

# CA Intermediate - New Syllabus

## Paper - 5 "Auditing and Ethics"

### Introductory Lecture - 1

#### (i) Expected Paper Pattern:

(A) Multiple Choice Questions.

(30 Marks)

✓(a) Case Studies - 2 case studies of 10 Marks each

✓(b) Individual MCQ - 10 MCQ of 1 Mark each

(B) Descriptive Questions.

✓(a) Correct/Incorrect - 1 Question of 14 Marks

✓(b) Other descriptive - 4 Questions of 14 Marks each.

(ii) Books: ✓(A) Study Material - ICAI

✓(B) Books - ✓(i) Main Book - detailed Concept Book  
- Tabular Form  
- Point wise

✓(ii) Question Bank - Part I : Descriptive Questions.  
Part II : Correct/Incorrect  
Part III : MCQ  
Part IV : Case Studies

✓(C) Class Notings - PDF - Google drive/LMS

(iii) Approach: (A) Proper Notes

(B) Revision

✓(i) ICAI - SM

✓(ii) Main Book

✓(iii) Learning

Notes

Q. Bank

(Update your Notes)



## Introductory Topics

(i) Meaning of Auditing: Auditing may be defined as a <sup>①</sup> Systematic and <sup>②</sup> Independent <sup>③</sup> Examination of data, records, statements, operations and performance <sup>④</sup> of an entity <sup>⑤</sup> for a stated purpose. <sup>⑥</sup>

① Step by step activity carried out in a planned manner.

Audit Engagement → Audit Planning → Audit Execution

↓

Audit Reporting

### Independence

① - Without being biased (objectivity)

② - Be honest and fair (integrity)

③ → Perform with due diligence (competency)

④ → No undue influence of others. (independence)

② Without having any undue influence of others.

③ Performing Appropriate Procedures like - Vouching and Verification

✓ Vouching → To Examine the Vouches (documents, invoices, records)

✓ Verification → To Examine Existence, Valuation etc. of Assets and Liabilities.

④ Subject Matter - To be examined

⑤ Corporate / Non-Corporate ; Profit Making or NPO ; Govt. or Non-Govt.

⑥ To enhance the reliance of Intended users

↓  
(Shareholders, Creditors, Govt, Banks etc.)

Auditor's purpose: To Express an opinion whether the financial statements reflect true and fair view.

(ii) Meaning of Ethu: Ethics are the Principles governing an Individual or a Group.

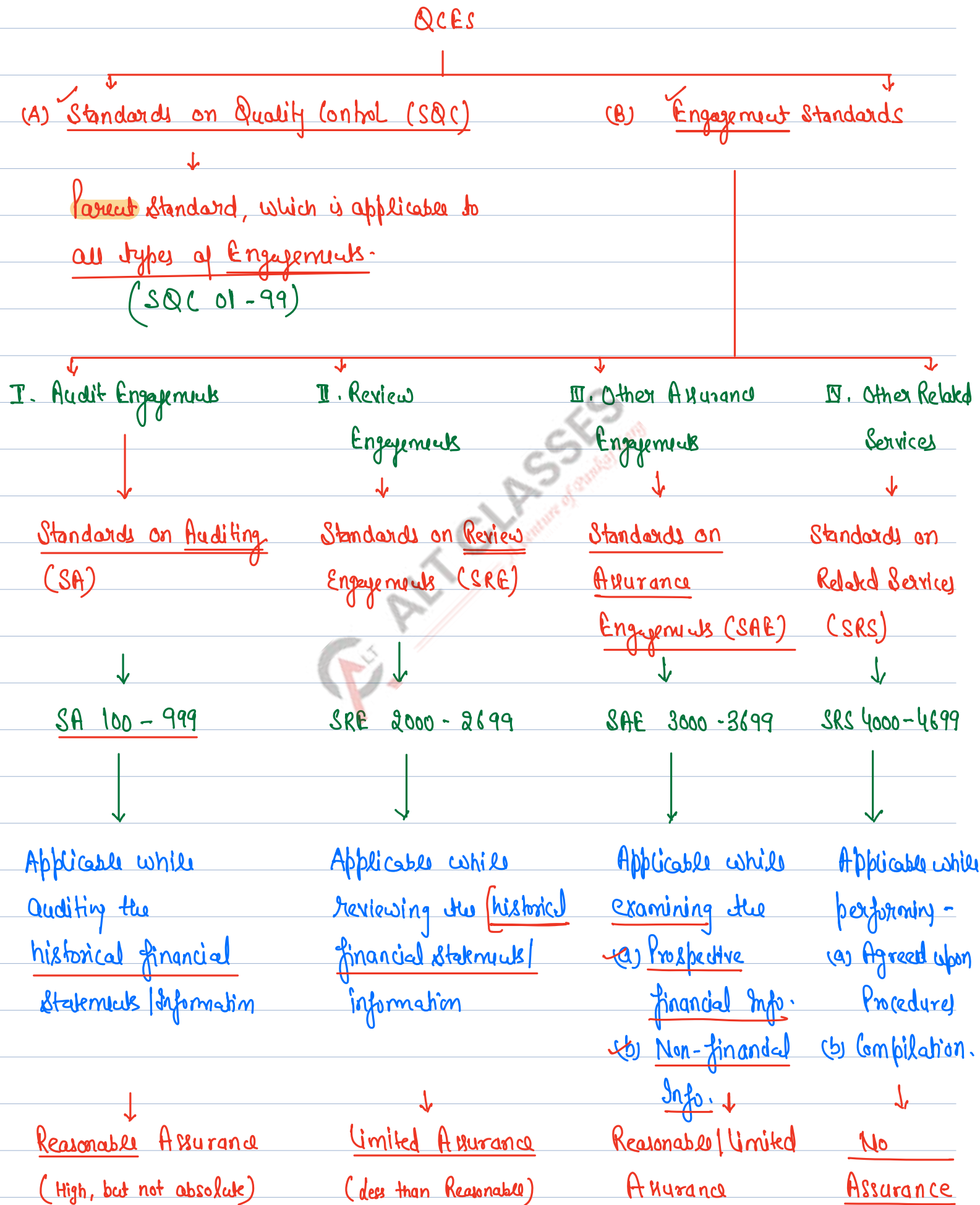
Fundamental Principles to be followed by a chartered Accountant as prescribed in Code of Ethics:

- ✓ (a) Integrity: Honesty; straight forwardness
- ✓ (b) Objectivity: Impartial and fair attitude; No Biasness.
- (c) Professional Competence and Due care (PCDC): Perform Diligently and in compliance with technical and Professional standards.
- ✓ (d) Confidentiality: Donot share the client's information with others.
- (e) Professional Behaviour: Members conduct should not discredit the profession.

Threats involved in compliance of fundamental Principles:

- (A) Self Review Threats: arises when a previous judgement need to be re-evaluated by a professional accountant responsible for that judgement.
- (B) Self Interest Threats: occurs as a result of financial or other interest of a professional accountant or relative.
- (c) Familiarity Threats: occurs when a professional accountant becomes too sympathetic to the interest of others.
- (d) Intimidation Threats: occurs when a professional accountant may be deterred from acting objectively (due to threat of replacement).
- (e) Advocacy Threats: occurs when a professional accountant promotes a position to the point that subsequent objectivity may be compromised.

## (ii) Classification of Quality Control and Engagement Standards: (QCES)



# Paper-5 "Auditing and Ethics"

(Introductory lecture - 2)

(1) Meaning of Auditing

(2) Meaning of Ethics

(3) Classification of Quality Control and Engagement Standards: QCES

✓ (A) Std. on Quality Control (SQC): Audit; Review; Other Assurance; Related Services

(B) Engagement Standards: (i) SA - Audit Engagements

(Umbrella Concept)

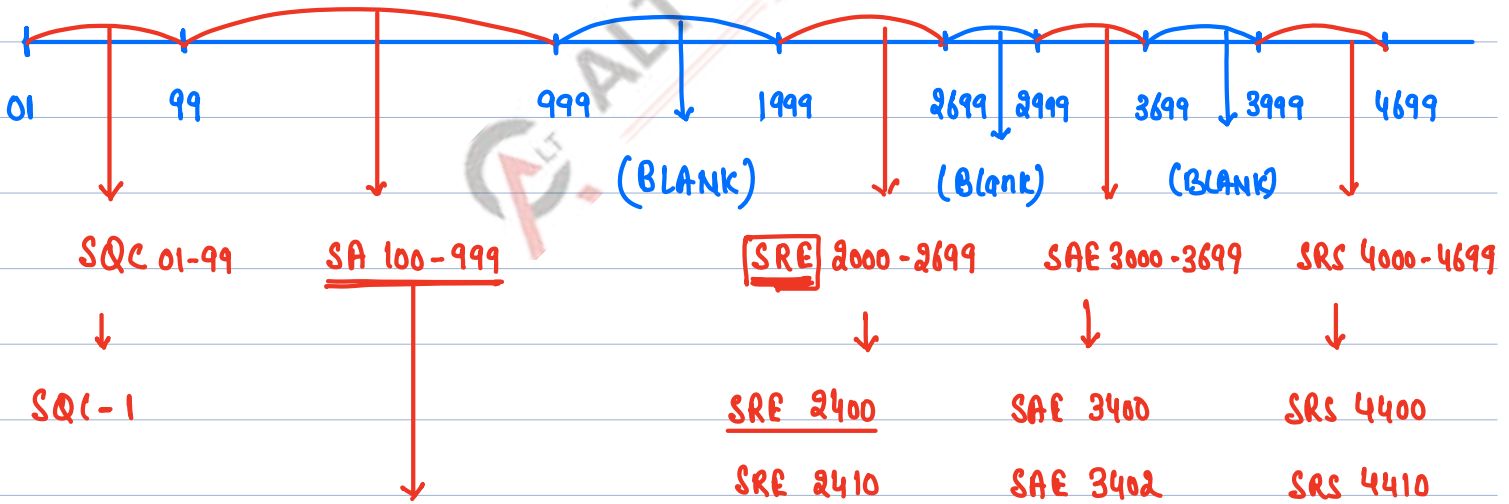
(ii) SRE - Review "

(iii) SAE - Other Assurance Engagements

(iv) SRS - Related Services



IFAC



SA 100-199 - Introductory Matters

SA 200-299 - General Principles (SA 200, 210, 220, 230, 240, 250, 260, 265, 299) - 9

SA 300-499 - Risk Assessment and Response (SA 300, 315, 320, 330, 402, 450) - 6

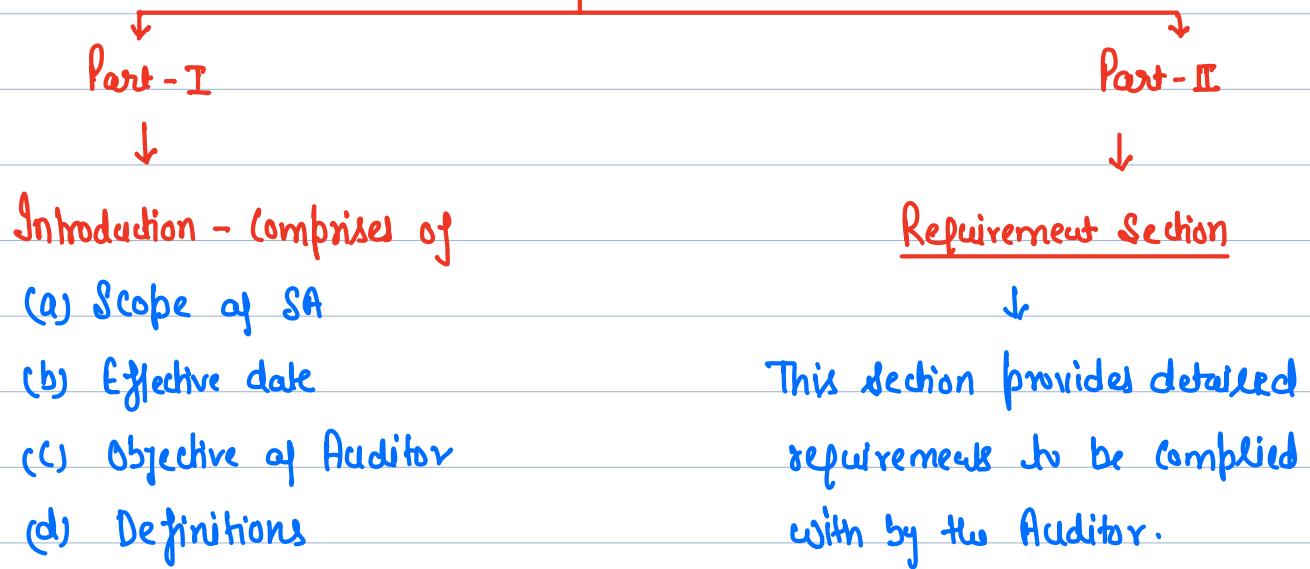
SA 500-599 - Audit Evidences (SA 500, 501, 505, 510, 520, 530, 540, 550, 560, 570, 580) - 11

SA 600-699 - Using Work of Others (SA 600, 610, 620) - 3

SA 700-799 - Audit Conclusion and Reporting (SA 700, 701, 705, 706, 710, 720) - 6

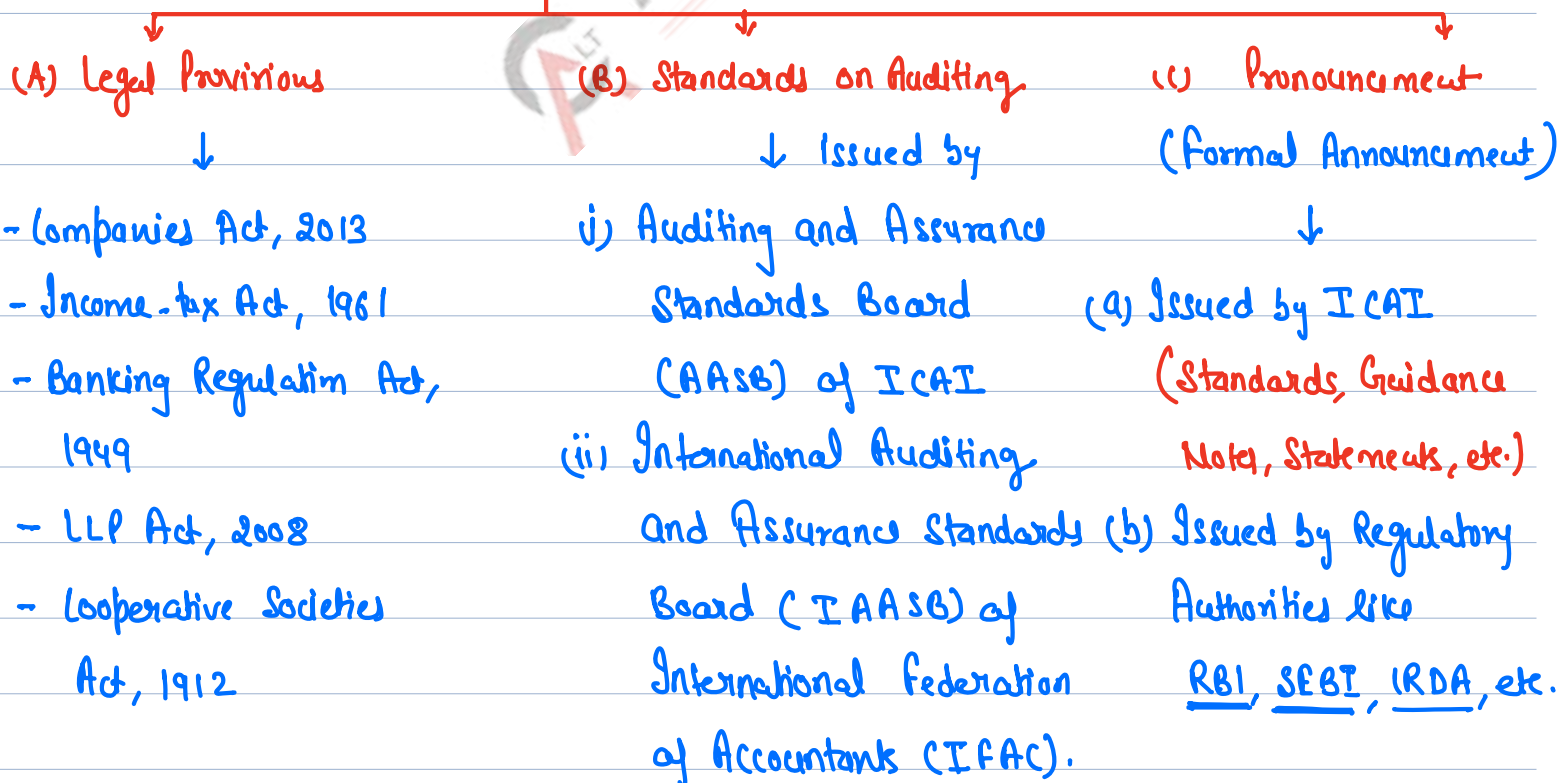
SA 800-899 - Specialised Areas (SA 800, 805, 810) - 3 (38)

#### (4) Format of Standards on Auditing:



Note: Both Introduction and Requirements need to be studied with Application and Other Explanatory Material.

#### (5) Framework of Auditing:



## ⑥ Types of Engagements:

2 types

### (A) Assurance Engagements

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

Examples: (i) Audit Engagements

(Reasonable Assurance)

✓ (ii) Review Engagements

(Limited Assurance)

✓ (iii) Other Assurance Engagements

e.g. Examination of Prospective Financial Info;

Examination of Internal Controls

(Limited / Reasonable Assurance)

### (B) Non-Assurance Engagements

An Engagement in which a Practitioner reports on fact findings, without obtaining any assurance about the subject matter and No Opinion / Conclusion is expressed.

Examples: Related Services Engagements

↓

(a) Compilation Engagement

(b) Agreed upon Procedures.

Note: Types of Assurance: (i) Absolute Assurance: Requires 100% satisfaction on accuracy of Subject Matter.

(ii) Reasonable Assurance: Implies High, but not absolute assurance.

(iii) Limited Assurance: Moderate assurance which is lower than the reason-able assurance.

## (7) Auditor's Overall Objectives:

As per SA-200 "Overall Objectives of an Independent Auditor and Conduct of an Audit in accordance with Standards on Auditing", Overall Objectives of the Independent Auditor is:



To obtain Reasonable Assurance<sup>(1)</sup> whether the financial statements<sup>(2)</sup> as a whole are free from material<sup>(3)</sup> misstatements<sup>(4)</sup>, whether caused due to error or fraud<sup>(5)</sup>, so as to express an opinion,<sup>(6)</sup>



whether the financial statements are prepared in all material respects as per the requirements of applicable financial reporting framework<sup>(6)</sup>



to issue a report thereon.

- (1) High, but not absolute
- (2) Sec. 2(40) of Companies Act, 2013 - B/S; SPL; CFS; SOCE and Notes
- (3) Materiality - SA 320 - Anything significant that can affect the economic decisions of users of F.S.
- (4) Misstatement - SA 450 - Difference in Amount, Classification, Presentation and Disclosure of a financial statement item.
- (5) Error or Fraud - SA 240 - Error - unintentional activity  
Fraud - Intentional act
- (6) Financial Reporting Framework (FRF): Principles / Standards / Guidelines on the basis of which financial statements are prepared and presented.



Examples of FRF: Framework for Preparation and Presentation of F.S.  
issued by ICAI; AS; Ind-AS; GAAP;  
IFRS / GFRS / Sch.-III of Companies Act, 2013.

Types of FRF: From Auditing point of view, FRF can be classified  
in 2 Categories

(A) Compliance FRF

↓  
Those FRFs, where management  
is not permitted to take any  
deviation from the requirements  
of FRF.

(B) Fair Presentation Framework

↓  
Those FRFs in which management  
is permitted to take deviations  
from the requirements of FRF

↓  
so as to ensure that F.S.  
reflects true and fair view.



# Chapter - 1 " Nature, Objectives and Scope of Audit "

- Topics to be covered:
- (i) Meaning and Nature of Auditing
  - (ii) Inherent Limitations of Audit
  - (iii) Meaning, Nature and Types of Engagements
  - (iv) Qualities of Auditor
  - (v) Engagement and Quality Control Standards

## (i) Meaning and Nature of Auditing:

### (A) Meaning of Auditing:

Audit may be defined as <sup>①</sup> Independent Examination of financial <sup>②</sup> information of an Entity, whether profit making or not; and irrespective of its size or form, when such examination is conducted so as to <sup>③</sup> express an opinion on true and fair view of financial results and financial position.

- 1. In-depth study
- 2. Written Practice
- 3. Conceptual clarity
- 4. QIA Practice (Regular)
- 5. Revision
- 6. Regular Tests.
- 7. Target  $\rightarrow 90+$

## Points to be ensured that f.s. not mislead anybody:

- (i) Ensure that accounts are drawn up with reference to entries in books of Accounts. (Posting)
- (ii) Entries in books of accounts are supported by sufficient and appropriate Evidences. (Vouchers)
- (iii) None of Entries in books of account has been omitted. (Completeness)
- (iv) Information contained in f.s. is clear and Unambiguous. (Understandability)
- (v) Amt. shown in f.s. are properly classified, described and disclosures are made in

### - Business transaction - happening.

(Occurrence of an Event)

↓ Measured in Money

Recording of Event in Books of Acc  
(Journal / Sub.)  
(Must have supporting documents)

↓

Posting into the ledger.

↓

Summarisation - T/B

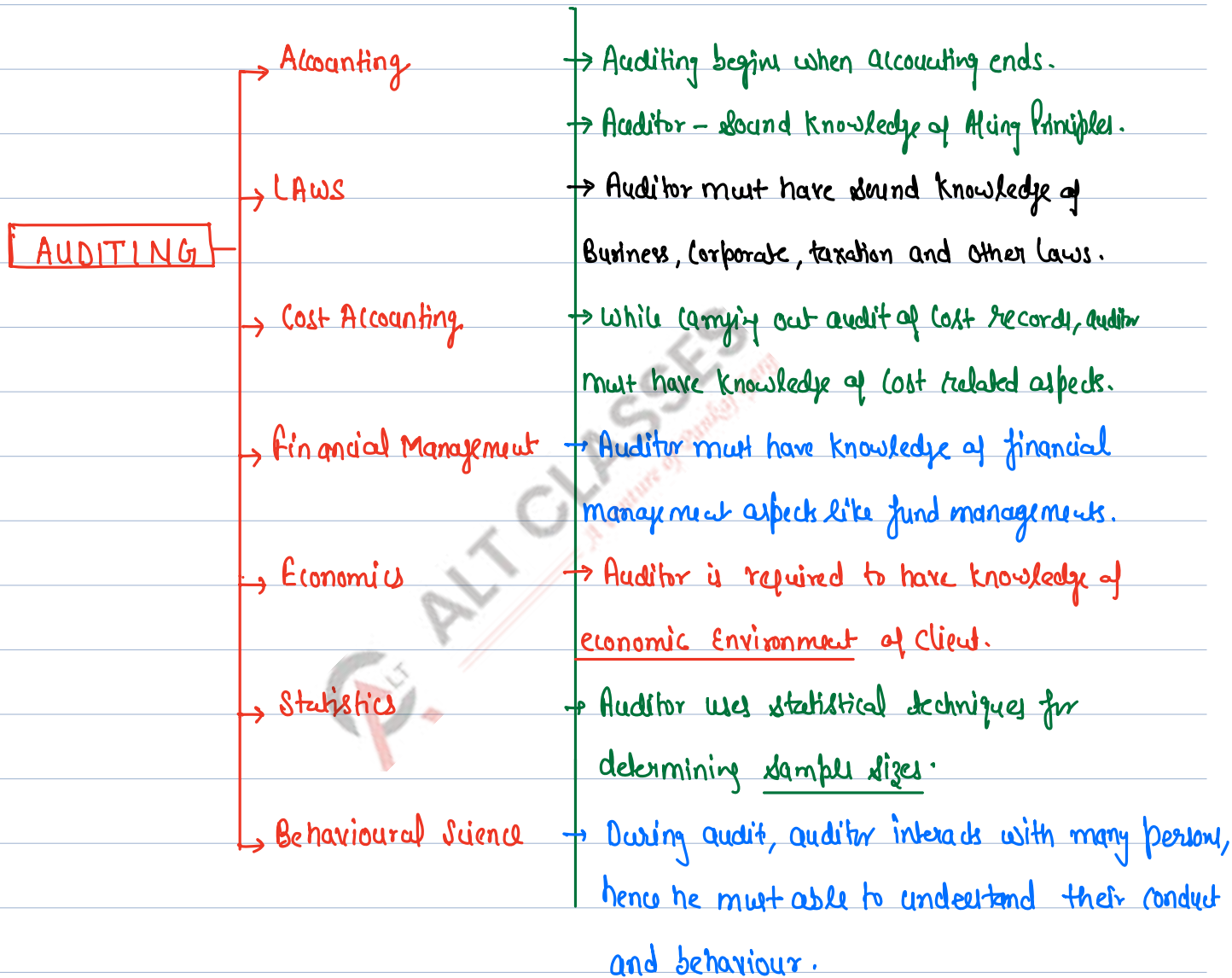
↓

finalisation - (f.s.)

Conformity with applicable ASS. (Reporting)

(vi) F.S. reflects true and fair view of financial results and financial position.  
(Reliable F.S.)

### (B) Interdisciplinary Nature of Auditing:



### (C) Objectives of Audit as per SA 200:

- Already discussed in -  
Introductory Lecture

## (D) Scope of Audit:

### i) Elements to be included in Scope

(a) Ensure that scope of audit cover all aspects of Entity related with f.s.

(b) Be satisfied that information contained in accounting records is reliable and sufficient.

(c) Study and Evaluate Accounting Systems and related Internal Controls.

(d) Ensure information is properly disclosed in the financial statements as per statutory requirements.

(e) Ensure that f.s. properly summarise the Events and Transactions recorded therein.

(f) Evaluate whether accounting policies selected by management are proper and whether such policies are consistently applied period to period basis.

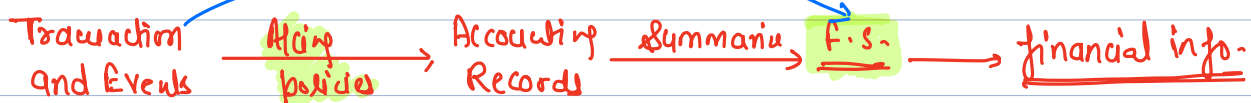
### ii) Elements not to be included in Scope

(a) Areas which fall outside the domain of his competency.

(e.g. Future projections;  
Non-financial matters;  
Viability of business)

(b) Authentication of documents.

(As auditor may not have relevant expertise)



(E) Audit vs. Investigation:

Noting - H.W. -



## (G) Mandatory Audit vs. Voluntary Audit:

- (i) Mandatory Audit:
- ① Required in case of Companies under Companies Act, 2013
  - ② Required in case of non-corporate Entities under Income-tax Act, 1961 (Sec. 44AB).

Sec. 44AB of Income-tax Act, 1961:

✓ Business: T/O or Sales  $> ₹ 1 \text{ crore}$

or

T/O or sales  $> ₹ 10 \text{ crores}$ , if

✓ (a) Cash receipts  $\leq 5\%$  of total receipts

And

✓ (b) Cash payments  $\leq 5\%$  of total payments

✓ Profession: Gross Receipts  $> ₹ 50 \text{ lakh}$

✓ Presumptive taxation u/s 44AD: T/O  $\leq 2 \text{ cr}$

↓

Assessee  $\rightarrow$  claims that Income is  $< 8\% / 6\%$

(ii) Voluntary Audit: Audit not required under any statutory requirements. Audit is carried out for the purpose of obtaining Grants / Subsidies / loans etc.

For Ex: In case of Schools, Audit may be required for obtaining Grants or Assistance from Govt.

- (H) Who appoints auditor:
- |                         |   |                             |
|-------------------------|---|-----------------------------|
| (i) Non Govt. Companies | : | <u>BOD / Members in AGM</u> |
| (ii) Govt. Companies    | : | <u>C &amp; AG of India</u>  |
| (iii) Partnership firm  | : | <u>Partners</u>             |
| (iv) LLP                | : | <u>Designated Partner.</u>  |

(I) To whom Audit report is submitted: to the persons making the appointment.  
Company → Members / Shareholders  
FIRM → Partners

Imp:

(ii) Inherent Limitations of Audit:

As per SA 200 "Overall Objectives of the Independent Auditor and Conduct of an audit in accordance with Standards on Auditing", Auditor is not expected to and cannot reduce audit risk to zero and therefore cannot obtain Absolute Assurance that the f.s. are free from material misstatement due to fraud or error. This is because of following Inherent limitations:

(A) Nature of Financial Reporting:

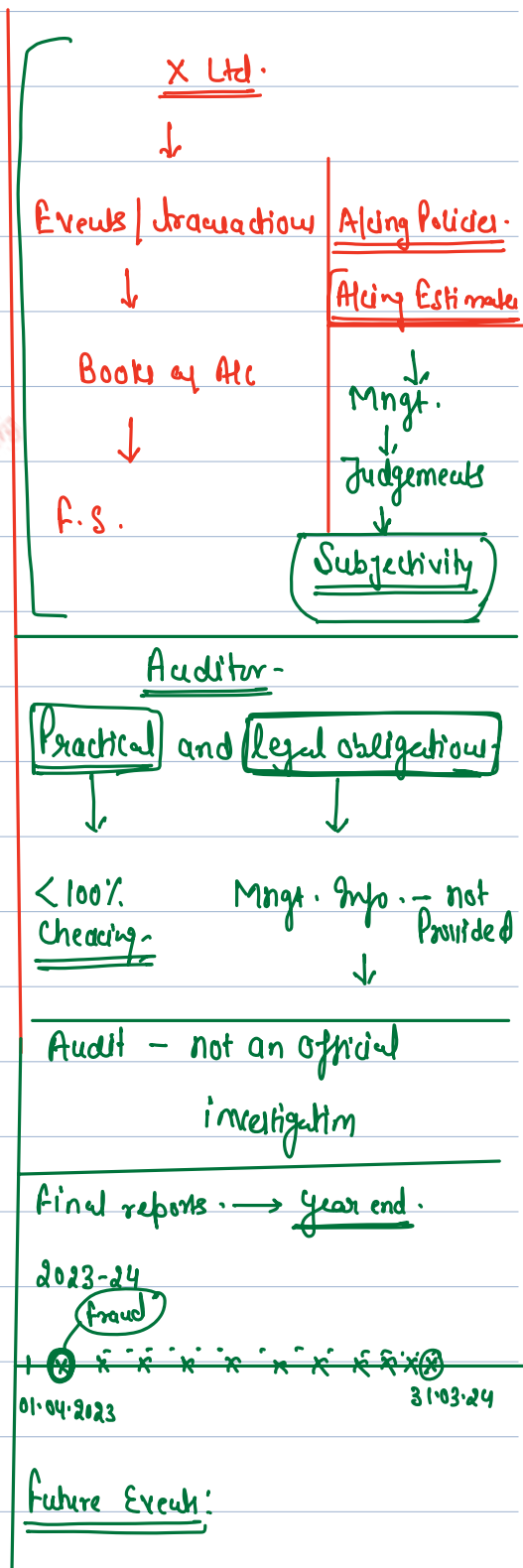
Prep<sup>n</sup> of f.s. is responsibility of management and for this purpose mangt. is required to select the appropriate accounting policies, FRF and ensure that f.s. are prepared as per selected policies and FRF.

Prep<sup>n</sup> of f.s. involves judgement by management which may be subjective.

(B) Nature of Audit Procedures:

There are certain Practical and legal limitations due to which auditor may not be able to collect audit evidences. For Ex:

i) Test checking of transactions and balance is an example of Practical limitation -



(ii) Auditor can not force management for providing necessary information. In case required information not provided to him, he can state the fact in audit report. (Legal limitation)

(c) Not in nature of Investigation: Audit is not an official investigation, hence he cannot obtain absolute assurance.

(D) Timeliness of financial reporting: Relevance of information decreases over time and auditor cannot verify each and every matter.

For Ex: Auditor appointed on 04.04.2023 for auditing the F.S. of FY 2022-23. Auditor is not able to attend physical verification of inventory held on 31.03.2023.

(E) Future Events: Future events may affect an entity adversely due to which a business might not be able to continue. Auditor is not able to comment on happening of future events as he examines the F.S. which contains historical financial information.

### (iii) Meaning, Nature and Types of Engagements:

(A) Engagement: In relation to audit, it is a formal agreement between auditor and client; whereby auditor agrees to provide auditing services to client.

Engagements can be classified as :

- (i) Assurance Engagements; and
- (ii) Non Assurance Engagements

Discussed in  
Introductory lecture

(B) Assurance Engagements: An Engagement in which a practitioner expresses an opinion/conclusion



designed to enhance the degree of confidence of intended users (other than responsible party)



about the outcome of evaluation of subject matter against criteria.

Examples:

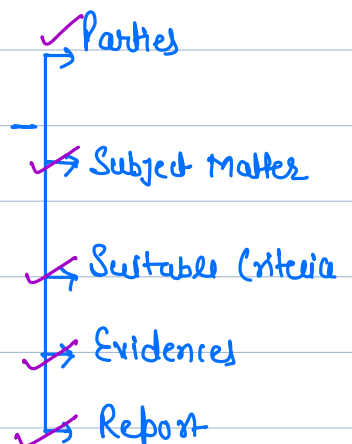
- (1) Audit of financial statements
- (2) Review of financial "
- (3) Examination of Prospective Financial Information
- (4) Report on Controls at an Organisation.

Types of Assurance:

- (A) Absolute Assurance (100% Accuracy)
- (B) Reasonable Assurance (High, but not Absolute)
- (C) Limited Assurance (lower level than reasonable)

Imp.

Elements of an Assurance Engagement: 5 Elements



X Ltd. - Sec. 128

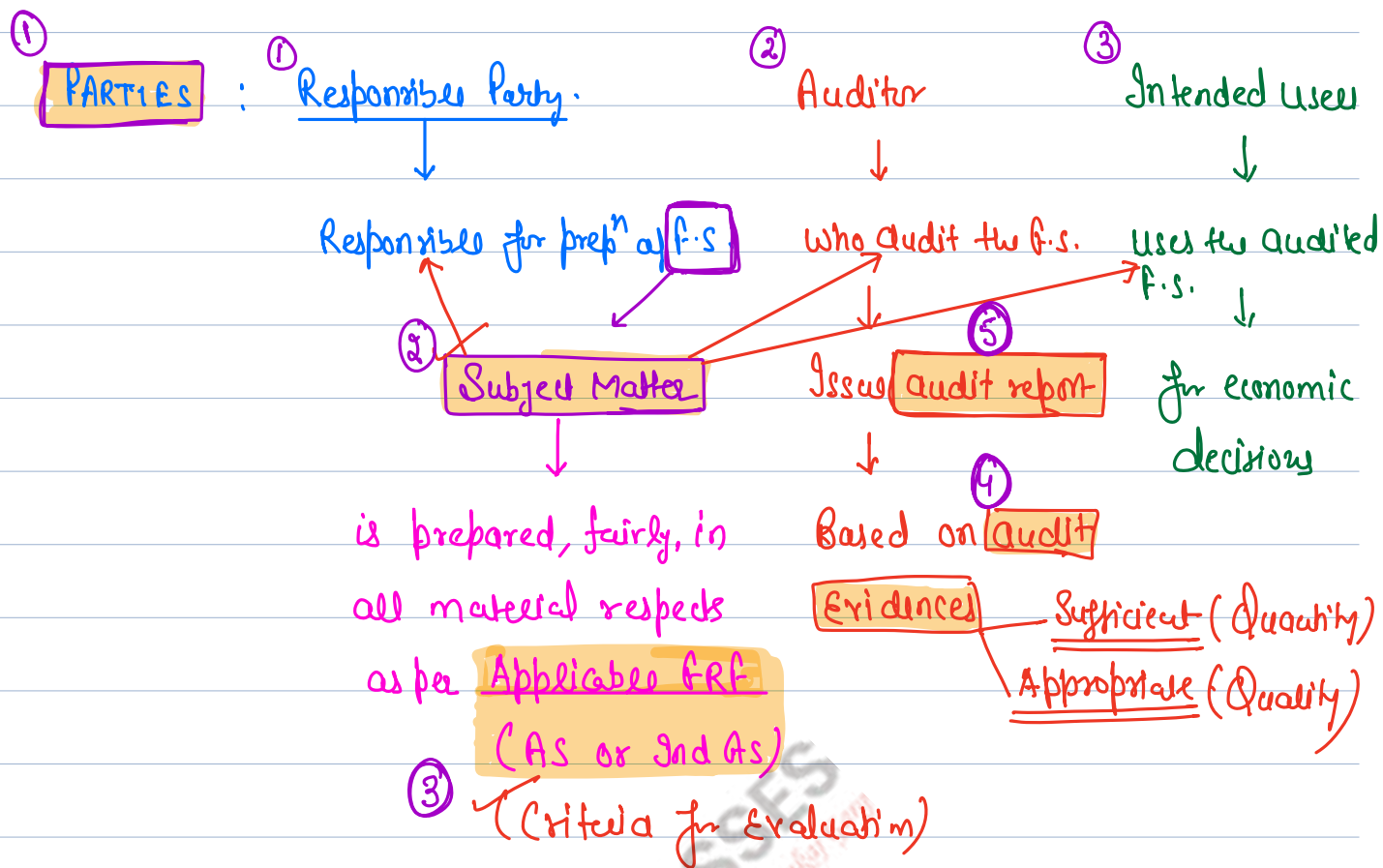
- Sec. 129 - F.S - Sch. III + AS

- True and fair view

- Sec. 136 - Circulation of F.S

- Sec. 139 - Auditor appointment - Sec. 143 - Audit Report



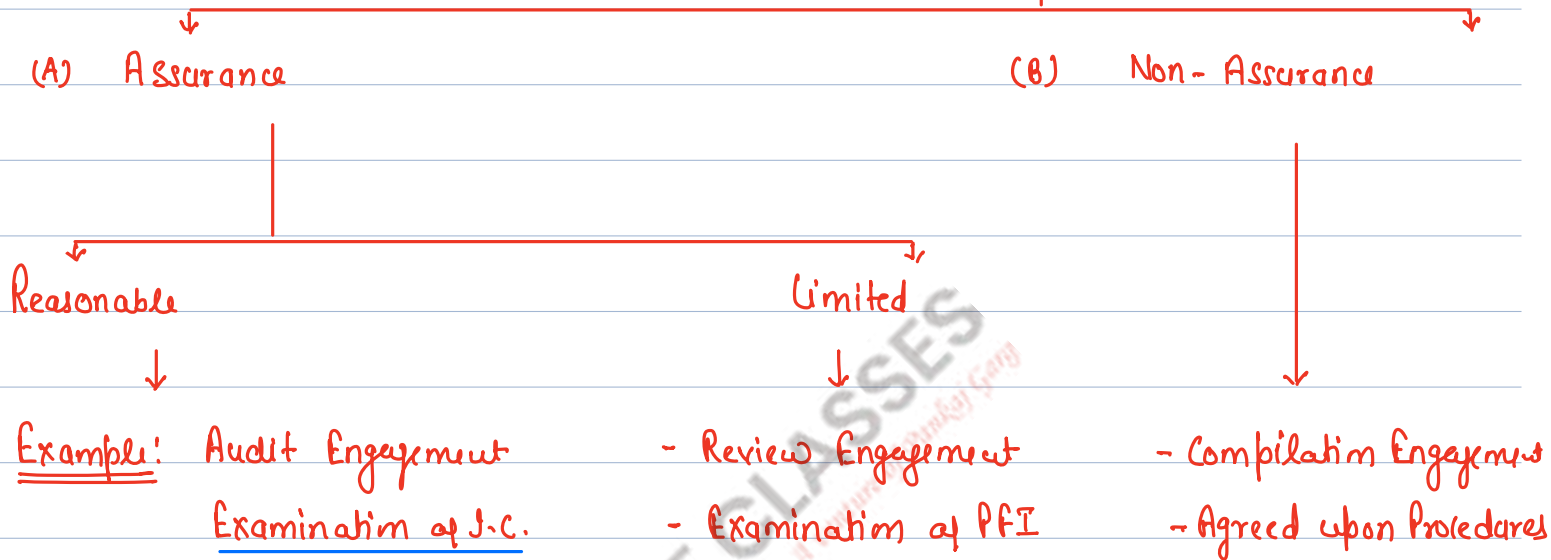


H.W.: Notings of (i) Elements of Assurance Engagement:  
 (ii) Reasonable Assurance vs. Limited Assurance:

# Chapter - 1 "Nature, Objectives and Scope of Audit"

Topics Covered:

- (i) Meaning and Nature of Auditing
- (ii) Inherent Limitations of Audit
- (iii) Meaning, Nature and Types of Engagements



Audit Engagement: <sup>Detailed</sup> Examination of Historical financial information contained in financial statements to obtain Reasonable Assurance.  
(High, but not absolute)

Review Engagement: Limited examination of Historical financial information contained in financial statements to obtain Limited Assurance.  
(Assurance lower than Reasonable)

Historical Financial Information: Information expressed in financial terms about economic events occurred in past.

Examination of PFI: <sup>\*</sup> Limited examination of Assumptions used in preparation of Prospective financial information to obtain Moderate Assurance.  
(Limited Assurance)

Past [8-10%]

Sales [50%] ↑

\* Reasonableness and Realistic nature of assumptions.

## Prospective Financial Information:

financial information based on assumption about occurrence of future events and possible actions by an Entity.

While examining PFI, practitioner obtains evidences as to:

- (a) whether assumptions used are not unreasonable.
- (b) PFI is prepared on the basis of assumption; and
- (c) PFI is properly presented and all material assumptions are adequately disclosed.

Examination of I.C.: Examination of design, description and operating effectiveness of Internal Controls prevailing in an Entity to obtain reasonable assurance. (may be limited assurance).

✓ Compilation Engagement: Non-Assurance Engagement in which a practitioner compiles the financial data on the basis of records and information given to him. (i.e. Prep<sup>n</sup> of F.S.)

✓ Agreed-upon Procedures: Non-Assurance engagement in which a practitioner perform the procedures as agreed among him and the client; and reports on facts identified during the engagement.

For Ex: Confirming year end balance of debtors having  
0/s > 50 lakh.

#### (iv) Qualities of Auditor:

##### Personal Qualities (Basic Human Qualities)

- Integrity, Objectivity and Independence
- Tactful approach, Firmness, Good Temper
- Rational decisions, patience, Reliability
- Confidentiality

##### Technical Qualities

- Sound knowledge of
  - (a) Accounting Principles and Techniques
  - (b) Auditing - Principles, Procedures, Standards.
  - (c) Industry
  - (d) Corporate, Economic and Taxation laws.

#### (v) Quality Control and Engagement Standards: (QCES)

- (A) Need for Standards:
- (i) To ensure carrying out audit against established Benchmarks.
  - (ii) To Improve Quality of financial reporting.
  - (iii) To promote uniformity.
  - (iv) To enhance professional knowledge and skills.
  - (v) To ensure audit Quality.

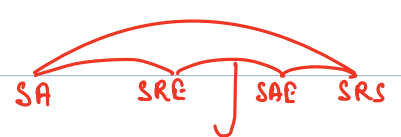
(B) Standards on Quality Control: SQC provides guidance as to the responsibilities of the firm for their system of Quality Control for conduct of audit

(Parent Standard)  
SQC-1

- review of historical financial info
- Other assurance, and
- Related Services.

Note: Details to be covered later.

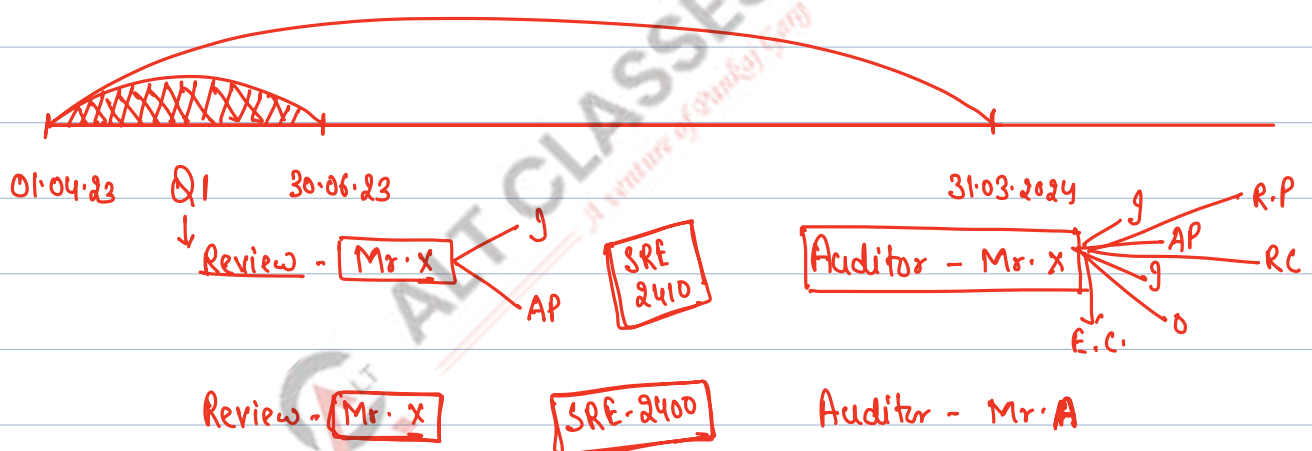
(C) Engagement Standards: Comprises of



(i) Standards on Auditing: SAs are to be applied in audit of Historical financial information.

(ii) Standards on Review Engagements: (SRE) are applied in review of Historical financial information  
(SRE 2000 - 2699)

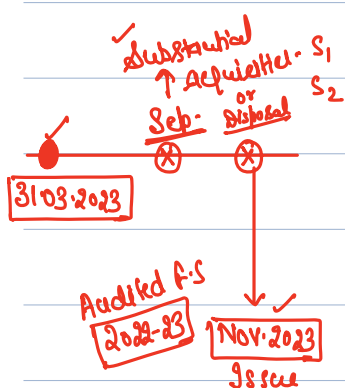
- SRE 2400 : Engagements to Review Historical financial statements  
✓ SRE 2410 : Review of Interim financial information performed by Independent auditor of the Entity.



(iii) Standards on Other Assurance Engagements:  
(SAE 3000 - 3699)

SAEs are applied in examination of subject matter other than Historical financial information.

Examples : Examination of PFI, Internal Controls etc.



SAE - 3400 : Examination of PFI.

SAE - 3402 : Assurance Reports on Controls at a Service Organization.

SAE - 3420 : Assurance Engagements to Report on the Compilation of Pro forma Financial information included in a Prospectus.

(iv) Standards on Related Services (SRS):

(SRS 4000 - 4699)

SRS apply in case of non-assurance Engagements. like agreed-upon Procedures and Compilation Engagement.

SRS- 4400 : Engagements to perform Agreed upon Procedures regarding financial information.

SRS- 4410 : Compilation Engagement.

(v) Duties in Relation to Engagement and Quality Control Standards:

(Noting - H.W.)



# Chapter 11 - Ethics and Terms of Audit Engagement

Topics to be covered: (1) Ethics and Fundamental Principles

(2) Independence of Auditors

(3) Professional skepticism

(4) Agreeing the terms of audit engagement (SA-210)

(5) Audit Quality (SQC-1 and SA 220)

## (1) Ethics and Fundamental Principles:

(A) Ethics: Principles of conduct governing an individual or group. Ethics have manifold importance in profession of auditing like other profession of law and medicine.

## (B) Principle Based Approach vs. Rule Based Approach:



- Requires compliance with spirit of ethics

( दिल से काम लेना )

- Requires professional accountants to exercise "Professional judgement" based on - Professional Experience

- Skills and

- Expertise



Requires strict follow-up of established Rules ( दिमाग से काम लेना )

- Spirit of Ethics may be overlooked.

- Rule Based Approach is rigid in nature as every practical situation may not be dealt with.

( Narrow outlook )

(C) Fundamental Principles: - Fundamental Principles establishes the standard of behaviour expected of a professional accountant.

- A professional accountant shall comply with each of the fundamental principles.

(i) Integrity: Principle of integrity requires the auditor to be straight forward, and honest.

It implies fair dealings and transparency.

Auditor should not be associated with any reports, returns, communications or information which may:

- (a) contains any false statement or misleading information; or
- (b) omits required information where such omission could be misleading.

(ii) Objectivity: Principle of objectivity requires that the professional judgement of auditor should not be compromised due to any biasness, conflict of interest or undue influence of others.

(iii) Professional competence and due care: It requires the following:

- (a) Attain and Maintain Professional Knowledge and Skills to that level so as to ensure that professional work is performed in accordance with current technical and professional standards.
- (b) Act Diligently and in accordance with technical and professional standards.
- (c) Exercise due care while performing professional work.

(iv) Confidentiality: Do not disclose the information acquired during the course of professional work with the others unless:

- ✓ (a) Required by law or regulation;
- ✓ (b) permitted by client or employer; or
- ✓ (c) there is a professional duty to disclose.

(For Ex: Disclosure required under Professional Code of conduct)



- (1) Professional Behaviour: Auditor must comply with the applicable legal and regulatory requirements; and
- should avoid any conduct that discredit the profession.

## (2) Independence of Auditors:

(A) Concept of Independence:- Independence is a State of Mind and Personal character.

- Independence may be defined as follows:

"Independence implies that Judgement of a person should not be subordinate to the wishes or direction of another person who might have engaged him."

(B) Perspectives of Independence: "Independence of auditors must not exist in fact, but should also appear to exist to all reasonable persons like shareholders, Government, Regulatory authorities, lenders etc."

There are two inter-linked perspectives of Independence.

### (i) Independence of Mind

State of Mind that permits an Opinion without being affected by influences that compromises

- ✓ Professional judgement;
- ✓ Integrity;
- ✓ Objectivity; and
- ✓ Professional skepticism.

### (ii) Independence of Appearance

↓ (Visible Standards)

Avoidance of fact and Circumstances that are so significant

↓

that a reasonable third party would reasonably conclude that

↓

firm's Integrity, objectivity and Professional skepticism are compromised.

(E.g. Provisions covered U/s 141 of CA, 2013)

## (C) Threats to Independence: 5 Types

(i) Self-Interest Threats: Threats that occur as a result of financial or other interest of a professional accountant.

Examples:

- (1) Direct or Indirect financial interest in a client.
- (2) Loan or guarantee from a client.
- (3) Undue dependence on client's fees.
- (4) Close business relationship with client.
- (5) Potential Employment with client.
- (6) Contingent fees for audit engagement.

(ii) Self Review Threat: Threat that occurs when a previous judgement to be re-evaluated by professional accountant responsible for that judgement.

Example: Auditor engaged for audit of financial statements was also assigned responsibility for compilation of financial statements.

