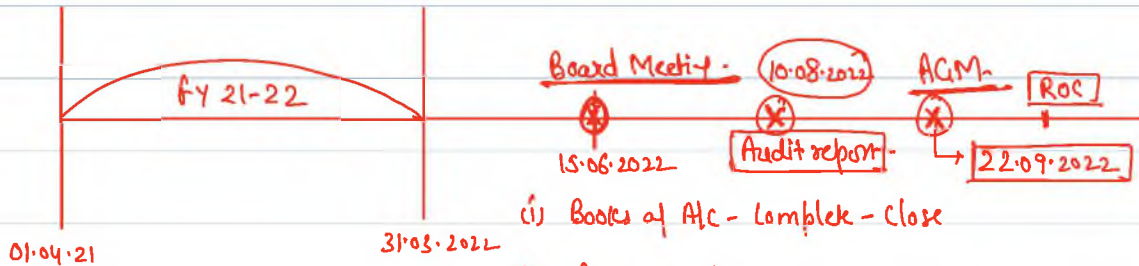
v.v. imp.
(i) Inquiry into propriety matters: Proviso to sec. 143(1):

- To be learned from book -

(ii) Reporting on Books of account and financial statements: Sec. 143(2)

- Auditor is required to make a report to the members of the company, on the accounts examined by him and financial statements which are laid before the members in general meeting.

- Report shall state the auditor's opinion on true and fair view of books of account and financial statements.



(i) Books of A/c - Complete - Close

(ii) F.S. - prepⁿ

(iii) F.S. - BoB - Board meeting - approve

(iv) F.S. - given to auditor

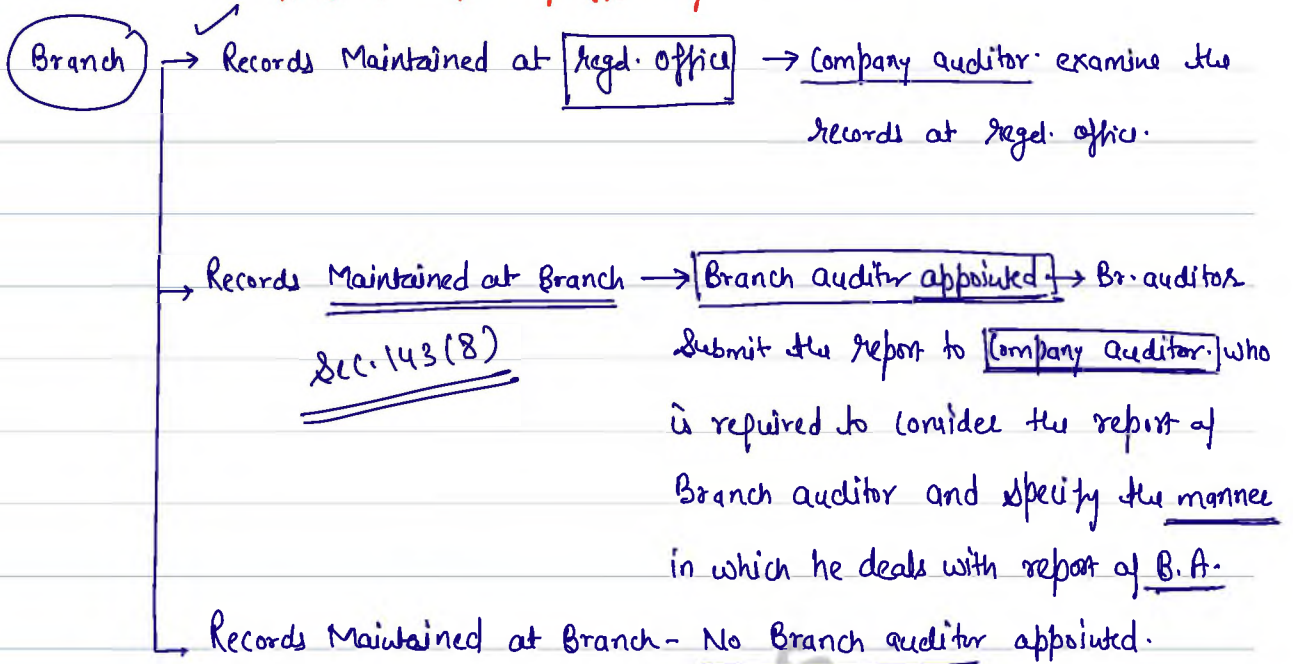
(v) Auditor examine the f.s. and issue audit report.

(vi) AGM - audited f.s. - adopt

(iii) Reporting on other matters : Sec. 143(3)

- to be learned from book -

- | | |
|--|---|
| (a) Info. and Explanation | (2) Such other matters as <u>prescribed</u> . |
| (b) Proper Books of A/c + Proper returns | ↓ (Rule 11) |
| (c) Report on accounts of Branch + Manner | (i) - Disclosure of Impact of pending litigations |
| (d) B/S + P/L A/c - agreement - books of A/c | (ii) - Provision for foreseeable losses - LIT contracts |
| (e) F.S. ———— Compliance with AS | (iii) - Delay - IEPF |
| (f) O/C → financial docs - adverse affect | (iv) - Mngt. Representation - <u>fund diversion</u> |
| (g) Director - Disqualified U/s 169(2) | (v) - Dividend - U/s 123 |
| (h) Q/R/A - Maintenance of A/c | (vi) - A/cy software - <u>Audit Trail facility</u> |
| (i) IFC - F.S. - in place and operating effectively. | |

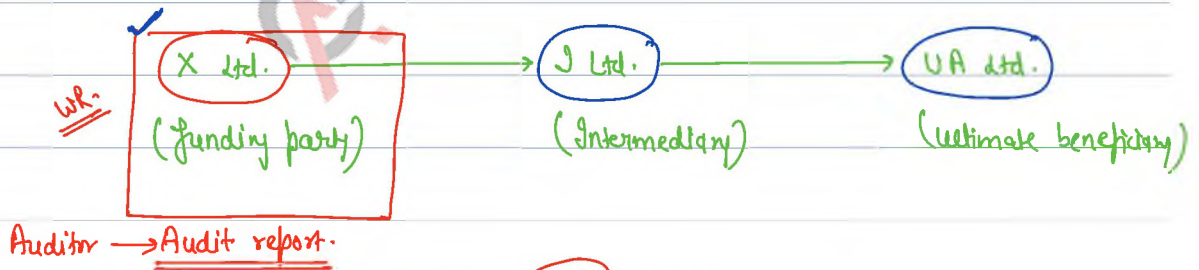


Company auditor may visited the branch to examine the records.

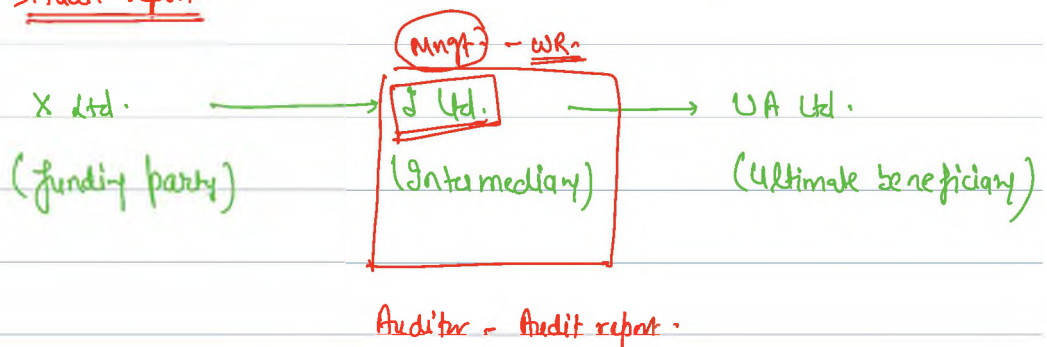
Co. Auditor may ask for the summarised return of the branch transactions, if branch not visited by him.

Rule 11

4 (1)



4 (2)

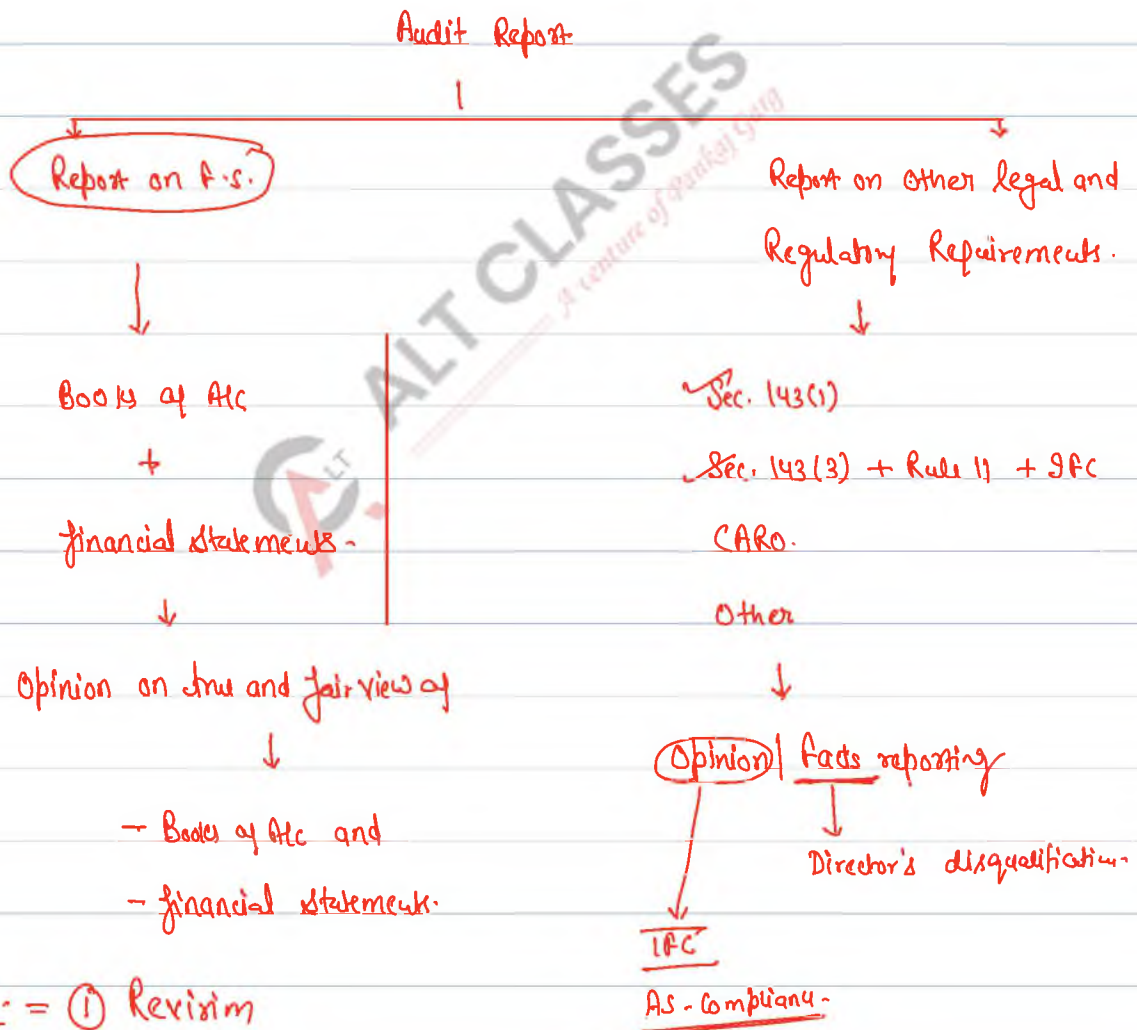


(iv) Reasons for adverse remarks: Sec. 143(4)

Where any of the matters covered U/s 143(3) is answered with negative or qualifier remarks,



auditor is required to state the reasons.



HW - = ① Revision

② Learning.

③ Written Practise - few Questions.

(v) Provisions w.r.t. Government Companies:

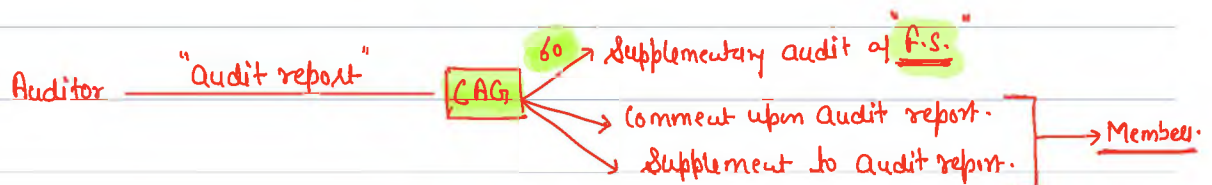
(a) Sec. 143(5): Rights of CAG to give directions:

- In case of Govt. Companies, CAGs appoint the auditor and may issue directions to such auditor as to the manner in which audit is to be carried out.
- Auditor of Govt. Co. in his report shall include the followings:
 - (a) Directions, if any, given by CAG.
 - (b) Actions taken thereon.
 - (c) Impact of such directions on financial statements.

(b) Sec. 143(6): Supplementary Audit:

- CAG shall within 60 days of receipt of audit report, have a right to order the supplementary audit of financial statements of a government company, by a person authorised by him; and
- to comment upon or supplement audit report.

Note: Any comment or supplement so made by CAG shall be sent by the company to every person to whom financial statements are being sent u/s 136.



(C) Sec. 143(7) : Test Audit

In case of government companies, CAG may, if considered necessary, pass an order, causing the entity to get the accounts audited.

	<u>Supplementary Audit</u>	<u>Test Audit</u>
① Related sections	Sec. 143(6)	143(7)
② Authority by whom order is passed	CAG	CAG
③ Companies on which provisions are applicable	Govt. Companies	Govt. Companies
④ Subject Matter	financial statements	Books of Account
⑤ Pre-condition	Audit of F.S. has already been done	- N.A. -
⑥ Time-limit within which order is to be passed	within 60 days of receipt of audit report.	as and when considered necessary by CAG.

(vi) Branch Audit : Sec. 143(8) and Rule 12 : will be covered separately.

(vii) Compliance with Auditing Standards : Sec. 143(9) and 143(10)

- Every auditor shall comply with auditing standards.
- C.G. shall prescribe the auditing standards (as recommended by ICAI) in consultation with and after considering the recommendations of NFRA.

(viii) Reporting on matters prescribed under CARO: Sec. 143(11)

CARO 2020 - Will be covered separately -

(ix) Reporting on Fraud: Sec. 143(12) to 143(15) and Rule 13

(a) Sec. 143(12): If auditor has reason to believe that an offence involving

✓ D₁ - [70 lakh] - Car -

✓ D₂ - [50 lakh] - Inv -

fraud of such amount as prescribed is being or has been committed, over the company, by the officer/employee of company

↓

auditor shall report that fraud to C.G. in prescribed manner. (Rule 13).

Note: If the amount of fraud is below threshold limit, auditor shall report the fraud to audit committee or BoD in prescribed manner.

(b) Sec. 143(13): It shall be deemed that auditor has not contravened^{*} any duty by reporting to C.G., if reporting is done in good faith. (* Breach of confidentiality).

(c) Sec. 143(14): Reporting requirement u/s 143(12) related to fraud also applicable, mutatis mutandis, over the:

(i) Cost Accountant; and (ii) Company Secretary.

