CA INTER | PAPER 5 [NEW SCHEME]

AUDITING & ETHICS

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0. FUNDAMENTALS OF AUDITING

1. **MEANING OF AUDIT:**
   An audit is an independent examination of financial information of any entity, whether or not profit oriented and irrespective of its size or legal form, when such an examination is conducted with a view to express an opinion thereon.
2. **OBJECTIVE OF THE AUDIT/AUDITOR:**
   To express opinion (Audit Report) on financial statements:
   a. Whether the financial statements are free from material misstatements and
   b. Whether they are prepared as per Applicable Financial Reporting Framework.
3. **AUDITOR:**
   "Auditor" is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or the firm.
   When it comes to acceptance of Responsibility or being accountable to regulatory authorities then engagement partner shall only be referred as auditor.
   Practically the meaning of auditor includes the following persons:
   ENGAGEMENT TEAM:
   a. Engagement Partner
   b. Audit Manager
   c. Paid assistant
   d. Senior article assistant
   e. Junior article assistant
   f. Any other designation
4. **BOOKS OF ACCOUNTS:**
   As per company's act, 2013 "books of account" as defined in Section 2(13) includes records maintained in respect of:
   a. All sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place.
   b. All sales and purchases of goods and services by the company.
   c. The assets and liabilities of the company and
   d. The items of cost as may be prescribed under section 148.

5. **FINANCIAL STATEMENTS:**
   a. Definition as per SA 200:
   A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with applicable financial reporting framework.
   The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information.
   b. Definition as per Companies Act: Financial statements includes the following:
   - Balance Sheet
   - Profit and Loss account or Income and Expenditure account
   - Cash flow Statement
   - Statement of change in equity, if applicable
   - Any explanatory notes annexed to or forming part of financial statements.

c. **USERS OF FINANCIAL STATEMENTS:**

Users	Purpose
Management	For day-to-day decision-making and performance evaluation.
Proprietor / shareholders	To analyse performance, profitability and financial position. **Note:** Prospective investors are interested in the track record of the company.
Lenders - banks & fin. Institutions	To determine the financial position and strength of the Company, Debt Service Coverage, etc.
Suppliers	To determine the credit worthiness of the company.
Customers	To know the general business viability before entering into long-term contracts and arrangements.
Government	• To ensure prompt collection of Direct and Indirect Tax revenues. • To evaluate performance and contribution to social objectives.
Research scholars	For study, research and analysis purpose.
Employees	Job security, bonus.

6. **APPLICABLE FINANCIAL REPORTING FRAMEWORK:**
   In view of the nature of the entity and the objective of the financial statements, the framework adopted by management for preparation and presentation of the financial statements is known as AFRFW.
   In other words, a financial reporting framework is nothing but, set of rules and regulations that are to be followed for preparation and presentation of financial statements.
   E.g., For a company the AFRFW is SCH III and Accounting standards.
7. **GENERAL PURPOSE FINANCIAL STATEMENTS (GPFS):**
   If the F/S are prepared in accordance with General Purpose Framework (GPFW) then they are called as GPFS.
8. **SPECIAL PURPOSE FINANCIAL STATEMENTS (SPFS):**
   Financial statements prepared in accordance with a special purpose framework.
   In other words, if the financial statements are prepared as per the requirement of a specific user, then they are known as SPFS.
9. **GENERAL PURPOSE FRAMEWORK:**
   A financial reporting framework designed to meet the common financial information needs of a wide range of users. (Framework may be understood as Rules and Regulations)
   Characteristics of GPFW:
   a. Fundamental accounting assumptions are used in this type of framework.
   b. Compliance with GAAP.
   c. Accounting standards as per AFRFW.
   d. Annual Preparation, periodically.

   Further this financial reporting framework may be a Compliance Framework (or) a Fair Presentation Framework.
10. **COMPLIANCE FRAMEWORK (CFW):**
    It refers to a framework where F/S are prepared and presented in accordance with the requirements of such framework without any deviation.
    a. The words "True and Fair View" do not appear in the financial statements in this type of framework.
    b. **E.g.,** Most of the special purpose financial statements are prepared as per compliance framework.

11. **FAIR PRESENTATION FRAMEWORK:**
It refers to a framework where F/S are prepared and presented in accordance with the requirements of such framework (CFW) AND
   a. Contains disclosures beyond the requirements of such framework (Explicitly / Implicitly) or
   b. May deviate from the requirement of the framework" so as to achieve fair presentation. (Explicitly)
   c. The words true and fair view appears only in this type of framework.

   E.g., Most of the general-purpose financial statements are prepared as per fair presentation framework.

12. **LEGAL FORM:**
There are several types of legal forms in which people ordinarily conduct businesses. This is similar to "Person" Definition under Income Tax.
The following are the various types of legal forms:
- Proprietorship firm
- Partnership firm
- Limited Liability Partnership
- Society and
- Company
- AOP or BOI
- Any other artificial Judicial Person.

13. **MISSTATEMENT:**
A difference between the Amount, Classification, Presentation, Or Disclosure of a reported financial statement item AND the Amount, Classification, Presentation, Or Disclosure that is required as per applicable financial reporting framework.
Misstatements can arise from error or fraud.

14. **FRAUD:**
An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.
   a. **FRAUDULENT FINANCIAL REPORTING:**
   It involves intentional misstatements, including omissions of amounts or disclosures in financial statements, to deceive financial statement users. Either Overstatement or understatement of performance / position.
   b. **MISAPPROPRIATION OF ASSETS:**
   Involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. Also, it involved misuse of resources.

15. **ERROR:**
The term "error" refers to unintentional mistakes in financial statements such as:
   a. Clerical errors, like errors of omission, errors of commission, errors of duplication and compensating errors.
   b. Misapplication of accounting policies (Called errors of principle).

From the point of view of audit these errors are two types namely – Self revealing errors (Apparent on record and easily identifiable) and non-self-revealing errors (Not apparent and require additional efforts to detect them).

1. NATURE, OBJECTIVE AND SCOPE OF AUDIT

Q NO 1. WRITE ABOUT THE ORIGIN AND HISTORY OF AUDITING PROFESSION?

ANSWER:

1. The reference to auditing is found in Kautilya's Arthshastra even in 4th century BC. It talks about fixed accounting year, a process for closure of accounts and audit for the same.
2. Concepts of periodical checking and verification existed even in those times. Even there are references in his monumental work to misstatements in financial statements due to abuse of power.
3. The word "audit" originates from Latin word "audire" meaning "to hear". In medieval times, auditors used to hear the accounts read out to them to check that employees were not careless and negligent. Industrial revolution in Europe led to astronomical expansion in volume of trade and consequently demand of auditors.
4. Coming to more recent history, the first Auditor General of India was appointed in British India in 1860 having both accounting and auditing functions. Later on, office of Auditor General was given statutory recognition.
5. Presently, Comptroller and Auditor General of India is an independent constitutional authority responsible for auditing government receipts and expenditures.
6. The Institute of Chartered Accountants of India was established as a statutory body under an Act of Parliament in 1949 for regulating the profession of Chartered Accountancy in the country.

Q NO 2. WRITE ABOUT MEANING AND NATURE OF AUDITING AND ASPECTS COVERED IN AUDIT?

ANSWER:

A. **AUDIT DEFINITION:** An audit is an independent examination of financial information of any entity, whether or not profit oriented and irrespective of its size or legal form, when such an examination is conducted with a view to express an opinion thereon.

B. **NATURE OF AUDITING:** An incisive analysis of above meaning of auditing brings out following points clearly:
   1. **INDEPENDENCE:** Audit is an independent examination of financial information Independence, here, implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him. The auditor should be independent of entity whose financial statements are subject to audit so that he can form an opinion without being affected by any influence.
   2. **NATURE OF FINANICAL INFORMATION:** The entity whose financial information is examined need not necessarily be profit oriented like in case of a business. It can be a non-profit organization like an NGO or a charitable trust. Audit can be undertaken in respect of any organization be it a small, medium or large. Further, it can be conducted for any entity irrespective of its legal structure i.e., such an entity may be a proprietary concern, a partnership firm, a LLP, a private company, a public company, a society or a trust.
   3. **TO EXPRESS OPINION:** The purpose of audit is to express an opinion on the financial statements. Auditing provides assurance. Its basic nature lies in providing assurance to users - providing confidence to users of financial statements. Such an assurance lends credibility to financial statements. Audited financial statements provide confidence to

users that financial information reflected in financial statements can be relied upon.

4. **PURPOSE:** The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. Users of financial statements may be shareholders, employees, customers, government and regulatory authorities, bankers etc. Enhancing of degree of confidence is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

C. ASPECTS TO BE COVERED IN AUDIT: In doing so, he has to see that financial statements would not mislead anybody by ensuring that:

1. The Information in the financial statements is in conformity with entries in books of accounts.
2. The journal entries in the books of accounts are supported by sufficient and appropriate (Proper) evidence.
3. Ensure that there are no omissions or duplications or fictitious entries in the financial statements.
4. The information conveyed by financial statements is clear and unambiguous (without confusion).
5. The amounts, classification, presentation and disclosures are as in conformity with accounting standards.
6. The financial statements present true and fair view of operational results and of assets and liabilities.

Q NO 3. WRITE SHORT NOTES ON RELATIONSHIP OF AUDITING WITH OTHER DISCIPLINES?

ANSWER:

A. NEED FOR DIVERSE KNOWLEDGE:

1. Auditing is interdisciplinary in nature. It draws from diverse subjects including accountancy, law, behavioural science, statistics, economics and financial management and makes use of these subjects.
2. Since audit of financial statements is concerned with financial information, a sound knowledge of accounting principles is a fundamental requirement for an auditor of financial statements to conduct audit and express an opinion. Similarly, good knowledge of business laws and various taxation laws helps auditor to understand financial statements in a better way in accordance with applicable laws.
3. During course of audit, auditor has to interact with lot of persons for seeking information and making inquiries. This can be done only if one has knowledge of human behaviour.
4. Auditors use statistical methods to draw samples in a scientific manner. It is not possible for an auditor to check each and every transaction. So, use of statistical methods to draw samples for conducting audit is made.
5. Knowledge of subject like economics helps auditor to be familiar with overall economic environment in which specific business is operating.
6. Financial management deals with issues such as funds flow, working capital management, ratio analysis etc. and an auditor is expected to be knowledgeable about these for applying some of audit procedures and carrying out audit effectively.
7. Besides, knowledge of financial markets comprised in study of financial management is expected from a professional auditor.

B. INTERRELATIONSHIP:

1. **AUDITING AND ACCOUNTING:** Auditing reviews the financial statements which are

nothing but a result of the overall accounting process.
2. **AUDITING AND LAW:** An auditor should have a good knowledge of business laws affecting the entity.
3. **AUDITING AND ECONOMICS:** Auditor is expected to be familiar with the overall economic environment of the client.
4. **AUDITING AND BEHAVIOURAL SCIENCE:** Knowledge of human behaviour is essential for an auditor to effectively discharge his duties.
5. **AUDITING AND STATISTICS & MATHEMATICS:** Auditor is also expected to have the knowledge of statistical sampling for meaningful conclusions and mathematics for verification of inventories.
6. **AUDITING AND DATA PROCESSING:** EDP auditing in itself is developing as a discipline in itself.
7. **AUDITING AND FINANCIAL MANAGEMENT:** Auditor is expected to have knowledge about various financial techniques such as working capital management, funds flow, ratio analysis, capital budgeting etc.
8. **AUDITING AND PRODUCTION:** Good auditor is one who understands the client and his business functions such as production, cost system, marketing etc.

Q NO 4. EXPLAIN THE OBJECTIVES OF AN AUDITOR AS PER SA 200

ANSWER:

A. OBJECTIVE OF THE AUDITOR: In conducting audit of financial statements, objectives of auditor in accordance with SA-200 "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing" are:

1. To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
2. To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

B. ANALYSIS OF THE ABOVE: An analysis of above brings out following points clearly:

1. Reasonable assurance is to be distinguished from absolute assurance. Absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements. However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance but it is not complete assurance.
2. Audit of financial statements is carried out by the auditor with professional competence and skills in accordance with Standards on Auditing. Audit procedures are applied in accordance with SAs, audit evidence is obtained and evaluated. On basis of that, conclusions are drawn and opinion is formed. It leads to high level of assurance which is called as reasonable assurance but it is not absolute assurance.
3. Misstatements in financial statements can occur due to fraud or error or both. The auditor seeks to obtain reasonable assurance whether financial statements as a whole are free from material misstatements caused by fraud or error. He has to see effect of misstatements on financial statements as a whole, in totality.
4. Obtaining reasonable assurance that financial statements as a whole are free from material misstatements enables the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
5. The opinion is reported and communicated in accordance with audit findings through a

written report as required by Standards on Auditing.

Q NO 5. WRITE ABOUT SCOPE OF AUDIT AND ITS INCLUSIONS AND EXCLUSIONS?

ANSWER:

Scope refers to range or reach of something. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. Users of financial statements may be shareholders, employees, customers, government and regulatory authorities, bankers etc. Enhancing of degree of confidence is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

Note: Applicable financial reporting framework means a framework adopted in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation. For example, in case of companies in India, financial reporting framework is provided under Schedule III of Companies Act,2013.

A. **SCOPE OF AUDIT INCLUDES:** The following points are included in scope of audit of financial statements:

1. **COVERAGE OF ALL ASPECTS OF ENTITY:** Audit of financial statements should be organized adequately to cover all aspects of the entity relevant to the financial statements being audited.
2. **RELIABILITY AND SUFFICIENCY OF FINANCIAL INFORMATION:**
   a. The auditor should be reasonably satisfied that information contained in underlying accounting records and other source data (like bills, vouchers, documents etc.) is reliable and sufficient basis for preparation of financial statements.
   b. The auditor makes a judgment of reliability and sufficiency of financial information by making a study and assessment of accounting systems and internal controls and by carrying out appropriate tests, enquiries and procedures.
3. **PROPER DISCLOSURE OF FINANCIAL INFORMATION:**
   a. The auditor should also decide whether relevant information is properly disclosed in the financial statements. He should also keep in mind applicable statutory requirements in this regard.
   b. It is done by ensuring that financial statements properly summarize transactions and events recorded therein and by considering the judgments made by management in preparation of financial statements.
   c. The management responsible for preparation and presentation of financial statements makes many judgments in this process of preparing and presenting financial statements.
      For example, choosing of appropriate accounting policies in relation to various accounting issues like choosing method of charging depreciation on fixed assets or choosing appropriate method for valuation of inventories.
   d. The auditor evaluates selection and consistent application of accounting policies by management. Whether such a selection is proper and whether chosen policy has been applied consistently on a period-to-period basis.
   e. Understand that financial statements of an entity are prepared on historical financial information basis.
      "Historical financial information" means information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

B. SCOPE OF AUDIT DO NOT INCLUDE:

1. Auditor is not expected to perform duties which fall outside domain of his competence. For example, physical condition of certain assets like that of sophisticated machinery cannot be determined by him. Similarly, it is not expected from an auditor to determine suitability and life of civil structures like buildings. These require different skillsets which may be performed by qualified engineers in their respective fields.
2. An auditor is not an expert in authentication of documents. The genuineness of documents cannot be authenticated by him because he is not an expert in this field.
3. An audit is not an official investigation into alleged wrong doing. He does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out an official investigation.
4. Audit is distinct from investigation. Investigation is a critical examination of the accounts with a special purpose.
   For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.
5. The objective of audit, on the other hand, as has already been discussed, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.

Q NO 6. WRITE A SHORT NOTE ON INHERENT LIMITATIONS OF AUDIT.

ANSWER:

The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error. These fundamental limitations arise due to the following factors:

A. NATURE OF FINANCIAL REPORTING:

1. Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.
2. One of the premises for conducting an audit is that management acknowledges its responsibility of preparation of financial statements in accordance with applicable financial reporting framework and for devising suitable internal controls. However, such controls may not have operated to produce reliable financial information due to their own limitations.
   Consider, for example, that management of a company has devised a control that all purchase bills should reflect stamp and signatures of an authorised person in "Goods Receiving Section" of the company stating the date and time of receiving goods in premises. It is an example of internal control devised by the company to ensure that only those purchase bills are produced for payment for which goods have been actually received.
   Now, what happens if concerned accountant and authorised person in "Goods Receiving Section" collude. It is a case of overriding of internal controls devised by the company due to collusion between two persons. Such a probable collusion is one of limitations of internal controls itself.

B. NATURE OF AUDIT PROCEDURES:

1. The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor

to obtain audit evidence.
For example, an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence.

2. Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence.
3. The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. It may be engaged in concealing fraud by designing sophisticated and carefully organized schemes which may be hard to detect by the auditor. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine. Therefore, he may be led to accept invalid audit evidence on the basis of unauthentic documents.
   It is quite possible that entity may have entered into some transactions with related parties. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.

C. NOT IN NATURE OF INVESTIGATION:

As already discussed, audit is not an official investigation. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.

D. TIMELINESS OF FINANCIAL REPORTING AND DECREASE IN RELEVANCE OF INFORMATION:

The relevance of information decreases over time and auditor cannot verify each and every matter. Therefore, a balance has to be struck between reliability of information and cost of obtaining it.
Consider, for example, an auditor who is conducting audit of a company since last two years. During these two years, he has sought detailed information from management of company regarding various matters. During his third- year, he chooses to rely upon some information obtained as part of audit procedures of second year. However, it could be possible that something new has happened and that information is not relevant. So, the information being relied upon by auditor is not timely and may have lost its reliability.

E. FUTURE EVENTS:

1. Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business. The business may cease to exist in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.
2. Therefore, it is in view of above factors, that an auditor cannot provide a guarantee that financial statements are free from material misstatements due to frauds or errors.

Q NO 7. WHAT IS AN ENGAGEMENT AND BENEFITS OF EXTERNAL AUDIT ENGAGEMENT?

ANSWER:

A. MEANING: Engagement means an arrangement to do something. In the context of auditing, it means a formal agreement between auditor and client under which auditor agrees to provide auditing services. It takes the shape of engagement letter.

B. EXTERNAL AUDIT ENGAGEMENTS: The purpose of external audit engagements is to enhance the degree of confidence of intended users of financial statements. Such engagements are also reasonable assurance engagements. For example, in India, companies are required to get their annual accounts audited by an external auditor. Even non-corporate entities may choose to have their accounts audited by an external auditor because of benefits of such an audit.

C. BENEFITS OF AUDIT: [NEED FOR AUDIT]: Audited accounts provide high quality information. It gives confidence to users that information on which they are relying is qualitative and it is the outcome of an exercise carried out by following Auditing Standards recognized globally.

1. **SHAREHOLDERS:** In case of companies, shareholders may or may not be involved in daily affairs of the company. The financial statements are prepared by management consisting of directors. As shareholders are owners of the company, they need an independent mechanism so that financial information is qualitative and reliable. Hence, their interest is safeguarded by an audit.
2. **MORAL CHECK:** An audit acts as a moral check on employees from committing frauds for the fear of being discovered by audit.
3. **GOVT:** Audited financial statements are helpful to government authorities for determining tax liabilities.
4. **BANKERS:** Audited financial statements can be relied upon by lenders, bankers for making their credit decisions i.e., whether to lend or not to lend to a particular entity.
5. **DETECTION OF MMS:** An audit may also detect fraud or error or both.
6. **INTERNAL CONTROLS:** An audit reviews existence and operations of various controls operating in any entity. Hence, it is useful at pointing out deficiencies.

Q NO 8. IS AUDIT- MANDATORY OR VOLUNTARY?

ANSWER:

1. It is not necessary that audit is always legally mandatory. There are entities like companies who are compulsorily required to get their accounts audited under law.
2. Even non-corporate entities may be compulsorily requiring audit of their accounts under tax laws. For example, in India, every person is required to get accounts audited if turnover crosses certain threshold limit under income tax law.
3. It is also possible that some entities like schools may be required to get their accounts audited for the purpose of obtaining grant or assistance from the Government.
4. Audit is not always mandatory. Many entities may get their accounts audited voluntarily because of benefits from the process of audit. Many such concerns have their internal rules requiring audit due to advantages flowing from an audit.

Q NO 9. WHO APPOINTS AN AUDITOR AND TO WHOM REPORT IS TO BE SUBMITTED?

ANSWER:

Generally, an auditor is appointed by owners or in some cases by constitutional or government authorities in accordance with applicable laws and regulations.

1. For example, in case of companies, auditor is appointed by members (shareholders) in Annual General Meeting (AGM). Shareholders are owners of a company and auditor is appointed by them in AGM.
2. However, in case of government companies in India, auditor is appointed by Comptroller and Auditor General of India (CAG), an independent constitutional authority.
3. Take case of a firm who engages an auditor to audit its accounts. In such a case, auditor is

appointed by partners of firm.

4. There may be a situation in which auditor may be appointed by a government authority in accordance with some law or regulation. For example, an auditor may be appointed under tax laws by a government authority.

TO WHOM REPORT IS SUBMITTED BY AN AUDITOR: The outcome of an audit is written audit report in which auditor expresses an opinion. The report is submitted to person making the appointment. In case of companies, these are shareholders- in case of a firm, to partners who have engaged him.

Q NO 10. WRITE ABOUT MEANING OF ASSURANCE ENGAGEMENT AND ELEMENTS THEREOF?

ANSWER:

A. MEANING:

1. "Assurance engagement" means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.
2. It means that the practitioner gives an opinion about specific information due to which users of information are able to make confident decisions knowing well that chance of information being incorrect is diminished.

B. ELEMENTS OF AN ASSURANCE ENGAGEMENT: Following elements comprise an assurance engagement:

1. **A 3 PARTY RELATIONSHIP:**
    a. An assurance engagement involves 3 parties [Responsible Party, Practitioner and Intended Users].
        i. A practitioner is a person who provides the assurance. The term practitioner is broader than auditor.
        ii. A responsible party is the party responsible for preparation of subject matter.
        iii. Intended users are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.
    b. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.
2. **AN APPROPRIATE SUBJECT MATTER:** It refers to the information to be examined by the practitioner. For example, financial information contained in financial statements while conducting audit of financial statements.
3. **SUITABLE CRITERIA:** These refer to benchmarks used to evaluate the subject matter like standards, guidance, laws, rules and regulations.
4. **SUFFICIENT APPROPRIATE EVIDENCE:**
    a. The practitioner performs an assurance engagement to obtain sufficient appropriate evidence. It is on the basis of evidence that conclusions are arrived and an opinion is formed by auditor.
    b. "Sufficient" relates to quantity of evidence obtained by auditor. "Appropriate" relates to quality of evidence obtained by auditor.
    c. One evidence may be providing more comfort to auditor than the other evidence. The evidence providing more comfort is qualitative and, therefore, appropriate. Evidence should be both sufficient and appropriate.
5. **A WRITTEN ASSURANCE REPORT IN APPROPRIATE FORM:** A written report is

provided containing conclusion that conveys the assurance about the subject matter. A written assurance report is the outcome of an assurance engagement.

Q NO 11. WRITE ABOUT MEANING OF REVIEW AND DIFFERENCE BETWEEN AUDIT AND REVIEW?

ANSWER:

1. We have learnt that audit is a reasonable assurance engagement. It provides reasonable assurance. However, review is a limited assurance engagement. It provides lower level of assurance than audit.

2. Further, review involves fewer procedures and gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up.
3. However, both "audit" and "review" are related to financial statements prepared on the basis of historical financial information.

REASONABLE ASSURANCE ENGAGEMENT	LIMITED ASSURANCE ENGAGEMENT
Reasonable assurance engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement.
It draws reasonable conclusions on the basis of sufficient appropriate evidence.	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
Example of reasonable assurance engagement is an audit engagement.	Example of limited assurance engagement is Review engagement.

Q NO 12. WRITE ABOUT ASSURANCE ENGAGEMENTS RELATED TO SUBJECT MATTERS OTHER THAN HISTORICAL FINANCIAL STATEMENTS?

ANSWER:

1. Besides reasonable assurance engagements and limited assurance engagements, there is another kind of assurance which is related to matters other than historical financial information. Such an assurance may relate to prospective financial information and not to historical financial information. It may relate to providing assurance on internal controls in an entity.
2. **"Prospective financial information"** means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It can be in the form of a forecast or projection or combination of both.
3. It is to be noted that in such type of assurance engagements, examination is not of historical financial information.
    a. Here, it is important to note the difference between "Historical financial information" and "Prospective financial information." The former relates to information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods. The latter relates to financial information based on assumptions about occurrence of future events and possible actions by an entity.
    b. Therefore, historical financial information is rooted in past events which have already occurred whereas prospective financial information is related to future

events.

4. **MODERATE ASSURANCE:**
    a. In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that management's assumptions on which the prospective financial information is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions and it is properly presented and all material assumptions are adequately disclosed.
    b. Hence, such type of assurance engagement provides only a "moderate" level of assurance.
    c. Prospective financial information relates to future events. While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future- oriented. The auditor is, therefore, not in a position to express an opinion as to whether the results shown in the prospective financial information will be achieved.
    d. Therefore, in such assurance engagements, practitioner provides a report assuring that nothing has come to practitioner's attention to suggest that these assumptions do not provide a reasonable basis for the projection.

Q NO 13. WHAT ARE THE QUALITIES OF AUDITOR?

ANSWER:

An auditor is concerned with the reporting on financial matters of business and other institutions. Financial matters inherently are to be set with the problems of human fallibility; errors and frauds are frequent.

1. **PERSONAL QUALITIES:** All those personal qualities that go to make a good businessman contribute to the making of a good auditor:
    a. Tact,
    b. caution,
    c. firmness,
    d. good temper,
    e. integrity,
    f. discretion,
    g. industry,
    h. judgement,
    i. patience,
    j. clear headedness and
    k. reliability are some of qualities which an auditor should have. In short,
2. In addition, he must have the shine of culture for attaining a great height. He must have the highest degree of integrity backed by adequate independence.
3. The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education.
4. **PROFESSIONAL QUALITIES:** He is called upon constantly to critically review financial statements and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert. An exhaustive knowledge of accounting in all its branches is utmost important in the practice of auditing. He must know thoroughly all accounting principles and techniques.

Q NO 14. WRITE ABOUT ENGAGEMENT AND QUALITY CONTROL STANDARDS?

ANSWER:

The following Standards issued under authority of ICAI Council are collectively known as

Engagement Standards:

1. **Standards on auditing (SAs)** which apply in audit of historical financial information.
2. **Standards on review engagements (SREs)** which apply in review of historical financial information.
3. **Standards on Assurance engagements (SAEs)** which apply in assurance engagements other than audits and review of historical financial information.
4. **Standards on Related Services (SRSs)** which apply in agreed upon procedures to information, compilation engagements and other related service engagements.

The purpose of issue of these standards is to establish high quality standards and guidance in the areas of financial statement audits and in other types of assurance services.

A. STANDARDS ON AUDITING:

1. Standards on Auditing apply in the context of an audit of financial statements by an independent auditor. It is important to remember that Standards on Auditing apply in audit of historical information. These establish high quality benchmarks and are followed by auditors in conducting audit of financial statements.
2. Standards on Auditing have been issued on wide spectrum of issues in the field of auditing ranging from overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit sampling, audit evidence and forming an opinion and reporting on financial statements. These cover all significant aspects of audit of financial statements. Some examples of Standards on Auditing are:
   a. SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing
   b. SA 230 Audit Documentation
   c. SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
   d. SA 500 Audit Evidence
   e. Revised SA 700 Forming an Opinion and Reporting on Financial Statements

B. STANDARDS ON REVIEW ENGAGEMENTS:

1. Standards on review engagements apply in the context of review of financial statements. We have already understood that review is a limited assurance engagement and it provides assurance which is lower than that provided by audit. It is due to the fact that review involves fewer procedures as compared to audit.
2. Since a review also provides assurance to users, it also involves obtaining sufficient appropriate evidence. For example, when an auditor performs review of interim financial information of an entity. **Examples of Standards on Review engagements are:**
   a. **SRE 2400 (Revised)** Engagements to Review Historical Financial Statements
   b. **SRE 2410** Review of Interim Financial Information Performed by the Independent Auditor of the Entity
3. It is to be noted that both Standards on auditing and Standards on review engagements apply to engagements involving historical financial information.

C. STANDARDS ON ASSURANCE ENGAGEMENTS:

1. There is another set of standards which apply in assurance engagements dealing with subject matters other than historical financial information. Such assurance engagements do not include "audit" or "review" of historical financial information. These standards are known as Standards on Assurance Engagements. For example, an assurance engagement relating to examination of prospective financial information.

2. It is to be noted that in such type of assurance engagements, examination is not of historical financial information or engagement may relate to providing assurance regarding non-financial matters like design and operation of internal control in an entity. Examples of Standards on Assurance Engagements are:
   a. SAE 3400 The Examination of Prospective Financial Information
   b. SAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

D. STANDARDS ON RELATED SERVICES:

1. Lastly, there are standards on related services. These standards apply in engagements to perform agreed-upon procedures regarding financial information.
2. **AGREED UPON PROCEDURES:** For example, an engagement to perform agreed-upon procedures may require the auditor to perform certain procedures concerning individual items of financial data, say, accounts payable, accounts receivable, purchases from related parties and sales and profits of a segment of an entity, or a financial statement, say, a balance sheet or even a complete set of financial statements.
3. **COMPILATION ENGAGEMENTS:** An engagement in which practitioner may be called upon to assist management with the preparation and presentation of historical financial information without obtaining assurance on that information. Such type of compilation engagements fall in the category of related services and practitioner issues a report clearly stating that it is not an assurance engagement and no opinion is being expressed.
4. These types of services are called related services and standards have been issued to deal with practitioner's responsibilities in this regard.
   Examples of Standards on related services are:
   a. SRS 4400 Engagements to perform agreed-upon procedures regarding financial information
   b. SRS 4410 (Revised) Compilation engagements

E. STANDARDS ON QUALITY CONTROL:

1. Standards on Quality Control (SQCs) have been issued to establish standards and provide guidance regarding a firm's responsibilities for its system of quality control for the conduct of audit and review of historical financial information and for other assurance and related service engagements.
2. SQC 1 has been issued in this regard. It requires auditors/practitioners to establish system of quality control so that firm and its personnel comply with professional standards and regulatory & legal requirements and reports issued are appropriate.
3. Its basic objective is that while rendering services, to which engagement standards apply, there should be a system of quality control with in firms to ensure complying with professional standards/legal requirements. System of quality control ensures issuing of appropriate reports in the circumstances.
4. Further, it is also to be remembered that Standards on Quality Control (SQCs) are to be applied for all services covered by Engagement Standards.