Ex: Auditor having recently been a director of the Company.

(iii) Advocacy Threat: Threat that occurs when a professional accountant promotes a position or opinion to the point that subsequent objectivity may be compromised.

Ex: Auditor dealing with shares and securities of client company.

(iv) Familiarity Threat: Threat that occurs when a professional accountant, because of a relationship, becomes too sympathetic to the interest of others.

For Ex:

(i) Former Partner of audit firm being a director of client.

(ii) Close relative of audit team member is in a senior position with the client.

(iii) Long association between auditor and the client.

(v) Intimidation Threats: Threat that occurs when a professional accountant may be deterred from acting objectively by threats - actual or perceived.

For Ex: (i) Threat to auditor of termination/removal.

(ii) Threat to Employee of not allowing bonus or promotion.

(D) Safeguards to Threats:

(Noting - H.W.)

## Chapter - 11 " Ethics and Terms of Audit Engagement "

Topics Covered: (1) Ethics and Fundamental Principles

(2) Independence, Threats to Independence and Safeguards

(3) Professional Skepticism: An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatements due to error or fraud; and includes Critical assessment of Audit Evidences.

- ★ Being alert to :
- (a) Contradictory Audit Evidences;
  - (b) Reliability of documents;
  - (c) Conditions indicating possibility of fraud;
  - (d) Circumstances suggesting need for additional audit procedures.

### Other Requirements:

- (i) Auditor shall plan and perform an audit with professional skepticism.
- (ii) Professional skepticism reduces risk of:
  - (a) Overlooking unusual circumstances.
  - (b) Overgeneralising when drawing conclusion.
  - (c) Using inappropriate assumptions in determining nature, timing and extent of audit procedures.
- (iii) Professional skepticism also includes consideration of sufficiency and appropriateness of audit evidences.

Note: A belief that management and TCWG are honest and have integrity, does not relieve auditor of need to maintain Professional Skepticism.

★ Those Charged with Governance (e.g. BoD)

## (4) 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:

- establishing the existence of pre-conditions for an audit; and
- common understanding of the terms between auditor and the client.

### Pre-conditions for an audit:

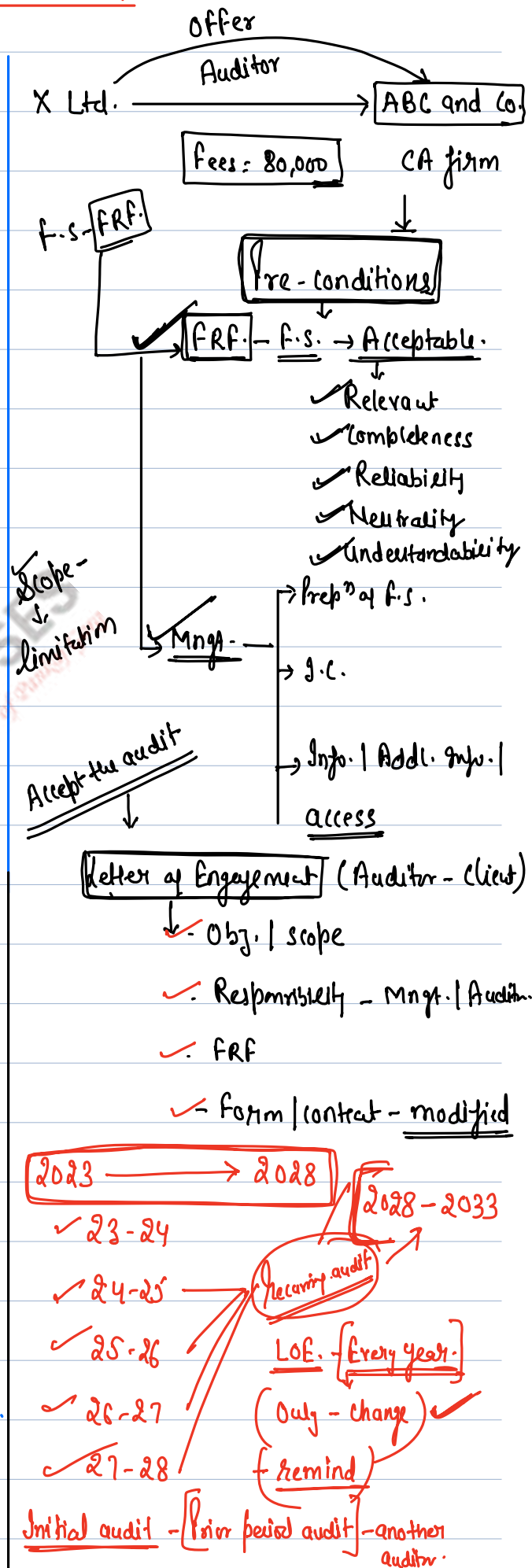
- Acceptable Financial Reporting Framework;

[Attributes - Relevance; Completeness; Reliability; Neutrality; Understandability].

- Acknowledgement by management of their responsibilities as to:

- Prep<sup>n</sup> of f.s. as per applicable FRF;
  - Selection and consistent application of appropriate accounting policies;
  - making reasonable accounting estimates and judgements;
  - Exercising necessary Internal Controls to enable the prep<sup>n</sup> of f.s. that are free from material misstatements.
- Providing the Auditor with:

- All relevant information required for purpose of audit.

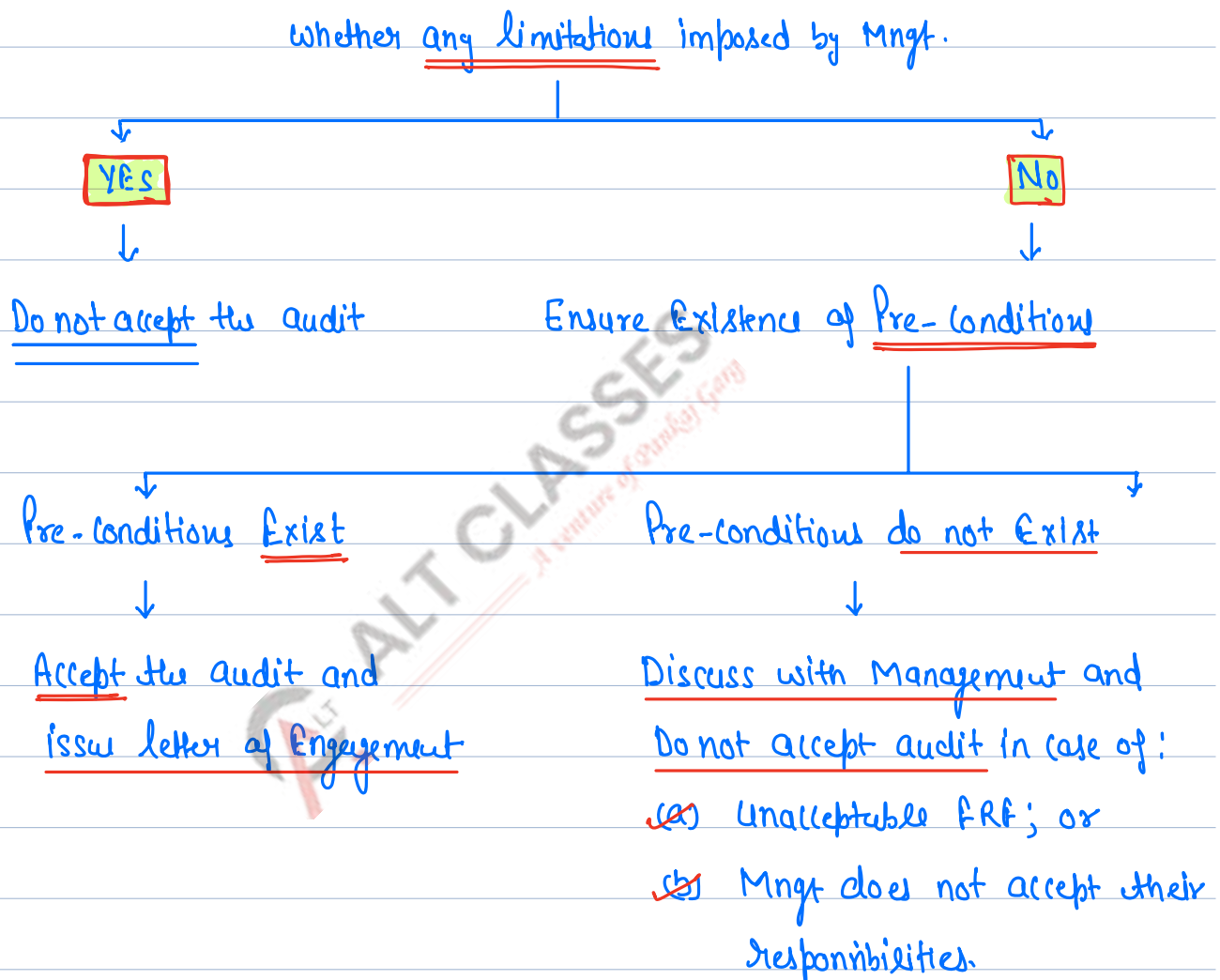


(b) Additional information required; and

(c) Unrestricted access to the persons within the Entity.

(B) Requirements of SA-210:

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



Audit Engagement letter: Agreed terms should be recorded in Letter of Engagement.

Letter of Engagement is sent by Auditor to client and

Includes: i) Objective and scope of audit of financial statement;

ii) Responsibilities of the Auditor;

iii) " " " Management;

iv) Identification of applicable FRF for prep<sup>n</sup> of F.S.; and

v) Reference to expected form and content of Audit Report.

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

Assess whether Circumstances<sup>\*</sup> requires (a) Revision of terms of audit engagement; or  
(b) Reminding the existing terms.

No Requirement



No need to issue

New Letter of Engagement

Requirement Exist



Issue New Letter of Engagement;

or

Record revised terms in letter of Engagement.

\* Circumstances in which there exist requirement of issue of New Letter of Engagement in case of Recurring Audit:

- (i) Any Indication that Entity misunderstand the objective and scope of audit Engagement.
- (ii) Any revised or special terms of audit engagement.
- (iii) changes in senior management.
- (iv) " " Ownership.
- (v) " " nature and size of entity's business.
- (vi) " " legal or regulatory requirements.
- (vii) " " financial reporting framework.
- (viii) " " Other reporting requirements.



(iii) Mngt. request for changes in terms of audit engagement, during course of audit:

(A) Request for change in terms of  
Audit Engagement

Auditor shall not agree to a change in terms of audit engagement where there is no reasonable justification for doing so.

Circumstances in which mngt. may request for changes in terms of audit Engagement:

- (a) change in circumstances affecting the need for the service;
- ✓ (b) Misunderstanding as to nature of audit originally requested; or
- ✓ (c) restriction on scope of audit engagement, whether imposed by mngt. or caused by circumstances.

(B) Request for change to a Review of f.s.  
Related Services (compilation)

Management request for changes that conveys a lower level of assurance or no assurance.

Auditor - Assess legal and contractual implications for change.

Determine reasonable justification for doing so.

Auditor satisfied with the mngt. request for change of audit to review or related services

- Work performed till date - remains relevant

- Work to be performed and report to be issued - as appropriate to revised engagement (Review or related service)

Note: In order to avoid confusion, report on related services should not include reference to: (a) Original Engagement; or (b) Any procedures that may have been performed in audit engagement.



If a request for the change is not considered reasonable, Auditor should deny the management.



[A request is considered not reasonable, if it appears that the change relates to information that is Incomplete, incorrect or unsatisfactory]

Management is not permitting the auditor to continue with the original audit engagement.



Auditor shall (a) withdraw from the engagement; and

(b) determine whether there is any obligation to report the circumstances to TCWG, owners or regulatory authorities.

# Chapter - 11 "Ethics and Terms of Audit Engagement"

- Topics Covered:
- (1) Ethics and Fundamental Principles
  - (2) Independence, Threats to Independence and Safeguards
  - (3) Professional Skepticism
  - (4) Agreeing the Terms of Audit Engagement (SA 210)

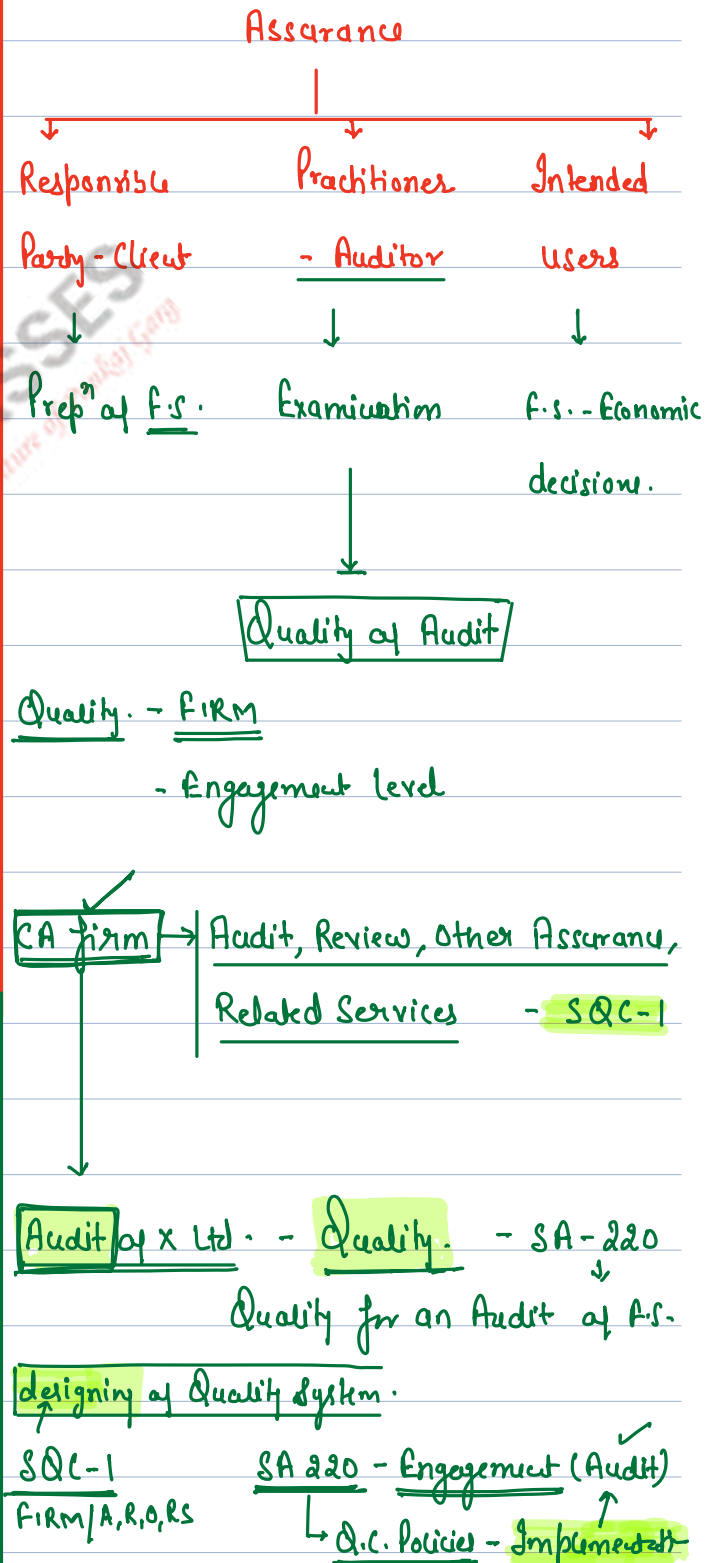
## (5) Audit Quality:

(A) SQC-1 "Quality Controls for Firms that performs audit and review of Historical Financial Information and Other Assurance and Related Services Engagements"

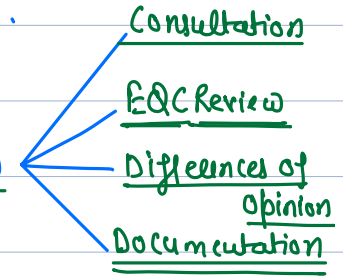
### (i) Purpose of SQC-1:

SQC-1 is a parent standard that requires firms to establish a system of Quality Control designed to provide a reasonable assurance that:

- (EP and others)
- (a) Firm and its personnel comply with the Professional Standards, legal and Regulatory Requirements; and
  - (b) Appropriate Reports are being issued in the circumstances.



(ii) Elements of System of Q.C.:

- ✓(A) Leadership Responsibilities
  - ✓(B) Ethical Requirements including Independence
  - ✓(C) Acceptance and Continuance of Client Relationship and Specific Engagements.
  - ✓(D) Human Resources
  - ✓(E) Engagement Performance
  - ✓(F) Monitoring
- 
- ```
graph LR; EP[Engagement Performance] --- C[Consultation]; EP --- EQC[EQC Review]; EP --- DO[Differences of Opinion]; EP --- D[Documentation];
```

(A) Leadership Responsibilities:

- Firm should establish policies and procedures designed to - promote an Internal culture based on recognition that quality is essential.
- Firm CEO/Managing Partner shall assume overall responsibility of Q.C. System.
- Persons assigned with operational Responsibility should have sufficient experience, ability and authority to assume that responsibility.

(B) Ethical Requirements:

Firm should establish policies and procedures designed to - provide it with reasonable assurance that firm and its Personnel comply with relevant Ethical Requirement.



Fundamental Principles as per Code of Ethics:

- (a) Integrity
- (b) Objectivity
- (c) Professional Competence and Due Care.
- (d) Confidentiality
- (e) Professional Behaviour.

## Policies and Procedures w.r.t. Independence:

Firm should establish policies and procedures to ensure that the firm, its personnel and others maintain Independence.

Such policies and procedures enable the firm to:

- (a) Communicate independence requirements to personnel.
- (b) Identify and evaluate the circumstances that create threats to independence.
- (c) Take appropriate action to eliminate the threats or reduce threats to acceptable level.

Note: If considered appropriate in the circumstances, firm should withdraw from the engagement.

SQC-1 also requires the following:

- (i) All breaches of Independence should be promptly notified to firm for appropriate action.
- (ii) Firm should obtain Annual written Confirmation from all firm personnel as to compliance with Independence requirements.

## (C) Acceptance and Continuance of Client Relationship and Specific Engagements:

- Firms should establish policies and procedures to assure that clients are accepted / continued only when:

- (a) Client integrity has been considered;
- (b) Competency and Capability required to perform an engagement has been evaluated; and
- (c) Compliance to ethical requirements has been ensured.

✓ Accepting engagement with client.

✓ Continue an Existing Engagement with client.

✓ Accepting new Engagement with Existing client.

- If there is any conflict of interest between the firm and the client, it should be properly resolved before accepting the Engagement.
- If after accepting the Engagement, firm obtain any information that would have caused it to decline the engagement, firm should consider:
  - (a) Professional and legal responsibilities to report to the person who made the appointment or to regulatory authorities; and
  - (b) Possibility of withdrawal from Engagement.

### Considerations as to Integrity of clients: (Noting - H.W.-)

- (D) Human Resources: Firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the Capabilities, competency and commitment to Ethical Principles to perform its engagement;
- ↓
- in compliance with professional standards, legal and regulatory requirements and appropriate reports are being issued in the circumstances.

Such policies and procedures shall address the following:

- (a) Staff Recruitment
  - (b) Career development;
  - (c) Capabilities, competencies
  - (d) Promotion;
  - (e) Compensation
  - (f) Performance Evaluation
  - (g) Estimation of Personnel needs. etc.
-

## (E) Engagement Performance:

- (i) Consultation: - Consultation should take place on difficult matters.
- " may be with the persons having appropriate knowledge and Experience. (within the firm or outside the firm).
  - Outside consultation may be required if firm is not having appropriate internal resources.

(ii) Engagement Quality Control Review: Significant judgements made in an engagement should be reviewed by EQC Reviewer for taking an Objective View before the report is issued.

Note: (a) EQCR is mandatory for audit of F.S. of listed Entities.

(b) Extent of EQCR depends upon complexity of engagement.

(iii) Difference of opinion: Among Engagement team members, with Consultants, with EQC Reviewer.

Ensure that reports are to be issued only after resolution of differences.

Imp  
(iv) Documentation: Firm should establish policies and procedures designed (Working Papers) for ensuring that final engagement file should be assembled on a timely basis.

(i.e. within 60 days after the date of audit report)

- Ensure Confidentiality, safe custody, integrity and retrievability of documents.
- Ownership: Audit documentation is property of auditor.  
Extracts of audit documentation may be made

available to client at discretion of auditor.

- Retention Period: 7 years from date of audit report.

(f) Monitoring: Ongoing consideration and evaluation of firm system of Quality Control



to ensure their relevancy,  
adequacy,  
operating effectiveness; and  
Compliance.



## Chapter - 11 " Ethics and Terms of audit engagement "

### (5) Audit Quality:

#### (B) SA - 220 " Quality Control for an audit of F.S.:

(A) Objective of Auditor: To implement Q.C. procedures  
↓  
at Engagement level

to provide the auditor with reasonable assurance that



- (a) Audit complies with professional standards and legal and regulatory requirements; and
- (b) Audit Report issued is appropriate in the Circumstances.

Note: SA-220 is premised on the basis that the firm is subject to SQC-1.

(B) Responsibilities of EP: EP is required to assume responsibilities for implementation of Q.C. Procedures, while performing an audit engagement. Q.C. Procedures related to:

(Engagement Partner)

- ✓ (i) Leadership Responsibilities for quality on audit.
- ✓ (ii) Compliance of Relevant Ethical Requirement.
- ✓ (iii) Acceptance and Continuance of Client Relationship and audit Engagements.
- ✓ (iv) Assignment of Engagement team (ET)
- ✓ (v) Engagement Performance
- ✓ (vi) Monitoring.

- from book -



(i) Leadership Responsibilities:

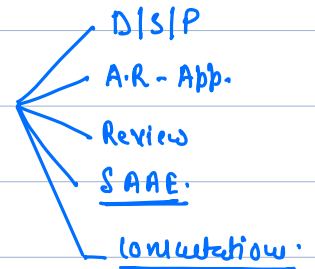
Noting - H.W.

(ii) Information to be obtained before accepting or continuing a client relationship:

Noting - H.W.

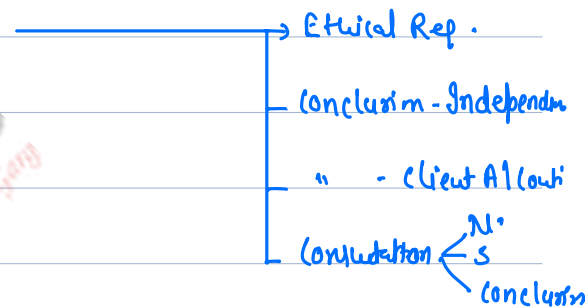
(iii) Engagement Performance:

Noting - H.W.



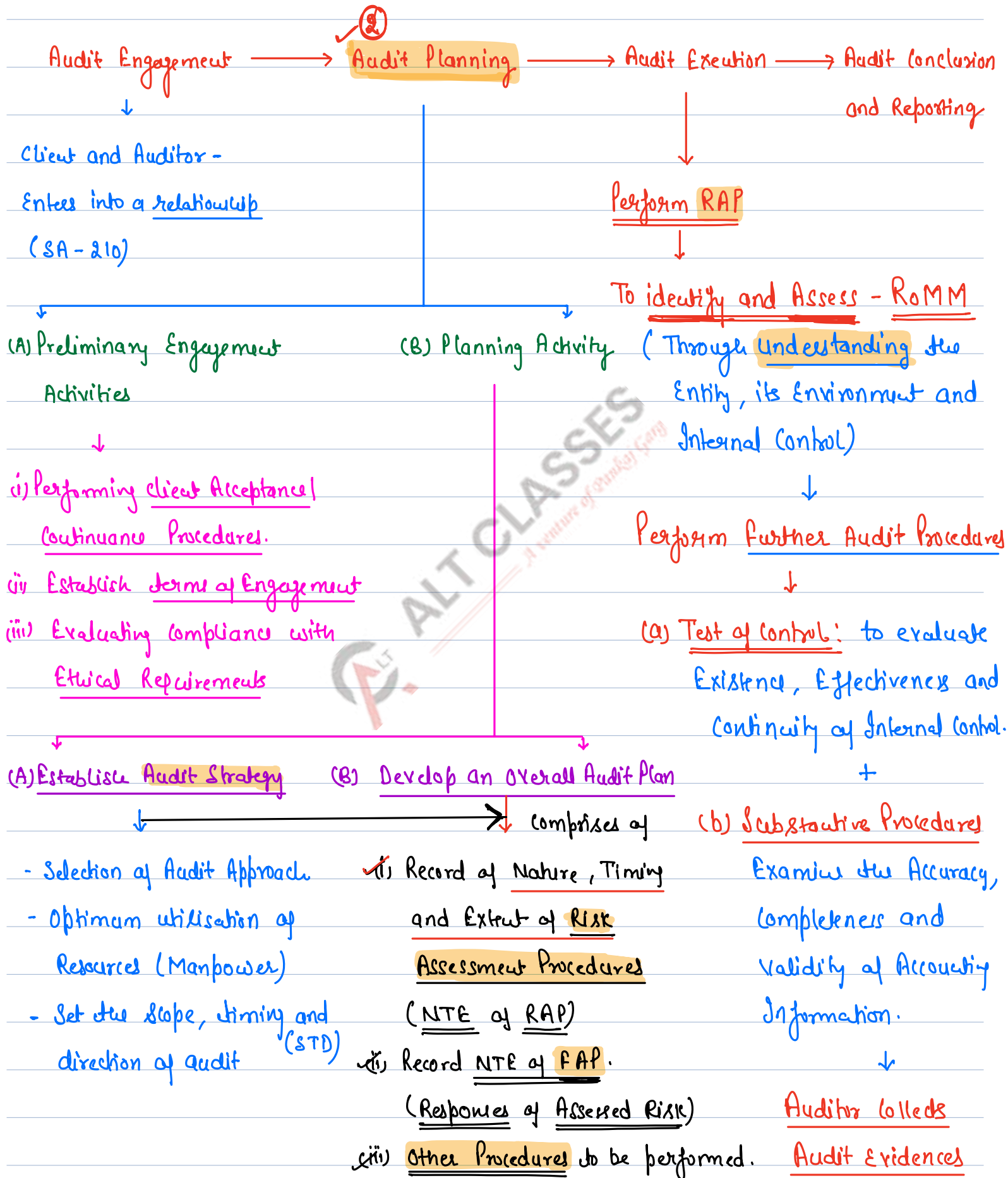
(iv) Documentation

Noting - H.W.



## Chapter - 2 "Audit Strategy, Audit Planning and Audit Programme"

### Overview of Audit Process:



Notes: Auditor is required to document the audit strategy and audit plan. Such documentation is known as Audit Programme.

(1) Auditor's Responsibility to plan an audit of f.s.:

(A) Meaning: Planning an audit involves developing an overall plan for the expected scope and conduct of audit and comprises of NTE of audit procedures.

(B) Auditing Standard dealing with planning: SA-300 "Planning an audit of financial statements"

Auditor's Objective: To Plan the audit so that it will be performed in an effective and efficient manner.

Imp-

(C) Benefits of Planning: (i) To devote appropriate attention to important areas of audit.

(ii) To Identify and resolve potential problems on a timely basis.

(iii) To perform audit in an efficient and effective manner through proper organising and managing the activities.

(iv) For Proper Direction and Supervision of team members and review of their work.

(v) Coordination of work performed by auditor of components and experts, if any.

(vi) For selection of engagement team members with appropriate competence and capabilities.

Benefits

ET

- Imp. Areas - Selection - Effective and  
- Potential - Direction Efficient  
Problem Supervision - Coordination  
Review

Imp  
(D) Planning - a continuous Process: Planning is not a discrete phase of audit; rather it is continuous process that often begins with shortly after completion of previous audit and continues until completion of current audit engagement.

Planning includes consideration of timing of certain activities that need to be completed prior to performance of further audit procedures, for example:

- (a) Performing Analytical Procedures as Risk Assessment Procedures;
- (b) Obtaining understanding of legal and regulatory framework;
- (c) Determination of Materiality;
- (d) " " Involvement of Experts;
- (e) Performing Other Risk Assessment Procedures (e.g. Inspection, Observation).

#### (E) Elements of Planning:

##### (i) Preliminary Engagement Activities

###### (a) Perform procedures regarding client Acceptance

Continuance: Obtain Info before accepting Engagement from new client; engagement from existing client.

##### (ii) Planning Activities

###### (A) Establish Audit Strategy

(B) Develop Overall Audit Plan.

###### (b) Evaluate Compliance with Ethical Requirements

including Independence: Obtain Info - Identify threats - take approach - withdraw.

###### (c) Establish understanding of terms: through issue of letter of engagement.

## (2) Audit Strategy:-

i) Meaning:- Selection of Audit approach so as to obtain necessary Assurance at lower cost, with optimum utilisation of resources



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

- Continuous / Final - A

- Procedures - NTE - B

- Team Members - C

① - A } strategy

② - C

③ - B | plan

Quality - competency  
No. of persons.

Timing, mgmt.

2 Imp:-

### (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

(Noting - H.W.)

## Chapter - 2 "Audit Strategy, Audit Planning and Audit Programme"

### Topics Covered:

#### (1) Auditor's Responsibility for planning an audit of F.S.

##### (a) Audit Strategy:

(i) Meaning

(ii) Benefits

Imp:-

(iii) Factors to be considered while establishing audit strategy:

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

(a) Identify the characteristics of Engagement;

(For Ex: FRF; Nature of Business segments to be audited; Industry specific Reporting requirements; Expected use of Audit Evidences obtained in previous audit).

- Characteristics of Engagement
- Reporting objectives
- Efforts - direct-ET
- Preliminary Eng. Activities
- Resources

Those charged with Governance (e.g. BOB)

(b) Ascertain Reporting objectives of the Engagement;

(For Ex: Time table for reporting - Interim or Final; Meeting with Mngt. and TCWG as to (a) NTE of Audit work; (b) Type and Timings of Reports; Timing of Review of work of ET)

(c) Factors that are significant in directing the engagement team efforts -

(For Ex: Volume of transactions; Significant industry developments; Significant change in FRF (AS); Significant recent developments as to changes in legal environment).

(d) Results of Preliminary Engagement Activities.

(For Ex: Results of Previous audit engagement indicating deficiencies in Internal Control; Need to maintain Professional Skepticism).

(e) NTE of necessary resources required to perform the audit -

(For Ex: Selection of ET; Assignment of work)

Engagement Team -

### (3) Audit Planning:

(A) Development of Audit Plan: Once audit strategy has been established, audit plan can be developed.

- Audit plans are based on understanding of client's business.
- Audit plan shall include description of:
  - (a) NTE of Risk Assessment Procedures to be performed.
  - (b) NTE of Further Audit Procedures to be performed.
  - (c) Other planned audit procedures to be performed.

### (B) Relationship between Audit Strategy and Audit Plan:

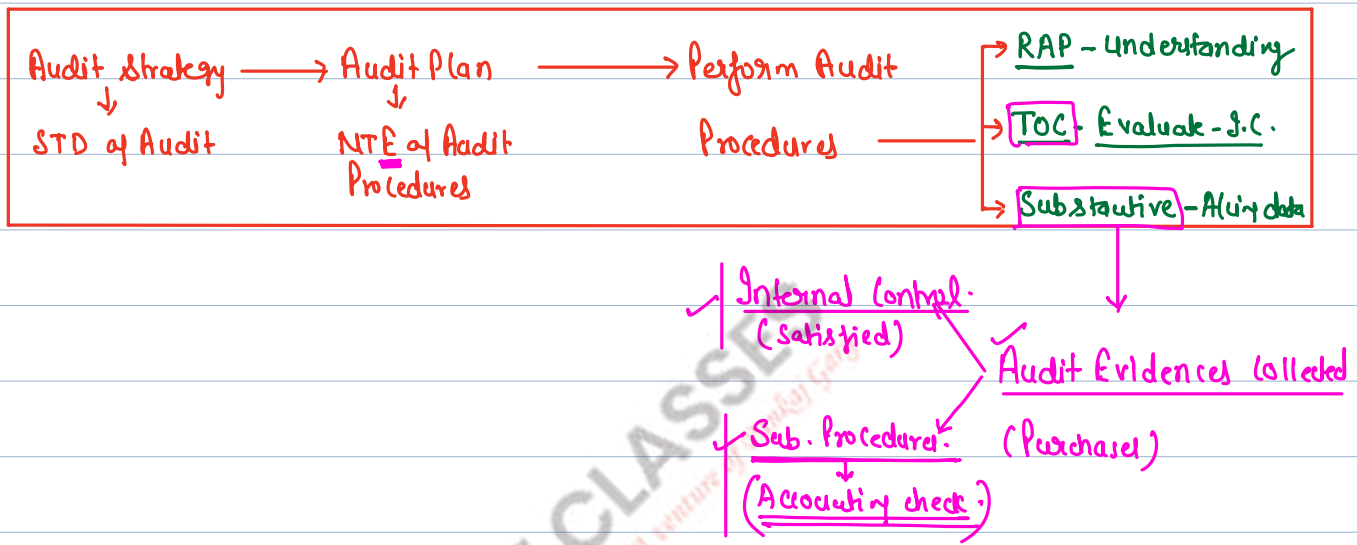
- Audit strategy establishes the scope, timing and direction of the audit.
- Audit planning involves development of overall audit plan that covers the NTE of audit procedures (RAP, FAP and others).
- Audit strategy and audit plan are interrelated to each other, as changes in one may require changes in another.
- Generally, audit strategy is prepared before audit planning and audit plan contains more detail than the audit strategy.
- Audit strategy provides a basis for development of overall audit plan.

### (C) 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:
  - (1) Unexpected events;
  - (2) Changes in condition; or
  - ✓ (3) Audit evidence obtained from results of

audit procedures performed.

For Example: Audit Evidence obtained through performing substantive procedures may contradict with the audit evidences obtained through tests of controls; which requires auditor to modify nature, timing and extent of further audit procedures.



(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 engagement team members and review their work.
- Planning of NTE of direction, supervision and review depends upon following factors:
  - (a) Size and complexity of client's business;
  - (b) Area of the audit;
  - (c) Risk of Material Misstatement; and
  - (d) Capability and competency of engagement team members.



(E) Documentation: Auditor shall document the following:

- (i) Audit Strategy: Record of key decisions considered necessary to properly plan the audit and to communicate significant matters to Engagement team.
- (ii) Audit Plan: - Record of planned NTE of RAP and FAP.  
- Record of proper planning of audit procedures that can be reviewed and approved prior to audit.
- (iii) Changes in audit strategy and audit plan: Record of explanations why significant changes are made and procedures finally adopted in the audit.

Note: Written record of audit strategy and audit plan shall form part of audit documentation.

H.w.: (Only Reading - Audit Programme)

## Chapter - 2 "Audit Strategy, Audit Planning and Audit Programme"

Topics Covered:

- (1) Auditor's responsibility to plan an audit of f.s.
- (2) Audit Strategy
- (3) Audit Planning

### ✓ (4) Audit Programme:

Audit Programme is detailed plan of applying audit procedures in the given circumstances with instructions for appropriate techniques to be adopted

↓  
for accomplishing audit objectives.

### Example:

Audit Procedures → Methods and Means  
(Techniques)

(i) RAP → Inspection, Inquiry and A.P.  
(Risk Assessment Procedures)

(ii) Tests of Controls → Inquiry, Inspection, Re-performance  
(Compliance Procedures)

(iii) Tests of Details → Inquiry, Inspection  
External confirmations  
Written Representations  
Re-calculation  
Re-performance

(iv) Substantive Analytical Procedures → Comparison - trend Analysis  
Ratio Analysis

✓ **RAP** - Identify | RoMM  
(NTE) Assess

↓  
Obtain understanding

| Entity, Environment

✓ **Internal Control**

↓ Techniques

Inquiry - Mngt / T/wk  
Other person

Inspection - Records  
Policy Manuals

A.P. - financial info

**FAP** { ToC | Compliance  
(Internal Control)  
Substantive Procedures  
- ToC - { Exn - Vouching -  
Balance  
- Verification -  
SAP

↓ - I, I, O, AP, EC, WR, RP

**Audit Evidence** ← Sufficient  
Appropriate

↓  
Evaluate → Conclusion

↓  
Expressed - opinion  
→ Audit Report

## Evolving audit programme for different audit:

- Evolving audit programme applicable to all business entities under all circumstances is not practical.
- This is due to (a) Varying nature, size, legal form of Business entities  
(b) work suitable to one business may not be suitable to another.  
(c) Efficiency and operation of Internal Controls and exact nature of services to be rendered by auditor differs from assignment to assignment.
- Hence, it is required to develop an audit programme that specify in detail, nature of work to be perform in a particular engagement.

## Assistants - to keep an open mind:

- During Initial stage, auditor should frame a programme, having regard to
  - nature, size and composition of business;
  - dependability of Internal control;
  - scope of work.
- Such programme may be considered as a Standard Programme.
- As experience is gained and information is collected, programme may be suitably altered, for relevant matters.
- If any work originally covered in audit programme, appears to be unnecessary, it may be dropped.
- Hence, assistants engaged in audit should be encouraged to keep an open mind beyond the programme given to them.  
Any significant matter, noticed by them, should be informed to Senior persons in the firm.

## Periodic Review of Audit Programme:

- ✓ Auditor is required to review the audit programme periodically to assess whether the same continues to be adequate for obtaining requisite knowledge and evidences about the transactions.
- Utility of audit programme can be maintained only by keep the programme under periodic review so that inadequacies or redundancies may be identified and audit programme may be updated.
- If periodic review is not done, auditor may not be able to identify the changes in business policies of the client; and audit work performed on the basis of obsolete audit programme, will not be considered effective and efficient and hence auditor may have face consequences of professional negligence.

M. Imp.

### Points to be considered in constructing audit programme :

- Stay within the scope and limitation of Engagement.
- Prepare written Audit Programme containing procedures needed to implement audit plan.
- Consider all possibilities of errors and fraud.
- Include audit objectives for each area of audit
- Provide sufficient details which serves as instructions to assistants for proper execution of audit work.
- Identify Evidences to be obtained for deriving necessary satisfaction.
- Identify procedures, useful in accomplishing the verification purpose.
- Coordinate the procedures to applied to related items.

Any 4-5

## Obtaining audit Evidences - Very basis for audit programme:

- Audit programme is designed for the purposes of obtaining audit evidences through prescribed procedures and techniques.
- Audit Evidences may be collected through any of the following:
  - (a) Documentary Examination
  - ✓ (b) Physical Examination
  - (c) Arithmetical calculations.
  - (d) Statements and Explanations of Mngt, officials and Employees.
  - (e) " " " " third parties
  - (f) Inter relationship of Accounting data.
  - (g) Inspection of Minute book.
  - (h) " " Subsidiary and Memoranda Book.

Example: - Verification of Cash in hand - Physical Examination (count)  
- " " Investments - Explanation / Statement from Bank (Ext. Confirmation)  
Pledged with Bank

Advantages of Audit Programme:

Disadvantages of Audit Programme:

(Noting - H.W.)

## Chapter - 3 "Risk Assessment and Internal Control"

Topics to be covered : ✓ (1) Audit Risk (SA 315)

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

✓ (3) Understanding the Entity and its Environment (SA 315)

✓ (4) Internal Control (SA 315)

✓ (5) Risk that require special consideration (SA 315)

(6) ✓ Evaluation of Internal Control System (SA 315 + 330)

(7) ✓ Testing " " " " (SA 315 + 330)

(8) ✓ Automated Environment, Digital Audit and IFC

(9) ✓ Auditor's responses to assessed risks (SA 330)

SA 300-499  
↓  
SA 300, 315, 320, 330, 4/2, 450

Overview of Audit Execution Stage: (Performing Audit procedures → To collect evidences)

✓ (A) Risk Assessment Procedures (RAP)

↓  
Obtain an understanding of - Entity

(Inquiry, Inspection and observation - its Environment

Analytical Procedures)

- including Internal Control

↓  
To Identify and Assess - Risk of Material Misstatement

(ROMM) ↓ at  
(Pervasive effect)

✓ (a) F.S. level (Overall level)

✓ (b) Assertion level for

- classes of Transactions ✓

- Account balances ✓

- disclosures

✓ (B) Responses to Assessed Risk (R)

Further Audit Procedures (FAP)

↓  
I. Tests of Controls (TOC) on  
Compliance Procedures:

Evaluation of Internal Control

- to determine its Existence,  
Effectiveness and Continuity.

II. Substantive Procedures

(TOC - V+V + SAP)

Examination of Atty Info

- to establish - Completeness;

Accuracy and validity.

(1) Audit Risk: Risk of Expressing Inappropriate audit opinion when F.S. are materially misstated. Audit Risk is a function of

✓ (A) - Risk of Material Misstatement (ROMM)

Risk that F.S. are materially misstated prior to audit

2 Components

Inherent Risk

Susceptibility of an assertion (Existence, Valuation, Measurement) about a class of transaction, account balance or disclosure to a Misstatement that could be material assuming that there are no related controls.

(Non-Existent Internal Control)

Control Risk

Risk that misstatement could occur in an assertion about a class of transaction, account balance or disclosure that could be material, if Internal controls fail to prevent, detect and correct irregularities on timely basis.

(Ineffective Internal Control)

✓ (B) Detection Risk

Risk that auditor's procedures may be ineffective to identify the material misstatements.

For Example:

Test-checking

Note: Both Inherent and Control Risk are Entity Risk and are influenced by client; not influenced by Auditor.

SA 200 requires that auditor shall obtain sufficient appropriate audit evidences to reduce audit risk to an acceptable low level and thereby enable the auditor to draw reasonable conclusion on which to base the opinion.







Example of Audit Risk: Compute Overall audit risk assuming the following:

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

Solution: Inherent Risk = 40% ✓

Control Risk = 25% ✓

Detection Risk : 40%

Risk of Material Misstatement = IR × CR

(RMM) = 40% × 25%

= 10%

Overall Audit Risk = RMM × DR

= 10% × 40%

= 4%

Identifying and Assessing RMM: Auditor is required to obtain understanding of the Entity, its Environment including Internal Control, so as to identify and assess RMM at (a) Overall level (f.s. level)  
(b) Assertion level.

- (a) Assessing RMM at Overall f.s. level: refers to RMM that relate pervasively to the f.s. as a whole and may affect many assertions.

Assertions: Representations used by Mngt. in preparation and presentation of F.S. (may be Implicit or Explicit)

Examples: Existence, Ownership, Completeness, Measurement, Valuation, Rights and Obligations, Cut-off, Presentation and disclosure.

(b) Assessing ROMM at Assertion level: refers to ROMM for the particular:  
(a) class of transactions;  
(b) account balances; or  
(c) disclosure.

Assessing ROMM at Assertion level assist the auditor in determine nature, timing and extent of audit procedures to be applied at assertion level.

Steps to be taken to Identify and assess ROMM:

| Step - 1                                                                    | Step - 2                                                                     | Step - 3                                                                    | Step - 4                                                                                |
|-----------------------------------------------------------------------------|------------------------------------------------------------------------------|-----------------------------------------------------------------------------|-----------------------------------------------------------------------------------------|
| ↓                                                                           | ↓                                                                            | ↓                                                                           | ↓                                                                                       |
| <u>Identify the Risk</u> throughout the process of obtaining understanding. | Assess Identified Risk and Evaluate whether it has <u>pervasive effect</u> . | Relate the Identified Risk to <u>what can go wrong at assertion level</u> . | Consider the <u>likelihood of</u> <u>Misstatement</u> and whether it is <u>material</u> |

Ex: Auditor identified that Related party transactions occurs outside the ordinary course of business

|                                                   |                                                     |                                         |
|---------------------------------------------------|-----------------------------------------------------|-----------------------------------------|
| (A) Limited no. of small transactions.            | (A) <u>Over/under statement</u> of financial items. | depends upon Existence of               |
| (B) <u>Significant txns</u> of <u>high values</u> | (B) <u>wrong valuation</u> at year-end              | J.C. and possible Mngt. <u>blatness</u> |
| (Pervasive effect - B)                            |                                                     |                                         |

## Risk Assessment Procedures :

SA 315 "Identifying and Assessing RoMM through understanding the Entity and its Environment" defines the term "Risk Assessment Procedures" as :



Audit Procedures <sup>★</sup> performed to obtain an understanding of the Entity, its Environment including Internal Control, to identify and assess RoMM, whether caused due to fraud or error, at the f.s. level and Assertion level.

Audit procedures required to be performed include :

- ✓ (a) Inquiries of Mngt. and others within the Entity;
- (b) Analytical Procedures; and
- (c) Inspection of Records and Observation of business operations.

LEARNING  
and NOTING  
(H.W.)

✓ (A) Inquiries of Mngt. and others:

| S.No. | Inquiry from _____              | Information obtained w.r.t. _____                                      |
|-------|---------------------------------|------------------------------------------------------------------------|
| 1.    | <u>Internal Audit Personnel</u> | Internal audit procedures relating to design and effectiveness of I.C. |
| 2.    |                                 |                                                                        |
| 3.    |                                 |                                                                        |
| 4.    |                                 |                                                                        |
| 5.    |                                 |                                                                        |
| 6.    |                                 |                                                                        |

## (B) Analytical Procedures: (Learning and Noting - How)

Share Capital - 5 Cr 5 Cr

Comparison:

+ Mngt. Rep - No Issu, red<sup>m</sup>  
buyback.

+ Minute Books.

|                 | 22-23 | 23-24 |
|-----------------|-------|-------|
| G.P Ratio       | ⊖     | ⊖     |
| opstode         | 12%   | 25%   |
| ch. mode        |       |       |
| Purch. / Sides. |       |       |

Romm - Identified / Asset -  
HIGH  
- Overall Risk

## (C) Inspection of Records and Observation of Business Operations:

- For Ex:
- (i) Inspecting documents relating to business plan, strategy, records like minute books, Internal control Policy manuals etc.
  - (ii) Inspecting reports prepared by the management e.g. Quarterly Mngt. reports, Interim financial statements etc.
  - (iii) Visiting Entity's premises and plant facilities
  - (iv) Observing Entity business operations.

## Chapter - 3 "Risk Assessment and Internal Control"

Topics Covered: (1) Audit Risk

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

Materiality

Accounting - FRF.

Books of Acc + F.S.

Auditing

SA-200 - Overall Objective.

F.S. - free from

✓ material

✓ mistake/mis

AS-1 - Disclosure of Accounting Policies

↓ selection

(a) Substance over form

(b) Prudence

(c) Materiality.

SA-320.

✓ Fundamental Accounting Assumptions:

(a) Going concern

(b) Consistency

(c) Accrual.

(i) Meaning of Materiality: - As per SA 320, misstatements <sup>including omissions</sup> could be material, if individually or in aggregate with other misstatements, could reasonably be expected to influence the economic decisions of users of financial statements.

- Materiality may be determined on quantitative as well as qualitative aspects; hence materiality is not a matter of relative size, for example, small theft of money by employees can indicate significant deficiency in internal control.

### (ii) Concept of Materiality - based on discussion in FRF:

- As per SA 320, a discussion presented in FRF provides a reference to the auditor in determining materiality for the audit.

For Example: Schedule III to the Companies Act, 2013, requires separate disclosure of financial items like:

(a) Shareholding  $> 5\%$  of share capital;

(b) Income or Expenditure items that exceeds  $1\%$  of Revenue from Operations or ₹ 1,00,000, whichever is higher.

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

(a) Any misstatement including omission are considered to be material, if they could reasonably be expected to affect the economic decision of users.

(b) Judgements about materiality to be made based on Circumstances; Size and nature of misstatements, etc.

(c) Materiality is to be considered on the basis of Common information needs of users of f.s.

(d) Materiality is a subject of professional judgement and may differ from person to person; any information which is material for a person might not be material for another person.

### (iii) Auditor's Consideration as to applying materiality concept:

- Concept of Materiality is required to be applied by the auditor both in planning and performing the audit and in forming an opinion on the f.s.

- During planning stage, Auditor is required to consider the materiality for the following:

(a) Determining NTE of RAP;

(b) Identifying and assessing ROMM; and

(c) Determining NTF of FAP.

- While performing the audit, auditor is required to consider the materiality for the following:

(a) Determining sufficiency and appropriateness of audit evidences;

(b) Evaluation of audit Evidences;

(c) Drawing Conclusion on the basis of audit Evidences.

(iv) Auditor's assumptions about Users of f.s. while determining materiality:

(a) Users have a Reasonable Knowledge of business and Economic activities; and accounting.

(b) Users are willing to study the f.s. with Reasonable diligence.

(c) Users understand that f.s. are prepared, presented and audited to levels of materiality.

(d) Users recognise the uncertainties inherent in measurement of Estimates.

(e) Users make reasonable Economic decisions on the basis of f.s.

(v) Performance Materiality:

Amount set by auditor, at less than materiality for the financial statements as a whole



so as to reduce the risk to an appropriate low level, that aggregate of uncorrected and undetected misstatements may exceed materiality for f.s. as a whole.

Materiality for Income / Expense:

1% of Rfo or ₹ 1 lakh : Higher

1% of Sur or ₹ 1 lakh : ₹ 5 lakh

While Auditing Expenses, misstatements identified - (40% drawn from Estimate)

(a) ₹ 55,000

(b) ₹ 40,600

(c) ₹ 62,000

(d) ₹ 31,150

(e) ₹ 41,000

(f) ₹ 70,600

(identified uncorrected)



### Example:

- while planning the audit, auditor fix the materiality for the revenue items - ₹ 5,00,000
- During course of performing audit procedures, auditor observed some misstatements in the samples selected in range of ₹ 30,000 to ₹ 75,000.
- Auditor is of the view, that if ignored, aggregate of such uncorrected and undetected misstatements may exceed ₹ 5 lakh.
- Hence auditor is required to determine performance materiality which may be fixed at any amount on professional judgement of auditor, say for example ₹ 40,000.

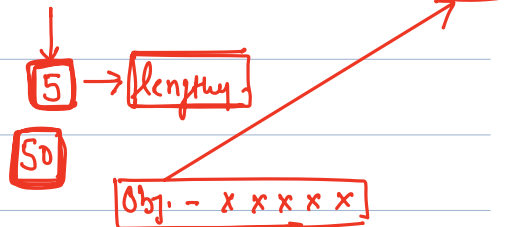
Remaining Gov. population -

→ undetected misstatement

(Identified uncorrected + undetected) > 5,00,000

Performance Materiality - ₹ 40,000

10 chapters × 20 = 200



### (vi) Determining materiality and performance materiality:

Auditor is required to determine the following:

- Materiality for the financial statements as a whole (at the time of establishing overall audit strategy)
- If required, based on the circumstances, materiality for the particular class of transactions, account balances or disclosures.  
(For Ex: Managerial Remuneration, Related Party disclosures, travelling expenses, trade receivables balances etc.)
- Performance Materiality, if circumstances so requires.