(d) Sec. 143(15): In case of non-compliance of sec. 143(12), a fine shall be imposed over the auditor, cost accountant or company secretary - ₹ 5 lakh (in case of a listed company);
- ₹ 1 lakh (in case of other companies).

Rule 13 - Manner of Reporting

Auditor has reason to believe that fraud is being or has been committed over the company by the Officer/Employee of the company.

Amount of fraud \geq 1 Cr. (Individually)

Amount of fraud $<$ 1 Cr.

Auditor shall within 2 days of his knowledge, report the fraud to the Audit Committee / Board seeking their reply with 45 days

Auditor shall within 2 days of his knowledge, report the fraud to Audit Committee / Board

Reply received

Reply not received

mentioning the following:

- (a) Nature of fraud
- (b) Approx. amt. involved
- (c) Parties involved

Within 15 days of reply

On Expiry of 45 days,

forward a report in

forward a report in

Form No. ADT-04

Form No. ADT-04

along with:

along with:

Board's Report shall

include the following:

- (a) Original report
- (b) Reply of Audit Committee / Board
- (c) Comments over reply

- (a) Original report
- (b) a statement that reply not received

- (a) Nature of fraud
- (b) Approx. amount
- (c) Parties involved (if action not taken)
- (d) Remedial action taken.

to C.G. (Secretary, MCA)

through speed post / regd. post, in a

sealed envelope, followed by a E-mail

for Confirmation, on letterhead having Contact details.

⑩ Signing of Audit report: (Sec. 145)

- ✓ Signing of Audit report shall be in accordance with the provisions as stated up to (4)(2).
- ✓ Qualification/Reservation/Comments w.r.t. financial transactions or matters that may have any adverse effect on the functioning of Company, shall be read out in the meeting.

⑪ Auditor to attend general meetings (Sec. 146): - Already covered -

⑫ Penalties for Contravention: ^(Sec. 147) - to be covered from book -

(a) Over the company: for contravention of - fine ranging from
Sec. 139 to Sec. 146 ₹ 25,000 to ₹ 5,00,000

(b) Over the officers: " - fine ranging from
in default: ₹ 10,000 to ₹ 1,00,000

(c) Over the auditor: for contravention of - Min fine: ₹ 25,000
Sec. 139, 144 and 145 Max. fine: ₹ 5,00,000 or
4 times of remuneration, whichever
is lower.

for wilful default: - Min. fine: ₹ 50,000
Max. fine: ₹ 25,00,000 or 8 times of remuneration,
whichever is lower
AND → Imprisonment up to 1 year.

Note: If auditor is convicted u/s 147



he shall be liable to

(a) refund the remuneration

and

(b) pay the damages.

Sec. 147(5): - For civil liabilities and criminal liabilities - in relation to ^{fraud}
= Partner(s) + firm → jointly and severally
- For criminal liabilities other than fine → concerned Partner(s)
(i.e. imprisonment)



ALT CLASSES

A culture of learning

(13) Branch Audit: Sec. 143(8), Rule 12 of CAAR, 2014 and **SA 600**

(a) Who can be appointed as Branch Auditor:

Accounts of a branch may be audited by:

(i) Company Auditor; or

(ii) any person qualified u/s 141 of Companies Act, 2013; or

(iii) in relation to a branch located outside India, by:

(a) Company Auditor; or

(b) Person qualified u/s 141 of Companies Act, 2013; or

(c) Person qualified under the laws of Country in which branch is situated.

(b) Duties of Branch Auditor:

- Branch Auditor shall prepare a report on accounts of the branch examined by him; and

✓ send it to the company auditor, who shall deal the report in such manner as he considers appropriate.

(c) Rights and duties of company auditor w.r.t. branches (Rule 12):

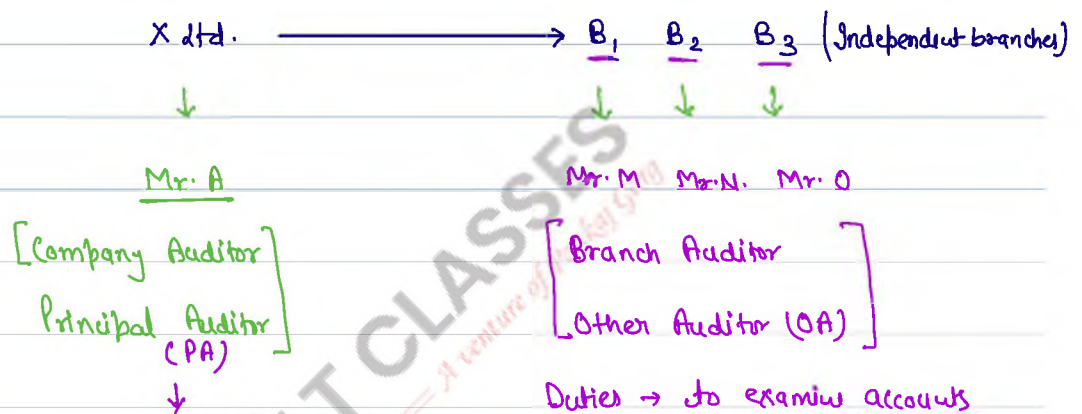
- Company Auditor's rights and duties w.r.t. branches are same as prescribed u/s 143(1) to 143(4).

- Branch Auditor shall submit his report to Company Auditor.

- However, provisions of sec. 143(12) relating to reporting of frauds also extends to branch auditor.

Note! For the purpose of evaluation of work of branch auditor by statutory auditor (Company auditor/ Principal auditor) "SA-600 - Using the Work of Another Auditor" ^{*} prescribes the procedures to be performed by statutory auditor.

* Excluded from syllabus.



✓ Duties :- Evaluate competency of OA.

- to determine whether he can rely on work of OA.

- to share time-table with OA

- to discuss significant findings of OA

- to visit the branches, if required

- reference of OA report in Main audit report. [Other Matter Para - SA 706]

maintained by branch

- to report on accounts examined by him

- to submit report to PA

(14) Cost Records and Cost Audit: - Sec. 148 of Companies Act, 2013

- Rule 14 of CARR, 2014

↪ Companies (Cost Records and Audit) Rules, 2014

(a) Requirement of Maintenance of Cost Records:

Sec. 148(1): C.G. may by order, in respect of certain companies engaged in production of prescribed goods or rendering of prescribed services

↓

direct that particulars relating to material, labour and other items of cost shall be included in the books of account.

Rule 3 of Companies (CRA) Rules, 2014:

Companies (including foreign companies) engaged in production of goods or rendering of services, as specified (Regulated Sector | Non-Reg. Sector)

↓

shall include cost records in their books

↓

if Overall T/o from all products or services during preceding [FY ≥ 35 cr.]

✓ Regulated sector: Telecommunication, Industrial Alcohol, Sugars,
Fertilisers, Drugs and Pharma, Electricity and
Petroleum products.

✓ Non-regulated sector: Iron, Cement, Steel, etc.

Example: (ABC Ltd.)

	Business - A (Fertiliser - <u>Reg.</u>)	Business - B (Steel - <u>Non-Reg.</u>)	Business - C (Other than Reg. NR)	Total	Records
T/o	10 Cr.	20 Cr.	-	30 Cr.	X
T/o	20 Cr.	5 Cr.	7 Cr.	32 Cr.	X
T/o	30 Cr.	-	10 Cr.	40 Cr.	Reg. Business
T/o	5 Cr.	10 Cr.	21 Cr.	<u>36 Cr.</u>	R + NR
T/o	-	45 Cr.	-	45 Cr.	NR

Note: Once the provisions become applicable over a company, it has to maintain the records forever (Once applicable, forever applicable)

(b) Requirement of Cost Audit:

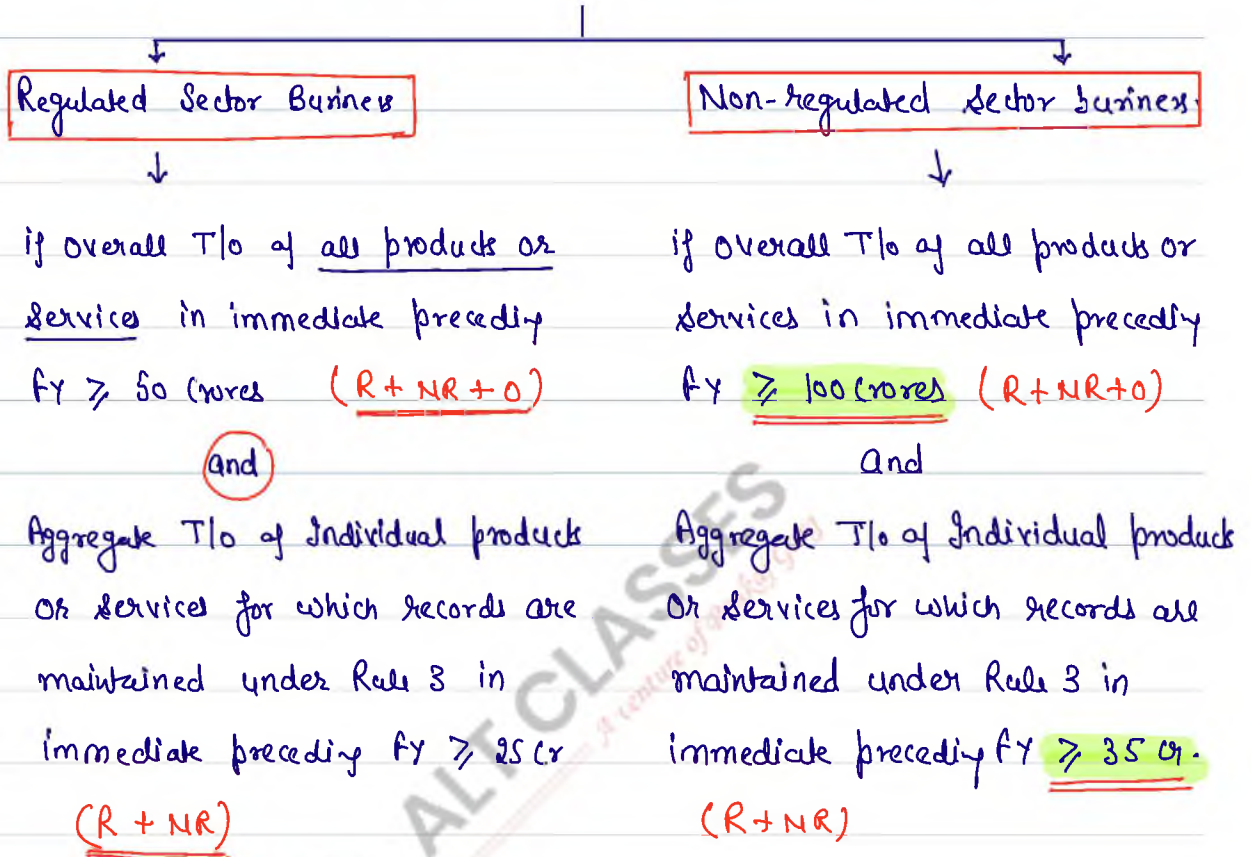
Sec. 148(2): C.G. may by order, direct that cost records of companies covered U/s 148(1) of Companies Act, 2013 having prescribed turnover or turnover

↓

need to be audited in prescribed manner.

Rule 4 of Companies (CRA) Rules, 2014 :

Cost records maintained under Rule 3 are required to be audited, in case of



Example:

Reg.	NR	Other	Total	Rule 3 (cost records)	R + NR	Rule 4 (cost Audit)
10 Cr.	25 Cr.	Nil	35 Cr.	✓ (R + NR)	35 Cr.	X
15 Cr.	25 Cr.	20 Cr.	60 Cr.	✓ (R + NR)	40 Cr.	R ✓ NR X
20 Cr.	40 Cr.	50 Cr.	<u>110 Cr.</u>	✓ (R + NR)	<u>60 Cr.</u>	R ✓ NR ✓
40 Cr.	-	70 Cr.	<u>110 Cr.</u>	✓ (R)	<u>40 Cr.</u>	R ✓ NR X
30 Cr.	90 Cr.	-	120 Cr.	✓ (R + NR)	120 Cr.	R ✓ NR ✓
-	30 Cr.	45 Cr.	<u>75 Cr.</u>	✓ (NR)	<u>30 Cr.</u>	R X NR X

Exemption from Cost Audit:

A company covered under Rule 3, is exempted from the requirements of audit of Cost records, if:

- (a) Revenue from exports in foreign exchange $> 75\%$ of total revenue; or
- (b) company is operating from a SEZ; or
- (c) company is engaged in generation of electricity for capitive consumption.

(c) Provisions related to appointment / removal / rights and duties of Cost Auditor; Cost Audit Report etc.

Chapter No. 10 - Part I - Common - law and Audit

Part II - Exclusive to Audit Paper - (i) CARO, 2020

(ii) Joint audit ✓

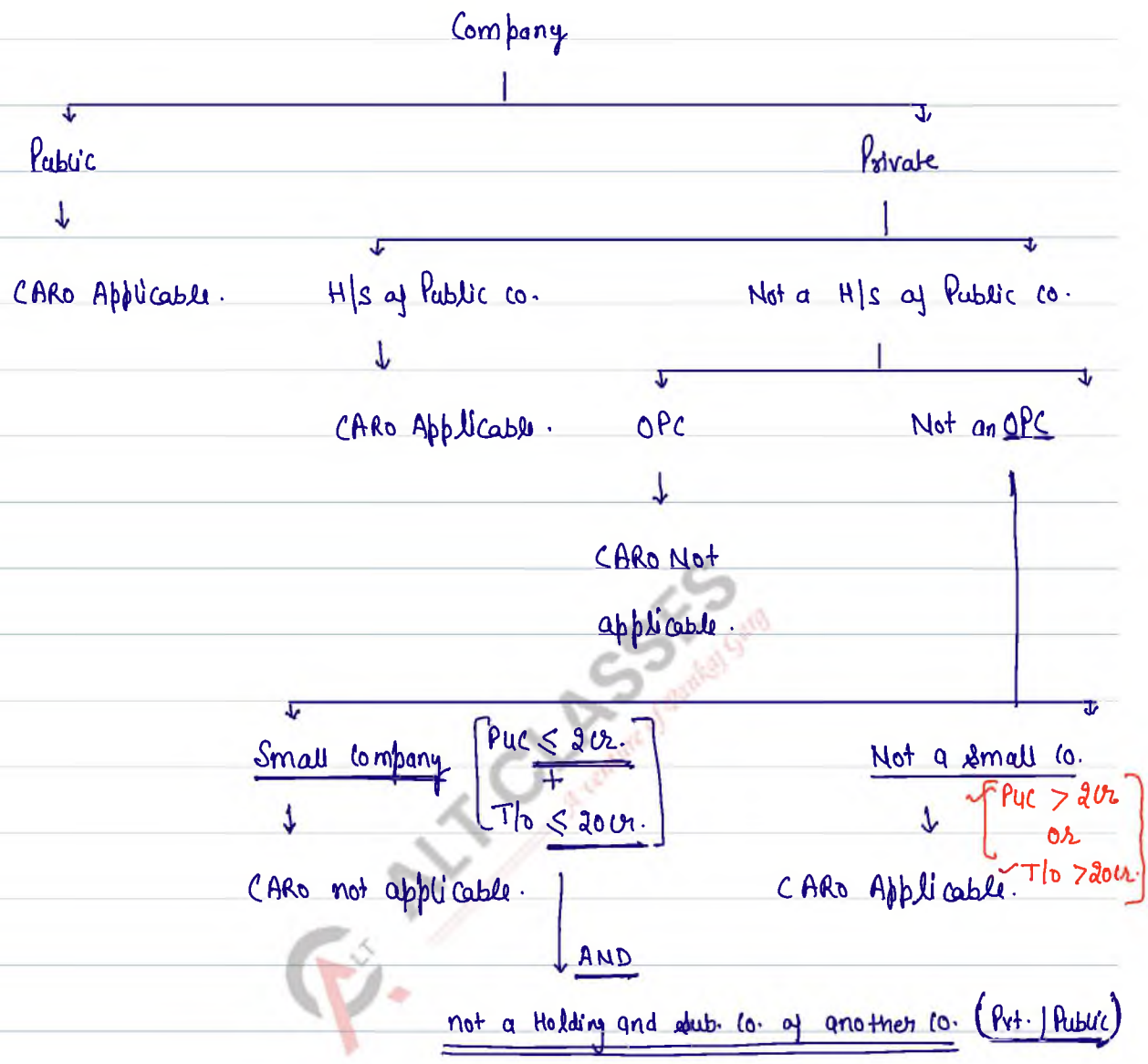
Chapter - 10 "Company Audit"

Topic - CARO, 2020

Ex.