Q NO 15. WHY ARE STANDARDS NEEDED AND WHAT ARE THE PRACTITIONERS DUTIES RELATED TO EQC STANDARDS?

ANSWER:

NEED OF STANDARDS:

1. Standards ensure carrying out of audit against established benchmarks at par with global practices.
2. Standards improve quality of financial reporting thereby helping users to make diligent

decisions.

3. Standards promote uniformity as audit of financial statements is carried out following these Standards.
4. Standards equip professional accountants with professional knowledge and skill.
5. Standards ensure audit quality.

DUTIES IN RELATION TO ENGAGEMENT AND QUALITY CONTROL STANDARDS:

1. It is the duty of professional accountants to see that Standards are followed in engagements undertaken by them. Ordinarily, these are to be followed by professional accountants. However, a situation may arise when a specific procedure as required in Standards would be ineffective in a particular engagement. In such a case, he is required to document how alternative procedures performed achieve the purpose of required procedure. Also, reason for departure has also to be documented unless it is clear.
2. Further, his report should draw attention to such departures. It is also to be noted that a mere disclosure in the report does not absolve a professional accountant from complying with applicable Standards.

2. ETHICS AND TERMS OF AUDIT ENGAGEMENTS

PART 1 – ETHICS

Q.NO.1. WRITE ABOUT MEANING OF ETHICS AND NEED FOR PROFESSIONAL ETHICS IN THE PROFESSION OF AUDIT?

ANSWER:

1. The term "Ethics" means moral principles which govern a person's behaviour or his conducting of an activity. It is the branch of knowledge that deals with moral principles.
2. Ethics is something which comes from an individual intrinsically. It has to be inculcated in the habit and temperament of an individual, so that there is an overall culture of ethics; the force has to be strong enough to withstand any selfish motive or temptation.
3. It is a state of mind to act and perform in accordance with moral principles. Ethics is the science of morals in human conduct. Such moral principles and rules of conduct impose obligations upon individuals.

NEED FOR PROFESSIONAL ETHICS:

1. Professions like law, medicine have their code of ethics. Auditing profession is no exception. Rather, in the profession of auditing, requirement of ethics is manifold. It is due to the reason that society in general, governments, clients, taxing authorities, employees, investors, the business and financial community in particular, have reposed tremendous trust in services rendered by Chartered Accountants.
2. The purpose of assurance engagements is to enhance confidence of the intended users. Therefore, users need to trust the person who is providing such services.
3. Professional ethics are based on morality. Human nature being what it is, a man, often, places his personal gain above service. Therefore, persons who as individuals and as a class, are willing to place public good above their personal gain have enjoyed respect and honour. But such a relationship can be maintained or enhanced only if the professional body to which they belong would interpret the concept of public interest as broadly as possible.
4. The respect and confidence enjoyed by a profession, to a great extent, is dependent on the strictness and scrupulousness with which such ethics are adhered to by self-discipline.
5. A distinguishing feature of the accountancy profession is its acceptance of the responsibility to act in the public interest.
6. Professional ethics seek to protect the interests of the profession as a whole and act as a shield that enables us to command respect.
7. A Chartered Accountant, either in practice or in service, has to abide by ethical behaviours. They are expected to follow the fundamental principles of professional ethics while performing their duties. Service users of professionals should be able to feel secure that there exists a framework of professional ethics which governs the provision of those services.
8. It is in this spirit of things that the Institute of Chartered Accountants of India (ICAI) requires its members to comply with the principles of ethics while performing their duties. The ethics for Chartered Accountants have, therefore, been codified as ethical compliance has always been a philosophy of the profession.
9. Chartered accountants, whether in practice or in service, are required to comply with the provisions of Code of Ethics.

10. Any deviation from the ethical responsibilities brings the disciplinary mechanism into action against the Chartered Accountants which may result into fines, suspension of membership, removal from membership or other disciplinary actions.

Q.NO.2. WRITE ABOUT PRINCIPLES BASED APPROACH VS RULES BASED APPROACH TO ETHICS (ETHICAL OR LEGAL)?

ANSWER:

1. Ethical guidance may follow principles-based approach or rules-based approach:
   a. The essence of principles-based approach to ethics is that it requires compliance with spirit of ethics. It requires accountants to exercise professional judgment in every situation based upon their professional knowledge, skill and expertise. It requires that accountants should use professional judgment to evaluate every situation to arrive at conclusions.
   b. However, rules-based approach to ethics strictly follows clearly established rules. It may lead to a narrow outlook and spirit of ethics may be overlooked while strictly adhering to rules. Further, rules- based approach is somewhat rigid as it may not be possible to deal with every practical situation relying upon rules.
2. Therefore, it is necessary that spirit of code is followed.

Q.NO.3. WHAT ARE THE FUNDAMENTAL PRINCIPLES OF PROFESSIONAL ETHICS?

ANSWER:

The fundamental principles of ethics establish the standard of behaviour expected of a professional accountant. A professional accountant shall comply with each of the fundamental principles. The fundamental principles of professional ethics are as under:

1. INTEGRITY:

a. A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships. Integrity implies fair dealing and truthfulness.
b. A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information contains:
   i. A materially false or misleading statement;
   ii. Contains statements or information provided negligently or
   iii. Omits or obscures required information where such omission or obscurity would be misleading.

2. OBJECTIVITY:

a. The principle of objectivity requires an auditor not to compromise professional judgment because of bias, conflict of interest or undue influence of others.

b. It requires that a professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.

3. **PROFESSIONAL COMPETENCE AND DUE CARE:**
   a. A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation and
   b. Act diligently and in accordance with applicable technical and professional standards. Diligence includes responsibility to act carefully, thoroughly and on a timely basis in accordance with requirements of an assignment.
4. **CONFIDENTIALITY:**
   a. Confidentiality principle requires a professional accountant to respect the confidentiality of information acquired as a result of professional or business relationships.
   b. Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant with the understanding that the information will not be disclosed to a third party.
   c. However, such confidential information may be disclosed, for example, when it is required by law, when it is permitted by law and is authorised by the client or employer or there is a professional duty or right to disclose when not prohibited by law.
5. **PROFESSIONAL BEHAVIOUR:** It requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession. A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

Q.NO.4. WRITE ABOUT INDEPENDENCE OF AUDITORS?

ANSWER:

1. Professional integrity and independence are essential characteristics of all the professions but are more so in the case of accountancy profession. Independence implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him, or to his own self-interest. It is not possible to define "independence" precisely.
2. Rules of professional conduct dealing with independence are framed primarily with a certain objective. The rules, by themselves, cannot create or ensure the existence of independence. Independence is a condition of mind as well as personal character and should not be confused with the superficial and visible standards of independence which are sometimes imposed by law.
3. These legal standards may be relaxed or strengthened but the quality of independence remains unaltered.
4. There are 2 interlinked perspectives of independence of auditors:
   a. **INDEPENDENCE OF MIND:** The state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and
   b. **INDEPENDENCE IN APPEARANCE:** The avoidance of facts and circumstances that

are so significant that a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

5. Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons. The relationship between the auditor and his client should be such that firstly, he is himself satisfied about his independence and secondly, no unbiased person would be forced to the conclusion that, on an objective assessment of the circumstances, there is likely to be an abridgement of the auditors' independence. Independence of an auditor assumes significance in context of providing confidence to users of financial statements.
6. As statutory auditor of a listed company, for example, the Chartered Accountant would cease to perform any useful function if the persons who rely upon the accounts of the company do not have any faith in the independence and integrity of the Chartered Accountant. In such cases, he is expected to be objective in his approach, fearless, and capable of expressing an honest opinion based upon the performance of work such as his training and experience enables him to do so.
7. Independence is dependent on the state of mind and character of a person and is a very subjective matter. One person might be independent in a particular set of circumstances, while another person might feel he is not independent in similar circumstances.
8. It is therefore the duty of every Chartered Accountant to determine for himself whether or not he can act independently in the given circumstances of a case and quite apart from legal rules, in no case to place himself in a position which would compromise his independence.

Q.NO.5. WRITE ABOUT THREATS TO INDEPENDENCE?

ANSWER:

Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of assurance engagements may differ and consequently different threats may exist requiring the application of different safeguards. The International Federation of Accountants (IFAC) had identified 5 types of threats:

A. SELF-INTEREST THREATS: Occurs when an auditing firm or any partner benefiting from a financial interest in the audit client.

Examples:

1. Direct financial interest or materially significant indirect financial interest in a client,
2. Loan or guarantee to or from the concerned client,
3. Undue dependence on a client's fees and, hence, concerns about losing the engagement,
4. Close business relationship with an audit client,
5. Potential employment with the client, and
6. Contingent fees for the audit engagement.

B. SELF-REVIEW THREATS:

1. Which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement* or when a member of the audit team was previously a director or senior employee of the client.
2. Instances where such threats come into play are:
   a. When an auditor having recently been a director or senior officer of the company, and

b. When auditors perform services that are themselves subject matters of audit.

***Non audit engagement** includes any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.)

C. ADVOCACY THREATS: Occurs when the auditor promotes a client's opinion to a point where people may believe objectivity is compromised.

Examples:

1. When an auditor deals with shares or securities of the audited company, or
2. becomes the client's advocate in litigation and third-party disputes.
3. In above situations, auditor can be perceived as backing and championing causes of auditee client and it may lead to belief that auditor is not acting and working objectively.

Remember that auditor has not only to be independent but also appear to be acting so.

D. FAMILIARITY THREATS: These are self-evident and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests.

Examples:

1. Close relative of the audit team working in a senior position in the client company,
2. Former partner of the audit firm being a director or senior employee of the client,
3. Long association between specific auditors and their specific client counterparts, and
4. Acceptance of significant gifts or hospitality from the client company, its directors or employees.

Example: Mr. S and Mr. W are partners in SW and Associates, a Partnership Firm of Chartered Accountants. During the financial year 2020-21, SW and Associates were appointed as auditors of Capable and Composed Limited. The brother of Mr. W was involved in the management of Capable and Composed Limited. Mr. S being aware of the whole situation, on behalf of SW and Associates did not accept the appointment as auditors of Capable and Composed Limited as it would act as a threat (familiarity threat) and affect independence of auditors.

E. INTIMIDATION THREATS:

1. Which occur when auditors are deterred from acting objectively with an adequate degree of professional scepticism.
2. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees or being threatened with litigation.
3. Such threats attempt to intimidate auditors to deter them from acting objectively.

Q.NO.6. WRITE ABOUT SAFEGUARDS TO INDEPENDENCE?

ANSWER:

The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats. The following are the guiding principles in this regard:

1. For the public to have confidence in the quality of audit, it is essential that auditors should always be and appears to be independent of the entities that they are auditing.
2. In the case of audit, the key fundamental principles are integrity, objectivity and professional scepticism, which necessarily require the auditor to be independent.
3. Before taking on any work, an auditor must consider whether it involves threats to his independence.

4. When such threats exist, the auditor should either withdraw from the task or take certain precautions to eliminate them.
5. If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

Q.NO.7. WRITE A SHORT NOTE ON PROFESSIONAL SKEPTICISM.

ANSWER:

MEANING: Professional skepticism refers to an attitude of questioning mind, being alert to unusual situations and a critical assessment of audit evidence.

1. Professional skepticism includes being alert to the following situations, for example:
    a. Audit evidence that contradicts other audit evidence obtained.
    b. Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
    c. Conditions that indicate possible fraud.
    d. Requirement of additional procedures than required under SA's.
2. Maintaining professional skepticism throughout the audit is necessary to reduce the risks of:
    a. Overlooking unusual circumstances.
    b. Over generalizing while taking decisions from audit observations.
    c. Taking inappropriate decisions regarding nature, timing, and extent of the audit procedures.
3. The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud, the SAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.
4. The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism.

PART 2 – SA 210 AGREEING THE TERMS OF AUDIT ENGAGEMENT

Q.NO.8. WRITE ABOUT SCOPE AND OBJECTIVE OF SA 210, AGREEING THE TERMS OF AUDIT ENGAGEMENTS?

ANSWER:

1. **SCOPE:** SA 210 deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, responsibility for which rests with management and, where appropriate, those charged with governance, are present.
2. **OBJECTIVE:** The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:
   a. Establishing whether the preconditions for an audit are present and
   b. Confirming that there is a common understanding between the auditor and management and, where appropriate, those charged with governance of the terms of the audit engagement.

Q.NO.9. WHAT ARE PRECONDITIONS FOR AN AUDIT?

ANSWER:

1. As per SA 210 "Agreeing the Terms of Audit Engagements", preconditions for an audit may be defined as the use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise on which an audit is conducted.
2. The auditor shall:
   a. Determine whether the financial reporting framework is acceptable and
   b. Obtain the agreement of management that it acknowledges and understands its responsibility:
      i. For the preparation of the financial statements in accordance with the applicable financial reporting framework including where relevant their fair representation.
      ii. For such internal control as management considers necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error and
      iii. To provide the auditor with:
         1. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters.
         2. Additional information that the auditor may request from management for the purpose of the audit and
         3. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.
3. **IF PRECONDITIONS FOR AN AUDIT ARE NOT PRESENT:** If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement:
   a. If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable or
   b. If the agreement of management is not obtained on matters relating to understanding of responsibility of management on preparation of financial statements, internal

controls for preparation of financial statements, providing access to all information to auditor and unrestricted access to persons within the entity.

4. **LIMITATION ON SCOPE PRIOR TO AUDIT ENGAGEMENT ACCEPTANCE:** If management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

Q.NO.10. WRITE ABOUT AGREEMENT ON AUDIT ENGAGEMENT TERMS THROUGH AN ENGAGEMENT LETTER?

ANSWER:

1. The audit engagement letter is sent by the auditor to his client. It is in the interest of both the auditor and the client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent.
2. **WITH TCWG:** The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate.
3. **MOST IMP IN NON-STATUTORY AUDITS:** Except in the cases where it is required under law to get accounts audited (for example in case of companies), audit is a matter of contract between auditor and client.
4. **MSUT BE IN WRITING:** It is, therefore, important, both for the auditor and client, that each party should be clear about the nature of the engagement. It must be reduced to writing and should exactly specify the scope of the work.
5. **CONTENTS:** Such a letter includes:
    a. The objective and scope of the audit of the financial statements
    b. The responsibilities of the auditor
    c. The responsibilities of management
    d. Identification of the applicable financial reporting framework for the preparation of the financial statements and
    e. Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

Note: If law or regulation prescribes in sufficient detail the terms of the audit engagement, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities.

Q.NO.11. WRITE A SHORT NOTE ON: CHANGE IN TERMS OF ENGAGEMENT AS PER SA 210?

ANSWER:

The reason to change terms may result from:

1. Change in circumstances.
2. Misunderstanding of nature of an audit or services originally requested or agreed.
3. A restriction on the scope of engagement imposed by management or caused by circumstances.

A. "ACCEPTANCE OF CHANGE" IN TERMS OF ENGAGEMENT BY AUDITOR:

1. If there is a reasonable justification and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement.
2. Further, the report would not include reference to:
    a. The original engagement

b. Any procedures that may have been performed in the original engagement.

3. Further the auditor and management shall agree and record the new terms of the engagement in a new engagement letter.

B. "NON-ACCEPTANCE" OF CHANGE IN TERMS OF ENGAGEMENT BY AUDITOR:

The auditor shall not agree for changes in the terms of the audit engagement where there is no reasonable justification for doing so.

C. WITHDRAWAL FROM ENGAGEMENT: If the auditor is unable to agree to a change of the terms of engagement and is not permitted by management to continue the original audit engagement:

1. The auditor shall withdraw from the audit engagement.
2. Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

EXAMPLE: Where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion.

Q.NO.12. WHAT SHOULD AUDITOR CONSIDER BEFORE AGREEING TO CHANGE THE AUDIT ENGAGEMENT TO THE ENGAGEMENT PROVIDING LOWER LEVEL OF ASSURANCE?

ANSWER:

1. If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.
2. Before agreeing to change an audit engagement to a review or a related service, an auditor who was engaged to perform an audit in accordance with SAs may also need to assess any legal or contractual implications of the change.
3. If the auditor concludes that there is reasonable justification to change the audit engagement to a review or a related service, the audit work performed to the date of change may be relevant to the changed engagement. However, the work required to be performed and the report to be issued would be those appropriate to the revised engagement.
4. In order to avoid confusing the reader, the report on the related service would not include reference to:
   a. The original audit engagement or
   b. Any procedures that may have been performed in the original audit engagement, except where the audit engagement is changed to an engagement to undertake agreed- upon procedures and thus reference to the procedures performed is a normal part of the report.
5. If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

Q.NO.13. STATE THE CIRCUMSTANCES WHERE SENDING NEW ENGAGEMENT LETTER, WOULD BE APPROPRIATE IN RECURRING AUDITS.

ANSWER:

A. INITIAL AUDIT ENGAGEMENT: The auditor must issue an engagement letter in case of newly accepted appointment for an audit.

B. RECURRING AUDIT:

1. If auditor of previous year(s) has also been Reappointed as auditor for current year, then the current year engagement is known as "Recurring audit".
2. In recurring audits, the auditor shall decide whether there is need to re-issue the engagement letter based on circumstances and depending on professional judgment of auditor. Circumstances where engagement letter is issued even in case of recurring audits:
   a. Any indication that the entity misunderstands the objective and scope of the audit.
   b. A Revised or special terms of Engagement.
   c. A change in legal or regulatory requirements.
   d. A change in the Applicable financial reporting framework.
   e. A change in audit reporting requirement.
   f. A recent change of Top management.
   g. A significant change in nature or size of the entity's business.

PART 3 – QUALITY CONTROL

INTRO TO AUDIT QUALITY:

1. The purpose of an independent audit is to provide confidence to users of audited financial statements. Therefore, high audit quality is essential to maintain confidence in the independent assurance provided by the auditors. It is the responsibility of auditor to maintain high audit quality.
2. SQC 1 and SA 220 both deal with quality control. Whereas SQC 1 deals with all engagements including audits, reviews and other assurance and related service engagements, SA 220 applies to audit engagements only.
3. Further, SQC 1 applies to entire firm. However, SA 220 applies to a particular audit engagement.

SQC 1 QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFORMATION, AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS

A. SCOPE AND OBJECTIVE:

1. SQC 1 requires that the firm should establish a system of quality control designed to provide it with reasonable assurance that:
   i. The firm and its personnel comply with professional standards and regulatory and legal requirements and
   ii. Reports issued by the firm or engagement partners are appropriate in the circumstances.
2. Firm's system of quality control should consist of policies designed to achieve these objectives.

B. ELEMENTS OF SYSTEM OF QUALITY CONTROL:

The firm's system of quality control should include policies and procedures addressing each of the following elements:

1. Leadership responsibilities for quality within the firm
2. Ethical requirements
3. Acceptance and continuance of client relationships and specific engagements
4. Human resources
5. Engagement performance
6. Monitoring

Quality control policies and procedures should be documented and communicated to the firm's personnel. By communicating, the firm recognizes the importance of obtaining feedback on its quality control system from its personnel. Therefore, the firm encourages its personnel to communicate their views or concerns on quality control matters.

C. LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM:

1. SQC 1 requires firms to establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements.
2. Such policies and procedures should require the firm's chief executive officer or the firm's managing partners to assume ultimate responsibility for the firm's system of quality control.
3. The example set by firm's leadership encourages an inner culture that recognizes high quality audit work.
4. Further, persons assigned operational responsibilities for the firm's quality control system by the firm's chief executive officer or managing partners should have sufficient and appropriate experience, ability and the necessary authority to assume

that responsibility.

D. ETHICAL REQUIREMENTS:

1. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements contained in the Code of ethics issued by ICAI.
2. The Code establishes the fundamental principles of professional ethics which include integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. Observance of "Independence" in all engagements is the basic requirement.
3. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and (including experts contracted by the firm and network firm personnel) maintain independence where required by the Code. Such policies and procedures should enable the firm to:
   a. Communicate its independence requirements to its personnel
   b. Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.
4. There should exist a mechanism in the firm by which engagement partners provide the firm with relevant information about client engagements and personnel of firm promptly notify firm of circumstances and relationships that create a threat to independence.
5. All breaches of independence should be promptly notified to firm for appropriate action. Its objective is to ensure that independence requirements are satisfied.
6. At least ANNUALLY, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent in terms of the requirements of the Code.

E. ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS:

1. A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about:
   a. Integrity of Client
   b. Competence (including capabilities, time and resources) to perform engagement
   c. Compliance with ethical requirements

   The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.
2. With regard to the integrity of a client, matters that the firm considers include, for example:
   a. The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
   b. The nature of the client's operations, including its business practices.
   c. Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.

   d. Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
   e. Indications of an inappropriate limitation in the scope of work.
   f. Indications that the client might be involved in money laundering or other criminal activities.
   g. The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.
3. If there is any conflict of interest between the firm and client, it should be properly resolved before accepting the engagement. Where the firm obtains information that would have caused it to decline an engagement if that information had been obtainable earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of:
   a. The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and
   b. The possibility of withdrawing from the engagement or from both the engagement and the client relationship.

F. HUMAN RESOURCES:

1. The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.
2. Such policies and procedures should address relevant HR issues including:
   a. recruitment,
   b. compensation,
   c. training,
   d. career development,
   e. performance evaluation etc.
3. There should be emphasis on the continuing professional development of firm's personnel.

G. ENGAGEMENT PERFORMANCE:

1. Consistency in quality of engagement performance is achieved through briefing of engagement teams of their objectives, processes for complying with engagement standards, processes of engagement supervision and training, methods of reviewing performance of work, appropriate documentation of work performed.
2. **CONSULTATION:**
   a. Consultation should take place in difficult or contentious matters pertaining to an engagement. Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter.
   b. A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by other firms or professional and regulatory bodies.
3. **ENGAGEMENT QUALITY CONTROL REVIEW:**
   a. Significant judgments made in an engagement should be reviewed by an engagement quality control reviewer for taking an objective view before the

report is issued.

b. The extent of the review depends on the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The review does not reduce the responsibilities of the engagement partner.
c. Engagement quality control review is mandatory for all audits of financial statements of listed entities. In respect of other engagements, firm should devise criteria to determine cases requiring performance of engagement quality control review.
d. There might be difference of opinion within engagement team, with those consulted and between engagement partner and engagement quality control reviewer. The report should only be issued after resolution of such differences.
e. In case, recommendations of engagement quality control reviewer are not accepted by engagement partner and matter is not resolved to reviewer's satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body.

4. **ENGAGEMENT DOCUMENTATION:**

a. Besides, the firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized. The assembly of engagement files should be completed in not more than 60 days after date of auditor's report in case of audit engagements and in other cases within the limits appropriate to engagements.
b. Policies and procedures should be designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.
c. Unless otherwise specified by law or regulation, engagement documentation is the property of the firm.
   The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.
d. Engagement documentation has to be retained for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.
e. In the specific case of audit engagements, the retention period ordinarily is no shorter than 7 years from the date of the auditor's report, or, if later, the date of the group auditor's report.

H. MONITORING: The firm should ensure that policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.

SA 220 QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS

A. SCOPE AND OBJECTIVE:

1. Engagement partner of a team is responsible for quality control procedures of a particular audit engagement in accordance with SA 220. Therefore, SA 220 is premised on the basis that the firm is subject to SQC 1. Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.
2. As per SA 220, the objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that
   a. The audit complies with professional standards and regulatory and legal requirements and
   b. The auditor's report issued is appropriate in the circumstances.

B. RESPONSIBILITIES OF ENGAGEMENT PARTNER: SA 220 is modelled on lines of SQC1. It describes responsibilities of engagement partner in relation to following matters:

1. Leadership responsibilities for quality on audits
2. Relevant ethical requirements
3. Acceptance and continuance of client relationships and audit engagements
4. Assignment of engagement teams
5. Engagement performance
6. Monitoring

C. LEADERSHIP RESPONSIBILITIES FOR QUALITY ON AUDITS: Leadership responsibility of an engagement partner is to take responsibility for the overall quality on each audit engagement. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise:

1. The importance to audit quality of:
   a. Performing work that complies with professional standards and regulatory and legal requirements;
   b. Complying with the firm's quality control policies and procedures as applicable;
   c. Issuing auditor's reports that are appropriate in the circumstances and
   d. The engagement team's ability to raise concerns without fear of reprisals.
2. The fact that quality is essential in performing audit engagements.

D. RELEVANT ETHICAL REQUIREMENTS: The responsibilities of an engagement partner in relation to ethical requirements in an audit engagement are as under:

1. Identifying a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level.
2. Reporting by engagement partner to the relevant persons within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement, where withdrawal is legally permitted.

E. ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND AUDIT ENGAGEMENTS: The responsibility of an engagement partner in this regard in an audit engagement is on lines of SQC 1 which requires the firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.

1. Information like integrity of principal owners,
2. Competence of engagement team and consideration of necessary capabilities including time and resources,
3. Compliance with relevant ethical requirements and
4. Significant matters arisen during current or previous audit engagement.

F. ASSIGNMENT OF ENGAGEMENT TEAMS: It should be ensured by engagement partner that the engagement team and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the engagement in accordance with professional standards and regulatory and legal requirements.

G. ENGAGEMENT PERFORMANCE:

1. Engagement partner has the responsibility for direction, supervision and performance of audit engagement in accordance with professional standards and regulatory and legal requirements. He is responsible for auditor's report being appropriate in circumstances.
2. Further, review of audit documentation before issue of audit report is his responsibility. It has to be ensured that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for issuance of auditor's report.
3. Engagement partner is also responsible for ensuring undertaking appropriate consultation on difficult or contentious matters by engagement team not only within the team but also with others at appropriate level within or outside the firm.
4. **EQCR:** For audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:
   a. Determine that an engagement quality control reviewer has been appointed.
   b. Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer.
   c. Not date the auditor's report until the completion of the engagement quality control review.
   d. If differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

H. MONITORING:

1. An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively.
2. The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the audit engagement.
3. **DOCUMENTATION:** The engagement partner should document following matters pertaining to an audit engagement:
   a. Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
   b. Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these

conclusions.

c. Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.
d. The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.

EXAMPLE OF AN ENGAGEMENT LETTER

Given below is example of an engagement letter:

PJ Shrimali & Co.
Chartered Accountants

24, MG Road,
Mumbai
10th August XXXX

To the Board of Directors of Pristine Products Limited

The objective and scope of the audit

You have requested that we audit the financial statements of Pristine Products Limited, which comprise the Balance Sheet as at March 31st, 20XX, the Statement of Profit & Loss, Cash Flow Statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

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

The responsibilities of the auditor

We will conduct our audit in accordance with Standards on Auditing (SAs) issued by the Institute of Chartered Accountants of India (ICAI). Those Standards require that we comply with ethical requirements. As part of an audit in accordance with SAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the company's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the company to cease to continue as a going

concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with SAs.

The responsibilities of management

Our audit will be conducted on the basis that management and, where appropriate, those charged with governance acknowledge and understand that they have responsibility:

a. For the preparation of financial statements that give a true and fair view in accordance with the financial reporting Standards. This includes:
- The responsibility for the preparation of financial statements on a going concern basis.
- The responsibility for selection and consistent application of appropriate accounting policies, including implementation of applicable accounting standards along with proper explanation relating to any material departures from those accounting standards.
- The responsibility for making judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the profit or loss of the entity for that period.

b. For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error and

c. To provide us with:

i. Access, at all times, to all information, including the books, accounts, vouchers and other records and documentation, of the company, whether kept at the head office of the company or elsewhere, of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters,

ii. Additional information that we may request from management for the purpose of the audit and

iii. Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence. This includes our entitlement to require from the officers of the company such information and explanations as we may think necessary for the performance of our duties as auditor. As part of our audit process, we will request from management and, where appropriate, those charged with governance, written confirmation concerning representations made to us in connection with the audit.

Fees

Our fees bill for Rs. XXXXXX (plus applicable taxes) and out of pocket expenses will be raised after completion of audit work.

Reporting

We will report to the members of Pristine Products Limited as a body, whether in our opinion, the financial statements give the information required by the Companies Act, 2013 in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the company as at March 31, 20XX, and its profit/loss, and its cash flows for the year ended on that date. The form and content of our report may need to be amended in the light of our audit findings.

Please sign and return the attached copy of this letter to indicate your acknowledgement of,

and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.
For PJ Shrimali & Co.
Chartered Accountants
Firm's Registration Number

(Signature)
(Name of the Member)
(Designation)

3. AUDIT REPORT

SA 700 (REVISED) FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

A. INTRODUCTION:

1. **SCOPE OF SA 700:** "Forming an Opinion and Reporting on Financial Statements", deals with the auditor's responsibility to form an opinion on the financial statements. It also deals with the form and content of the auditor's report issuedas a result of an audit of financial statements.
2. **NEED OF SA 700:**
   a. The requirements of this SA are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally and the need to increase the value of auditor reporting by making the information provided in the auditor's report more relevant to users.
   b. This SA promotes consistency in the auditor's report, but recognizes the need for flexibility to accommodate particular circumstances of individual jurisdictions.
   c. Consistency in the auditor's report, when the audit has been conducted in accordance with SAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards.
   d. It also helps to promote the user's understanding and to identify unusual circumstances when they occur.
3. **OBJECTIVE OF THE AUDITOR:** The objectives of the auditor as per SA 700 (Revised) are:
   a. To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
   b. To express clearly that opinion through a written report.