## Revision as the audit progresses:

- If Auditor conclude that a lower materiality for the f.s. as a whole or particular transactions, account balances or disclosures, than that initially determined, is appropriate, auditor may revised the materiality and consider <sup>(a)</sup> whether there is a need to revise performance materiality and whether NTE of audit procedures remain appropriate.

- Materiality need to be revised as a result of:

- ☒ (a) Changes in Circumstances;
- ☒ (b) New Information obtained
- ☒ (c) Changes in Auditor's Understanding of Entity and its operations as a result of performing audit procedures.

MCQ: As per SA 320, in case of revision in materiality level, auditor need to consider:

- (a) Need to revise P. Materiality
- (b) NTE of Audit procedures remain appropriate.
- (c) Either (a) or (b)
- ☒ (d) Both (a) and (b)

Documentation: Auditor documentation shall include the following:

- (a) Materiality for the financial statements as a whole.
- (b) " " " particular classes of transactions, account balances or disclosures.
- (c) Performance Materiality.
- (d) Revision of (a), (b) or (c) as audit progresses.

- Imp  
(vii) Benchmark of Materiality: Materiality may be determined as a %age of
- Profit before tax;
  - Total Revenue;
  - Total Expenses;
  - Total Equity,
  - Gross Profit
  - Net Assets value etc.

Most commonly used Benchmark in case of Profit making Entities are Profit Before tax. In case of other entities, other benchmark may be applied.

Factors affecting identification of appropriate Benchmark:

(a) Elements of the financial statements.

[For Ex: Assets, Liabilities, Equity, Income and Expenses]

(b) Items on which the attention of the User of f.s. tends to be focused.

[For Ex: to evaluate financial performance, user may focus on profits]

(c) Nature of the Entity

(d) Industry and Economic Environment in which Entity operates.

(e) Entity Ownership structure and the way in which it is financed.

[For Ex.: In case of finance through debts, more emphasis will be on assets and claims over them].

(f) Relative Volatility of the benchmark.

(viii) Materiality and Audit Risk: - Self-study from book -

## Chapter - 3 "Risk Assessment and Internal Control"

Topics covered: (1) Audit Risk (SA-315)

(2) Materiality in planning and performing an audit (SA 320)

Imp-  
(3) Understanding the Entity and its Environment: (SA 315)

As per SA-315, auditor is required to obtain understanding of following:

### Examples.

(a) Relevant Industry, Regulatory and Other factors including applicable FRF.

Industry factors: Market, competition,  
Product technology, suppliers,  
Customers etc.

(b) Nature of Entity: including -  
- its operations (e.g. Business activities)  
- its ownership and Governance structure  
- types of Investments (e.g. Investment activities)  
- Entity financing structure (e.g. Equity/Debt)

Regulatory factors: Legal provisions,  
Regulation, taxation, Govt.  
Policies etc.

Other factors: Economic conditions,  
Interest rates, inflation etc.

(c) Selection and Application of Accounting Policies  
including, reasons for changes thereto.

(d) Objectives, strategies and Business risk  
that may result in ROMM

Industry developments  
- New Products and Services  
(Increased product liability)  
- Expansion of Business  
(Inaccurate estimates - demand)

(e) Measurement and review of financial performance

→ KPI (Key Performance Indicators)  
→ Trends, Ratios  
→ Reports of Credit Agencies  
→ Budgets, Variance Analysis

MCQ: Auditor is required to obtain an understanding of Entity, its Environment including I.C. as per the requirements of SA 315.

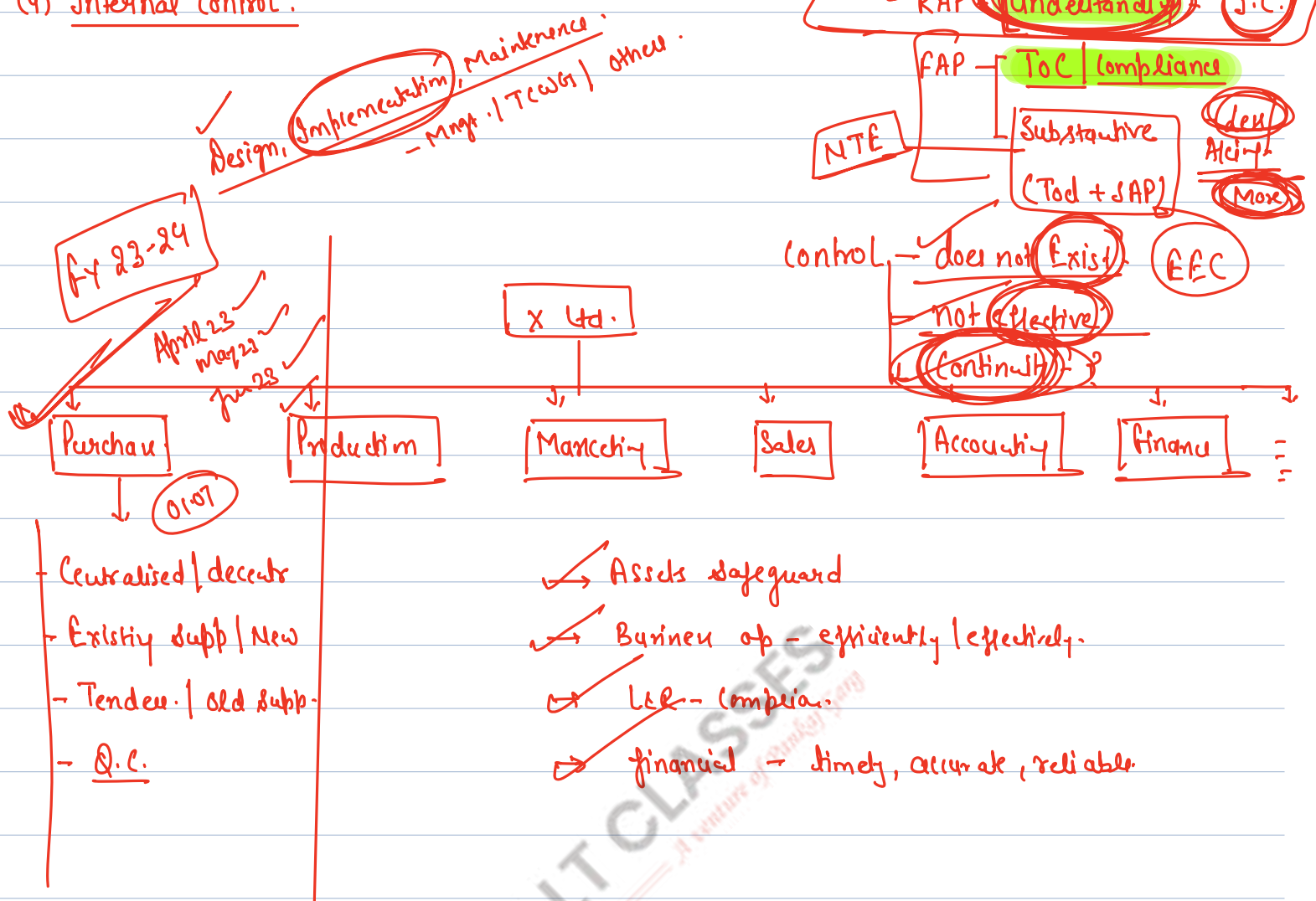
Such activity is :

- (a) One time activity to be carried out at Initial stage.
- (b) " " " " " " " " " " Conclusion stage.
- (c) Both (a) and (b)
- ✓(d) Continuous activity throughout the audit.

Understanding of Entity - a Continuous process :

- Obtaining understanding of Entity, its Environment including Internal Control is a Continuous, dynamic process carried out throughout the audit for gathering, updating and analysing information.
- Such understanding helps the auditor in :
  - (a) Assessing ROMM.
  - (b) Determining Materiality
  - (c) Determining appropriateness of selection and application of accounting policies.
  - (d) Identifying areas where special audit considerations may be necessary.
  - ✓(e) Developing expectations of recorded amount while using analytical procedures.
  - (f) Evaluation sufficiency and appropriateness of audit evidences.

#### (4) Internal Control:



#### (A) Meaning of Internal Control:

(DIM) SA 315 defines the term "Internal Control" as the processes, designed, implemented and maintained by TCWG / Mngt. / others within the entity to provide reasonable assurance as to the achievement of Entity's Objectives of :

- (i) Reliability of financial reports;
- (ii) Effective and efficient business operations;
- (iii) Safeguarding of Assets; and
- (iv) Compliance of laws and Regulations.

## (B) Objectives of Internal Control:

- i) Only authorised 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 authorised purposes. (i.e. for business use). Assets are safeguarded from unauthorised use.
- iv) To ensure the existence of assets recorded in books of accounts. (i.e. recorded assets are compared with the actual assets at reasonable intervals and in case of any difference, appropriate action is taken).

## (C) Benefits of Understanding of Internal Control to auditor: (RAP)

- i) To identify types of potential misstatements.
- ii) " " factors that affect RMM.
- iii) To design NTE of FAP. (ToC + Substantive)

## (D) Limitations of Internal Control:

- i) Internal control can provide reasonable assurance as to achieving the objectives of financial reporting only.
- ii) Involvement of human judgement in decision making. (that can be faulty).
- iii) Lack of understanding the purpose of Internal Control.
- iv) Collusion among employees.
- v) Judgements by management on nature and extent of control (that may be biased).
- vi) Limitation in case of smaller entities (Owner-Manager is able to override the controls as they are less structured).

(E) Components of Internal Control System: 5 Components

- ✓ (i) Control Environment (Governance and Mngt. functions that set the tone of an organisation)
- ✓ (ii) Entity's Risk Assessment Process
- ✓ (iii) Information System
- ✓ (iv) Control Activities
- ✓ (v) Monitoring

| Name of Component                          | Elements Covered in the Component                                                                                                                                                                                                                                                                                                                                                                                                         | Auditor's understanding of the Component                                                                                                                                                                                                                                                                                                   |
|--------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (i) <u>Control Environment</u>             | <ul style="list-style-type: none"> <li>(a) <u>Communication and Enforcement of Integrity and Ethical Values.</u></li> <li>(b) <u>Commitment to Competence</u></li> <li>(c) <u>Participation by Top Mgt.</u></li> <li>(d) <u>Management Philosophy and Attitude.</u></li> <li>(e) <u>Organisational Structure</u></li> <li>(f) <u>Assignment of Authority and Responsibility</u></li> <li>(g) <u>HR Policies and Procedures</u></li> </ul> | <p>Auditor shall obtain an understanding of Control Environment and Evaluate whether:</p> <ul style="list-style-type: none"> <li>(a) Mngt. has <u>created a culture of honesty and Ethical behaviour.</u></li> <li>(b) <u>[Strength] of components of Control Environment provide foundation for [Other components of I.C.]</u></li> </ul> |
| (ii) <u>Entity Risk Assessment Process</u> | <p>Entity Risk Assessment process involves:</p> <ul style="list-style-type: none"> <li>(a) <u>Identifying Business Risk</u> related to financial reporting.</li> <li>(b) Assess <u>Significance</u> of those risk.</li> <li>(c) Assess <u>Likelihood</u> of their occurrence.</li> <li>(d) Deciding upon the actions to <u>address</u> such risk.</li> </ul>                                                                              | <p>Auditor should obtain understanding of Entity Risk Assessment Process as it assist the auditor in identifying RoMM.</p>                                                                                                                                                                                                                 |



### Impact of satisfactory Control Environment:

- acts as a positive factor while assessing ROMM.
- Not an absolute deterrent to fraud
- Influences auditor's evaluation of effectiveness of other components of control.



## Chapter - 3 " Risk Assessment and Internal Control "

Topics Covered: (1) Audit Risk (SA 315)

(2) Materiality in planning and performing an audit (SA 320)

(3) Identifying and Assessing ROMM (SA 315)

(4) Internal Control (SA 315)

✓(A) Meaning of Internal Control

✓(B) Objectives " " "

✓(C) Benefits of understanding of Internal Control

✓(D) Limitations of Internal Control

✓(E) Components of Internal Control

✓(f) Controls relevant to Audit:

- There is a direct relationship between Objectives of the Entity and the Controls it implements.

- Controls implemented in the Entity's may or may not be relevant for the purposes of audit.

- To determine whether controls, individually or in combination with others, are relevant to audit purpose, auditor may consider following factors:

(a) Materiality;

(b) Significance of related risks;

(c) Size of the Entity;

(d) Nature of Entity's business, its organisation structure and ownership characteristics.

(e) Diversity and complexity of Entity's operations

(f) Applicable legal and regulatory requirements

(g) Nature and complexity of systems forming part of I.C.

(h) Circumstances and Applicable components of I.C.

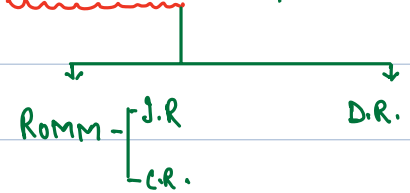
(g) Other Points: Heading from book

## (5) Risks that require special consideration: (SA 315)

In Exercising judgement as to which risks are significant risk, Auditor shall consider the following:

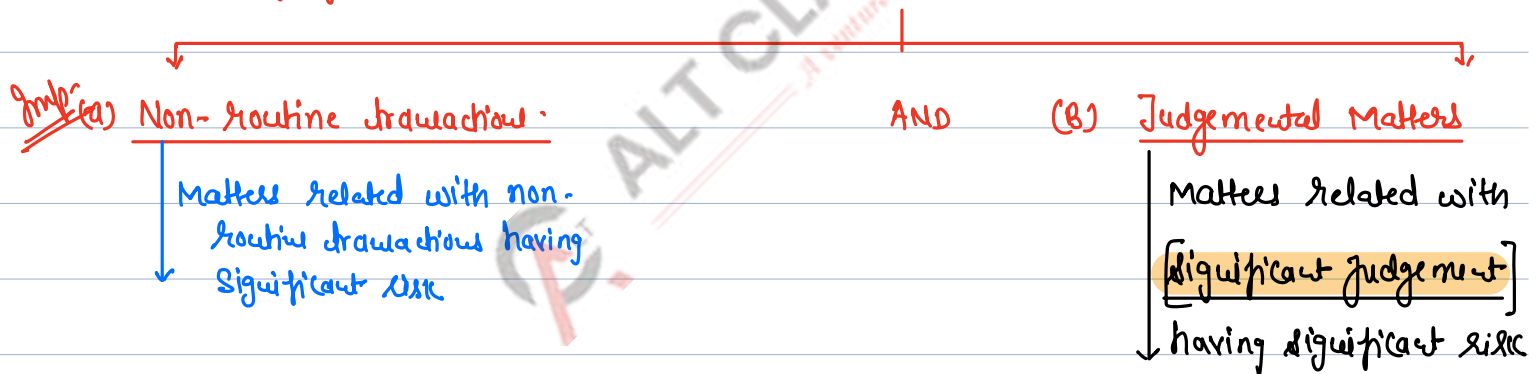
- whether the risk is a risk of fraud.
- whether the risk is related to significant economic, accounting and other developments.
- Complexity of transaction.
- whether risk involves significant transactions with related parties.
- Degree of subjectivity in the measurement of financial information; and
- whether the risk involves significant unusual transactions.

Audit Risk: - Inapp. Audit opinion



SA-200

Note: Significant risks often relate to significant



i) Greater Management Intervention to

Specify accounting treatment

ii) Greater 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.

i) Accounting Principles for Accounting Estimates or Revenue Recognition may be subject to different interpretation.

ii) Required judgement may be subjective or complex or require assumptions about effects of future events.

## (6) Evaluation (Review) and Testing of Internal Control System:

(A) Evaluation of I.C. System enables the auditor to obtain Reasonable assurance that - (i) Accounting system is adequate; and  
(ii) All accounting information which should be recorded, is in fact recorded.

(B) Auditor is required to obtain Necessary information for the purposes of Evaluation of Internal Control.

(Important aspects of business;  
Nature of business activities;  
Size of Business;  
Systems followed in Manufacturing, trading  
and other Activities, etc.)

(C) Methods to be used for collection of information for the purposes of Evaluation of Internal Control: 4 Methods

### (i) Narrative Records:

- Complex and Exhaustive description of system as found in operation, by the auditor.
- Recommended where no formal control system is in operation.
- More suited to small business, as to comprehend the system in operation is a difficult task.

### (ii) Check list:

- Series of instructions and/or questions which a member of auditing staff must follow

I.C.Q. - sales

| Q.                  | YES | NO | N.A.<br>↓         |
|---------------------|-----|----|-------------------|
| - Credit Appraisal. | ✓   |    | <u>irrelevant</u> |
| - Invoices - 4      | ✓   |    |                   |
| ✓ follow-up         | ✓   |    |                   |

↓  
Existence  
↓  
deficiency  
↓  
Explanation

Check list - Instructions / Questions  
↓  
Audit team

✓ Narrative records - Observations.

Flow Charts.

and/or answer.

- This is on the job requirement and instructions are framed having regard to desirable elements of control.
- Example: Are tenders invited before placing purchase order?  
Is the purchase order form standardised?  
Are Purchase order forms pre-numbered?

### (iii) Internal Control Questionnaire:

- Comprises of comprehensive series of questions concerning Internal Control.
- Most widely used form for collecting information as to existence, operation and efficiency of Internal Control.
- Answers are to be given as YES/NO/NA.
- 'Yes' answer indicates satisfactory performance; 'No' answer indicates weakness and requires further explanation. 'NA' reply is given for questions not relevant to business.
- ICD is issued to client with a request to get it filled.

Sample ICD for F.S. Items (Creditors, Cash, Inventory, etc.): Reading from book

- (iv) Flow-chart: - Graphic presentation of each part of Internal Control and is considered to be most concise way of recording of review of system.
- Minimises narrative explanations.
  - Give bird's eye view of system and flow of transactions and integration.

(D) Benefits of Evaluation of I.C. System:

(E) Formulating Audit Programme:

Learning + Noting - H.W.

## (f) Testing of I.C. System: (SA 330)

- After reviewing internal control system, Auditor needs to examine whether and how far the same is actually in operation - (i.e. Existence)
- For this purpose, Auditor should plan and perform actual testing of system in operation, in a manner that all important areas are covered in a span of say, 3 years.
- Tests of Controls may include:
  - (a) Inspection of documents supporting transactions to collect audit evidence that Internal Control operated effectively.  
For Ex: Verifying that a transaction has been authorised.
  - (b) Inquiry and observation of Internal Control which leave no audit trail.  
For Ex: Determining who actually performs a function, not merely who is supposed to perform it.
  - (c) Re-performance of procedures that were originally performed as part of Internal Control.  
For Ex: Reconciliation of Bank accounts.
  - (d) Testing of Internal Control on computerised applications or overall IT function.  
For Ex: Access controls or Program change controls

## Chapter - 3 "Risk Assessment and Internal Control"

Topics Covered: (1) Audit Risk (SA 315)

(2) Materiality in planning and performing an audit (SA 320)

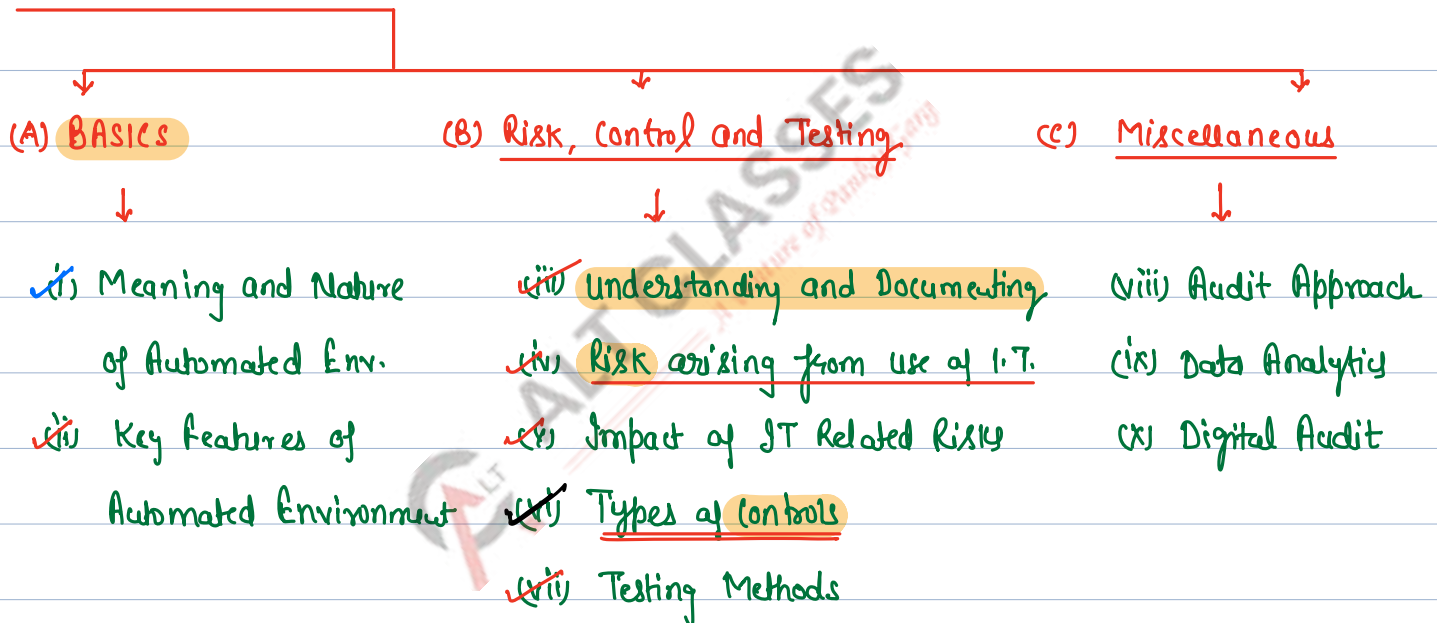
(3) Identifying and Assessing ROMM (SA 315)

(4) Internal Control (SA 315)

(5) Risks that require special consideration

(6) Evaluation and Testing of Internal Control System

(7) Automated Environment:



(i) Meaning and Nature of Automated Environment:

- Business Environment where the processes, operations, accounting and decisions are being carried out using the computer systems (also known as Info. system).
- Such environments are more system driven; with less manual intervention.
- Complexity of such environment depends upon level of automation.

✓ For Example: Integrated ERP Systems (e.g. SAP, Oracle) are considered more complex to audit as compared to off the shelf accounting software (e.g. Tally, Busy)

### civ) Key Features of Automated Environment:

- (a) Faster Business Operations
- (b) Accuracy in data processing and Computation.
- (c) Ability to process voluminous data.
- (d) Integration of Business Operation.
- (e) Better Security and Controls
- (f) Less Manual Intervention
- (g) Provides latest Information.
- (h) Connectivity and Networking Capabilities.

## PART B - Risk, Control and Testing

### ciii) Understanding and Documenting the Environment:

SA 315 - Identifying and Assessing ROMM through Understanding the Entity and its Environment.

Automated Environment - Business Env. -  $\begin{matrix} P \\ O \\ A \\ D \end{matrix}$  -  $\begin{matrix} \text{Com. System} \\ \text{(Info. System)} \end{matrix}$

- (a) Industry, Reg. - FRF.
- (b) Nature - its operation
- (c) Accounting Policies
- (d) Objectives / Strategic Business Risk
- (e) M/R of financial per.

Auditor is required to obtain understanding of following:

- (a) Information Systems being used (i.e. Applications like Finnacle)
- (b) Purpose of Info. System (Financial and Non-financial)
- (c) Location of I.T. System (Local or Global)
- (d) Architecture (Desktop; Cloud based, web application; Mobile based etc.)
- (e) Versions (Diff. versions have varied functions and risks)
- (f) Interfaces within the system (e.g. Multiple system exist for data processing)
- (g) Inhouse vs. Packaged
- (h) Outsourced Activities (IT Maintenance and Support)
- (i) Key Persons (e.g. CEO; CISO; DBA)

Note: Auditor should document the understanding.



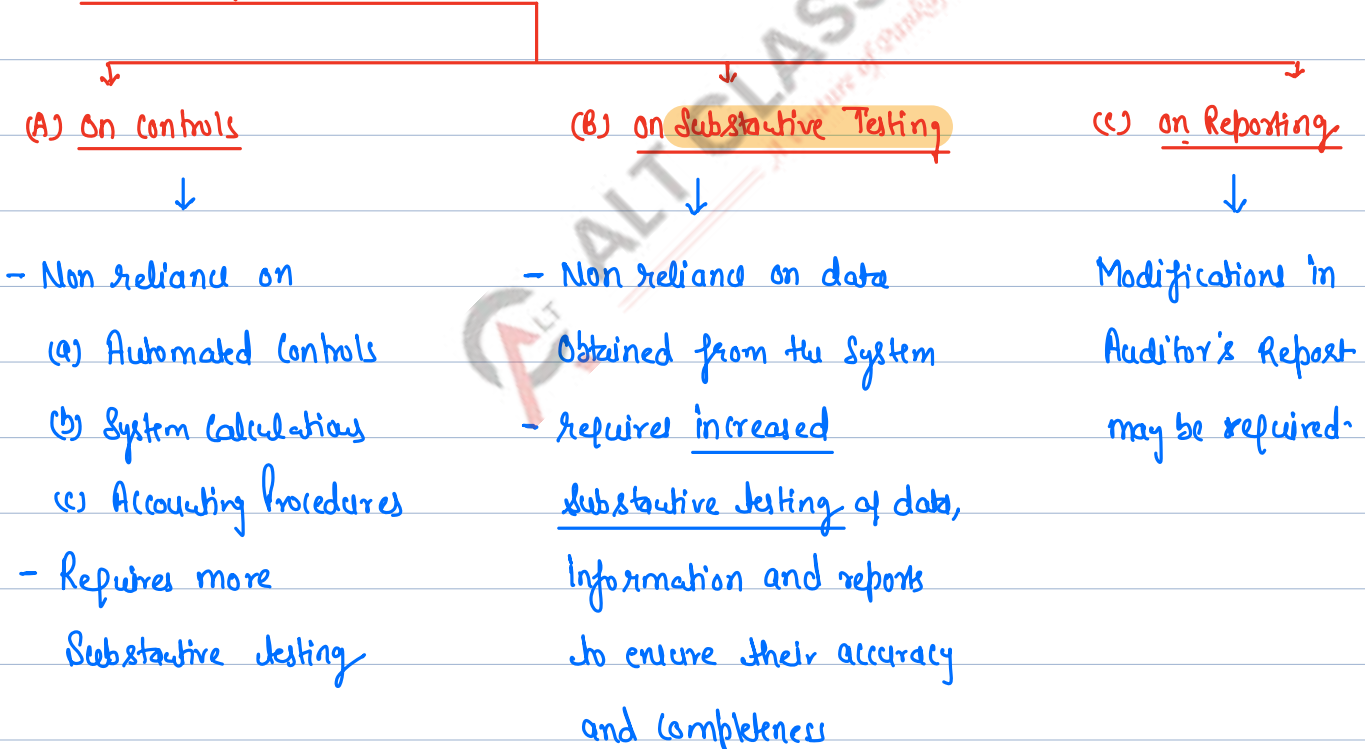
Imp  
(iv)

### Risk arising from use of IT System:

Consider the following risk:

- ✓ (a) Inaccurate processing of data; or processing inaccurate data or both;
- ✓ (b) Unauthorised access to data;
- ✓ (c) Data security;
- ✓ (d) Excessive / Privileged access (Super Access);
- ✓ (e) Lack of adequate segregation of duties;
- ✓ (f) Unauthorised changes to programs;
- ✓ (g) Failure to make necessary changes to Programs.
- ✓ (h) Potential loss of data (due to system failure or other reasons)

### (v) Impact of IT Related Risk:





## (vi) Types of Controls:

### (A) Based on Nature

### (B) Based on Technical Aspects

#### (a) Automated Controls

Controls embedded  
within the Systems

#### (b) Manual Controls

Controls based on reports / info.  
generated by I.T. System

#### (a) General IT Controls

- Policies / procedures related to many applications and support effective functioning of application controls.
- Ensure Integrity of Information and Security of data.
- Includes Control over
  - (i) Data Center and Network Operations
  - (ii) Program changes
  - (iii) Access Security
  - (iv) Application system - Acquisition, development and Maintenance

#### (b) Application Controls

- Manual or automated Procedures that operate at business Process level → to ensure accuracy, Completeness and Integrity of data.
- Examples:
  - (i) Edit Check and Validation of Input data.
  - (ii) Sequence number check.
  - (iii) User Limit check.
  - (iv) Reasonable check.
  - (v) Mandatory data field.

#### (c) IT dependent Controls

- Manual Controls based on reports produced from IT System.
- Design and effectiveness of such controls depends on reliability of source data.

## Relationship among Elements of Control:

- Effectiveness and reliability of Application and IT Dependent controls depends upon the effectiveness of General IT Controls.
- General IT controls needed to support the functioning of Application Controls.
- Both General IT controls and Application controls are needed to ensure complete and accurate information processing.

## Components of General IT Controls:

| Component                                                               | Objectives                                                                                          | Activities                                                                                                                                                                                               |
|-------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (i) <u>Data Center and Network Operation</u>                            | To ensure that production system are <u>processed</u> to meet financial reporting (FR) objectives.  | (a) Overall management of computer operation Activities<br>(b) Backups - Monitoring ; storage ; retention.<br>(c) Recovery from failures - Business continuity Plan (BCP) ; Disaster Recovery Plan (DRP) |
| (ii) <u>Program change</u>                                              | To ensure <u>modified programs</u> continue to meet FR objectives.                                  | (a)<br>(b)<br>(c)                                                                                                                                                                                        |
| (iii) <u>Access Security</u>                                            | To ensure <u>access to programs and data is authenticated and authorized</u> to meet FR objectives. | (a)<br>(b)<br>(c)                                                                                                                                                                                        |
| (iv) <u>Application System Acquisition, development and Maintenance</u> | To ensure that systems are <u>developed, configured and implemented</u> to meet FR objectives.      | (a)<br>(b)<br>(c)                                                                                                                                                                                        |

(vii) Testing of controls: Following testing methods can be used:

- (a) Inquiry
- (b) Inspection
- (c) Observation
- (d) Re-performance

Inquiry: Most efficient method; but provides least audit evidence.  
Hence, using inquiry alone is not sufficient.

✓ Inquiry in combination with Inspection: Most efficient and effective.

Re-performance: Most effective and gives best audit evidence. But time consuming and least efficient most of the time.

Commonly used methods:

(i) Obtain an understanding of how an automated transaction is processed using a combination of Inquiry, Observation and Inspection.

(ii) Observe how a user, process transactions under different scenarios.

(iii) Inspect two configuration defined in application.

(iv) Conduct Re-performance using raw source data.

e.g. Reconciliation  
Statement

## Part C - Miscellaneous

### (viii) Audit Approach:

4 Stages



Risk Assessment

→ Consider Risk arising from use of IT  
(e.g. Inaccurate processing, Inaccurate data, Loss of data,  
unauthorised access; unauthorised change to programs)



Understand and  
Evaluate

→ Controls to Mitigate IT Related Risk  
(e.g. General IT Controls, Application Controls)



Test for operating  
Effectiveness

→ To Ensure Reliability and Completeness  
of Information.



Reporting

→ Reporting of deficiencies in I.C. to Mngt.  
(Through letter of weakness)

(ix) <sup>Imp</sup>Data Analytics: - It is a Analytical Process through which meaningful information is generated from raw data.

- Data Analytic methods used in an audit are known as Computer Assisted Audit Techniques (CAATs)

- Examples: (a) Spreadsheets like MS-Excel

(b) Specialised Audit Tools like IDEA and ACL

### Applications of data Analytics:

(a) Check Completeness of data and population that is used in ToC/ToD/SAP.

(b) Selection of Audit Samples - Random sampling / Systematic sampling.

(c) Re-computation of balances - (e.g. Construction of trial balance)

(d) Re-performance of calculations - (e.g. depreciation, Interest etc.)

(e) Analysis of Journal Entries (f) Fraud Investigation

(x) Digital Audit: Placing Assurance on effectiveness of IT System implemented in an Organisation.

Use of Digital Technology by

↓  
Entities



- To revamp business operations.
- To rethink the way business is conducted.
- To restructure the business models.
- To automate the business processes

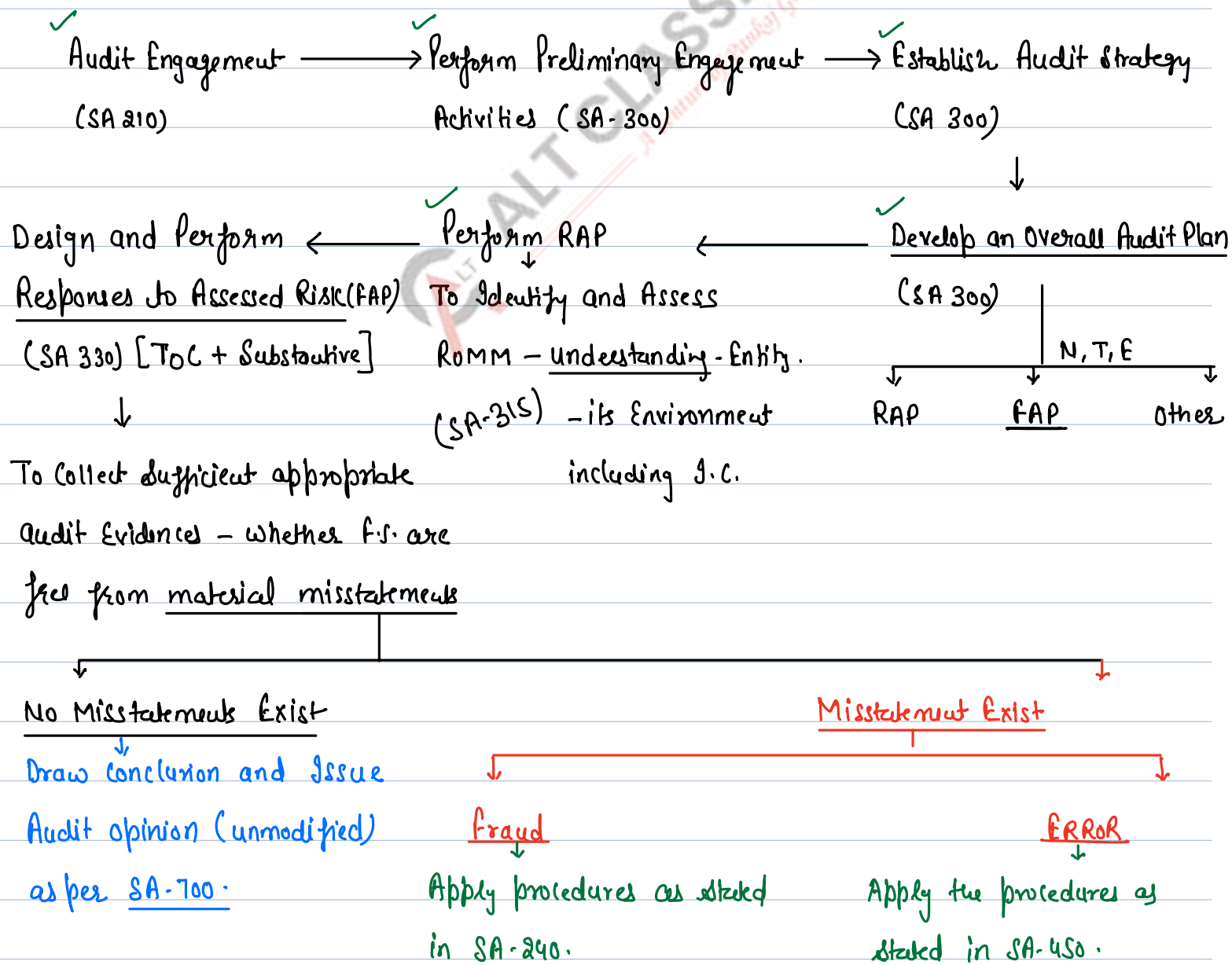
↓  
Auditor

- Use of Artificial Intelligence, data Analytics etc. to understand the business in a better way.
- To conduct audit in a more efficient and effective manner.
- To identify the Risks.

## Chapter - 3 "Risk Assessment and Internal Control"

- Topics Covered:
- (1) Audit Risk (SA 315)
  - (2) Materiality in planning and performing an audit (SA 320)
  - (3) Identifying and Assessing ROMM (SA 315)
  - (4) Internal Control (SA 315)
  - (5) Risks that require special consideration
  - (6) Evaluation and Testing of Internal Control System
  - (7) Automated Environment

### (8) Auditor's Responses to Assessed Risks (SA 330):



(i) Types of Responses: SA 330 requires the auditor to design and perform audit procedures which are appropriate to assessed risks



for the purpose of collection of sufficient appropriate audit evidences.

Responses are classified in two categories —

- (a) Compliance procedures (Tests of controls - TOC)
- (b) Substantive " (Tests of details - TOd)  
+ Substantive Analytical Pro. - SAP)

### ✓ (ii) Designing and Performing TOC:

- Tests of Controls may be defined as audit procedures designed to evaluate operating effectiveness of controls in preventing or detecting and correcting material misstatements at the assertion level.
- Auditor shall design and perform TOC to obtain SAAE as to the operating effectiveness of controls when:
  - (a) he expects that controls are operating effectively; or
  - (b) substantive procedures alone cannot provide SAAE.
- In designing and performing TOC, auditor shall perform other audit procedures in combination with Inquiry to obtain audit evidence about operating effectiveness of controls, including:
  - (a) How the controls were applied at relevant times during the audit.
  - (b) Consistency with which they are applied.
  - (c) By whom and by what means they were applied.
- Inquiry alone is not sufficient to test operating effectiveness of controls. Inquiry combined with inspection or re-performance may provide more assurance than Inquiry combined with observation, as observation is pertinent only at the point in time at which it is made.



Matters to be considered in determining the Extent of Tests of Controls:

- (a) Frequency of performance of Controls
- (b) Length of time
- (c) Expected rate of Deviation
- (d) R/R - Audit Evidences
- (e) Extent to which A.E obtained from Tests of other Controls.

~~Imp~~

Factors to be considered while using Audit Evidences obtained in previous audits:

- (a) Effectiveness of Other Elements of Control - C.E, Monitoring, E.R.P.
- (b) " " General I.T. Controls
- (c) " " Controls and its application by the Entity.
- (d) Risk arises from characteristics of Controls (Manual or automated)
- (e) ROMM and Extent of Reliance on Controls.
- (f) Personnel changes that significantly affect the application of Controls.
- (g) Lack of a change in a particular Controls required due to changed Circumstances.

Specific Inquiries by Auditor when deviations from Controls are detected:

When deviations from Controls upon which the Auditor intends to rely are detected, Auditor shall make specific inquiries to understand these matters, their potential consequences and determine whether

- |                                                                      |                                    |                                                                                |
|----------------------------------------------------------------------|------------------------------------|--------------------------------------------------------------------------------|
| ↓                                                                    | ↓                                  | ↓                                                                              |
| (a) ToC performed provide appropriate basis for reliance on Controls | (b) Additional ToCs are necessary. | (c) Potential risk of Misstatement need to be addressed using Sub. procedures. |

(iii) Substantive Procedures: Procedures designed to detect material misstatements at the assertion level are known as Substantive Procedures.

- Sub. Procedures Comprises of
- (a) Tests of details - ToD (of Drawdowns and Balances)  
(Vouching) (Verification)
  - (b) Substantive Analytical Procedures (SAP)



Examples: Tests of details of Transactions (Vouching)

(a) Payment of Electricity Bills - Vouching -

- (i) Electricity Bill - Amount Payable
- (ii) Receipts/ Bank Statement - Paid
- (iii) Authorisation

Electricity Exp - 2022-23 - ? 12.00 lacs. } Assurance - Comparison  
2021-22 - ? 11.50 lacs. } SAP.

## Tests of details of Balances (Verification)

e.g. Trade Receivable. 50,00,500 (Existence, valuation)

(list of receivables)

|   |             |           |                |
|---|-------------|-----------|----------------|
| A |             | 15,70,000 | Request Letter |
| B | Amount with | 12,06,000 | Confirmation   |
| C |             | 10,01,000 | (E.C.)         |
| D |             | 4,09,500  |                |

### Appropriateness / Reasonableness:

| Trade Receivable | 2022-23 | 2023-24 |          |
|------------------|---------|---------|----------|
| Sales            | 15%     | 16%     | → S.A.P. |

- ✓ SAP - More applicable to large volume of transactions that can be predicted over time.

For Ex: Rental Income of a Bldg: No. of Apartments  $\times$  Rental Rate p.m.  
 $\times$  Occupancy Ratio  $\times$  12 Months.  
 $= 50 \times 50,000 \times 100\% \times 12 \text{ M}$   
 $= 300,00,000$

Substantive Procedures: - LEARNING and Noting -

## Chapter - 3 " Risk Assessment and Internal Control "

Topics Covered: 1) Audit Risk (SA 315)

2) Materiality in planning and performing an audit (SA 320)

3) Identifying and Assessing ROMM (SA 315)

4) Internal Control (SA 315)

5) Risks that require special consideration

6) Evaluation and Testing of Internal Control System

7) Automated Environment

8) Auditor's Responses to Assessed Risk (SA-330)

| SA 200 - 299 - General Principles     |                        | ⑥ SA 300 - 499 - Planning and Response <sup>Risk</sup> |                            |
|---------------------------------------|------------------------|--------------------------------------------------------|----------------------------|
| SA - 200                              | SA-250 - X             | SA - 300 - <u>Planning</u>                             | 450 - <u>Misstatements</u> |
| SA - 210                              | SA - 260 - TWC         | ✓ - 315 - <u>ROMM</u>                                  |                            |
| SA - 220                              | SA - 265 - Deficiency  | ✓ - 320 - <u>Materiality</u>                           |                            |
| "                                     | " in I.C.              |                                                        |                            |
| SA - 230 - <u>Audit Documentation</u> |                        | ✓ - 330 - <u>Responses to Assessed Risk</u>            |                            |
| SA - 240 - X                          | SA - 299 - Joint Audit | - 402 - X                                              |                            |

(9) Misc. Topics:

✓(a) Manual and Automated Elements in I.C.

✓(b) Internal Financial Controls

(c) Documenting the Risk

(d) Assessing and Reporting of Audit findings

- From Book -

### (a) Manual and Automated Controls:

- An Entity Internal Control system comprises of Manual and automated controls. Whether to use manual or automated controls, is a matter to be decided by the management, based on the Circumstances, level of automation etc.
- Manual controls include procedures like - Approval and Review of transactions;
  - Reconciliations on periodic basis;
  - Follow-up of reconciling items; etc.
- Automated controls include General IT controls like controls over data centers and network operations, access security controls; and Application IT controls.
- Manual Controls are considered more suitable where judgements are required, for example - (a) Unusual or non recurring transactions;
  - (b) Circumstances where error are difficult to predict or defined;
  - (c) Circumstances requiring response outside the scope of automated environment; And
  - (d) monitoring the effectiveness of automated Environment.
- Manual controls are considered less suitable in following cases:
  - (a) High Volume or recurring transactions;
  - (b) Situations where errors can be anticipated or predicted
  - (c) Control activities where specific way to perform the control can be adequately designed and automated.

(b) Internal Financial Controls: Policies and procedures adopted by the company for ensuring:- Reliability of financial reporting;

- Efficiency and effectiveness of operations;
- Compliance with laws and regulations;
- Safeguarding of Assets; and

# - Prevention and Detection of fraud and Error.

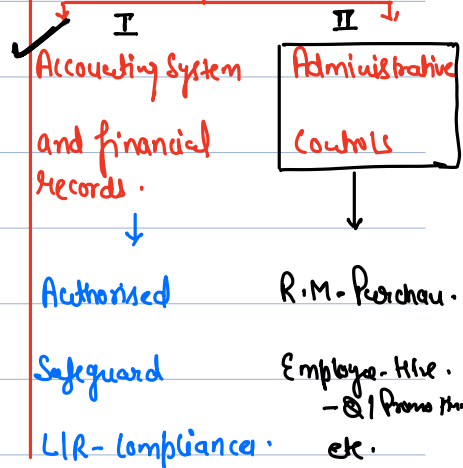
## Statutory Requirements w.r.t. Internal financial Controls:

(A) Sec. 134(5): Listed Companies - Director's Responsibility statements.

Statement that the directors have laid down  
IFC to be followed by the company and  
such controls are adequate and operating  
effectively.

(Establish; Adequate; Effectively operate)

## Internal control.



(B) Sec. 143(3)(i): Auditor is required to report whether company has adequate Internal controls w.r.t. financial statements in place and operating effectiveness of such controls.

(Existence and Adequacy; Effectively operate)

Exemption: Reporting not applicable in case of a private company which is

(a) OPC or Small company; or

(b) having T/O < 50 Cr as per latest audited F.S. and aggregate borrowings from bank, F.I or Body Corporate at any point of time\* during the FY < 25 Cr.

\* throughout the year

# PUC ≤ 4 Cr  
+  
T/O ≤ 40 Cr

Example:

|           |                |                 |                     |                          |               |
|-----------|----------------|-----------------|---------------------|--------------------------|---------------|
| A(P) Ltd. | OPC            | Pusc - 50 Lakh  | Turnover - 51 Cr.   | B - Bank/FI/B.C - 10 Cr. | No            |
| B(P) Ltd. | Other than OPC | Pusc - 3 Cr.    | T/O - 35 Cr.        | Borrowings - 31 Cr.      | No (Small Co) |
| C(P) Ltd. | "              | Pusc - 5 Cr.    | <u>T/O - 45 Cr.</u> | Borrowing - 26 Cr.       | YES           |
| D(P) Ltd. | "              | Pusc - 3.99 Cr. | T/O - 41 Cr.        | Borrowing - 24 Cr.       | No            |
| E(P) Ltd. | "              | Pusc - 2 Cr.    | T/O - 49.8 Cr.      | Borrowing - 24.6 Cr.     | No            |
| FPO Ltd.  | "              | Pusc - 2.68 Cr. | T/O - 35 Cr.        | Borrowing - 8 Cr.        | YES           |

(c) Sec. 177(4)(vii): Audit Committee: shall act in accordance with terms of reference as specified by Board, which shall include - Evaluation of IFC and Risk Mngt. System.

(d) Sec. 149(8): Company and Ind. directors shall abide by provisions specified in Schedule IV - [Code for Independent Directors]

↓  
Role and Functions of Ind. directors

↓  
Ind. directors shall satisfy themselves - Integrity of financial information and that financial controls and risk Mngt. system are robust and defensible.

(e) Documenting the Risk: (a) Discussion among ET and conclusions  
(b) Key Elements of Understanding - Entity.

- Environment

- Components of I.C.

Source of info. from which understanding obtained;  
RAP Performed.

(c) Identified and Assessed ROMM <  $\begin{matrix} \text{f.s. level} \\ \text{Assessment level} \end{matrix}$   
(d) Identified Risk and related Controls

(f) Assessing and Reporting - Audit findings: Learn Question from Q. Bank  
(Noting - H.W.)

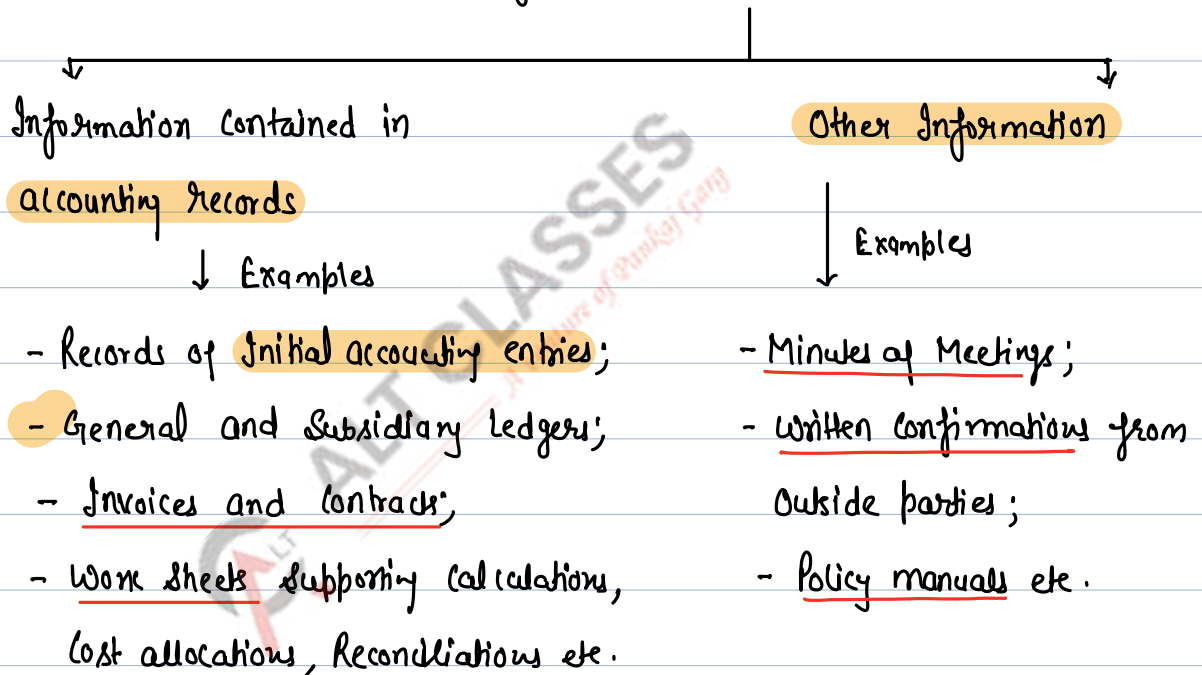
## Chapter - 4 "Audit Evidence"

Topics to be covered: SA 500, 501, 505, 510, 520, 530, ~~540~~, 550, 560, 570, 580  
+ SA 610

Chapter - 7

### (I) SA-500 "Audit Evidence":

(i) Meaning: Information used by Auditor in arriving at the conclusion on which auditor's opinion is based. Information includes



### (ii) Types of Audit Evidence:

(A) Depending upon Nature:

- Documentary: Written documents like loan Agreement; FDR
- Visual: in the form of observations like observing, Physical verification of Inventories.
- Oral: No Physical Evidence. For Ex: Discussion with Mngt.

### (B) Depending upon Source:

- Internal: Originates within the Entity. For Ex. Sales Invoice; GRN; Debit Note or Credit Note issued, etc.
- External: Originates outside the Entity. For Ex. Purchase Invoice; Supplier's Challan; Bank Statement, etc.

### (iii) Relevance and Reliability of Audit Evidences:

Relevance: deals with logical connection with purpose of audit procedure and assertion under consideration.

Note: A given set of audit procedure may provide audit evidence that is relevant to certain assertions, but not others.