	<u>SH of public co.</u>	<u>PUC</u> ✓ (≤ 1 cr.)	<u>T/o</u> ✓ (≤ 10 cr.)	<u>Borrowings</u> ✓ (≤ 1 cr.)	
1 - X (P) Ltd.	YES				CARo Applicable
2 - Y (P) Ltd.	No	0.90 cr.	6 cr.	0.4 cr.	CARo Not applicable.
3 - A (P) Ltd.	No	0.90 cr. ✓	11 cr.	0.9 cr. ✓	CARo Not applicable. as it is a small company.
4 - B (P) Ltd.	No	1.90 cr. ✓	19 cr. ✓	0.95 cr.	CARo Not applicable as it is a small company
5 - C (P) Ltd.	No	0.90 cr.	4 cr.	1.05 cr.	CARo Not applicable as it is a small company
6 - XY (P) Ltd.	No	2.10 cr.	6 cr.	1.05 cr.	CARo applicable.

	<u>SHs of Public co.</u>	<u>PUC</u> ✓	<u>RES</u>	<u>T/o</u> ✓	<u>Borrowings</u>	
7. M (P) Ltd.	No	1.90 cr. ≤ 2 cr.	1.40 cr.	18 cr. ≤ 20 cr.	6 cr.	CARo <u>not applicable</u> as it is a small co.
8. N (P) Ltd.	No	1.00 cr. ✓ ≤ 2 cr.	1.04 cr.	21 cr. ✓ ≤ 20 cr. ✗	5 cr.	<u>CARo Applicable</u> as it is <u>not a small co.</u> does not and it satisfies the exemption conditions.



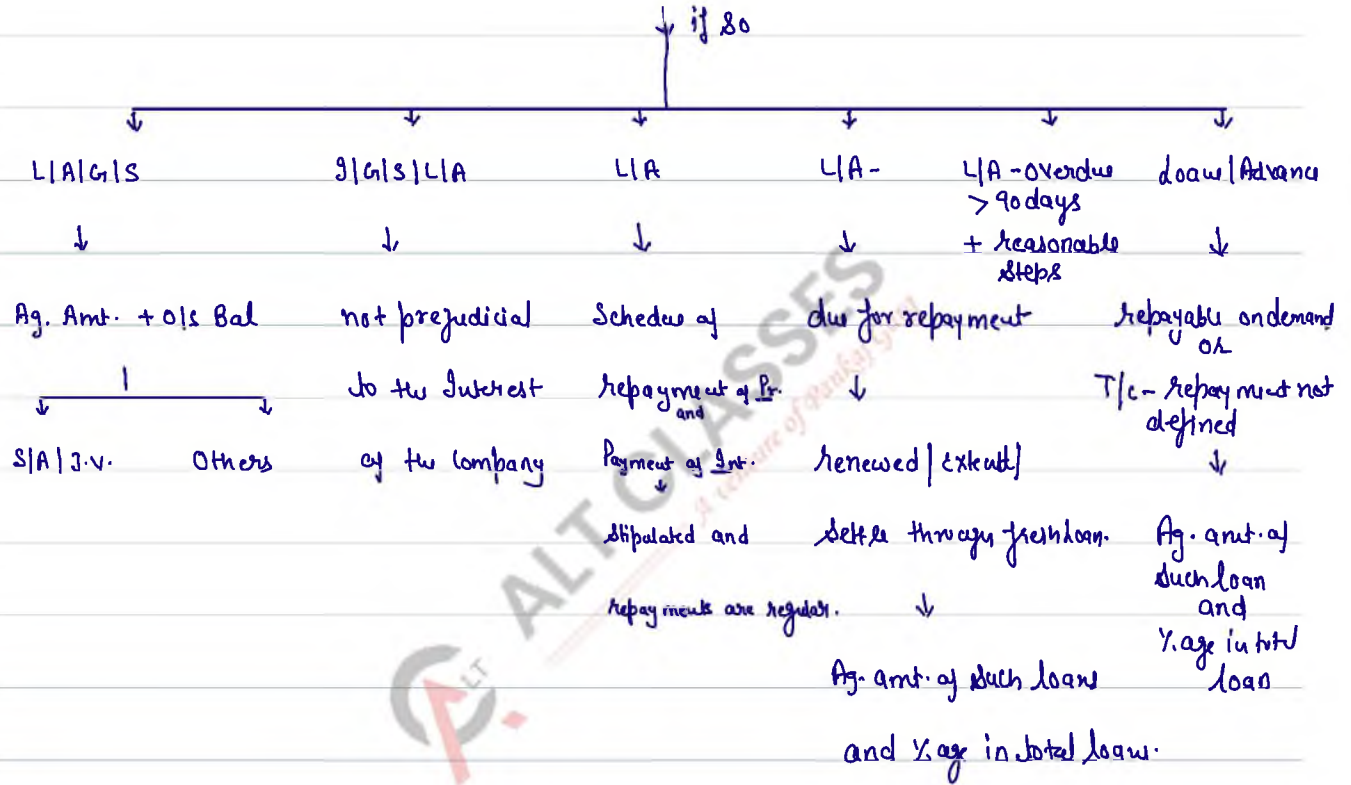
Matters to be Reported under CARO, 2020:

(i) Property, Plant and Equipments: Para 3(i)

(ii) Inventories: Para 3(ii)

(iii) Loans and Advances | Investments | Guarantees | Security: [Para 3(iii)]

whether any Inv. | G/S | loan → granted to Companies, firms, LLP, others



(iv) Compliance of Sec. 185 and 186:

In respect of L | G | S → provisions of Secs. 185 and 186 are complied with.

→ If not, provide the details thereof.

(v) Public deposits: Para 3 (v)

↓

- If deposits are accepted → directives of RBI
→ Provisions of Secs. 73 to 76 and other provisions

are
Complied
with

↓

If not

↓

Nature of Contraventions to be stated.

- If - Order - CLB | NCLT | RBI | Court | Other Tribunal - Complied with or not.

(vi) Cost Records: Para 3 (vi)

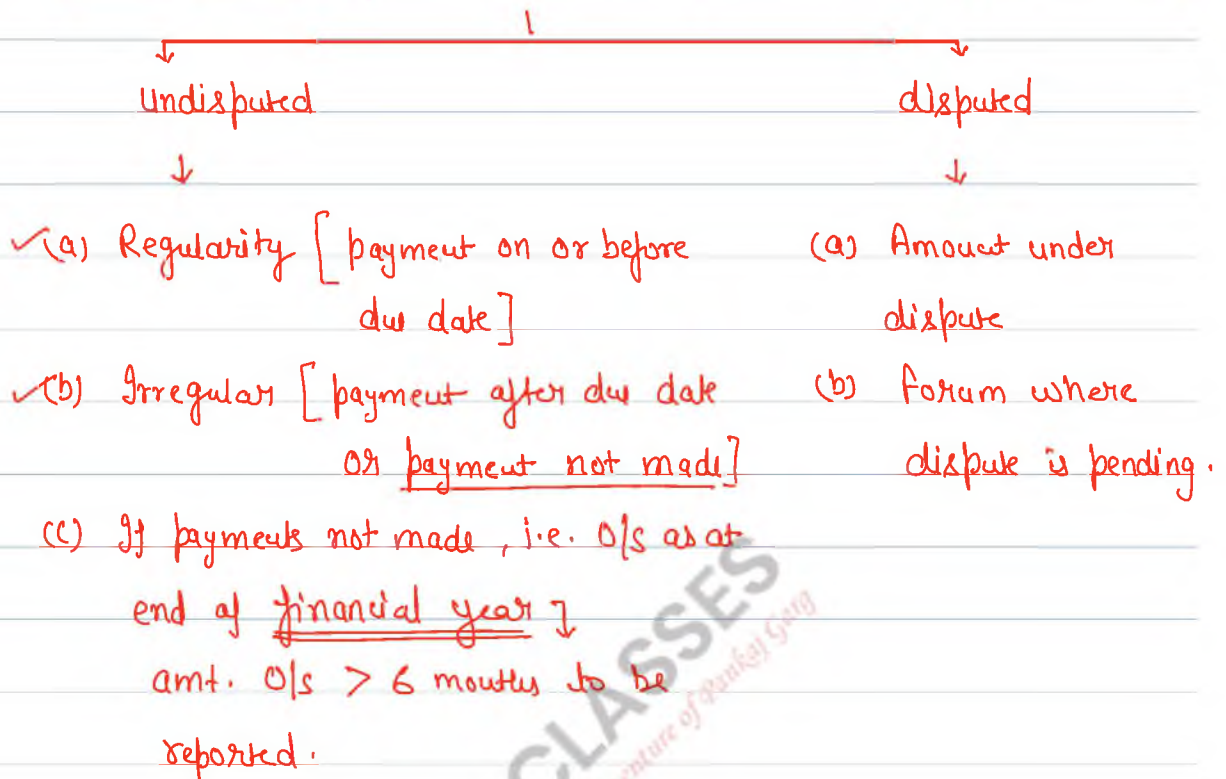
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whether Co. is required to maintain cost records U/s 148(1) of the Companies Act, 2013

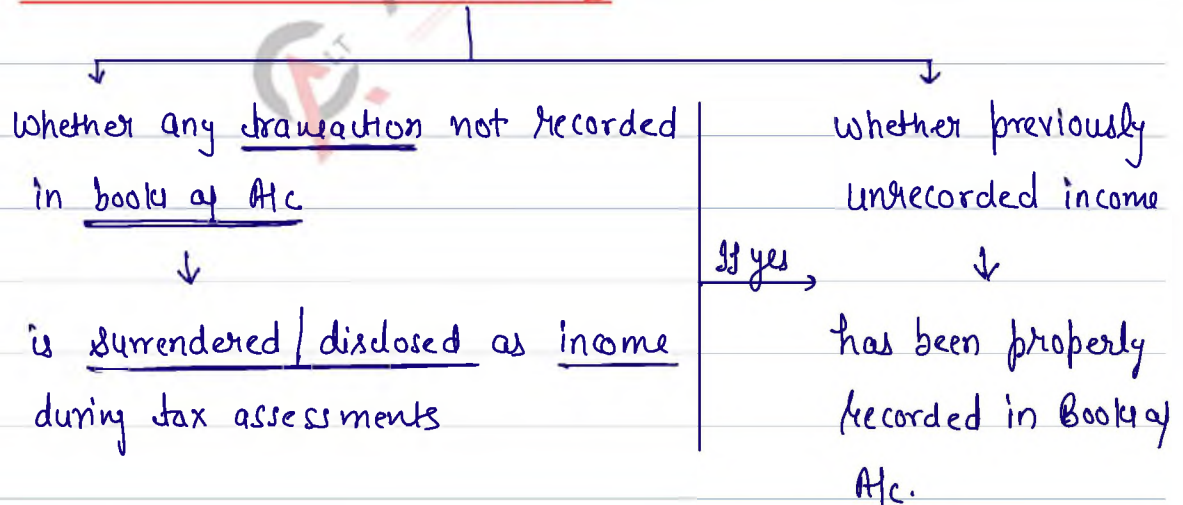
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If yes, whether such records are being made and maintained.

(vii) Statutory dues: (PF, ESI, GST, Excise, VAT, Custom duty, J-tax, cess etc.)



(viii) Unrecorded Income: [Para 3 (viii)]



(ix) Repayment of dues: Para 3 (ix)

- (a) Details of default in repayment of principal / payment of interest
- (b) Company is declared as wilful defaulter
- (c) T/L → utilised for the purpose
- (d) Funds → raised - < → utilised for <.
- (e) Funds → raised to meet out the obligations of S/J.V./A
- (f) Loan → raised - pledge of securities - S/J/A.
default in repayment of such loans.

(x) - (i) Money raised through public issue: [Para 3(x)]

↓

(IPO / FPO)

whether applied for the purposes for which money was raised.

↳ If not → provide details → delay

→ default

→ subsequent rectification

(ii) Preferential Allotment:

whether company has made any preferential allotment or private placement of Shares / FCD / PCO / optionally convertible debⁿ. ↓

If yes → whether provisions of Sec. 42 and 62 are

↓ being complied with. and

funds were used for the purpose for which funds were raised if not provide the details

(xi) Fraud : Para 3 (xi)

(a) Whether any fraud on the company or by the company, noticed or reported during the year;

↓

If yes, nature of fraud and amount involved is to be indicated.

(b) Whether any Report U/s 143(12) of Companies Act, 2013 in Form no ADT-4, filed with C.G.

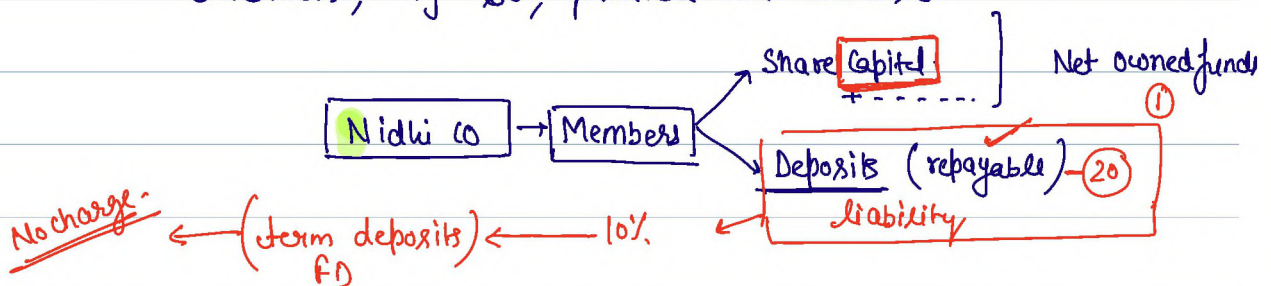
(c) Whether auditor has considered whistle-blower complaints, if any recd. by the company during the year.

(xii) Nidhi Companies : [Para 3 (xii)]

(a) Compliance of Net Owned Funds to deposit liability ratio i.e. 1:20 to meet the liability.