B. FORMING OF AN OPINION:

1. The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
2. In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:
   a. Whether sufficient appropriate audit evidence has been obtained.
   b. Whether uncorrected misstatements are material, individually or in aggregate.
   c. The evaluations.

C. EVALUATIONS BY THE AUDITOR:

1. The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.
2. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements.
3. **QUALITATIVE ASPECTS OF ENTITIES ACCOUNTING PRACTICES:** SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices:
   a. Management makes a number of judgements about the amounts and disclosures in the financial statements.

b. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgements.
c. The auditor may conclude that the cumulative effect of lack of neutrality, together with the effect of uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality include the following:
   i. The selective correction of misstatements brought to management's attention during the audit.
   Example: Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.
   ii. Possible management bias in the making of accounting estimates. SA 540 addresses possible management bias in making accounting estimates.
d. Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

4. **SPECIFIC EVALUATIONS BY THE AUDITOR:** In particular, the auditor shall evaluate whether:
   a. The financial statements adequately disclose the significant accounting policies selected and applied.
   b. The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate.
   c. The accounting estimates made by management are reasonable.
   d. The information presented in the financial statements is relevant, reliable, comparable, and understandable.
   e. The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements and
   f. The terminology used in the financial statements, including the title of each financial statement, is appropriate.
5. **EVALUATIONS IN CASE OF FAIR PRESENTATION FRAMEWORK:** Further, when the financial statements are prepared in accordance with a fair presentation framework, the evaluation mentioned above shall also include an evaluation by the auditor as to whether the financial statements achieve fair presentation which shall include consideration of:
   a. The overall presentation, structure and content of the financial statements and
   b. Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.
6. The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.

D. KEY DEFINITIONS OF SA 700:

a. **GENERAL PURPOSE FINANCIAL STATEMENTS:** Financial statements prepared in accordance with a general-purpose framework.
b. **GENERAL PURPOSE FRAMEWORK:** A financial reporting framework designed to meet the common financial information needs of a wide range of users.

The financial reporting framework may be a fair presentation framework or a compliance framework.

FAIR PRESENTATION FRAMEWORK: The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework AND:

i. **Acknowledges explicitly or *implicitly*** that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework or

ii. **Acknowledges explicitly** that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

COMPLIANCE FRAMEWORK: The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above.

E. FORM OF OPINIONS [TYPES]:

1. **UNMODIFIED OPINION:** The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
2. **MODIFIED OPINION:**
   a. If the auditor Concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement or
   b. Is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatements.

   the auditor shall modify the opinion in the auditor's report in accordancewith SA 705.

WORDINGS OF UNMODIFIED OPINION:

When expressing an unmodified opinion on financial statements, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

a. In our opinion, the accompanying financial statements present fairly, in all material respects, […] in accordance with [the applicable financial reporting framework]; or

b. In our opinion, the accompanying financial statements give a true and fair view of […] in accordance with [the applicable financial reporting framework].

The phrases "present fairly, in all material respects," and "give a true and fair view" are regarded as being equivalent

When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as "with the foregoing explanation" or "subject to" in relation to the opinion, as these suggest a conditional opinion or a weakening or modification of opinion.

F. CONTENTS / ELEMENTS OF AUDITOR'S REPORT FOR AUDIT CONDUCTED AS PER SA's:

The auditor's report shall be in writing. This SA- 700 requires the use of specific headings, which are intended to assist in making auditor's report more recognizable, where audit is conducted in accordance with the relevant Standardson Auditing.

1. Title
2. Addressee
3. Auditor's Opinion
4. Basis for Opinion

5. **Material Uncertainty related to Going Concern (SA 570)**
6. **Key Audit Matters (SA 701)**
7. **Emphasis of Matter Paragraph (SA 706)**
8. **Other Matter Paragraph (SA 706)**

Applicable as per the relevant standard

9. Responsibilities of management for the Financial Statements.
10. Auditor's Responsibilities for the Audit of the Financial Statements.
11. Other Information Para (SA 720)
12. Report on Other Legal and regulatory requirements / Other Reporting Responsibilites.
13. Signature of the Auditor.
14. Place of Signature. [Ordinarily the city where the audit report is signed]
15. Date of the Auditor's Report (On / After Date of Approval of Financial statements)
    UDIN (Unique Document Identification Number w.e.f.1st July, 2019)

DETAILED EXPLANATION FOR ABOVE ELEMENTS:

1. **TITLE:** The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor.
   For example, "Independent Auditor's Report," distinguishes the independent auditor's report from reports issued by others.
2. **ADDRESSEE:**
   - The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement.
   - Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed.
   - The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance ofthe entity whose financial statements are being audited.
   - In case of a company, the report is addressed to the shareholders of the company.
3. **AUDITOR'S OPINION:** The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."The Opinion section of the auditor's report shall also:
   a. Identify the entity whose financial statements have been audited
   b. State that the financial statements have been audited.
   c. Identify the title of each statement comprising the financial statements.
   d. Refer to the notes, including the summary of significant accounting policies and
   e. Specify the date of, or period covered by, each financial statement comprising the financial statements.
4. **BASIS FOR OPINION:** The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:
   1. States that the audit was conducted in accordance with Standards on Auditing.
   2. Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs.
   3. Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
   4. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.
5. **GOING CONCERN:** Where applicable, the auditor shall report in accordance with SA 570 (Revised):

a. Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.
b. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.
c. The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in thepreparation of the financial statements.
d. Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's judgement, a material uncertainty exists related to events orconditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.
e. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgement, appropriate disclosure of the nature and implications of the uncertainty is necessary for:
    a. In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or
    b. In the case of a compliance framework, the financial statements not to be misleading.

6. **KEY AUDIT MATTERS:**
    a. For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701.
    b. When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.
    c. Law or regulation may require communication of key audit matters for audits of entities other than listed entities. Example, Entities characterized in such law or regulation as public interest entities.
    d. The auditor may also decide to communicate key audit matters for other entities, including those that may be of significant public interest, for example because they have a large number and wide range of stakeholders and considering the natureand size of the business.
    Examples of such entities may include financial institutions (such as banks, insurance companies, and pension funds), and other entities such as charitable institutions.
7. **OTHER INFORMATION:** Where applicable, the auditor shall report in accordance with SA 720 (Revised).
8. **RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS:** SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." This section of the auditor's report shall describe management's responsibility for:
    a. Preparing the financial statements in accordance with the applicable financial reporting framework, and

b. For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error and
c. Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

SA 210 requires the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.

OVERSIGHT OF THE FINANCIAL REPORTING PROCESS: This section of the auditor's report shall also identify those responsible for the oversight of the financial reporting process, when those responsible for such oversight are different from Management. In this case, the heading of this section shall also refer to "Those Charged with Governance" or such term that is appropriate in the context of the legal framework applicable to the entity.

9. **AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS:** The auditor's report shall include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."

I. PRIMARY RESPONSIBILITIES: This Section of The Auditor's Report Shall State:

- **a. That the objectives of the auditor are to:**
  - **i.** Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
  - **ii.** Issue an auditor's report that includes the auditor's opinion.
- **b. That reasonable assurance is a high level of assurance, but is not a guarantee** that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and
- **c. That misstatements can arise from fraud or error, and either:**
  - **i.** Describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financialstatements; or
  - **ii.** Provide a definition or description of materiality in accordance withthe applicable financial reporting framework.

II. ADDITIONAL RESPONSIBILITES UNDER SA's: The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report shall further:

a. State that, as part of an audit in accordance with SAs, the auditor exercises professional judgement and maintains professional skepticism throughout the audit and

b. Describe an audit by stating that the auditor's responsibilities are:

   i. To identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error; to design and perform audit procedures responsive to those risks; and to obtain audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

ii. To obtain an understanding of internal control relevant to theaudit in order to design audit procedures that are appropriate inthe circumstances.

iii. To evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

iv. To conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

v. When the financial statements are prepared in accordance with a fair presentation framework, to evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

c. When SA 600 applies, further describe the auditor's responsibilities in a group audit engagement by stating, the division of responsibility for the financial information of the entityby indicating the extent to which the financial information of components is audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions /branches/subsidiaries or other components audited by other auditors

III. COMMUNICATION RELATED RESPONSIBILITIES: The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report also shall:

a. State that the auditor communicates with those charged with governance regarding, among other matters, the planned scope andtiming of the audit and significant audit findings, including any significant deficiencies in internal control that the auditor identifies during the audit.

b. For audits of financial statements of listed entities, state that the auditor provides those charged with governance with a statement that the auditor has complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters that may reasonably be thought to bear on the auditor's independence, and where applicable, related safeguards and

c. For audits of financial statements of listed entities and any other entities for which key audit matters are communicated in accordance with SA 701, state that, from the matters communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. The auditor describes these matters in the auditor's report unless law or regulation precludes public disclosure.

LOCATION OF THE DESCRIPTION OF THE AUDITOR'S RESPONSIBILITIES SECTION: The description of the auditor's responsibilities for the audit of the financial statements shall be included:

1. Within the body of the auditor's report.

2. Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix or
3. By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so.

10. OTHER REPORTING RESPONSIBILITIES:

a. **REPORT ON LEGAL AND REGULATORY REQUIREMENTS:** If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled "Report on Other Legal and Regulatory Requirements" or otherwise as appropriate to the content of the section, unless these other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the SAs in which case the other reporting responsibilities may be presented in the same section as the related report elements required by the SAs.

b. **REPORT ON AUDIT OF FINANCIAL STATEMENTS:** If other reporting responsibilities are presented in the same section as the related report elements required by the SAs, the auditor's report shall clearly differentiate the other reporting responsibilities from the reporting that is required by the SAs.
If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements stated above shall be included under a section with a heading "Report on the Audit of the Financial Statements."
The "Report on Other Legal and Regulatory Requirements" shall follow the "Report on the Audit of the Financial Statements."

11. SIGNATURE OF THE AUDITOR:

a. **INDIVIDUAL CAP:** The auditor's report shall be signed. The report is signed by the auditor (i.e., the engagement partner) in his personal name.
b. **FIRM [SPF / PF / LLP]:** Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm.
c. **MRN & FRN:** The partner/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India. They also include the registration number of the firm, wherever applicable, as allotted by ICAI, in the audit reports signed by them.

12. PLACE OF SIGNATURE: The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.

13. DATE OF THE AUDITOR'S REPORT: The auditor's report shall be dated NO EARLIER THAN:

- **OBTAIN SAA EVIDENCE:** The date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements AND
- **APPROVAL OF F/S:** All the statements that comprise the financial statements, including the related notes, have been prepared and Those with the recognized authority have asserted that they have taken responsibility for those financial statements

The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in SA 560.

14. UDIN

a. It was noticed that financial documents/ certificates attested by third person misrepresenting themselves as CA Members were misleading the Authorities and Stakeholders. ICAI also received number of complaints of signatures of CAs being forged by non CAs.

b. To curb the malpractices, the Professional Development Committee of ICAI implemented in phased manner an innovative concept of UDIN i.e., Unique Document Identification Number.

c. All Certificates were made mandatory with effect from 1st February, 2019 as per the Council decision taken at its 379th Meeting held on 17th – 18th December, 2018.

d. Chartered Accountants having full-time Certificate of Practice can register on UDIN Portal and generate UDIN by registering the certificates attested/certified by them.

e. Accordingly, an auditor is required to mention the UDIN with respect to each audit report being signed by him, along with his membership number while signing an audit report. The same is shown in the below illustration.

G. AUDITOR'S REPORT PRESCRIBED BY LAW OR REGULATION:

1. SA 200 explains that the auditor may be required to comply with legal or regulatory requirements in addition to SAs.
2. When the differences between the legal or regulatory requirements and SAs relate only to the layout and wording of the auditor's report, the requirements stated below set out the minimum elements to be included in the auditor's report to enable a reference tothe Standards on Auditing.
3. Where specific requirements in a particular law or regulation do not conflict with SAs, the layout and wording required by this SA assist users of the auditor's report in more readily recognizing the auditor's report as a report of an audit conductedin accordance with SAs.
4. If the auditor is required by law or regulation to use a specific layout, or wordingof the auditor's report, the auditor's report shall refer to Standards on Auditing only if the auditor's report includes, at a minimum, each of the following elements:

a. A title.

b. An addressee, as required by the circumstances of the engagement.

c. An Opinion section containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements.

d. An identification of the entity's financial statements that have been audited.

e. A statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall refer to the Code of Ethics issued by ICAI.

f. Where applicable, a section that addresses, and is not inconsistent with, the reporting requirements relating to going concern as per SA 570 (Revised).

g. Where applicable, a Basis for Qualified (or Adverse) Opinion section that addresses, and is not inconsistent with, the reporting requirements relating to going concern as per SA 570 (Revised).

h. Where applicable, a section that includes the information required by SA 701, or additional information about the audit that is prescribed by law or regulation and that addresses, and is not inconsistent with, the reporting requirements in that SA.

i. A description of management's responsibilities for the preparation of the financial statements and an identification of those responsible for the oversight of the financial reporting process that addresses, and is not inconsistent with, the requirements as contained in this SA 700.

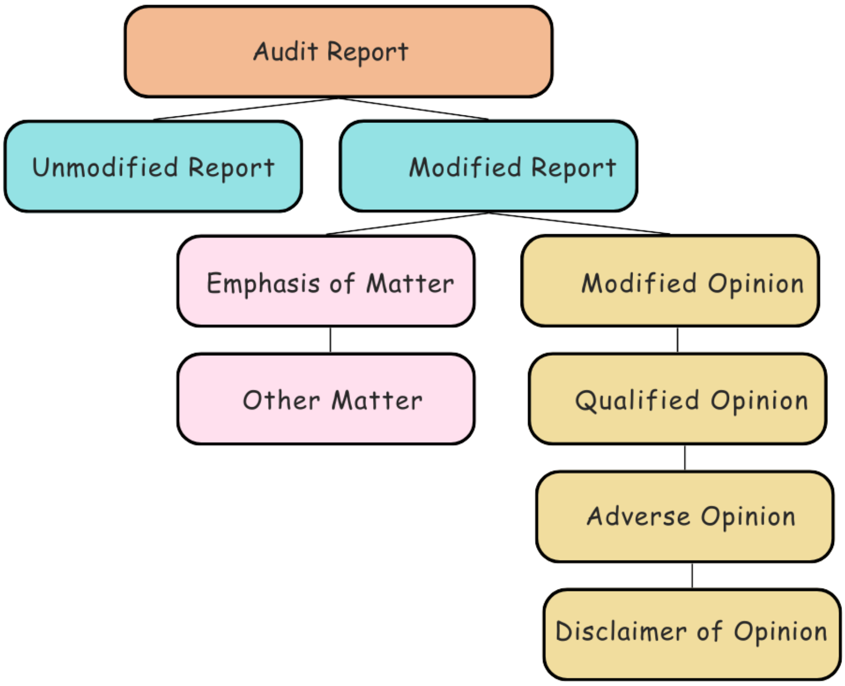
j. A reference to Standards on Auditing and the law or regulation, and a description of the auditor's responsibilities for an audit of the financial statements that addresses, and is not inconsistent with, the requirements as contained in this SA 700.

k. The auditor's signature.

l. The Place of signature.

m. The date of the auditor's report.

SA 705 MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITORS REPORT



A. SCOPE OF SA 705:

1. Standard on Auditing (SA) 705 "Modifications to the Opinion in the Independent Auditor's Report" deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised) "Forming an Opinion and Reporting on Financial Statements", the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.
2. This SA also deals with how the form and content of the auditor's report is affected when the auditor expresses a modified opinion.

B. CIRCUMSTANCES WHEN A MODIFICATION TO THE AUDITOR'S OPINION IS REQUIRED: The auditor shall modify the opinion in the auditor's report in the following circumstances:

1. The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement or
2. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

C. OBJECTIVE OF THE AUDITOR: The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:

a. The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement or

b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

D. TYPES OF MODIfiED OPINIONS: There are 3 types of modified opinions, namely:

1. **QUALFIED OPINION:** The auditor shall express a qualified opinion when:

   a. The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, BUT NOT pervasive, to the financial statements or

b. The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

2. **ADVERSE OPINION:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually orin the aggregate, are BOTH material and pervasive to the financial statements.
3. **DISCLAIMER OF OPINION:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be BOTH material and pervasive.
   The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

E. DEFINITION OF PERVASIVE:

1. A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on thefinancial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence.
2. Pervasive effects on the financial statements are those that, in the auditor's Judgement:
   a. Are not confined to specific elements, accounts or items of the financial statements.
   b. If so confined, represent or could represent a substantial proportion of thefinancial statements or
   c. In relation to disclosures, are fundamental to users' understanding of the financial statements.

F. WHICH TYPE OF OPINION IS APPROPRIATE:

The decision regarding which type of modified opinion is appropriate depends upon:

1. The nature of the matter giving rise to the modification that is:
   a. whether the financial statements are materially misstated or,
   b. in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated

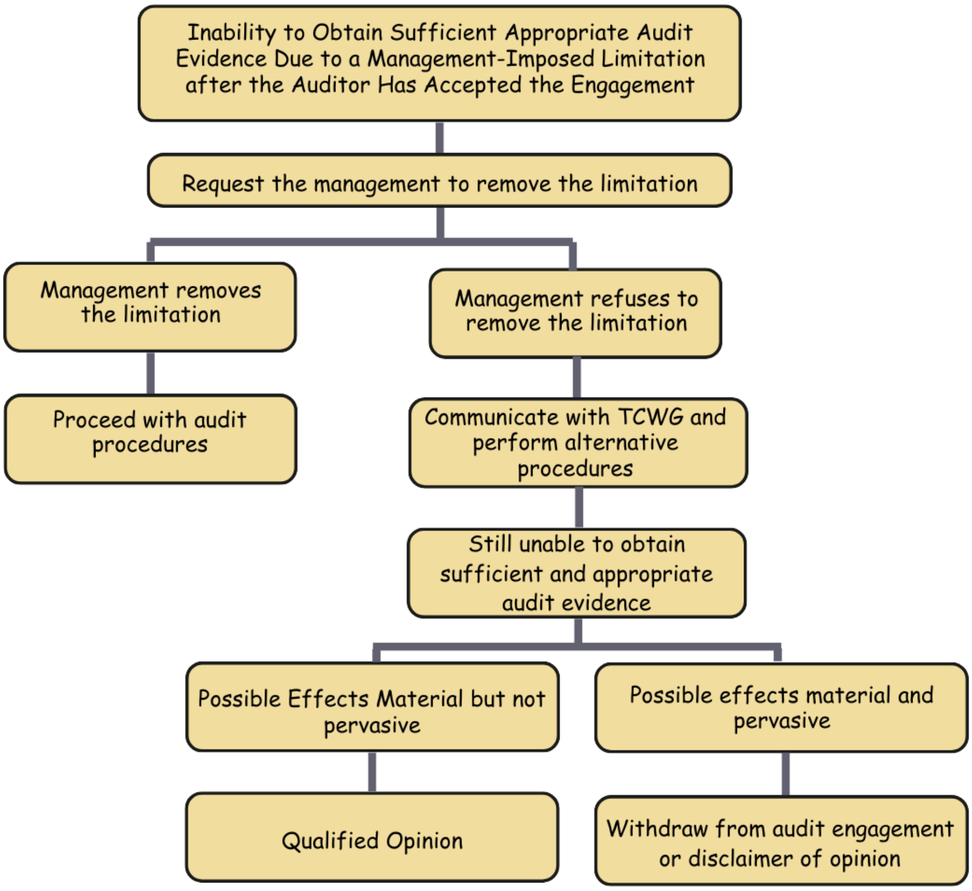
   AND
2. The auditor's judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements.

The table below illustrates how the auditor's judgement about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

NATURE OF MATTER	CASE	MMS EXIST?	PERVASIVE?	OPINION
Sufficient and appropriate audit evidence Obtained	A	No	NA	Unqualified Opinion
	B	Yes	No	Qualified Opinion
	C	Yes	Yes	Adverse Opinion
SITUATION	CASE	IS IT MATERIAL?	IS THE POSSIBLE EFFECT PERVASIVE?	OPINION
Sufficient and appropriate evidence NOT Obtained	A	Yes	No	Qualified Opinion
	B	Yes	Yes	Disclaimer Opinion

G. CONSEQUENCE OF AN INABILITY TO OBTAIN SUFFICIENT APPROPRIATE AUDIT EVIDENCE DUE TO A MANAGEMENT-IMPOSED LIMITATION AFTER THE AUDITOR HAS ACCEPTED THE ENGAGEMENT:

1. If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers is likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.
2. If management refuses to remove the limitation referred above, the auditor shall communicate the matter to those charged with governance and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.
3. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:
   a. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion or
   b. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
      i. Withdraw from the audit, where practicable and possible under applicable law or regulation; or
      ii. If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.
4. If the auditor decided to withdraw, before such withdrawal shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.



H. REFERENCE IN AUDIT REPORT IN CASE OF MODIFIED OPINION: When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

1. The Opinion paragraph and Basis for opinion paragraph headings shall be appropriately modified where the auditor expresses a modified opinion:
   a. In case of Qualified Opinion:
      i. Qualified Opinion
      ii. Basis for Qualified Opinion
   b. In case of Adverse Opinion:
      i. Adverse Opinion
      ii. Basis for Adverse Opinion

   c. In case of Disclaimer Opinion:
      i. Disclaimer Opinion
      ii. Basis for Disclaimer Opinion
2. Within the basis for opinion section, include a description of the matter giving rise to the modification.

I. DESCRIPTION OF BASIS FOR OPINION PARA IN CASE OF MODIFIED OPINION:

1. **MMS IN F/S - QUALIFY:** If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures in the notes to the financial statements), the auditor shall include in the Basis for Opinion section a description and quantification of the financial effects of the misstatement, **unless impracticable**.
2. **UNABLE TO QUANTIFY:** If it is not practicable to quantify the financial effects, the auditor shall so state in this section.

3. **MMS IN NARRATIVE DISCLOSURES:** If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the Basis for Opinion section an explanation of how the disclosures is misstated.
4. **MMS BY WAY OF NON-DISCLOSURE:** If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed, the auditor shall:
   a. Discuss the non-disclosure with those charged with governance.
   b. Describe the nature of the omitted information; and
   c. Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so, and the auditor has obtained sufficient appropriate audit evidence about the omitted information.
5. **INABILITY TO OBTAIN EVIDENCE:** If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the Basis for Opinion section the reasons for that inability.
6. **IN CASE OF DISCLAIMER OF OPINION:** When the auditor disclaims an opinion on the financial statements, the auditor's report shall not include the following elements required by SA 700 (Revised).
   a. A reference to the section of the auditor's report where the auditor's responsibilities are described; and
   b. A statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

   Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the Basis for Opinion section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof.

J. DESCRIPTION OF AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS WHEN THE AUDITOR DISCLAIMS AN OPINION ON THE FINANCIAL STATEMENTS:

When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

a. A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;

b. A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
c. The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised).

Note: Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.

K. COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE:

When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification.

SA 706 EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

A. **SCOPE:** SA 706 deals with additional communication in the auditor's report when the auditor considers it necessary to:
   a. **EOMP:** Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or
   b. **OMP:** Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to user's understandingof the audit, the auditor's responsibilities or the auditor's report.

B. **OBJECTIVE OF THE AUDITOR AS PER SA 706:** As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs in The Independent Auditor's Report", the objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgement it is necessary to do so, by way of clear additional communication in the auditor's report, to:
   1. **EOMP:** A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements or
   2. **OMP:** As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

C. **DEFINITIONS**
   1. **EMPHASIS OF MATTER PARAGRAPH [EOMP]:** Emphasis of Matter paragraph is a paragraph included in the auditor's report that refers to a matter **appropriately** presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements.
   2. **OTHER MATTER PARAGRAPH [OMP]:** A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

D. **USAGE OF EMPHASIS OF MATTER PARAGRAPH:** Emphasis of Matter paragraph is used to draw user's attention to a matter which is important for user's understanding of F/S' s in view of the auditor's judgment and this shall be included in auditors report provided:
   1. The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter.
   2. When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

   Examples of when it is used:
   1. An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
   2. A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
   3. A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
   4. Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.

E. MANNER OF PRESENTATION OF EMPHASIS OF MATTER:

1. Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
2. Shall express the matter being emphasized (highlighted) and give the reference to such matter in the financial statements. Accordingly, this paragraph shall refer only to information presented or disclosed in the financial statements; and
3. Also state that the auditor's opinion is not modified in respect of the matter emphasized.
4. An Emphasis of Matter Para is not a substitute for
   a. A modified Opinion in accordance with SA 705
   b. Disclosures in Financial statements as per AFRFW.
   c. Reporting in accordance with SA 570 when a material uncertainty exists relating to entities ability to continue as a going concern.

F. OTHER MATTER PARAGRAPHS IN THE AUDITOR'S REPORT: The auditor shall include an Other Matter paragraph in the auditor's report, provided:

a. This is not prohibited by law or regulation and
b. When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

G. SEPARATE SECTION FOR OTHER MATTER PARAGRAPH: When the auditor includes an Other Matter paragraph in the auditor's report, the auditor shall include the paragraph within a separate section with the heading "Other Matter," or other appropriate heading.

H. COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE: If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the wording of this paragraph.

SA 701 COMMUNICATING KEY AUDIT MATTERS IN THE INDEPENDENT AUDITOR'S REPORT

A. SCOPE: SA 701 deals with the auditor's responsibility to communicate key audit matters in the auditor's report. It is intended to address both the auditor's judgement as to what to communicate in the auditor's report and the form and content of such communication.

B. APPLICABILITY:

1. **LISTED ENTITIES:** For audits of complete sets of general-purpose financial statements of **listed entities**, the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701.
2. **LAW OR REGULATION:** When the auditor is required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.
3. **PUBLIC INTEREST:** The auditor may also decide to communicate key audit matters for other entities, including those that may be of significant public interest, for example because they have a large number and wide range of stakeholders and considering the nature and size of the business.

C. DEFINITION OF KEY AUDIT MATTER:

D. PURPOSE OF COMMUNICATING KEY AUDIT MATTERS:

1. The purpose of communicating key audit matters is to enhance the communicative value of auditor's report by providing greater transparency about the audit that was performed.
2. KAM provides additional information to the intended users of the F/S to assist them in understanding the entity and areas of significant management judgments used.
3. Communicating key audit matters in the auditor's report is:
   a. NOT a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make;
   b. NOT a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705;
   c. NOT a separate opinion on individual matters.
   d. NOT a substitute for reporting in accordance with SA 570, where a material uncertainty there related to going concern of the entity.

E. DETERMINING KEY AUDIT MATTERS: The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

1. Areas of higher assessed risk of material misstatement or significant risks identified in accordance with SA 315
2. Significant auditor judgements relating to areas in the financial statements that involved significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty.
3. The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the matters determined, as stated above, were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

F. MANNER OF COMMUNICATING KEY AUDIT MATTERS: The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters". The introductory language in this section of the auditor's report shall state that:

1. Key audit matters are those matters that, in the auditor's professional judgement,

were of most significance in the audit of the financial statements[of the current period]; and

2. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

G. COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE: The auditor shall communicate with those charged with governance:

a. Those matters the auditor has determined to be the key audit matters; or

b. If applicable, depending on the facts and circumstances of the entity and the audit, the auditor's determination that there are NO key audit matters to communicate in the auditor's report.

The following illustrates the presentation in the auditor's report if the auditor has determined there are NO key audit matters to communicate:

Key Audit Matters

[Except for the matter described in the Basis for Qualified (Adverse) Opinion section or Material Uncertainty Related to Going Concern section,] We have determinedthat there are no [other] key audit matters to communicate in our report.

SA 710 COMPARATIVE INFORMATION - CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS

A. SCOPE:

1. This Standard on Auditing (SA) deals with the auditor's responsibilities regarding comparative information in an audit of financial statements.
2. When the financial statements of the prior period have been audited by a predecessor auditor or were not audited, the requirements and guidance in SA 510 regarding opening balances also apply.

B. THE NATURE OF THE COMPARATIVE INFORMATION:

1. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework.
2. There are 2 different broad approaches to the auditor's reporting responsibilities in respect of such comparative information:
   a. Corresponding figures and
   b. Comparative financial statements.
3. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement.
4. The essential audit reporting differences between the approaches are:
   a. For corresponding figures, the auditor's opinion on the financial statements refers to the current period only whereas
   b. For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

C. OBJECTIVES: As per SA 710, the objectives of the auditor are:

1. To obtain sufficient appropriate audit evidence about whether the comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting framework and
2. To report in accordance with the auditor's reporting responsibilities.

D. DEFINITION OF COMPARATIVE INFORMATION: The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

E. AUDIT PROCEDURES REGARDING COMPARATIVE INFORMATION:

1. The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reportingframework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:
   a. The comparative information agrees with the amounts and other disclosures presented in the prior period and
   b. The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.
2. If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists.

3. If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560.
4. As required by SA 580, the auditor shall request written representations forall periods referred to in the auditor's opinion. The auditor shall _ item that is separately disclosed in the current year's statement of profit and loss.