For Ex: Inspection of documents as to collection of trade receivables after period-end may provide evidences regarding Existence and Valuation; but not necessarily of Cut-off.

|          |                    |
|----------|--------------------|
| April -- | Bank Stmt          |
| [X] =    | 5,50,600           |
| 20.04    | (Final Settlement) |

Imp:

#### Reliability:

Following generalisations may be useful for consideration of reliability of Information to be used as audit evidences:

- Audit Evidences Obtained from Independent sources outside the Entity are considered more reliable.
- Reliability of internal evidences is increased when related controls are robust, strong and effective.
- Audit Evidences obtained directly by the auditor are considered more reliable than evidences obtained indirectly.
- Audit evidences in documentary form are more reliable than oral evidences.
- Audit Evidences provided by original documents are more reliable than evidences provided by photocopies.



#### (iv) Sufficiency and Appropriateness of audit Evidences:

(A) Sufficiency: It is measurement of Quantity of audit Evidence and may be affected by following factors:

- (1) Materiality of Subject Matter: More evidences will be required for material items / assertions to be evaluated and vice versa (i.e. less evidences will be needed for immaterial items).
- (2) RoMM: More evidences will be required for assertions having higher RoMM and vice versa.
- (3) Size of Population: More Evidences will be required in case of large size of population and vice versa.
- (4) Nature of Population: More Evidences will be required for heterogenous population; less evidences will be required for homogenous population.

(B) Appropriateness: It is a measurement of quality of audit evidences and is influenced by the source and nature.

For Ex: External evidences are considered more appropriate than Internal evidences.

Documentary evidences are considered more appropriate than Oral Evidences.

Note: Higher is the relevancy / Appropriateness of Audit Evidences, lower can be the sufficiency of audit Evidences.



## (v) Audit Procedures to be performed to collect audit Evidence:

### (A) Risk Assessment Procedure (RAP)

↓  
Procedures performed to obtain understanding of the Entity, its Environment including Internal Control

↓  
to identify and assess RoMM.  
(Details of RAP already covered in SA 315)

### (B) Further Audit Procedures (FAP) ; or Responses to Assessed Risk

(SA-330)

#### (A) Tests of Controls (ToC)

↓  
Procedures performed to Evaluate Existence, Effectiveness and Continuity of Internal Controls

#### (B) Substantive Procedures

↓  
Procedures performed to examine Accuracy, Validity and Completeness of accounting data and financial information

#### (A) Tests of details (Tod)

- ↓ of
- drawal occurred during the year (i.e. Vouching of drawal)
  - and
  - account balances that Exist at year end (i.e. Verification of assets and liabilities)

#### (b) Substantive Analytical Procedures (SAP)

involves Consideration of  
(a) Comparison ; and  
(b) Relationships  
among financial and non-financial data.  
(Details of SAP will be covered in SA 520).

Note: Nature and timing of audit procedures are effected by:

(a) Availability of audit evidences in electronic form only.

(b) " " " " at certain point of time only.

(vi) Methods to obtain audit Evidences: Methods and means to be used for the purpose of collection of audit Evidences are:

(a) Inquiry: Seeking information from knowledgeable persons, of both financial and non-financial matters, within the Entity or outside the entity.

(b) Inspection: i.e. Examination of records, documents etc.

(c) Observation: Looking at a process or procedure being performed by others.  
e.g. Observing physical count of inventory conducted by Mngt.

(d) External Confirmations: Audit Evidence obtained by Auditor as a direct written response to the auditor from a third party in paper form or electronic medium.

For Ex: Auditor sends a letter to a trade receivable to confirm the year end balance as at B/S date.

(e) Re-calculation: Checking mathematical accuracy of documents, records or financial items.

For Ex: Calculating Interest payable to debenture-holders;  
Calculating liabilities for Income-tax.

(f) Re-performance: Independent execution of procedures or controls by auditor that were originally performed as part of Entity's I.C.

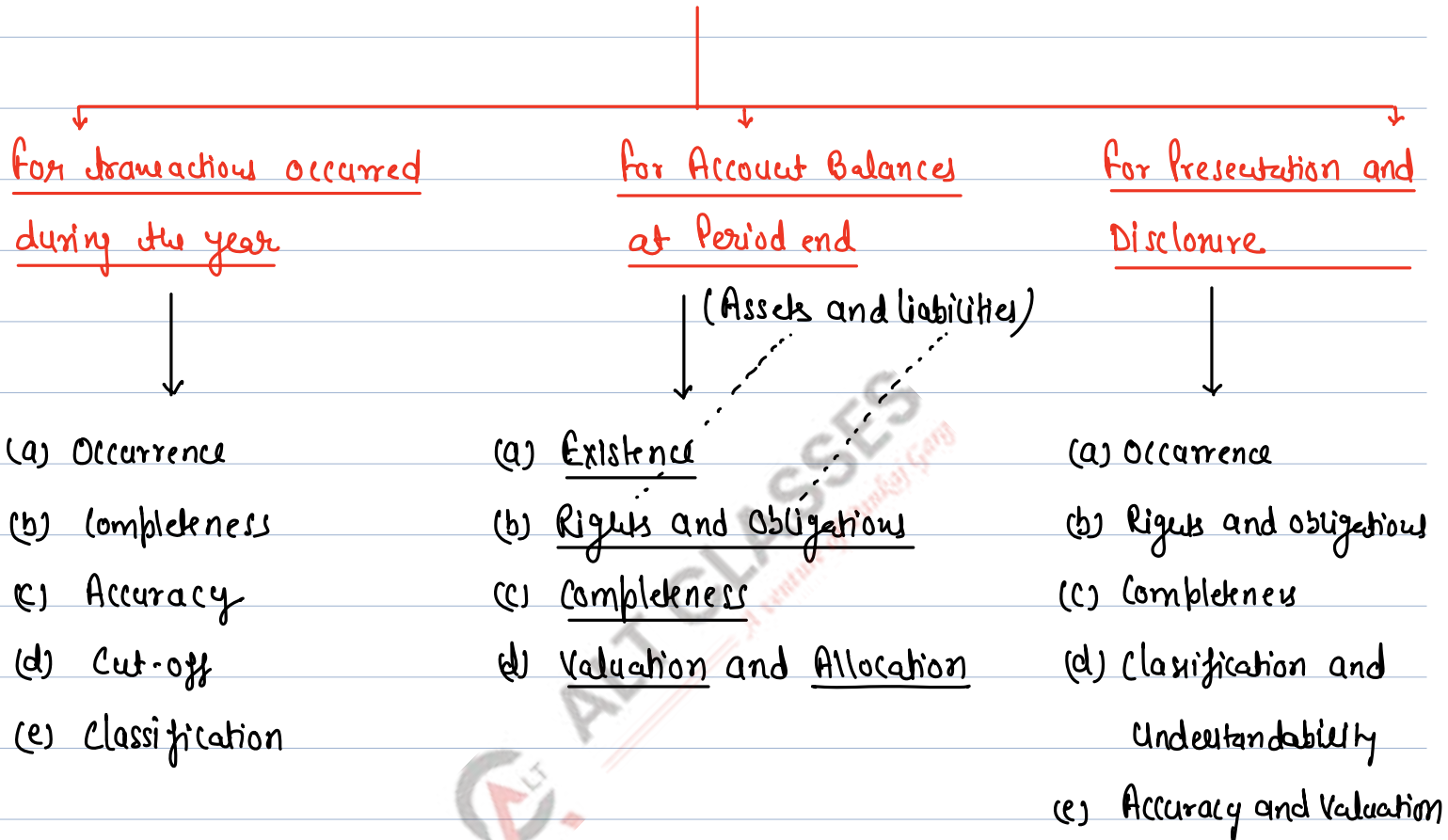
For Ex: Auditor evaluates the existence and effectiveness of Internal Control by performing control activities.

(g) Analytical Procedures: Evaluation of financial information made by a study of relationship among financial and non-financial data.

For Ex: Analysing debtor T/O ratio of last 5 years to find reasonableness

of year end balances of trade receivables.

(vii) Assertions: Representation by management that are embodied in the financial statements, as used by auditor to consider the different types of potential misstatements that may occur.



## Chapter - 4 "Audit Evidence"

### (I) SA-500 "Audit Evidence" :

(i) Meaning

(ii) Types of Audit Evidence

(iii) Relevance and Reliability

(iv) Sufficiency and Appropriateness

(v) Audit Procedures to be performed

(vi) Methods to obtain audit evidences

(vii) Assertions

ALREADY COVERED

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

(A) Info. produced by the Entity

(e.g. BRS, Rent Agreement)

Evaluate whether info. is sufficiently reliable for his purpose, including :

(a) Obtaining audit evidence as to accuracy and completeness of Info.  
and

(b) Evaluating whether Info. is sufficiently precise and detailed.

(B) Info. produced by the Entity using

work of Mngt. Expert

(e.g. Actuary, Architect, Advocate)

(i) Evaluate Competency, Capability and Objectivity of Mngt. Expert.

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

(iii) Evaluate appropriateness of Expert's work as audit Evidence

Management Expert: An Individual or Organisation possessing expertise in a field Other than accounting or auditing



whose work is used by the entity to assist the Entity in preparing F.S.

## Matters affecting NTE of audit procedures when information to be used as audit evidence has been prepared using work of management expert:

- Learning and Noting - H.w. -

### (ix) Auditor's duties if doubt arises over reliability of audit evidence:

- ✓ If audit evidences obtained from one source is Inconsistent with that obtained from another; or auditor has doubt over the reliability of information to be used as audit evidence



Auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter

and

shall consider the effects of the matter, if any, on other aspects of audit.

### (x) Selecting items for testing to obtain audit evidences:

#### (A) Selecting All Items (100%)

↓ Appropriate, if

- Population constitutes a small no. of large value items.
- There is a significant risk and other means do not provide SAAE.
- Process performed automatically by an Info. system makes 100% examination cost effectively.

#### (B) Selecting Specific Items (Judgement Selection)

- Appropriate for -
- High value items;
  - Suspicious items;
  - Unusual items;
  - All items over a certain amount

Selection depends on :

- (a) Auditor's understanding of the Entity;
- (b) Assessed ROMM;
- (c) Characteristics of population being tested.

#### (C) Sampling.



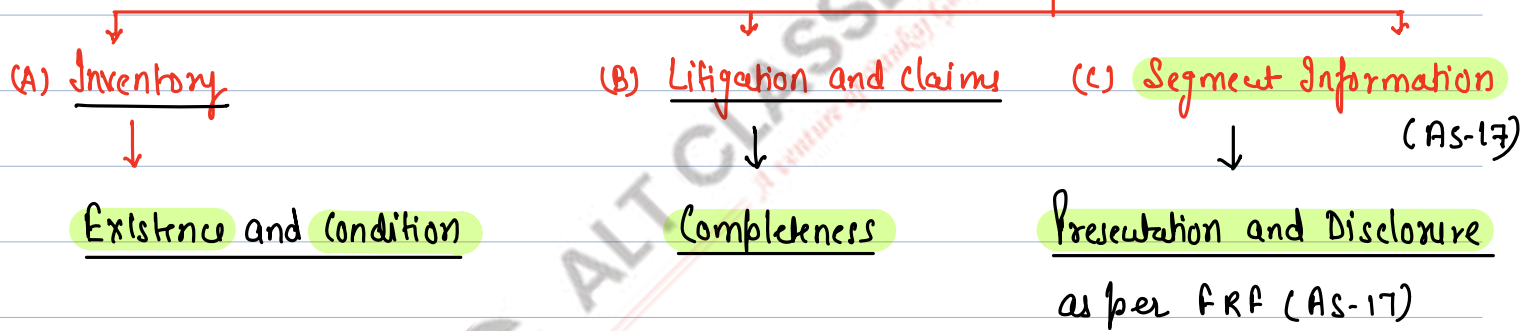
Details will be covered in SA-530

Note: 100% Examination is unlikely in case of ToC; however it is more common for ToD.

- (xi) Misc. Topics:
- (a) Need for Audit Evidence
  - (b) Sources of Audit Evidence
  - (c) Nature and timing of audit procedures
  - (d) Audit Trail (Learning + Noting)
  - (e) Evaluation of Audit Evidences

From Book

(2) SA-501 "Audit Evidence - Specific Consideration for Selected Items":



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

- Auditor is required to obtain SAAE w.r.t. Existence and Condition of Inventory, if material.
- For this purpose, Auditor is required to perform following procedures:
  - (a) Attend Physical Inventory Count (unless impractical) do as to:
    - (i) Evaluate Management instructions and procedures for recording the results of inventory count;
    - (ii) Observe the performance of management count procedures;
    - (iii) Perform test count;
    - (iv) Inspect the Inventory.

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

\* Inspection of records;

Vouching;

Reconciliation for Inventory.

Bin card

| Date | In | out | Balance. |
|------|----|-----|----------|
| -    | ✓  | ✓   | ✓        |
| -    | ✓  | ✓   | ✓        |

Qty

Perpetual Inv. Records

Stores ledger

| Date | In |   |   | Issues |   |   | Bal |
|------|----|---|---|--------|---|---|-----|
|      | Q  | R | A | Q      | R | A |     |
|      |    |   |   |        |   |   |     |
|      |    |   |   |        |   |   |     |
|      |    |   |   |        |   |   |     |
|      |    |   |   |        |   |   |     |
|      |    |   |   |        |   |   |     |
|      |    |   |   |        |   |   |     |
|      |    |   |   |        |   |   |     |
|      |    |   |   |        |   |   |     |

Matters relevant in planning the attendance of Physical Inventory Counting:

- (i) Nature of Inventory;
- (ii) Stages of completion of WIP;
- (iii) ROMM related to inventory;
- (iv) Nature of J.C. related to inventory;
- (v) whether adequate procedures are established and proper instructions are issued for Physical count.
- (vi) Timing of Physical count.
- (vii) Need for Assistance of Auditor's expert.
- (viii) Maintenance of Perpetual Inventory system.
- (ix) Locations at which inventory is held.



## Chapter - 5 "Audit Evidence"

(1) SA-500 "Audit Evidence"

(2) SA-501 "Audit Evidence - Specific Consideration for Selected Items"

(A) Audit Procedures w.r.t. Inventory - Existence and Condition - Special Cases

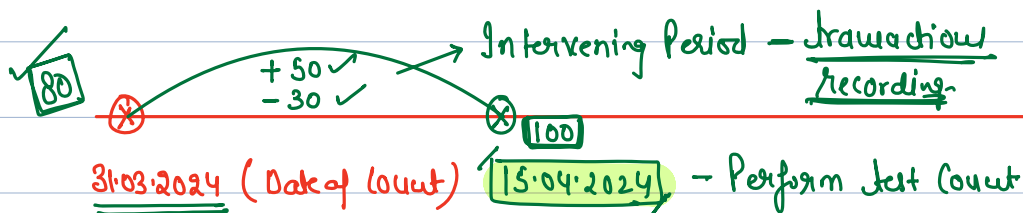
(a) To attend Inventory Count is impractical: (e.g. Security concerns)

- ↓
- Perform Alternate Audit Procedure to collect SAAE w.r.t. Existence and Condition of Inventory -
  - If auditor not able to collect SAAE from alternate audit procedure, auditor need to modify the audit opinion. (Qualified / Disclaimer)

★ Inspection of documentary records (Sale Invoice / Purchase Invoice)

External Confirmation from Suppliers.

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



Make or observe some physical count on an alternate date and perform procedures on drawactions that occurred during intervening period to ensure their appropriate recording.

★ Vouching of Invoices (Sale / Purchase); Reconciliation etc.

Reporting Aspects

↓  
Misstatements identified

→ Material +

→ Pervasive Effect

(Adverse opinion)

→ Material (not Pervasive)  
(Qualified opinion)

→ No Audit Evidences

→ Mat + Pervasive

(Disclaimer of opinion)

→ Material (not pervasive)

(Qualified opinion)

Qualified  
(Material + Not Pervasive) → Misstatement  
→ No A. Evidence

Adverse → Misstatements

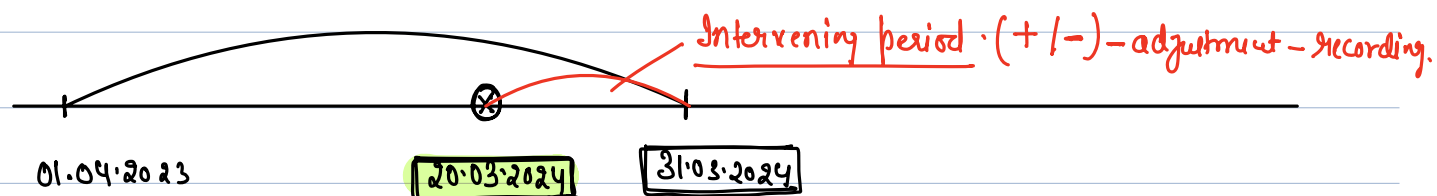
(Mat + Pervasive)

Disclaimer - No Evidences

(Material + Pervasive)

Q Q / (A) / (D)

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



- Perform audit procedures to obtain audit evidence whether the transactions during the intervening period are recorded appropriately.
- while designing audit procedures for this purpose, consider the following matters:

- whether perpetual inventory records are properly adjusted.
- Reliability of perpetual inventory records.
- Reasons for significant differences between info. obtained during the physical count and perpetual inventory records.

### (d) Audit procedures if inventory lying with 3<sup>rd</sup> parties (warehouse; job worker; consignee)

- Obtain External Confirmation from third parties.
- Perform Inspection and other procedures as appropriate.



- Inspection of documentation e.g. warehouse receipts
- Attending or arranging another auditor to attend 3<sup>rd</sup> party Physical Counting of Inventory.
- Obtaining another auditor report on adequacy of 3<sup>rd</sup> party Internal Control for ensuring that inventory is properly counted and adequately safeguarded.

## (B) Audit Procedures w.r.t. Litigation and claims: - Completeness

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

- (1) Inquiry of Mngt. and Others within the Entity, including in-house legal counsel.  
(2) Review Legal Expenses account.  
(3) Review the minutes of meetings of TCSG and correspondance between Entity and External legal counsel.

(IRR)

(ii) If auditor assesses higher RoMM regarding litigation and claims, he shall seek direct communication with Entity's External legal counsel, through a letter of inquiry.

\* Such communication requires management permission and Meeting, if any held with a representative of management in attendance.

(iii) If Entity External legal counsel is prohibited to communicate, Auditor shall perform alternate audit procedure.

(iv) If Management refuses to permit auditor to communicate; or External legal counsel refuses to respond; or Auditor unable to collect SAAE from alternate audit procedures, modify the opinion (Qualified/disclaimer) in accordance with SA 705.

### Note: Use of Specific Letter of Inquiry:

If auditor considers that it is unlikely that external legal counsel respond appropriately to a letter of general inquiry, auditor may seek direct communication through a specific letter of inquiry, which shall include: (a) List of litigation and claims;

(b) Management assessment on outcome of each litigation and claim.

and Estimate of financial Implications.

- (c) Request that External legal Counsel confirm the reasonableness of Mngt. Assessment and provide the Auditor with further information, if list is considered to be incomplete or incorrect.

### Circumstances requiring <sup>\*</sup>meeting with External Legal Counsel:

- (a) Auditor determines that matter is a significant risk.
  - (b) Matter involved is complex.
  - (c) There is disagreement between mngt. and Entity External legal counsel.
- \* Meetings require Management permission and are held with a mngt. representative in attendance.

### (C) Audit procedures w.r.t. Segment Information - Presentation and Disclosure:

Auditor is required to Obtain SAAE regarding presentation and disclosure of segment information in accordance with applicable FRF (AS-17/Sch-III)

by: (i) Obtaining an understanding of methods used by mngt. in determining segment information;

(ii) Evaluate whether such methods are likely to result in disclosure as per applicable FRF.

(iii) Test the application of such methods.

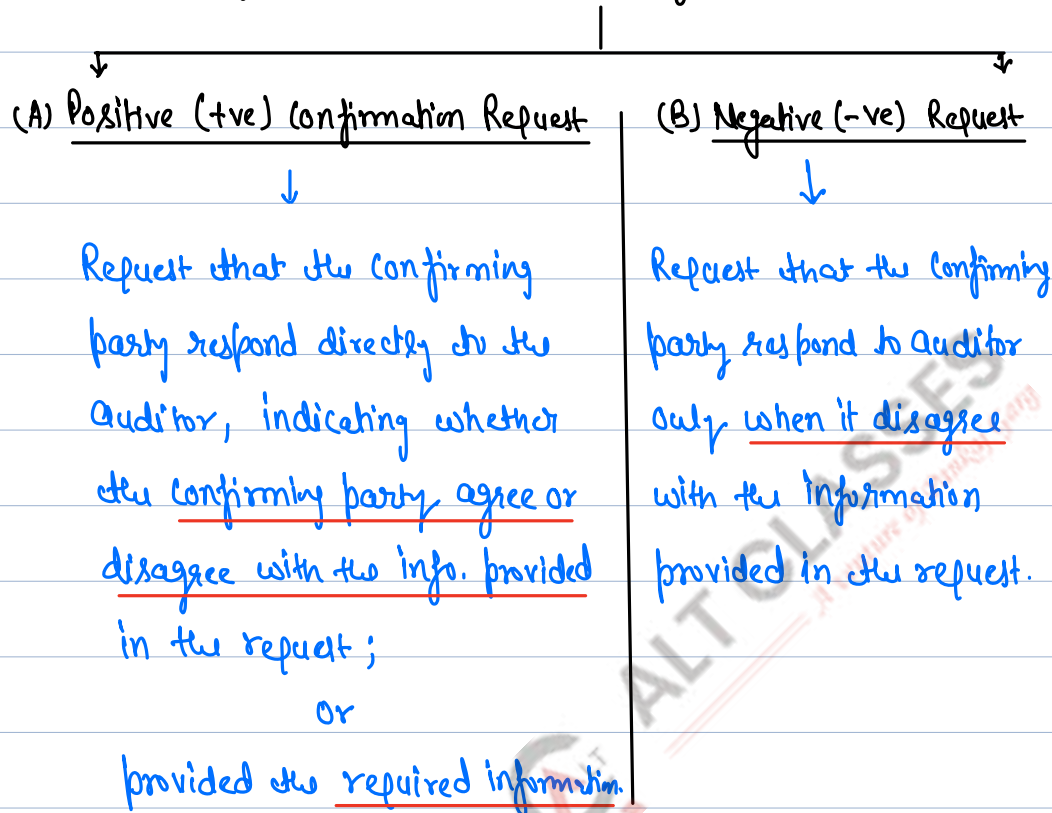
(iv) Performing analytical procedures or other procedures as appropriate.

Examples of matters that are relevant when obtaining an understanding of the methods used by Mngt: (Learning and noting - How)

### (3) External Confirmations (SA 505):

#### (A) Meaning and Types of Confirmation Request:

- Audit Evidence obtained as a direct written response from a third party in paper form or electronic form.
- Confirmations are of two types:



#### (B) Areas where External Confirmations may be used:

- Inventories held by third parties.
- Property title deeds held by lawyers or financiers for safe custody or as security.
- Investments held for safe keeping by third parties.
- Amount due to lenders.
- Trade Receivables and Payables - O/S Balances
- Long outstanding share application money.

Trade Receivable - 50,00,000  
(150 items)

Info. to be confirmed - O/S Bal as on 31.03.

From whom  
150 ——— 20 parties — (Confirming Parties)

Request Letter - designing  
+ve request { with Info.  
without Info. }

-ve request.

(a) Mr. X - Letter - O/S Bal - 31.03.2024  
₹ 6,50,000  
Agree/disagree → PLS. Confirm.  
(+ve)

Mr. X - Letter - O/S Bal - 31.03.2024  
PLS. confirm the Balance -  
(+ve)

(b) Mr. X - Letter - O/S Bal - 31/03/2024  
₹ 60,400 ✓  
If disagree - PLS. respond.  
(-ve)

↓ Result

- (a) No-Response → Addl. Audit Procedure.  
(b) Exception → Investigate for inconsistency.  
(c) Confirmation → SAAE ✓  
(If no doubt on reliability)

### (C) Effects of +ve and -ve Request:

- Response to a +ve request is expected to provide reliable audit evidence. But there is a risk that confirming party may reply without verifying correctness of information; such risk may be reduced by using blank confirmation request.
- Use of "Blank confirmation request" may result in lower response rate.
- Negative requests provide a less persuasive audit evidence as compared to +ve requests. Hence limited use of -ve request is recommended. -ve requests should be used only when the following conditions are satisfied:
  - (a) Lower ROMM;
  - (b) Population comprises of large no. of transactions of homogenous nature of small amount.
  - (c) Expected exception rate is low.
  - (d) Auditor is not aware of the circumstances that 3rd party may disregard the request.

Exception: A response that indicates a difference between

Info. requested and

Info. provided by confirming party.

### (D) External Confirmation Procedure:

When using EC requests, auditor shall maintain control over EC requests, including:

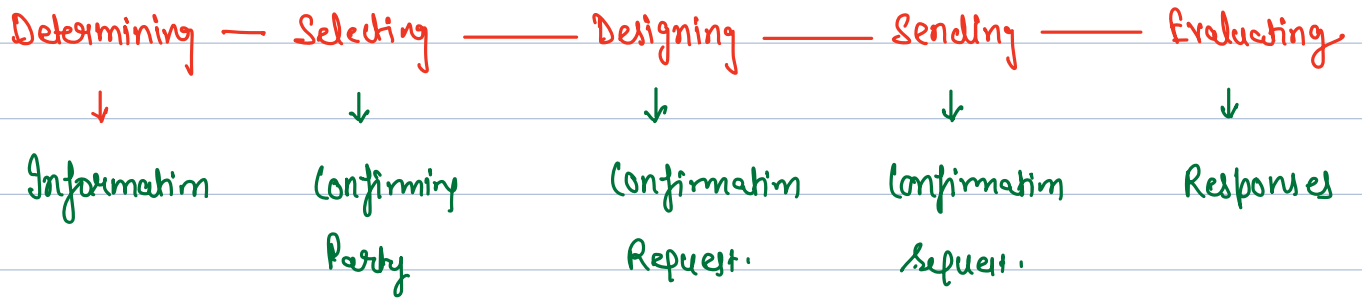
- Determining the information to be confirmed.
- Selecting the appropriate party from whom information is to be confirmed.  
(Confirming party - Knowledgeable, Ability, Willingness; objectivity)
- Designing the confirmation request including determining that request are properly addressed. (-ve request; +ve  $\left\{ \begin{array}{l} \text{with info} \\ \text{without info} \end{array} \right.$ )



(iv) Sending the Confirmation Request, including follow-up.

(v) Evaluate the responses

- Third Party Agree (No doubt - SAAE)
- " " disagree (Exception)
- Non-response (no reply recd.)
- Response deemed unreliable



V.V. Imp.

(E) Factors to be considered while designing EC Requests:

V.V. Imp.

(F) Management Refusal to allow auditor to send Confirmation request:

(Learning and Noting - H.W.)



## Chapter - 4 " Audit Evidence "

- ① SA 500 - Audit Evidence
- ② SA 501 - Audit Evidence - Specific Consideration for Selected Items
- ③ SA 505 - External Confirmations
- ④ SA 510 - Initial Audit Engagement - Opening Balances

Example - applicability:

|                    | <u>FY 22-23</u>                                                                      | <u>FY 23-24</u>            | <u>SA 510 - Applicable / N.A.</u> |
|--------------------|--------------------------------------------------------------------------------------|----------------------------|-----------------------------------|
| A Ltd.             | Auditor - Mr. X                                                                      | Auditor - Mr. X            | No                                |
| B Ltd.             | <span style="border: 1px solid black; padding: 2px;">Auditor - Mr. X</span>          | Auditor - Mr. A            | <u>YES</u>                        |
| C Ltd. (New Co.)   | XXX                                                                                  | Auditor - Mr. M            | No                                |
| (Inc. on 01.05.23) |                                                                                      |                            |                                   |
| XY and Sons        | <span style="border: 1px solid black; padding: 2px;">Audit not</span>                | <u>Audit required</u>      | <u>YES.</u>                       |
| (Partnership firm) | <span style="border: 1px solid black; padding: 2px;">required as</span>              | <u>T/b &gt; Threshold</u>  |                                   |
|                    | <span style="border: 1px solid black; padding: 2px;">T/b &lt; threshold limit</span> | <u>Mr. R.M. - Auditor.</u> |                                   |

### ① Meaning of Initial Audit Engagement and Opening Balances:

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

- (i) Unaudited;
- (ii) audited by predecessor auditor.

(b) Opening Balances: - Account Balances that exist at beginning of the period.

- These are based upon the closing balances of prior period and reflect the effect of transactions and events of prior period and accounting policies applied in the prior period.
- They also include the matters requiring disclosures that exist at beginning of the period e.g. contingencies.

② Objectives of the auditor: Auditor objective in relation to examination of opening balances of initial audit engagement is to Obtain SAAE as to:

- (a) whether op. balances do not contain any material misstatements; and
- (b) whether accounting policies reflected in opening balances have been consistently applied; and changes, if any, are appropriately accounted for; and disclosed in the f.s. in accordance with applicable FRP.

v. imp:

③ Audit Procedures w.r.t. Opening Balances:

(i) Obtain SAAE as to opening balances to ensure that they do not contain any material misstatement that may affect the current period f.s. For this purpose:

~~(a)~~ Ensure that closing balances of prior period have been correctly brought forward; Adjustment, if any, are disclosed as prior period item in the current year sth. of P&L.

~~(b)~~ Determine that op. bal. reflect application of appropriate Accounting Policies.

~~(c)~~ Perform any of the following:

(a) Perusing the copies of latest audited f.s., along with audit report; or

(b) Evaluate whether audit procedures performed in current period provides relevant evidence w.r.t. op. balances; or

(c) Perform specific audit procedures to obtain evidence regarding op. balances.

(ii) If auditor obtain audit evidence as to misstatements in op. balances that could affect current period f.s.; perform additional procedures

as appropriate to determine the effect on current period f.s.

- (iii) If auditor concludes that such misstatements exist in current period f.s., auditor shall communicate the misstatements with appropriate level of Mngt. and Twn.

#### ④ Reporting w.r.t. Opening Balances:

- (a) If auditor unable to obtain SAE regarding the opening balances, he shall express a Qualified Opinion or disclaimer of opinion, as appropriate.

(Matter - Material but not pervasive)

(Matter - Material as well as Pervasive)

- (b) If auditor concludes that opening balances contain a misstatement that could affect the current period f.s. and effect of such misstatement is not properly accounted for or not adequately disclosed, auditor shall express a qualified opinion or adverse opinion, as appropriate.

(Misstatement - Material but not Pervasive)

(Misstatement - Material + Pervasive)

#### ⑤ Misc. Toplu:

- (i) Matters on which nature and extent of procedures depends  
(Aging Policies; Nature of f.d.tms, RoMM; Sig. of Op. Bal.; Audited)

- (ii) Prior period f.s. audited by predecessor auditor:

- (iii) Specific audit procedures for CA/CL:

- (iv) Specific audit procedures for Non CA/Non CL:

- (v) Consistency of Aging Policies:

Heading from  
- book -

## (5) SA-520 "Analytical Procedures"

### (i) Meaning and Nature of Analytical Procedures

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

"Evaluation of financial information through analysis of plausible relationships among financial and non-financial data; and also includes → necessary investigation of identified fluctuations or relationships that differ from relevant information."

Example: Hotel - Room Rental Income → Analytical Procedures (Predictive Model)

$$\begin{aligned} & \downarrow \\ & = \left( \frac{\text{Avg. Room rent}}{\text{Per day}} \right) \times \left( \frac{\text{No. of Rooms}}{\text{in a category}} \right) \times \left( \frac{\text{Occupancy}}{\text{Ratio}} \right) \times 365 \text{ days} \\ & = ₹ 10,000 \times 120 \times 80\% \times 365 \\ & = ₹ 35.04 \text{ Crore.} \end{aligned}$$

Actual Room rent recorded in statn. of Per = ₹ 40.05 Crore

Difference

= ₹ 5.01 Crore [14.29% of Prediction]

Tolerable Range of Misstatement =  $\pm 4\%$

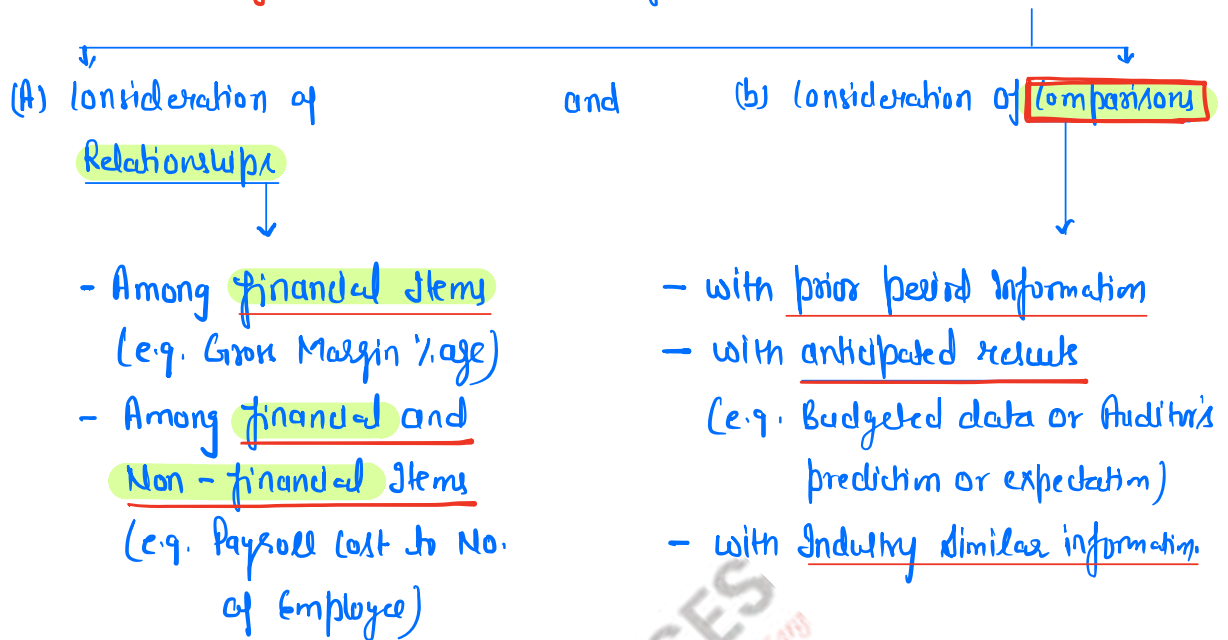
Auditor need to investigate the fluctuation.

↓  
(a) Inquiry of Mngt.

↓  
(b) Other Audit Procedure

(If Mngt. unable to provide explanation or Explanation provided are inadequate)

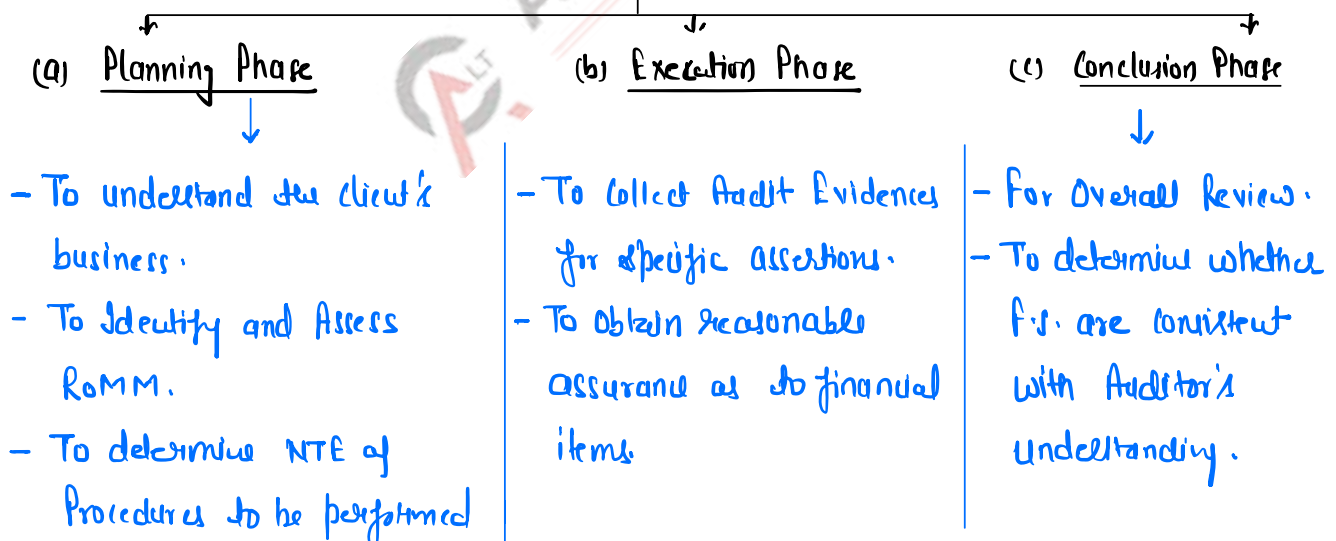
Nature of Analytical Procedures: Analytical Procedures comprises of:



(ii) Need and Purpose of A.P. : (H.W. — Learning + Noting)

(iii) Application of Analytical Procedures:

Analytical procedures may be applied during different phases of Audit:



[Note: Use of AP during Initial Phase of audit is dealt by SA 300 and SA 315.]

Note: SA-520 provides the requirement related to use of AP as SAP- Sub. Analytical Procedure

## Chapter - 4 " Audit Evidence

Topics Covered: (1) SA-500 " Audit Evidence "

(2) SA-501 " Audit Evidence - Specific Consideration for Selected Items "

(3) SA-505 " External Confirmations "

(4) SA-510 " Initial Audit Engagements - Opening Balance "

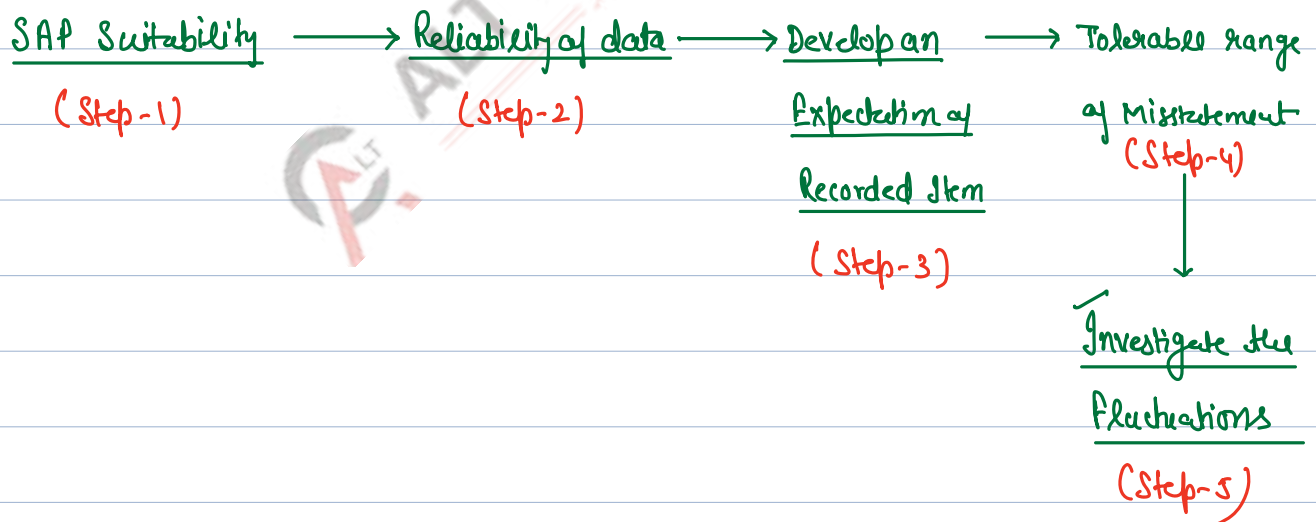
(5) SA-520 " Analytical Procedures ":

(i) Meaning and Nature:

(ii) Need and Purpose:

(iii) Application of AP:

(iv) Steps while performing Substantive Analytical Procedures:



Step-1: To determine suitability of Substantive AP (SAP):

- Auditor is required to determine nature of audit procedures to be performed over the accounting data, to reduce the audit risk to an acceptable low level. (Tod / SAP / Combination of Tod and SAP).
- While determining use of analytical procedures, as SAP, auditor should consider certain factors like:

(a) Availability of relevant and reliable data.

(b) Degree of disaggregation (classification) of available data.

(c) Type of accounting information - SAPs are more useful for certain type of accounts than for others. e.g. for B/s items, subject to management judgements, SAPs may not be effective.

(d) Source of information

(e) Predictability of information: SAPs are more suitable to large volume of transactions that tend to be predictable over time.

(f) Nature of Assertion: SAPs are more effective more some assertions (like Completeness, valuation etc.) than for others (like Existence, Rights and obligations).

(g) Nature of RoMM.

Note: Different SAPs will provide different levels of assurance.

### Step-2: Evaluate Reliability of data:

- Auditor should evaluate the reliability of data over which SAPs 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.

SC-NRI

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

While developing the expectation and evaluating the expectation, auditor should consider the following:



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

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

Tolerable range depends on professional judgement of auditor and based on desired levels of assurance.

Step-5: Investigating the difference beyond tolerable range:

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

- (a) Inquiring the management and obtaining evidences relevant to management response; or
- (b) Performing other audit procedures as seems appropriate in the circumstances.

Note: Need to perform other audit procedures arises when:

(a) Mngt. is unable to provide explanation;

or

(b) Explanation provided by Mngt. is inadequate.

Example: AP  $\rightarrow$  for Payroll Salary - No. of Employees  $\times$  Avg. Sal. p.M.  $\times$  12 Months.

$$= 750 \times 25650 \times 12 \text{ M}$$

$$= 23,08,50,000$$

$$\text{Recorded Amount} = ₹ 30,10,70,650 - 6,50,00,000 = 23,60,70,650$$

$$\text{Difference} = ₹ 7,02,20,650$$

$$\text{Tolerable range} = \pm 5\%$$

Fluctuation

= 30.42%



Requires Investigation



Inquiry with Management — Response

↓ Pending Court Case.  
as to revision of  
Salary of last year.

(2017-2022)

↓ Decision — against —

[₹ 6.50 Crores — Prior Period]

Ask — Court judgement  
↓  
Certified copy.

Imp:-

(V) Techniques while Using SAP:

(a) Trend Analysis: Most Commonly Used technique.

Involves comparison of data of current period with data of one or more prior periods.

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

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

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

For Ex:- Sales discount and Commission against Volume of Sales (No. of Items Sold);

- Rental Income based on Occupancy of premises.
- Raw Material Consumption to production.

- Interest Expense against interest bearing obligations;
- %age of waste/scrap produced in a production process.

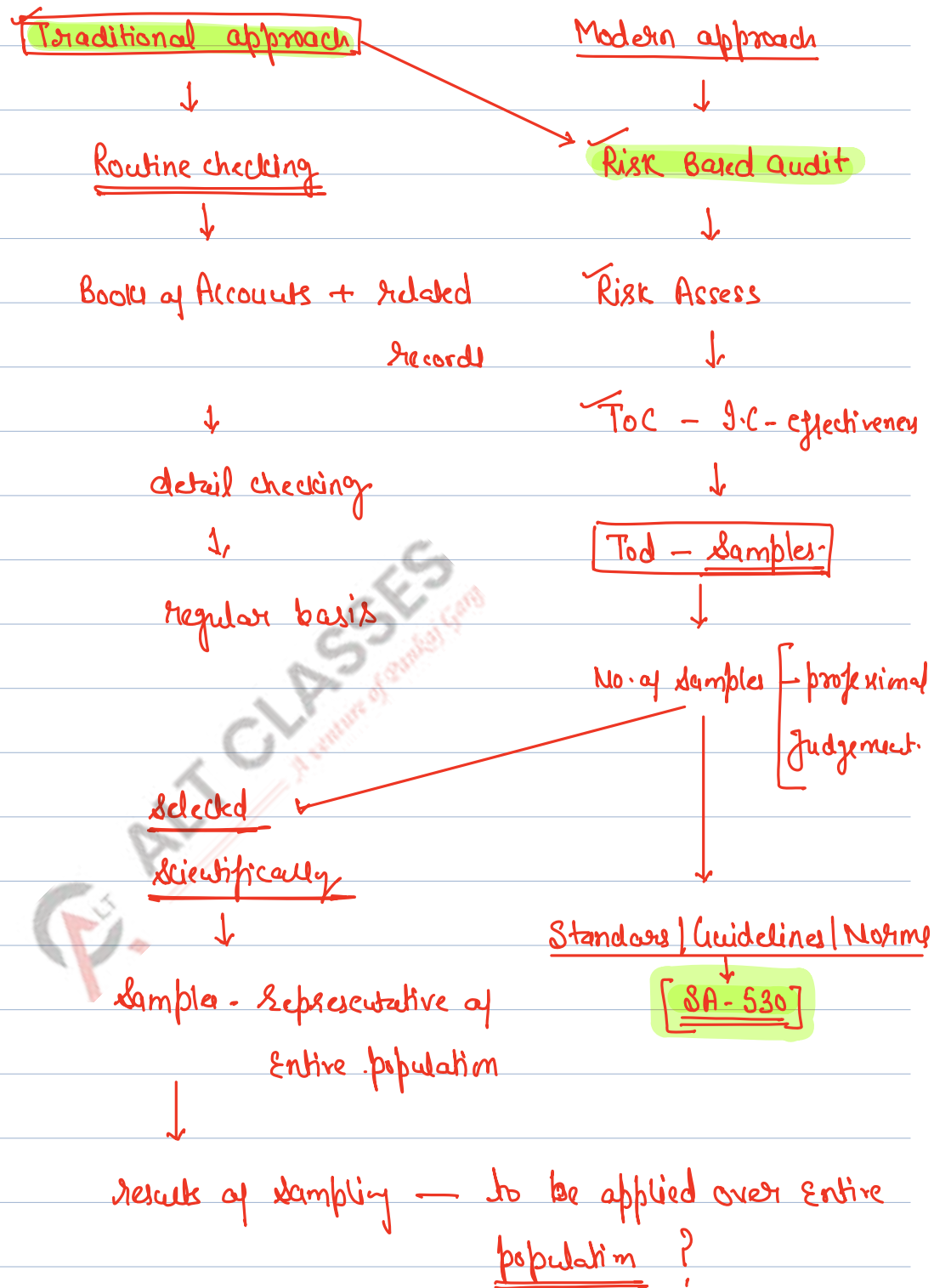
(d) Structural Modelling: A modelling tool that construct a statistical model from financial and/or non-financial data of prior periods so as to predict the current period Balances

|       | $I_1$ | $I_2$ | $I_3$    |
|-------|-------|-------|----------|
| 19-20 | X     | Y     | $Z_1$    |
| 20-21 | $X_1$ | Y     | $Z_2$    |
| 21-22 | $X_2$ | Y     | $Z_4$    |
| 22-23 | $X_3$ | Y     | $Z_8$    |
| 23-24 | $X_4$ | Y     | $Z_{16}$ |

(6) Audit Sampling (SA-530): - Recorded class of last batch.  $\leftarrow$

# Chapter - 7 "Audit Sampling"

## Overview:



- SA-530 → Types of Sampling ; Sampling Techniques ; Methods.
- Sampling Risk
  - Sample design, size, selection etc.

## (1) Introduction to Sampling:

- (i) Limitations of traditional approach
- (ii) Adoption of Standards <sup>while</sup> using sampling

- to be covered from book-

## (2) Meaning and types of sampling:

- SA-530 "Audit Sampling" deals with the auditor's responsibilities while applying test checking in an audit of financial statements.
- SA 530 defines the term "Sampling" as - "Application <sup>①</sup> of audit procedures to less than 100% of items within a population <sup>②</sup>, in a manner that all sampling units <sup>②</sup> has equal chances of selection so as to provide the auditor a reasonable basis to draw a conclusion on the entire population".

① Population: Entire set of data from which samples are selected.

② Sampling Unit: Individual transactions forming a population.

Samples: Sampling units selected for audit purposes.

Example: Sales of ABC Ltd. consists of 1000 transactions amounting for ₹ 100 Crores.

Population: 1000 transactions. (100 Crores)

Sampling Unit: Each transaction.

Samples: 1000 transactions:

|                         |      |     |       |
|-------------------------|------|-----|-------|
| upto 1 lakh (10%)       | 800  | 80  | 10%   |
| 1 lakh - 10 lakh (10%)  | 105  | 25  | 2.5%  |
| 10 lakh - 1 crore (40%) | 70   | 50  | 28.6% |
| > 1 crore (40%)         | 25   | 25  | 40%   |
|                         | 1000 | 180 | 71.6% |

18%  
Approx

# Chapter - 7 "Audit Sampling"

(Lecture No. 2)

(1) Introduction to sampling

(2) Meaning and types of sampling:

Sampling is primarily classified as —

- (A) Statistical sampling
- (B) Non-Statistical sampling  
(Judgement sampling)

✓ Statistical Sampling: Sampling approach, which has the following features:

- (a) Random selection
- (b) Use of Probability theory
- (c) Ensures equal chances of selection of sampling units
- (d) Helps in determination of sampling risk.

Example: Systematic Sampling; Random Sampling.

Characteristic: (a) More Scientific

(b) Widely accepted and applied

(c) No Personal biasness.

Advantage:

(i) More objective and defensible selection.

(ii) Provide means of deriving a calculated risk for a particular sample size — 10% / 20% / 30% / 40%.

(iii) Provide means for determination of a sample size for a specific risk — 5% — — — — — →

(iv) Better presentation of Entire population, particularly in case of heterogeneous population (through use of stratification)

(v) Ensures consistency in sample size irrespective of sampling units in population.