(b) Maintenance of 10% unencumbered term deposits

(c) any default in repayment of deposits or interest thereon, if so, provide the details.



(xiii) Transaction with RP: [Para 3 (xiii)]

- Whether transactions are in compliance with provisions of Secs. 177 and 188 of Companies Act, 2013, wherever applicable
- details are disclosed in the financial statements as per applicable ASs.

(xiv) Internal Audit System: [Para 3 (xiv)]

↓

- Whether IA System is commensurate with nature and size of business;
- " reports of Internal Auditors are considered by statutory auditors.

(xv) Non Cash transaction with directors: [Para 3 (xv)]

Whether company has entered into any non-cash transaction with the directors or persons connected with them

↓

If yes, whether provisions of Sec. 192 are complied with.

(xvi) Regn. with RBI: [Para 3 (xvi)]

- whether Co. is required to obtain regn. from RBI u/s 45-IA of RBI Act,
If yes, whether regn. obtained or Not.
- whether Co. has conducted Non financial business or housing finance activity without holding valid CoR.
- CIC - fulfill the criteria of CIC.
- No. of CICs, if group has > 1 CIC.

(xvii) Cash losses: In Current year and in immediate preceding FY

[Para 3(xvii)]

↓

If yes, amount of losses.

(xviii) Resignation of Statutory auditor: [Para 3(xviii)] ↓

- Whether there has been any resignation of statutory auditor during the year.

- If yes, whether the auditor has considered the issues, objections or concerns raised by outgoing auditor.

(xix) Existence of Material uncertainty: Para 3(xix)

Whether on the basis of - financial ratios,

↙ Ageing

↙ Expected dates of realisation of financial assets and payment of financial liabilities

↙ Other information accompanying the f.s.

↙ Auditor's knowledge of BoD/Mngt. plans

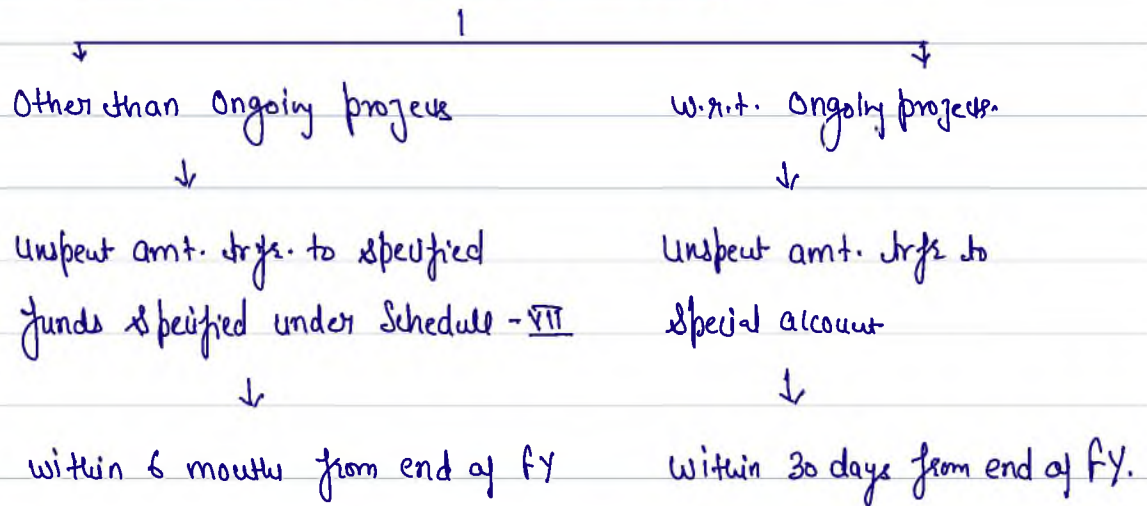
↓

Whether auditor is of the opinion that no material uncertainty exist as on date of audit report

↓

that company is capable of meeting its liabilities that exist on Balance Sheet date, as and when fall due, within a period of 1 year from BS date.

(XX) Transfer of unspent CSR amount: [Para 3 (xx)]



(XXi) Qualification / adverse remarks in CARO reports of Group Companies: [Para 3 (xxi)]

↓
Whether any qualification or adverse remarks are given by auditors in CARO reports of Companies of whom CFS are prepared.

↓
If yes, details of such companies and Para No. of CARO report and Qualification / adverse remarks.

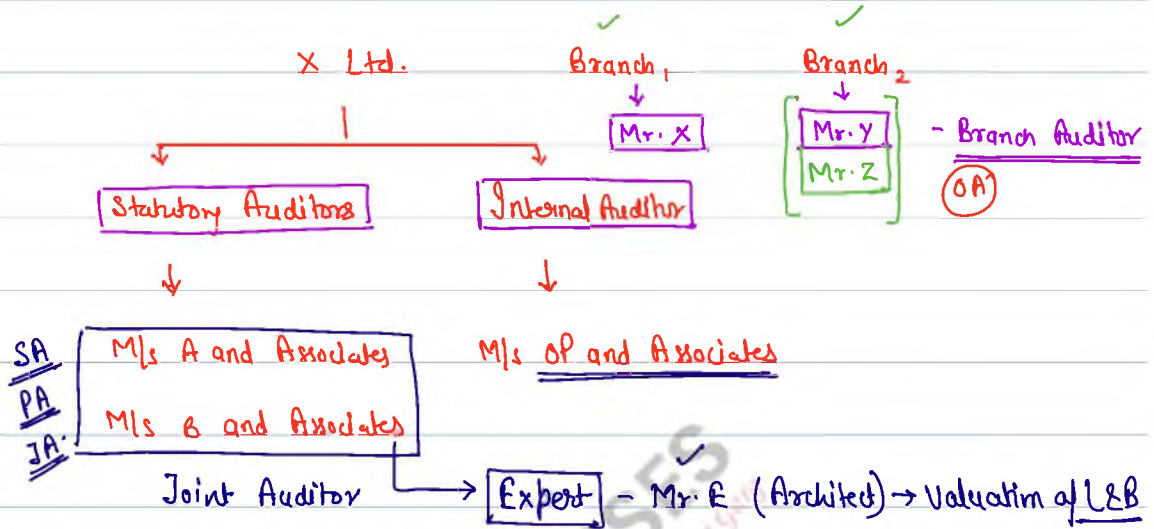
Sec. 2(85): Small Co. - PUC - ≤ 204 + T/O - ≤ 2004
(Not a H/S/sec. 8 Co.)

Pvt. Co. → H/S of another Pvt. Co. → not a small Co. → conditions to be checked

Pvt. Co. → H/S of another Public Co. → not a small Co. → CARO applicable.

(15) CARO, 2020

(16) Joint Audit :



(i) Joint Auditors → A and Associates + B and Associates → SA 299

(ii) PA and OA → PA → A and Associates
B and Associates
OA → Mr. X
Mr. Y → SA 600

(iii) SA and JA: SA → A and Associates
B and Associates
JA → OP and Associates → SA - 610

(iv) SA and AE: SA → A and Associates
→ B and Associates
AE → Mr. E → SA - 620

SA-299

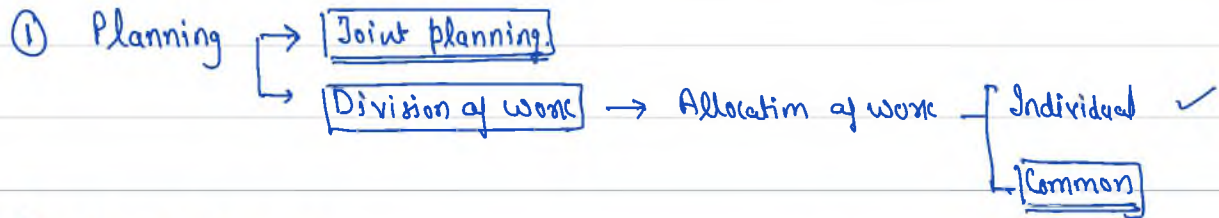
X Ltd.



Statutory auditors

A and Associates

B and Associates



② Coordinating →

③ Reporting → Single Report
→ Separate reports - disagreement → OMP ✓

④ Review → No requirement to review the work of another joint auditor.

Chapter → 11 "Audit Reports" [SA-700, 701, 705, 706, 710]

Audit Reports - Types

(A) Unmodified Reports

issued → Unmodified opinion on F.S. (SA-700)
 Without any EOM/OM Para Addl. Info.
 F.S. → Reflects True and Fair View or prepared as per applicable FRF

(B) Modified Reports

(a) with Unmodified opinion (SA-706)

F.S. → Reflects T&F View
 Prepared as per applicable FRF

- EOM Para → Financial Matter adequately disclosed in the F.S.
 - OM Para → Auditor's Responsibility, Audit report and audit
 Other Matter

(b) with Modified opinion

(i) Qualified → [Except for the effects of - - - -] F.S. reflects True and fair view - - - -

(ii) Adverse → Because of significance of - - - - F.S. do not reflect T&F view

(iii) Disclaimer → Due to non availability of info, we are not able to express any opinion (SA-705)

- Miss statement → Material - [Not Pervasive → Q, Pervasive → A]
 - Evidence not available → Material - [Not Pervasive → Q, Pervasive → D]

Written Report → Auditor → Expresses his opinion

F.S. - [General Purpose F.S.] → Common Users → Common Purpose [SA-700, 701, 705, 706]

[Special Purpose F.S.] → Specific Users → Specific requirement [SA-800 along with SA 700, 705, 706]

SA-800 → F.S. → Special Purpose framework

SA-805 → Single financial statement

SA-810 → Summary F.S.

General Purpose financial statement → Financial Reporting framework

(a) Fair Presentation Framework
 (b) Compliance Framework

↓
 Mngt. is permitted to take deviations

(True and fair view)

↓
 Mngt. is not permitted to take deviation

(True and correct)

Elements - Unmodified Report

1. Title - Independent Auditor's Report
2. Addressee - To the Members - - - - -

Report on Financial Statements

3. Opinion Section

4. Basis for opinion Section

5. Material uncertainty relating to Going concern
SA-570

6. Key Audit Matters - SA 701 (if required)

7. Other Information - SA 720

8. Mngt. Responsibility as to f.i.

9. Auditor's Responsibility

B [Report on other legal and Regulatory requirements

10. Date.

11. Place

12. Signature

3. Qualified opinion
4. Basis for Qualified opinion

Chapter - 11 " Audit Reports "

- ① Meaning of audit report: Report through which auditor expresses his opinion on F.S. is known as audit report.
- In case of General purpose financial statements, audit report is prepared as per requirements of SA 700, 701, 705 and 706.
 - However, in case of Special purpose financial statements, audit report is prepared on the basis of requirements of SA - 800.

② Types of Audit Reports: 2 types

(A) Unmodified Reports.

Unmodified reports are issued when auditor concludes that F.S. are being prepared in all material respects in accordance with applicable F.R.F.

(B) Modified Reports.

(a) Matters that affect audit opinion SA 705

→ Qualified: Material Misstatements identified but not pervasive. Audit Evidences for Material items not available (No Pervasive effect).

→ Adverse: Material Misstatements identified having Pervasive effect.

→ Disclaimer: Audit Evidences for Material items not available (having Pervasive effect).

(b) Matters that do not affect audit opinion SA-706

→ Em Para: Para included in audit reports for financial matters.

→ OM Para: Para included in audit reports for auditor's responsibility areas.

Example:

- (i) Inventory \rightarrow Wrong valuation \rightarrow B/s - Total Assets = 18 lac - Adverse
(Value \rightarrow 10 lac)
- (ii) Investments \rightarrow Long term \rightarrow (Certificates \rightarrow B/s - Total Assets - Disclaimer
(value \rightarrow 2 Cr.) Not available. (3 Cr.)
- (iii) Trade receivables \rightarrow ₹ 10 lac \rightarrow Evidences \rightarrow B/s - Total Asset. - Qualified
not available. 20 Cr.
- (iv) Employee Benefit \rightarrow ₹ 20 lac \rightarrow wrongly \rightarrow Total Exp. - Qualified
Expenses (debited in bal) measured 12 Cr.
- (v) Misc. Income \rightarrow Not recorded \rightarrow Total Income. - Unmodified
(2 lac) 50 Cr.

③ Elements of an Unmodified audit report:

(i) Title: "Independent Auditor's Report" may be used so as to distinguish it from other reports.

(ii) Addressee: - Audit report shall be addressed as appropriate.
- Generally it is addressed to those for whom it is prepared.
For example, in case of a company, report is addressed to Members of the company.

(iii) Opinion Section: It shall cover the following:
(a) Identify the Entity.

- (b) Identify the title of each financial statement.
- (c) Specify the period / date covered by each f.s.
- (d) Statement that financial statements have been audited.

Opinion may be expressed as :

- In Our opinion, based on information and explanation provided to us, the financial statements present fairly in ^{all} material respects the financial position,
-----, -----, -----, -----, -----
in accordance with [applicable FRA].

Or

- In Our opinion, based on information and explanation provided to us, the financial statements give a true and fair view of



in accordance with [applicable FRA].

Use Basis for opinion Section: This section covers the following:

- (a) State that audit was performed in accordance with standards on Auditing.
- (b) Refer to section of Auditor's Report that describes the auditor's responsibilities.
- (c) Compliance of ethical requirements as stated in Code of ethics issued by ICAI.
- (d) Auditor's believing that they had obtained sufficient and appropriate audit evidences to provide a basis for opinion.

(vi) Material Uncertainty relating to Going Concern: (MURGC)

where applicable, auditor should report in accordance with SA 570.

(vii) Key Audit Matters:

In case of listed entity, auditor shall communicate Key Audit Matters in auditor's report as per requirements of SA 701.

(viii) Other Information:

Where applicable, auditor shall report in accordance with SA 720.

✓ (ix) Moys. Responsibilities for the financial statements:

✓ (x) Auditor's Responsibilities for the financial statements:

(xi) Reporting on Other legal and Regulatory Requirements:

This section will include reporting on matters covered U/s 143(3), 143(1), 143(11) and Rule 11 of Companies (Audit and Auditor's) Rules 2014.

(xii) Signature: In personal name and name of firm along with Membership Number and Firm Regn. No.

(xiii) Place: The City where audit report is signed.

(xiv) Date: Date on which audit report is signed.