F. AUDIT REPORTING REGARDING CORRESPONDING FIGURES:

1. **CORRESPONDING FIGURES:** Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as "current period figures"). The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.
2. When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures EXCEPT in the following circumstances:
   a. If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:
      i. Refer to both the current period's figures and the corresponding figures inthe description of the matter giving rise to the modification *when the effects or possible effects* of the matter on the current period's figures are material or
      ii. In other cases, explain that the audit opinion has been modified because ofthe effects or possible effects of the unresolved matter on the comparabilityof the current period's figures and the corresponding figures.
   b. If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinionhas been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.
   c. **PRIOR PERIOD FINANCIAL STATEMENTS NOT AUDITED:**
      i. If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited.
      ii. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.
   d. **PRIOR PERIOD FINANCIAL STATEMENTS AUDITED BY A PREDECESSOR AUDITOR:** If the financial statements of the prior period were audited by a predecessor auditor and the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report:
      i. That the financial statements of the prior period were audited by the predecessor auditor.

ii. The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and
iii. The date of that report.

G. AUDIT REPORTING FOR COMPARATIVE FINANCIAL STATEMENTS:

1. **DEFINITION OF COMPARATIVE FINANCIAL STATEMENTS:** Comparative information where amounts and other disclosures for the prior period are included for comparision with financial statements of the current period but, if audited, are referred in the auditors opinion. The level of Information included in those comparative financial statements is comparable with that of the financial statements of the current period.
2. **AUDITOR'S OPINION:** When comparative financial statements are presented, the auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed.
3. **DIFFERENCE OF OPINION:** When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph in accordance with SA 706.
4. **PRIOR PERIOD FINANCIAL STATEMENTS AUDITED BY A PREDECESSOR AUDITOR:**
   a. If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:
      i. That the financial statements of the prior period were audited by a predecessor auditor.
      ii. The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and
      iii. The date of that report,

      unless the predecessor auditor's report on the prior period's financial statements is revised with the financial statements.
   b. If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor shall communicate the misstatement with the appropriate level of management and those charged with governance and request that the predecessor auditor be informed.
   c. If the prior period financial statements are amended, and the predecessor auditor agrees to issue a new auditor's report on the amended financial statements of the prior period, the auditor shall report only on the current period.
5. **PRIOR PERIOD FINANCIAL STATEMENTS NOT AUDITED:**
   a. If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph that the comparative financial statements are unaudited.
   b. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

SA 299 JOINT AUDIT OF FINANCIAL STATEMENTS

A. MEANING: The process of appointing two or more individuals or firms or combination of individuals and firms is known as joint audit. (SA 299 – Joint Audit of Financial Statements). Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually.

B. VARIOUS ADVANTAGE OF JOINT AUDIT:

a. Sharing of expertise.
b. Mutual consultation.
c. Lower workload.
d. Better quality of performance.
e. Improved service to the client.
f. A sense of healthy competition towards a better performance.
g. In respect of multi-national companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.

C. THE GENERAL DISADVANTAGES MAY BE THE FOLLOWING:

a. The fees being shared.
b. Psychological problem where firms of different standing are associated in the joint audit.
c. General superiority complexes of some auditors.
d. Problems of co-ordination of the work.
e. Areas of work of common concern being neglected.
f. Uncertainty about the liability for the work done.

D. RESPONSIBILITY OF JOINT AUDITOR:

1. **Individual / Separate Responsibilities:** Where work is divided among the joint auditors on a suitable basis then each joint auditor is responsible only for the work performed by them. Generally, the work will be divided based on the following basis.
   a. Items of Assets or liabilities
   b. Income or Expenditure
   c. Geographical areas
   d. Identified units
   e. Period of Financial statements
2. **Joint / Combined Responsibility:** In the following areas all the joint auditors will have indivisible or combined responsibility.
   a. In respect of audit work which is not divided among themselves and carried by all of them.
   b. In respect of decisions taken by all the joint auditors in respect of common areas.
   c. In respect of matters brought to the notice of all joint auditors by one of them and there is an agreement among all of them.
   d. Examining that the financial statements of the entity comply with the requirements of the relevant statutes
   e. For verifying presentation and disclosure requirements of financial statements as per AFRFW.

f. For ensuring that the audit report complies with relevant standards and Statue applicable.

E. AUDIT REPORTING IN CASE OF JOINT AUDIT:

1. Generally, all the joint auditors arrive common conclusions and express common opinion through a single audit report.
2. However, joint auditor is NOT bound by majority's opinion.
3. If there is a difference of opinion among joint auditors then such disagreeing auditor can express his own opinion by a separate report.
4. In such a case each joint auditor shall refer about other joint auditor's report in their audit report.

Note: Each joint auditor is entitled to rely on the work performed by another joint auditor and need not review the work performed by others.

F. COORDINATION AMONG J/A's: Further there should be proper coordination between joint auditors. If during the course of the work, a joint auditor finds any matter that effects other joint auditors work, then he shall bring it to the notice of other joint auditors **before date of audit report**.

G. SPECIAL CONSIDERATIONS AS PER SA – 299:

1. The Engagement partner and Key engagement Team from each of the Joint auditors shall be involved in planning the audit.
2. All joint auditors should establish jointly the overall audit strategy as required under SA – 300. (Steps involved in developing overall strategy are discussed in "Audit Strategy, Planning and Programme")
3. Before Commencement of audit, All Joint auditors shall discuss and develop a Joint audit plan. The following points shall be kept in mind:
    a. Identify division of areas and common areas.
    b. Ascertain reporting objectives of engagement team.
    c. Communicate significant factors identified with each of the joint auditors for directing engagement team efforts.
    d. Consider the results of preliminary engagement activities.
    e. Ascertain the nature, timing and extent of resources necessary to accomplish the engagement
4. Each of the Joint auditors shall assess the risk of Material Misstatement and communicate to other Joint auditors.
5. The Joint auditors should discuss and document the nature, timing and extent of audit procedures to be performed for Common areas and Specific areas of audit to be performed.
6. Joint auditors shall obtain common engagement letter and common management representation letter regarding fulfilment of responsibilities by management.
7. The Work allocation between joint auditors shall be documented and signed by all the joint auditors which shall also be communicated to those charged with governance.

AUDIT OF BRANCH OFFICE ACCOUNTS

A. BOOKS OF ACCOUNTS AND AUDIT OF BRANCHES [SECTION 128]:

1. As per section 128(1) of the Companies Act, 2013, every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.
2. It may be noted that all or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the company shall, within 7 days thereof, file with the Registrar a notice in writing giving the full address of that other place.
3. Also note that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.
4. Further where a company has a branch office in India or outside India, it shall be deemed to have complied with the provisions of sub-section (1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns periodically are sent by the branch office to the company at its registered office or the other place referred in (1).
5. **AUDIT OF BRANCHES:** Further, sub-section (8) of section 143 of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by:
   a. **COMPANY AUDITOR:** The auditor appointed for the company (herein referred to as the company's auditor) under this Act or
   b. **ANOTHER CAP:** By any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or
   c. **FOREIGN BRANCHES:** Where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by:
      i. The company's auditor or
      ii. By an accountant or
      iii. By any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country
6. The duties and powers of the company' s auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed.
7. It may be noted that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shalldeal with it in his report in such manner as he considers necessary.
8. **REPORTING BY BRANCH AUDITOR:** Further as per rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relatesto the concerned branch.

B. SA 600 [USING THE WORK OF ANOTHER OTHER]:

1. For better understanding, let us now have a look at the following definitions:
   a. **Principal auditor** means the auditor with responsibility for reporting on the financial information of an entity when that financial information includes the financial

information of one or more components audited by another auditor.

b. **Other auditor** means an auditor, other than the principal auditor, with responsibility for reporting on the financial information of a component which is included in the financial information audited by the principal auditor.

c. **Component** means a division, branch, subsidiary, joint venture, associated enterprises or other entity whose financial information is included in the financial information audited by the principal auditor.

2. **USING THE WORK OF ANOTHER AUDITOR:**

a. When the accounts of the branch are audited by a person other than the company's auditor (or principal auditor), there is need for a clear understanding of the role of such other auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole;

b. Also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit.

c. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in **SA 600, "Using the Work of another Auditor".**

d. It makes clear that in certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.

e. Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment.

f. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

   i. Advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit.

   ii. The principal auditor would inform the other auditor of matters such as are as requiring special consideration,

   iii. Procedures for the identification of inter -component transactions that may require disclosure and the time-table for completion of audit and

   iv. Advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

g. The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list.

h. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

REPORTING REQUIREMENTS UNDER THE COMPANIES ACT, 2013

Section 143 of Companies Act, 2013 contains, inter alia, reporting requirements of auditor of a company in form of duties.

1. **REPORTING REQUIREMENT RELATING TO MATTERS [SECTION 143(1)]:** Under section 143(1), auditor shall inquire into following matters given as under:
   1. Whether loans and advances made by the company on the basis of security:
      a. Have been properly secured and
      b. Whether the terms on which they have been made are prejudicial to the interests of the company or its members.
   2. Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company.
   3. Whether any Shares or Securities held by the company are sold at a price less than purchase price. However, this point shall not apply to banking and investment companies.
   4. Whether loans and advances made by the company have been shown as deposits.
   5. Whether personal expenses have been charged to revenue account.
   6. Where it is stated in the books and documents of the company that any shares have been allotted for cash:
      a. Whether cash has actually been received in respect of such allotment and
      b. If no cash has actually been received, the position as stated in the account books and the balance sheet is correct, regular and not misleading.

   Reporting Requirements: If the auditor got a positive response he can ignore above matters. However, if there are any negative or adverse comments observed then he shall state them in his report along with reasons.

   In the audit report these matters should be included under the section "reporting on legal and other regulatory requirements".

2. **REPORTING ON ACCOUNTS EXAMINED [SECTION 143(2)] :**
   1. The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under sub- section (11).
   2. Further, auditor has to report whether to best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial yearand profit or loss and cash flow for the year and such other matters as prescribed under Rule 11 of the Companies (Audit and Auditors) Rules, 2014.

3. **ADDITIONAL REPORTING REQUIREMENTS UNDER SECTION 143(3):** Further, in terms of section 143(3), the auditor's report shall also state
   a. Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;
   b. Whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books **AND** proper returns adequate for the purposes of his audit have been received from branches not visited by him;

c. Whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditors has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
d. Whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
e. Whether, in his opinion, the financial statements comply with the accounting standards.
f. The observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
g. Whether any director is disqualified from being appointed as a director under sub-section (2) of the section 164.
h. Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.
i. Whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls; However, it may be noted that the reporting requirement on adequacy of internal financial controls (IFCs) with reference to financial statements shall not be applicable to a private company which is a:
   i. One person company; or
   ii. Small company; or
   iii. Company having turnover less than Rs. 50 crore as per latest audited financial statement and having aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year less than Rs. 25 crore.
j. such other matters as are prescribed **in Rule 11 of the Companies (Audit and Auditors) Rules, 2014** which are as under:
   a. Whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
   b. Whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
   c. Whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.
   d.
      i. Whether the management has represented that, to the best of it's knowledge and belief, other than as disclosed in the notes to the accounts, NO funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding,whether recorded in writing or otherwise, that the Intermediary shall,
         - whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or

- provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries.

ii. Whether the management has represented, that, to the best of it's knowledge and belief, other than as disclosed in the notes to the accounts, NO funds have been received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties") with the understanding, whether recorded in writing or otherwise, that the company shall:

- whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries")or
- provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries and

iii. Based on such audit procedures that the auditor has considered reasonable and appropriate in thecircumstances, nothing has come to their notice that has caused them to believe that the representations under sub- clause (i) and (ii) contain any material misstatement.

e. Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.

f. Whether the company has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

REPORTING REQUIREMENT: While reporting, where any of the matters required to be included in the audit report is answered in the negative or with a qualification, the report shall state the reasons therefor in terms of Section 143(4). Further, every auditor shall comply with the auditing standards as required under section 143(9).

4. REPORTING ON ANY OTHER MATTER SPECIFIED BY CENTRAL GOVERNMENT: As per **section 143(11)**, the Central Government may, in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.
[Note: Companies (Auditor's Report) Order, 2020 has been notified in this perspective]

5. REPORTING ON FRAUDS [SECTION 143(12)]:

A. **REPORTING TO THE CENTRAL GOVERNMENT:** As per section 143(12) of the Companies Act, 2013 read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve INDIVIDUALLY an amount of Rs. 1 crore or above, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as prescribed.

B. **REPORTING TO THE AUDIT COMMITTEE OR BOARD:** In case of a fraud involving lesser than the specified amount [i.e., less than Rs. 1 crore], the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time andin such manner as prescribed.

Besides, auditor has also to report matters pertaining to fraud at point (xi) of paragraph 3 of CARO,2020.

THE COMPANIES (AUDITOR'S REPORT) ORDER, 2020 [CARO, 2020]

APPLICABILITY OF THE ORDER: The Companies Auditor Report Order, 2020 (CARO) is an additional reporting requirement Order. The order applies to every company including a foreign company. However, it shall not apply to following classes of companies:

1. A Banking Companies
2. An Insurance company
3. A Company licensed to operate under section 8 of the Companies Act;
4. A One Person Company.
5. A Small company and
6. A Private Limited Company:
   a. Not being a subsidiary or holding company of a public company and
   b. The Total Paid up capital and reserves & surplus shall not exceed Rs. 1 Crore as on the balance sheet date and
   c. The Total Borrowings from banks and financial institutions shall not exceed Rs. 1 Crore at any point of time during the financial year and
   d. Total Turnover calculated as per Schedule III (including revenue from discontinuing operations) shall not Exceed Rs. 10 crores during the financial year as per the financial statements.

ADDITIONAL POINTS:

1. **In the case of holding and subsidiary companies:**
   a. The limits for applicability of CARO should be computed on the basis of standalone financial statements of holding and subsidiary companies separately but not on the basis of consolidated financial statements.
   b. CARO, 2020 reporting shall not apply to the Auditor's Report on Consolidated Financial Statements "EXCEPT Clause 21".
2. **In the case of companies having branches:**
   a. The limits for the purpose of Applicability of CARO shall be computed from the entire company's view including the amounts form all the branches but not w.r.t each branch wise.
   b. Once it is applicable to the company as a whole, then each and every branch of the company will be covered under CARO. Therefore, all the branch auditors of the company are also required to report on these 21 matters in their branch audit report of the concerned branches.

MATTERS TO BE INCLUDED IN AUDITOR'S REPORT: The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:

1. FIXED ASSETS:

a. **FIXED ASSET REGISTER:** Whether the company is maintaining proper records showing full particulars including
   1. Quantitative details of PPE and Intangible Assets (Fixed Assets) and
   2. Situation of PPE.

b. **PHYSICAL VERIFICATION:**
   1. Whether these fixed assets have been physically verified by the management at reasonable intervals.
   2. Whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of accounts.

c. **IMMOVABLE PROPERTY:** Whether the title of immovable properties is held in the name of the company. If not, provide the details of the same:
   1. Description of the Property
   2. Gross Carrying Value
   3. Held in Name of (I.e., Promoter or director or employees)
   4. Reason for Not being held in name of Company.

d. **REVALUATION (NEWLY ADDED IN 2020):**
   Whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so:
   1. Whether the revaluation is based on the valuation by a Registered Valuer.
   2. Specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets.

e. **DISCLOSURE OF BENAMI TRANSACTIONS (NEWLY ADDED IN 2020):** Whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made there under, if so, whether the company has appropriately disclosed the details in its financial statements.

2. INVENTORIES:

a. **PHYSICAL VERIFICATION:**
   1. Whether physical verification of inventory has been conducted at reasonable intervals by the management.
   2. Whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account.

b. **WORKING CAPITAL LOANS (NEWLY ADDED IN 2020):**
   1. Whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets;
   2. Whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details

3. INVESTMENTS, GUARANTEE, SECURITY, LOANS OR ADVANCES TO COMPANIES, FIRMS, LLP's OR ANY OTHER PARTIES:

a. **APPLICABILITY:** Whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate:
   1. **TO RELATED PARTIES:** The aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates.
   2. **TO UNRELATED PARTIES:** The aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties OTHER THAN subsidiaries, joint ventures and associates.

b. **TERMS AND CONDITIONS:** Whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest.

c. **REPAYMENT REGULARITY:** In respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular.

d. **OVERDUE > 90 DAYS:** If the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest.

e. **RESCHEDULING OR EXTENTION OF OVERDUE LOANS (NEWLY ADDED IN 2020):** Whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the over dues of existing loans given to the same parties, if so,

   1. Specify the aggregate amount of such dues renewed or extended or settled by fresh loans and
   2. The percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans].

f. **DEMAND LOANS WITHOUT REPAYMENT PERIOD:** Whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, if so,

   1. Specify the aggregate amount, percentage thereof to the total loans granted,
   2. Aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013

4. **OTHER LOANS, INVESTMENTS, GUARANTEES MADE BY COMPANY:** In respect of loans, Investments, Guarantees, and securities provided by company, whether provisions of section 185 & 186 have been complied with? If not, provide the details thereof.

5. **DEPOSITS:**

In case the company has accepted deposits from the public,

a. Verify the compliance with the following:

   1. The provisions of Sections 73 to 76 of the Co.'s Act, 2013 or
   2. Whether the directives issued by the RBI and
   3. An order passed by CLB or any court or any other Tribunal, if any.

b. If there is any Non-compliance, the nature of contraventions should be stated.

6. **COST RECORDS:**

a. Whether maintenance of cost records has been prescribed by the Central Government under sub section (1) of section 148 of the Co.'s Act, 2013 is applicable.

b. If applicable, whether such accounts and records have made and maintained.

7. **STATUTORY DUES:**

a. **UNDISPUTED DUES:**

   1. Is the company regular in depositing undisputed statutory dues e.g. provident fund, ESI, Income Tax, service tax and any other statutory dues with the appropriate authorities, and
   2. if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date, they became payable, shall be indicated by the auditor. (Only Information and not opinion)

b. **DISPUTED DUES:** In case dues have not been deposited on account of any dispute, the auditor shall indicate

   1. The amounts involved in dispute and

2. The forum where dispute is pending.

Note: A mere representation to the concerned department shall not constitute a dispute.

8. **DISCOVERY OF UNDISCLOSED INCOME:** Whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year. (Author Note: May Be treated as prior period items in the accounting records)

9. **DEFAULT IN REPAYMENT OF DUES:**

   a. **LENDER WISE DEFAULT:**

      1. Whether the company has defaulted in repayment of borrowings of loans to a financial institution, Bank, Debenture holders or Governments.
      2. If so, the period and amount of default to be reported each lender wise in the following Format:
         a. Nature of Borrowing
         b. Name of the lender
         c. Amount Not Paid on Due Date
         d. Whether Principal or Interest or both
         e. Delay in Days
         f. Remarks, if any.

   b. **WILFUL DEFAULTER:** Whether the company is a declared willful defaulter by any bank or financial institution or other lender.

   c. **PURPOSE OF TERM LOANS:** Whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported.

   d. **ST LOAN FOR LT PURPOSE:** Whether funds raised on short term basis have been utilized for long term purposes, if yes, the nature and amount to be indicated.

   e. **LOANS TAKEN TO MEET SUBSIDIARY COMPANY NEEDS:** Whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case.

   f. **LOAN AGAINST PLEDGE OF SECURITES OF SUBSIDIARIES:**

      1. Whether the company has raised any loans during the year "ON PLEDGE OF SECURITIES HELD IN SUBSIDIARY/ASSOCIATE/JOINT VENTURE and if So, Give details thereof
      2. Also report whether the company has defaulted in repayment of such loans.

10. **END USE OF FUNDS RAISED:**

   a. **IPO / FPO:**

      1. Whether the money raised by way of initial or further public offer (including debt instruments) were utilized for the purposes for which those are raised.
      2. If not, the details along with the defaults, delays & subsequent rectifications, if any, to be reported.

   b. **PREFERENTIAL ALLOTMENT:**

      1. Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review &
      2. If so, verify the following:
         - Compliance with section 42 of the act. and

- The amount raised have been used for the purpose for which they are raised.

3. If not provide the details in respect of the amount involved & nature of non-compliance

11. REPORTING OF FRAUDS:

a. **NOTICED OR REPORTED:**
   1. Whether any fraud by the company or on the company ~~by its officers or employees~~ has been noticed or reported during the year.
   2. If yes, the nature and the amount involved is to be indicated.

b. **SEC. 143(12):** Whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government.

c. **WHISTLE BLOWER COMPLAINTS:** Whether the auditor has considered whistle-blower complaints, if any, received during the year by the company.

12. NIDHI COMPANY:

a. Whether Nidhi Company has complied with the net owned funds (i.e., net worth) to deposits in the ratio of 1:20 to meet out the liability.
   i.e., for every one rupee of net owned funds, Nidhi company cannot accept more than 20 rupees of deposits.

b. Whether Nidhi Company is maintaining 10% Unencumbered term deposits as specified in Nidhi Rules, 2014 to meet out the liability.

c. Whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof.

13. RELATED PARTY TRANSACTION:

Whether all transaction with related parties is

a. In compliance with section 177 & 188 where applicable, &

b. Details have been disclosed in the financial statements etc., as required by applicable accounting standards.

14. INTERNAL AUDIT SYSTEM:

a. Whether the company has an internal audit system commensurate with the size and nature of its business.

b. Whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor.

15. NON-CASH TRANSACTION: Whether Company has entered into any Non-Cash Transactions with directors & if so provisions of section 192 have been complied with.

16. NON-BANKING FINANCIAL INSTITUTION:

a. **45IA OF RBI ACT:** Whether the company is required to be registered under section 45-IA of Reserve Bank of India Act 1934, and If so, whether the registration has been obtained.

b. **NBFC ACTIVITIES (NEW):** Whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934.

c. **CORE INVESTMENT COMPANY (NEW):**
   1. Whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so,
   2. Whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria.

3. Whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group.

17. CASH LOSSES: Whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses.

18. RESIGNATION OF AUDITORS:

a. Whether there has been any resignation of the statutory auditors during the year, if so,

b. Whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

19. MATERIAL UNCERTAINITY: On the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, *Whether the auditor is of the opinion that no material uncertainty exists as on the **date of the audit report** that company is capable of meeting its liabilities **existing at the date of balance sheet** as and when they fall due within a period of one year from the balance sheet date.*

20. CORPORATE SOCIAL RESPONSIBILITY FUND:

a. Whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act.

c. Whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of sub-section (6) of section 135.

21. MODIFIED OPINION (CARO) IN OTHER GROUP COMPANIES:

a. Whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements,

b. if yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.

REASONS TO BE STATED FOR UNFAVOURABLE OR QUALIFIED ANSWERS:

1. Where, in the auditor's report, the answer to any of the questions referred to in above is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.
2. Where the auditor is unable to express any opinion on any specified matter,his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

4. COMPLETION AND REVIEW

WHAT ARE THE PROCEDURES TO BE PERFORMED BEFORE SIGNING THE AUDIT REPORT?

ANSWER:

There are still procedures to be performed by auditor after completion of substantive procedures involving detailed checking:

1. An auditor has to deal with effect of subsequent events.
2. He has to obtain sufficient appropriate evidence regarding appropriateness of use by management of going concern assumption in preparation of financial statements.
3. Misstatements identified during audit have to be evaluated and communicated.
4. Communication regarding significant audit findings and other matters is made to those charged with governance.
5. Written representations are obtained.

All such procedures are performed before signing of audit report.

SA 560 SUBSEQUENT EVENTS

DEFINITIONS:

1. **SUBSEQUENT EVENTS:** the events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.
2. **DATE OF THE FINANCIAL STATEMENTS:** The date of the end of the latest period covered by the financial statements.
3. **DATE OF APPROVAL OF THE FINANCIAL STATEMENTS:** The date on which all the statements that comprise the financial statements, including the related notes, have been prepared and those with the recognized authority have asserted that they have taken responsibility for those financial statements.
4. **DATE OF THE AUDITOR'S REPORT:** The date the auditor dates the report on the financial statements in accordance with SA 700.
5. **DATE THE FINANCIAL STATEMENTS ARE ISSUED:** The date that the auditor's report and audited financial statements are made available to third parties.
   The date the financial statements are issued generally depends on the regulatory environment of the entity. In some circumstances, the date the financial statements are issued may be the date that they are filed with a regulatory authority. Since audited financial statements cannot be issued without an auditor's report, the date that the audited financial statements are issued must not only be at or later than the date of the auditor's report, but must also be at or later than the date the auditor's report is provided to the entity.

Q NO 1. WHAT DO YOU MEAN BY SUBSEQUENT EVENTS AND GIVE FEW EXAMPLES?

ANSWER:

1. **SUBSEQUENT EVENTS:** Events occurring between the date of the financial statements and the date of the auditor's report and facts that become known to the auditor after the date of the auditor's report are known as subsequent events.
   For Example:
   a. a company which may have planned an agreement to merge between the date of the financial statements and the date of the auditor's report or

   b. a fire claim amount of an entity receivable from insurance company as on date of financial statements may have been settled at a reduced amount before date of auditor's report.
2. **TYPES:** Financial statements may be affected by certain events that occur after the date of THE financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify 2 types of events:
   a. **ADJUSTING EVENTS:** Those that provide evidence of conditions that existed at the date of the financial statements and
      Examples:
      1. Declaration of insolvency of a major debtor of the entity between the date of financial statements and the date of auditor's report providing evidence on the recoverability of the money due from debtor as on date of the financial statements.
      2. Settling a legal claim outside the court at a reduced amount between the date of financial statements and the date of auditor's report for which provision has already been made in financial statements. It provides evidence onadjustment in provision amount already made in financial statements, if any.
   b. **NON-ADJUSTING EVENTS:** Those that provide evidence of conditions that arose after the date of the financial statements.
      Examples:
      1. Issue of new share capital.
      2. Planned merger of the company.
      3. Destruction of substantial inventories due to fire between the date of the financial statements and the date of auditor's report.

Q NO 2. WRITE ABOUT SCOPE AND OBJECTIVE OF SA 560?

ANSWER:

1. **SCOPE:** SA 560 deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements.
2. **OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 560:** The objectives of the auditor are to:
   a. Obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statementsare appropriately reflected in those financial statements and
   b. Respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report.

Q NO 3. WRITE ABOUT AUDIT PROCEDURES RELATING TO EVENTS OCCURRING BETWEEN THE DATE OF THE FINANCIAL STATEMENTS AND THE DATE OF THE AUDITOR'S REPORT?

ANSWER:

1. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.
2. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.
3. The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near

as practicable thereto.

4. **AUDIT PROCEDURES:** The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:
   a. Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
   b. Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
   c. Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
   d. Reading the entity's latest subsequent interim financial statements, if any.
   e. Such information may also be obtained by auditor from accounting records pertaining to period after date of financial statements, reading entity's latest available budgets etc.

VERIFY ADJUSTEMENTS: When, as a result of the procedures performed, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

WRITTEN REPRESENTATION: The auditor shall request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580, "Written Representations" that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

Q NO 4. WRITE ABOUT THE AUDIT PROCEDURES WHEN THE FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE DATE OF THE AUDITOR'S REPORT BUT BEFORE THE DATE THE FINANCIAL STATEMENTS ARE ISSUED?

ANSWER:

1. **DISCUSS WITH MANAGEMENT:** The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
   a. Discuss the matter with management and, where appropriate, those charged with governance.
   b. Determine whether the financial statements need amendment and, if so,
   c. Inquire how management intends to address the matter in the financial statements.
2. **MANAGEMENT AMENDS F/S :** If management amends the financial statements, the auditor shall:
   a. Carry out the audit procedures necessary in the circumstances on the amendment.
   b. Extend the audit procedures, already referred, to the date of the new auditor's report and
   c. Provide a new auditor's report on the amended financial statements.

   d. The new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

3. **AMENDED F/S OF ONLY SUBSEQUENT EVENTS:** When law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent events or events causing that amendments and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment, the auditor is permitted to restrict the procedures on subsequent events to that amendment. In such cases, the auditor shall either:
   a. Amend the auditor's report to include an additional date restricted to that amendment that thereby indicates that the auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements described in the relevant note to the financial statements OR
   b. Provide a new or amended auditor's report that includes a statement in an Emphasis of Matter paragraph or Other Matter(s) paragraph that conveys that auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements as described in the relevant note to the financial statements.
4. **NO REQUIREMENT TO AMEND AS PER LAW:** In some entities, management may not be required by the applicable law, regulation or the financial reporting framework to issue amended financial statements and, accordingly, the auditor need not provide an amended or new auditor's report. However, when management does not amend the financial statements in circumstances where the auditor believes they need to be amended, then:
   a. If the auditor's report has not yet been provided to the entity, the auditor shall modify the opinion as required by SA 705 and then provide the auditor's report or
   b. If the auditor's report has already been provided to the entity, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity, those charged with governance, not to issue the financial statements to third parties before the necessary amendments have been made.
   c. If the financial statements are nevertheless subsequently issued without the necessary amendments, the auditor shall take appropriate action, to seek to prevent reliance on the auditor's report.

Q NO 5. WRITE ABOUT THE AUDIT PROCEDURES RELATED TO SUBSEQUENT EVENTS WHEN FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE FINANCIAL STATEMENTS HAVE BEEN ISSUED?

ANSWER:

1. After the financial statements have been issued, the auditor has no obligation to perform any audit procedures regarding such financial statements. However, when, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
   a. Discuss the matter with management and, where appropriate, those charged with governance.
   b. Determine whether the financial statements need amendment and, if so,
   c. Inquire how management intends to address the matter in the financial statements.
2. **MANAGEMENT AMENDS F/S:** If the management amends the financial statements, the

auditor shall:

a. Carry out the audit procedures necessary in the circumstances on the amendment.

b. Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation.

c. Unless such circumstances when law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent events or events causing that amendments and those responsible for approving the financial statements are not prohibited from restricting their approval to thatamendment apply:

    i. Extend the audit procedures, already referred, to the date of the new auditor's report, and the date the new auditor's report no earlier than the date of approval of the amended financial statements and

    ii. Provide a new auditor's report on the amended financial statements.

    iii. When the circumstances are such that law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent events or events causing that amendments and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment, amend the auditor's report, or provide a new auditor's report as already discussed.

d. The auditor shall include in the new or amended auditor's report an Emphasis of Matter paragraph or Other Matter(s) paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditor.