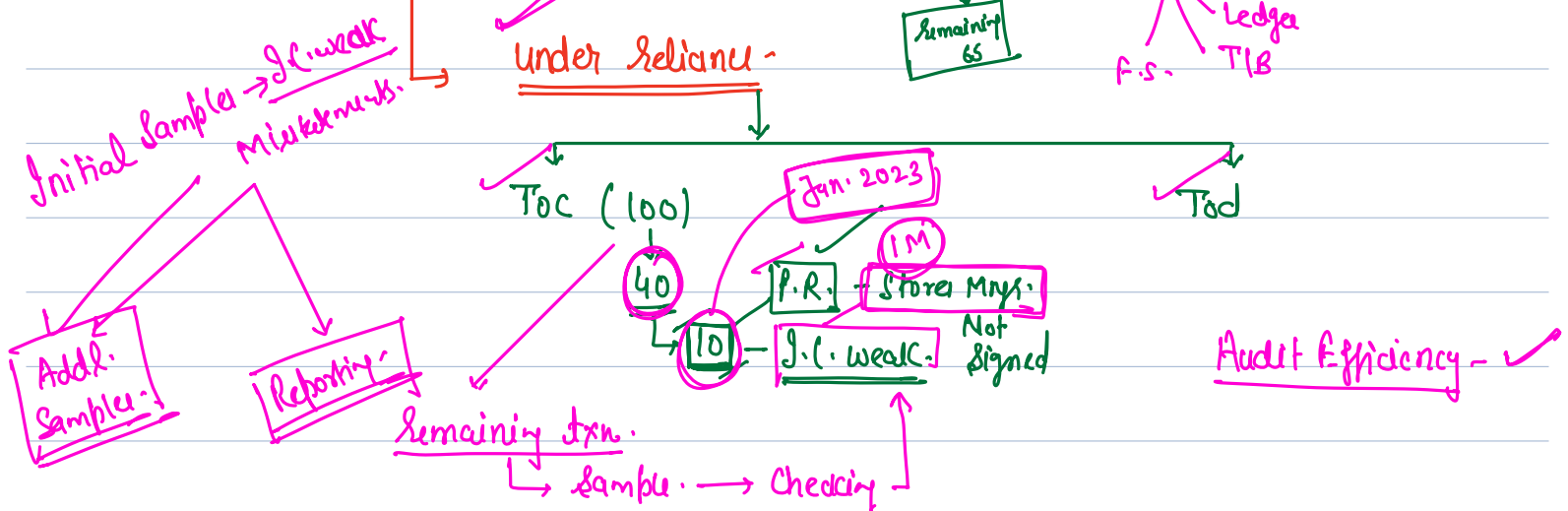
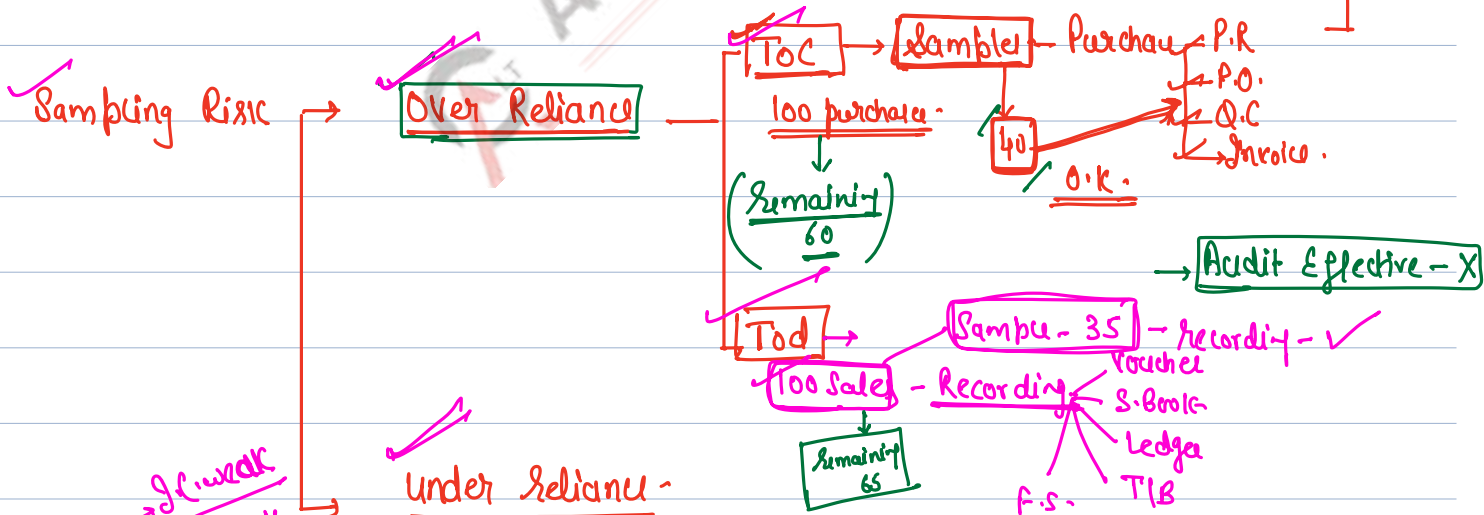
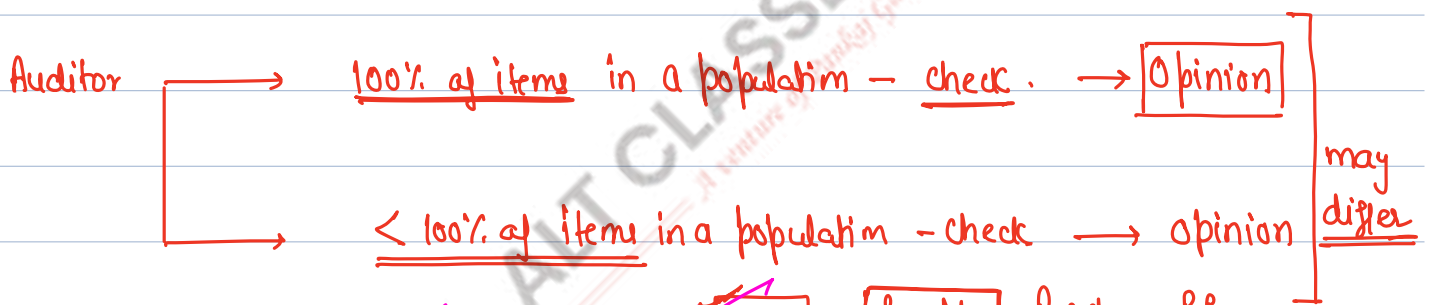
Sample size = 100 items

Population: 1000  $\frac{1000}{100}$  : Every 10th

→ : 1200  $\frac{1200}{100}$  : Every 12th

Example: Haphazard Selection.

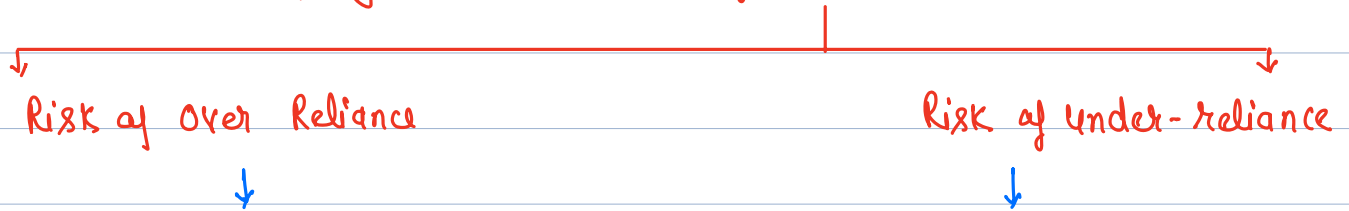
### ③ Sampling Risk and Non-sampling Risk:





Sampling Risk: Risk that the Auditor's conclusion based on examination of samples may be different from the conclusion, if the entire population was subjected to same audit procedures.

Sampling risk can be classified as:



(a) w.r.t. TOC → Auditor may consider that Internal Controls are more effective when actually they are not.

Auditor may consider that I.C. are less effective when actually they are more effective.

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

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

↓ Impact

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

↓ Impact

It affects 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.

Main causes of non-sampling risk:

- (i) Human Mistake
- (ii) Misinterpretation of sampling results.
- (iii) Inappropriate procedures used.
- (iv) Relying on erroneous confirmations, doubtful written representations.

#### (4) Sample design, size and selection:

- ✓ (A) Sample design: 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:
- (a) Purpose of audit procedures; and
  - (b) Characteristics of the population from where samples are to be drawn. [Appropriateness; Completeness]

Reliable and accurate

- For designing purposes, auditor may use the concept of

(A) Stratification ; and (b) Value weighted selection

Stratification: - Concept of stratification generally applies in case of heterogeneous population.

- Stratification involves conversion of heterogeneous population into homogeneous groups, known as 'Strata'.
- Samples are selected from each 'Strata' and hence represent the entire population.

For Example: In case of a large entity, having sales value ranging from low amount to high amounts, sales may be classified as:

- (a) Sales upto ₹ 1 lakh
- (b) Sales ranging above 1 lakh but upto ₹ 10 lakh
- (c) " " above ₹ 10 lakh but upto ₹ 1 cr.
- (d) " " above ₹ 1 cr.

From each group samples are selected based on assessed risk.

Stratification helps in determination of samples in a manner that represent entire population.

Value weighted selection: In case of value weighted selection approach, population is being designed in a manner that more consideration is given to high value transactions; and less consideration is given to low value transactions.

- Individual transactions of highest value are considered by the auditor while designing the population.

Benefit: More efforts are directed to the larger value items. and hence can result in smaller sample size.

For Ex: In XYZ Ltd, purchases ranges from ₹ 10000 to ₹ 5 Cr.

Total Purchases = ₹ 90 Crore.

Auditor consider all purchases above ₹ 50 lakh. Total of such transaction amounts to ₹ 80 Crore.

Note: This approach may be used in conjunction with Systematic method of selection and is most efficient when selecting items using Random selection.

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

while determining the sample size, auditor need to consider the following:

(i) Size of the Organisation (Bigger is the size, larger no of items to be selected)

(ii) State of Internal Control. (In case of weak I.C., sample size for substantive tests to be increased).

(iii) Adequacy and reliability of books and records. (In case of adequate and reliable records, sample size may be lower)

(iv) Tolerable error Range.

(In case of High tolerable rate of deviation, sample size for Toc can be lower)

(In case of High tolerable misstatement, sample size for Tod can be lower)

(v) Degree of desired confidence or assurance.

In case of higher desired assurance, sample size to be increased. And vice versa.

Factors affecting Sample Size in case of Toc and Tod: - from book -

|                |                                                                                       | Sample size- |
|----------------|---------------------------------------------------------------------------------------|--------------|
| Toc - Increase | Extent to which auditor's risk assessment takes into account <u>relevant controls</u> | Increase     |
|                | Expected <u>rate of deviation</u>                                                     | "            |
|                | <u>Tolerable</u> " " "                                                                | Decrease     |
|                | Desired <u>level of Assurance</u>                                                     | Increase     |

|                                                  |                                                    |          |
|--------------------------------------------------|----------------------------------------------------|----------|
| Tod - Increase                                   | Auditor Assessment of <u>Material Misstatement</u> | Increase |
|                                                  | Desired <u>level of Assurance</u>                  | "        |
|                                                  | <u>Tolerable</u> <u>Range of Misstatement</u>      | decrease |
|                                                  | Expected <u>number of misstatements</u>            | Increase |
| Use of stratification                            |                                                    | decrease |
| Applying more procedures to evaluate a assertion |                                                    | decrease |

(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 of sample selection: ✓ (i) Random number selection

✓ (1) Random number selection

✓ (ii) Systematic Selection

(iii) Monetary Unit Selection

#### (iv) Block Selection

iii) Haphazard selection.

to be learned  
from book

Example : Population comprises of 100 transactions of credit purchases

Sample size : 25 Items

①  $\frac{\text{Population}}{\text{Sample Size}} = \frac{100}{25} = \text{Every 4th transaction}$   
(Sampling Interval) Systematic

Voucher / drawaction : 4 | 8 | 12 | 16 | 20 | 24 | 28 | 32 | 36 | 40 | - - - - -

3 | 7 | 11 | 15 | 19 | 23

2 | 6 | 10 | 14 | 18 | 22 | 26 | 30 | 34

1 | 5 | 9 | 13 | 17

② Random No. Table: 25 out of 100

$[10, 11, 12, 18, 19, 51, 61, 71, 74, 75, 76, 77, 91, 92, 98, \dots]$

✓ 3, 4, 5, 6, 11, 12, 13, 19, 21, 23, 41, 42, 46, 51

③ 100 Journalism - data analytical tool - Arrange Monetary wiu.

High Value Strawman - (First 25) - (Value Weighted Selection)

④ Judgement Based → Highly Risky | R.P. | Complex | Haphazard Selection  
No systematic basis / no scientific base

⑤ Auditor — 25 drawings · Sequence · gap · Uniform x

5 Block — 5 drawings each

$$\frac{100}{5} = 20 \text{ (Block size)}$$

01-20

21-40

41-60

61-80

81-100

06, 07, 08, 09, 10,

23, 24, 25, 26, 27

54, 55, 56, 57, 58

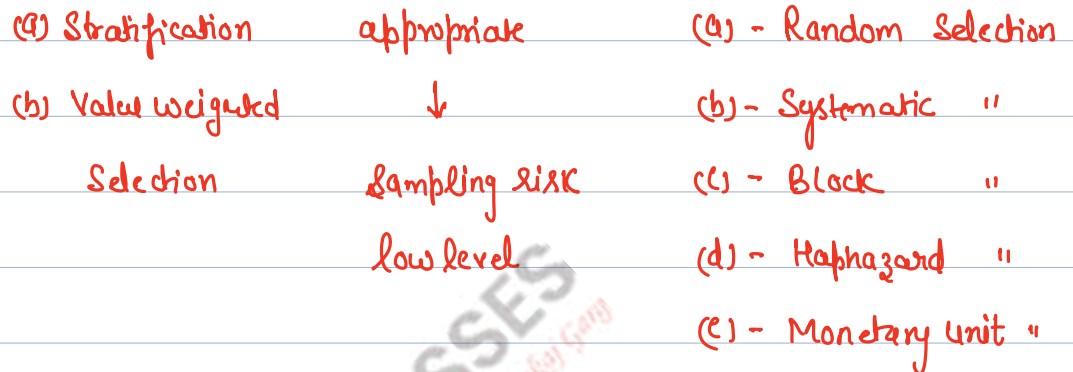
61, 62, 63, 64, 65

92, 93, 94, 95, 96

# Chapter - 7 "Audit Sampling"

(Part - III)

- Topics Covered:
- (i) Introduction to Sampling
  - (ii) Meaning and types of sampling
  - (iii) Sampling Risk and Non Sampling Risk
  - ✓ (iv) Sample Design, Size and Selection



Example: Population - Sales = > 1000 transactions (Heterogenous Nature)

2022-23

Amount: Approx 100 Crores

Trade Receivables as at 31.03.2023 : 50 parties (Amount: 35 Cr.)

Year End Balances Confirm

Procedures: External Confirmation

✓ (i) Sample design = 50 Parties

Stratification:

✓ Related parties

5

Export Sale

10

5

Govt. Sale

5

5

Whole Sale

30

10

✓ (ii) Sample size = 25

✓ (iii) Sample selection

5 - R<sub>1</sub>

Systematic Sampling - Every 2<sup>nd</sup>

5

Random Selection

S<sub>1</sub>  
S<sub>2</sub>  
Y  
Z  
A  
B  
C  
D  
E  
F  
G



✓ (iv) Designed audit procedure.

E.C.  
SA 505

✓ Mngt. Refuse

(R<sub>1</sub>)



Alternate audit

Procedure - (R<sub>1</sub>)

✓ Mngt. Refuse (X)

(X)

23 + 2 (Replacement sample)

- Original sample : 25 — Audit Procedures (E.C.) - 23
- Replacement sample : 2 — Alternate Audit procedure - 2
- — Audit procedures (E.C.)



Audit Evidences - collected



Audit conclusion → sample → Population

(v) Performing audit procedures and Evaluating result of audit sampling:

- Auditor should perform designed audit procedures over the selected items (original samples).
- However, if designed audit procedure cannot be performed over the selected items, auditor shall consider the following:  
(original samples)

(a) Perform Alternate audit procedure over the original samples on which the designed audit procedures cannot be performed.

(b) Select replacement samples and perform designed audit procedures over them

↓  
If auditor is not able to collect audit evidences by performing alternate audit procedures over the original samples, auditor shall treat it as:

(a) deviation w.r.t. Internal Control; (in case of TOC)

(b) Misstatement w.r.t. accounting data. (in case of TOD)

↓  
- Auditor shall investigate the nature and causes of deviations and misstatements identified and evaluate their possible effect on audit opinion.

↓  
- Auditor shall project misstatements found in the sample 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 anomalous misstatement, if uncorrected, still need to be considered, in addition to the projection of non-anomalous misstatements.

### Evaluating Result of audit sampling:

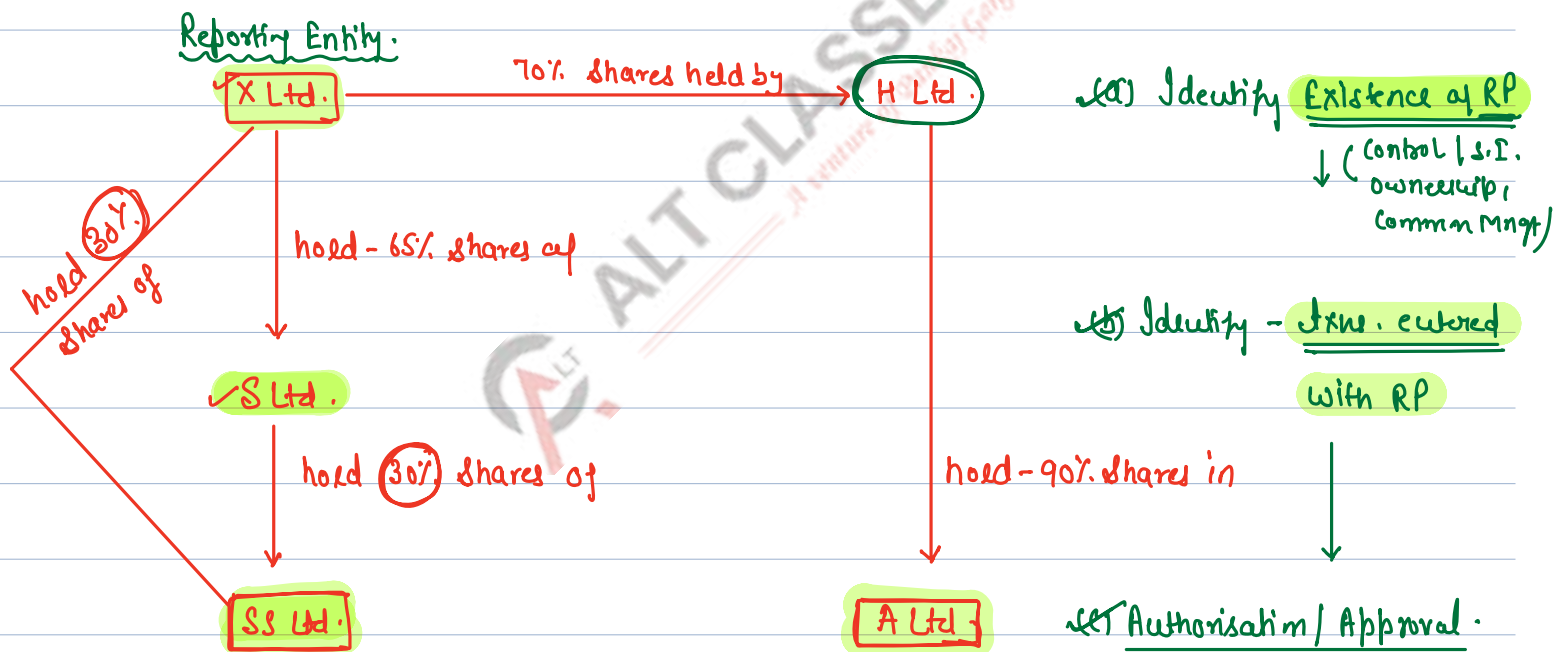
- Auditor shall evaluate the results of the sample and determine whether the use of audit sampling has provided a reasonable basis for conclusion for the entire population that has been tested.

- 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 (in case of Toc) and misstatements (in case of Tod), auditor is also required to consider the qualitative aspects of misstatements identified by him. (For Ex: Type of transaction; timing of occurrence of transaction; processing of transaction by a person).

## Chapter - 4 "Audit Evidence"

- Topics Covered:
- (1) SA - 500 "Audit Evidence"
  - (2) SA - 501 "Audit Evidence - Specific Consideration for Selected Items"
  - (3) SA - 505 "External Confirmations"
  - (4) SA - 510 "Initial Audit Engagements - Opening Balance"
  - (5) SA - 520 "Analytical Procedures"
  - (6) SA - 530 "Audit Sampling"

### (7) SA - 550 "Related Parties":



### Auditor's duties:

- (a) - Inquire - Undisclosed / unidentified RP (Nature, Relations)
  - (b) - Inquire - Trans. entered into with RP / unidentified Trans. (Nature)
  - (c) - RP Trans. - Authorised by App. Authority
  - (d) - APP. Acting and disclosure → applicable FRF.
  - (e) Make appropriate disclosures (AS-18 / Sch.-III)
- RAP → Responses (ToC + Substantive)

(i) Meaning of Related Party:

Only Reading

✓ (ii) Nature of RP Relationships and Transactions: (Learning + Noting)

✓ (iii) Understanding the Entity RP Relationships and Transactions: (L + Noting)

Inquiry - Identity, Nature of Relationship, Transactions Type purpose; Controls G/A/D - FRF  
Autho → RP & N.  
Autho → O/S Normal

(iv) Consideration specific to smaller entities: Reading

✓ (v) ~~Inquiry~~ Records/ Documents to be inspected to verify existence of RP Relationships and Transactions: - Learning + Noting -

(vi) Auditor's response in case of Transactions entered into by Entity as normal course of business:

(a) Inspect the underlying contract to evaluate whether:

- (i) Business rationale of the transaction suggest any fraudulent financial reporting or misappropriation of assets;
- (ii) Terms of transactions are consistent with Management Explanation; and
- (iii) Transaction have been appropriately accounted for and disclosed in accordance with applicable FRF.

(b) Obtain audit evidence that transactions have been appropriately authorised and approved.

## (8) Using the work of Internal Auditors (SA 610):

### (i) Meaning of Internal Audit Function:

A function of an Entity that performs assurance and consulting activities designed to



evaluate and improve effectiveness of

- Entity's Governance
- Risk Management; and
- Internal Control Processes.

100 - 199 - X

200 - 299 - 200, 210, 220

- 230, 240, 250, 260, 265, 299

300 - 499 - 300, 315, 320, 330

- 402, 450

500 - 599 - 500, 501, 505, 510, 520, 530, 550

- 540, 560, 570, 580

600 - 699 - **610**

- 600, 620

Imp:

### (ii) Objectives and Scope of Internal Audit Function: includes the activities relating to

(GRI)

Governance



To assess the Governance Process in accomplishment of objectives on -

- (a) Ethics and values
- (b) Performance Management
- (c) Accountability
- (d) Communicating Risk

Risk Management



- Identifying and evaluating significant exposures to risk
- Improvement of Risk Mngt. and Internal Control
- Detection of Fraud

Internal Control



- Evaluation of Internal Control Processes
- Examination of financial and operating information
- Review of Operating Activities
- Review of Compliance with laws and Regulations

### (iii) Requirements of SA 610:

(A) Using the work of Internal Auditor

(B) Using direct Assistance of Internal auditor.

## (A) Using the work of Internal Auditor:

(a) Evaluate whether, in which area and to what extent, work of Internal Auditor can be used:

For this purpose, External auditor shall evaluate the following:

- (i) Objectivity of the Internal Auditor;
- (ii) Level of Competence of Internal auditor; and
- (iii) Application of Systematic and Disciplined Approach, using Quality Control.

Note: External auditor shall not use the work of Internal Audit function, if he determines that:

- (a) Organisational status of Internal Audit function do not adequately support the Objectivity of Internal audit function.
- (b) Internal Auditor is not sufficiently competent.
- (c) Approach used by Internal Auditor is not systematic and disciplined.

(b) Evaluate nature and scope of work of Internal Auditors - so as to determine:

- Nature and Extent of work to be used; and
- Degree of reliance that can be placed.

Areas where statutory auditor can use the work of Internal auditor:

- (i) Testing the operating effectiveness of controls;
- (ii) Substantive Procedures involving limited judgements;
- (iii) Observation of Inventory Count



(iv) Tracing transactions through info. system

(v) Testing of compliance with regulatory requirements

Circumstances in which external auditor shall plan to use less work of Internal Auditor:



## Chapter - 4 " Audit Evidence "

- Topics Covered:
- (1) SA - 500 " Audit Evidence "
  - (2) SA - 501 " Audit Evidence - Specific Consideration for Selected Items "
  - (3) SA - 505 " External Confirmations "
  - (4) SA - 510 " Initial Audit Engagements - Opening Balance "
  - (5) SA - 520 " Analytical Procedures "
  - (6) SA - 530 " Audit Sampling "
  - (7) SA - 550 " Related Parties "
  - (8) SA - 610 " Using the work of Internal Auditors "

- (i) Meaning of Internal Audit function
- (ii) Objectives and Scope of Internal Audit function
- (iii) Requirements of SA-610:

### (A) Using the work of Internal Auditors:

✓(a) Evaluate whether, in which area and to what extent, work of Internal auditor can be used.

✓(b) Evaluate nature and scope of work of Internal auditors.

✓(c) Using work of Internal auditors:

If External auditor plans to use the work of Internal auditor he shall:

(i) Discuss the planned use of work of Internal auditor;

(ii) read the reports of Internal auditors to obtain understanding of nature and extent of audit procedures performed and related findings.

- (iii) perform sufficient audit procedures on the work of Internal Auditors as a whole that he plans to use, to determine its adequacy for External auditor's purpose.

✓ Discussion and coordination with Internal auditor [N, T, E, Materiality, Sampling, Documentation, Review]

- Examples where coordination between external auditor and Internal auditor is considered effective: [Discussion; Informing of significant Matter by EA → IA  
IA → EA]

## (B) Using Direct Assistance of Internal Auditor:

Direct Assistance: Using Internal Auditors to perform audit procedures under the direction, supervision and review of External Auditor.

I. Direct assistance from Internal auditor can be taken, if:

- (a) Not prohibited by law and regulation;
- (b) No significant threat as to Objectivity of Internal auditor;
- (c) I.A. is sufficiently competent and capable.

II. Determine NTE of work on which direct assistance can be taken:

Direct assistance is not advisable on following matters:

- ✓ (a) Matters involving significant judgements in audit;
- ✓ (b) Matters on which External Auditor assesses higher ROMM;
- ✓ (c) Matters on which IA is already engaged under direction of Mngt.
- ✓ (d) Matters on which external auditor has to take decision under this SA regarding Internal audit function.

### III. Using Direct Assistance:

- Obtain written agreement from authorised representative of the Entity that (a) IA is allowed to follow EA Instructions.
    - (b) Entity will not intervene in the work of IA, performed for external auditor.
  - Obtain written agreement from I.A. as to the Confidentiality.
  - Exercise Quality Control measures as to direction, supervision and review of Internal Auditor.
-

## Chapter - 6 "Audit Documentation"

(1) Meaning: SA 230 "Audit Documentation" the term audit documentation is defined as to the record of:

- (a) Audit Procedures performed;
- (b) Audit Evidences obtained; and
- (c) Audit Conclusion Reached.

Ex: Audit Programme

Ex: EC / Records / Observations / WR

Ex: Audit Report

(2) 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.
- (c) Evidence that audit was planned and performed in accordance with the Standards on Auditing and applicable legal and regulatory requirements.

<sup>Imp:</sup>  
(3) Purposes of Audit documentation:

- (a) Assist (ET) to plan and perform an audit
- (b) Assist (EP) to direct and supervise the audit and discharge review responsibilities.
- (c) Enable (ET) to be accountable for its work.
- (d) Enables conduct of Q.C. reviews and inspections (EQCR)
- (e) Enables conduct of External inspections in accordance with legal, regulatory and other requirements. (for e.g. Peer Review; Quality Review; NFRA)
- (f) Retaining a records of matters of Continuing significance for future audits.

#### (4) Form, Content and Extent of Audit Documentation:

Auditor shall prepare audit documentation that is sufficient to enable an experienced auditor to understand the following:

- (a) NTE of audit procedures performed;
- (b) Results of audit procedures performed and audit evidences collected;
- ✓ (c) Significant matters arising during the audit and conclusions reached thereon; and
- (d) Significant Professional Judgements made in reaching the conclusions.

#### Examples of documentation of NTE of audit procedure:

- (a) Characteristics of Matters/Items tested;
- (b) Who performed audit work;
- (c) Date when such work was completed;
- (d) Who reviewed the audit work and date and extent of such review.

- Examples of Significant Matters:
- (a) Matters that give rise to significant risk. (like risk of fraud; RP transactions)
  - (b) Results of audit procedures indicating that
    - F.S. are materially misstated; or
    - a need arise to revise the assessment of RoMM.
  - (c) Significant difficulty in applying necessary audit procedures.
  - (d) Findings that require modifications in audit opinion or inclusion of Emphasis of Matter Para in audit report. (SA-705)  
(SA-706)

## Examples of Significant Professional Judgement - Documentation requirements:

- (a) Rationale for auditor conclusion when a requirement provides that auditor shall consider certain information and that information is significant in particular engagement.
- (b) Basis for auditor conclusion on reasonableness of area of subjective judgements (e.g. Accounting Estimates)
- (c) Basis for auditor's conclusion about authenticity of a document in case of any doubt (e.g. Doubt on reliability of Confirmation request).

V. Imp:-

## 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 ROMM.
- (iv) Significance of audit Evidences obtained
- (v) Nature and extent of Exceptions identified
- (vi) Need to document a conclusion
- (vii) Audit Methodology and Audit Tools/Techniques used.

- (5) Examples of audit documentation:
- Audit Programmes, Confirmation requests;
  - Written Representations;
  - ICA; check list, Narrative Records, Flowcharts
  - Correspondances with Mngt, TCG, etc.
  - Analysis

Note: Copy of Entity records may form part of audit documentation; but audit



documentation is not a substitute of Fairly Records.

Note: Records not Included in Audit documentation:

- (a) Superseded draft of working Papers
- (b) Notes that reflect preliminary thinking
- (c) Duplicate documents
- (d) Previous copies of documents corrected for Typographical errors.

⑥ Preparation of audit documentation: Auditor shall prepare audit documentation on a timely basis.

It helps the auditor to enhance the quality of audit and facilitates effective review and evaluation of audit Evidences Obtained and Conclusion 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.

⑦ Assembly of Audit file:

Meaning: One or more folders or other storage media, in physical or electronic form, containing the records of audit documentation for a specific engagement.

Requirements: (a) Auditor shall assemble the documentation in audit file and complete the administrative process of assembly of final audit file within 60 days from date of audit report.  
(b) This process does not involved performance of new audit procedure or drawing of new conclusion.  
However, following changes may be made to documentation:

(i) Deleted superfluous documentation;

(ii) Sorting, collating, cross referencing working papers.

(iii) Signing off completion check list.

(iv) Documenting Evidence that auditor has obtained, discussed and agreed with members of ET before date of audit report.

(c) After the assembly, auditor shall not delete the audit documentation before end of its retention period.<sup>\*</sup>

<sup>\*</sup> Not shorter than 7 years from the date of audit report.

(8) Ownership:  
(SQC-1 / SA 230)

Unless otherwise specified by law or regulation, audit documentation is the property of the auditor.

However, Auditor, may, at his discretion, provide extracts from audit documentation to clients, provided such disclosure does not undermine the validity of work performed or Independence of auditor.

(9) Completion Memorandum: Audit documentation summary that describes:

(a) Significant matters identified during audit; and

(b) How such matters are addressed.

- Completion memorandum facilitates effective and efficient reviews and inspection of audit documentation.

- It also 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 him to achieve the overall objectives of the audit.

e.g. Going Concern - 570  
Related Parties - 550  
Related - 240

## Chapter 7 - Completion and Review

| <u>Classification of SAs:</u> | SA 100-199 | Introductory Matters                             | No Std. issued                                                           |
|-------------------------------|------------|--------------------------------------------------|--------------------------------------------------------------------------|
|                               | SA 200-299 | General Auditing Principles                      | SA 200, 210, 220, 230, <sup>1</sup> 240, <sup>2</sup> 250, 260, 265, 299 |
| ① SA 260                      | SA 300-499 | Assessing the Risk and Response to assessed risk | SA 300, 315, 320, 330, <sup>3</sup> 402, 450                             |
| ② SA 265                      | SA 500-599 | Audit Evidence                                   | SA 500, 501, 505, 510, 520, 530, <sup>4</sup> 540, 550, 560, 570, 580    |
| ③ SA 450                      | SA 600-699 | Using work of others                             | SA 600, 610, <sup>5</sup> 620                                            |
| ④ SA 560                      | SA 700-799 | Conclusion and Reporting                         | SA 700, 701, 705, 706, 710, <sup>6</sup> 720                             |
| ⑤ SA 570                      | SA 800-899 | Specialised Area                                 | SA 800, 805, 810, <sup>7</sup> 820, <sup>8</sup> 830, <sup>9</sup> 840   |
| ⑥ SA 580                      |            |                                                  |                                                                          |

### (i) Communication with Those Charged with Governance: (SA 260)

(i) Meaning of TCWG: Person(s) / Organisation(s) with responsibility to overseeing the strategic direction of the entity; and obligations related to accountability of the entity.

Note: TCWG may include managerial personnel.

### (ii) Role of Communication:

- To assist auditor and TCWG in understanding of matters related with audit and developing constructive relationships.
- To assist auditor in obtaining the relevant information w.r.t. audit from TCWG. e.g., Info. related with understanding of Entity and Environment; Sources of Evidence etc.
- To assist TCWG in fulfilling their responsibilities to oversee the financial reporting process.

Note: Auditor is required to determine the appropriate person within the Organisation to whom communication is to be made.

### (iii) Matters to be Communicated:

#### (a) Auditor's responsibilities in relation to audit of F.S:

(For this purpose, letter of engagement as issued under requirements of SA 210, may be used).

#### (b) Planned scope and timing of audit: including auditor's plan to assess ROMM; auditor's approach towards internal control, application of concept of materiality; significant risks identified during the audit etc.

Imp-

#### (c) Significant findings from the audit:

- i) Qualitative aspects of accounting policies, practices, estimates and financial statement disclosures.
- ii) Significant difficulties encountered during the audit.

Examples: (A) Non-availability of expected information

(B) Delay / Unwillingness by mgmt. in providing necessary information.

(C) Limitations imposed by management

(D) Unnecessary brief time for completion of audit.

#### (iii) Significant matters discussed with management and written Representations requested from them:

For Example: (A) Non-compliance with Laws and Regulation

(B) Transactions with Related Parties

(C) Subsequent Events Occurring after B/S date.

#### (iv) Circumstances that may affect the form and content of audit report

For Ex: Circumstances leading to modified opinion

#### (v) Any other matter, that appears significant to auditor.

(D) Auditor's Independence: Required in case of audit of f.s. of listed

Entities. Statement of Independence comprises of:

- (i) Compliance of Ethical requirements including independence;
- (ii) Any relationship that may affect independence;
- (iii) Related safeguards that are applied to eliminate identified threats to independence.

Note: Auditor's independence should be communicated in written form only.

(iv) Communication process and Documentation: - Reading from book -

(2) Communicating Deficiencies in Internal Control to Those and Management (SA 265):

(A) Meaning of deficiency in I.C.:

I.C. is said to be deficient, if

- (a) I.C. required to prevent, or detect and correct material misstatements in the f.s. is missing (i.e. Non Existent I.C.)  
(Or)
- (b) I.C. unable to prevent or detect and correct material misstatements in the f.s. on timely basis.  
(i.e. Ineffective I.C.)

(B) Auditor's Responsibilities:

- (i) Auditor should determine whether deficiencies in I.C. exist. For this purpose, auditor is required to (a) Plan as per SA 300.
- (b) Perform RAP as per SA 315.

(i) Perform ToC/ Compliance procedures as per SA 330.

(ii) If based on the procedures performed, Auditor is of the opinion that deficiencies in I.C. exist, he should determine, whether such deficiency either individually or in aggregate with other deficiencies constitute significant deficiency.

(a) Deficiencies are not significant

Auditor shall communicate such deficiencies to management in writing.

(b) Deficiencies are significant

Auditor shall communicate significant deficiencies to TCWG and Mngt. in writing.

(c) Matters to be considered in determining whether a deficiency or combination of deficiencies in internal control constitute significant deficiency:

(Learning and Noting - any four points)

(D) Indicators of Significant deficiencies:

(i) Evidences of ineffective aspects of Control Environment

For Ex.: - Significant drawbacks in which management is interested, not scrutinised by TCWG.

- Mngt. fraud not prevented by I.C.

- Mngt. fails to take corrective actions on deficiencies previously communicated.

(ii) Absence of Entity Risk Assessment Process.

(iii) Evidence of ineffective Entity Risk Assessment Process.

(iv) Evidence of ineffective response to identified significant risk.

(v) Evidence of Mngt./TCWG inability to oversee the preparation of F.S.



- (vi) Misstatements detected by auditor's procedures that were not prevented, detected and corrected by Entity I.C.
- (vii) Correction of prior period items in current year statement of P&L.

### (E) Communication of deficiencies:

Communication shall be through a formal letter known as "Letter of weakness", which shall comprise of following matters:

- (i) Description of deficiency;
- (ii) Explanation as to their potential effect;
- (iii) Sufficient information so as to explain that
  - (a) Purpose of audit is to express an opinion on F.S.; and
  - (b) Internal Controls are evaluated to design the NTE of Substantive audit procedures and not for the purpose of expressing an opinion on effectiveness of I.C.
- (iv) Statement that matters reported in this letter are limited to deficiencies identified and considered significant by the auditor. (i.e. Other deficiencies in I.C. may exist).



## Chapter - 7 "Completion and Review"

### Topics Covered :

- (1) SA-260 "Communication with TCWG"
- (2) SA-265 "Communicating deficiencies in I.C. to TCWG and Mngt."
- (3) SA-450 "Evaluation of Misstatements identified during the audit:"

(i) Meaning and Causes of Misstatements: Misstatement may be defined as difference between:



- (a) Amount, classification, presentation or disclosure of a reported financial statement item; and
- (b) Amount, classification, presentation or disclosure that is required for that item in accordance with the FRF.

Causes of Misstatement: Misstatements in F.S. items may be caused due to following:

- (a) Inaccuracy in gathering or processing data from which F.S. are prepared;
- (b) Omission of any amount or disclosure;
- (c) Inappropriate selection and application of accounting policies;
- (d) Incorrect Aging Estimates, may be due to misinterpretation or ignorance of facts;
- (e) Unreasonable judgements of management regarding accounting estimates.

(ii) Auditor's procedures when misstatements identified:

$\frac{505600}{505600} - \frac{506500}{506500}$   
 $\frac{505600}{505600} \rightarrow \frac{506500}{506500}$

Auditor identify the misstatements, which are material in nature and not due to fraud (i.e. not trivial)

(In case of fraud, requirements of SA 240 apply)

Determine whether any change is required in Audit Strategy and Audit Plan

Communicate to Management with a request for the correction

Follow the requirements of SA 300.

Management Agree and Corrections made

Management Refuses

Perform additional procedures to determine whether misstatements remains

Understand the reason for not making corrections

No Misstatement Remains

Misstatement remains

Satisfactory reasons

Unsatisfactory reasons

No further duty

Re-assess the Materiality

Misstatements appears to be Material

Unmodified Opinion

Request Mngt. for correction

Inform to T&WG - Uncorrected Misstatement  
- Possible effect on audit opinion  
- Request for correction

↓  
Misstatements Not Corrected



- (1) Modify the opinion; and
- (2) Obtain WR from mgmt. and TCG as to their believing that uncorrected misstatements are immaterial.

### Evaluation of Effect of Uncorrected misstatements:

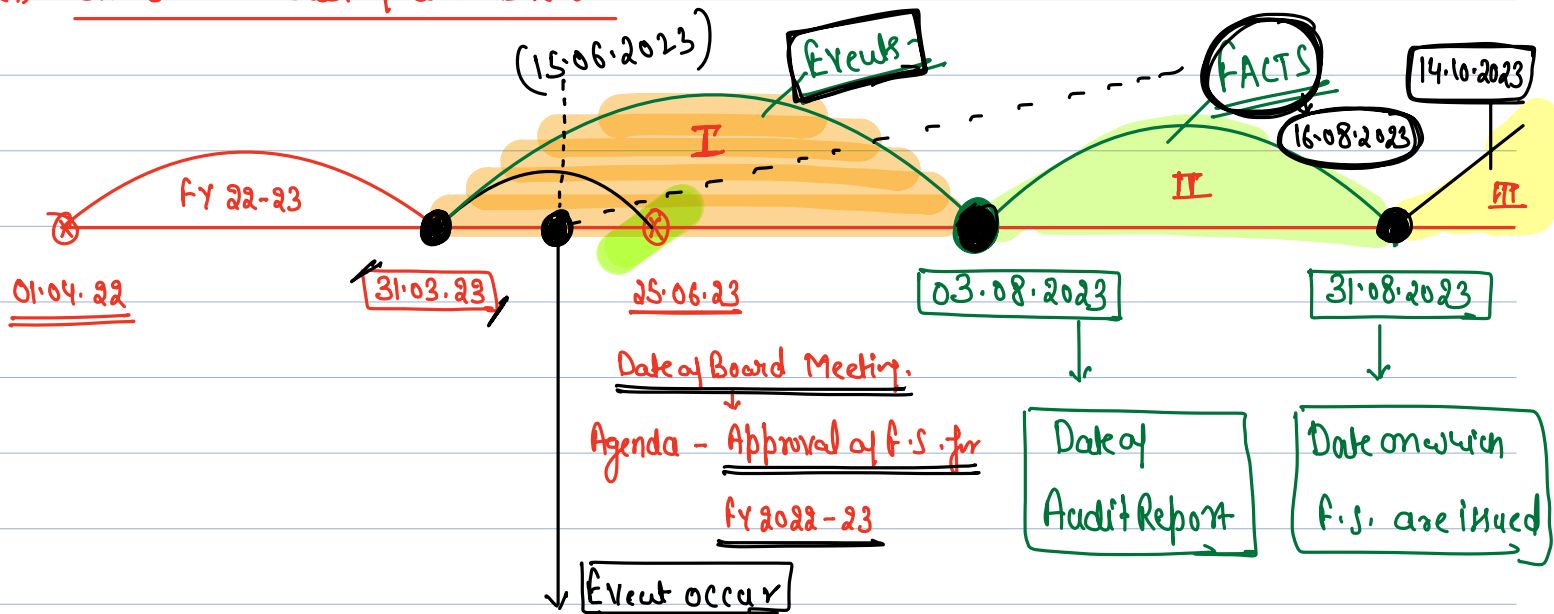
Auditor is required to determine whether uncorrected misstatements are material, whether individually or in aggregate with other uncorrected misstatements. For this purpose, auditor shall consider the following:

- (a) Size and Nature of Misstatements both in relation to particular classes of transactions, account balances or disclosures and the f.s. as a whole;
- (b) Effects of uncorrected misstatements related to prior period on the relevant classes of transactions, account balances or disclosures and the f.s. as a whole.

Documentation Requirements: Audit documentation shall include the following:

- (a) Amount below which misstatements would be regarded as clearly trivial;
- (b) All misstatements accumulated during the audit and whether they have been corrected; and
- (c) Auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

#### (4) SA-560 "Subsequent Events":



- ✓ - that provide evidence of conditions that existed at the date of f.s. (Adjusting Event)
  - Declarator of Insolvency of a Major debtor
  - Court's judgement on pending litigation
- ✓ - Those Events that provide evidence of conditions arise after date of f.s. (Non adjusting Events - requires disclosures - Director's Report + Notes on AU.)
  - Issue of share capital.
  - Planning of Mergers
  - Loss of assets due to fire

#### (i) Meaning of Subsequent Events:

Events occurring after the Balance Sheet date but before the date of auditor's report; and includes

Facts that have become known to the auditor after the date of auditor's report.

Types of Events: - To be covered from book -

(ii) Objectives of Auditor: (a) To obtain SAAE about whether Events occurring between date of f.s. and date of auditor's report that require adjustment of, or disclosure in f.s. are appropriately reflected in f.s.

- (b) Respond appropriately to the facts that become known to the auditor after the date of auditor's report that had they been known to auditor at that date, may have caused the auditor to amend the auditor's report.

Imp-

(iii) Audit Procedures in case of Subsequent Events:

- (a) Perform procedures to obtain SAAE that all events requiring adjustment or disclosure have been identified.
- (b) For this purpose, Auditor shall:
- (i) Obtain an understanding of the procedures followed by management to identify the events.
  - (ii) Inquire the mgmt. and TCWG as to occurrence of significant events that may affect the financial statements.
  - (iii) Study the Interim F.S., if any, prepared by the Entity subsequent to Balance Sheet date.
  - (iv) Read the minutes of the meeting, if any, held after B/S date.
- (c) If auditor identifies any event which require any adjustment or disclosure, auditor shall ensure its appropriate treatment in the books of account as per requirements of applicable FRF. (AS4 and AS 10)
- (d) Obtain a WR from Mngt. and TCWG that all known events that require adjustment / disclosure as per FRF have been appropriately adjusted / disclosed.

(iii) Audit Procedures w.r.t. facts which become known to auditor

- |                                                              |                       |
|--------------------------------------------------------------|-----------------------|
| (a) after date of A.R., but before date the F.S. are issued: | Reading from<br>book. |
| (b) after the date of issue of F.S.                          |                       |

# Chapter - 7 "Completion and Review"

## Topics Covered:

- (1) SA - 260 "Communication with TCWG"
- (2) SA - 265 "Communicating deficiencies in G.C. to TCWG and Mngt."
- (3) SA - 450 "Evaluation of Misstatements identified during the audit:"
- (4) SA - 560 "Subsequent Events"
- (5) SA - 570 "Going Concern":

✓ AS-1 "Disclosure of Accounting Policies" → Fundamental Accounting Assumptions



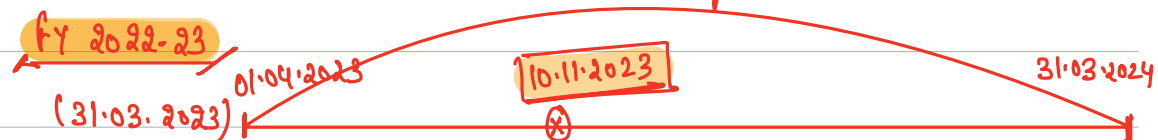
- No Intention / No necessity — shut down / Curtail operation  
i.e. business will continue for foreseeable future

- If G.C. assumption is following → Assets and Liabilities  
able to realise. / (B.V.)  
able to discharge

If G.C. assumption is not appropriate → Liquidation Basis

- Responsibility for assessing appropriateness of G.C. Basis

↓ Management and TCWG



(i) Period → G.C. assess — Minimum 12 Months

(ii) Events / conditions — doubt on G.C.

(A) Financial (B) Operating (C) Other

Material Uncertainty

(iii) Mngt. → make plans - to mitigate the uncertainties

↓  
Plan - feasible / viable - ✓

(iv) Mngt. is satisfied with the plans.

✓ Adequate Disclosures required in the f.s.

Auditor: → RAP → Understanding → Mngt. Assessment of Entity ability to  
Continue as a G.C.

No such assessment  
was performed by  
Mngt.

Mngt. Assess the G.C.  
Basis.

↓  
Ask Mngt. Basis for  
intended use of G.C.

↓  
Discuss whether any  
Events Exist

↓  
Plans to address

↓  
viability of Plan.

↓  
[ Evaluating Mngt. Assessment  
(Substantive procedure)

↓  
[ Conclusion and reporting.

→ Period selected by Mngt. (≥ 12 Months)

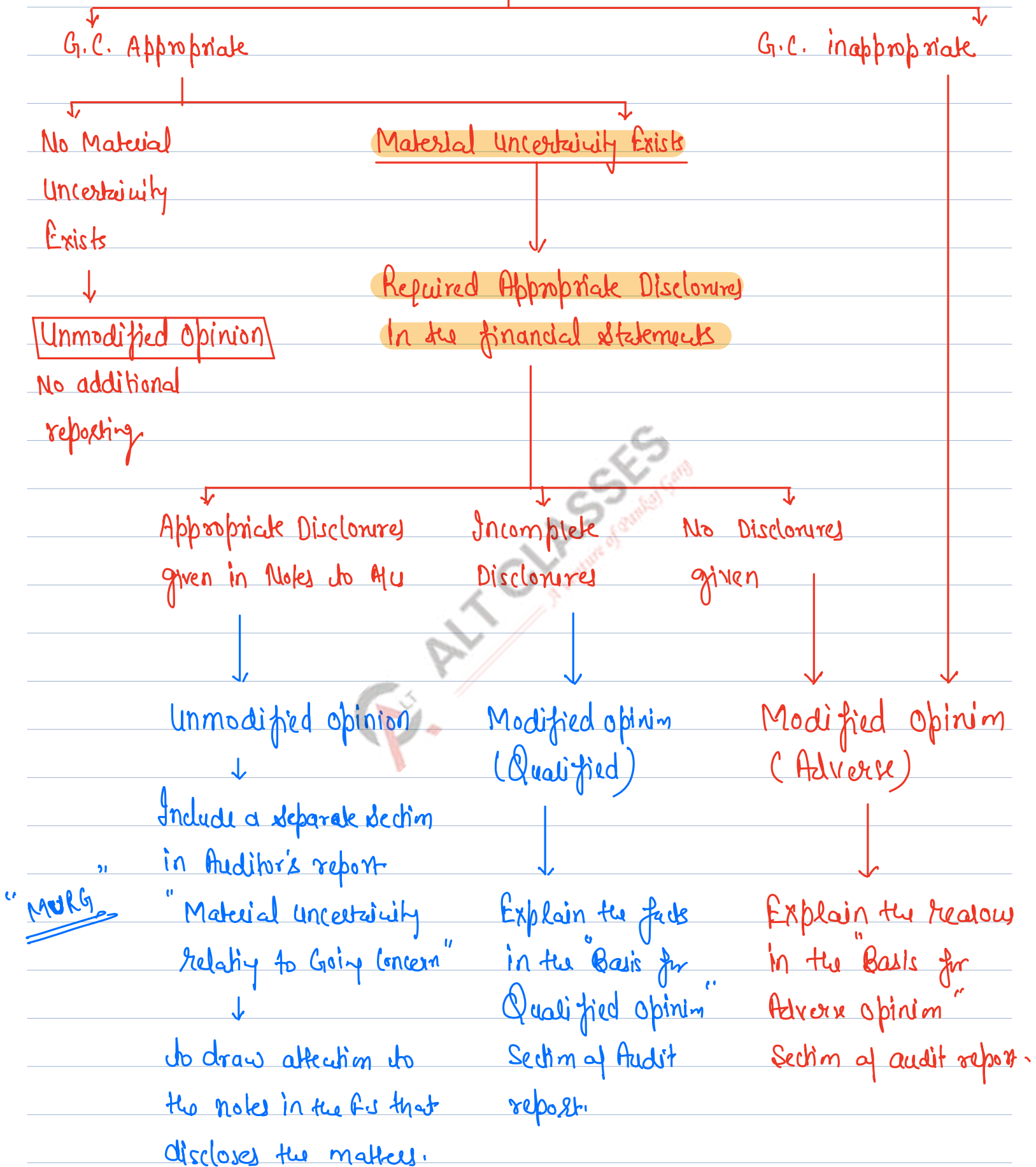
→ Events/conditions - doubt

→ adequacy of Disclosures made.