Elements of Audit Report

Unmodified Report

1. Title
2. Addressee
3. Opinion Section
4. Basis for opinion section

SA 570

- ① G.C. appropriate - Unmodified Opinion (No MORG)
- ② G.C. Inappropriate - Adverse opinion
- ③ G.C. appropriate but Uncertainty Exist → f.s. disclosure
 - MURG
 - Unmodified Opinion
 - Qualified
- ④ G.C. appropriate but Uncertainty Exist - f.s. disclosure not proper
 - Qualified
 - Adverse

Company

5. → MURG [- Only - Material Uncertainty - Going concern - SA 570]
6. → KAM [Only - in case of listed entity - SA 701]
7. → Other Info [Only → in case of an entity providing Other info - companies - SA 720]

8. Mngt. Responsibilities as to f.s.
9. Auditor's responsibilities as to f.s.

10. Reporting on Other Legal and Regulatory Requirements (if any)
 [companies → Sec. 143(3), 143(11), Rule 11]

11. Signature
12. Date
13. Place

Modified

(with modified opinion)

Qualified	Adverse	Disclaimer
3. Qualified opinion	4. Adverse opinion	5. Disclaimer of Opinion
4. Basis for Qualified opinion	6. Basis for Adverse opinion	7. Basis for Disclaimer of opinion
5. MORG (if required)	6. KAM (if required)	7. Other info. (if required)
Not required	Not required	Not required
8. KAM (if required)	9. Other info. (if required)	10. Other info. (if required)
11. Other info. (if required)	12. Other info. (if required)	13. Other info. (if required)

Change

viii) Mngt. Responsibilities for the financial statements:

This section of audit report covers the management responsibilities as to:

- (a) Preparation of financial statements in accordance with applicable financial reporting framework.
- (b) Maintenance of adequate records for safeguarding of assets and prevention and detection of fraud and error.
- (c) Making reasonable and prudent accounting estimates.
- (d) Design, implementation and maintenance of necessary internal controls.
- (e) Assessing the appropriateness of Going Concern Basis of accounting.
- (f) Oversee the financial reporting process.

ix) Auditor's Responsibilities for the financial statements:

This section of audit report covers the following:

- (a) State that objective of the auditor is to obtain reasonable assurance that financial statements as a whole are free from material misstatements and issue the auditor's report that includes an auditor's opinion.
- (b) Explanation w.r.t. reasonable assurance and application of concept of Materiality.
- (c) Statement that auditor exercises professional judgement and maintain professional skepticism throughout the audit.

(d) In addition, this section also states the auditor's responsibilities w.r.t.:

- (i) Identifying and assessing RMM.
- (ii) Designing and performing procedures which are responsive to assessed risks.
- (iii) Obtaining sufficient and appropriate audit evidences.
- (iv) Obtaining understanding of Internal Control.
- (v) Expressing opinion on existence and effectiveness of Internal financial controls.
- (vi) Conclude on appropriateness of Management Use of Going Concern Basis of accounting.
- (vii) Evaluate the overall presentation, structure and content of financial statements.

Note: Description of auditor's responsibilities may be included:

✓ (a) within the auditor's report.

OR

✓ (b) as annexure to the auditor's report.

OR

✓ (c) by a reference of a website of appropriate authority, if law and regulation permits it.

④ Modifications that affect audit opinion:
 SA-705 "Modifications to the opinion in the Independent Auditor's Report"

(A) Types of Modified opinion: 3 types

(i) Qualified opinion: It is issued when:

(a) financial statements are misstated and misstatements are material, but do not have pervasive effect.

(b) Auditor is not ^{or} ^{seen} able to collect sufficient appropriate evidences for transactions that are material, but do not have pervasive effect.

(ii) Adverse opinion: It is issued when auditor concludes that financial statements are misstated and misstatements are material as well as having pervasive effect.

(iii) Disclaimer of opinion: It is issued when auditor is not able to collect sufficient appropriate audit evidences for transactions that are material as well as having pervasive effect.

	Material but Not Pervasive (overall)	Material as well as Pervasive (overall)
Misstatements Identified	1 / <u>Qualified</u>	2 / <u>Adverse</u>]
Audit Evidences Not available	3 / <u>Qualified</u>	4 / <u>Disclaimer</u>

(B) Considerations while issuing modified opinions:

(i) Opinion Section: Use the heading - Qualified Opinion
Adverse Opinion
Disclaimer of opinion.

Wordings of opinion:

Qualified opinion:

" In our opinion, to the best of info. and explanation provided to us, except for the effects of matters described in Basis for Qualified Opinion Section, the financial statements, have been prepared, fairly, in material respects, in accordance with [applicable FRF].

Adverse opinion:

In our opinion, to the best of information and explanation provided to us, because of significance of matters described in Basis for adverse opinion section, the financial statements do not reflect true and fair view of _____ in accordance with [applicable FRF].

Disclaimer of opinion:

Because of significance of matters described in Basis for disclaimer of opinion section, the auditor has not been able to collect sufficient and appropriate audit evidences to provide a basis for audit opinion on F.S, hence no opinion is being expressed.

(iii) Basis for opinion section:

- Amend the heading → Basis for Qualified Opinion; OR
" " Adverse " ; OR
" " Disclaimer of Opinion
- Basis for opinion section in case of modified opinion, shall include a detailed description of matters due to which opinion is modified. Detailed description shall be as follows:

(a) If opinion is modified due to material misstatements, audit report shall include →

(A) Description of Misstatement

(B) Quantification of financial effect.

(C) If financial effect is not quantifiable, state the fact.

For example: If provision is not appropriately recorded for, this section shall provide

- reasons for not making provision
- amt. required to be recorded.

(b) If opinion is modified due to non availability of information, this section of audit report shall state the reasons for inability to obtain sufficient and appropriate audit evidence.

For example: Records not available due to

- Limitations imposed by Mngt.
- being destroyed by fire.
- being seized by Income Tax Authorities

(c) Amend the statement w.r.t. auditor's believing that evidences are sufficient and appropriate to provide a basis for Qualified opinion or Adverse Opinion.

(d) In case of Disclaimer of opinion, auditor's report shall not mention the auditor's believing as to collection of audit evidences.

(iii) Auditor's Responsibility Section:

When auditor disclaims the opinion, the auditor shall amend the description of auditor's responsibilities so as to include only the following:

- Statement that auditor's responsibility is to conduct an audit of financial statements in accordance with standards on Auditing and to issue auditor's report.
- Statement that because of significance of matters described in basis for disclaimer of opinion section, auditor was not able to collect sufficient and appropriate audit evidences so as to provide a basis for an audit opinion.
(SAAE)
- Statement about auditor's independence and other ethical requirements.



⑤ Modifications in audit report that do not affect audit opinion:

SA 706 - "Emphasis of Matter Paragraph and Other Matter Paragraph" in the Independent Auditor's Report.

(A) Emphasis of Matter (EOM) Para:

A Para included in the auditor's report that refers to a matter appropriately reflected / disclosed in the financial statements

↓

that in the auditor's judgement, is of such significance

↓

that it is fundamental to user's understanding of financial statements.

Requirements of EOM Para:

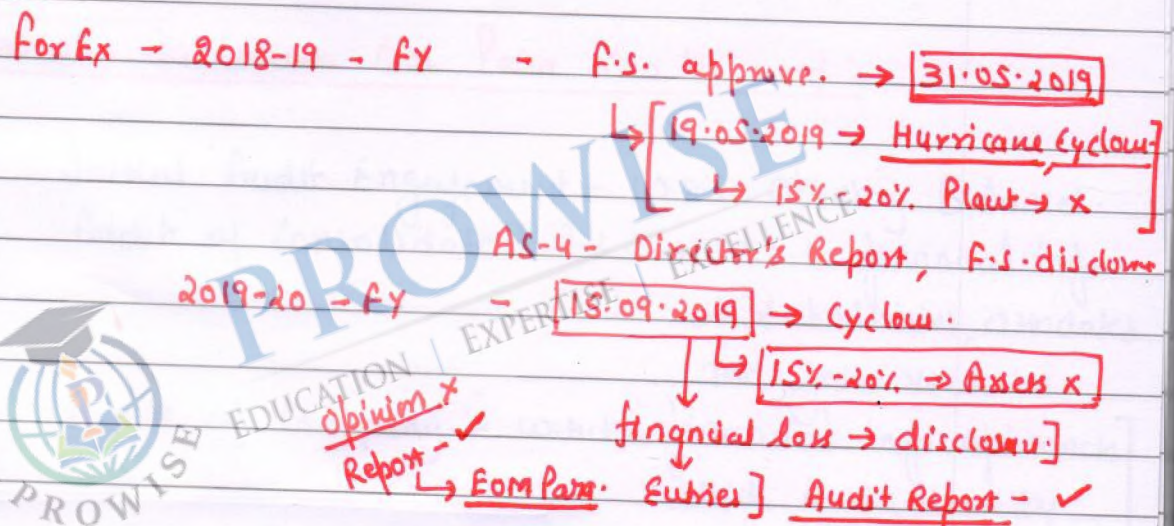
- (i) EOM Para is not a substitute of modified opinion / MURGI / KAM.
- (ii) EOM Para should be included in the audit report in a separate section titled as "Emphasis of Matter".
- (iii) EOM Para refers only to information which is appropriately disclosed in the financial statements.
- (iv) It must be indicated that auditor's opinion is not modified in respect of this matter.

Location in audit report:

EOM Para may be located in audit report immediately following the Basis for Opinion section.

Circumstances in which FOM Para may be used:

- (i) Uncertainty as to future outcome of an exceptional litigation.
- (ii) Significant subsequent events.
- (iii) Early application of new accounting standards in advance of its effective date.
- (iv) Occurrence of major catastrophe that may have a significant effect on entity financial position.



(B) Other Matter Para (OM Para):

A Para included in the auditor's report that refers to a Matter other than those presented / disclosed in financial statements

↓

that in the auditor's judgement is relevant for user's understanding of audit, auditor's responsibilities and auditor's report.

Requirements of OM Para:

- (i) OM Para is not a substitute of KAM / Modified opinion.

- (ii) OM Para should be included in the audit report in a separate section titled as "Other Matters".
- (iii) OM Para may be located in the audit report immediately after "Key Audit Matters".
- (iv) If Other Matter is related with other legal and Regulatory requirements, it may be placed in "Reporting on Other legal and Regulatory Requirements Section" of the audit report.

Situations in which OM Para can be used:

- (a) Initial Audit Engagement - w.r.t. Opening Balances.
- (b) Audit of Consolidated F.S. → w.r.t. financial info. of subsidiaries, associates and Joint Ventures.
- (c) Audit of Company - w.r.t. financial info. of branches which is audited by Branch auditor.

⑥ Key Audit Matters: (KAM)

SA 701 "Communicating Key Audit Matters in the Independent Auditor's Report"

- SA 701 applies to audit of general purpose financial statements of Listed Entities.
- In case, auditor disclaims an opinion on financial statements as per SA 705, auditor should not report on KAM.

Meaning and Purpose of KAM:

- Key Audit Matters are those matters that in the auditor's judgement were of most significance in the audit of financial statements of current period.
- These matters are selected from matters communicated to TCWG (as per requirements of SA 260).

Note: Matters communicated to TCWG as per requirements of SA 260 comprises of -

- (a) Auditor's Responsibilities
- (b) Planned scope and timing of audit
- (c) Significant findings
- (d) Other Matters. (Auditor's Independence)

Purposes of KAM:

- (i) To enhance the communicative value of the auditor's report by providing greater transparency.
- (ii) To provide additional information to users of financial statements.
- (iii) To assist the users in understanding the entity and areas of significant management judgements.
- (iv) To provide a basis to further engage with management and TCWG about certain matters relating to entity.

Considerations for determining Key Audit Matters:

Key audit matters are to be determined from the matters communicated to TCWG, considering the following:

- (i) Areas of higher assessed risk of material misstatement.
- (ii) Significant transactions relating to financial statements that involved management judgements.
- (iii) Effect of subsequent events and transactions that occurred during the year.

⑦ Comparative Info:

SA 710 - "Comparative Info. - Corresponding figures and Comparative F.S."

(A) Meaning of Comparative Info:

Those amounts and disclosures included in the financial statements of an Entity in respect of one or more prior periods in accordance with applicable FRF.

Comparative Info. can be presented in two ways:

(a) Corresponding figures: Comparative Info. where amounts and other disclosures for prior period are included as integral part of current period F.S.

and

intended to be read only in relation to amounts and disclosures to current period.

(b) Comparative F.S.: Comparative Info. where amounts and other disclosures for prior period are included for comparison with F.S. of current period and if audited, are referred to in auditor's opinion.

Note: In case of corresponding figures, auditor's opinion on financial statements refers to current period only. However, in case of comparative F.S., auditor's opinion refers to each period covered by the comparative F.S.

(B) Auditor's Procedures for verification of corresponding figures:

(i) Auditor is required to obtain SAAF about whether the comparative info. included in the F.S. has been appropriately presented. (i.e. as corresponding figures on comparative F.S.)

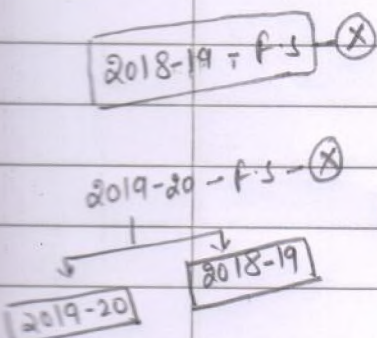
(ii) For this purpose, auditor may perform the following procedures:

(a) Determine whether financial statements include comparative info. If yes, whether such information is appropriately classified.

(b) Evaluate whether the comparative information agree with the amount and disclosures presented in Prior Period Financial Statements.

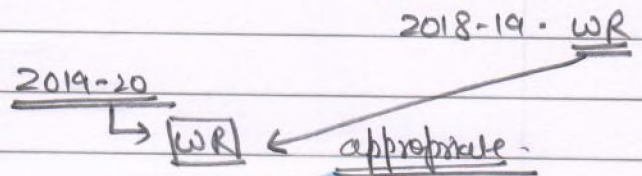
(c) Evaluate whether the accounting policies are consistently applied and if there is any change in accounting policies, ascertain whether such changes have been appropriately presented and disclosed.

(d) In case of any doubt as to existence of material misstatement in comparative information, auditor need to perform additional procedures.



In case, the f.s. of prior period were audited by same auditor, procedures as covered by SA 560 may apply.

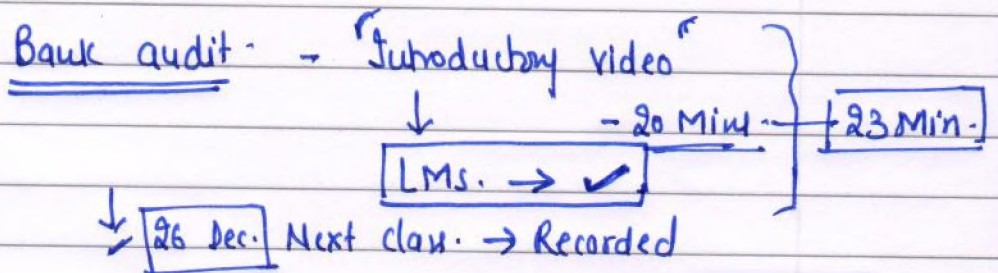
(e) Obtain a WR from mgmt. to re-affirm that WR they previously made with respect to prior period financial statements remains appropriate.



(iii) Auditor need not to refer to corresponding figures in audit report except when the prior period f.s. were audited and a modified report was issued thereon and that modification not yet resolved.

510 → Initial audit
→ Opening Bal

710 → Initial + Recurring.
→ All Issu. of prior period.



Ch - 11 " Audit Report " - Notes + Scanner

Chapter - 12 "Audit of Banks" (Lecture No.1)

↓
Part - I

i) Banking operations

ii) conducting an Bank Audit / Auditing framework

↓
Part - II

i) Verification of Advances

ii) " " Incomes

iii) " " Expenses

I. Banking Operations :

i) Types of Banks:

(A) Commercial Banks: Widest spread banking institutions in India that provide a number of products and services to general public and other segments of economy.

Its main functions are: i) to accept deposits; and
ii) to grant advances.

(B) Regional Rural Banks: Banks set up in rural areas in different states, to cater basic banking and financial needs of rural communities.