3. If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need to be amended, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity, those charged with governance, that the auditor will seek to prevent future reliance on the auditor's report.

4. If, despite such notification, management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report.

SA 570 GOING CONCERN

Q NO 1. WRITE ABOUT MEANING OF GOING CONCERN AND ITS SIGNIFICANCE IN FINANCIAL REPORTING AND RELEVANT STANDARD ON AUDITING?

ANSWER:

1. Going concern is one of the fundamental accounting assumptions. The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.
2. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidatethe entity or to cease operations, or has no realistic alternative but to do so.
3. The significance of Going Concern is due to its effect on preparation of financial statements. Ability or otherwise of an enterprise to be viewed as going concern affects its preparation of financial statements.
4. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.
5. When an enterprise is not viewed as a going concern, the financial statements are prepared on liquidation basis. For example, inventories may need to be writtendown as these may be sold for a lower price. Assets may have to be recorded atthe likely prices they will fetch.
6. SA 570 Going Concern deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report.

Q NO 2. WRITE ABOUT RESPONSIBILITY FOR ASSESSMENT OF THE ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN?

ANSWER:

1. The preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.
2. Management's assessment of the entity's ability to continue as a going concern involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions. The following factors are relevant to that judgment:
   a. The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the outcome occurs.
   b. The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions.
   c. Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time theywere made.

Q NO 3. WRITE ABOUT OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 570?

ANSWER:

The objectives of the auditor are:

1. To obtain sufficient appropriate audit evidence regarding and conclude onthe appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;

2. To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and
3. To report in accordance with this SA.

Q NO 4. WRITE ABOUT RESPONSIBILITIES OF THE AUDITOR UNDER SA 570?

ANSWER:

1. The auditor's responsibilities are:
   a. To obtain sufficient appropriate audit evidence regarding and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements and
   b. To conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.
2. These responsibilities exist even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.
3. However, as described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to a material uncertainty about the entity's ability to continue asa going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

Q NO 5. WRITE ABOUT RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES RELATED TO ASSESSMENT OF GOING CONCERN?

ANSWER:

1. When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern.
2. In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern and:
   a. If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them or
   b. If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern basisof accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity'sability to continue as a going concern.
3. The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

Examples of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern:

The following are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern:

FINANCIAL EVENTS OR CONDITIONS

1. Net liability or net current liability position
2. Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets
3. Indications of withdrawal of financial support by creditors
4. Negative operating cash flows indicated by historical or prospective financial statements
5. Adverse key financial ratios
6. Substantial operating losses or significant deterioration in the value of assets used to generate cash flows
7. Arrears or discontinuance of dividends
8. Inability to pay creditors on due dates
9. Inability to comply with the terms of loan agreements
10. Change from credit to cash-on-delivery transactions with suppliers
11. Inability to obtain financing for essential new product development or other essential investments

OPERATING EVENTS OR CONDITIONS:

1. Management intentions to liquidate the entity or to cease operations
2. Loss of key management without replacement
3. Loss of a major market, key customer(s), franchise, license, or principal supplier(s)
4. Labour difficulties
5. Shortages of important supplies
6. Emergence of a highly successful competitor

OTHER EVENTS OR CONDITIONS

1. Non-compliance with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions
2. Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy
3. Changes in law or regulation or government policy expected to adversely affect the entity
4. Uninsured or underinsured catastrophes when they occur

Q NO 6. WRITE ABOUT Evaluating management's assessment OF GOING CONCERN

ANSWER:

1. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. Management's assessment of the entity's ability to continue as a going concern is a key part of the auditor's consideration of management's use of the going concern basis of accounting.
2. It is not the auditor's responsibility to rectify the lack of analysis by management.In some circumstances, however, the lack of detailed analysis by management to support its assessment may not prevent the auditor from concluding whether management's use of the going concern basis of accounting is appropriate in the circumstances.
3. For example, when there is a history of profitable operations and a ready access to financial resources, management may make its assessment without detailed analysis. In

this case, the auditor's evaluation of the appropriateness of management's assessment may be made without performing detailed evaluation procedures if the auditor's other audit procedures are sufficient to enable the auditor to conclude whether management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate in the circumstances.

4. In other circumstances, evaluating management's assessment of the entity's abilityto continue as a going concern, may include an evaluation of the process management followed to make its assessment, the assumptions on which the assessment is based and management's plans for future action and whether management's plans are feasible in the circumstances.
5. **PERIOD OF ASSESSMENT:**
   a. **AS PER MANAGEMENT AND AFRFW:** In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation if it specifies a longer period.
   b. **MINIMUM 12 MONTHS:** If management's assessment of the entity's ability to continue as a going concern covers less than 12 months from the date of the financial statements, the auditor shall request management to extend its assessment period to at least 12 months from that date.

Q NO 7. WHAT ARE THE ADDITIONAL AUDIT PROCEDURES WHEN EVENTS OR CONDITIONS ARE IDENTIFIED THAT CASE SIGNIFICANT DOUBT ON ENTITIES ABILITY TO CONTINUE AS A GOING CONCERN?

ANSWER:

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:

1. Where management has not yet performed an assessment of the entity'sability to continue as a going concern, requesting management to make its assessment.
2. Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
3. Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:
   a. Evaluating the reliability of the underlying data generated to preparethe forecast and
   b. Determining whether there is adequate support for the assumptions underlying the forecast.
4. Considering whether any additional facts or information have become available since the date on which management made its assessment.
5. Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

Examples of audit procedures when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as going concern:

1. Analysing and discussing cash flow, profit and other relevant forecasts with management
2. Analysing and discussing the entity's latest available interim financial statements
3. Reading the terms of debentures and loan agreements and determining whether any have been breached
4. Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties
5. Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications
6. Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds
7. Evaluating the entity's plans to deal with unfilled customer orders
8. Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern
9. Confirming the existence, terms and adequacy of borrowing facilities
10. Obtaining and reviewing reports of regulatory actions
11. Determining the adequacy of support for any planned disposals of assets

Q NO 8. WRITE ABOUT AUDITOR'S CONCLUSIONS ON ENTITIES ABILITY TO CONTINUE AS A GOING COCNERN?

ANSWER:

1. The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.
2. Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.
3. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary.

Q NO 9. WRITE ABOUT AUDITORS CONCLUSION ON ADEQUACY OF DISCLOSURES WHEN EVENTS OR CONDITIONS HAVE BEEN IDENTIFIED?

ANSWER:

1. **MATERIAL UNCERTAINTY EXIST:** If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:
   a. Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions and
   b. Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.
2. **NO MATERIAL UNCERTAINTY EXIST:** If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based

on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

Q NO 10. WRITE ABOUT IMPLICATIONS FOR THE AUDITOR'S REPORT RELATED TO GOING COCERN?

ANSWER:

I. IF USE OF GOING CONCERN BASIS OF ACCOUNTING IS INAPPROPRIATE:

If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.

II. IF USE OF GOING CONCERN BASIS OF ACCOUNTING IS APPROPRIATE BUT A MATERIAL UNCERTAINTY EXISTS:

A. ADEQUATE DISCLOSURE IS MADE IN THE FINANCIAL STATEMENTS: If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:

a. Draw attention to the note in the financial statements that discloses such matters.
b. State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

B. ADEQUATE DISCLOSURE IS NOT MADE IN THE FINANCIAL STATEMENTS:

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:

a. Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705.
b. In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

III. MANAGEMENT UNWILLING TO MAKE OR EXTEND ITS ASSESSMENT:

If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the implications for the auditor's report. In such a situation, a qualified opinion or a disclaimer of opinion in the auditor's report may be appropriate, because it may not be possible for the auditor to obtain sufficient appropriate audit evidence regarding management's use of the going concern basis of accounting in the preparation of the financial statements.

During course of audit of a company, CA. Varun Aggarwal notices that company is facing significant skilled labour shortages resulting in hampering of operations of company. The company's manufacturing is dependent upon skilled labour coming from villages in certain districts of Eastern UP. However, due to job opportunities available near villages now, many are not interested in going out from their native villages.

Such a situation has led to company not being able to keep its commitments, losing out on orders and fall in its revenues. Fixed costs of the company remain at a high level. As a result, company is facing a liquidity crunch and is not able to pay its creditors on time. The bankers of company are also not willing to help the company to tide over liquidity

crisis. The auditor is having doubts over going concern status of the company.
How should management of the company try to address auditor's concerns? What audit procedures may be performed by auditor in such a situation?

ANSWER:

Significant shortage of skilled labour, inability to pay creditors on time and overall liquidity crisis faced by the company are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

In such a situation, management should try to address auditor's concerns by preparing its future plan of action including preparation of cash flow forecast showing inflow and outflow of cash. Such a cash flow forecast should address auditor's concerns regarding liquidity crisis being faced by the company.

The auditor should perform audit procedures to evaluate the reliability of the underlying data to prepare the forecast and determining whether there is adequate support for the assumptions underlying the forecast. The auditor should also consider whether any additional facts or information have become available since the date on which management made its assessment.

SA 450 EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

Q NO 1. WRITE ABOUT EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT AS PER SA 450 AND STATE ITS OBJECTIVES?

ANSWER:

1. Before forming an opinion on the financial statements, the auditor evaluates effects of identified misstatements on the audit and of uncorrected misstatements on financial statements after consideration of materiality.
2. Uncorrected misstatements refer to those misstatements that the auditor has accumulated during the audit and that have not been corrected.
3. SA 450 deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.
4. **The objective of the auditor is to evaluate:**
   a. The effect of identified misstatements on the audit and
   b. The effect of uncorrected misstatements, if any, on the financial statements.

Q NO 2. WRITE ABOUT ACCUMULATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT AND CONSIDERATION OF IDENTIFIED MISSTATEMENTS AS THE AUDIT PROGRESSES?

ANSWER:

1. **ACCUMULATION OF MISSTATEMENTS:** The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial.
2. A misstatement may arise from a variety of factors. For example,
   a. An inaccuracy in gathering or processing data from which financial statements are prepared or
   b. An omission of an amount or disclosure can result into a misstatement.
   c. An entity has wrongly capitalized machinery repair expenses amounting to Rs.5 lacs resulting in overstatement of profits. It is an example of misstatement.
3. **CONSIDERATION OF IDENTIFIED MISSTATEMENTS:** The auditor shall determine whether the overall audit strategy and audit plan need to be revised if:
   a. The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material or
   b. The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with SA 320.
4. The auditor may request management to examine a class of transactions, account balance or disclosure in order for management to understand the cause of a misstatement identified by the auditor, perform procedures to determine the amount of the actual misstatement in the class of transactions, account balance or disclosure, and to make appropriate adjustments to the financial statements. Sucha request may be made, for example, based on the auditor's projection of misstatements.
5. If, at the auditor's request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain.

Q NO 3. WRITE ABOUT COMMUNICATION AND CORRECTION OF MISSTATEMENTS IDENTIFIED?

ANSWER:

1. **TIMELY COMMUNICATION:** The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation. Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the items are misstatements, inform the auditor if it disagrees and take action as necessary.
   a. **MANAGEMENT CORRECTS MMS:** The auditor shall request management to correct those misstatements. The correction by management of all misstatements, including those communicated by the auditor, enables management to maintain accurate accounting books and records and reduces the risks of material misstatement of future financial statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods.
   b. **MANAGEMENT REFUSES TO CORRECT:** If management refuses to correct some or all of the misstatements communicatedby the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement.
2. **EVALUATING THE EFFECT OF UNCORRECTED MISSTATEMENTS:**
   a. **REEVALUATE MATERIALITY:** Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results.
   b. **MATERIALITY OF UNCORRECTED MISSTATEMENTS:** The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider:
      i. The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence and
      ii. The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.
3. **COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE:**
   a. The auditor shall communicate with those charged with governance regarding uncorrected misstatements and the effect that they, individually or in aggregate,may have on the opinion in the auditor's report, unless prohibited by law or regulation.
   b. The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected.
   c. The auditor shall also communicate with those charged with governance the effectof uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as awhole.
4. **WRITTEN REPRESENTATION FROM MANAGEMENT:** The auditor shall request a written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.

Q NO 4. WRITE ABOUT DOCUMENTATION REGARDING MISSTATEMENTS IDENTIFIED DURING AUDIT?

ANSWER:

The audit documentation shall include:

1. The amount below which misstatements would be regarded as clearly trivial.
2. All misstatements accumulated during the audit and whether they have beencorrected; and
3. The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

You are nearing completion of audit of a company. On going through your working papers, it is noticed that finished goods inventory was overvalued by Rs. 2 crore. It has also been noticed that freight of Rs.10 lacs paid on import of machinery was charged to statement of profit and loss.

Discuss, how you should, proceed and communicate in above situation before signing audit report.

ANSWER:

The instances highlighted in above situation are examples of misstatements identified during the audit. Over valuation of inventory of finished goods by Rs. 2 crore and wrongly charging freight of Rs. 10 lacs paid on machinery to statement of profit and loss instead of capitalizing are examples ofmisstatements.

The auditor should communicate above identified misstatements to those charged with governance and request for correction of these misstatements. In case, these are not corrected, understand the reasons for not making the corrections and reassess materiality. It should also be considered whether uncorrected statements are material individually or in aggregate. Effect of uncorrected misstatements on the opinion in auditor's report should be communicated to those charged with governance.

SA 580 WRITTEN REPRESENTATIONS

Q NO 1. WRITE MEANING OF WRITTEN REPRESENTATION AND HOW IT IS USED AS AUDIT EVIDENE?

ANSWER:

1. **WRITTEN REPRESENTATIONS:** A written representation is a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.
2. **WRITTEN REPRESENTATIONS AS AUDIT EVIDENCE:**
   a. Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based.
   b. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence.
   c. Written representations are an important source of audit evidence. If management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist.
   d. Further, a request for written, rather than oral, representations in many cases may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.
   e. Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities, or about specific assertions.

Q NO 2. WRITE ABOUT SCOPE AND OBJECTIVE OF SA 580?

ANSWER:

SCOPE: SA 580- Written representations deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance.

Objectives of auditor in accordance with SA 580

THE OBJECTIVES OF THE AUDITOR ARE:

a. To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor.
b. To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs and
c. To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

FROM WHOM: The auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned. Written representations relate to fulfilment of management's responsibilities or to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

Q NO 3. WRITE ABOUT WRITTEN REPRESENTATIONS ABOUT MANAGEMENT'S RESPONSIBILITIES?

ANSWER:

Written representation about management's responsibilities involves confirmation of fulfilment of management's responsibilities in following areas:

I. PREPARATION OF THE FINANCIAL STATEMENTS:

1. The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation, as set out in the terms ofthe audit engagement.
2. Due to its responsibility for the preparation and presentation of the financial statements and its responsibilities for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing and presenting the financial statementsand the assertions therein on which to base the written representations.
3. In some cases, however, management may decide to make inquiries of others who participate in preparing and presenting the financial statements and assertions therein, including individuals who have specialized knowledge relating to the matters about which written representations are requested. Such individuals may include:
   a. An actuary responsible for actuarially determined accountingmeasurements.
   b. Staff engineers who may have responsibility for and specializedknowledge about environmental liability measurements.
   c. Internal counsel who may provide information essential to provisionsfor legal claims.
4. In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the mattersincluded in the representations.
5. To reinforce the need for management to make informed representations, the auditor may request that management include in the written representations, confirmation that it has made such inquiries as it considered appropriate to place it in the position to be able to make the requested written representations.

II. INFORMATION PROVIDED AND COMPLETENESS OF TRANSACTIONS:
The auditor shall request management to provide a written representation that:

a. It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement and
b. All transactions have been recorded and are reflected in the financial statements.

Q NO 4. WHY WRITTEN REPRESENTATIONS ABOUT MANAGEMENT RESPONSIBILITIES ARE NECESSARY?

ANSWER:

1. Audit evidence obtained during the audit that management has fulfilled its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities.

2. This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities.
3. For example, the auditor could not conclude that management has provided the auditor with all relevant information agreed in the terms of the audit engagement without asking it whether, and receiving confirmation that, such information has been provided.
4. The written representations requiring fulfilment of management responsibilities in relation to above draw on the agreed acknowledgement and understanding of management of its responsibilities in the terms of the audit engagement by requesting confirmation that it has fulfilled them.
5. The auditor may also ask management to reconfirm its acknowledgement and understanding of those responsibilities in written representations. This is particularly appropriate when:
    a. Those who signed the terms of the audit engagement on behalf of the entityno longer have the relevant responsibilities.
    b. The terms of the audit engagement were prepared in a previous year.
    c. There is any indication that management misunderstands those responsibilities or
    d. Changes in circumstances make it appropriate to do so.

DESCRIPTION OF MANAGEMENT'S RESPONSIBILITIES IN THE WRITTEN REPRESENTATIONS:

Management's responsibilities shall be described in the "Written representations required about management responsibilities" in the manner in which these responsibilities are described in the terms of the audit engagement.

Q NO 5. WRITE ABOUT OTHER WRITTEN REPRESENTATIONS RELATED TO OTHER THAN MANAGEMENT RESPONSIBILITES?

ANSWER:

1. Other SAs require the auditor to request written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor shall request such other written representations.
2. In addition to the written representation about management's responsibilities regarding preparation of financial statements, the auditor may consider it necessary to request other written representations about the financial statements. Such written representations may supplement, but do not form part of, the written representation relating to management's responsibilities regarding preparation of financial statements. They may include representations about the following:
    a. Whether the selection and application of accounting policies are appropriate and
    b. Whether matters such as the following, where relevant under the applicable financial reporting framework, have been recognized, measured, presented or disclosed in accordance with that framework:
        i. Plans or intentions that may affect the carrying value or classification of assets and liabilities.
        ii. Liabilities, both actual and contingent.
        iii. Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral and
        iv. Aspects of laws, regulations and contractual agreements that may affect the financial statements, including non-compliance.

Q NO 6. WRITE ABOUT ADDITIONAL WRITTEN REPRESENTATIONS ABOUT INFORMATION PROVIDED TO THE AUDITOR?

ANSWER:

In addition to the written representation required by auditor regarding management responsibility about information provided to auditor, the auditor may consider it necessary to request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware.

Q NO 7. WRITE ABOUT WRITTEN REPRESENTATIONS ABOUT SPECIFIC ASSERTIONS/

ANSWER:

1. When obtaining evidence about, or evaluating, judgments and intentions, theauditor may consider one or more of the following:
    a. The entity's past history in carrying out its stated intentions.
    b. The entity's reasons for choosing a particular course of action.
    c. The entity's ability to pursue a specific course of action.
    d. The existence or lack of any other information that might have been obtained during the course of the audit that may be inconsistent with management's judgment or intent.
2. In addition, the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements, in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, orthe completeness of, a specific assertion.

    For example, if the intent of management is important to the valuation basis for investments, it may not be possible to obtain sufficient appropriate audit evidence without a written representation from management about its intentions. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

Q NO 8. WRITE ABOUT DATE OF AND PERIOD(S) COVERED BY WRITTEN REPRESENTATIONS?

ANSWER:

1. The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements. The writtenrepresentations shall be for all financial statements and period(s) referred to in the auditor's report.
2. Because written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustmentto or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.
3. The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate.
4. Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request

from them written representations that cover the whole of the relevant period(s) still applies.

Q NO 9. WRITE ABOUT AUDIT PROCEDURES IF THERE EXISTS DOUBT AS TO THE RELIABILITY OF WRITTEN REPRESENTATIONS OR REQUESTED REPRESENTATION NOT PROVIDED?

ANSWER:

1. **NOT RELIABLE:**
   a. If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations and audit evidence in general.
   b. In particular, if written representations are inconsistent with other audit evidence,the auditor shall perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the reliability of representations and audit evidence in general.
   c. If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705, having regard to the requirement of disclaimer of opinion.
2. **NOT PROVIDED:** If management does not provide one or more of the requested written representations, the auditor shall:
   a. Discuss the matter with management.
   b. Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations and audit evidence in general and
   c. Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705 having regard to the requirement of disclaimer of opinion.
3. **DISCLAIMER OF OPINION:** The auditor shall disclaim an opinion on the financial statements in accordance with SA 705 if:
   a. **NOT RELIABLE:** The auditor concludes that there is sufficient doubt about the integrity of management such that the written representations about management fulfilling its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions are not reliable; or
   b. **NOT PROVIDED:** Management does not provide the written representations relating to fulfilling its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions.

Q NO 10. WRITE ABOUT FORM OF WRITTEN REPRESENTATIONS?

ANSWER:

The written representations shall be in the form of a representation letter addressed to the auditor. If law or regulation requires management to make written public statements about its responsibilities, and the auditor determines that such statements provide some or all of the representations required regarding management responsibilities, the relevant matters covered by such statements need not be included in the representation letter.

ILLUSTRATIVE WRITTEN REPRESENTATION LETTER

On the letterhead of the entity

To
PJ Shrimali & Co. 15th July, 2022
Chartered Accountants
Dear Sir,
This representation letter is provided in connection with your audit of the financial statements of XXXX Limited for the year ended March 31, 2022 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the applicable accounting standards in India.
We confirm that (to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves):

FINANCIAL STATEMENTS:

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated 17th August 2021, for the preparation of the financial statements in accordance with financial reporting Standards, in particular, the financial statements give a true and fair view in accordance with the applicable accounting standards in India.
- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements ofapplicable accounting standards in India. (SA 550)
- All events subsequent to the date of the financial statements and for which applicable accounting standards in India require adjustment or disclosure have been adjusted or disclosed. (SA 560)
- The effects of uncorrected misstatements are immaterial, both individuallyand in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. (SA 450)

INFORMATION PROVIDED:

- We have provided you with: -
  Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  Additional information that you have requested from us for the purpose of the audit; and
  Unrestricted access to persons within the entity from whom you determinedit necessary to obtain audit evidence.
  - All transactions have been recorded in the accounting records and are reflected in the financial statements.
  - We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
  - We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves: -
    - Management;
    - Employees who have significant roles in internal control; or
    - Others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicatedby employees, former

employees, analysts, regulators or others.

- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (SA 550)

Chief Financial Officer

CA R Gurumurthy is about to complete audit of a company. Before completion, he asks management to provide him a written representation confirming that management has fulfilled its responsibilities regarding preparation of financial statements. He also wants management to confirm in writing about providing of all the necessary information and completeness of transactions to him. The management feels that auditor is seeking irrelevant documents near the completion of audit. Why view of management is not proper? What possible implications it may lead to?

ANSWER:

The view of management is not proper. Audit evidence obtained during the audit that management has fulfilled its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities. This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities.

In case of refusal of management to provide such a confirmation, it may lead to disclaimer of opinion by the auditor.

SA 260 COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

Q NO 1. COMMUNICATION FROM AUDITOR IS IMPORTANT WITH THOSE CHARGED WITHGOVERNANCE. AN EFFECTIVE TWO-WAY COMMUNICATION IS IMPORTANT.

ANSWER:

1. The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.
2. The auditor in obtaining from those charged with governance information relevant to the audit.
   For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and
3. Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

Q NO 2. WHO ARE "THOSE CHARGED WITH GOVERNANCE"?

ANSWER:

1. The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process.
2. For some entities, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.
3. Governance structures vary by entities, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics.
   a. For example, in some entities, a supervisory board exists that is separate from executive board. In other entities, both supervisory and executive functions are performed by a single board.
   b. In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure. For example, company directors.
   c. In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.
   d. In most entities, governance is the collective responsibility of a governing body, such as a board of directors, a supervisory board, partners, proprietors, a committee of management, trustees, or equivalent persons.
   e. In some smaller entities, however, one person may be charged with governance, for example, the owner-manager where there are no other owners, or a sole trustee.
   f. Such diversity means that it is not possible to specify for all audits the persons with whom the auditor is to communicate particular matters.
4. Also, in some cases, the appropriate persons with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities and some not-for-profit organizations.

a. In such cases, the auditor may need to discuss and agree with the engaging party the relevant persons with whom to communicate.
b. In deciding with whom to communicate, the auditor's understanding of an entity's governance structure and processes obtained in accordance with SA 315 is relevant. The appropriate persons with whom to communicate may vary depending on the matter to be communicated.

Q NO 3. WRITE ABOUT SCOPE AND OBJECTIVE OF SA 260?

ANSWER:

SCOPE: SA 260 deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements.

OBJECTIVES: The objectives of the auditor are:

a. To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit.
b. To obtain from those charged with governance information relevant to the audit.
c. To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process and
d. To promote effective two-way communication between the auditor and those charged with governance.

Q NO 4. WHAT ARE THE MATTERS TO BE COMMUNICATED BY AUDITOR AS PER SA 260?

ANSWER:

Following matters are required to be communicated by auditor with those charged with governance:

a. **AUDITOR'S RESPONSIBILITIES:** The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that:
   i. The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance and
   ii. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.
b. **PLANNED SCOPE AND TIMING OF THE AUDIT:** The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor.
c. **SIGNIFICANT FINDINGS FROM THE AUDIT:** The auditor shall communicate with those charged with governance:
   a. The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity
   b. Significant difficulties, if any, encountered during the audit;
   c. Unless all of those charged with governance are involved in managing the entity:
      i. Significant matters arising during the audit that were discussed,or subject to

correspondence, with management;

ii. Written representations the auditor is requesting

d. Circumstances that affect the form and content of the auditor's report, if any and

e. Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of thefinancial reporting process.

d. **COMMUNICATION OF AUDITOR'S INDEPENDENCE IN CASE OF LISTED ENTITIES:** In the case of listed entities, the auditor shall communicate with those chargedwith governance:

a. A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence and

i. All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence ofthe auditor and

ii. The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

Q NO 5. WRITE ABOUT THE COMMUNICATION PROCESS UNDER SA 260?

ANSWER:

1. The auditor shall communicate with those charged with governance the form, timing and expected general content of communications.
2. The auditor shall communicate in writing with those charged with governance regarding significant findings from the audit if, in the auditor's professional judgment, oral communication would not be adequate.
3. Written communications need not include all matters that arose during the course of the audit. The auditor shall communicate in writing with those charged with governance regarding auditor independence when required in case of listed entities.
4. The auditor shall communicate with those charged with governance on a timely basis.

ADEQUACY OF THE COMMUNICATION PROCESS: The auditor shall evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor shall evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and shall take appropriate action.

DOCUMENTATION: Where matters required by SA 260 to be communicated are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation.

SA 265 COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT

Q NO 1. WRITE ABOUT SCOPE AND OBJECTIVE OF SA 265?

ANSWER:

1. **SCOPE:** SA 265 deals with the auditor's responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements.
2. The auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the risks of material misstatement. In making those risk assessments, the auditor considers internal control in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control.
3. The auditor may identify deficiencies in internal control not only during this risk assessment process but also at any other stage of the audit.
4. SA 265 specifies which identified deficiencies the auditor is required to communicate to those charged with governance and management.
5. **OBJECTIVE OF AUDITOR IN ACCORDANCE WITH SA 265:** The objective of the auditor is to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

Q NO 2. WHAT DO YOU MEAN BY "DEFICIENCY IN INTERNAL CONTROL" AND "SIGNIFICANT DEFICIENCY IN INTERNAL CONTROL"?

ANSWER:

a. DEFICIENCY IN INTERNAL CONTROL: This exists when:

- **i.** A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis or
- **ii.** A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

b. SIGNIFICANT DEFICIENCY IN INTERNAL CONTROL:

- a. A deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.
- b. The significance of a deficiency or a combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude of the misstatement.
- c. Significant deficiencies may, therefore, exist even though the auditor has not identified misstatements during the audit.

Q NO 3. WHAT ARE THE MATTERS THAT THE AUDITOR MAY CONSIDER IN DETERMINING WHETHER A DEFICIENCY OR COMBINATION OF DEFICIENCIES IN INTERNAL CONTROL CONSTITUTES A SIGNIFICANT DEFICIENCY, GIVE FEW EXAMPLES?

ANSWER:

The matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency are:

1. The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
2. The susceptibility to loss or fraud of the related asset or liability.
3. The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
4. The financial statement amounts exposed to the deficiencies.
5. The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
6. The importance of the controls to the financial reporting process, for example:
    a. General monitoring controls (such as oversight of management).
    b. Controls over the prevention and detection of fraud.
    c. Controls over the selection and application of significant accounting policies.
    d. Controls over significant transactions with related parties.
    e. Controls over significant transactions outside the entity's normal course of business.
    f. Controls over the period-end financial reporting process (such ascontrols over non-recurring journal entries).
7. The cause and frequency of the exceptions detected as a result of thedeficiencies in the controls.
8. The interaction of the deficiency with other deficiencies in internal control.

Q NO 4. GIVE FEW EXAMPLES OF INDICATORS OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL?

ANSWER:

1. Evidence of ineffective aspects of the control environment, such as:
    a. Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.
    b. Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
    c. Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
    d. Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
    e. Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
    f. Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
2. Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
3. Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
4. Evidence of management's inability to oversee the preparation of the financial statements.

Q NO 5. DETERMINATION OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL AND COMMUNICATING TO THOSE CHARGED WITH GOVERNANCE?

ANSWER:

1. **DETERMINATION:** The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control. If the auditor has identified one or more deficiencies in internal control, the auditor shall

determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies.

2. **COMMUNICATION TO THOSE CHARGED WITH GOVERNANCE:**
   a. The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis.
   b. The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis:
      i. In writing, significant deficiencies in internal control that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances and
      ii. Other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention.
3. The auditor shall include in the written communication of significant deficiencies in internal control:
   a. A description of the deficiencies and an explanation of their potential effects;and
   b. Sufficient information to enable those charged with governance andmanagement to understand the context of the communication.
   c. In particular, the auditor shall explain that:
      i. The purpose of the audit was for the auditor to express an opinion on the financial statements.
      ii. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control and
      iii. The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged withgovernance.