→ Perform Additional Procedures as  
required under the Circumstances



# Conclusion and Reporting.



## (1) Factors relevant to Mngt. assessment of G.C.:

- (a) Degree of uncertainty associated with the outcome of future event;
- (b) Size and complexity of the Entity;
- (c) Nature and condition of Entity's business;
- (d) Degree to which business is affected by external factors;
- (e) Judgements about the future based on the information available at the time when judgement is made.

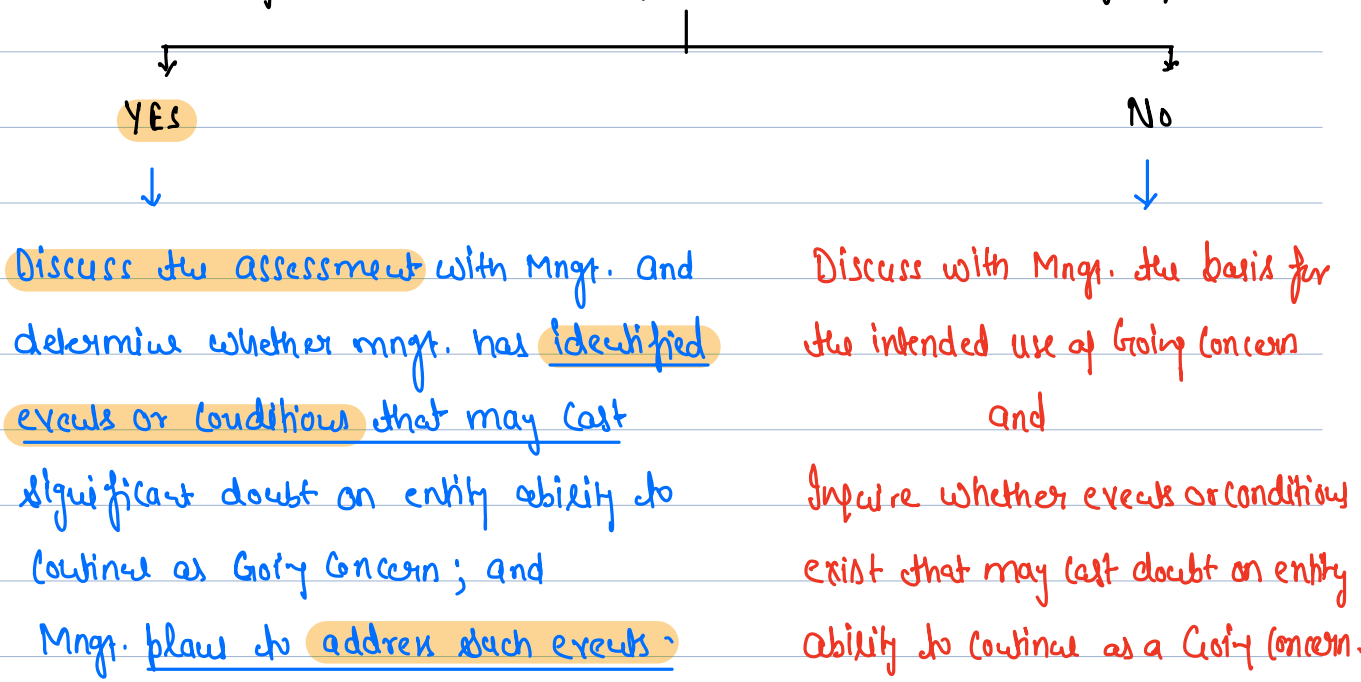
✓(2) Responsibilities of Auditor: | — learning + Noting —

✓(3) Objectives of Auditor:

✓(4) Auditor's procedures and reporting:

### ✓(A) Risk Assessment Procedure:

- Consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern.
- For this purpose, auditor shall determine whether mngt. has performed a preliminary assessment of entity ability to continue as a going concern



## Events or Conditions that may cast doubt on G.C. assumption:

| (a) Financial                                                                                                                                                                                                                                                                                                                                          | (b) Operating                                                                                                                                                                       | (c) Others                                                                                                                                                                                                                  |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"><li>- Negative operating cash flow</li><li>- <u>Net Current liability position</u></li><li>- Inability to pay creditors</li><li>- Discontinuation of Dividend</li><li>- Non availability of funds for necessary expansion.</li><li>- Inability to pay to fund providers</li><li>- Adverse financial ratios</li></ul> | <ul style="list-style-type: none"><li>- Labour shortage</li><li>- shortage of raw material</li><li>- Loss of major market.</li><li>- Emergence of a successful competitor</li></ul> | <ul style="list-style-type: none"><li>- Non Compliance with statutory requirements</li><li>- <u>changes in legal and regulatory requirements</u></li><li>- Uninsured or underinsured catastrophes which may occur</li></ul> |

## (B) Evaluating Mngt. Assessment:

- Auditor shall evaluate management assessment of the Entity ability to continue as a Going Concern.
- For this purpose, auditor shall cover the same period as that used by Mngt; or the period specified by Law or regulation, if it specifies a longer period.
- If the period selected by mngt. is < 12 months, Auditor shall request management to extend its assessment to at least 12 Months.

## Auditor's duties when mngt. is unwilling to make or extend its assessment:

- Consider the implications for the auditor's report.
- In such situations, qualified opinion or disclaimer of opinion may be appropriate, as auditor may not be able to obtain SAAE.

### (c) Performing additional procedures:

If auditor identified events or conditions that may cast significant doubt on Entity ability to continue as a going concern



auditor shall obtain SAAE to determine whether a material uncertainty exist relating to Going concern, through performing additional procedures

Additional procedures may include the following:

- (a) Evaluate Mngt. plans for future actions; whether such plans are likely to improve the situation; whether such plans are feasible to implement.
- (b) Analyse the cash flow forecast, if available; Evaluate the reliability of data used to prepare the forecast; determine whether there is adequate support available for assumptions underlying the forecast.
- (c) Request WR from mngt. and TCSG regarding their plans for future actions and feasibility of these plans.
- (d) Confirm existence of any arrangement to provide financial support; and assessing the financial ability of such parties to provide additional funds.

## Chapter - 7 "Completion and Review"

### Topics Covered :

- (1) SA - 260 "Communication with TCWG"
- (2) SA - 265 "Communicating deficiencies in I.C. to TCWG and Mngt."
- (3) SA - 450 "Evaluation of Misstatements identified during the audit:"
- (4) SA - 560 "Subsequent Events"
- (5) SA - 570 "Going Concern"
- (6) SA - 580 "Written Representations" :

#### (i) Meaning and Nature of WR:

- SA 580 defines the term "Written Representation" as a "written Statement provided by Mngt/TCWG to auditor:

(a) to confirm certain matters

or

(b) to support other audit

evidences.

- WR are recognised as audit evidences being necessary information required by auditor.
- However, WRs do not provide sufficient appropriate audit evidences on their own w.r.t. the matters to which they relate to.
- Hence, if auditor forms the conclusion solely on the basis of WRs, it will not be considered as a right approach.
- Auditor should request WR from Mngt/TCWG having responsibilities for preparation of financial statements and having knowledge of concerned matters.

### (ii) Objectives of Auditor:

(a) To obtain WR from Mngt/Tcwg that they believe that they have fulfilled their <sup>(a)</sup> responsibility for preparation of F.S. and <sup>(b)</sup> for completeness of information provided to auditor.

(b) To support other audit evidences relevant to the F.S. or specific assertions by means of WR.

(c) To respond appropriately to WR provided by Mngt/Tcwg; or if mngt/Tcwg does not provide the WR requested by auditor.

### (iii) Matters on which WR is required:

#### ✓ (A) WR w.r.t. Management Responsibilities:

(a) for prep<sup>n</sup> and presentation of financial statements in accordance with applicable FRF.

Note: If management uses qualifying language in the WR that "WR are made to the best of its knowledge and belief"; auditor can accept such wordings if it seems reasonable and he is satisfied that WR is being made by person having knowledge and responsibilities of matters addressed in WR.

(b) for providing to auditor with all relevant information and access as agreed in terms of audit engagement

Note: WR must describe the management responsibilities in the manner in which these responsibilities are described in terms of audit engagement.

Imp:  
Circumstances in which auditor can ask the management to reconfirm its acknowledgement and understanding of responsibilities:

Auditor may ask the management to reconfirm its acknowledgement and understanding of responsibilities in following circumstances:

- (a) Those who signed the terms of audit engagement on behalf of Entity, no longer in the Entity or have the relevant responsibilities.
- (b) Terms of audit Engagement were prepared in previous year.
- (c) There is any indication that management misunderstand the responsibilities;
- (d) Changes in circumstances.

(B) Other WRs: Auditor may ask other WR as required by other Standards on Auditing, for example:

- (i) WR as to selection and application of accounting policies;
- (ii) WR as to recognition, measurement, presentation and disclosure of significant financial items;  
for ex: RP transactions, subsequent events, classification of assets and liabilities etc.
- (iii) Communication of all deficiencies in Internal Control of which management is aware.
- (iv) Specific assertions in the financial statements.  
for ex: classification of financial items;

(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 cover the entire period for which audit is conducted and reported in audit report.
- WR shall be in the form of a representation letter addressed to auditor.

V. Imp.

#### (v) Auditor's duties when WRs not provided:

- (a) Discuss the matter with management.
- (b) Re-evaluate the integrity of management and evaluate its effect on reliability of representations and audit evidence in general;
- (c) Take appropriate action, including determining possible effect on the opinion in auditor's report in accordance with SA 705 having regard to requirements of disclaimer of opinion.

#### (vi) Auditor's duties when reliability of WR is doubtful:

- If auditor has concerns about the competency, integrity, ethical values of mgmt, auditor shall evaluate its effect on reliability of representations and audit evidence in general.
- If WRs provided are inconsistent with other audit evidence, auditor shall perform procedures to resolve the matter.
- If auditor conclude that WR are not reliable



Take appropriate action, including determining possible effect on the opinion in auditor's report in accordance with SA 705 having regard to requirements of disclaimer of opinion.

## Chapter - 8 "Audit Reports" (Lecture No. 1)

(i) Basics of Audit Report: A report through which auditor expresses opinion on the financial statements is known as audit report.

Financial statements may be classified as

- General Purpose F.S. - Requirements of SA 700, 701, 705 and 706 shall apply.
- Special Purpose F.S. - Requirements of SA 800 shall apply along with SA 700, 705 & 706.

Notes: For audit of Single F.S. or Element - Requirements of SA 805 shall apply along with SA 700, 705 and 706.

For Engagements related to Summary F.S. - Requirements of SA 810 shall apply.  
For Comparative F.S. - Requirements of SA 710 shall apply.

(ii) Types of Audit Reports: 2 types

(A) Unmodified report

- Reports issued when auditor concludes that F.S., as a whole, are prepared in all material respects in accordance with applicable FRF.
- Opinion expressed in Unmodified opinion (SA 700)

(B) Modified reports

(a) with unmodified opinion

Opinion issued is unmodified, but report includes following para:

- (i) Emphasis of Matter (EOM Para); and/or
- (ii) Other Matter Para (OM Para)  
(SA-706 shall apply)

(b) with modified opinion

Auditor modifies his opinion on the F.S. 3 types

- (i) Qualified opinion | SA-705
- (ii) Adverse Opinion | shall apply.
- (iii) Disclaimer of opinion

### (3) Forming an opinion on the financial statements:

- SA 700 requires that auditor shall form his opinion whether the f.s. are prepared in all material respects in accordance with applicable FRF.
- To form this opinion, auditor needs to conclude as to whether he has obtained reasonable assurance that f.s. as a whole are free from material misstatements, whether caused due to error or fraud.
- Conclusions shall take into account consideration of:
  - (a) whether SAAE has been obtained;
  - (b) whether uncorrected misstatements are material; and
  - (c) Evaluations

#### - Evaluations:

(a) Evaluation shall include consideration of Qualitative aspects of Entity's accounting practices including indicators of possible biasness in management judgements.

(b) To Evaluate, whether in view of requirements of applicable FRF:

(i) f.s. adequately disclose significant accounting policies selected and applied.

(ii) Accounting estimates made by the management are reasonable.

(iii) Information presented in f.s. is relevant, reliable, comparable and understandable.

(iv) f.s. provide adequate disclosures to enable the users to understand the effect of financial transactions and events on the information conveyed in the f.s.

Planning Activities



Perform audit procedures



Collect SAAE



Evaluate the Evidence



Draw conclusion



Express opinion

- (4) Audit Reports: SA 700 covers the details of audit reports in following three cases:
- (i) Audit conducted in accordance with SA 700.
  - (ii) " " as per requirements of law and regulation. (Reading from book)
  - (iii) Audit conducted in accordance with SA and ISA.

Elements of audit report when audit was conducted in accordance with SA:

- (i) Title: Audit report may be titled as "Independent Auditor's Report" so as to distinguish this report from the reports issued by others.
- (ii) Addressee: Auditor's report shall be addressed as appropriate. As per SA-700, auditor's report is to be addressed to persons for whom it is prepared (i.e. Members)
- (iii) Opinion Section: This section covers the following:
  - (a) Statement that financial statements have been audited.
  - (b) Identify the Entity.
  - (c) " the title of each financial statement.
  - (d) Specify the period / date to which F.S. belongs to.
  - (e) Opinion on the financial statements.
- (iv) Basis for opinion: This section of audit report will provide the following:
  - (a) Statement that audit was conducted in accordance with Standards on auditing.
  - (b) Refer to the section of the audit report that describes the

## Auditor's Responsibilities.

- (c) Statement that auditor complies with Code of Ethics issued by ICAI and Ethical requirements including independence.
- (d) Covers auditor's believing that they had sufficient and appropriate audit evidences to provide a basis for opinion.

(v) Going Concern: Where applicable, auditor shall report in accordance with SA 570. (i.e. Going Concern appropriate;  
Material uncertainty Exist;  
Appropriate disclosures given in f.s.)

(vi) Key Audit Matter: In case of Listed Entity, auditor shall communicate Key Audit Matter (KAM) in the auditor's report as per SA 701.

(vii) Other Information: <sup>★</sup> Where applicable, auditor shall report in accordance with SA 720.

★ Information included in annual report in which audited financial statements are included.

(viii) Management responsibilities for the f.s.:

- (a) To prepare the financial statements as per applicable FRF.
- (b) To maintain adequate records for safeguarding of assets and prevention and detection of fraud.
- (c) To make reasonable judgements and estimates

- (d) To design, implement and maintain necessary internal controls.
- (e) To assess appropriateness of Going Concern Basis of accounting.
- (f) To oversee the financial reporting process.

### (ix) Auditor's responsibilities for the audit of F.S.:

- This section states the overall objectives of the Auditor w.r.t. obtaining reasonable assurance that F.S. as a whole are free from material misstatement and issue the auditor's report that includes auditor's opinion.
- Explanation w.r.t. reasonable assurance and application of concept of materiality.
- Statement that Auditor exercises professional judgement and maintain professional skepticism throughout the audit.
- State the auditor's responsibilities relating to:
  - (a) Identification and assessment of ROMM;
  - (b) Designing and performing procedures responsive to assessed risks;
  - (c) Obtaining sufficient appropriate audit evidence;
  - (d) Understanding of Internal Controls;
  - (e) expressing an opinion on adequacy and operating effectiveness of Internal financial Controls w.r.t. F.S.
  - (f) Evaluation of appropriateness of use of G.C. Basis of accounting.
  - (g) Evaluate the overall presentation, structure and context of F.S.
- In addition, this section shall also cover the following:
  - (a) Responsibilities as to matters to be communicated to TCWG.
  - (b) Statement to TCWG on compliance with ethical requirements including independence.
  - (c) Determining Key Audit matters (KAM) out of the matters communicated to TCWG.



Note: Description of auditor's responsibilities may be included:

- (a) within the main body of auditor's report;
- (b) as appendix to the main auditor's report;
- (c) by a reference of a website of appropriate authority if law and regulations expressly provide for it.

(xi) Other reporting requirements: Other reporting responsibilities will be reported under a separate section titled as "Reporting on other legal and Regulatory Requirements".

(xii) Signature: Signature should be in personal name and firm's name along with membership no. and firm regn. no. (FRN).

(xiii) Place: City where audit report is signed.

(xiv) Date: Date should not be earlier than the date on which audit evidence are collected.

(xv) UDIN: (Unique Document Identification Number) - Mention the UDIN w.r.t. each audit report signed by auditor.

(5) Home work - Q. 10 and 18 - (Learning and Noting)

(A) Qualitative Aspects of Entity Accounting Practices

(B) Indicators of possible Management Bias: (Lack of Neutrality)



# Chapter - 11 " Audit Reports "

(Lecture No. 2)

Topics Covered: (1) Basics of Audit Report

(2) Types of Audit Reports

✓(3) Forming an opinion on F.S.

✓(4) Audit Reports - (i) Audit conducted in accordance with SA

(ii) Auditor's Report prescribed by law and Reg.

(iii) Audit conducted in accordance with SA and ISA.

(5) Supplementary info. presented with the audited F.S.

(SA-700)

(6) Modifications to the Opinion in the Independent Auditor's Report: (SA-705)

(i) Circumstances when a modification in auditor's report is required:

✓(A) Auditor concludes that based on audit evidences obtained, F.S. as a whole are not free from material misstatements; Or.

✓(B) Auditor is unable to obtain SAAE to conclude that F.S. as a whole are free from material misstatements.

(ii) Objectives of auditor as per SA 705:

To Express clearly an appropriately modified opinion on the F.S. that is necessary when:

(a) Auditor concludes that based on audit Evidences obtained, F.S. as a whole are not free from material misstatements; Or

(b) auditor is unable to obtain SAAE to conclude that F.S. as a whole are free from material misstatements.

✓(iii) Types of modified opinion: 3 types — (a) Qualified opinion

(b) Adverse opinion

(c) Disclaimer of opinion

(a) Qualified opinion: It is expressed when:

✓ (A) Auditor having obtained SAAE concludes that financial statements are misstated and misstatements are material, but <sup>not</sup> do have pervasive effect.  
Or

(B) Auditor is not been able to collect SAAE for transactions / matters that are material, but do not have pervasive effect.

(b) Adverse opinion: Adverse opinion is expressed when auditor having obtained SAAE, concludes that F.S. are materially misstated and such misstatements are having pervasive effect.

(c) Disclaimer of opinion: Auditor expresses disclaimer of opinion when he is not able to collect SAAE for transactions / matters that are material as well as having pervasive effect.

Note: Decision regarding which type of modified opinion is appropriate, depends upon:

✓ (a) Nature of the matter giving rise to modification (i.e. whether the F.S. are materially misstated or auditor not able to collect SAAE).

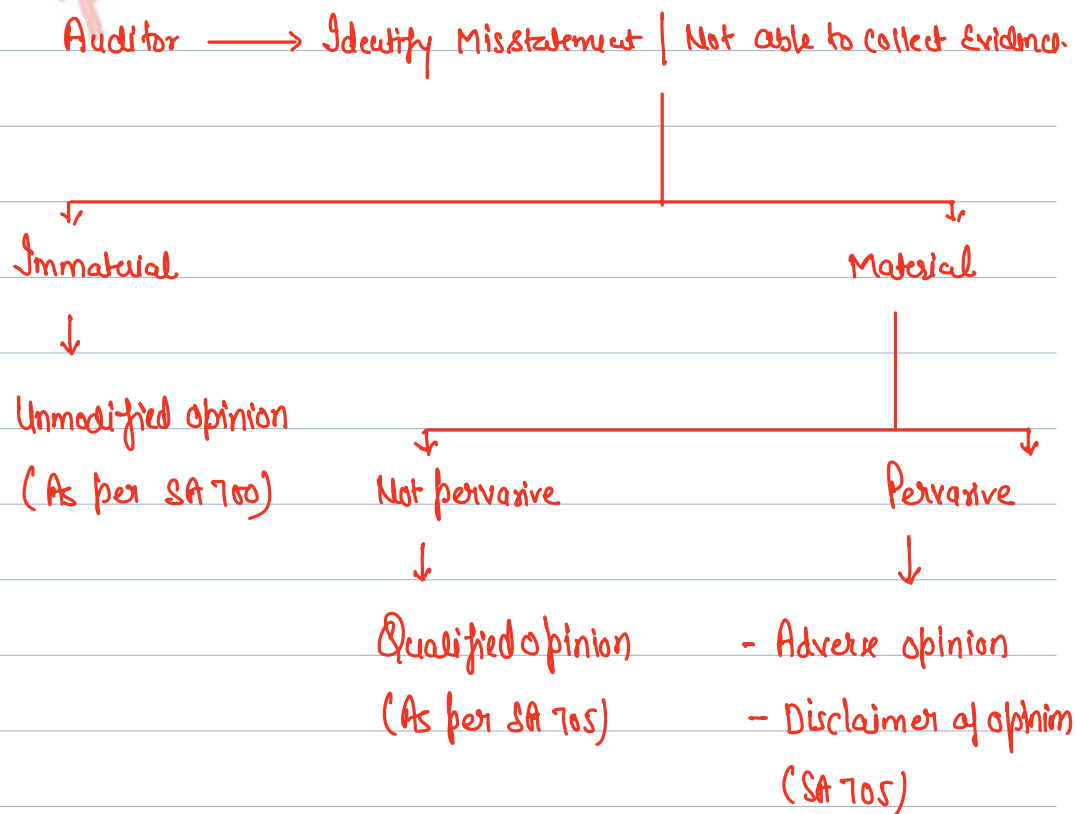
✓ (b) Auditor's judgement about the pervasiveness of the effects.

| Nature of Matter<br>giving rise to modification<br>↓ | Auditor's judgement<br>- Not Pervasive - | Material as well as<br><u>Pervasive</u> |
|------------------------------------------------------|------------------------------------------|-----------------------------------------|
| (a) F.S. are materially<br>Misstated                 | Qualified                                | Adverse                                 |
| (b) SAAE not obtained                                | Qualified                                | Disclaimer of opinion                   |

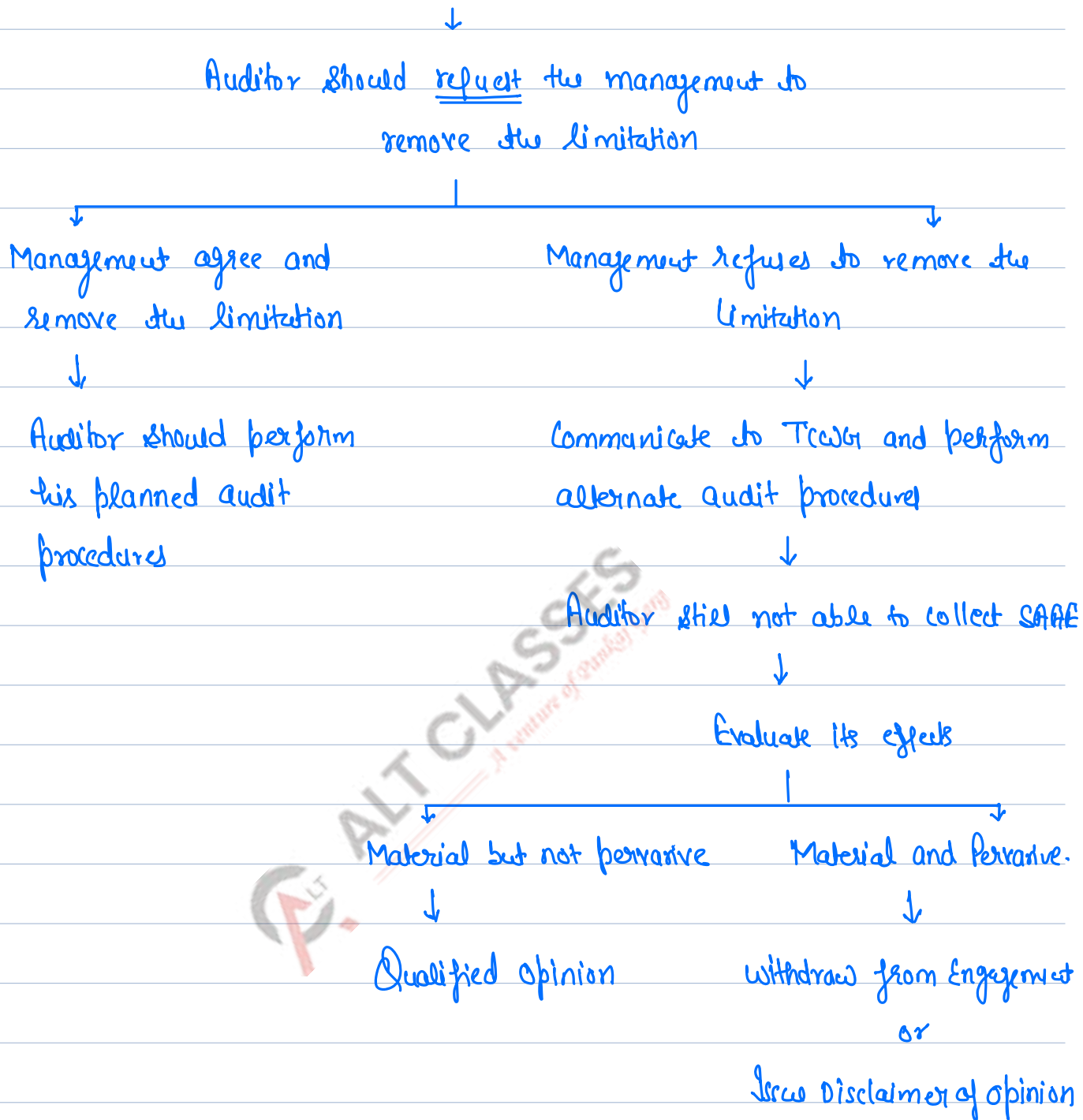
Note: Pervasive Effects: Pervasive effects on the F.S. are those that in the auditor's judgement:

- (a) are not confined to specific element, account or item of the F.S.
- (b) if so confined, represent a substantial proportion of the financial statements; or
- (c) in relation to disclosures, are fundamental to user's understanding of the F.S.

Summary:



(iv) Auditor unable to collect SAAE due to Limitations imposed by Mngt:



(v) Form and Content of Auditor's report when opinion is modified:

(I) Opinion Section: Use the heading - Qualified opinion  
- Adverse opinion  
- Disclaimer of opinion  
as appropriate.

## Wordings of Opinion:

### Qualified Opinion:

In our opinion, except for the effects of matters described in "Basis for Qualified Opinion Section", the financial statements present fairly, in all material respects, in accordance with (applicable FRF)

### Adverse Opinion:

In our opinion, to the best of our information and explanation provided to us, because of the significance of matters described in "Basis for Adverse Opinion Section", the financial statements do not reflect true and fair view of (state of affairs, - - - - -) in accordance with the (applicable FRF).

Imp:

### Disclaimer of Opinion:

When the auditor disclaims an opinion, he shall:

- ✓(a) State that the auditor does not express an opinion on the F.S.
- ✓(b) State that because of the significance of the matters described in Basis for disclaimer of Opinion Section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the F.S.; and
- ✓(c) Amend the statement required by SA 700, which indicates that the F.S. has been audited, to state that auditor was engaged to audit the F.S.

## II. Basis for opinion section:

- Amend the heading → Basis for Qualified opinion  
→ " " Adverse "  
→ " " Disclaimer of " | as appropriate.
- Auditor shall include a detailed description of matters due to which opinion is modified.

- 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.

Ex: If provision is not appropriately accounted for, Basis for Qualified opinion section shall provide:

- (a) Reasons for not making provision
- (b) Amount required to be recorded.

- If opinion is modified due to non availability of information, audit shall state the reasons for inability to obtain SAAE.

For Ex: Records not available due to

- (a) Limitations imposed by management;
- (b) Limitations " " Circumstances (like records destroyed by fire; records seized by tax authorities)

- ✓ If opinion is modified due to non disclosure of information required to be disclosed, auditor shall:

- ✓ Discuss the non-disclosure with TCG;
- ✓ Describe the nature of omitted disclosure;

(c) Unless prohibited by law and regulation, include the omitted disclosure, if it is practicable to do so, and auditor has obtained SAAE about the omitted information.

### Imp: III. Auditor Responsibility Section in case of disclaimer of opinion:

When auditor disclaims the opinion, the auditor shall amend the description of auditor's responsibilities so as to include the following:

- Statement that auditor's responsibility is to conduct an audit of F.S. in accordance with SAs and to issue auditor's report.
- Statement that because of significance of matter described in "Basis for Disclaimer of Opinion Section", auditor was not able to collect SAAE so as to provide a basis for an audit opinion.
- Statement about auditor's independence and other ethical requirements.

### Notes:

(1) When auditor disclaims an opinion on the F.S., auditor report shall not include "KAM Section" as per SA 701.

(2) When auditor expects to modify the opinion, he shall communicate with TCWG, the circumstances that led to expected modification and wordings of the modification.



## (7) EOM Paragraph and OM Paragraph in the Independent Auditor's Report:

(SA 706) :

(i) Auditor's Objective as per SA 706: To draw user's attention, by way of clear additional communication in auditor's report w.r.t.

(EOM)

(a) a matter that is appropriately presented or disclosed in the F.S., which is of such importance that it is fundamental to user's understanding of F.S.; or

(OM)

(b) a matter that is relevant to user's understanding of audit, auditor's responsibilities or the auditor's report.

### (ii) Meaning of EOM and OM Paragraph:

(A) EOM: A Paragraph included in auditor's report that refers to a matter appropriately presented or disclosed in the F.S.

↓

that in the auditor's judgement is of such importance that it is fundamental to user's understanding of the F.S.

(B) OM: A Paragraph included in the Auditor's report that refers to a matter other than those presented or disclosed in the F.S.

↓

that in the auditor's judgement is relevant to user's understanding of audit;

auditor's responsibilities; or

auditor's report.

### (iii) Requirements w.r.t. EOM Para:

#### Imp: (A) Circumstances in which EOM may be included:

- (1) Uncertainty as to future outcome of exceptional litigation or regulatory action.
- (2) Significant subsequent events occurs after the date of f.s., but before the date of audit report.
- (3) Early application of a new AS that has a material effect on f.s. (if permitted).
- (4) Occurrence of a major catastrophe that may have a significant effect on entity financial position.

#### (B) Manner of Inclusion in auditor's report:

- EOM Para should be included in the auditor's report in a separate section titled as "Emphasis of Matter".
- Include in the para a clear reference to the matter being emphasized and to where relevant disclosure that fully describe the matter can be found in the f.s.
- EOM Para refer only to information which is appropriately disclosed in the financial statements.
- It must be indicated that auditor's opinion is not modified in respect of this matter.
- EOM para may be located in audit report immediately following the "Basis for opinion section".

Note: EOM Para is not a substitute for

- (a) Modified opinion when required by Circumstances. (SA 705)
- (b) Disclosure in the financial statements.
- (c) reporting in accordance with SA 570 w.r.t. MURG.

(iv) Requirements w.r.t. OM Para:

- (1) OM Para should be included in the audit report in a separate section titled as "Other Matters".
- (2) OM Para may be located in the auditor's report immediately after "Key Audit Matters".
- (3) OM Para should be included in audit report when not prohibited by law or regulation.
- (4) OM Para is not a substitute for KAM.

Note: If auditor expects to include an EOM or OM para in the auditor's report, he shall communicate with TCGI regarding this expectation and the wordings of these paragraphs.

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# Chapter - 11 "Audit Reports"

(Lecture No. 3)

Topics Covered: (1) Basics of Audit Report

(2) Types of Audit Reports

(3) Forming an opinion on f.s.

(4) Audit Reports - (i) Audit conducted in accordance with SA

(ii) Auditor's Report prescribed by Law and Reg.

(iii) Audit conducted in accordance with SA and ISA.

(5) Supplementary info. presented with the audited f.s.

(SA-700)

(6) Modifications to the opinion in the Independent Auditor's Report (SA 705)

(7) EOM Paragraph and OM Paragraph in the Independent Auditor's Report (SA 706)

(8) Communicating Key Audit Matters (KAM) in the Independent Auditor's Report:

(SA 701):

|                                                                | TWC           | KAM           | Reporting                                               | Auditor                                 | Matter                                                               |
|----------------------------------------------------------------|---------------|---------------|---------------------------------------------------------|-----------------------------------------|----------------------------------------------------------------------|
|                                                                |               |               | As per 705                                              | ↓                                       | TWC SA-260                                                           |
| - (Modification) -<br>as per SA 705                            | ✓<br>(SA-260) | ✓<br>(SA-701) | (a) Opinion Section<br>(b) Basis for<br>Opinion Section | Audit procedures<br>↓<br>Audit Evidence | - Responsibility<br>- Scope/Time<br>- Sig. finding<br>- Independence |
| - (EOM/OM Para) -<br>as per SA-706                             | ✓<br>(SA-260) | ✓<br>(SA-701) | As per 706<br>(a) EOM Para<br>(b) OM Para               | +<br>Significant findings<br>+          |                                                                      |
| - Material uncertainty<br>as to Going concern<br>as per SA-570 | ✓<br>(SA-260) | ✓<br>(SA-701) | As per 570<br><u>MURG</u>                               | Significant observations                |                                                                      |
| - Other Matter Communicated to TWC - Significant -             |               |               |                                                         |                                         | <u>SA 701</u>                                                        |

### (i) Meaning and Purposes of KAM:

- KAM are those matters that in the auditor's judgement were of most significance in the audit of f.s. of current period.
- KAM are selected from the matters communicated to TCWG.
- KAM given in the audit report will serve the following purposes:
  - (A) To Enhance the communicative value of the auditor's report by providing greater transparency.
  - (B) To provide additional information to users of f.s. to assist them in understanding those matters that in the auditor's professional judgement were of most significance in audit of f.s. of current period.
  - (C) To assist the intended users in understanding the entity and areas of significant management judgement in audited f.s.

### (ii) Nature of communication of KAM:

Communicating KAM in the auditor's report is not:

- (A) a substitute for the disclosures in the financial statements; or
- (B) a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement as per SA 705; or
- (C) a substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; or
- (d) a separate opinion on individual matters.

### (iii) Considerations for determining KAM:

KAM are to be determined from matters communicated to TCG after considering the following:

- (A) Areas of Higher assessed RMM or significant risks identified in accordance with SA 315.
- (B) Significant judgements of auditor relating to statements that involved management judgements. For Ex: (i) Determination of Provisions  
(ii) " " Fair Values  
(iii) Selection of Accounting Policies  
(iv) Accounting Estimates
- (C) Effect of significant events and transactions occurred during the year.

### (iv) Manner of Reporting:

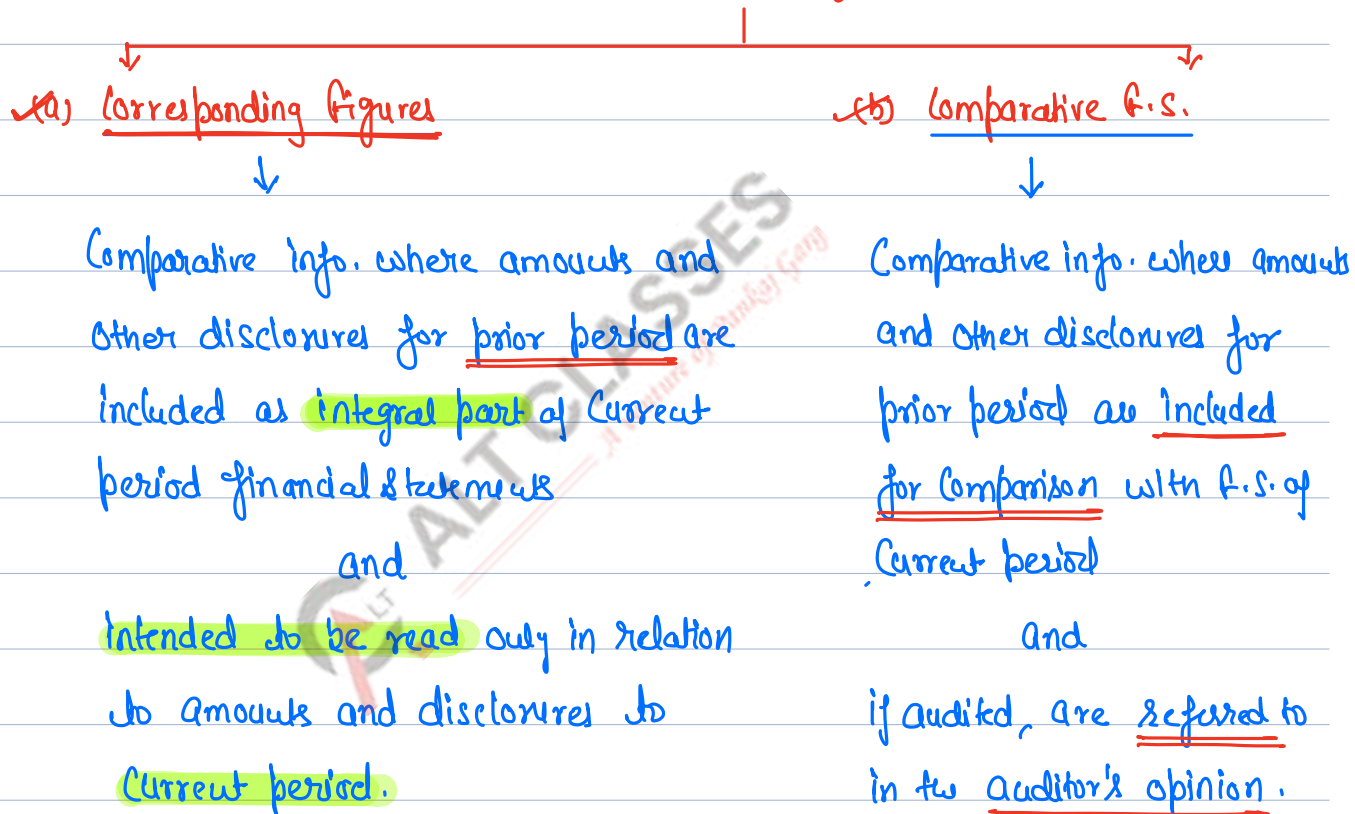
- Auditor shall describe each KAM, using an appropriate sub-heading, in a separate section of the auditor's report under the heading "Key Audit Matters".
- Before giving the detail about KAM, introduction as to KAM is to be given as follow:  
"KAM are those matters that in the <sup>auditor's</sup> professional judgement were of most significance in audit of f.s. of current period and these matters were addressed in the context of audit of f.s. as a whole and auditor does not provide a separate opinion on these matters."
- Description of each KAM in the KAM Section of the auditor's report shall include a reference to the related disclosure, if any, in the f.s. and shall address (a) why the matter was considered to be of most significance in the audit and therefore, determined to be a KAM; and  
(b) How the matter was addressed in the audit.

(9) Comparative Information - Corresponding Figures and Comparative Financial Statements:  
(SA-710)

(A) Meaning and Nature of Comparative information:

Those amounts and disclosures included in the financial statements of an Entity in respect of one or more prior periods in accordance with the applicable FRF.

Comparative info. can be presented in two ways:



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 Objective as per SA 710:

- ✓ (i) To obtain SAAE about whether the comparative information included in the f.s. has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable FRF; and
- ✓ (ii) To report in accordance with the auditor's reporting responsibilities.

Imp:

## (C) Audit Procedures for Verification of Comparative Information:

(1) Auditor is required to determine whether financial statements include comparative information.

If yes, whether such information is appropriately classified.  
For this purpose, auditor is required to evaluate the following:

(a) whether the comparative info. agree with the amount and disclosures presented in prior period f.s.

For Ex: B/s as at 31.03.2022

B/s as at 31.03.2021

As at  
31.03.2022

As at  
31.03.2021 = As at  
31.03.2021

As at  
31.03.2020

Comparative  
Prior Period  
Valid.

Current  
↓  
WR

(b) 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.

(2) In case of any doubt as to existence of material misstatement in comparative information, auditor need to perform additional procedures.

Note: In case F.S. of prior period were audited by same auditor, procedures as covered by SA 560 will apply.

(3) Obtain a written representation from the management to re-affirm that wk they previously made with respect to prior period financial statements remains appropriate.

Imp-

(A) Audit Reporting regarding corresponding figures:

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances:

(1) If the auditor's report on prior period includes a modified opinion and the matter which gives rise to the modification is unresolved: Auditor shall modify the auditor's opinion on the current period F.S.

In the "Basis for Modified Opinion" Para, auditor shall:

- (a) Refer to both current period figures and corresponding figures in the description of the matter giving rise to modification (if possible effects of the matter on the current period is material); or
- (b) In other cases, explain that the audit opinion has been modified because of possible effects of unresolved matter on the comparability of current period figures and corresponding figures.

(2) If auditor obtains Audit Evidence that a material misstatement exist in the prior period F.S. on which unmodified opinion was issued:

Auditor shall express a Qualified opinion or adverse opinion in the auditor's report on the current period financial statements.

(3) If prior period F.S. not audited:

Auditor shall state in an OM Para in the auditor's report that corresponding figures are unaudited.

Ex:

FY 2022-23

FY 2021-22

22-23

21-22

21-22

20-21

(Current)

(Prior)

(Current)

↓ 5 or (R.P.)

I Provision ☒ Unresolved ← Audited - Modification  
e.g. Provision-Bad debt x

Modified opinion - CY / PY - description para.

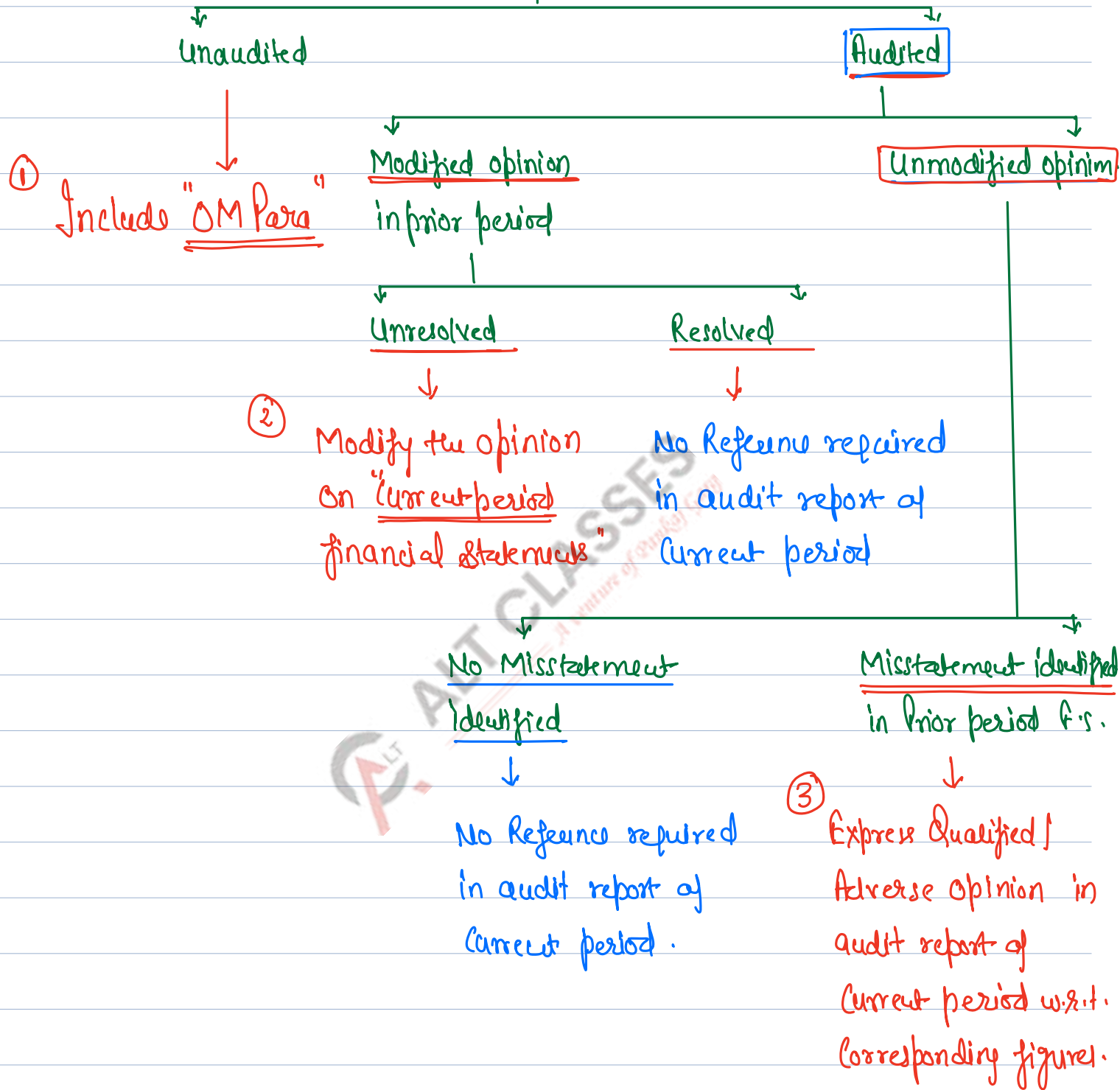
II (Misstatements identified) Audited - Unmodified opinion  
↓ Prior period  
Modified (corresponding figures)

III

Unaudited.

OM Para. - Unaudited-

# Prior period F.S.



← →  
- MCO + Correct / Incorrect -

# Chapter - 8 "Audit Reports"

(1) Jo (9) : Basics and Types of Audit Reports; SA 700, 701, 705, 706, 710

## (10) Branch Audit:

(A) who can be appointed as branch auditor - Sec. 143(8)

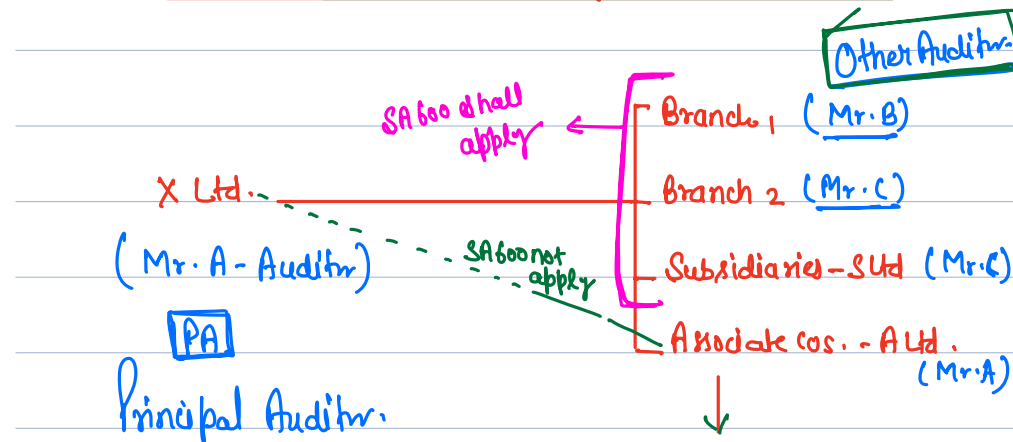
where a company has branch office, accounts of that office shall be audited by either of following: ~~(a)~~ Company auditor; or (Sec. 141)

~~(b)~~ any other Qualified person; or

~~(c)~~ In relation to foreign branch, Company auditor; or any other Qualified person under Company law; or any person duly qualified under the laws of the country in which branch is situated.

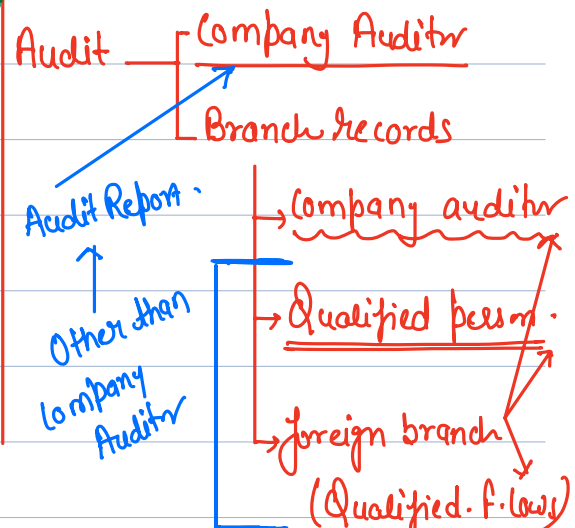
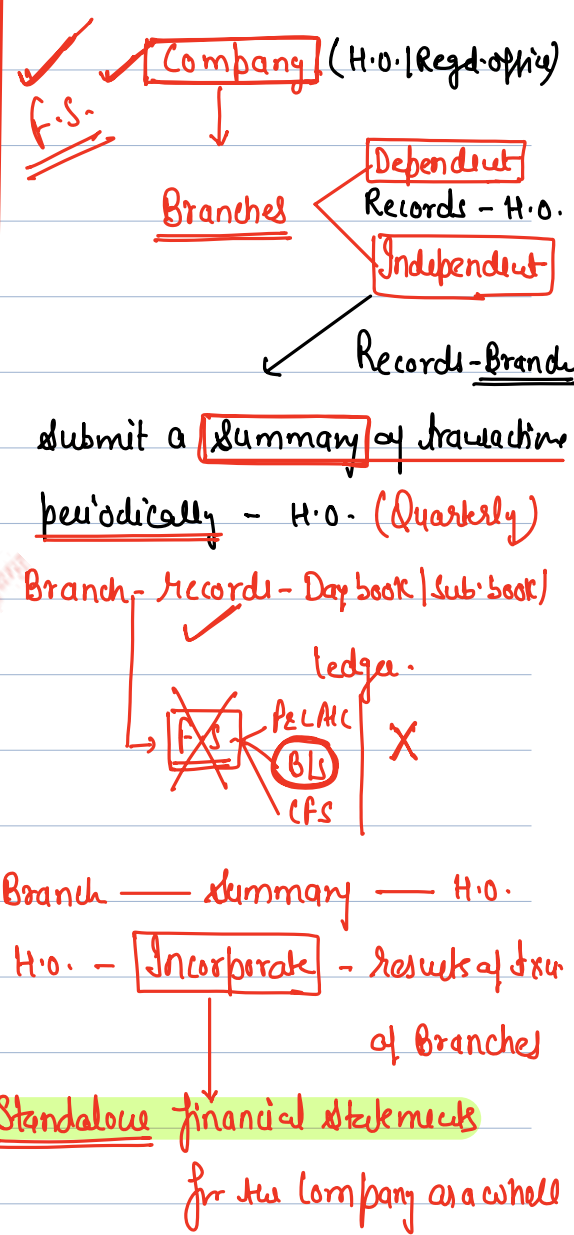
Note: Branch auditor shall submit his report to Company Auditor.