(C) Co-operative Banks: Banks set up on the basis of co-operative principles and usually cater to the needs of agricultural and rural sectors.

(d) Payments Banks: Banks allowed to accept restricted deposits, but cannot issue loans and credit cards.

Customers can open saving / current accounts and also avail facility of ATM cum debit cards, internet banking and mobile banking.

(e) Development banks: Banks that provide funds for infrastructural facilities.

(f) Small Finance Banks: Banks that make available basic financial and banking facilities to unserved and unorganised sectors.

(ii) Functions and responsibilities of RBI:

- (1) Development and supervision of Banks and Non-banking financial institutions.
- (2) Issuance and Regulation of Currency.
- (3) To Regulate the activities of Commercial and other banks.
- (4) Determining the monetary and credit policies
- (5) To Act as banker to the C.G., S.G., Commercial banks and other banks.

(iii) Regulatory Framework:

- | | |
|--|---------------------------------------|
| → (1) Banking Regulation Act, 1949 | → (6) <u>Companies Act, 2013</u> |
| → (2) RBI Act, 1934 | → (7) Cooperative Societies Act, 1912 |
| → (3) SBI Act, 1955 | → (8) J.T. Act, 2000 |
| → (4) SBI (Subsidiary Banks) Act, 1959 | → (9) PMLA, 2002 |
| → (5) Regional Rural Banks, 1976 | → (10) <u>SARFAESI Act, 2002</u> |

(iv) Features of Banking operations:

- (i) Voluminous and complex transactions
- (ii) Extensive use of technology
- (iii) large geographical network of branches
- (iv) diversified and large range of product and services.
- (v) strict vigilance and compliances.

II. Auditing Framework:

(A) Auditor: (i) Eligibility: Auditor of a banking company shall be duly qualified as per the requirements of Sec. 141 of Companies Act, 2013.

(ii) Appointment:

- Banking Company: Act the AGM (with approval of RBI).
- Nationalised Bank: Appointed by bank through BOD (with approval of RBI)
- State Bank of India: By CAG in consultation with C.G.
- Regional Rural Bank: By the Bank with approval of C.G.

(iii) Remuneration:

- Banking Company: shall be determined as per Sec. 142
- Nationalised Bank: RBI in consultation with C.G.
- State Bank of India: RBI in consultation with C.G.

(iv) Power writ. access to books etc: same as those of a company auditor.

(B) Types of Audit Reports:

(i) Statutory audit report in case of Nationalised bank: to be made to C.G. and shall state the following:

- (1) whether B/s contain all necessary particulars and is properly drawn up so as to exhibit a true and fair view of state of affairs
- (2) whether P&L A/c show a true picture of profit or loss.
- (3) whether information or explanation called by the auditor has been provided and whether it is satisfactory.
- (4) whether the drawings of bank are within the powers of the bank.
- (5) whether the returns received from branches of the bank are adequate.
- (6) Any other matter which auditor considers to be brought to the notice of the C.G.

(ii) Additional Reports to be issued by statutory auditor:

- (1) Report on adequacy and operating effectiveness of IFC over financial reporting required in case of banking companies U/s 143(3)(i) of Companies Act.
- (2) Long Form Audit Report (LFAR).
- (3) Report on compliance with SLR Requirements.
- (4) Report on whether the Treasury Operations of the bank have been conducted in accordance with RBI instructions. (IRAC Norms)
- (5) Report on whether Income Recognition, asset classification and provisioning have been made as per the guidelines issued by RBI.
- (6) Report on whether any serious irregularity noticed in working of bank.
- (7) Report on instances of adverse Credit-deposit ratio in rural area.
- (8) Report on status of compliance with regard to implementations of recommendations of Ghosh Committee relating to fraud and of Tilani Committee on Internal Control and Inspection / Credit System.

(iii) Long Form Audit Report (LFAR):

- LFAR has to be furnished by the auditor in addition to main audit report.
- Matters to be dealt with in LFAR have been specified by RBI.
- LFAR is to be submitted before 30th June every year.
- While LFAR does not require any executive summary of observations, auditor may consider providing the same to bring out the key observations from the whole document.

civ Reporting of Fraud:

- Circular issued by RBI regarding "Liability of Accounting and Auditing profession" states that if an accounting professional, during the course of internal or external audit, finds anything suspicious on fraudulent activity or act of excess power, auditor should refer the matter to the regulator (RBI).
- Any deliberate failure on the part of auditor shall render himself liable for action.
- Reporting is required in case of all scheduled commercial banks.
- Auditor is not expected to look into each and every transaction, but to evaluate the system as a whole.
- While reporting such matters, auditor need to consider the requirements of SA-250 "Consideration of laws and Regulations in audit of F.S."
- SA 240 also requires the auditor to obtain reasonable assurance that F.S. taken as a whole are free from material misstatements, whether caused by fraud or error.

(c) Conducting the bank audit:

- | | |
|--|--|
| (i) Initial Considerations | (vi) Establish the <u>Overall Audit Strategy</u> . |
| (ii) <u>Understanding bank and its Environment</u> | (vii) Develop the <u>audit plan</u> |
| (iii) <u>Identifying and assessing RMM</u> | (viii) <u>Execution</u> |
| ^{Imp.} (iv) <u>Understanding the Risk Mngt. Process</u> | (ix) <u>Reliance / Reviews on other Reports.</u> |
| ^{Imp.} (v) <u>Engagement Team Discussions</u> | |

Requirements of a Risk Management System in a Bank:

(i) Involvement of TCOG: TCOG shall approve the Risk Management policies of the Bank. While approving the policies, it should be ensured that policies are consistent with:

- (a) Bank business objectives and strategies;
- (b) Capital strength
- (c) Management expertise
- (d) Regulatory requirements.

(ii) Identification, Measurement and Monitoring of Risk: Risk that may affect the achievement of bank goals and objectives should be Identified, measured and monitored.

(iii) Control Activities: Banks must exercise controls to manage the risks,

Including: (a) Segregation of duties;

(b) Verification and approval of transactions

(c) Setting of limits; and

(d) reporting and approval of exception.

(iv) Monitoring of Activities: Independent Risk Mngt. unit (RMU) should be set up which regularly assess the risk mngt. models, methodologies and assumptions used to measure and manage risk.

(v) Reliable Info. System: Banks must have a reliable information system that provides adequate financial, Operational and Compliance information to Mngt. and TCOG, on a timely and consistent basis.

Imp-

Benefits of Engagement Team Discussions:

- (i) Provide an opportunity to team members to share their insights based on their knowledge of bank and its environment.
- (ii) Provide an opportunity to team members to exchange information about the bank's business risks.
- (iii) Provide an understanding among the team members as to the effects of results of RAP on other aspects of audit, including decisions about the NTE of further audit procedures.

Imp-

Matters to be discussed with ET: (Noting - How)

(d) Assessing Risk of Fraud:

- As per SA 240, auditor objective is to identify and assess RMM in the f.s. due to fraud and to obtain SAAE on identified misstatements and to respond appropriately.
- To recognise the possibility of misstatements due to fraud, auditor should maintain an attitude of professional skepticism.
- RBI has also framed guidelines that deal with prevention of money laundering and KYC Norms. These guidelines require the banks to establish policies, procedures and controls to detect and to recognise and report money laundering activities.

III. Verification of Advances:

(A) Types of Advances:

→ Funded loans: Loans where there is actual transfer of funds from the bank to the borrower.
For Ex: Term loan, Cash credit, OD, demand loan etc.

→ Non-funded facilities:

↓
Facilities which do not involve transfer of funds.

For Ex: Letter of Credit, Bank Guarantee.

Based on prudential Norms: (IRAC Norms)

(A) Performing Advances (PA)

- Also known as Standard assets
- Such Advances which does not disclose any problem and does not carry more than normal risk.

(B) Non-Performing Advances (NPA)

Advances:

- (a) that cease to generate income for bank.
- (b) Interest / principal of which remains Overdue^① or out of order^② for a [specified period]

Note: ① An account is said to be 'Overdue', if it is not paid on due date.

② An account shall be treated as out of order

- If o/s balance remains in excess of sanctioned limit / drawing power, or
- If there are no credits continuously for 90 days as on B/S date or credits are not enough to cover the interest debited during the same period.

NPA classification w.r.t. specified advances:

- (a) Term loans: Interest / Instalment of Principal remained overdue for a period > 90 days.
- (b) Cash Credit / Overdraft: Account remained Out of Order for a period > 90 days.
- (c) Bills purchased / Bill discounted: Bill remains overdue for a period > 90 days.

NPA classification based on period of irregularity: 3 types

- (a) Sub-standard assets: Assets which has been classified as NPA for a period ≤ 12 Months.
- (b) Doubtful assets: Assets which has remained NPA for a period > 12 Months.
- (c) Loss assets: Assets in respect of which loss has been identified by the bank or internal auditors or the RBI inspection team, but the amount has not be written off, fully or partly.

Standard ↓ <u>Normal Risk</u>	(irregular) overdue > 90 out of order days [Special Mention Accounts - SMA]	Substandard ↓ (12 Months)	Doubtful ↓ > 12 Months.	Loss ↓ <u>Loss Identified</u>
-------------------------------------	---	---------------------------------	---------------------------------	-------------------------------------

Provisioning Requirements: (A) Standard assets : 0.40% [0.25% on SME / Agricultural Advances]

(B) Sub-standard : 15% + Addl. provision - unsecured portion - 10%

(C) Doubtful - (i) unsecured portion - 100%

(ii) Secure portion - 25% - upto 1 year

40% - > 1 year but upto 3 years

100% - > 3 years

(d) Loss Assets - 100%

(B) Types of Securities and Modes of Creation of Security:

- Primary Security: Security offered by the borrower for the bank finance or security against which credit extended by the bank.
- Collateral Security: Additional security, can be in the form of: movable or immovable assets, tangible or intangible assets.

Modes of Creation of Security:

- | | |
|---|---|
| (i) <u>Mortgage</u> : (a) <u>Equitable</u> (b) <u>Registered</u> | Immovable Properties - <u>Land/Bldg.</u> |
| (ii) <u>Pledge</u> : Physical transfer of possession of goods | Movable Properties - Gold |
| (iii) <u>Hypothecation</u> : Creation of <u>equitable charge</u> . | Movable Properties - Car/ <u>Stock</u> etc. |
| (iv) <u>Lien</u> : Creation of <u>legal charge</u> with consent of owner | <u>Fixed deposits</u> |
| (v) <u>Assignment</u> : <u>transfer of existing and future rights</u> in favour of <u>another person (lender)</u> | <u>Ex: Life Insurance Policies</u> |

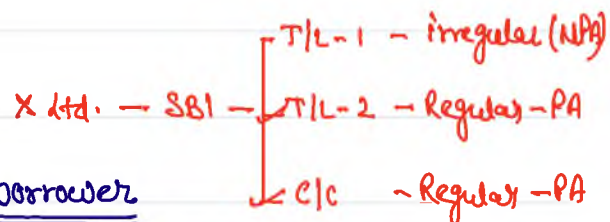
(C) Special Cases w.r.t. NPA Classification:

(i) Accounts regularised near B/S date:

An account should be classified as NPA, if it appears that it has inherent weakness and few credits near the balance sheet date tries to make it regular.

(ii) Asset classification - borrower-wise:

All the facilities granted by the bank to borrower will have to be treated as NPA and not the particular facility.



(iii) Advances under Consortium:

Consortium advances should be classified based on the record of recovery of the respective individual member bank and other aspects having a bearing on the recoverability of the advances.

(iv) Govt. Guaranteed advances:

- Credit facilities backed by C.G. guarantee, though overdue out of order, will be classified as NPA only when C.G. repudiates its guarantee when invoked.
- Credit facilities backed by State Govt. guarantee, should be classified as NPA in normal way.

(v) Agricultural Advances:

Agricultural advances shall be classified as NPA, if interest and/or instalment of Principal is overdue for



Short duration crops: Crops, other than long duration crops.

Long duration crops: Crops with crop season longer than one year.

Ex. Short duration crop (3 months)



Chapter - 12 "Audit of Bank" (Lecture No. 2/3)

(D) Computation of Drawing Power (DP):

Example: X Ltd. $\xrightarrow{\text{Overdraft / Cash Credit Limit}}$ Canara Bank

Limit Sanctioned = 50 lakh.

Conditions: (i) Security - Primary security - Hypo. of Inventory
- Collateral " - Mortgage of Factory L&B

(ii) Monthly stock statement

(iii) Drawing Power = 80% of Net Current Assets
[Paid stock + debtors] \times 80%.

Stock - > 3 Month old - Not Considered

Debtor - 76 Month " - " "

	Inventory (\leq 3 M old)	Creditors	Debtor	<u>Drawing Power</u>
Jan. 2023	<u>40,00,000</u>	-	<u>10,00,000</u> + 20,00,000	= 80% of 50 = 40 lakh
Feb. 2023	50,00,000	-	12,00,000 + 32,00,000	= 80% of 70 = 56 lakh
March 2023	30,00,000	-	5,00,000 + 15,00,000	= 80% of 40 = 32 lakh

May 22 Exam:

(i) Meaning of Drawing Power: - Limit upto which a firm or company can withdraw from the sanctioned working capital limit.

- It is calculated based on primary security less margin as on a particular date.

(ii) Bank's duties w.r.t. DP: (a) Ensure that drawings in working capital limits are covered by adequacy of the current assets.

(b) DP is to be calculated on basis of Current stock statement. However, in case of some borrowers, bank may rely on older stock statement, which should be older than 3 months.

(c) Outstanding in the account based on DP calculated from stock statements older than 3 months is deemed as irregular.

(iii) Auditor's concern: Auditor should properly examine the following in detail:

- ✓ (a) Stock statements
- ✓ (b) Quarterly returns
- ✓ (c) Other statements
- ✓ (d) Audited annual accounts and annual report.

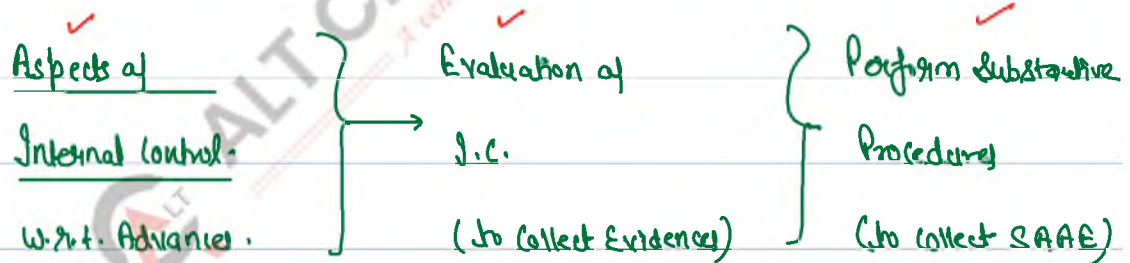
Monthly stock statements from which the audited accounts are prepared and submitted should be compared and reasons for deviation, if any should be inquired.

(iv) Computation of DP:

- DP is calculated as per the guidelines framed by the BOD of the bank and agreed upon by the statutory auditors.
- While calculating drawing power, following are to be duly considered:
 - (a) Ageing of Inventory and trade receivable
 - (b) trade payables
 - (c) Margin to be kept.