On reviewing internal control over inventories as part of statutory audit of a company, auditor finds that physical verification is not being conducted at regular intervals as stipulated by the management. The auditor finds it to be significant deficiency in internal control over inventories.

He points it out to the management in a one-liner as under: -

"Physical verification of inventories is not being conducted at regular intervals as stipulated by management." Is above communication by auditor proper? Ignore statutory reporting requirements, if any in this regard.

ANSWER:

While pointing out significant deficiencies in internal control, auditor has not only to communicate significant deficiencies giving their description but also explain the potential effects and sufficient information to those charged with governance and management to understand context of communication.

Therefore, the above communication is not proper. Not only significant deficiency has to be communicated, it should also be explained to management the potential effects of not carrying out physical verification of inventories at regular intervals as stipulated by management. It should explain that such a significant deficiency can lead to misstatement of inventories impacting profits of the company. Highlighting importance of such a control, it should be stated that responsibility be fixed for concerned persons for adhering to such an important control.

5. AUDIT DOCUMENTATION

Q.NO.1. WRITE ABOUT THE CONCEPT AND OBJECTIVE OF DOCUMENTATION AS PER SA 230?

ANSWER:

A. **MEANING:** Audit Documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. (Terms such as "working papers" or "work papers" are also sometimes used.)

B. **OBJECTIVE OF THE AUDITOR:** The objective of the auditor is to prepare documentation that provides:

1. A sufficient and appropriate record of the basis for the auditor's report and
2. Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Q.NO.2. WRITE ABOUT NATURE AND PURPOSE OF DOCUMENTATION AS PER SA 230?

ANSWER:

A. **NATURE OF AUDIT DOCUMENTATION:** Audit documentation provides:

1. Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and
2. Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

B. **PURPOSE OF AUDIT DOCUMENTATION:** The following are the purpose of Audit documentation:

1. Assisting the engagement team to plan and perform the audit.
2. Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.
3. Enabling the engagement team to be accountable for its work.
4. Retaining a record of matters of continuing significance to future audits.
5. Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
6. Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Example: A new team member of the auditors of Extremely Vibrant Limited was of the view that Audit Documentation does not help in planning the audit of any company. Explain whether Audit Documentation has any relation with regard to planning the audit of a company.

ANSWER:

Audit Documentation helps in planning the audit of a company in a proper manner and also helps in conducting the audit of that company in a more effective way.

Q.NO.3. WRITE ABOUT FORM, CONTENT AND EXTENT OF DOCUMENTATION AND FACTORS AFFECTING THERE OF?

ANSWER:

A. **MANNER OF DOCUMENTATION:** The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

a. The nature, timing and extent of the audit procedures performed.
b. The results of the audit procedures performed and the audit evidence obtained and

c. Significant matters arising during the audit and the conclusions reached thereon and significant professional judgements made in reaching those conclusions.

MEANING OF AN EXPERIENCED AUDITOR: A person who has a reasonable knowledge of:

1. Applicable financial reporting Framework,
2. Accounting standards,
3. Auditing standards and
4. Knowledge of clients' business.

B. DOCUMENTATION OF NTE OF AUDIT PROCEDURES: Further in documenting the nature, timing and extent of audit procedures performed, the auditor shall record:

1. **TESTS PERFORMED:** The identifying characteristics of the specific items or matters tested.
2. **PERFORMED BY WHOM:** Who performed the audit work and the date such work was completed and
3. **REVIEW BY WHOM:** Who reviewed the audit work performed and the date and extent of such review.
4. **SIGNIFICANT MATTERS:** The auditor shall document discussions of significant matters with management, those charged with governance, and others, including:
   a. the nature of the significant matters discussed and
   b. when and with whom the discussions took place.
5. **INCONSISTENCIES:** If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency.

C. FACTORS AFFECTING FORM, CONTENT AND EXTENT OF DOCUMENTATION: The form, content and extent of audit documentation depend on factors such as:

1. The size and complexity of the entity.
2. The nature of the audit procedures to be performed.
3. The identified risks of material misstatement.
4. The significance of the audit evidence obtained.
5. The nature and extent of exceptions identified.
6. The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
7. The audit methodology and tools used.

Q.NO.4. WRITE ABOUT EXAMPLES OF AUDIT DOCUMENTATION?

ANSWER:

A. INCLUDES: Audit documentation may be recorded on paper or on electronic or other media. Example of Audit Documentation includes:

1. Audit programmes.
2. Analyses.
3. Issues memoranda.
4. Summaries of significant matters.
5. Letters of confirmation and representation.
6. Checklists.
7. Correspondence (including e-mail) concerning significant matters.

B. COPIES OF ENTITIES RECORDS:

1. The auditor may include copies of the entity's records (for example, significant and specific contracts and agreements) as part of audit documentation.
2. Audit documentation is not a substitute for the entity's accounting records.

C. DOES NOT INCLUDE: The auditor need not include in audit documentation of:

1. Superseded drafts of working papers and financial statements,
2. Notes that reflect incomplete or preliminary thinking,
3. Previous copies of documents corrected for typographical or other errors, and
4. Duplicates of documents.

Q.NO.5. WRITE ABOUT TIMELY PREPARATION AND ASSEMBLY OF AUDIT DOCUMENTATION AND ALSO ABOUT AUDIT FILE?

ANSWER:

A. AUDIT FILE: Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

B. TIMELY PREPARATION OF AUDIT DOCUMENTATION:

1. The auditor shall prepare audit documentation on a timely basis.
2. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalised.
3. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

C. ASSEMBLY OF THE FINAL AUDIT FILE:

1. **TIMELY BASSIS:** The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.
2. **SQC REQUIREMENT FOR P & P:** SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files.
3. **60 DAYS TIME LIMIT:** An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.
4. **ADMINISTRATIVE PROCESS:** The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature. Examples of such changes include:
   a. Deleting or discarding superseded documentation.
   b. Sorting, collating and cross-referencing working papers.
   c. Signing off on completion checklists relating to the file assembly process.
   d. Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.

D. RETENTION OF AUDIT DOCUMENTATION:

1. After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.
2. SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation.
3. The retention period for audit engagements ordinarily is no shorter than 7 years from the date of the auditor's report, or, if later, the date of the group auditor's report.

E. OWNERSHIP OF AUDIT DOCUMENTATION:

1. Standard on Quality Control (SQC) 1 provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor.
2. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

Q.NO.6. WRITE ABOUT DOCUMENTATION OF SIGNIFICANT MATTERS AND RELATED SIGNIFICANT PROFESSIONAL JUDGMENTS?

ANSWER:

A. DOCUMENTATION OF SIGNIFICANT MATTERS:

1. Judging the significance of a matter requires an objective analysis of the facts and circumstances.
2. Examples of significant matters include:
    a. Matters that give rise to significant risks.
    b. Results of audit procedures indicating
        i. That the financial statements could be materially misstated, or
        ii. A need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
3. Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
4. Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter Paragraph in the auditor's report.

B. DOCUMENTATION RELATED TO PROFESSIONAL JUDGMENT:

1. An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results.
2. Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment.
3. In the following cases the auditor shall document his use of Professional judgment if such judgment is relating to matters or decisions which are related to significant matters:
    a. The rationale for the auditor's conclusion when a requirement provides that the auditor 'shall consider certain information or factors, and that consideration is significant in the context of the particular engagement. (E.g., Reliance company changes useful life of 90% of fixed assets during FY 2018 – 2019 and here the auditor can document the information about number of years, reasons for changes in useful life etc. As these may be significant matters according to auditor.)

b. The basis for the auditor's conclusion on the reasonableness of areas of subjective judgments (E.g., the reasonableness of significant accounting estimates).
c. The basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.

Q.NO.7. WRITE ABOUT AUDIT SUMMARY MEMORANDUM?

ANSWER:

1. The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes:
    a. the significant matters identified during the audit and
    b. how they were addressed.
2. Such a summary may facilitate effective and efficient review and inspection of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist auditor's consideration of the significant matters.
3. It may also help the auditor to consider whether there is any individual relevant SA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

6. AUDIT EVIDENCE

SA 500 AUDIT EVIDENCE

Q.NO.1. SA 500 – "AUDIT EVIDENCE", EXPLAINS WHAT CONSTITUTES AUDIT EVIDENCE IN AN AUDIT OF FINANCIAL STATEMENTS, AND DEALS WITH THE AUDITOR'S RESPONSIBILITY TO DESIGN AND PERFORM AUDIT PROCEDURES TO OBTAIN SUFFICIENT APPROPRIATE AUDIT EVIDENCE TO BE ABLE TO DRAW REASONABLE CONCLUSIONS ON WHICH TO BASE THE AUDITOR'S OPINION. COMMENT.

ANSWER:

1. Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the true and fairness of Financial Statements. This can be achieved only if the financial statements and accounts are evaluated objectively.
2. Objective examination implies critical examination and scrutiny of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a true and fair view about the financial results and state of affairs.

Note: An opinion founded on a reckless and negligent examination and evaluation may expose the auditor to legal action with consequential loss of professional standing and prestige. He needs evidence to obtain information for arriving at his judgement.

Q.NO.2. EXPLAIN THE DEFINITION OF AUDIT EVIDENCE AND WHAT INCLUDES IN AUDIT EVIDENCE, BROADLY?

ANSWER:

A. DEFINITION:

1. Audit evidence may be defined as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based.
2. Audit evidence includes both:
   a. Information contained in the accounting records underlying the financial statements and
   b. Other information.

B. DETAILED EXPLANATION ON INCLUSIONS:

1. **INFORMATION CONTAINED IN THE ACCOUNTING RECORDS:** Accounting records include:
   a. The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers.
   b. Invoices
   c. Contracts
   d. The general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries and
   e. Records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.
2. **OTHER INFORMATION:** This authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the financial statements and this includes, for example:
   a. Minutes of the meetings

b. Written confirmations from trade receivables and trade payables

c. Manuals containing details of internal control etc

Note: The auditor uses a combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements. When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence.

Q.NO.3. WRITE ABOUT VARIOUS TYPES OF AUDIT EVIDENCE?

ANSWER:

A. DEPENDING UPON NATURE:

1. **Visual:** For example, observing physical verification of inventory conducted by the client's staff.
2. **Oral:** For example, discussion with the management and various officers of the client.
3. **Documentary:** For example, fixed deposit certificate, loan agreement, sales bill etc.

B. DEPENDING UPON SOURCE:

1. **Internal Evidence:** Evidence which originates within the organisation being audited is internal evidence.

   Example: Sales invoice, Copies of sales challan and forwarding notes, goods received note, inspection report, copies of cash memo, debit and credit notes, etc.
2. **External evidence:** The evidence that originates outside the client's organization is external evidence.

   Example: Purchase invoice, supplier's challan and forwarding note, debit notes and credit notes coming from parties, quotations, confirmations, etc.
3. **COMPLEMENTARY:**
   a. In an audit situation, the bulk of evidence that an auditor gets is internal in nature. However, substantial external evidence is also available to the auditor.

   b. Since in the origination of internal evidence, the client and his staff have the control, the auditor should be careful in putting reliance on such evidence.

   c. It is not suggested that they are to be suspected; but an auditor has to be alive to the possibilities of manipulation and creation of false and misleading evidence to suit the client or his staff.

   d. The external evidence is generally considered to be more reliable as they come from third parties who are not normally interested in manipulation of the accounting information of others.

   e. However, if the auditor has any reason to doubt the independence of any third party who has provided any material evidence e.g., an invoice of an associated concern, he should exercise greater vigilance in that matter.

   f. As an ordinary rule the auditor should try to match internal and external evidence as far as practicable. Where external evidence is not readily available to match, the auditor should see as to what extent the various internal evidence corroborates each other.

Q.NO.4. WRITE ABOUT RELEVANCE AND RELIABILITY OF AUDIT EVIDENCE?

ANSWER:

While audit evidence is primarily obtained from audit procedures performed during the course of the audit, it may also include information obtained from other sources. E.g., Previous audits. The quality of all audit evidence is affected by the relevance and reliability of the information upon which it is based.

A. RELEVANCE:

1. Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration.
2. The relevance of information to be used as audit evidence may be affected by the direction of testing.

   Example:

   If the purpose of an audit procedure is to test for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure. On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.
3. A given set of audit procedures may provide audit evidence that is relevant to certain assertions, but not others.

   For example, inspection of documents related to the collection of receivables after the period end may provide audit evidence regarding existence and valuation, but not necessarily cut-off. Similarly, obtaining audit evidence regarding a particular assertion, for example, the existence of inventory, is not a substitute for obtaining audit evidence regarding another assertion, for example, the valuation of that inventory. On the other hand, audit evidence from different sources or of a different nature may often be relevant to the same assertion.
4. Test of controls are designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. Designing test of controls to obtain relevant audit evidence includes identifying conditions (characteristics or attributes) that indicate performance of a control, and deviation in conditions which indicate departures from adequate performance. The presence or absence of those conditions can then be tested by the auditor.
5. Substantive procedures are designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures. Designing substantive procedures includes identifying conditions relevant to the purpose of the test that constitute a misstatement in the relevant assertion.

B. RELIABILITY:

1. The reliability of information to be used as audit evidence is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.

   For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity.
2. While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:
   a. **INDEPENDENT SOURCES:** The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.

b. **RELATED CONTROLS ARE EFFECTIVE:** The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
c. **OBTAINED DIRECTLY:** Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
d. **DOCUMENTART FORM:** Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
e. **ORIGINAL EVIDENCE:** Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

Q.NO.5. WRITE ABOUT THE NEED OF SUFFICIENT AND APPROPRIATE AUDIT EVIDENCE?

ANSWER:

1. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit.
2. It may, however, also include information obtained from other sources such as previous audits.
3. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management's expert.
4. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.
5. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence.
6. The evidence can be obtained by performing Audit procedures and these includes:
   a. Inquiry
   b. Inspection,
   c. Observation,
   d. Confirmation,
   e. Recalculation,
   f. Re-performance and
   g. Analytical procedures.

Note: Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

Q.NO.6. WRITE ABOUT SUFFICIENCY AND APPROPRIATENESS OF AUDIT EVIDENCE?

ANSWER:

1. As explained in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.
2. The sufficiency and appropriateness of audit evidence are interrelated.

A. SUFFICIENCY OF AUDIT EVIDENCE: Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by:

1. The auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and
2. The quality of such audit evidence (the higher the quality, the less may be required).
3. Further the following factors may influence the auditor's judgement about sufficiency of audit evidence:
   a. **MATERIALITY:** It may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements.
   Example, Less evidence would be required in case assertions are less material to users of the financial statements. But on the other hand, if assertions are more material to the users of the financial statements, more evidence would be required.
   b. **RISK OF MATERIAL MISSTATEMENT:** It may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of 2 components described as follows at the assertion level:
      i. **Inherent risk:** The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.
      ii. **Control risk:** The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control.
   Example, Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand, if assertions have a higher risk of material misstatement, more evidence would be required.
   c. **SIZE OF A POPULATION:** It refers to the number of items included in the population.
   Example, Less evidence would be required in case of smaller, more homogeneous population but on the other hand in case of larger, more heterogeneous populations, more evidence would be required.

B. APPROPRIATENESS OF AUDIT EVIDENCE:

1. Appropriateness is the measure of the quality of audit evidence. It talks about its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.
2. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.
   Note: Obtaining more audit evidence, however, may not compensate for its poor quality.

Q.NO.7. WRITE ABOUT SOURCES OF OBTAINING AUDIT EVIDENCES?

ANSWER:

1. Some audit evidence is obtained by performing audit procedures to test the accounting records.

   Example:
    a. Through analysis and review,
    b. Reperforming procedures followed in the financial reporting process, and
    c. Reconciling related types and applications of the same information.
2. Through the performance of such audit procedures, the auditor may determine that the accounting records are internally consistent and agree to the financial statements.
3. More assurance is ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually.
   Example: Corroborating information obtained from a source independent of the entity may increase the assurance the auditor obtains from audit evidence that is generated internally, such as evidence existing within the accounting records, minutes of meetings, or a management representation.
4. Information from sources independent of the entity that the auditor may use as audit evidence may include confirmations from third parties, analysts' reports, and comparable data about competitors.

Q.NO.8. WRITE ABOUT AUDIT PROCEDURES TO OBTAIN AUDIT EVIDENCE?

ANSWER:

The audit procedures such as inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry described below may be used as risk assessment procedures, test of controls or substantive procedures, depending on the context in which they are applied by the auditor. Audit procedures to obtain audit evidence can include:

A. INSPECTION:

1. Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.
2. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.
   Example: Example of inspection used as a test of controls is inspection of records for evidence of authorization. Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as an inventory or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition. Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

B. OBSERVATION:

1. Observation consists of looking at a process or procedure being performed by others.

2. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.
   Example: The auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities.

C. EXTERNAL CONFIRMATION:

1. An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
2. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only.
   Example: The auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, what the relevant details are.
3. External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions.
   Example: The absence of a "side agreement" that may influence revenue recognition.

D. RECALCULATION: Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

E. RE-PERFORMANCE: Re-performance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.
Example: Re-performing the reconciliation of bank statement, re-performing the aging of accounts receivable.

F. ANALYTICAL PROCEDURES:

1. Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data.
2. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

G. INQUIRY:

1. **MEANING:** Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures.
2. **FORMAT:** Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
3. **WHAT DO WE GET:** Responses to inquiries may provide the auditor with:
   a. Information not previously possessed or with corroborative audit evidence.
   b. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, *for example, information regarding the possibility of management override of controls.*
   c. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.
4. **INQUIRIES ABOUT MANAGEMENT INTENTIONS:** Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of

inquiries about management intent, the information available to support management's intent may be limited. In these cases, the auditor shall understand:

a. Management's past history of carrying out its stated intentions,
b. Management's stated reasons for choosing a particular course of action, and
c. Management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

5. **WRITTEN REPRESENTATION:** In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

NOTE: The audit procedures inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry may be used as risk assessment procedures, tests of controls or substantive procedures, depending on the context in which they are applied by the auditor.

Audit evidence obtained from previous audits may, in certain circumstances, provide appropriate audit evidence where the auditor performs audit procedures to establish its continuing relevance.

Q.NO.9. WRITE ABOUT NATURE AND TIMING OF THE AUDIT PROCEDURES WHEN ACCOUNTING RECORDS ARE AVAILABLE IN ELECTRONIC FORM?

ANSWER:

1. The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time.
   For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce, or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference.
2. Certain electronic information may not be retrievable after a specified period of time.
   For example, if files are changed and if backup files do not exist.
3. Accordingly, the auditor may find it necessary as a result of an entity's data retention policies to request retention of some information for the auditor's review or to perform audit procedures at a time when the information is available.

Q.NO.10. WRITE ABOUT RISK ASSESSMENT PROCEDURES AND FURTHER AUDIT PROCEDURES IN BRIEF?

ANSWER:

The auditor can obtain required audit evidence by performing audit procedures as below:

A. RISK ASSESSMENT PROCEDURES: Risk assessment procedures refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

B. FURTHER AUDIT PROCEDURES: Further Audit Procedures comprise of:

1. **TESTS OF CONTROLS:** Test of controls may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. These are performed by auditor:
   a. When required by the SAs or
   b. When the auditor has chosen to do so and

2. **SUBSTANTIVE PROCEDURES:**
   a. Substantive procedures are designed to detect material misstatements at the assertion level. They comprise:
      i. Tests of details and
      ii. substantive analytical procedures.
   b. Designing substantive procedures includes identifying conditions relevant to the purpose of the test that constitute a misstatement in the relevant assertion.
   c. In other words, Substantive procedure may be defined as an audit procedure designed to detect material misstatements at the assertion level

Q.NO.11. IN OBTAINING AUDIT EVIDENCE FROM SUBSTANTIVE PROCEDURES, THE AUDITOR IS CONCERNED WITH THE VARIOUS ASSERTIONS. WHAT DO YOU MEAN BY THE TERM ASSERTIONS AND ALSO EXPLAIN VARIOUS CLASS OF ASSERTIONS?

ANSWER:

1. **MEANING:** Assertions refer to representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.
2. **USAGE BY MANAGEMENT AND AUDITOR:** The Use of Assertions:
   a. **BY MANAGEMENT:** In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation and disclosure of the various elements of financial statements and related disclosures.
   b. **BY AUDITOR:** Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following 3 categories:
      i. **ASSERTIONS RELATED TO CLASS OF TRANSACTIONS AND EVENTS FOR THE PERIOD UNDER AUDIT:**
         a) **Occurrence:** Transactions and events that have been recorded have occurred and pertain to the entity.
         b) **Completeness:** All transactions and events that should have been recorded have been recorded.
         c) **Accuracy:** Amounts and other data relating to recorded transactions and events have been recorded appropriately.
         d) **Cut-off:** Transactions and events have been recorded in the correct accounting period.
         e) **Classification:** Transactions and events have been recorded in the proper accounts.
      ii. **ASSERTIONS RELATED TO ACCOUNT BALANCES:**
         a) **Existence:** Assets, liabilities, and equity interests exist.
         b) **Rights and obligations:** the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
         c) **Completeness:** All assets, liabilities and equity interests that should have been recorded have been recorded.
         d) **Valuation and allocation:** Assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.
      iii. **ASSERTIONS RELATED TO PRESENTATION AND DISCLOSURES:**

a) **Occurrence and rights and obligations:** Disclosed events, transactions, and other matters have occurred and pertain to the entity.
b) **Completeness:** All disclosures that should have been included in the financial statements have been included.
c) **Classification and understandability:** Financial information is appropriately presented and described, and disclosures are clearly expressed.
d) **Accuracy and valuation:** Financial and other information are disclosed fairly and at appropriate amounts.

3. **COMBINATION OF ASSERTIONS:** The auditor may use the assertions as described above or may express them differently provided all aspects described above have been covered. For example, the auditor may choose to combine the assertions about transactions and events with the assertions about account balances.
4. **CONSIDERATION OF LAW AND REGULATION:** When making assertions about the financial statements of certain entities, especially, for example, where the Government is a major stakeholder, management may often assert that transactions and events have been carried out in accordance with legislation or proper authority. Such assertions may fall within the scope of the financial statement audit.
5. We must clearly understand that each item contained in financial statements asserts something to the readers of the accounts to indicate the ownership, existence, quantity of various things, etc. Auditing is concerned with the testing of the authenticity of the information which is conveyed.

EXAMPLE 1: When we find in the balance sheet, an item under current assets reading as "cash in hand - Rs. 8,000"

The obvious assertions that would strike the mind are the following:

a. The firm concerned had Rs. 8,000 in hand in valid notes and coins on the balance sheet day.
b. That the cash was free and available for expenditure to the firm and
c. That the books of account show a cash balance of identical amount at the end of the day on which the balance sheet is drawn up.

EXAMPLE 2:

Particulars	Rs.	Rs.
Plant and Machinery (at cost)		2,00,000
Less: Depreciation till the end of previous year	70,000	
Less: Depreciation for the current year	13,000	(83,000)
Net WDV		**1,17,000**

The assertions are as follows:

a. The firm owns the plant and machinery.
b. The historical cost of plant and machinery is Rs. 2 lacs.
c. The plant and machinery physically exist.
d. The asset is being utilised in the business of the company productively.
e. Total charge of depreciation on this asset is Rs. 83,000 to date on which Rs. 13,000 relates to the year in respect of which the accounts are drawn up. and
f. The amount of depreciation has been calculated on recognised basis and the calculation is correct.

6. **ASSERTIONS MAY BE EXPLICIT / IMPLIED:**

a. The assertions are generally implied and not specifically spelt out, though some explicit assertions are also found in the financial statements.
b. Explicit assertions are made when the reader will be left with an incomplete picture. Sometimes without them it may even be misleading.

For Example: Secured Loans Rs. 4,00,000

The description does not give us a complete picture. We do not know:

a. The name of the lender, if it is relevant
b. The nature of security provided and
c. The rate at which interest in payable.

A specific mention is required about these things for a proper appreciation of the item and the financial position.

7. **NEGATIVE ASSERTIONS:** Negative assertions are also encountered in the financial statements and the same may be expressed or implied.

   For example:

   Explicit Negative Assertion: If it is stated that there is no contingent liability then it would be an expressed negative assertion.

   Implied Negative Assertion: If in the balance sheet there is no item as "building", it would be an implied negative assertion that the entity did not own any building on the balance sheet date.

8. **OVERALL REPRESENTATION:**
   a. Every financial statement contains an overall representation in addition to the specific assertions so far discussed. Each financial statement purports to present something as a whole in addition to its component details. For example, an income statement purports to present "the results of operations" a balance sheet purports to present "financial position".
   b. The auditor's opinion is typically directed to these overall representations. But to formulate and offer an opinion on the overall truth of these statements he has first to inquire into the truth of many specific assertions, expressed and implied, both positive, and negative, that makes up each of these statements. Out of his individual judgements of these specific assertions he arrives at a judgement on the financial statement as a whole.

Q.NO.12. WRITE ABOUT THE CONCEPT OF AUDIT TRAIL?

ANSWER:

1. **MEANING OF AUDIT TRAIL:**
   a. An audit trail is a documented flow of a transaction. It is used to investigate how a source document was translated into an account entry and from there it was inserted into financial statement of an entity. It is used as audit evidence to establish authentication and integrity of a transaction. Audit trails help in maintaining record of system and user activity.
      Like, in case of banks, there is an audit trail keeping track of log-on activity detailing record of log-on attempts and device used.
   b. It is a step-by-step record by which accounting, trade details, or other financial data can be traced to their source. Audit trails are used to verify and track many types of transactions including accounting and financial transactions.
   c. Audit trails (or audit logs) act as record-keepers that document evidence of certain events, procedures or operations, because their purpose is to reduce fraud, material errors, and unauthorized use.
   d. However, audit trails involve costs. The cost is not only in terms of system

expenditure but also in terms of time involved in analysing data made available by audit trails. However, use of automated tools can be made to analyse large volume of data thrown up by audit trails.

2. **BENEFITS OF AUDIT TRAIL:**
   a. Audit trails help to enhance internal controls and data security. Audit trails can help in fixing responsibility, rebuilding events and in thorough analysis of problem areas. For example, audit trails can track activities of users thus fixing responsibility for users. These can also be used to rebuild events upon occurring of some problem.

   b. Audit trail analysis can specify reason of the problem. It can also help in ensuring operation of system as intended. In this way, audit trails can help entities in their regular system operations.
   c. Systems which have a feature of audit trail inspires confidence in auditors. It helps auditors in verifying whether controls devised by the management were operating effectively or not.
   d. It aids in verification whether a transaction was indeed performed by a person authorised to do it. Since audit trails also enhance data security, these can be used by auditor while performing audit procedures thus increasing reliability of audit evidence obtained.

Q.NO.13. WRITE ABOUT INFORMATION TO BE USED AS AUDIT EVIDENCE?

ANSWER:

A. INFORMATION PREPARD BY MANAGEMENT EXPERT: When information to be used as audit evidence has been prepared using the work of a management's expert, the nature, timing and extent of audit procedures may be affected by such matters:

1. The nature and complexity of the matter to which the management's expert relates.
2. The risks of material misstatement in the matter.
3. The availability of alternative sources of audit evidence.
4. The nature, scope and objectives of the management's expert's work.
5. Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.
6. The extent to which management can exercise control or influence over the work of the management's expert.
7. Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
8. The nature and extent of any controls within the entity over the management's expert's work.
9. The auditor's knowledge and experience of the management's expert's field of expertise.
10. The auditor's previous experience of the work of that expert.

B. INFORMATION PREPARD BY MANAGEMENT: When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances:

1. Obtaining audit evidence about the accuracy and completeness of the information; and
2. Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes.

Q.NO.14. WHEN DESIGNING TESTS OF CONTROLS AND TESTS OF DETAILS, THE AUDITOR SHALL DETERMINE MEANS OF SELECTING ITEMS FOR TESTING THAT ARE EFFECTIVE IN MEETING THE PURPOSE OF THE AUDIT PROCEDURE.

EXPLAIN?

ANSWER:

SELECTING ITEMS FOR TESTING TO OBTAIN AUDIT EVIDENCE: When designing tests of controls and tests of details, the auditor shall determine means of selecting items for testing that are effective in meeting the purpose of the audit procedure. The means available to the auditor for selecting items for testing are:

a. Selecting all items (100% examination).
b. Selecting specific items and
c. Audit sampling.

The application of any one or combination of these means may be appropriate depending on the auditors' judgement to obtain audit evidence.

A. **SELECTING ALL ITEMS:**

1. The auditor may decide that it will be most appropriate to examine the entire population of items that make up a class of transactions or account balance (or a stratum within that population).
2. 100% examination is unlikely in the case of tests of controls; however, it is more common for tests of details.
3. 100% examination may be appropriate when, For example:
   i. The population constitutes a small number of large value items
   ii. There is a significant risk and other means do not provide sufficient appropriate audit evidence or
   iii. The repetitive nature of a calculation or other process performed automatically by an information system makes a 100% examination cost effective.

B. **SELECTING SPECIFIC ITEMS:**

1. The auditor may decide to select specific items from a population. In making this decision, factors that may be relevant include:
   i. The auditor's understanding of the entity,
   ii. The assessed risks of material misstatement, and
   iii. The characteristics of the population being tested.
2. The judgmental selection of specific items is subject to non-sampling risk. Specific items selected may include:
   i. **High value or key items:** The auditor may decide to select specific items within a population because they are of high value, or exhibit some other characteristic.
   For example: Items that are suspicious, unusual, particularly risk- prone or that have a history of error.
   ii. **All items over a certain amount:** The auditor may decide to examine items whose recorded values exceed a certain amount so as to verify a large proportion of the total amount of a class of transactions or account balance.
   iii. **Items to obtain information:** The auditor may examine items to obtain information about matters such as the nature of the entity or the nature of transactions.