(B) SA-600 "Using the Work of Another auditor":



✓ Standalone F.S. = X Ltd. + B<sub>1</sub> + B<sub>2</sub>

✓ Consolidated F.S. = X Ltd. (Standalone) + Sub. + Ass. + J.V.



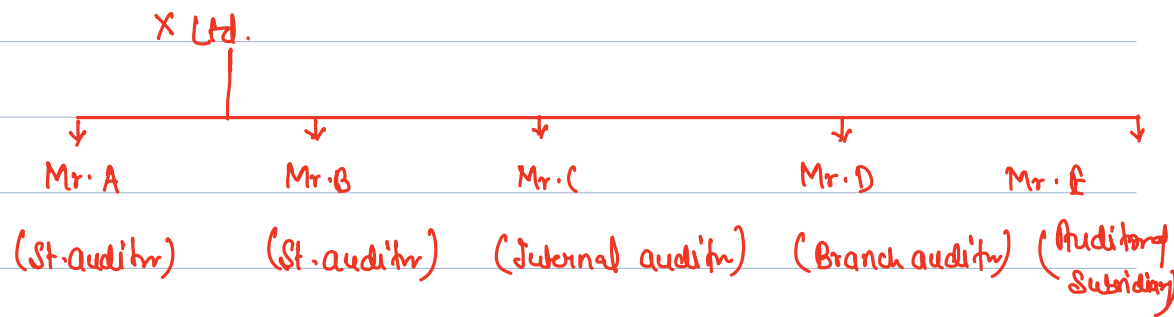
- (i) Rights of Principal Auditor: (a) where another auditor is appointed for the component, PA is entitled to rely upon the work of such auditor, unless a doubt arises.
- (b) In special circumstances, PA is entitled to
- ✓ Visit the component; and
  - ✓ Examine the books of account and other records of the component.

✓ (ii) Procedures of PA:

- (a) Inform the other auditor the following —
- Matters requiring special consideration
  - Procedures for identification of inter-component transactions.
  - Time table for completion of audit
- (b) Advise the OA as to significant accounting, auditing and reporting requirements and obtain representation as to compliance.
- (c) Discuss audit procedures applied or review of written summary of OA procedures and findings.
- (d) Visit the other auditor.

Note: NTE of procedures depends upon circumstances of the engagement and PA knowledge of professional competence of OA.

## (11) Joint Audit:



- Joint Auditor: Mr. A and Mr. B [SA 299 shall apply]  
(Statutory Auditors)

- St. auditors and Internal auditor [SA 610 shall apply]  
using work of

- St. auditors and Branch auditor [SA 600 shall apply]  
using work of

- St. auditor and Auditor of subsidiaries [SA 600 shall apply]  
using work of - audit of <sup>CFS</sup>

- St. auditor and Auditor's Expert [SA 620 shall apply]  
using work of

- St. auditor and Mngt. Expert [SA 500 shall apply]  
using work of

## (i) Meaning, [Advantages] and Disadvantages of joint audit: - from book -

Noting - H.W.

✓ Sec. 139(3): Members may resolve that audit shall be carried out by >1 auditor.

## SA-299 "Joint Audit of financial statements":

### ✓ (A) Audit Planning, Risk Assessment and Allocation of work:

- EP and key members of ET of each of the joint auditors shall be involved in planning the audit.
- Audit Strategy shall be established jointly.



- Joint auditors shall discuss and develop a joint audit plan. While developing audit plan, joint auditors shall -
  - Identify division of audit areas;
  - Identify common audit areas;
  - Ascertain reporting objectives;
  - Consider factors that are significant in directing ET efforts;
  - Consider results of preliminary engagement activities
  - Ascertain NTE of resources necessary to perform the audit.
- ROMM to be considered by each of the joint auditor and shall be communicated to other joint auditor.
- Joint auditors shall obtain Common WR(s).
- " " " " Common Engagement Letter.
- Joint auditors shall divide the work among themselves on mutual understanding; based on identifiable units or other similar consideration (e.g. nature of financial item, time period etc.)
- Work allocation document is to be prepared and signed by all joint auditors and communicated to TCWG.

Imp:-  
 (B) Responsibilities of Joint Auditors:

- In respect of audit work divided among joint auditors; each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of audit procedures.
- All joint auditors shall be jointly and severally responsible for:
  - for work not divided among joint auditors and carried by all.
  - for decisions as to NTE of audit procedures for subject matter of Common interest.

- (c) Examining whether f.s. comply with requirements of relevant statutes.
- (d) Examining presentation and disclosure of financial items in f.s.
- (e) Ensuring that audit report comply with requirements of relevant statutes, standards on auditing and other relevant pronouncements.

### (C) Reporting Consideration:

- Joint Auditors shall arrive at a common opinion and issue a single report signed by all joint auditors.
- However, if difference of opinion exist among the joint auditors, separate reports shall be issued.
- In case of separate reports issued by joint auditors, such reports shall include a reference of separate report issued by other joint auditor.
- Such reference shall be made under the heading "Other Matter Para" as per requirements of SA 706.
- A joint auditor is not bound by the views of majority of joint auditors. In such case, separate reports are to be issued.

## Chapter - 8 "Audit Reports"

- (1) to (9) - Basics and types of audit reports, SA 700, 701, 705, 706, 710
- (10) - Branch audit and SA 600
- (11) - Joint audit and SA 299
- (12) - Reporting requirements under Companies Act, 2013:

✓(i) Inquiry into propriety matters: Sec. 143(1)

(a) whether loans and advances made by the company, on the basis of security, have been properly secured and whether the terms are prejudicial to interests of the company or its members.

Ex: H Ltd.

|                           |   |        |                           |
|---------------------------|---|--------|---------------------------|
| Loan - ₹ 5 crore          | → | S Ltd. | (RoI - 2.5%)              |
| Security - L&B (Mortgage) |   |        |                           |
| ↓                         |   |        |                           |
| ₹ 4 cr                    |   |        | - Reporting required -    |
| Loan - ₹ 1 cr.            | → | A Ltd. |                           |
| Security - ₹ 3 cr. (L&B)  |   |        | - No reporting required - |
| Roi - 11.5%               |   |        |                           |

(b) Whether transactions represented by book entries are prejudicial to the interests of the company. (Set-off, dep<sup>n</sup>, provisions etc.)

(c) In case of non-banking and non-investment company, whether assets consists of share, deb<sup>n</sup> and other securities are being sold at a price lower than acquisition cost.

(d) whether loans and advances made are shown as deposits

| I                                                         | II                                                |
|-----------------------------------------------------------|---------------------------------------------------|
| Ex: Cash = 50 lakt. Cash = 10 lakt. doan Jo Co = 40 lakt. | Ex: Cash = 50 lakt. Cash = 10 lakt. FO = 40 lakt. |

(e) whether personal expenses have been charged to revenue account.

(f) Where it is stated in book that shares have been allotted for cash, whether cash has actually been received in respect of such allotment and if not, whether position stated in B/s is correct and not misleading.

Note: Reporting required only in case of negative findings.

(ii) Reporting on Accounts: Sec. 143(2)

Auditor shall make a report to the members of the company on:

- (a) accounts examined by him; and
- (b) f.s. laid before the company in General meeting.

Report shall state that to the best of his information and knowledge, the accounts and f.s. reflects a true and fair view of state of affairs, financial results, cash flows and such other matters as prescribed under Rule 11 of CAAR, 2014.

(iii) Reporting on Other Matters: Sec. 143(3)

- (a) Information and Explanation.
- (b) keeping Proper Books of Accounts and Returns from Branches not visited.
- (c) Branch Auditor's report
- (d) B/S + P&L A/c - agreed with books of A/c and Return.
- (e) f.s. comply with ASs.
- (f) Observations/Comments on financial matters - adverse effect
- (g) whether any director disqualified u/s 164(2).
- (h) Q/A/R related to maintenance of accounts.
- (i) Adequacy of IFC w.r.t. f.s. and its operating effectiveness.

Exception: Pvt. co - OPC / Small co.

↳ T/o < 50 crores and Borrowings < 25 cr

- (j) Other Matters as prescribed.

(Rule 11 of Companies (Audit and Auditor's) Rules, 2014)

## Rule 11 of Companies (Audit and Auditor's) Rules, 2014:

- (i) Disclosure of Impact of pending litigation on financial position.
- (ii) Provision for material foreseeable losses on long term contracts including derivative contracts.
- (iii) Delay in drawing up amount to IEPF
- (iv) - Mngt. representation that no funds advanced to intermediaries for benefit of ultimate beneficiaries
  - Mngt. representation that no funds received from funding company for benefit of ultimate beneficiaries.
  - Mngt. representations do not contain material misstatements.
- (v) Dividend declared/paid is in accordance with Sec. 123.
- (vi) A/cing slw used by co. has feature of recording audit trail.
  - ↓  
Operated throughout the year to record all transactions.
  - ↓  
No tampering
  - ↓  
preserved for specific period.

(iv) Sec. 143(4): State the reasons for negative remarks on matters reported u/s 143(3).

(v) Sec. 143(5)(6)(7): xxx

(vi) Sec. 143(8): Branch Audit

(vii) Sec. 143(9): Every auditor shall comply with auditing standards.

Sec. 143(10): Auditing standards - C.G. - [ICAI] - NFRA

(viii) Sec. 143(11): C.G. may, by an order, direct, in respect of specified companies, that the auditor's report shall include a statement on such matters as specified.

\* Companies (Auditor's Report) Order, 2020 [CARO]

(ix) Reporting of fraud: Sec. 143(12)

If an auditor in the course of performance of his duties as auditor,



has reason to believe that an offence of fraud involving such  
amount as prescribed (Rule 13: ₹1 Cr.)



is being or has been committed [in the company]

- Individually -



by its [officers or employees]



Auditor shall report the matter to C.G. in prescribed manner.

Note: If amt. of fraud is  $< 1 Cr.$ , Auditor shall report the matter to  
the Audit Committee or Board of Directors, as the case may be.

Ex:

|   | Amt. of fraud    | Fraud Committed by | Fraud Committed on | Reporting.                              |
|---|------------------|--------------------|--------------------|-----------------------------------------|
|   |                  |                    |                    | <u>Sec 143(12)</u>                      |
| ① | ₹ 1.5 Cr.        | Director           | Company            | C.G.                                    |
| ② | <u>₹ 0.9 Cr.</u> | Director           | Company            | <u>Audit Committee</u><br><u>or BoD</u> |
| ③ | ₹ 1.50 Cr.       | Creditor           | Company            | - N.A. -                                |
| ④ | ₹ 1.25 Cr.       | Company            | Employees          | - N.A. -                                |

(13) CARO, 2020: Applicability of CARO, 2020:

CARO shall apply to Every Company including foreign company.  
Except the following:

(a) Banking Companies;

(b) Insurance " ;

(c) Sec. 8 " ;

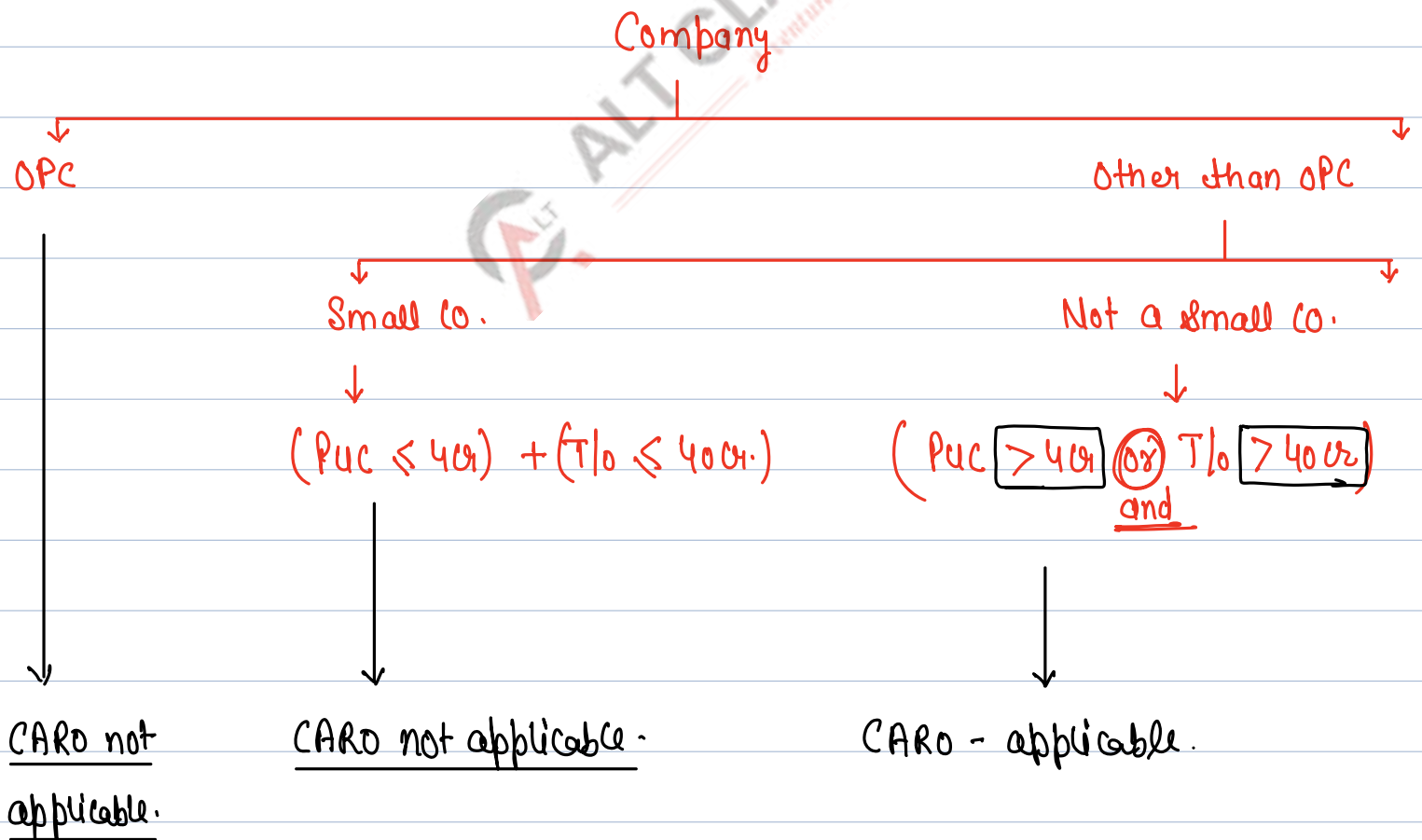
(d) OPC and Small Companies; [ $Pvt. Co. - PUC \leq 4cr \oplus Tlo \leq 40cr$ ]

(e) Pvt. Limited Company (not being sub. or holding of public Co.)

✓ having  $PUC + RES \leq 1cr$  as on B/s date;

✓ borrowings from bank or F.I.  $\leq 1cr$  at any point of time; and  $\oplus$

✓ total revenue as disclosed in Sch. III  $\leq 10 cr$ .





Ex. ABC (P) Ltd. - Sub. of X (P) Ltd. - (Not a Small Company)  
being a subsidiary

PUC = 80 lakh

RES = 10 lakh

Borrowing = 25 lakh

Revenue = 8 Cr.

(CARO not applicable)

Ex. ABC (P) Ltd. - Sub. of X Ltd. (not a small co.  
being a subsidiary)

PUC = 80 L

RES = 10 L

Borrowing = 25 L

Revenue = 8 Cr.

(CARO applicable)

Ex. ABC (P) Ltd. - Sub. of X (P) Ltd. (not a small co.)

PUC : 80 L

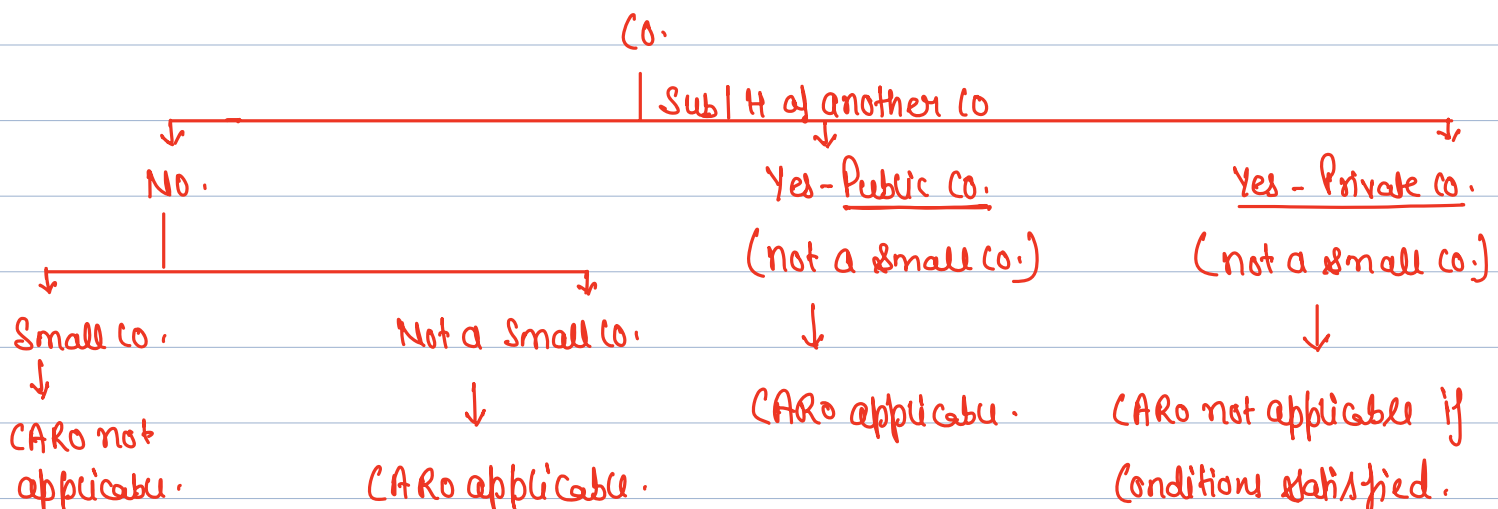
RES : 25 L

} > 1 Cr.

✓ Borrowing : 25 L

✓ Tlo : 9 Cr.

(CARO applicable)



## Chapter - 8 "Audit Reports"

(13) CARO, 2020: (A) Applicability: All companies including foreign companies  
Except - Banking / Ins. / Sec. 8 / OPC / Small companies

Pvt. Companies (Not H/s of Public Company)

satisfying 3 conditions.

(a) PUC + RES  $\leq$  1 Cr; and

(b) Borrowings  $\leq$  1 Cr; and

(c) Total revenue  $\leq$  10 Cr.

Note: CARO, 2020 shall not apply to auditor's report on CFS  
except Para 3(xxi).

(B) Matters to be reported under CARO, 2020: Para 3

(i) - Property, Plant and Equipment: (a) Proper records showing full particulars of PPE

" " " " " of Intangible Assets.

(b) Physical Verification -  $\rightarrow$  Mgmt. - Reasonable Interval.  
Discrepancies noticed / dealt properly

(c) Title deeds - Immovable properties. - name of Co.  
If not - detail.

(d) Revaluation - PPE + Intangible Assets  
If yes - Valuation - Regd. Valuer

Specify - Change -  $\geq 10\%$  - NCV - each class

(e) Proceedings for holding Benami Property; disclosure

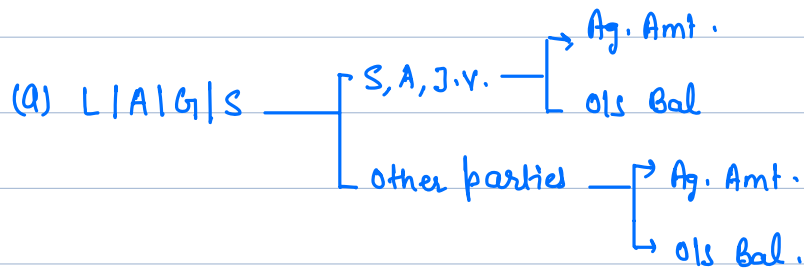
(ii) Inventories - Para 3(ii) - (a) Physical Verification: Reasonable interval; coverage & Procedures

Discrepancies -  $\geq 10\%$ ; dealt in books of Acc.

(b) Working Capital Limit: Sanctioned W.C.  $> 5$  Cr (Bank + F.I.)

- Quarterly Return / statements - agree - Acc.

(iii) Investments, Guarantees, Security, loans or advances in nature of loan:



(b) I/LA/G/S  $\rightarrow$  not prejudicial to interests of company.

(c) LIA  $\longrightarrow$  Schedule of repayment of Principal; | repayment receipt - regular  
payment of Interest

(d) L1A.  $\longrightarrow$  amt. Overdue.  $\longrightarrow$   $> 90$  days  
reasonable steps for recovery.

(e) L/A  $\rightarrow$  due  $\rightarrow$  renewed / Extended / Settled  $\rightarrow$  Ag. Amt. of such dues  
 $\rightarrow$  %age to total loans

(f) LIA  $\rightarrow$  repayment on demand without terms of repayment

- Ag. Amt. of such loan.
- %age to total loan.
- Ag. amt. - loan - promoter / R.P.

(iv) Compliance of Sec. 185 and 186: Loans / Investments / Guarantees / Security  
↓  
provisions of Sec. 185 and 186 - Complied with  
If not - provide the details thereof.

(v) Public deposits : Compliance of directives issued by RBI  
Provisions of Secs. 73 to 76 of Companies Act, 2013  
or other relevant provisions of Companies Act, 2013  
↓  
If not → nature of Contraventions

- Compliance of Order passed by
  - CLB
  - NCLT
  - Court
  - Any other Tribunal.

(vi) Cost Records : Maintenance of cost records specified by C.G. vs 148(1)



whether such accounts and records have been so made and maintained.

(vii) Statutory dues :

- Undisputed
  - Regular → depositing - Appropriation
  - Irregular → Arrear - last day of FY - > 6 M
- disputed
  - Amount under dispute.
  - Forum where dispute is pending.

(viii) Unrecorded Income : transaction not recorded in books of A/c - surrendered or disclosed as Income

↓ If so

whether unrecorded income → properly recorded in books of Account.

(ix) Repayment of dues :

- (a) Default repayment of loans/Borrowings/Jutt
  - Nature
  - Name of lender
  - Am't. not paid
- (b) Declared - wilful defaults - Bank/F.I./Other lender.
  - P.I.
  - No. of days
- (c) Term loans → applied for purposes - If not -
  - Am't - dividend
  - Purpose
- (d) Funds - S/term basis - utilised for long term purpose
  - If yes → nature and amount
- (e) Funds - raised - obligations - S/A/J.V.
  - details - nature
  - Am't.
- (f) Loan - raised - Pledge of securities - S/A/J.V. - details  
Report any default in repayment of such loans.

(X) Application of Money and Preferential allotment:

✓ ✓  
IPO/FPO - funds raised - applied - Purposes.  
If not → details - delay / default / sub.  
rectification

→ Preferential Allotment / Private Placement

↓  
Sec. 62

shares  
↓  
Sec. 42

Compliance - If not - nature of non-compliance.

## Chapter - 8 "Audit Reports"

### (13) CARO, 2020

(A) Applicability of CARO, 2020:

(B) Matters to be Reported under CARO, 2020:

- Imp: (xi) : Fraud : (a) Fraud Noticed or reported - Nature and amt. involved  
(b) Report (ADT-4) filed with C.G.  
(c) Consideration of whistle-blower complaints.

Note: Audit Considerations w.r.t. Fraud:

- ✓ Sec. 143(12) of Companies Act, 2013 - reporting of fraud to C.G.
- ✓ Rule 13 of CAAR, 2014 - Manner of reporting of fraud
- SA-240 "Auditor's Responsibilities related to fraud in an audit of F.S."
- Para 3 (xi) of CARO, 2020

- (xii) Nidhi Companies : (a) Net Owned Funds : Deposit Liability Ratio - 1 : 20  
(b) 10% - Unencumbered term deposits  
(c) Defect in payment of Interest, deposits ; If so - details.

- (xiii) Related Parties : (a) Compliance of Sec. 177 and 188  
(b) Disclosures in the F.S. as per Applicable Ass.

- (xiv) Internal Audit System : (a) Existence of Internal audit system - Commensurate with nature and size of business.  
(b) Consideration of Internal auditor reports.

- (xv) Non Cash Drawals with directors : Whether such Drawals occurs  
whether Sec. 192 - Complied with.

(Xvi) Regn. with RBI: (a) whether regn. required O/L 45-IA of RBI Act, 1934 (NBFC) and whether regn. obtained.

(b) whether - NBF/H.F. - without valid CoR

(c) Co. - CIC ; criteria ; exempted or unregd. CIC - criteria

(d) Group > 1 CIC ; no. of CICs forming part of group.

(Xvii) Cash losses: whether Co - incurred Cash losses in FY and immediate preceding FY; If yes - Indicate the amount

|                          |
|--------------------------|
| 1001                     |
| Revenue Accrual >        |
| 801 Exp. Accrual 801     |
| Cash Receipt < Cash Exp. |
| 701 7.801                |

(Xviii) Resignation of Auditor: whether st. Auditor - resigned during the year;  
If yes - whether auditor - Considered - issues, objections or concerns raised by Outgoing auditor.

(Xix) - Material Uncertainty: on basis of

- financial ratios
- financial assets - ageing and realisability
- financial liabilities - payment
- Other info. accompanying f.s.
- Auditor's knowledge - BoD / Mngt. plans

↓  
Opinion - no material uncertainty exist - date of audit report

↓  
Company - meet its liabilities existing at date of BS  
- as and when fall due - period - 1 year



(xx) Transfer of Unspent CSR amount:

- (a) whether, for other than ongoing projects;  
Unspent amt. → trfd. to fund specified in  
Sch. VII - 6 months.
- (b) whether, in case of ongoing project, unspent  
amt. → trfd. to special account within  
period specified. (30 days)

✓ Ongoing projects -

→ Amt. not spent → 30 days  
Period → Unspent CSR  
Acc  
(Special account)

✓ Other than ongoing projects -

- Amt. not spent → Funds specified  
in Sch. VII  
Period → 6M.

(xxi) CFS: Whether there have been any Qualifications / Adverse remarks in  
CARO reports of companies included in CFS.

↓ If yes.

Indicate details of companies and Paragraph no. of CARO report  
containing the Qualification or  
adverse remark.

# Chapter - 10 "Audit of Banks"

↓  
Part - I

↓

✓ (i) Banking operations

✓ (ii) Auditing Framework

✓ Auditor

✓ Audit Report

✓ Bank Audit Approach

- Conducting a Bank audit

- Assessing risk of fraud

↓  
Part - II

↓

(iii) Types and Classification of Advances

(iv) Computation of Drawing Power

(v) Audit of Advances

(vi) " " Revenue Items (Incomes)

(vii) " " " " (Expenses)

I. Banking operations:

(a) Types of Banks:

→ Commercial Banks

→ Regional Rural Banks

→ Co-operative Banks

→ Payments Banks

→ Development Banks

→ Small Finance Banks

(Reading from book)

(b) Regulating Body and its function: RBI

(c) Banking operations: are carried at Branch level.

(d) Regulatory Framework:

Imp:

(e) Peculiarities of Banking operations:

(i) Voluminous and complex transactions.

(ii) Extensive use of technology.

(iii) Wide spread network of branches/offices.

(iv) Diversified and large range of products and services

(v) Strict vigilance and compliance requirements.

(f) Form and content of F.S: 3<sup>rd</sup> Schedule of Banking Regulation Act, 1949. Form A - B/S; Form B - P&L A/c.

## 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.

Imp.

(ii) Appointment - Banking Company: at the AGM (with approval of RBI).

- Nationalised Banks: Appointed by bank through BOD (with approval of RBI).

- State Bank of India: by CAG in consultation with C.G.

- Regional Rural Banks: by bank with approval of C.G.

(iii) Remuneration:

→ Banking Company: shall be determined as per Sec. 142 of Companies Act, 2013

→ Nationalised banks including SBI: RBI in consultation with C.G.

(iv) Power w.r.t. access to books, accounts, documents and Vouchers:  
Same as that of Company Auditor.

## (B) Types of Audit Report:

(i) Statutory Audit Report in case of nationalised Banks: To be made to C.G.

and state the following:

(a) F.S. - True and view of affairs | Info. and explanations - provided/satisfactory.

(b) whether transactions - within the powers of bank;

(c) whether returns received from branches are adequate for audit purposes;

(d) whether P&L A/c - True and fair view of Profit or loss for the period.

(e) Any other Matter which auditor considers to be brought to notice of C.G.

(ii) Format of Report: should be in compliance with Standards on Auditing.

- Info. as to no. of unaudited branches is to be specified in audit report.

Audio  
O.K.  
Refresh

- Reporting requirements U/s 143(3) and Rule 11 of CAAR, 2014 are applicable in case of Audit of banking company.
- Reporting under CARO, 2020 - not applicable.

(iii) Additional reports to be issued by statutory auditor:

(Learning + Noting - H.W) - Any four points.

- IFC - adequacy and op. effectiveness U/s 143(3)(i)
- LFAR
- Compliance with SLR Requirements
- " " IRAC Norms
- Treasury operations
- Serious Irregularities
- Ghosh / Kilawi Committee
- Adverse Credit - deposit ratio.

(iv) LFAR: - LFAR has to be furnished by auditor in addition to main report.

- Matters to be reported in LFAR - specified by RBI.
- LFAR is to be submitted before 30th June Every year.
- auditor should make proper plan for timely submission of LFAR.
- 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.

(v) Reporting of fraud to RBI:

- 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 or fraudulent activity or act of excess power, he should refer the matter to the regulator (RBI).

- Any deliberate failure on part of auditor shall render him liable for action.
- Reporting is required in case of all Scheduled Commercial Banks.
- 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. as a whole are free from material misstatements, whether caused by fraud or error.

### (C) Bank Audit Approach:

- Drawing an audit plan
- Control Environment at Bank

- heading from book -

### ~~Imp's~~ (iii) Engagement Team Discussion:

(A) Matters to be discussed among ET:

(B) Benefits of discussion:

( Learning and Noting - H.W. )

## Chapter - 10 "Audit of Banks"

### Topics Covered:

#### I. Banking Operations

#### II. Auditing Framework

(A) Auditor

(B) Types of Audit Reports

(C) Bank Audit Approach

(D) Conducting an Audit:

(i) Initial Considerations

(ii) Understanding of bank and its Environment

(iii) Identifying and assessing ROMM

Imp: (iv) Understanding of Risk Mngt. Process

(v) Engagement Team Discussion

(vi) Establishing Overall audit Strategy

(vii) Developing audit plan

(viii) Other Considerations

(ix) Stress Testing

(x) BASEL III Framework

(xi) Reliance and Review on Other Reports

### Requirements of an Effective Risk Management System in a Bank:

(a) Involvement of TCG: TCG shall approve the Risk Management policies of Banks.

While approving such policies, ensure that policies are consistent with:

(a) Bank Business objectives and strategies

(b) Capital strength;

- (c) Management Expertise;
- (d) Regulatory Requirements;
- (e) Acceptable Risk.

(b) Identification, Measurement and Monitoring the risk: Risk that may effect the achievement of Goals and Objectives of the bank should be Identified, Measured, and Monitored.

(c) Control Activities: Banks must exercise controls to manage the risks, including:

- (i) Segregation of duties;
- (ii) Verification and Approval of transactions;
- (iii) Setting of limits;
- (iv) Reporting and approval of exceptions.

(d) Monitoring the risk: Independent Risk Management unit should be set-up which regularly assess the Risk Management Models; Methodologies and Assumptions used to measure and manage the risk.

(e) Reliable Info. System: Banks must have a reliable info. system that provide financial, operational and compliance information to mgmt. and TCGs on a timely and consistent basis.

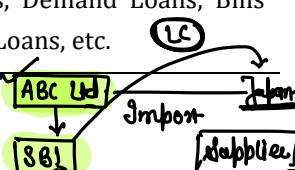
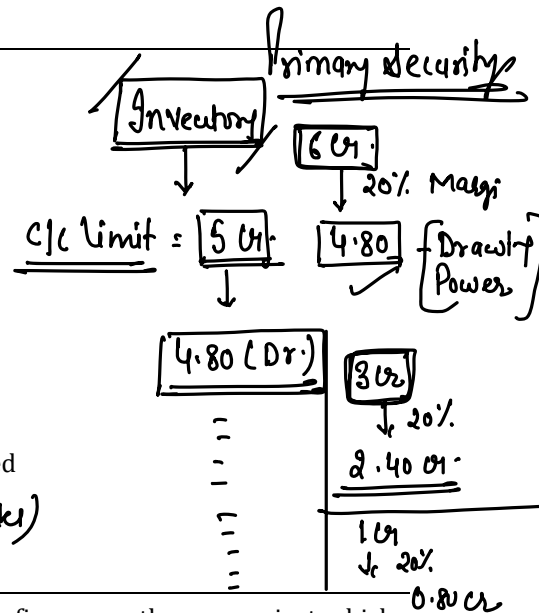
Imp:-  
(F) Assessing Risk of fraud:

- As per SA 240, Auditor's objective is to identify and assess ROMM in the f.s. due to fraud and to obtain SAAE on identified misstatements and to respond appropriately to assessed risk.
- To recognise the possibility of misstatements due to fraud, Auditor should maintain an attitude of Professional Skepticism.
- RBI has also issued guidelines that deals with prevention of money laundering and KYC Norms. These guidelines requires the banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.



|                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
|--------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Assessing Risk of Fraud</b> | <ul style="list-style-type: none"> <li>As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor's objective is to identify and assess the risks of material misstatement in the financial statements due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately.</li> <li>The attitude of professional skepticism should be maintained by the auditor so as to recognise the possibility of misstatements due to fraud.</li> <li>The RBI has framed specific guidelines that deal with prevention of money laundering and "Know Your Customer (KYC)" norms. The RBI has from time to time issued guidelines ("KYC Guidelines – Anti Money Laundering Standards"), requiring banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.</li> </ul> |
|--------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

### 10.3 – Types and Classification of Advances

|                                  |                              |                                                                                                                                                                                                                                                                                                                                                         |
|----------------------------------|------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ✓ <b>Types of Advances</b>       | <b>Funded loans</b>          | <ul style="list-style-type: none"> <li>Loans where there is an actual transfer of funds from the bank to the borrower.</li> <li><b>Examples:</b> Term loans, Cash credits, Overdrafts, Demand Loans, Bills Discounted and Purchased, Interest-bearing Staff Loans, etc.</li> </ul>                                                                      |
|                                  | <b>Non-funded facilities</b> | <ul style="list-style-type: none"> <li>Facilities which do not involve transfer of funds.</li> <li>Examples: Letters of credit, Bank guarantees, etc.</li> </ul>                                                                                                     |
| ✓ <b>Disclosure Requirements</b> | ✓ <b>Nature wise</b>         | (i) <u>Bills purchased and discounted</u><br>(ii) <u>Cash credits, Overdrafts and loans repayable on demand</u><br>(iii) <u>Term Loans</u>                                                                                                                                                                                                              |
|                                  | ✓ <b>Security wise</b>       | (i) <u>Secured by tangible assets</u><br>(ii) <u>Covered by Bank/Government guarantees</u><br>(iii) <u>Unsecured</u>                                                                                                                                                                                                                                    |
|                                  | ✓ <b>Location wise</b>       | I. Advances <u>in India</u><br>(i) <u>Priority sectors</u><br>(ii) <u>Public sector</u><br>(iii) <u>Banks</u><br>(iv) <u>Others</u><br>II. Advances <u>outside India:</u><br>(i) <u>Due from Banks</u><br>(ii) <u>Due from Others:</u><br>(a) <u>Bills Purchased and discounted</u><br>(b) <u>Syndicated loans (foreign banks)</u><br>(c) <u>Others</u> |
| ✓ <b>Creation of Security</b>    | ✓ <b>Primary security</b>    | Security offered by the borrower for bank finance or the one against which credit has been extended by the bank.                                                                                                                                                   |

|                                                                                                    |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|----------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ✓ <b>Collateral security</b>                                                                       | It is an additional security and can be in any form i.e. tangible or intangible asset, movable or immovable asset.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| ✓ <b>Examples of Securities</b>                                                                    | <ul style="list-style-type: none"> <li>(a) ✓ Personal Security of Guarantor</li> <li>(b) ✓ Goods/Stocks/Debtors/Trade Receivables</li> <li>(c) ✓ Gold Ornaments and Bullion</li> <li>(d) ✓ Immovable Property</li> <li>(e) ✓ Plantations (For Agricultural Advances)</li> <li>(f) ✓ Third Party Guarantees</li> <li>(g) ✓ Banker's General</li> <li>(h) ✓ Lien Life Insurance Policies</li> <li>(i) ✓ Stock Exchange Securities and Other Instruments</li> </ul>                                                                                                                                                  |
| ✓ <b>Mode of Creation of Security</b>                                                              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| Security may be created by different modes like Mortgage, Pledge, Hypothecation, Lien, Assignment. |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| ✓ <b>Mortgage</b>                                                                                  | <ul style="list-style-type: none"> <li>• Registered Mortgage can be affected by a 'Mortgage Deed' signed by the mortgagor.</li> <li>• Equitable mortgage, is affected by a mere delivery of title deeds or other documents of title with intent to create security thereof.</li> </ul>                                                                                                                                                                                                                                                                                                                            |
| ✓ <b>Pledge</b>                                                                                    | <ul style="list-style-type: none"> <li>• It involves physical delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance.</li> <li>• Legal ownership of the goods remains with the pledger while the lending banker gets certain defined interests in the goods.</li> </ul>                                                                                                                                                                                                                                                                |
| ✓ <b>Hypothecation</b>                                                                             | <ul style="list-style-type: none"> <li>• Hypothecation is the creation of an equitable charge, which is created in favour of the lending bank by execution of hypothecation agreement in respect of the movable securities belonging to the borrower.</li> <li>• Borrower holds the physical possession of the goods. Neither ownership nor possession are transferred to the bank.</li> <li>• Borrower periodically submits statements regarding quantity and value of hypothecated assets (like stocks, debtors, etc.) to the bank on the basis of which the drawing power of the borrower is fixed.</li> </ul> |
| ✓ <b>Lien</b>                                                                                      | Lien is creation of a legal charge with consent of the owner, which gives lender a legal right to seize and dispose/liquidate the asset under lien.                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| ✓ <b>Assignment</b>                                                                                | <ul style="list-style-type: none"> <li>• It is a transfer of an existing or future debt, right or property belonging to a person in favour of another person.</li> <li>• Only actionable claims (i.e., claim to any debt other than a debt secured by a mortgage of immovable property or by hypothecation or pledge of movable property) such as book debts and life insurance policies are accepted by banks as security by way of assignment.</li> </ul>                                                                                                                                                       |

|                                                                                                                                                                                                                                      |                                        |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |  |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|
| Audit of Banks                                                                                                                                                                                                                       |                                        | Chapter 10                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |  |
|                                                                                                                                                                                                                                      | <div>Set-Off</div>                     | <div><div><div>Set-off is a statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor.</div><div>Right of set-off enables a bank to combine two accounts (a deposit account and a loan account) of the same person provided both the accounts are in the same name and same right.</div><div>For this purpose, all branches of a bank are treated as one single entity. Right of set-off can be exercised in respect of time-barred debts also.</div></div></div> |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |  |
| <div><div>Prudential Norms</div><div><div>Performing</div><div>Std.</div><div>SMA</div><div>Overdue &gt; 90</div><div>Non-performing</div><div>SS</div><div>12M</div><div>Doubtful</div><div>Loss</div><div>stress</div></div></div> | Non - Performing Advances              | <div>An Advance will be classified as NPA if:</div> <div><div>(a) It ceases to generate income for a bank.</div><div>(b) interest and/or installment of principal remain <b>overdue</b> for a period of more than 90 days in respect of a term loan;</div><div>(c) account remains '<b>out of order</b>' in respect of an Overdraft/Cash Credit (OD/ CC);</div><div>(d) the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.</div></div>                                                                                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |  |
|                                                                                                                                                                                                                                      |                                        | Overdue                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.                                                                                                                                                                                                                                                                                                                                                                                                                        |  |
|                                                                                                                                                                                                                                      |                                        | Out of Order                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | An account should be treated as 'out of order' if: <div><div>outstanding balance remains continuously in excess of the sanctioned limit/drawing power or</div><div>if there are no credits continuously for 90 days as on the date of Balance Sheet; or credits are not enough to cover the interest debited during the same period.</div></div>                                                                                                                                                                                              |  |
|                                                                                                                                                                                                                                      |                                        | Special Mention accounts                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | <div>Special Mention accounts (SMA) are those accounts which are resulting signs of incipient stress leading to the possibility that borrowers may default on debt obligations.</div> <div>SMA 0 – Accounts showing stress signals</div> <div>SMA 1 – Overdue between 31 to 60 days</div> <div>SMA 2 – Overdue between 61 to 90 days</div> <div>Such a classification is significant as early recognition of such accounts enables banks to initiate timely remedial actions to prevent potential slippages of such accounts into NPAs.</div> |  |
| <div><div>PA-</div><div>Std.</div><div>SMA-</div><div>Sub std.</div><div>Doubtful</div><div>Loss</div><div>NPA</div></div>                                                                                                           | Classification as per prudential norms | Standard assets                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | Assets which do not disclose any problem and does not carry more than normal risk.                                                                                                                                                                                                                                                                                                                                                                                                                                                            |  |
|                                                                                                                                                                                                                                      |                                        | Sub-standard assets                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | Asset which has remained NPA for a period less than or equal to 12 months.                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |  |
|                                                                                                                                                                                                                                      |                                        | Doubtful assets                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | Asset which has remained in the substandard category for a period of 12 months.                                                                                                                                                                                                                                                                                                                                                                                                                                                               |  |

|                                                |                                                                                                                                                                                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                                                                                                                                             |                                                                                                                                                                                                                                             |
|------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ✓                                              |                                                                                                                                                                                             | Loss assets                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | Asset in respect of which loss has been identified by the bank or internal auditors or the RBI inspection, but the amount has not been written off, wholly. |                                                                                                                                                                                                                                             |
|                                                | Provisioning Requirements                                                                                                                                                                   | Standard assets                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | 0.40%                                                                                                                                                       |                                                                                                                                                                                                                                             |
|                                                |                                                                                                                                                                                             | Sub-standard assets                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 15%                                                                                                                                                         |                                                                                                                                                                                                                                             |
|                                                |                                                                                                                                                                                             | Doubtful assets                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Unsecured portion                                                                                                                                           | 100%                                                                                                                                                                                                                                        |
|                                                |                                                                                                                                                                                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Secured portion                                                                                                                                             | 25% to 100% depending upon the period for which advance has remained doubtful. <ul style="list-style-type: none"><li>• Upto one year - 25%</li><li>• More than one year but upto 3 years - 40%</li><li>• Above three years - 100%</li></ul> |
|                                                | Loss assets                                                                                                                                                                                 | 100%                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |                                                                                                                                                             |                                                                                                                                                                                                                                             |
| <u>Special cases w.r.t. NPA Classification</u> | Classification as NPA should be based on record of recovery. Availability of security or net worth of borrower/guarantor is not to be considered for purpose of treating an advance as NPA. |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                                                                                                                                             |                                                                                                                                                                                                                                             |
|                                                | Asset Classification <u>borrower-wise</u>                                                                                                                                                   | Asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.                                                                                                                                                                                                                                                                                                                                                                                    |                                                                                                                                                             |                                                                                                                                                                                                                                             |
|                                                | Accounts <u>regularised</u> near <u>B/S date</u>                                                                                                                                            | <ul style="list-style-type: none"><li>• Where it appears that an account has inherent weakness and few credits near the balance sheet tries to make it regular, the account should be classified as NPA.</li><li>• Auditor should check for sample transactions immediately before and after closing of financial year to get a knowledge of objective behind the transactions if they have any relation to each other which might show an arrangement to prevent Borrower account(s) from slipping into NPA category.</li></ul> |                                                                                                                                                             |                                                                                                                                                                                                                                             |
|                                                | Govt. <u>guaranteed advances</u>                                                                                                                                                            | <ul style="list-style-type: none"><li>• Credit facilities backed by C.G. guarantee, though overdue will be classified as NPA only when govt. repudiates its guarantee when invoked. This exemption is only for asset classification and provisioning and not for the purpose of recognition of income. Interest on such advances should not be taken to income account unless it has been realized.</li><li>• Credit facilities backed by S.G. guarantee should be classified as NPA in normal way.</li></ul>                    |                                                                                                                                                             |                                                                                                                                                                                                                                             |
|                                                | Advances under <u>Consortium</u>                                                                                                                                                            | <ul style="list-style-type: none"><li>• Consortium advances mean advancing loans to a borrower by two or more Banks jointly by forming a Consortium. Joint appraisal, control and monitoring will facilitate for exchange of valuable information among the Banks. Usually, a Bank with a higher share will lead the consortium.</li></ul>                                                                                                                                                                                       |                                                                                                                                                             |                                                                                                                                                                                                                                             |

|     |                                                               |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|-----|---------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|     |                                                               | <ul style="list-style-type: none"> <li>Classification of Consortium advances should be based on the record of recovery of respective individual member banks and other aspects having a bearing on the recoverability of the advances.</li> <li>Where the remittances by borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, account should be treated as not serviced in the books of the other member banks and therefore, an NPA.</li> <li>Banks participating in consortium, need to arrange to get their share of recovery transferred from the lead bank or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.</li> </ul> |
|     | <b>Erosion in Value of Securities</b>                         | <p>In case there arise erosion in value of security or any fraud is committed by Borrowers, banks can directly classify these accounts as Doubtful or Loss Assets, irrespective of the period for which the account has remained NPA.</p> <p>(i) Erosion in value of securities by more than 50% of value assessed by the bank or accepted by RBI inspection team at time of last inspection, would be considered as "significant", requiring the asset to be classified as doubtful straightaway and provided for adequately.</p> <p>(ii) If realisable value of security as assessed by bank/approved valuers/ RBI is less than 10% of outstanding in borrowal accounts, existence of security should be ignored and the asset should be classified as loss asset. In such cases asset should either be written off or fully provided for.</p>             |
|     | <b>Advances Against Term Deposits, NSCs, KVPs/ IVPs, etc.</b> | <p>Advances against Term Deposits, NSCs eligible for surrender, KVP/IVP and life policies need <u>not be</u> treated as NPAs, provided <u>adequate margin</u> is available in the accounts.</p> <p>100000 — 70000 = 30000<br/> +2100 1% p.m.<br/> +2100<br/> +2100<br/> Qtr. 2100<br/> due 30.06.2022<br/> 30.09.2023<br/> 09.11.2023</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|     | <b>Agricultural Advances affected by Natural Calamities</b>   | <p>Where, in the wake of natural calamities, short-term agricultural loans are converted into term loans or there is rescheduling of repayment period or fresh short-term loans are sanctioned, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as NPA.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| 9%. | <b>Advances to Staff</b>                                      | <ul style="list-style-type: none"> <li>Interest-bearing staff advances should be included as part of advances portfolio of bank. In case of housing loan or similar advances granted to staff members <u>where interest is payable after recovery of principal</u>, interest need not be considered <u>as overdue</u> from the first quarter onwards.</li> <li>Such loans/advances should be classified as NPA only when there is a <u>default</u> in <u>repayment of installment of principal</u> or <u>payment of interest</u> on respective due dates.</li> </ul> <p>10.14</p> <p>1000000 — 20000 = 9,80,000 — 20000 = 9,60,000 — 20000</p> <p>Principal - due - interest - due -</p> <p>9% - 2% = 7%</p> <p>Subsided rate</p> <p>Just for loan</p> <p>1000000 - 20000 = 980000<br/> 980000 - 20000 = 960000<br/> 960000 - 20000 = 940000</p>             |

|                                       |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|---------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ✓ <b>Agricultural Advances/ Loans</b> | <p>Interest and/or Instalment of principal is <b>overdue</b> for –</p> <ul style="list-style-type: none"> <li>• two crop seasons, in case loans granted for Short Duration crops,</li> <li>• one crop season, in case loans granted for Long Duration crops (i.e. more than 1 year)</li> </ul> <p style="text-align: center;"><b>Points to Remember</b></p> <ul style="list-style-type: none"> <li>• Long duration crops mean the crops with crop season longer than one year.</li> <li>• Short Duration Crops means the crops, other than long duration crops.</li> <li>• Crop season means the period up to harvesting of the crops, as determined by the State Level Bankers' Committee in each State.</li> </ul> |
|---------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

#### ✓ 10.4 - Computation of Drawing Power (DP)

|                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|--------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Meaning of DP</b>           | <ul style="list-style-type: none"> <li>• DP is an important concept for Cash Credit (CC) facility availed from banks and financial institutions.</li> <li>• It may be defined as the limit up to which a firm or company can withdraw from the working capital limit sanctioned.</li> </ul>                                                                                                                                                                                                                                                                  |
| <b>Sanctioned Limit vs. DP</b> | <ul style="list-style-type: none"> <li>• Sanctioned limit is the total exposure that a bank can take on a particular client for facilities like cash credit, overdraft, export packing credit, non-funded exposures etc.</li> <li>• On the other hand, DP refers to the amount calculated based on primary security less margin as on a particular date.</li> </ul>                                                                                                                                                                                          |
| <b>Considerations</b>          | <ul style="list-style-type: none"> <li>• All accounts should be kept within both DP and sanctioned limit at all times.</li> <li>• Accounts which exceed the sanctioned limit or DP or are against unapproved securities or are otherwise irregular should be brought to the notice of the Management/Head Office regularly.</li> </ul>                                                                                                                                                                                                                       |
| <b>Bank's Duties</b>           | <ul style="list-style-type: none"> <li>• Banks should ensure that drawings in the working capital account are covered by the adequacy of the current assets.</li> <li>• DP is required to be arrived at based on current stock statement. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months.</li> <li>• Outstanding in the account based on DP calculated from stock statements older than 3 months is deemed as irregular.</li> </ul> |
| <b>Auditor's Concern</b>       | <ul style="list-style-type: none"> <li>• Stock statements, quarterly returns and other statements submitted by the borrower to the bank should be scrutinized in detail. Audited Annual Report submitted should be scrutinized properly.</li> <li>• Monthly stock statement of the month for which the audited accounts are prepared and submitted should be compared and the reasons for deviations, if any, should be ascertained.</li> </ul>                                                                                                              |
| <b>Computation of DP</b>       | <ul style="list-style-type: none"> <li>• Ensure that DP is calculated as per extant guidelines formulated by the BoD of respective bank and agreed upon by concerned statutory auditors.</li> </ul>                                                                                                                                                                                                                                                                                                                                                          |

## Chapter - 12 "Audit of Banks" (Lecture No. 2)

### 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, O/D, 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<sup>①</sup> or out of order<sup>②</sup> 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  $\leq 12$  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           | (irregular)                         | Substandard | Doubtful       | Loss                   |
|--------------------|-------------------------------------|-------------|----------------|------------------------|
| ↓                  | overdue $> 90$<br>out of order days | (12 Months) | $> 12$ Months. | <u>Loss Identified</u> |
| <u>Normal Risk</u> | [Special Mention<br>Accounts - SMA] |             |                |                        |

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><br>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.