- (V) Stock Audit: - Stock audit should be carried out by the banks for all accounts having funded exposure of > ₹ 5 (cores).
- Auditors can also advise for stock audit in other cases if circumstances so require.
 - Bank branches should obtain stock audit reports from the lead bank in case of consortium finance arrangements for working capital.
 - Report submitted by stock auditors should be reviewed and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of DP.

(E) Audit procedure:



Noting - H.W.

- Completeness
- Valuation
- Existence
- Secured / unsecured
- Provisions

Chapter-12 "Audit of Banks" (Lecture No.3)

(IV.) Audit of Revenue Items (Incomes):

- (i) Composition of Income:
- | | |
|---------------------|-----------------------|
| (A) Interest Earned | - heading from book - |
| (B) Other Incomes | |

(ii) Audit Approach and Procedures:

(a) Auditor's concern: To obtain reasonable assurance that :

- recorded income arises from transactions taking place in the relevant period, pertains to the bank. [Occurrence]
- there is no unrecorded income. [Completeness]
- Income is recorded at appropriate amount. [Measurement]

(b) RBI's directions: Income should be recognised on accrual basis as per AS-9, if that income exceeds:

✓ Gross Commission = 2 Cr. [$< 1\% \text{ of Total Income}$]
Total Income = 180 Cr.
Net Commission = 1.2 Cr. [$2 \text{ Cr.} - 0.8 \text{ Cr.}$]
Net Profit before tax = 100 Cr. [$> 1\% \text{ of Net Profit}$]

1% of Total Income
of bank computed on
Gross Basis

1% of Net profit before taxes
Computed on net of costs.

Note: If any item of income is not considered material as per the above norms, it may be recognised when received and in such case, auditor need not to qualify their report.

Example: (A) Gross Commission = 2 Cr. Total Income 180 Cr.

As Gross Commission is $< 1\%$ of Total Income, bank may recognise this income on Cash basis.

(B) Net Commission = 1.2 Cr. Profit before taxes 100 Cr.

As net Commission is $> 1\%$ of Net Profit before taxes, bank should recognise this income on accrual basis.

(c) Revenue certainty: If no uncertainty exist as to ultimate collection of revenue, banks should recognise revenue income on accrual basis i.e. as it is earned.

(d) Revenue uncertainty: In case of significant uncertainty regarding, ultimate collection of income arising in respect of NPA, RBI guidelines requires that banks should not recognise income on NPA until it is actually realised.

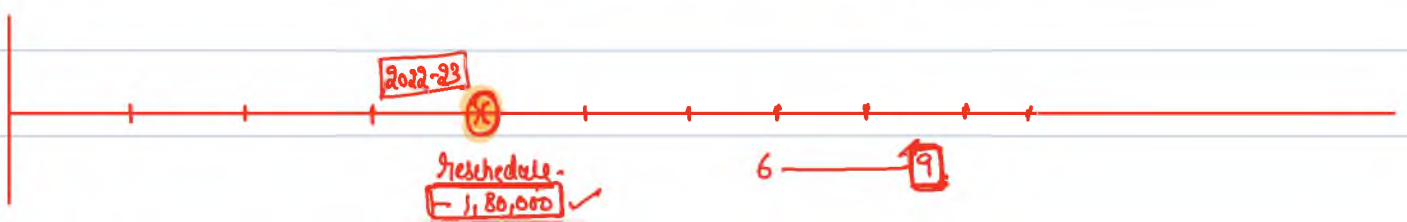
(e) Advances against securities: Interest on advances against fixed deposits, NSCs, KVP, IVP and Life insurance policies, may be recognised on due dates, provided adequate margins are available.

(f) Bills Purchased | — Self Study —

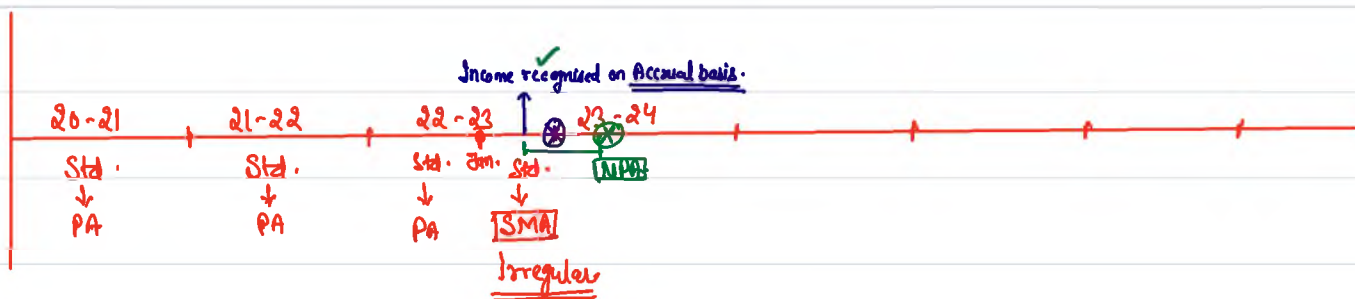
(g) Bills for collection

(h) Renegotiation:

- Fees/Commission earned by a bank as a result of renegotiation or rescheduling of outstanding debts should be recognised on accrual basis over the time covered by the re-negotiated period.
- Test check the Interest earned by the banks from the selected samples.
- Test check the fees and commission earned by the banks.



(iii) Reversal of Income:



- If any advance becomes NPA as at close of any year, entire **interest accrued** and credited to income account in the past periods, should be reversed, if the same is not realised.
- This requirement will apply for Govt. Guaranteed Advances also.
- In respect of NPA's, any **fees, commission etc.** that have accrued should cease to accrue in current period and should also be **reversed, if uncollected.**
- In case of banks which have wrongly recognised income in the past should reverse the interest, or make a provision for an equivalent amount.

(iv) Partial Recoveries in NPA:

- In the absence of a clear agreement between bank and borrower for the purpose of appropriation of recoveries in NPA, banks are required to adopt an accounting policy and appropriate the recovery amount in a uniform manner.
- Appropriate policy to be followed is to recognise income as per AS-9 when certainty attaches to realisation and accordingly amount reversed or not recognised in the past should be accounted for.
- Interest partly or fully realised in NPA, to be considered as Income.

(v) Income on Investments: - Self Study -

Chapter - 13 "Audit of different Entities"

Part - A	Part - B	Part - C	Part - D
✓ - Govt. Audit	- Audit of Sole trader	- Audit of	Audit of
✓ - Audit of local bodies	- Audit of Partnership firms	- Charitable Institutions	Co-operative Societies
- Audit of NGOs	- Audit of LLP	- Hospital, - Cinema, club, hotel - Hire purchase and leasing companies	

Part A "Govt. Audit"

(i) Meaning of Govt. Audit: Examination of financial, administrative and other operations (J.O.S.P) - purpose - conclusion and recommendation.
Examination of F.S.

(ii) Characteristics of Govt. Audit:

- Public accounting of Govt. funds
- " " of aspects of public administration
- Neither equipped nor intended to work as investigating agency
- Objective - ensure accountability of administration
- Function - CAG: - Indian Audit and accounts dept.
- CAG. - authorities: - act - conformity - Constitution/laws

(iii) Objectives of Govt. Audit: (a)

(b)

(c)

(d)

(iv) Legal framework of CAG: (a) Appointment: President of India

(b) Term: 6 years or 65 years of age - earlier
Both hours of

(c) Removal: proven misbehaviour/incapacity + Parliament

(d) Remuneration: Equivalent to Judge of SC

(e) Powers and duties (149): CAG (Duties, Powers and ...) Act.

(f) Maintenance of A/c (150): Union/State - President - advice of CAG

(g) Submission of A/c (151): Report on A/c - President/Governor.

(v) Duties of CAG: (a) Compilation and Submission of accounts

(b) Rendering assistance in accounts maintenance

(c) Auditing and reporting: - I. Expenditure from Consolidated fund

II. Transactions from Contingency fund

III. Financial statements

(d) Audit of receipts and expenditures: of any body/authority which is substantially financed.

(e) Audit of grants or loans: for any specific purpose from Consolidated fund.

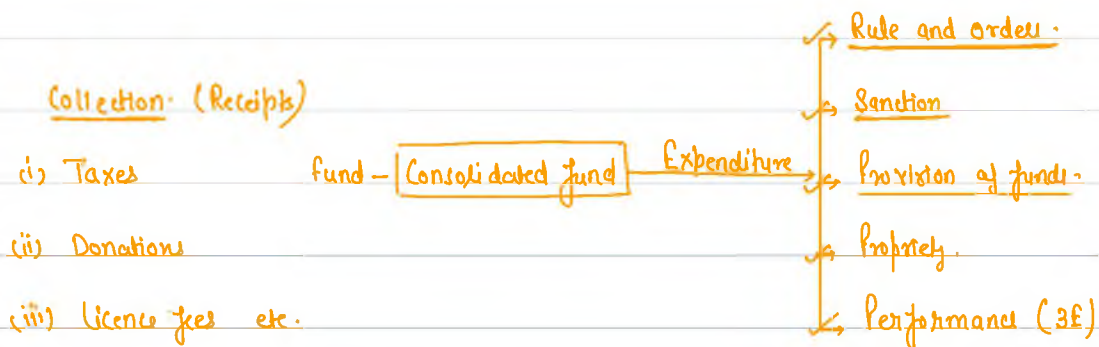
(f) Audit of receipts of Union and States.

(g) Audit of accounts of stores and stock.

(h) Audit of Govt. companies.

- (vi) Powers of CAG :
- (a) Inspection : of any office of accounts under the control of Union or State Govt. and any office responsible for creation of Initial or Subsidiary accounts.
 - (b) Transmission : of any accounts, books, papers or documents relevant to the transactions under audit, to any specified place.
 - (c) Inquiry : as considered necessary for the preparation of any accounts or report which is his duty to prepare.

- (vii) Expenditure Audit :
- (a) Audit against Rules and Orders
 - (b) " " provision of funds
 - (c) Propriety Audit
 - (d) Audit of Sanctions
 - (e) Performance Audit



- (a) Audit against Rules and Order: (i) Not inconsistent with the Constitution and laws
(ii) Consistent with the audit/accounts requirements
(iii) Not in conflict with the Rules orders etc. of higher authorities
(iv) If not approved by competent authority, whether issuing authority possess rule making power.

- (b) Audit of Sanctions: (i) Expenditure is covered by sanction;
(ii) Sanctions are from competent authority, having power vested by Constitution.

- (c) Audit against provision of funds: (i) Existence of provision of funds for which expenditure is to incurred.
(ii) Actual expenditure does not exceed the appropriation made.

- (d) Propriety audit: - Verification of transactions on tests of - public interest
- Commonly accepted Customs
- Standards of Conduct
- Focus is on substance of transactions
- Principles - (i) Expenditure should not be more than the occasion demands.
(ii) No direct/indirect benefit to person sanctioning expenditure.
(iii) Expenditure should not be for benefit of a particular person
(iv) No benefit to managerial personnel, employees, etc.

(e) Performance Audit: In relation to Govt. programmes, schemes, projects etc, performance audit comprises of:

(i) Economy audit: Acquisition of resources economically.

(ii) Efficiency audit: Examination of executive actions to achieve the desired results.

(iii) Effectiveness audit: Performance appraisal, i.e. achieved results being compared with anticipated results (desired results).

(vii) Audit of Receipts: (a)

(b)

(c)

(d)

(e)

(ix) Audit of stores and stock: (a)

(b)

(c)

(d)

(e)

(x) Audit of Commercial Accounts:

(i) Departmental Enterprises → Audit → Same lines → as for Govt.

(ii) Statutory Corporations → Audit → Respective laws.

(iii) Government Companies → Audit → Companies Act, 2013

Chapter - 13 "Audit of different Entities"

Part - A "Audit of local bodies"

(i) Meaning of local bodies :

(ii) Revenue / Expenses of local bodies :

(iii) Financial Administration of local bodies :

(a) Budgetary Procedures

↓ to ensure

- financial accountability
- Control over expenditure
- Compliance of rules and regulations in raising and utilisation of funds

(b) Expenditure Control

↓

- through dividing the powers among -
- legislative wing (council)
 - executive wing (officers)

(c) Accounting Systems

↓

- Cash basis
- Subsidiary records for taxes, assets etc.
- Separate Vouchers
- Monthly Bank reconciliation
- Submission of summary reports

(iv) Types of Grants : (a) General Purpose (b) Specific purpose

(c) Statutory and Compensating Grants

(v) Objectives of audit of local bodies :

Reporting - fairness of financial statements

- Strength and weakness of systems of financial control
- adherence to legal and administrative requirements
- benefits / Value derived from money spent

Detection and

Prevention of

(a) Errors and frauds

(b) Misuse of resources.

"Audit of NGOs"

Audit Framework:

(A) Preliminary activities: - MOA/ AOA/ Bye-laws/ Trust deed

- Accounting System

- Organisational charts

- Minutes of the meetings

(B) Substantive Testing: (i) Audit of Receipts: Donations, Grants, Subscriptions, Membership fees, Interest, dividends

(ii) Audit of Expenses: Expenses are in conformity with
- the objects of NGO;
- the statutory provision;
- Bye-laws, Rules and Regulations.

(iii) Assets and liabilities: Fixed assets, Investments, Cash Balances, Inventories, Loans etc.

Part - B " Audit of Sole trader, partnership firms and LLPs "

(i) Audit of Sole trader : Self study from book

(ii) Audit of Partnership firms : Self study from book

(iii) Audit of LLPs :

(a) Books of A/c (Sec. 34 and Rule 24) :

- Prescribed books are to be maintained (Receipts and Expenditures, assets and liabilities, Inventories, WIP, finished goods, cost of goods produced and other particulars).
- CASH or accrual Basis.
- Double Entry System of accounting.
- Maintained at Regd. office.
- Preserved for prescribed period (8 years).

(b) Statement of account and Solvency : (Sec. 34 and Rule 24)

- Shall be prepared within 6 Months from the end of FY and to be filed with Registrar.
- shall be signed by the designated partner
- shall be filed with Registrar in Form 8 within 30 days from the end of 6 months from the expiry of relevant FY.

(C) Audit of Accounts (Sec. 34 and Rule 24):

(i) Requirement of Audit: Audit shall be required if T/O > 40 lakh (and)

Contribution > 25 lakh

T/O ≤ 40 lakh Or
Contribution ≤ 25 lakh. } → audit not required

(ii) Tenure: Appointment shall be for each financial year and auditor shall continue in the office till

(a) New auditors are appointed

or

(b) they are re-appointed.

(iii) Eligibility: CA in practice

(iv) Appointment: First auditor: at any time, but before end of first FY
by designated partner

Sub. auditor: 30 days before the end of relevant FY
by designated partner.

Note: If designated partner fails to make the appointment, partner shall appoint the auditor.