C. **AUDIT SAMPLING:** Audit sampling is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from it.

Q.NO.15. WRITE ABOUT AUDIT PROCEDURE TO BE FOLLOWED IF AUDITOR IDENTIFIES INCONSISTENCY IN OR DOUBTS OVER RELIABILITY OF AUDIT EVIDENCE?

ANSWER:

1. If audit evidence obtained from one source is inconsistent with that obtained from another or
2. The auditor has doubts over the reliability of information to be used as audit evidence, the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.
   For example: responses to inquiries of management, internal audit, and others are inconsistent.

3. SA 230 includes a specific documentation requirement if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter.

Q.NO.16. WHO IS MANAGEMENT'S EXPERT. WHAT FACTORS AN AUDITOR SHALL CONSIDER WHILE PLACING RELIANCE ON WORK OF SUCH AN EXPERT?

ANSWER:

MANAGEMENT's EXPERT: An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

RELYING ON THE WORK OF A MANAGEMENT'S EXPERT: If the entity has employed or engaged experts, the auditor may rely on the works of experts, provided he is satisfied that sufficient and appropriate audit evidence is obtained with reasonable assurance to form an opinion on the financial statements. When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

a. Evaluate the competence, capabilities and objectivity of that expert.
b. Obtain an understanding of the work of that expert. and
c. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

Q.NO.17. WRITE ABOUT EVALUATION OF AUDIT EVIDENCE?

ANSWER:

1. SA 500 "Audit Evidence" is applicable to all the audit evidence obtained during the course of the audit to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.
2. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.
3. The auditor has to conclude whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment.

SA 610 USING THE WORK OF INTERNAL AUDITOR

Q.NO.1. WRITE ABOUT INTERNAL AUDIT FUNCTION AND THEIR OBJECTIVES AND SCOPE?

ANSWER:

A. **MEANING:** Internal audit function refers to a function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the:
   1. Entity's governance,
   2. Risk management and
   3. Internal control processes.

B. **OBJECTIVE AND SCOPE:** The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the following:
   1. **ACTIVITIES RELATING TO GOVERNANCE:** The internal audit function may assess the governance process in its accomplishment of objectives on:
      a. Ethics and values,
      b. Performance management and accountability,
      c. Communicating risk and control information to appropriate areas of the organization and
      d. Effectiveness of communication among those charged with governance, external and internal auditors, and management.
   2. **ACTIVITIES RELATING TO RISK MANAGEMENT:**
      a. The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process).
      b. The internal audit function may perform procedures to assist the entity in the detection of fraud.
   3. **ACTIVITIES RELATING TO INTERNAL CONTROL:**
      a. **Evaluation of internal control:** The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation, and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control.
      For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit.
      b. **Examination of financial and operating information:** The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
      c. **Review of operating activities:** The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non- financial activities of an entity.
      d. **Review of compliance with laws and regulations:** The internal audit function may be assigned to review compliance with laws, regulations, and other external requirements, and with management policies and directives and other internal requirements.

Q.NO.2. HOW THE EXTERNAL AUDITOR MAY MAKE USE OF THE INTERNAL AUDIT FUNCTION FOR PURPOSES OF THE AUDIT?

ANSWER:

While the objectives of an entity's internal audit function and the external auditor differ, the function may perform audit procedures similar to those performed by the external auditor in an audit of financial statements. If so, the external auditor may make use of the function for purposes of the audit in one or more of the following ways:

i. USING WORK PERFORMED BY INTERNAL AUDIT FUNCTION [TYPE 1]:

a. To obtain information that is relevant to the external auditor's assessments of the risks of material misstatement due to error or fraud.

b. Unless prohibited, or restricted to some extent, by law or regulation, the external auditor, after appropriate evaluation, may decide to use work that has been performed by the internal audit function during the period in partial substitution for audit evidence to be obtained directly by the external auditor.

ii. DIRECT ASSISTANCE [TYPE 2]: Unless prohibited, or restricted to some extent, by law or regulation, the external auditor may use internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

Q.NO.3. WRITE ABOUT SCOPE AND PURPOSE OF SA 610?

ANSWER:

1. **SCOPE:** Standard on Auditing (SA) 610 deals with the external auditor's responsibilities if using the work of internal auditors. This includes
   a. Using the work of the internal audit function in obtaining audit evidence and
   b. Using internal auditors to provide direct assistance under the direction, supervision and review of the external auditor.

   Note: Nothing in this SA requires the external auditor to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor. It remains a decision of the external auditor in establishing the overall audit strategy.

2. **EXTERNAL AUDITOR'S RESPONSIBILITY FOR THE AUDIT:**
   a. The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement.
   b. Although they may perform audit procedures similar to those performed by the external auditor, neither the internal audit function nor the internal auditors are independent of the entity as is required of the external auditor in an audit of financial statements in accordance with SA 200.

3. **PURPOSE:**
   a. This SA, therefore, defines the conditions that are necessary for the external auditor to be able to use the work of internal auditors. It also defines the necessary work effort to obtain sufficient appropriate evidence that the work of the internal audit function, or internal auditors providing direct assistance, is adequate for the purposes of the audit.
   b. The requirements are designed to provide a framework for the external auditor's judgments regarding the use of the work of internal auditors to prevent over or undue use of such work.

Q.NO.4. WRITE ABOUT OBJECTIVES OF THE EXTERNAL AUDITOR, WHERE THE ENTITY HAS AN INTERNAL AUDIT FUNCTION AS PER SA 610?

ANSWER:

The objectives of the external auditor, where the entity has an internal audit function and the external auditor expects to use the work of the function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor, or to use internal auditors to provide direct assistance, are to determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent. and having made that determination:

a. **TYPE 1:** If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit and
b. **TYPE 2:** If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work.

Q.NO.5. WRITE ABOUT EVALUATING THE INTERNAL AUDIT FUNCTION BY EXTERNAL AUDITOR?

ANSWER:

The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following:

A. The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors;
B. The level of competence of the internal audit function; and
C. Whether the internal audit function applies a systematic and disciplined approach, including quality control.

A. OBJECTIVITY AND ITS EVALUATION:

1. Objectivity refers to the ability to perform those tasks without allowing bias, conflict of interest or undue influence of others to override professional judgments.
2. Factors that may affect the external auditor's evaluation in relation to Objectivity include the following:
   a. Whether the organizational status of the internal audit function, including the function's authority and accountability, supports the ability of the function to be free from bias, conflict of interest or undue influence of others to override professional judgments.
      For example, whether the internal audit function reports to those charged with governance or an officer with appropriate authority, or if the function reports to management, whether it has direct access to those charged with governance.
   b. Whether those charged with governance oversee employment decisions related to the internal audit function.
      For example, determining the appropriate remuneration policy.
   c. Whether there are any constraints or restrictions placed on the internal audit function by management or those charged with governance, for example, in communicating the internal audit function's findings to the external auditor.
   d. Whether the internal audit function is free of any conflicting responsibilities, for example, having managerial or operational duties or responsibilities that are outside of the internal audit function.

B. COMPETENCE AND ITS EVALUATION:

1. Competence of the internal audit function refers to the attainment and maintenance of knowledge and skills of the function as a whole at the level required to enable assigned tasks to be performed diligently and in accordance with applicable professional standards.

2. Factors that may affect the external auditor's determination in relation to competence include the following:
   a. Whether the internal audit function is adequately and appropriately resourced relative to the size of the entity and the nature of its operations.
   b. Whether there are established policies for hiring, training and assigning internal auditors to internal audit engagements.
   c. Whether the internal auditors have adequate technical training and proficiency in auditing.
   d. Whether the internal auditors possess the required knowledge relating to the entity's financial reporting and the applicable financial reporting framework.

OBJECTIVITY AND COMPETENCE:

1. The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors and the level of competence of the function are particularly important in determining whether to use and, if so, the nature and extent of the use of the work of the function that is appropriate in the circumstances.
2. **Objectivity and competence may be viewed as a continuum:**
   a. The more the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and the higher the level of competence of the function, the more likely the external auditor may make use of the work of the function and in more areas.
   b. However, an organizational status and relevant policies and procedures that provide strong support for the objectivity of the internal auditors cannot compensate for the lack of sufficient competence of the internal audit function.
   c. Equally, a high level of competence of the internal audit function cannot compensate for an organizational status and policies and procedures that do not adequately support the objectivity of the internal auditors.

C. APPLICATION OF A SYSTEMATIC AND DISCIPLINED APPROACH:

1. The application of a systematic and disciplined approach to planning, performing, supervising, reviewing and documenting its activities distinguishes the activities of the internal audit function from other monitoring control activities that may be performed within the entity.
2. Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:
   a. The existence, adequacy and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting, the nature and extent of which is commensurate with the size and circumstances of an entity.
   b. Whether the internal audit function has appropriate quality control policies and procedures.

Q.NO.6. WHAT ARE THE CIRCUMSTANCES WHEN WORK OF THE INTERNAL AUDIT FUNCTION CANNOT BE USED BY EXTERNAL AUDITOR?

ANSWER:

The external auditor shall not use the work of the internal audit function if the external auditor determines that:

a. The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors.
b. The function lacks sufficient competence or
c. The function does not apply a systematic and disciplined approach, including quality control.

Q.NO.7. WRITE ABOUT DETERMINING THE NATURE AND EXTENT OF WORK OF THE INTERNAL AUDIT FUNCTION THAT CAN BE USED BY AN EXTERNAL AUDITOR?

ANSWER:

1. As a basis for determining the areas and the extent to which the work of the internal audit function can be used, the external auditor shall consider the nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and audit plan.
2. In other words, once the external auditor has determined that the work of the internal audit function can be used for purposes of the audit, a first consideration is whether the planned nature and scope of the work of the internal audit function that has been performed, or is planned to be performed, is relevant to the overall audit strategy and audit plan that the external auditor has established.
3. Examples of work of the internal audit function that can be used by the external auditor include the following:
    a. Testing of the operating effectiveness of controls.
    b. Substantive procedures involving limited judgment.
    c. Observations of inventory counts.
    d. Tracing transactions through the information system relevant to financial reporting.
    e. Testing of compliance with regulatory requirements.

Q.NO.8. WHAT ARE THE CIRCUMSTANCES IN WHICH THE EXTERNAL AUDITOR SHALL PLAN TO USE LESS OF THE WORK OF THE INTERNAL AUDIT FUNCTION AND PERFORM MORE OF THE WORK DIRECTLY?

ANSWER:

The external auditor shall make all significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly if:

1. The more judgment is involved in:
    a. Planning and performing relevant audit procedures and
    b. Evaluating the audit evidence gathered.
2. The higher the assessed risk of material misstatement at the assertion level, with special consideration given to risks identified as significant.
3. The less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and
4. The lower the level of competence of the internal audit function.

Q.NO.9. WRITE ABOUT USING THE WORK OF THE INTERNAL AUDIT FUNCTION?

ANSWER:

If the external auditor plans to use the work of the internal audit function, the external auditor shall

A. Discuss the planned use of its work with the function as a basis for coordinating their respective activities.

B. Read the reports of the internal audit function relating to the work of the function that the external auditor plans to use to obtain an understanding of the nature and extent of audit procedures it performed and the related findings.

C. Perform sufficient audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit.

Q.NO.10. WRITE ABOUT DISCUSSION AND COORDINATION WITH THE INTERNAL AUDIT FUNCTION?

ANSWER:

1. In discussing the planned use of their work with the internal audit function as a basis for coordinating the respective activities, it may be useful to address the following:
   a. The timing of such work.
   b. The nature of the work performed.
   c. The extent of audit coverage.
   d. Materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures), and performance materiality.
   e. Proposed methods of item selection and sample sizes.
   f. Documentation of the work performed.
   g. Review and reporting procedures.
2. Coordination between the external auditor and the internal audit function is effective when, for example:
   a. Discussions take place at appropriate intervals throughout the period.
   b. The external auditor informs the internal audit function of significant matters that may affect the function.
   c. The external auditor is advised of and has access to relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement.

Q.NO.11. DETERMINING WHETHER, IN WHICH AREAS, AND TO WHAT EXTENT INTERNAL AUDITORS CAN BE USED TO PROVIDE DIRECT ASSISTANCE?

ANSWER:

1. **MEANING:** Direct assistance refers to the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.
2. **EVALUATION:** The external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate:
   a. The existence and significance of threats to objectivity and
   b. The level of competence of the internal auditors who will be providing such assistance.
   c. The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity.
3. **PROHIBITION ON TYPE 2:** The external auditor shall not use an internal auditor to provide direct assistance if:
   a. There are significant threats to the objectivity of the internal auditor; or
   b. The internal auditor lacks sufficient competence to perform the proposed work.
4. **RESTRICTIONS ON USING DIRECT ASSISTANCE IN CERTAIN AREAS:** The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:

   a. Involve making significant judgments in the audit.
   b. Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited.
   c. Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function or
   d. Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.
5. **WRITTEN AGREEMENTS:** Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:
   a. **FROM MANAGEMENT:** Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor and
   b. **FROM INTERNAL AUDITORS:** Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

SA 530 AUDIT SAMPLING

Q.NO.1. WRITE A BASIC INTRODUCTION TO AUDIT SAMPLING?

ANSWER:

1. There is a growing realisation that the traditional approach to audit is economically wasteful because all the efforts are directed to check all transactions without any exception. This invariably leads to more emphasis on routine checking, which often is not necessary in view of the time and the cost involved. With the shift in favour of formal internal controls in the management of affairs of organisations, the possibilities of routine errors and frauds have greatly diminished i.e., the internal controls as designed by the management are for the very purpose of Prevention, Detection and Correction of Frauds and Errors. Thus, the auditors often find extensive routine checking as nothing more than a ritual because it rarely reveals anything material.
2. Now the approach to audit and the extent of checking are undergoing a progressive change in favour of more attention towards the questions of principles and controls with a curtailment of nonconsequential Irrelevant routine checking.
3. By routine checking we traditionally think of extensive checking and vouching of all the entries, disregarding the concept of materiality.
4. The extent of the checking to be undertaken is primarily a matter of judgment of the auditor, there is nothing statutorily stated anywhere which specifies what work is to be done, how it is to be done and to what extent it has to be done. It is also not obligatory that the auditor must adopt the sampling technique. What he is to do as an auditor is to express his opinion on the financial statements and become bound by that.
5. To ensure good and reasonable standard of work, he should adopt standards and techniques that can lead him to an informed professional opinion. On consideration of this fact, it can be said that it is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking (i.e., sampling), he should adopt standards and techniques which are widely followed and which have a recognised basis.
6. Since statistical theory of sampling is based on a scientific law, it can be relied upon to a greater extent than any arbitrary technique which lacks in basis and acceptability. This enables the auditor to make conclusions and express fair opinion without having to check all of the items within the financial statements.

Q.NO.2. DEFINE THE TERM AUDIT SAMPLING AND MENTION THE OBJECTIVE OF AUDITOR?

ANSWER:

A. DEFINITION AS PER SA530:

According to SA 530 – Audit Sampling, Audit sampling refers to the application of audit procedures to less than 100% of items within a population based on which the auditor draws conclusions about the population.

B. OBJECTIVE OF AUDITOR UNDER SA- 530:

The objective of the auditor when using audit sampling is to provide a reasonable basis to draw conclusions about the population from which the sample is selected.

C. APPLICABILITY:

1. SA 530 becomes applicable when the auditor has decided to use audit sampling in performing audit procedures. This standard deals with the auditor's use of:
   a. Statistical and
   b. Non-statistical sampling
2. When designing and selecting the

a. Audit sample and
b. Performing tests of controls and tests of details, and evaluating the results from the sample.

Q.NO.3. DEFINE THE TERM POPULATION AND DISCUSS THE CHARACTERISTICS OF POPULATION.

ANSWER:

Population refers to the entire set of data from which a sample is selected and the auditor wishes to draw conclusions on such population. The auditor should select sample items which can be expected to be representative of the population.

1. **APPROPRIATENESS:**
    a. The auditor will need to determine that the population from which the sample is drawn is appropriate.
    b. Appropriate means population from which the samples are drawn shall be relevant for the specific objective under audit as projections on population is made based on sample.
    c. Remember audit procedures are applied on sample based on which conclusions are arrived on population.
    d. **Example:**
        a. If the auditor's objective were to test for overstatement of accounts receivable, the population could be defined as the accounts receivable listing.
        b. On the other hand, when testing for understatement of accounts payable, the population would not be the accounts payable listing, but rather subsequent disbursements, unpaid invoices, suppliers' statements, unmatched receiving reports, or other populations that would provide audit evidence of understatement of accounts payable.
2. **COMPLETENESS:** The population also needs to be complete, which means that if the auditor intends to use the sample to draw conclusions about whether a control activity is operated effectively during the financial reporting period, the population needs to include all relevant items i.e., all the activities that form part of that relevant internal control, throughout the entire period. If population is complete in all respects, the conclusions drawn on the population will be considered to be reasonable.
3. **RELIABLE:** When performing the audit sampling, the auditor performs audit procedures to ensure that the information upon which the audit sampling is performed is sufficiently complete and accurate. Auditor should obtain evidence about the reliability of population. If population is not reliable with respect to accuracy and source, the sample drawn will definitely not be relevant for the specific audit objective.

Q.NO.4. WHAT DO YOU MEAN BY SAMPLING UNIT, APPROACH TO SAMPLING AND REPRESENTATIVE SAMPLE?

ANSWER:

A. SAMPLING UNIT:

1. The individual items that make up the population are known as sampling units. The population can be divided into sampling units in a variety of ways. It is a selection from the population that is used as an extrapolation of the population.
2. Audit procedures are applied on these units and the conclusions drawn from them are projected on the population.
3. In simple words, conclusions drawn on the sample becomes the conclusion of the population from where it is drawn.

4. **Example:** If the auditor's objective were to test the validity of accounts receivables, the sampling unit could be defined as customer balances or individual customer invoices. The auditor defines the sampling unit in order to obtain an efficient and effective sample to achieve the particular audit objectives.

B. APPROACH TO SAMPLING:

1. Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion about the population, from which the sample is drawn. Audit sampling can be applied using either
   a. Non-statistical or
   b. Statistical sampling approaches.
2. The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgement. However, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

STATISTICAL SAMPLING:

1. Statistical sampling is an approach to sampling that has
   a. The random selection of the sample units and
   b. The use of probability theory to evaluate sample results including
   c. Measurement of sampling risk characteristics.
2. Sample is chosen by applying certain mathematical and statistical methods.

NON - STATISTICAL SAMPLING: A sampling approach that does not have the above features considered as non-statistical sampling.

C. REPRESENTATIVE SAMPLE:

1. Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.
2. Sampling Process is performed on:
   a. **Test of controls** to identify deviations from expected internal controls
   b. **Test of details** to identify misstatements of account balances and class of transactions

Q.NO.5. WRITE ABOUT THE DIFFERENCE BETWEEN STATISTICAL SAMPLING AND NON-STATISTICAL SAMPLING?

ANSWER:

A. STATISTICAL SAMPLING- MORE SCIENTIFIC:

1. **USE OF PROBABILITY:** Audit testing done through this approach is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.
2. **LARGE NUMBER:** Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.
3. **NO PERSONAL BIAS:** There Is no personal bias of the auditor in case of statistical sampling.
4. **SCIENTIFIC EVALUATION:** Since it is scientific, the results of sample can be evaluated and projected on the whole population in a more reliable manner.

5. In larger organisations, with huge transactions, statistical sampling is always recommended as it is unbiased and the samples selected are not prejudged.

For Example: An auditor while verifying the Purchases during the year realised that the purchase transactions in that year are more than 45000 in number, then in such case, statistical sampling will be highly recommended in the audit program. Random Sampling (discussed ahead in this topic) is the method you decide to choose sample in such a situation.

B. NON-STATISTICAL SAMPLING:

1. **PERSONAL BIAS:** Under this approach, the sample size and its composition are determined on the basis of the personal experience and knowledge of the auditor. The expected degree of objectivity cannot be assured in non-statistical sampling because the risk of personal bias in selection of sample items cannot be eliminated.
   For example, March, June and September may be selected in year one and different months would be selected in the next year, On basis of value of items, top 10 highest value. Etc.
2. **CHECKING AT YEAREND:** It is a common practice to check large number of items towards the close of the year so that the adequacy of cut-off procedures can also be determined. Also, because yearend transaction is prone to high risk of misappropriation.
3. **NOT SCIENTIFIC:** The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific.
4. **CANNOT BE MEASURED:** The closeness of the qualities projected by the sample results with that of the whole population cannot be measured because the sample has not been selected in accordance with the mathematically based statistical techniques.
5. However, it may be stated that the auditor with his experience and knowledge of the client's business can evaluate accurately enough the sample findings to make audit decision and the mathematical proof of accuracy in some cases may be a luxury which the auditor cannot afford.
6. **NOT REPRESENTATIVE:** This method is simple to operate but sometimes the sample may not be a true representative of the total population because of personal bias and no scientific method of selection.

Q.NO.6. HOW SAMPLING IS DIFFERENT FROM TRADITIONAL METHODS OF CHECKING?

ANSWER:

1. In most of the circumstances, the evidence available is not conclusive and the auditor always takes a calculated risk in giving his opinion. Even by undertaking 100% checking of the transactions, the auditor does not derive absolute satisfaction.
2. Auditors can derive good satisfaction by undertaking a much lesser checking by adoption of sampling technique in the auditing process.
3. It is a mathematical truth that the sample, if picked purely on a random basis would reveal the features and characteristics of the population. By adopting the sampling technique, the auditor only checks a part of the whole mass of transactions.
4. The satisfaction he used to derive earlier, by checking all the transactions, can be derived by a sample checking provided he can put reliance on the internal controls and checks within the client's organisation because they provide the reliability of the records.
5. **TEST OF CONTROLS:** Sampling is used as a part of Test of controls. Auditor will check few internal controls and their operating effectiveness. Based on the conclusion derived, he can then design the sample size for test of details (i.e., checking of transactions and balances)

a. If the internal control is satisfactory in its design and implementation, a much smaller sample can give the auditor the necessary reliability of the result he obtains.
b. On the other hand, if in certain areas controls are slack or not properly implemented, the auditor may have to take a much larger sample for getting satisfactory result.

6. **PROFESSIONAL JUDGMENT:** Another truth about the sampling technique should be noted. It can never bring complete reliability; it cannot give precisely accurate results. It is a process of estimation. It may have some error. What error is tolerable for a particular matter under examination is a matter of the individual's judgment in that particular case.

Example

Mr. X may consider that in his estimation of stores valuation, an error of 2% may not be material; he also decides that he needs at least 98% reliability of the result. He is to pick up the requisite number of items of the stores for reliability of the result. The requisite number he can get from the random number table. The question of reliability of the result is directly linked with the reliability of the internal control and of the books and records; when these are satisfactory, lesser degree of reliability of the sampling estimation may suffice – if these are not satisfactory, the auditor may have to decide upon a higher degree of reliability which can only be obtained from a larger sample.

Q.NO.7. WHAT ARE THE FACTORS THE AUDITOR SHALL CONSIDER WHEN DECIDING UPON EXTENT OF CHECKING ON A SAMPLING PLAN?

ANSWER:

The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:

1. Size of the organisation under audit.
2. State of the internal control.
3. Adequacy and reliability of books and records.
4. Tolerable error range.
5. Degree of the desired confidence.

Q.NO.8. WHAT ARE THE ADVANTAGES OF STATISTICAL SAMPLING?

ANSWER:

1. In statistical sampling, the sample results are measurable as to the adequacy and reliability of the audit objectives whereas in non-statistical sampling the auditor's opinion determines the sample size but it cannot be measured how far the sample size would fulfil the audit objective.
2. **ADVANTAGES:** The advantages of statistical sampling may be summarized as follows:
   a. The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
   b. The sample selection is more objective and thereby more defensible.
   c. The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
   d. It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e., the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.

e. It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.
f. It is widely accepted way of sampling as it is more scientific, without personal bias and the result of sample can be evaluated and projected in more reliable way.

3. **CIRCUMSTANCES WHERE STATISTICAL SAMPLING IS NOT SUITABLE:** Under some audit circumstances, statistical sampling methods may not be appropriate. The auditor should not attempt to use statistical sampling when another approach is either necessary or will provide satisfactory information in less time or with less effort.
   a. For instance, when exact accuracy is required or in case of legal requirements etc.
   b. Sometimes the audit staff has no knowledge about sampling technique used, in such circumstances using statistical sampling becomes complex and inappropriate.

Q.NO.9. WHAT ARE THE REQUIREMENTS AS TO SAMPLE DESIGN, SAMPLE SIZE AND SAMPLE SELECTION?

ANSWER:

The Requirement relating to sample design, sample size and sample selection are as below:

1. **SAMPLE DESIGN:** The auditor shall consider the purpose of audit procedure and characteristics of population from which the sample will be drawn.
2. **SAMPLE SIZE:** The auditor shall determine the sample size that is sufficient to reduce sampling risk to an acceptable low level.
3. **SAMPLE SELECTION:** The selection of sample shall be in such a way that each item of population will have a chance of selection.

Q.NO.10. WHAT ARE THE FACTORS THE AUDITOR SHALL CONSIDER WHILE CHOOSING A SAMPLE DESIGN?

ANSWER:

When designing an audit sample,

1. The auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose.
2. Consideration of the nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling.
3. The auditor's consideration of the purpose of the audit procedure includes a clear understanding of what constitutes a deviation or misstatement so that all, and only, those conditions that are relevant to the purpose of the audit procedure are included in the evaluation of deviations or projection of misstatements.

   EXAMPLE:

   In a test of details relating to the existence of accounts receivable, such as confirmation, payments made by the customer before the confirmation date but received shortly after that date by the client, are not considered a misstatement. Also, a wrong posting between customer accounts does not affect the total accounts receivable balance.

   Therefore, it may not be appropriate to consider this a misstatement in evaluating the sample results of this particular audit procedure, even though it may have an important effect on other areas of the audit, such as the assessment of the risk of fraud or the adequacy of the allowance for doubtful accounts.
4. In considering the characteristics of a population, for tests of controls, the auditor makes an assessment of the expected rate of deviation based on the auditor's understanding of

the relevant controls or on the examination of a small number of items from the population. This assessment is made in order to design an audit sample and to determine sample size.

EXAMPLE:

If the expected rate of deviation is unacceptably high, the auditor will normally decide not to perform tests of controls.

5. Similarly, for tests of details, the auditor makes an assessment of the expected misstatement in the population. If the expected misstatement is high, 100% examination or use of a large sample size may be appropriate when performing tests of details.

Q.NO.11. WRITE A SHORT NOTE ON THE STRATIFICATION AND VALUE WEIGHTED SELECTION

ANSWER:

In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection is appropriate

A. STRATIFICATION: Dividing a population into discrete sub population which have identifying characteristics is called as Stratification. Each Sub population is called as Stratum and units under those sub population are referred to as Strata.

1. Audit efficiency may be improved if the auditor stratifies a population by dividing it into sub-populations which have an identifying characteristic.
2. The objective of stratification is to select sample from all parts of population having different characteristics.
3. When performing tests of details, the population is often stratified based on monetary value.
4. The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum.
5. The results of samples from the units drawn under each sub population are projected to that respective stratum. In order to draw an opinion on the overall population, the auditor needs to combine the results of all the stratum to check for possible deviation or risk of material misstatement.
6. Projected misstatements of each stratum will be combined together to consider the possible effect of misstatement in the account balances and class of transactions.

EXAMPLE:

20% of the items in a population may make up 90% of the value of an account balance. The auditor may decide to examine a sample of these items. The auditor evaluates the results of this sample and reaches a conclusion on the 90% of value separately from the remaining 10% (on which a further sample or other means of gathering audit evidence will be used, or which may be considered immaterial).

B. VALUE-WEIGHTED SELECTION: In value weighted selection, the sample size, its selection and evaluation will result in a conclusion in monetary amounts.

1. When performing tests of details, it may be useful to identify the sampling unit as the individual monetary units.
2. The auditor will be more focused towards larger value items (higher chances of selection) and can results in smaller sample size.
3. This approach may be used in combination with the systematic method of sample and is most efficient when selecting items using random selection.

Q.NO.12. WRITE ABOUT SAMPLE SIZE AND WHAT ARE THE FACTORS THAT AFFECT SAMPLE SIZE IN GENERAL?

ANSWER:

1. The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.
2. The level of sampling risk that the auditor is willing to accept affects the sample size required.
3. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.
4. The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment.
5. There are various factors typically have on the determination of sample size. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non- statistical approach is chosen.

A. EXAMPLES OF FACTORS INFLUENCING SAMPLE SIZE FOR TESTS OF CONTROLS:

The following are factors that the auditor may consider when determining the sample size for tests of controls. These factors, which need to be considered together:

1. When there is an increase in the extent to which the auditor's risk assessment takes into account relevant controls.
2. The more assurance the auditor intends to obtain from the operating effectiveness of controls and the larger the sample size will need to be.
3. When the auditor's assessment of the risk of material misstatement at the assertion level includes an expectation of the operating effectiveness of controls, the auditor is required to perform tests of controls.
4. The greater the reliance the auditor places on the operating effectiveness of controls in the risk assessment, the greater is the extent of the auditor's tests of controls (and therefore, the sample size is increased). Thus, sample size will increase.
5. If there is an increase in the tolerable rate of deviation. Then sample size will decrease, as lower the tolerable rate of deviation, larger the sample size needs to be. Tolerable error is the maximum error in the population that auditor is ready to accept in a given sample size. Smaller the tolerable error, larger will be the sample size.
6. When there is an increase in the expected rate of deviation of the population to be tested then sample size will increase, as higher the expected rate of deviation, larger the sample size needs to be so that the auditor is in a position to make a reasonable estimate of the actual rate of deviation. Factors relevant to the auditor's consideration of the expected rate of deviation include:
    a. The auditor's understanding of the business (in particular, risk assessment procedures undertaken to obtain an understanding of internal control).
    b. Changes in personnel or in internal control.
    c. The results of audit procedures applied in prior periods and the results of other audit procedures.
7. An increase in the auditor's desired level of assurance that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population will increase the sample size. Thus, the greater the level of assurance that the auditor desires that the results of the sample are in fact indicative of the actual incidence of deviation in the population, the larger the sample size needs to be.