X Ltd. → SBI → T/L-1 - irregular (NPA)  
→ T/L-2 - Regular - PA  
→ C/L - Regular - PA

### (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:

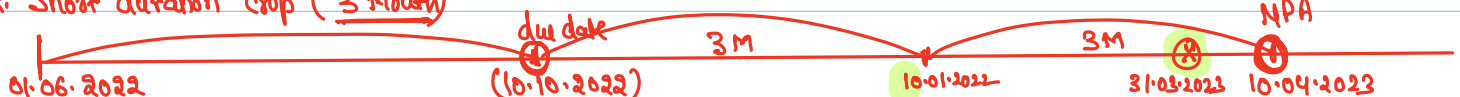
Agricultural advances shall be classified as NPA, if interest and/or instalment of Principal is overdue for

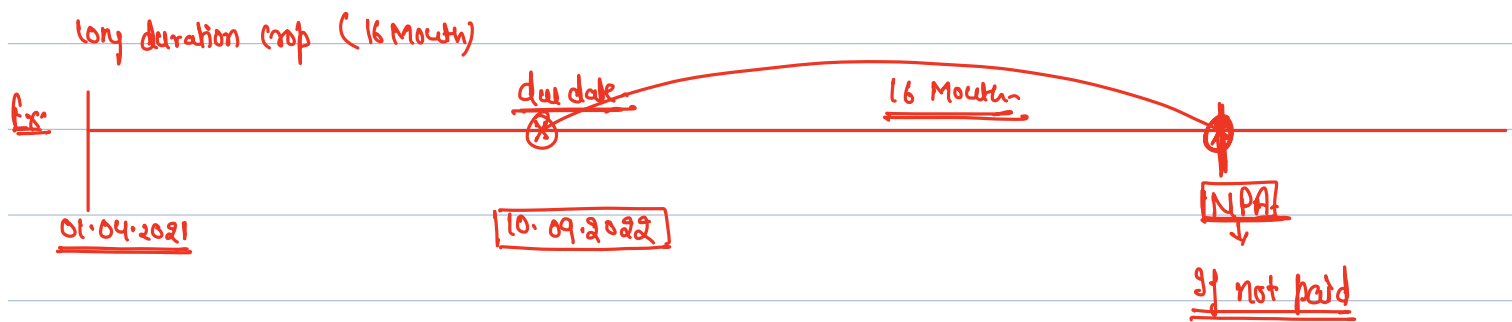


Short duration crops: Crops, other than long duration crops.

Long duration crops: Crops with crop season longer than one year.

Ex. Short duration crop (3 months)





### (vi) Erosion in value of securities:

Erosion > 50% of value assessed by  
Bank or accepted by RBI  
Inspection at the time  
of last inspection

Considered as significant

Asset will be directly classified as  
Doubtful.

Ex: Loan = 3 lakh

Security value = 5 lakh (at time of loan)

Current Value = 2.40 lakh

to be considered as doubtful.

Realisable value < 10% of outstanding  
of security in borrowers etc.

Existence of security should be ignored.

Asset should be classified as loss  
asset and need to be written off  
or fully provided for.

Ex: Loan = 3 lakh

Security value = 5 lakh (at time of loan)

Current Value = 25,000

to be classified as loss Asset.

### (vii) Agricultural advances affected by Natural calamities:

If due to natural calamities, short-term agricultural loans converted into term loans  
or repayment period is rescheduled or fresh short term loans are sanctioned, term loans  
as well as fresh short term loans are considered as current dues and not classified NPA.

## Chapter - 12 "Audit of Banks" (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  $\rightarrow$  > 3 Month old - Not considered

Debtor  $\rightarrow$  > 6 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:

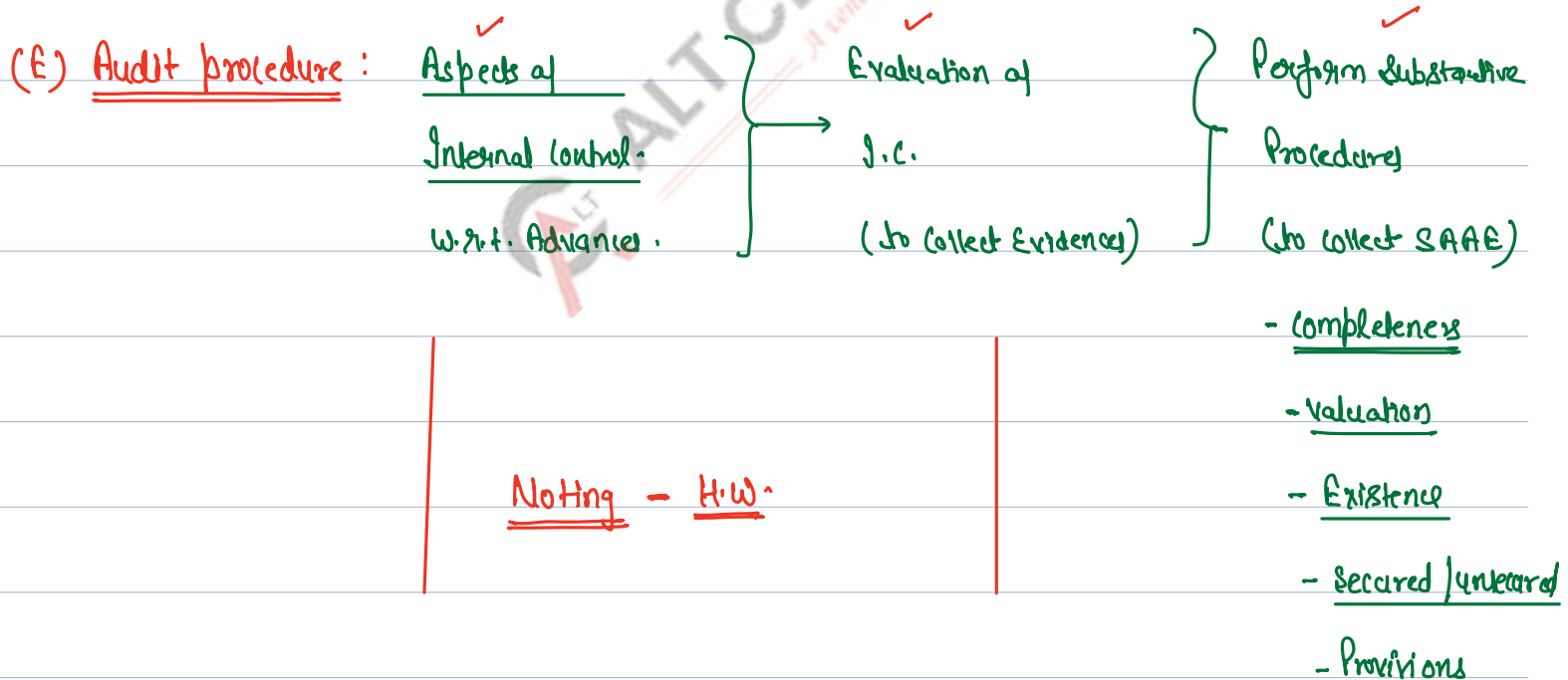
- ✓ (a) Stock Statements
- ✓ (b) Quarterly returns
- ✓ (c) Other statements
- ✓ (d) Audited annual accounts and annual report.

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 crores.
- 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.





## Chapter - 10 "Audit of Banks"

### Topics Covered:

- I. Banking operations :
- II. Auditing framework :
- III. Types and Classification of Advances :
- IV. Computation of DP
- V. Verification (Audit) of Advances :

(A) Audit approach: Auditor is primarily concerned with Obtaining Evidence as to:

- (i) Amount shown in B/s are O/s as on B/s date. (Existence)
- (ii) Advances represent amt. due to bank. (Right)
- (iii) Advances are supported by loan documents. (Validity & Accuracy)
- (iv) No unrecorded advances. (Completeness)
- (v) Basis of Valuation is appropriate and applied properly and recoverability recognised in valuation. (Valuation)
- (vi) Disclosure, classification is as per recognised accounting policies and statutory requirements. (Presentation, disclosure, and Classification)
- (vii) Provisions made as per RBI Norms, ASs and GAAPs.

### (B) How to obtain audit Evidences :

- (i) By Study and Evaluation of Internal Controls relating to advances;
- (ii) By Examining
  - Validity of recorded amount;
  - Loan documentation; (Inspection)
  - Existence, Enforceability and Valuation of securities
- (iii) By reviewing the Operations of accounts.
- (iv) By checking compliance with RBI Norms.
- (v) By Carrying out appropriate APs.

## (v) Evaluation of Internal Control:

(Learning + Noting) - Any 6 points

### (vi) Audit of Revenue Items:

#### (A) Income

##### (a) Interest Earned: Advances [CIC, O/D, TIL, BP, BD, etc.]

Investments

Balance with RBI

Inter-Bank loans, etc.

##### (b) Other Income: - Commission, Brokerage, Exchange

- Profit on sale / revaluation of

Investments / Fixed assets.

- Dividend Income

- Others

#### (B) Expenses

##### (a) Interest Expense:

- Deposits (SB, FD, R.D.)

- Borrowings from RBI

- Inter-Bank Borrowings

##### (b) Operating Expenses:

- Payments to Employees

- Rent, Taxes, Lighting

- Printing Stationery, Telephone

- Repair, Maintenance, Insurance

Audit, marketing, audit fee.

etc.

### Provision and Contingencies

#### ✓ Audit of Revenue Items (Incomes):

(i) Audit Approach and Procedures ✓

(ii) Reversal of Income ✓

(iii) Partial recoveries in NPA ✓

(iv) Take-out Finance.

#### Audit of Revenue Items (Expenses):

(i) Verification of Interest Expense

(ii) " " Operating "

(iii) " " Provision and

Contingencies

## Verification of Interest Expense:

- (i) Compute Weighted average interest rate based on analysis of types of deposits outstanding at End of each quarter.  
Rate so computed shall be compared with actual average rate for CY and inquire for the difference.
- (ii) Compare average rate of interest with that of PY and inquire for the difference.
- (iii) Ascertain changes in Interest rates on saving deposits and term deposits during the year.  

$\overset{\text{21-22}}{\text{21-22}} \quad \overset{\text{22-23}}{\text{22-23}} \quad \overset{\text{23-24}}{\text{23-24}}$   
(4-5%)    (5-7%)    (5-7%)
- (iv) Check calculation of interest and ensure the following:
  - (a) Interest provided upto BIs date
  - (b) " rates are as per bank regulations, RBI directives and agreement with depositors.
  - (c) Interest on Inter bank balances has been provided at the rates prescribed by H.O.
  - (d) Interest rates on saving deposits are in accordance with the Rules framed by the bank.

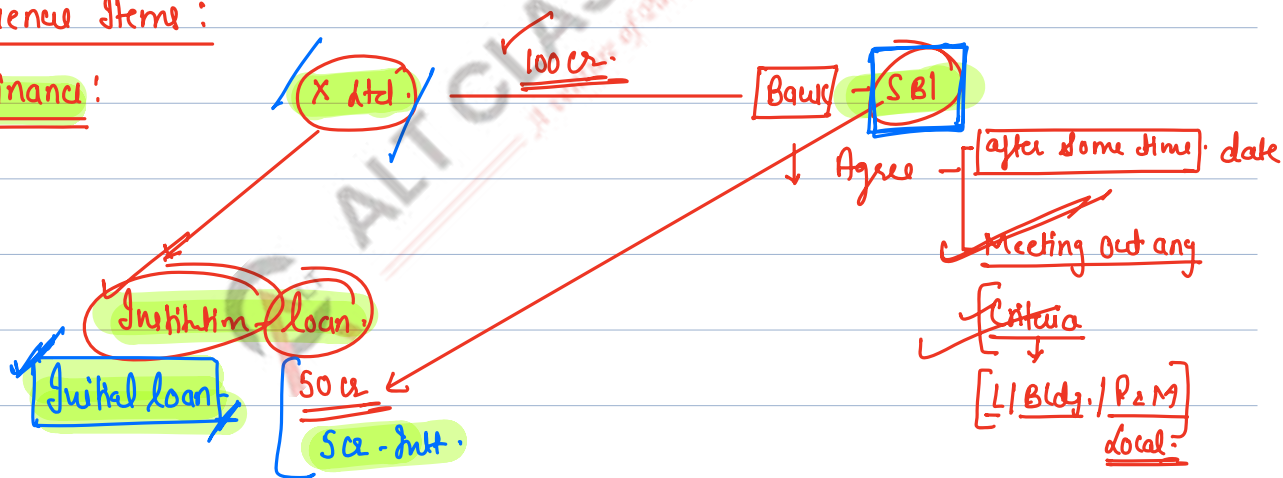
## Verification of Operating expenses:

- (a) Evaluate IC system including Authorisation procedure, so as determine NTF of Sub. procedures.
- (b) Examine significant deviations in respect of any major expenditure.
- (c) Perform Analytical review for payments
- (d) Examine supporting documents of payments.
- (e) Check calculations of payments made.

- Imp - Verification of Provisions and Contingencies:
- Ascertain compliance with regulatory requirements as contained in RBI Circulars.
  - Obtain understanding as to how bank computes provisions on NPA and Standard Assets.
  - Examine Basis of classification of advances into Std, Sub-Standard, doubtful and loss assets.
  - Examine whether o/s Balance of advances matches with GL.
  - Obtain Stn. of Computation of tax provision and verify nature of items debited and credited in P&L A/c.
  - Examine other provisions for expenditure as to Circumstances requiring provisioning and adequacy of same.

### Audit of Revenue Items:

#### Take-out finance:



- Method of financing whereby a loan that is procured later will be used to replace the initial loan. In such financing, lender promises to provide funds at a particular date or when particular <sup>(initial loan)</sup> criteria for completion of projects are met.
- Account is classified by lending bank as NPA, based on record of recovery;
- Income of such financing should not be recognised unless realised from borrower or taking over institution.

## 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 :

- (i) recorded income arises from transactions taking place in the relevant period, pertains to the bank [Occurrence]
- (ii) there is no unrecorded income. [Completeness]
- (iii) Income is recorded at appropriate amount. [Measurement]

(b) RB's directions: Income should be recognised on accrual basis as per AS-9, if that income exceeds:

✓ Gross Commission = 2 Cr. [ $< 1\%$  of Total Income]

Total Income = 180 Cr.

Net Commission = 1.2 Cr. [ $> 1\%$  of Net Profit]

Net Profit before tax = 100 Cr.

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.

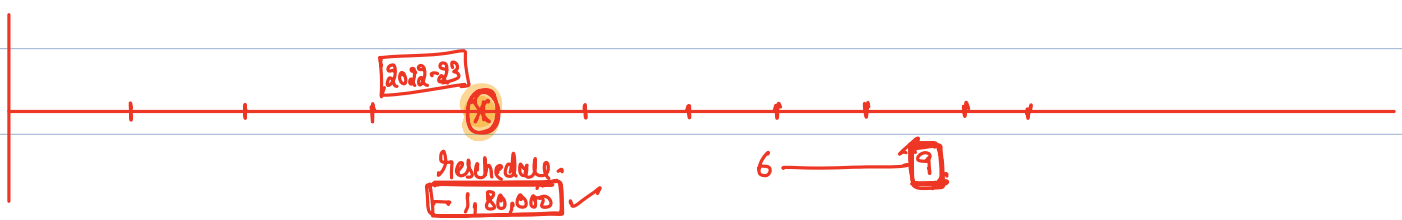
(e) Advances against securities: Interest on advances against fixed deposits, NSCs, KVP, IVP and Life insurance policies, may be recognised on due dates, provided adequate margin are available.

(f) Bills Purchased | — Self Study —

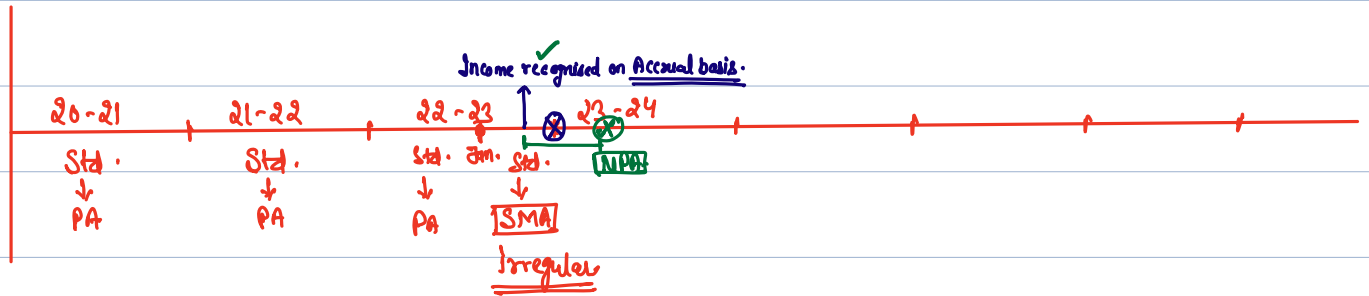
(g) Bills for collection

(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 -



## Ch. 9 - Audit of different types of Entities



### (1) Govt. Audit:

(A) Meaning: - Objective, Systematic, Professional and Independent Examination of F.A.O operations of Public Entity.

- Purpose → To Evaluate and Verify the F.A.O operations  
→ To present a report — Audit findings  
— Conclusions; and  
— Recommendations.

- Examination of F.S. → To Express opinion on fairness of presentation.

### (B) Objectives:

- Accounting for public funds.
- Appraisal of Government Policies: and official administrative items
- Base for corrective actions: against lapses of lower hierarchy.
- Administrative Accountability: towards legislature

### (C) Legal framework of CAG:

Appointment → President of India

Term → 6 years or 65 years of age - Earlier

Remuneration → Equivalent to SC Judge

Removal → Incapacity / Misbehaviour +  $\frac{2}{3}$ rd approval - <sup>Both</sup> Houses

Article 149 → Powers and duties (as prescribed)

" 150 → Maintenance of account - Union/State

" 151 → Submission of Accounts

Report - President / Governor.

(d) Duties of C & AG:

(i) Compilation and Submission of Accounts

(ii) Providing Information and rendering assistance for F.S.

(iii) Auditing and Reporting - (a) Expenditure from Consolidated Fund  
(b) All drawdowns of Contingency Fund  
(c) F.S. of dept. of Union/States.

(iv) Audit of receipts and Expenditure of substantially financed Entities (Amt  $\geq$  25 lakh + Amt  $\geq$  75% of Total Expenditure)

(v) Audit of Grants or loans - specific purpose from Consolidated Fund.

(vi) Audit of receipts of Union and States.

(vii) " " Accounts of stores and stock.

(viii) " " Govt. Companies.

(e) Powers of C & AG:

(i) Inspection



Office of accounts under  
Control of Union or State

(ii) Transmission



Accounts, books, papers or  
documents - relevant  
to drawdowns under audit

(iii) Inquiry



as considered  
necessary for prep<sup>n</sup>  
of accounts or reports.

- <sup>Imp:</sup>  
(i) Expenditure Audit: (i) Audit against Rules and Orders: Expenditure incurred confirms to relevant provisions of statutory enactments and financial rules and regulations.
- (ii) Audit of Sanction: All expenditures should have proper sanction given by competent authority.
- (iii) Audit against provision of funds: There should exist provision of funds out of which expenses are met.
- (iv) Propriety Audit: Expenditure should be incurred with due regard to Principle of Propriety.
- (v) Performance Audit: 3 E Audit — Economy  
Efficiency  
Effectiveness

— Details to be covered from book —

- H.W - (1) Categories of Rules, Regulations and Orders against which Regularity is Conducted.
- (2) Verification Points while carrying audit against Rules, Regulations and Orders.
- (3) " " " " " of Sanctions
- (4) " " " " " Provision of funds.
- (5) " " " " " Propriety audit
- (6) " " " " " Performance "
- (7) Procedure for conducting performance audit.

## Ch. 9 - Audit of different Entities

### (I) Govt. Audit:

(A) Meaning

(B) Objectives

(C) Legal framework of C & AG

(D) Duties of C & AG

(E) Powers of C & AG

(F) Expenditure Audit

Imp:

(G) Receipt Audit: (i) Revenues → Correctly assessed, realised and credited to Govt. Alc.

(ii) For Proper Assessment and Collection of revenue, Regulations and procedures → framed

(iii) Reg. and Pro. → carried out.

(iv) Checks are imposed → detection and investigation of

- irregularities

- double refunds.

- forged refunds

- Other loss of revenue.

(v) Systems and Procedures → Correct and regular accounting of demands, collection, refunds.

### (h) Audit of Stores and Inventories:

↓  
All Purchases - P & M,

Equipments etc.

- Regulations - devised and carried out

- Deficiencies / defects → brought to notice of Govt.

- Purchases - sanctioned, Economical, Rules

- Prices - Reasonable, agree - contract

- Certificates - Q/Q - Inspecting / Receiving

- Accounts - R/S/B

## (i) Audit of Commercial Accounts:

### (A) Departmental Activities:

(e.g. Dept. of Telecommunication)

### (B) Statutory Corporation:

(e.g. LIC of India; GIC)

### (C) Govt. Companies:

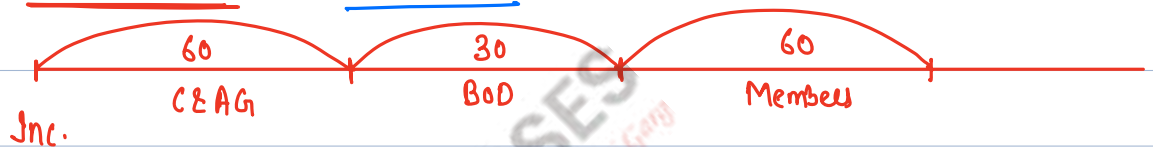
(Incorporated under Companies Act, 2013)

## Audit aspects

- same manner as of any Govt. deptt., where Commercial Acc. kept.
- Provisions contained in statute governing the Corp.
- audit will be carried out by auditors appointed by C&AG.

## (j) Role of C&AG under Companies Act, 2013:

Govt. Co. - First Auditor → Sec. 139(7)



Tenure: till conclusion of first AGM

✓ Subsequent Auditor: - Every financial year

Sec. 139(5)

- within 180 days of commencement of FY
- appointed by C&AG
- Tenure - till conclusion of next AGM.

Govt. Co.

Sec. 143(5): C&AG → direct the auditor - manner in which audit is to be carried out.

Auditor - Audit report →

- Directions
- Action
- Impact

Sec. 143(6): Supplementary Audit - → Order within 60 days of report.  
(F.S.) → comment upon or supplement  
↓  
sent by Co. to every person - F.S.

Sec. 143(7): Test Audit → Accounts of Govt. Co. or

Govt. owned or controlled  
Companies

Reporting Procedures: - Reading from book -

## (a) Audit of Local Bodies:

### (a) Meaning of Municipality:

### (b) Sources of Revenue: Property taxes; Octroi, Profession tax, taxes on Advt. etc.

### (c) Classification of Expenditure:

(i)

(ii)

(iii)

(iv)

(v)

(vi)

### (d) Types of Revenue Grants: 3 types

(a) General Purpose: To bridge gap between needs and resources.

(b) Specific Purpose: for provision of certain services or performance of certain tasks.

### (c) Statutory and Compensatory Grant:

Grants given to local bodies as compensation due to loss of any revenue.

### (e) Financial Administration:

(i) Budgetary Procedure

(ii) Expenditure Control

(iii) Accounting System.

## Imp (f) Objectives of audit of local bodies: (Learning + Noting - H.W.)

### (3) Audit of NGOs:

(i) Meaning of NGO

(ii) Incorporation

(iii) Sources and Application of funds

(iv) Provisions related with Audit: (Companies Act, 2013, I-tax Act 1961, FCRA, 2010)

- NGO regd. under Society Regn. Act, 1860

or

Indian Trusts Act, 1882

Auditor shall be appointed  
by Mngt. of Society or Trust

- NGO regd. as Sec. 8 Company

Auditor shall be appointed  
by Members of the Co.

- FCRA, 2010 → Audit Report → Ministry of Home Affairs

→ within 60 days from end of F.Y.

Imp

Points to be considered while planning the audit: learn + Noting (H.W.)

(First 5 Points)

Specific points to be verified: ✓ Funds - Noting and learning

✓ Receipts - " " "

✓ Expenses | Reading

✓ Assets and Liabilities | "

Imp

Receipts: (a) Contribution and Grants for projects and programmes / f.c.

(b) Receipts from fund raising programmes.

(c) Membership fees:

(d) Subscription.

(e) Interest and dividend



Funds:

- Corpus Funds: Contribution towards Corpus - letter of donors
- Reserve
- Ear-Marked Funds: Funds made for specific purpose —
  - donors instruction.
  - Board Resolution.
  - Rules & Reg.
- Projects / Agency Balances disbursements needs to be as per Ag. with donors
- Loans: - check loan agreements, Counterfoil of receipts etc.

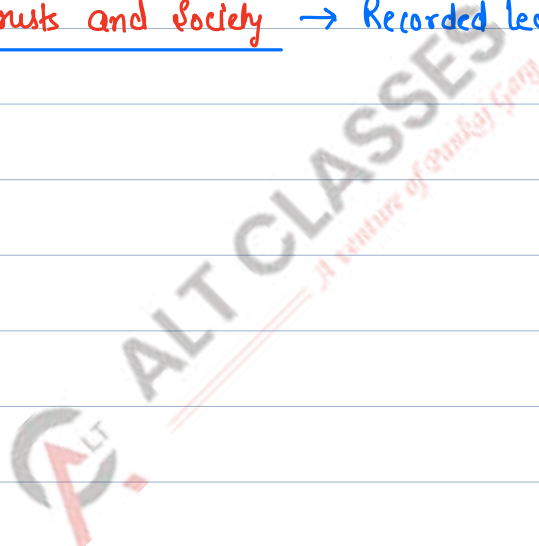
## Chapter - 9 "Audit of different Entities"

Part A - Govt. Audit, Audit of Local bodies and NGO

Part B - Audit of Trader, Partnership Firms and LLPs

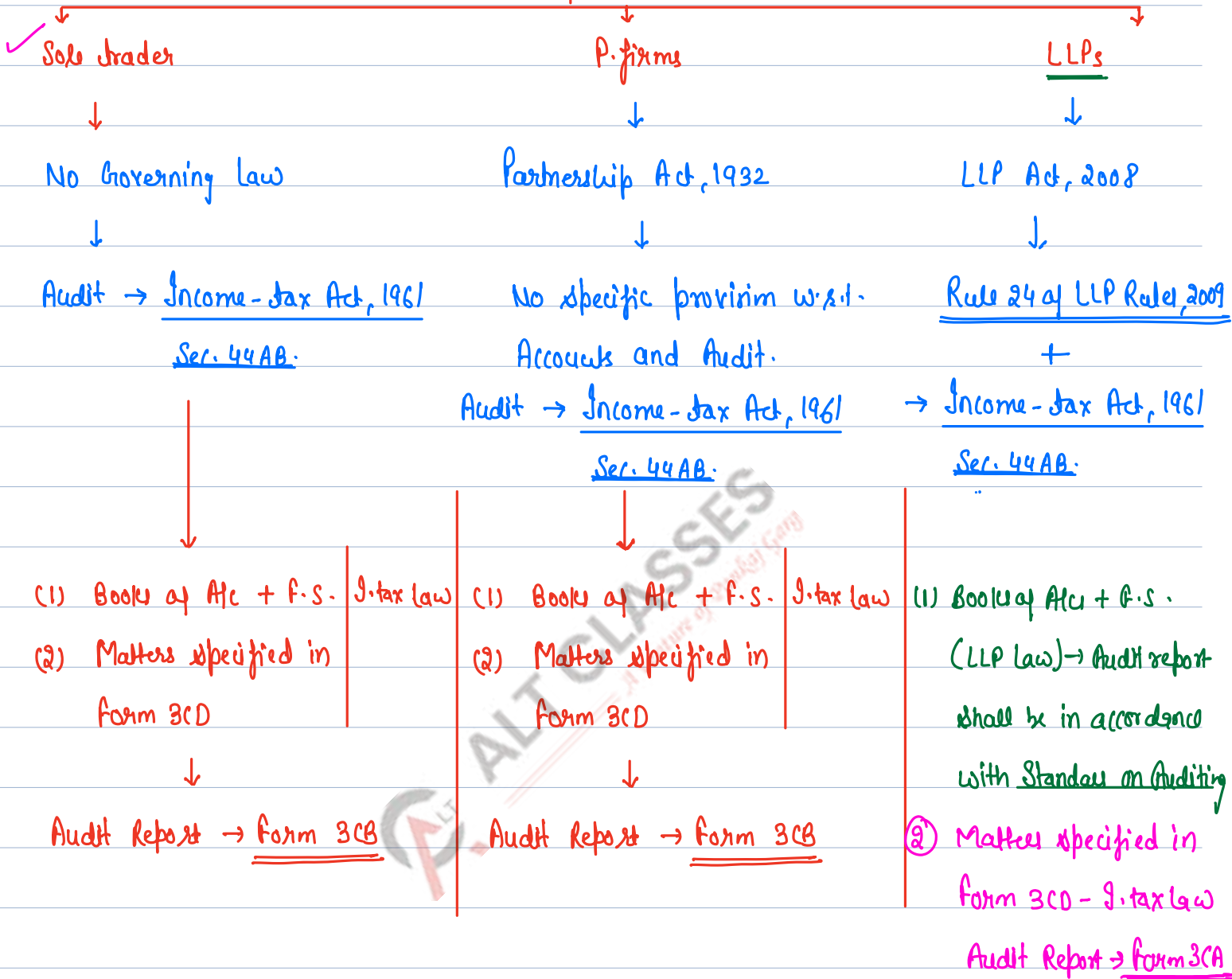
Part C - Audit of Charitable Institution, Educational Institution, Hospital, Cinema, Club, Hotel, Hire purchase and Leasing Companies → Recorded Lecture (Earlier Batch)

Part D - Audit of Cooperative Societies, Multistate Cooperative Society → Recorded Lecture  
" " Trusts and Society → Recorded Lecture (New Batch)



# Ch-9 "Audit of different Entities"

## Part - B



## Audit of LLP: (a) Legal provisions

|     | Contribution | Turnover | Small LLP (Both) | Audit (either) |
|-----|--------------|----------|------------------|----------------|
| (A) | 20 lakh.     | 45 lakh. | No.              | No.            |
| (B) | 26 lakh      | 39 lakh  | No               | No             |
| (C) | 24 lakh      | 39 lakh. | <b>YES</b>       | No.            |
| (d) | 26 lakh.     | 45 lakh  | No.              | <b>YES</b>     |

Auditor shall be appointed by designated partner.<sup>\*</sup>



\* If designated partner fails to appoint auditor, other partners may appoint the auditor.

Advantages of Audit : - Self Study -

Returns to be maintained and filed by LLP with RoC:

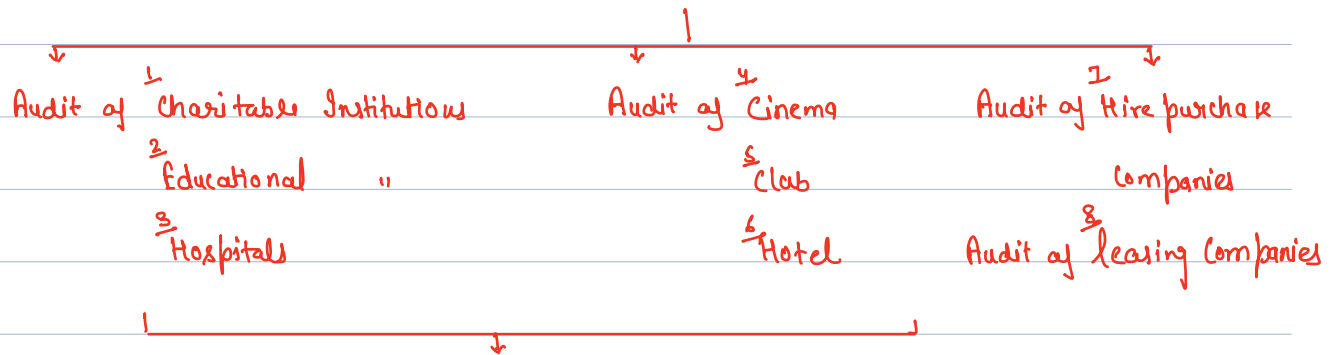
(A) Annual Return : Form 11 (within 60 days of end of fy)

(B) Stn. of Ac and Solvency : Form 8. (with 30 days from end of 6 Months of fy)

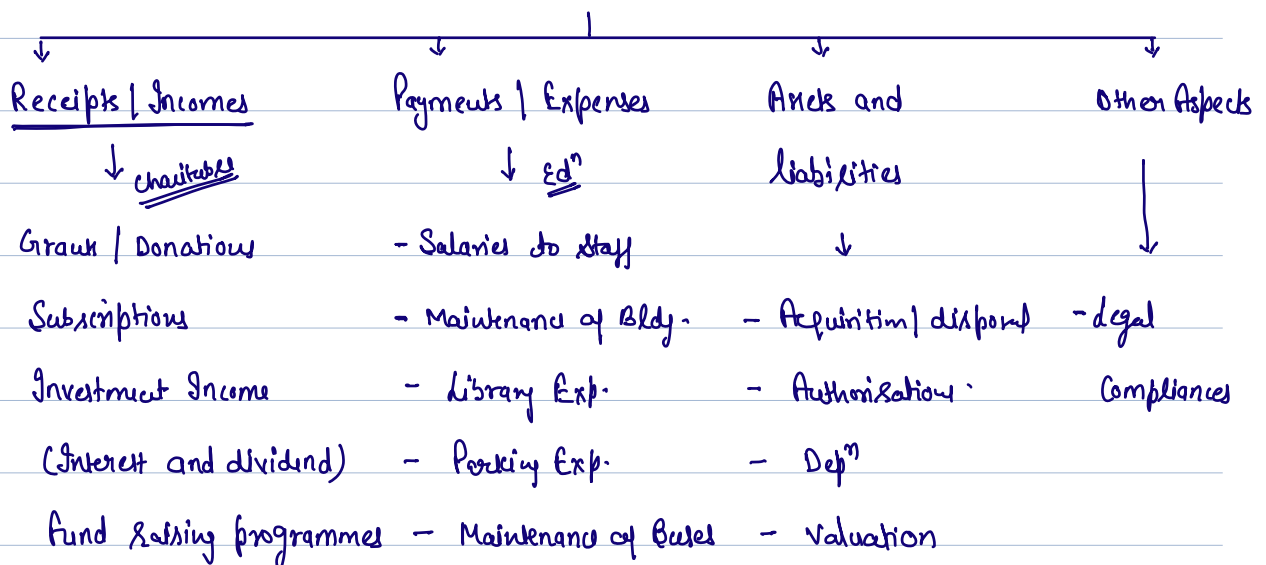
Auditor's duty regarding LLP Audit : - Self Study -

## Chapter - 13 "Audit of different Entities"

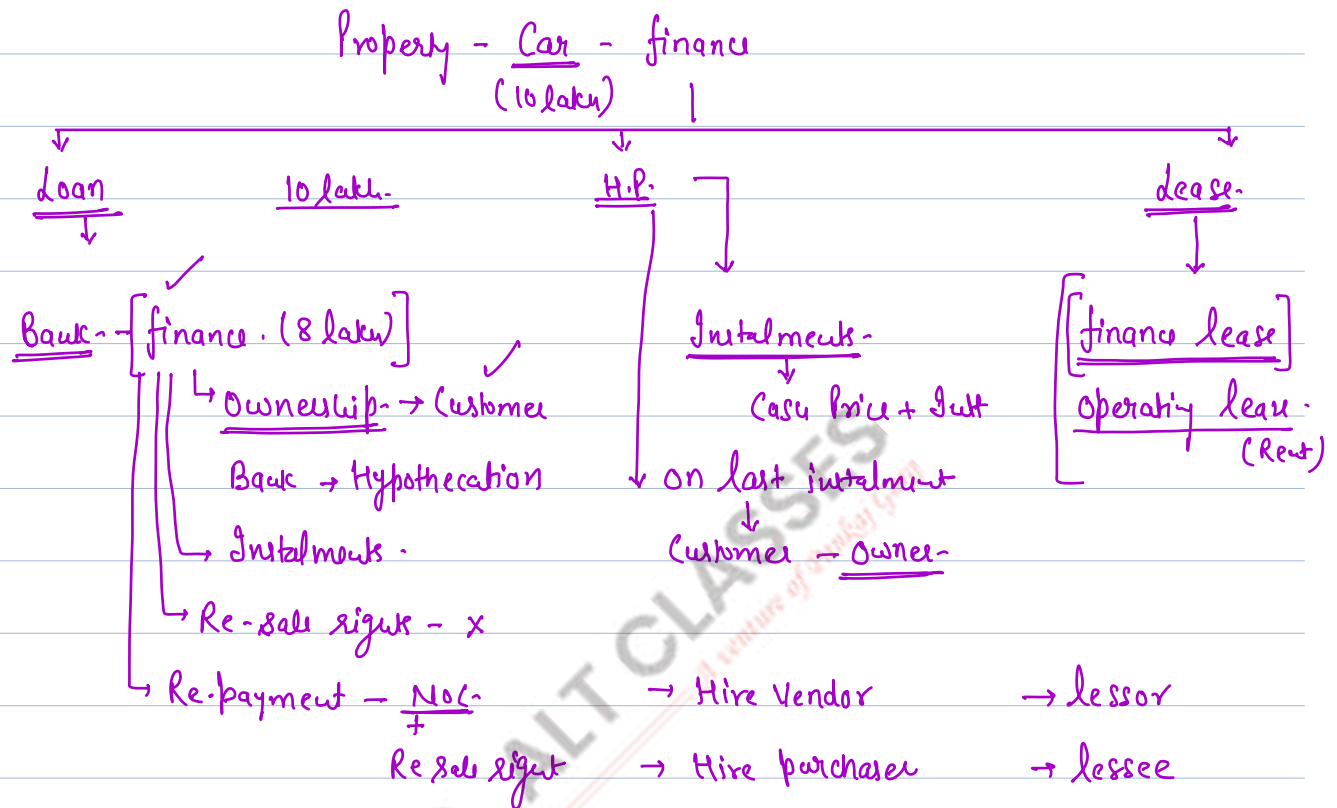
### Part - C "Misc. Audits"



Substantive Checking: Extent of substantive testing depends on existence and effectiveness of I.C. system.

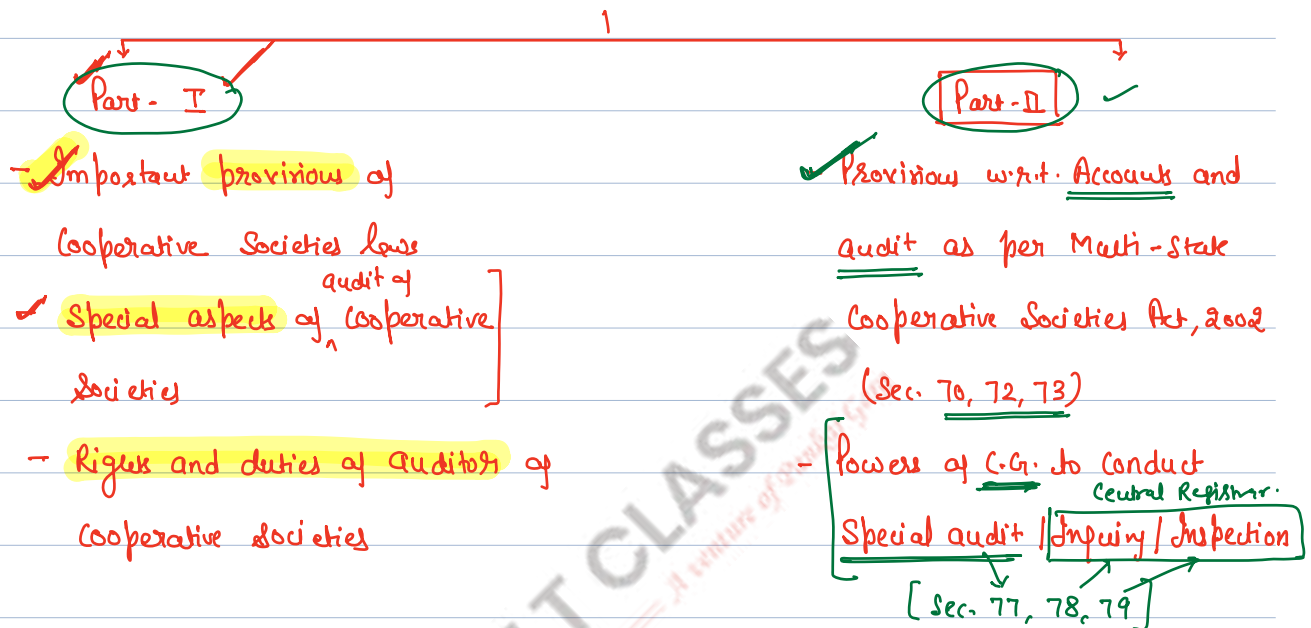
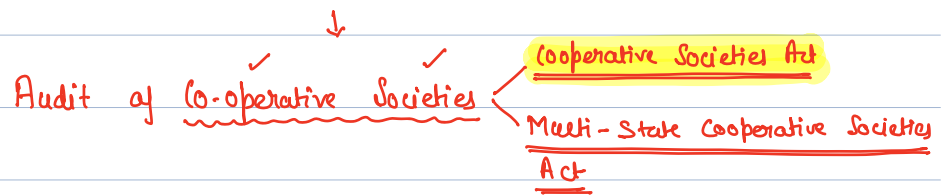


# Hire - Purchase and lease transactions



| ✓                      | <u>Asset</u>         | <u>lease period</u>                | <u>lease payment</u>                                    | <u>ownership</u>    |
|------------------------|----------------------|------------------------------------|---------------------------------------------------------|---------------------|
| ✓ <u>Finance lease</u> | [selected by lessee] | ✓<br>Approx. life of Asset         | ↓<br>Covers full value of asset + finance chg. - lessee | offered to lessee   |
| <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"



### I. Important Provisions of Cooperative Societies law:

- (i) Qualification of auditor: CA + Persons holding diploma in co-operative accounts.
- (ii) Appointment of auditor: by Registrar.
- (iii) Books, Accounts and Other records:
  - Sum of money recd. and expended
  - Sales and purchases
  - assets and liabilities
- (iv) Restriction on shareholding: 20% of total no. of shares / ₹ 1,000  
(for persons other than regd. society)
- (v) 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  $\rightarrow$  Reserve fund

(ix) Contribution for charitable purpose: 10% of NP

(x) Utilisation of reserve funds

(xi) Contribution to Edh fund:

## II. Special features of cooperative societies audit: (H.W.)

### III: Rights and duties of auditor of cooperative societies: (H.W.)

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



(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

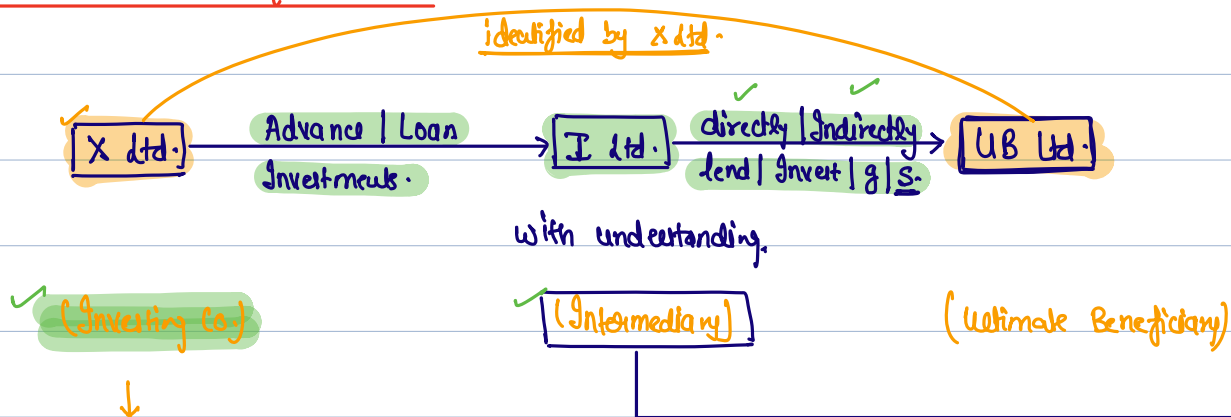
(b) " " " at discount

(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:

Self-Study -

(c) Types of Reserves: Capital and Revenue

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

(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:

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## 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.2: 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 -



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A venture of Ganga Gang



⑦ Audit of Trade Receivable:

Q.1. It is important to carry out tests of controls for checking the effectiveness of internal controls over sales as a part of debtor's audit procedure.

Mention the points to be considered while performing tests of controls.

(4 Marks)

Q.2. Write the audit procedure for verification of valuation of trade receivable.

(4 Marks)

Q.3. Mention the Analytical Review procedures that is to be performed by the auditor for the purpose of obtaining evidences regarding various assertions relating to trade receivables, loans and advances.

(4 Marks)

⑧ Audit of Cash and Cash Equivalent:

Q.1: Explain direct confirmation procedure w.r.t. bank balances as on B/s date.

(4 Marks)

Q.2: Mention the disclosure requirements of Sch-III of Companies Act, 2013, w.r.t. Cash and Cash Equivalent.

(3 Marks)

## ⑨ Audit of Inventories:

Q.1: Auditor is required to evaluate certain assertions while examining the financial statement items.

Mention Any four assertions, that are to be evaluated while verifying the inventories.

Q.2: How will you vouch/verify the following: Goods sent on Consignment.

Q.3: What are the points to be considered while verifying valuation of

(a) Raw Materials and Consumables

(b) finished Goods and Goods held for resale

## ⑩ Audit of loans and advances and Other Current Assets:

Q.1: Mention the Criteria on the basis of which an asset is to be classified as Current asset. (4 Marks)

Q.2: Mention the disclosure requirements of Sch-III w.r.t. loans and advances granted to promoters, directors, KMPs and other related parties. (3 Marks)

## Chapter - 9 "Audit of Items of financial statements" (Lecture-4)

### (ii) Audit of PPE:

✓ Q.1: Certain Revenue Expenses, if incurred for creating an asset or adding to the value of asset by achieving higher productivity, are to be classified as expenditure of capital nature. Explain with Examples. (4 Marks)

Q.2: Briefly explain the audit procedure to be performed by an auditor while verifying the property, plant and equipments of a company w.r.t to evaluation of "Rights and obligation" assertion. (4 Marks)

### (12) Audit of Intangible fixed assets: - Self study -

### (13) Misc. Provisions:

(A) CSR Activities: If a company is covered U/s 135 of Companies Act, 2013, company shall disclose the following w.r.t. CSR Activities:

i) Amt. required to be spent during the year.

ii) Amt. of expenditure incurred.

iii) Shortfall at the end of year

iv) Total of P's Shortfall

v) reasons for shortfall

vi) nature of CSR Activities

vii) details of related party transactions

viii) where a provision is made as to any liability incurred by any contractual obligation movements in provision to be disclosed

(B) Rounding off (for figures in financial statements):

If Total Income  $< 100$  cr.  $\longrightarrow$  Rounding off  $\longrightarrow$  nearest hundreds,  
thousands, or decimals  
lakhs,  
millions

If Total Income  $\geq 100$  cr.  $\longrightarrow$  Rounding off  $\longrightarrow$  nearest lakhs,  
millions or decimals  
crores thereof

(C) Disclosures w.r.t. details of Benami Property:

If any proceedings have been initiated / pending against any company, for holding any benami property, under the Benami Transactions (Prohibition) Act, 1988 and rules made thereunder, company shall disclose the following:

(a) Details of such property, including year of acquisition.

(b) Amount of such property,

(c) Details of Beneficiaries;

(d) If recorded in the books of A/c, reference to the items in B/s.

(e) If not recorded in the books of A/c, facts shall be stated with reasons.

(f) Where there are proceedings against the company under this law, details as to nature of proceedings, status of proceedings and company's view on the same should be disclosed.

(d) Disclosure of Ratios:

(i) Current Ratio

(ii) Debt Equity Ratio

(iii) Debt Service Coverage Ratio

(iv) RoE Ratio

(v) Inventory T/o Ratio

(vi) Trade Receivables T/o Ratio

(vii) Trade payables T/o Ratio

(viii) Net Capital T/o Ratio

(ix) N.P. Ratio

(x) ROCE

(xi) Return on Investment

$$\frac{\text{Earnings}}{\text{EBIT}} \left( \frac{\text{Principal + Intt}}{\text{100}} \right) = \frac{100}{100 + 5064} = 1.50$$
$$= 100 / 1.50 = -$$

Note: In case of any change in ratio by more than 25% as compared to preceding year, explanation for such changes also to be provided.

(e) Details of Crypto Currency or Virtual Currency:

If company has traded or invested in crypto or virtual currency during the financial year, company is required to disclose the following:

- (i) Profit/loss on transactions involving crypto or virtual currency.
- (ii) Amount of currency held as at the reporting date.
- (iii) Deposit / advance taken from any person for the purpose of trading or investing in crypto currency or virtual currency.



## Chapter- 9 " Audit of Items of F.S. " ( Lecture-5)

### ⑭ Audit of sale of products and services:

Q.1: How will you verify the following : Consignment sales

Q.2: Briefly describe the audit procedure to be performed by an auditor to ensure that transactions related with sale of goods and services are appropriately measured and recorded in the books of A/c.

### ⑮ Audit of Other Incomes: [Interest, dividend, Gain (loss) on sale of Investments]

- Learn full topic from book -

### ⑯ Audit of Purchases: - Homework -

## Chapter - 9 "Audit of F.S. Items" (Lecture 6)



### Income Statement Items



(a) Revenue Incomes

(b) Revenue Expenses



(i) Sale of Goods and rendering of services

(ii) Other Incomes



(i) Audit of Purchases

(ii) Audit of Employee Benefit Exp.

(iii) Audit of dep<sup>n</sup>

(iv) Audit of Other Expenses

#### ⑪ Audit of Employee Benefit Expense:

Q.1: How will you vouch/verify the "Employee Benefit Expense" while carrying out audit of X Ltd.

#### ⑫ Audit of depreciation and amortisation:

Q.1: Mention the attributes to be considered by Auditor while verifying the depreciation and amortisation expense.

#### ⑬ Audit of Other Expenses:

Q.1: Mention the attributes to be considered by Auditor while verifying revenue expenses like rent, power and fuel, travelling expenses etc.

Q.2: How will you verify the following (a) Rent Expense

(b) Legal and Professional Expenses