(D) Annual Return:

- To be filed by LLP with the Registrar.
- within 60 days from the end of FY
- in prescribed form (Form 11)

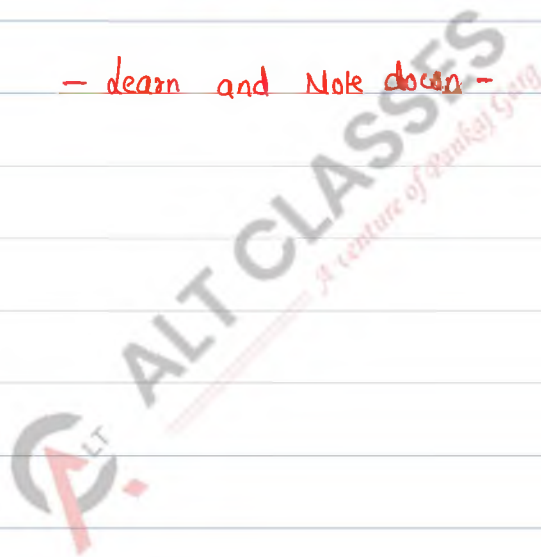
(E) Inspection of documents: (filed with Registrar)

- Incorporated documents
- Names of the partners and changes if any
- Statement of A/c and Solvency (Form 8)
- Annual Return (Form 11)

Any person
Fees - ₹ 50

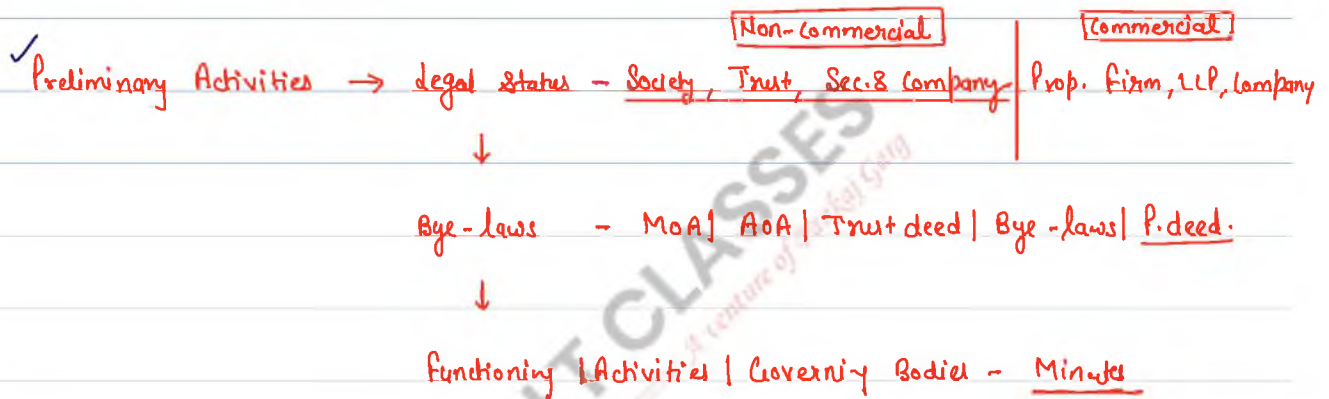
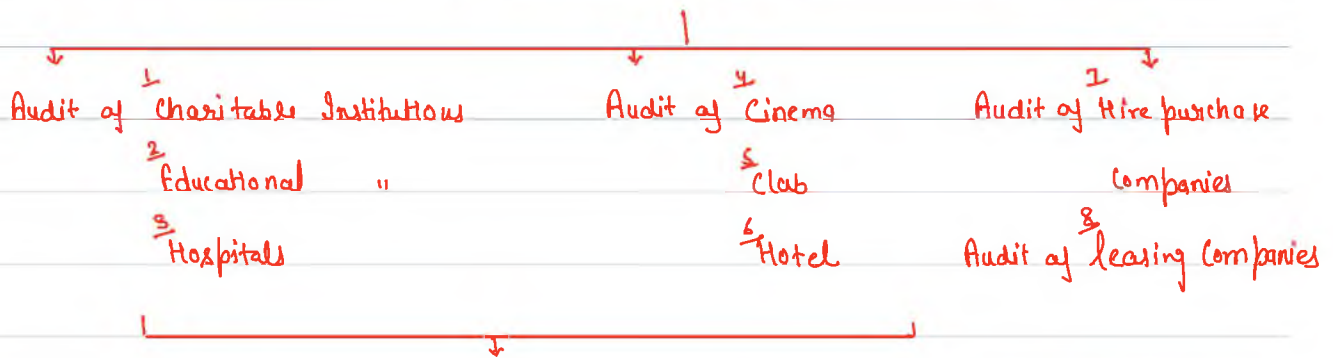
(F) Power of Registrar to obtain information: (Sec. 38)

- learn and Note down -

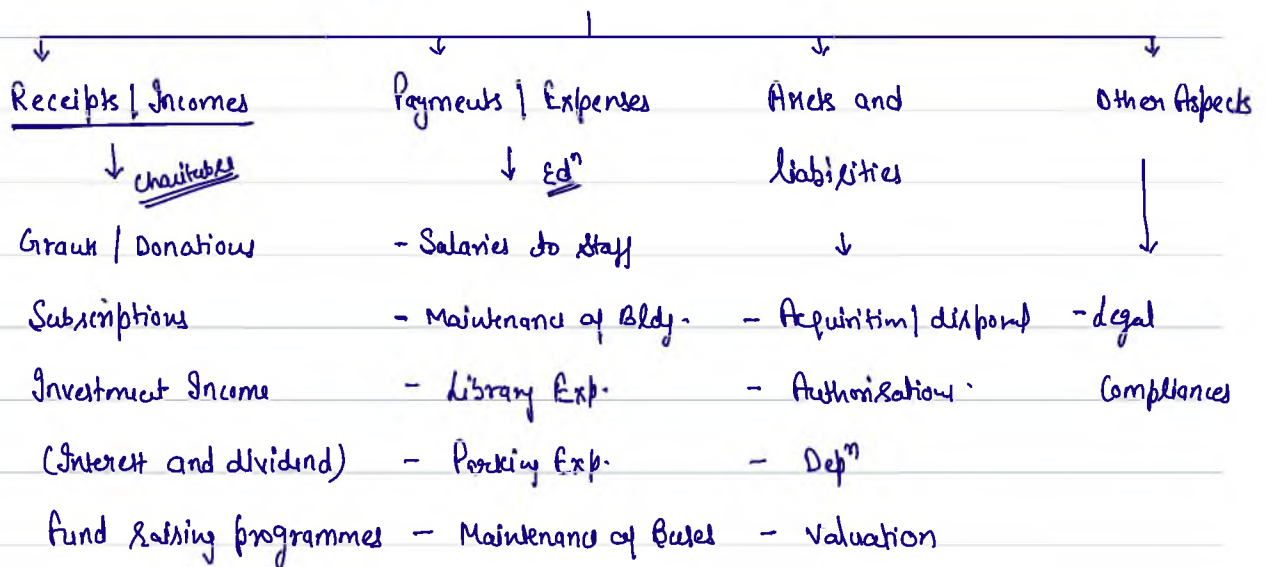


Chapter - 13 "Audit of different Entities"

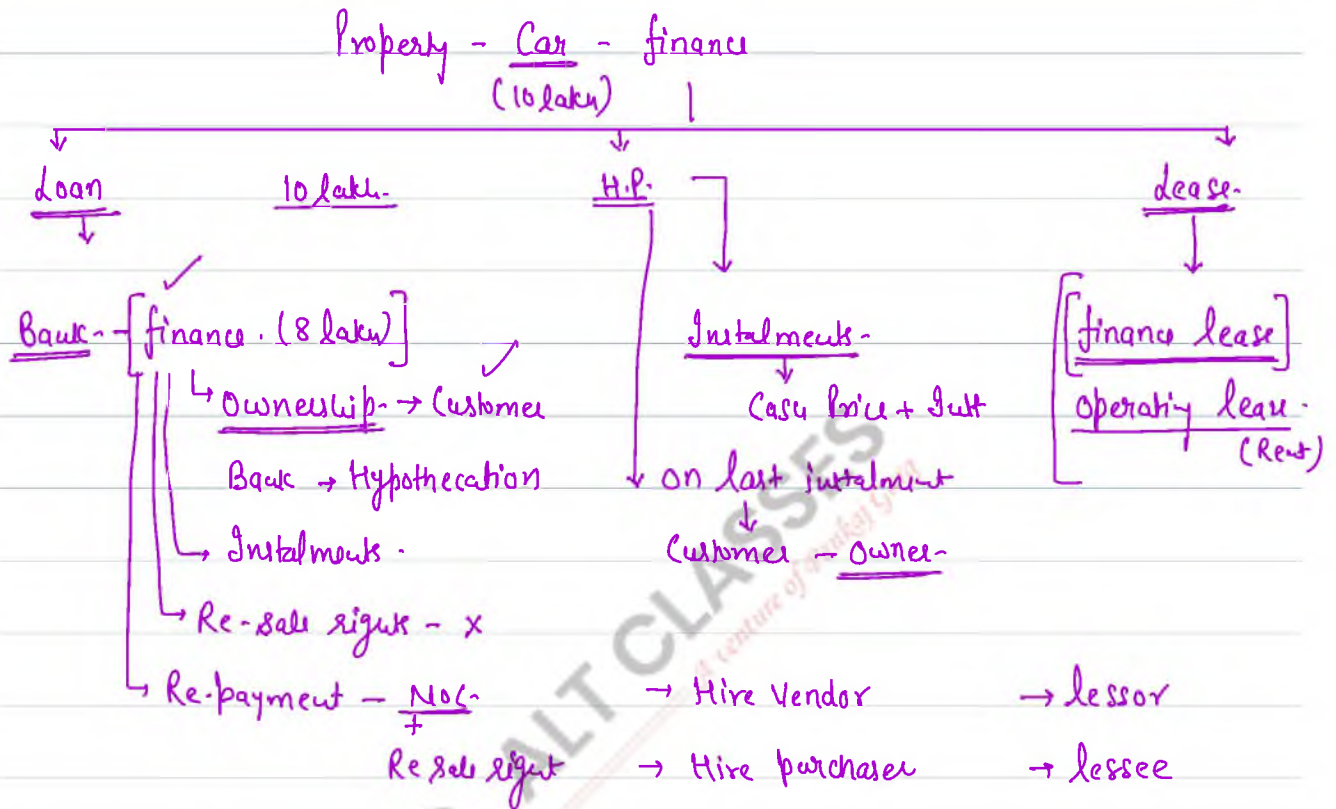
Part - C "Misc. Audits"



Substantive Checking: Extent of substantive testing depends on existence and effectiveness of I.C. system.



Hire - Purchase and lease transactions



	<u>Asset</u>	<u>lease period</u>	<u>lease payment</u>	<u>ownership</u>
✓ <u>Finance lease</u>	[selected by <u>lessee</u>]	✓ Approx. life of Asset	✓ Covers <u>full value</u> of <u>asset</u> + <u>financing</u> - <u>lessee</u>	offered to
<u>operating lease</u>	selected by lessor	short period as decided by parties	<u>Rent</u>	remains with lessor

Chapter - 13 "Audit of different Entities"

Audit of Co-operative Societies

- Cooperative Societies Act
- Multi-State Cooperative Societies Act

Part - I

- Important provisions of Cooperative Societies law
- Special aspects of Cooperative Societies
- Rights and duties of auditors of Cooperative Societies

Part - II

- Provisions with Accounts and audit as per Multi-State Cooperative Societies Act, 2002 (Sec. 70, 72, 73)

Powers of C.G. to Conduct Special audit / Inquiry / Inspection
Central Registrar.
[Sec. 77, 78, 79]

I. Important Provisions of Cooperative Societies law:

- Qualification of auditor: CA + Persons holding diploma in co-operative accounts.
- Appointment of auditor: by Registrar.
- Books, Accounts and Other records:
 - sum of money recd. and expended
 - sales and purchases
 - assets and liabilities
- Restriction on shareholding: 20% of total no. of shares / ₹ 1,000
(for persons other than regd. society)
- Restrictions on loans:
 - to be made only to members of society.
 - to others (with the sanction of Registrar).

(vi) Restriction on borrowings: - loans and deposits can be accepted from members and others.

(vii) Investment of funds:

(viii) Appropriation of profit: 25% of NP → Reserve fund

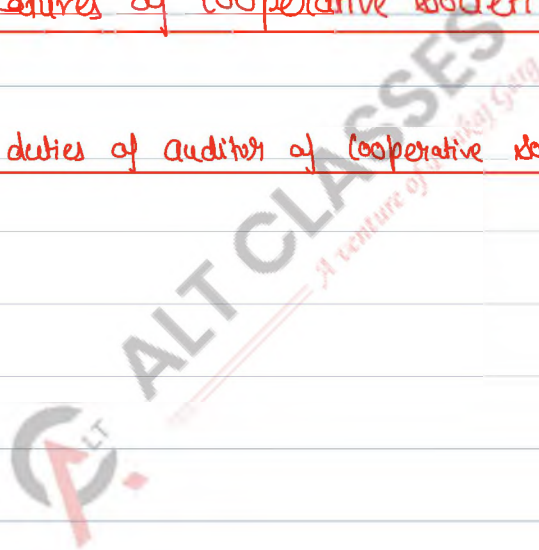
(ix) Contribution for charitable purpose: 10% of NP

(x) Utilisation of reserve funds

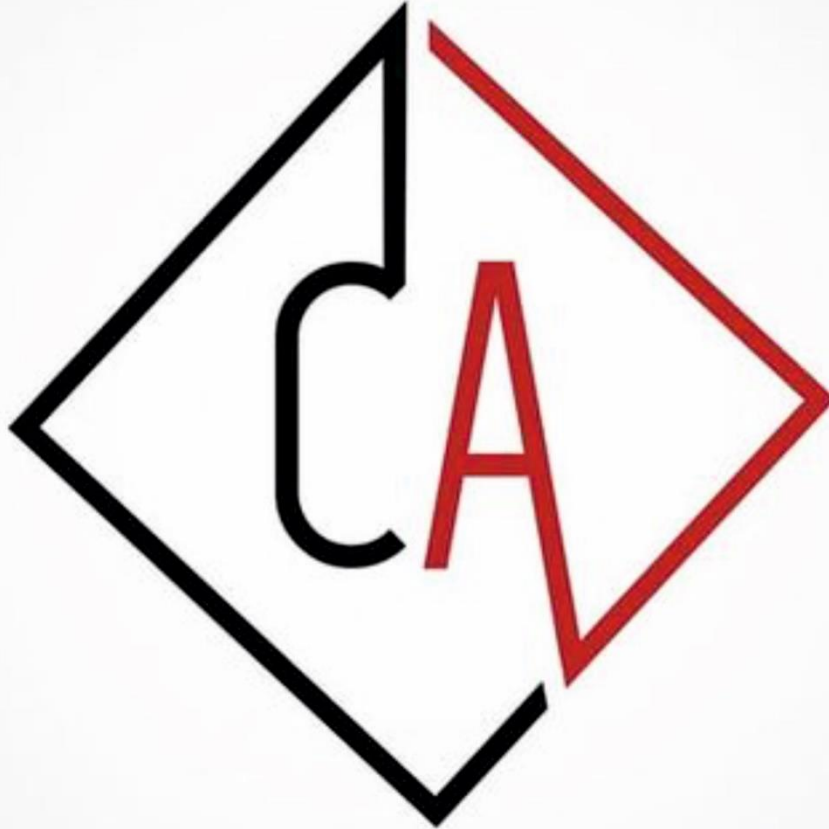
(xi) Contribution to Edⁿ fund:

II. Special features of cooperative societies audit: (H.W.)

III: Rights and duties of auditor of cooperative societies: (H.W.)



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