8. In case of large populations, the actual size of the population has little, if any, effect on sample size. For small populations however, audit sampling may not be as efficient as alternative means of obtaining sufficient appropriate audit evidence. Therefore, there will be negligible effect on sample size due to increase in the number of sampling units in the population.

B. EXAMPLES OF FACTORS INFLUENCING SAMPLE SIZE FOR TESTS OF DETAILS:

The following are factors that the auditor may consider when determining the sample size for tests of details. These factors, which need to be considered together.

1. The higher the auditor's assessment of the risk of material misstatement, the larger the sample size needs to be.
2. The more the auditor is relying on other substantive procedures (tests of details or substantive analytical procedures) to reduce to an acceptable level the detection risk regarding a particular population, the less assurance the auditor will require from sampling and, therefore, the smaller the sample size can be. Hence, if there is an increase in the use of other substantive procedures directed at the same assertion, the size of sample will decrease.
3. An increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population will increase the sample size. Hence, greater the level of assurance that the auditor requires that the results of the sample are in fact indicative of the actual amount of misstatement in the population, the larger the sample size needs to be.
4. An increase in tolerable misstatement will decrease the sample size as lower the tolerable misstatement, the larger the sample size needs to be.
5. The greater the amount of misstatement the auditor expects to find in the population, the larger the sample size needs to be in order to make a reasonable estimate of the actual amount of misstatement in the population. Factors relevant to the auditor's consideration of the expected misstatement amount include:
    a. The extent, to which item values are determined subjectively,
    b. The results of risk assessment procedures,
    c. The results of tests of control,
    d. The results of audit procedures applied in prior periods, and the results of other substantive procedures.

    So, sample size will increase in case of an increase in the amount of misstatement the auditor expects to find in the population.
6. When stratification of the population is appropriate then sample size will decrease as when there is a wide range (variability) in the monetary size of items in the population, it may be useful to stratify the population.
7. There will be negligible effect on sample size due to number of sampling units in the population. For large populations, the actual size of the population has little, if any, effect on sample size. Thus, for small populations, audit sampling is often not as efficient as alternative means of obtaining sufficient appropriate audit evidence.

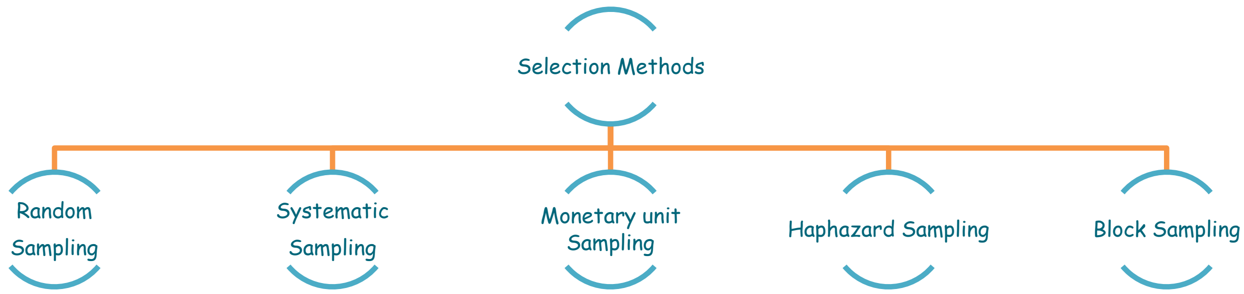
TOLERABLE MISSTATEMENT: A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

TOLERABLE RATE OF DEVIATION: A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

Q.NO.13. WRITE ABOUT SAMPLE SELECTION AND METHODS OF TESTING UNDER SAMPLING?

ANSWER:

The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection. This can be achieved with statistical sampling. Because the purpose of sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected, it is important that the auditor selects a representative sample, so that bias is avoided, by choosing sample items which have characteristics typical of the population.



A. SIMPLE RANDOM SAMPLING:

1. Under this method each unit of the whole population, *e.g.* purchase or sales invoice, has an equal chance of being selected
2. Random number tables are simple and easy to use and also provide assurance that the bias does not affect the selection.
3. This method is considered appropriate where the population has a reasonably similar units and in a reasonable range.

B. STRATIFIED SAMPLING: Stratification means dividing heterogeneous (Diversified) population into Homogeneous (having similar characteristics) sub population, where samples are drawn from each sub population.

1. This method involves dividing the whole population to be tested in a few separate groups called strata.
2. Each stratum is treated as if it was a separate population and items are selected from each of these stratums.
3. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgment.

Example: Trade receivables balances may be divided into four groups as follows:

a. Balances in excess of Rs.10,00,000;
b. Balances in the range of Rs. 5, 50,001 to Rs. 10,00,000;
c. Balances in the range of Rs. 2,25,001 to Rs. 5,50,000; and
d. Balances Rs. 2,25,000 and below.

From these above groups the auditor may pick up different percentage of items from each of the group.

e. From the top group i.e., balances in excess of Rs 10,00,000, the auditor may examine all the items.
f. From the second group - 25 per cent of the items; from the third group - 10 per cent of the items and
g. From the lowest group - 2 per cent of the items may be selected.

C. INTERVAL SAMPLING OR SYSTEMATIC SAMPLING:

1. Systematic selection is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval.
2. Although the starting point may be determined haphazardly, the sample is more likely to be truly random if it is determined by use of a computerized random number generator or random number tables.
3. When using systematic selection, the auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval corresponds with a particular pattern in the population.

EXAMPLE:

If in a population of branch sales, particular branch sales occur only as every 100th item and the sampling interval selected is 100. The result would be that either the auditor would have selected all or none of the sales of that particular branch.

If Accountant A is responsible to record all transaction in a particular month and Accountant B for next month; if this structure is same throughout the year, and the auditor determines as his sample to check every transaction of alternate months, then only one accountant's work is checked by the auditor i.e., either Accountant A or B depending upon which month the checking started from. The work of other is overlooked and there could be a possibility of material misstatement in the transactions recorded by him. Therefore, systematic sampling when chosen as a method should be carefully applied to bring together every type of transaction within its purview. More than one starting point can be considered to minimize such risk.

D. MONETARY UNIT SAMPLING: It is a type of value-weighted selection in which sample size, selection and evaluation of results are in monetary amounts.

E. HAPHAZARD SAMPLING: Haphazard sampling has no structured approach, does not involve judgement and does not even use the random number tables.

1. In this method the auditor selects the sample without following a structured technique.
2. Even though no structured technique is used, the auditor would on the other hand avoid any conscious bias or predictability.
3. This method is not superior when compared with other statistical sampling methods.
4. In this method also all the sampling units in the population have a chance of selection.

F. BLOCK SAMPLING:

1. This method involves selection of a block(s) of contiguous Adjacent items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population.
2. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.
3. Usually, a range of continuous transaction shall have similar characteristics, therefore, selection of a group at one time will not give a reasonable basis for opinion on the overall population as different types of transactions and unusual transactions may not be covered in the group taken all at once.

4. Further, if the client has the idea of the block selection pattern of the auditor, then material misstatements and deviations can be easily overlooked by management's practice of recording them.
5. There is a close similarity between this method and non-statistical sampling. Consequently, it has similar characteristics, namely, simplicity and economy. On the other hand, there is a risk of bias and of establishing a pattern of selection which may be noted by the auditees.

EXAMPLE:

Take the first 200 sales invoices from the sales day book in the month of September; alternatively take any four blocks of 50 sales invoices. Therefore, once the first item in the block is selected, the rest of the block follows items to the completion.

Q.NO.14. WRITE A SHORT NOTE ON SAMPLING RISK.

ANSWER:

A. MEANING:

1. The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure.
2. In other words, the risk of selecting an inappropriate sample is also known as sampling risk.
3. The following are the consequences or erroneous conclusions due to sampling risk:

B. TEST OF CONTROLS:

1. **RISK OF OVER RELIANCE:** Treating that the controls are more effective than they actually are. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
2. **RISK OF UNDER RELIANCE:** Treating that the controls are less effective than they actually are. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

C. TEST OF DETAILS:

1. **RISK OF INCORRECT ACCEPTANCE:** Treating that a material misstatement does not exist when in fact it exist in the population. This type of risk leads to audit risk.
2. **RISK OF INCORRECT REJECTION:** Treating that a material misstatement exists when in fact it does not exist in the population. This may not affect the audit risk.

Q.NO.15. WRITE A SHORT NOTE ON NON-SAMPLING RISK.

ANSWER:

1. Non-Sampling Risk is the risk that the auditor reaches an erroneous conclusion for any reason other than sampling risk. Non sampling risk can never be mathematically measured.
2. Following are the examples of non-sampling risk:
   a. Use of inappropriate audit procedures.
   b. Misinterpretation of audit evidence.
3. Following are the sources of non-Sampling risk:
   a. Human Mistakes.
   b. Misinterpreting the sample results.
   c. Relying on erroneous information e.g., erroneous confirmation.

Q.NO.16. WRITE ABOUT PERFORMING AUDIT PROCEDURES ON SELECTED SAMPLES?

ANSWER:

1. The auditor shall perform audit procedures, appropriate to the purpose, on each item selected.

2. If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item.
3. If replacement is not possible or reasonable, alternative audit procedure can be applied.
4. If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor shall treat that item as a deviation from:
   a. The prescribed control, in the case of tests of controls, or
   b. A misstatement, in the case of tests of details.

An example of when it is necessary to perform the procedure on a replacement item is when a voided check (Cancelled cheque) is selected while testing for evidence of payment authorization. If the auditor is satisfied that the check has been properly cancelled such that it does not constitute a deviation, an appropriately chosen replacement is examined. A replacement would then mean a proper and valid cheque through which payment has been made.

An example of when the auditor is unable to apply the designed audit procedures to a selected item is when documentation relating to that item has been lost. If the documentation of a sales is lost, like the sales order record, sales invoice, document for dispatch etc, then confirmation can be sought from the debtor as per SA 505. If it is a cash sale, the cash book can be cross verified for the existence of such transactions.

An example of a suitable alternative procedure might be the examination of subsequent cash receipts together with evidence of their source and the items they are intended to settle when no reply has been received in response to a positive confirmation request.

Another example for replacement of a sample could be, if all transactions of computerized sales are being checked, for example sales recorded through a bar code scanner, and incidentally a sample of manual billing gets selected, then such item can be replaced after adequately checking the correctness of the manual bill with the supporting documents available.

Q.NO.17. WRITE ABOUT NATURE AND CAUSE OF DEVIATIONS AND MISSTATEMENTS.

ANSWER:

1. In analysing the deviations and misstatements identified, the auditor may observe that many have a common feature, for example, type of transaction, location, product line or period of time.
2. In such circumstances, the auditor may decide to identify all items in the population that possess the common feature, and extend audit procedures to those items. In addition, such deviations or misstatements may be intentional, and may indicate the possibility of fraud.
3. Therefore, the auditor shall investigate the nature and causes of any deviations or misstatements identified, and evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit.
4. In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population.
5. The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.

   Anomaly may be defined as a misstatement or deviation that is demonstrably not representative of misstatements or deviations in a population.

Q.NO.18. WRITE ABOUT PROJECTION OF MISSTATEMENTS?

ANSWER:

1. The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded.
2. **TREATMENT OF ANOMALY:** When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.
3. **TOD – EXTRAPOLATION:** For tests of details, the auditor shall project misstatements found in the sample to the population.
4. **FOR TOC – NO PROJECTION:** For tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.

Q.NO.19. WRITE ABOUT EVALUATION OF SAMPLE RESULTS?

ANSWER:

The auditor shall evaluate the results of the sample and assess whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

1. In case of Test of Controls an unexpectedly high sample deviation rate may lead to an increase in the assessed risk of material misstatement.
2. An unexpectedly high misstatement amount in a sample may cause the auditor to believe that a class of transactions or account balance is materially misstated.
3. The best way to evaluate the result of sample by auditor is to consider projected misstatement and anomalous misstatement.
4. When the projected misstatement plus anomalous misstatement exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested.
5. The closer the projected misstatement plus anomalous misstatement is to tolerable misstatement, the more likely that actual misstatement in the population may exceed tolerable misstatement.
6. Also, if the projected misstatement is greater than the auditor's expectations of misstatement used to determine the sample size, the auditor may conclude that there is an unacceptable sampling risk that the actual misstatement in the population exceeds the tolerable misstatement.

CONCLUSION:

If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested:

1. The auditor may request Management to investigate misstatements that have been identified or
2. Conduct additional audit procedures.
3. For example, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

Note:

1. Projected misstatements are calculated based on those that are repetitive in nature.
2. Anomalous misstatements are those that are not repetitive in nature but are considered while calculating materiality of aggregate misstatements on whole population.

Q.NO.20. WHAT ARE THE PRECAUTIONS TO BE TAKEN WHILE APPLYING TEST CHECKING?

ANSWER:

Precautions to be taken while applying test check techniques are

1. Thorough study of accounting system should be done before adopting sampling.
2. Proper study of internal control systems.
3. Areas which are not suitable for sampling should be carefully considered. E.g., compliance with statutory provisions, transactions of unusual nature etc.
4. Proper planning for Sampling methods to be used and explaining the staff,
5. Transactions and balances have to be properly classified (stratified)
6. Sample size should be appropriately determined.
7. Sample should be chosen in unbiased way,
8. Errors located in the sample should be analysed properly.

SA 501 AUDIT EVIDENCE - SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS

Q.NO.1. WRITE ABOUT SCOPE AND OBJECTIVE OF SA 501?

ANSWER:

The auditor has to express his opinion on financial statements of an entity. For this, he has to examine the books of accounts. He needs evidence in support of transactions recorded in books of accounts. There are some transactions for which he needs specific considerations. For example, inventory.

SA 501- "Audit Evidence- Specific Considerations for Selected Items" deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence with respect to certain aspects of inventory, litigation and claims involving the entity, and segment information in an audit of financial statements.

OBJECTIVE OF THE AUDITOR: The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:

1. Existence and condition of Inventory.
2. Completeness of litigation and claims involving the entity. and
3. Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

Q.NO.2. WRITE ABOUT CONSIDERATIONS RELATED TO ATTENDANCE AT PHYSICAL INVENTORY COUNTING AS PER SA 501?

ANSWER:

When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

1. **PHYSICAL INVENTORY COUNTING:** Attendance at physical inventory counting, unless impracticable, to:
   - **i.** Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting.
   - **ii.** Observe the performance of management's count procedures.
   - **iii.** Inspect the inventory and
   - **iv.** Perform test counts.
2. **RECONCILE WITH RECORDS:** Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.
3. Attendance at Physical Inventory Counting Involves:
   - **a.** Inspecting the inventory to ascertain its existence and evaluate its condition, and performing test counts.
   - **b.** Observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and
   - **c.** Obtaining audit evidence as to the reliability of management's count procedures.

   These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out.
4. Matters relevant in planning attendance at physical inventory counting include, for example:
   - a. Nature of inventory.
   - b. Stages of completion of work in progress.
   - c. The risks of material misstatement related to inventory.
   - d. The nature of the internal control related to inventory.

e. Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
f. The timing of physical inventory counting.
g. Whether the entity maintains a perpetual inventory system.
h. The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate
i. Whether the assistance of an auditor's expert is needed to obtain sufficient appropriate audit evidence.

Q.NO.3. WRITE ABOUT AUDIT PROCEDURES WHERE PHYSICAL INVENTORY COUNTING CONDUCTED OTHER THAN AT THE DATE OF THE FINANCIAL STATEMENTS?

ANSWER:

1. If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor shall, in addition to the procedures required above, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded.
2. Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:
   a. Whether the perpetual inventory records are properly adjusted.
   b. Reliability of the entity's perpetual inventory records.
   c. Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.

Q.NO.4. WHAT IF THE AUDITOR UNABLE TO ATTEND PHYSICAL INVENTORY COUNTING DUE TO UNFORESEEN CIRCUMSTANCES. COMMENT IN LIGHT OF SA 501?

ANSWER:

1. **ALTERNATIVE DATE:** If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions.
2. **PHYSICAL COUNTING IMPRACTICABLE:** Attendance at Physical Inventory Counting becomes impractical:
   a. If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.
   b. If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.
   c. In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory. For example, where inventory is held in a location that may pose threats to the safety of the auditor.
   d. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable.
   e. Further, as explained in SA 200, the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

f. In some cases where attendance is impracticable, alternative audit procedures, for example inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

g. In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

Q.NO.5. WRITE ABOUT AUDIT PROCEDURES WHEN INVENTORY UNDER THE CUSTODY AND CONTROL OF A THIRD PARTY?

ANSWER:

When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

a. Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.

b. Perform inspection or other audit procedures appropriate in the circumstances. Other audit procedure may include, For Example:

   a. Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts.
   b. Requesting confirmation from other parties when inventory has been pledged as collateral.
   c. Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
   d. Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.

Q.NO.6. WRITE ABOUT AUDIT PROCEDURES REGARDING LITIGATION AND CLAIMS INVOLVING THE ENTITY?

ANSWER:

1. Litigation and claims involving the entity may have a material effect on the financial statements and thus may be required to be disclosed or accounted for in the financial statements.
2. **GENERAL AUDIT PROCEDURE:** The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:
   a. Inquiry of management and, where applicable, others within the entity, including in-house legal counsel.
   b. Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel and
   c. Reviewing legal expense accounts.
   d. In addition to the procedures identified above other relevant procedures include, for example, using information obtained through risk assessment procedures carried out as part of obtaining an understanding of the entity and its environment to assist the auditor to become aware of litigation and claims involving the entity.

e. Audit evidence obtained for purposes of identifying litigation and claims that may give rise to a risk of material misstatement also may provide audit evidence regarding other relevant considerations, such as valuation or measurement, regarding litigation and claims. SA 540 establishes requirements and provides guidance relevant to the auditor's consideration of litigation and claims requiring accounting estimates or related disclosures in the financial statements.

3. **DIRECT COMMUNICATION WITH EXTERNAL LEGAL COUNSEL:**
   a. If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel.
   b. The auditor shall do so through a letter of inquiry requesting the entity's external legal counsel to communicate directly with the auditor.
   c. If law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures.
   d. If it is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general inquiry, for example if the professional body to which the external legal counsel belongs prohibits response to such a letter, the auditor may seek direct communication through a letter of specific inquiry. For this purpose, a letter of specific inquiry includes:
      i. A list of litigation and claims.
      ii. Where available, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including costs involved and
      iii. A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered by the entity's external legal counsel to be incomplete or incorrect.

4. **MEETING EXTERNAL LEGAL COUNSEL:** In certain circumstances, the auditor also may judge it necessary to meet with the entity's external legal counsel to discuss the likely outcome of the litigation or claims. This may be the case, for example, where:
   a. The auditor determines that the matter is a significant risk.
   b. The matter is complex.
   c. There is disagreement between management and the entity's external legal counsel.

   Note: Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

5. **MANAGEMENT REFUSES DIRECT COMMUINICATION:** Further if management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding and the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

Q.NO.7. WRITE ABOUT OBTAINING SUFFICIENT AND APPROPRIATE EVIDENCE REGARDING SEGMENT INFORMATION BY AN AUDITOR?

ANSWER:

1. **DEFINITION OF SEGMENT INFORMATION:** Segment Information refers to information about different types of products and services of an enterprise and its operations in different geographical areas.
2. The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:
   a. Obtaining an understanding of the methods used by management in determining segment information:
      i. Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and
      ii. Where appropriate, testing the application of such methods; and
      iii. Performing analytical procedures or other audit procedures appropriate in the circumstances.

   b. The auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements taken as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a standalone basis.
3. **UNDERSTANDING OF THE METHODS USED BY MANAGEMENT:** Depending on the circumstances, example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:
   a. Sales, transfers and charges between segments, and elimination of intersegment amounts.
   b. Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
   c. The allocation of assets and costs among segments.
   d. Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

SA 505 EXTERNAL CONFIRMATIONS

Q.NO.1. WRITE ABOUT SCOPE AND OBJECTIVES OF EXTERNAL CONFIRMATIONS?

ANSWER:

1. **SCOPE OF SA 505:**
   a. The Standard on Auditing (SA) 505 "External Confirmations" deals with the auditor's use of external confirmation procedures to obtain audit evidence in accordance with the requirements of SA 500.
   b. Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity.
2. **OBJECTIVE:**
   a. SA505 is intended to assist the auditor in designing and performing external confirmations procedures to obtain relevant and reliable audit evidence.
   b. Thus, the objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

Q.NO.2. WHAT ARE IMPORTANT DEFINITIONS COVERED UNDER SA 505 External Confirmation?

ANSWER:

1. **EXTENAL CONFIRMATION:** External confirmation may be defined as audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
2. **POSITIVE CONFIRMATION REQUEST:** A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.
3. **NEGATIVE CONFIRMATION REQUEST:** A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.
4. **NON-RESPONSE:** A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.
5. **EXCEPTION:** A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party. The exception needs to be assessed to the entire population after analyzing the reason for difference.

Q.NO.3. WRITE ABOUT EXTERNAL CONFIRMATION PROCEDURES ADOPTED BY THE AUDITOR TO OBTAIN AUDIT EVIDENCE?

ANSWER:

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

a. **DETERMINING THE INFORMATION TO BE CONFIRMED OR REQUESTED:** External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements. They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a "side agreement".
b. **SELECTING THE APPROPRIATE CONFIRMING PARTY:** Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed.

For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.

c. **DESIGNING THE CONFIRMATION REQUESTS:**

a. Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor.

b. The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses.

c. Facors to consider when designing confirmation requests include:

i. The assertions being addressed.
ii. Specific identified risks of material misstatement, including fraud risks.
iii. The layout and presentation of the confirmation request.
iv. Prior experience on the audit or similar engagements.
v. The method of communication (for example, in paper form, or by electronic or other medium)
vi. Management's authorisation or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation.
vii. The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

d. **SENDING THE REQUESTS:**

a. Sending the requests, including follow-up requests when applicable, to the confirming party.

b. Determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation requests before they are sent out.

c. **Follow-Up on Confirmation Requests:** The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time.
For example, the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request.

d. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required of the confirming parties.

Determining the information to be confirmed. → Selecting the appropriate confirming party. → Designing the confirmation requests and → Sending the requests, including follow-up requests.

Q.NO.4. WRITE ABOUT MANAGEMENT'S REFUSAL TO ALLOW THE AUDITOR TO SEND A CONFIRMATION REQUEST. WHAT STEPS AS AN AUDITOR DO YOU TAKE?

ANSWER:

If management refuses to allow the auditor to send a confirmation request, the auditor shall:

1. Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness:
   a. A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation.
   b. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request.
   c. The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.
2. Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures:
   a. The auditor may conclude that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures.
   b. **For example**, if management's request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation in accordance with SA 240.
3. Perform alternative audit procedures designed to obtain relevant and reliable audit evidence. Examples of alternative audit procedures the auditor may perform include:
   a. For accounts receivable balances – examining specific subsequent cash receipts, shipping documentation, and sales near the period-end.
   b. For accounts payable balances – examining subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.
4. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260.
5. The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705.

Q.NO.5. WRITE ABOUT NEGATIVE CONFIRMATIONS REQUEST AS AN AUDIT PROCEDURE?

ANSWER:

1. Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:
   a. The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion.

   b. The population of items subject to negative confirmation procedures comprises a

large number of small, homogeneous, account balances, transactions or conditions.
   c. A very low exception rate is expected and
   d. The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.
2. The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request.
3. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.
4. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise.

For example, Holders of bank deposit accounts may be more likely to respond if they believe that the balance in their account is understated in the confirmation request, but may be less likely to respond when they believe the balance is overstated. Therefore, sending negative confirmation requests to holders of bank deposit accounts may be a useful procedure in considering whether such balances may be understated, but is unlikely to be effective if the auditor is seeking evidence regarding overstatement.

Q.NO.6. WRITE ABOUT EVALUATING THE EVIDENCE OBTAINED THROUGH EXTERNAL CONFIRMATIONS?

ANSWER:

1. The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether performing further audit procedures is necessary.
2. When evaluating the results of individual external confirmation requests, the auditor may categorise such results as follows:
   a. A response by the appropriate confirming party indicating agreement with the information provided in the confirmation request, or providing requested information without exception.
   b. A response deemed unreliable.
   c. A non-response or
   d. A response indicating an exception.
3. The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether performing further audit procedures is necessary, as required by SA 330.

SA 510 INITIAL AUDIT ENGAGEMENTS – OPENING BALANCES

Q.NO.1. WRITE ABOUT SCOPE AND OBJECTIVE OF SA 510?

ANSWER:

1. **SCOPE:**
   a. The Standard on Auditing (SA) 510 "Initial Audit Engagements-Opening Balances" deals with the auditor's responsibilities relating to opening balances when conducting an initial audit engagement.
   b. In addition to financial statement amounts, opening balances include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.
   c. When the financial statements include comparative financial information, the requirements and guidance in SA 710 also apply.
2. **OBJECTIVE OF AUDITOR WITH RESPECT TO OPENING BALANCES:** In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:
   a. Opening balances contain misstatements that materially affect the current period's financial statements and
   b. Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.
3. **DEFINITIONS:**
   a. **INITIAL AUDIT ENGAGEMENT:** an engagement in which either:
      i. The financial statements for the prior period were not audited or
      ii. The financial statements for the prior period were audited by a predecessor auditor.
   b. **OPENING BALANCES:** Opening Balances means:
      i. Those account balances that exist at the beginning of the period.
      ii. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period.
      iii. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.
   c. **PREDECESSOR AUDITOR:** The auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor.

Q.NO.2. WRITE ABOUT AUDIT PROCEDURES FOR OBTAINING SUFFICIENT APPROPRIATE AUDIT EVIDENCE ABOUT OPENING BALANCES BY THE AUDITOR?

ANSWER:

1. **AUDIT PROCEDURE:** The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:
   a. Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss.
   b. Determining whether the opening balances reflect the application of appropriate accounting policies and

c. Performing one or more of the following:
   i. Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements.
   ii. Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances or
   iii. Performing specific audit procedures to obtain evidence regarding the opening balances.

2. **MMS IDENTIFIED:**
   a. If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements.
   b. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance.

Q.NO.3. THE NATURE AND EXTEND OF PROCEDURES ADOPTED BY THE AUDITOR TO OBTAIN AUDIT EVIDENCE REGARDING OPENING BALANCES ARE AFFECTED BY VARIOUS FACTORS. COMMENT?

ANSWER:

1. **FACTORS:** The nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances depend on such matters as:
   a. The accounting policies followed by the entity.
   b. The nature of the account balances, classes of transactions and disclosures and the risks of material misstatement in the current period's financial statements.
   c. The significance of the opening balances relative to the current period's financial statements.
   d. Whether the prior period's financial statements were audited and, if so, whether the predecessor auditor's opinion was modified.
2. If the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements.
3. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.
4. **FOR CURRENT ASSETS AND LIABILITIES:** For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures.

   For example:
   a. The collection (payment) of opening accounts receivable (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.
   b. In the case of inventories, however, the current period's audit procedures on the

closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:

1) Observing a current physical inventory count and reconciling it to the opening inventory quantities.
2) Performing audit procedures on the valuation of the opening inventory items.
3) Performing audit procedures on gross profit and cut-off.

5. **FOR NON- CURRENT ASSETS AND LIABILITIES:** For non-current assets and liabilities,
   a. Such as property plant and equipment, investments and long-term debt, some audit evidence may be obtained by examining the accounting records and other information underlying the opening balances.
   b. In certain cases, the auditor may be able to obtain some audit evidence regarding opening balances through confirmation with third parties.

   For example, for long-term debt and investments audit evidence may be obtained through confirmation with third parties. In other cases, the auditor may need to carry out additional audit procedures.

Q.NO.4. WRITE ABOUT AUDITORS CONCLUSIONS AND REPORTING RELATED TO CONSISTENCY OF ACCOUNTING POLICIES RELATING TO OPENING BALANCES?

ANSWER:

1. The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, and whether changes in the accounting policies have been properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.
2. If the auditor concludes that:
   a. The current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework; or
   b. A change in accounting policies is not properly accounted for or not adequately presented or disclosed in accordance with the applicable financial reporting framework, the auditor shall express a qualified opinion or an adverse opinion as appropriate in accordance with SA 705.
3. **REPORTING BY THE AUDITOR WITH REGARD TO OPENING BALANCES:**
   a. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.
   b. If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705.

SA 550 RELATED PARTIES

Q.NO.1. WRITE ABOUT SCOPE OF THIS SA 550 AND DEFINITION OF RELATED PARTY?

ANSWER:

SCOPE: The Standard on Auditing (SA)550 "Related Parties" deals with the auditor's responsibilities regarding related party relationships and transactions when performing an audit of financial statements. Specifically, it applies in relation to risks of material misstatement associated with related party relationships and transactions.

DEFINITION OF RELATED PARTY: A party that is either

i. **AFRFW:** A related party as defined in the applicable financial reporting framework, or
ii. **AFRFW IS SILENT:** Where the applicable financial reporting framework establishes minimal or no related party requirements:
   a. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity.
   b. Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
   c. Another entity that is under common control with the reporting entity through having:
      i. Common controlling ownership.
      ii. Owners who are close family members or
      iii. Common key management.

   However, entities that are under common control by a state (i.e., a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

MEANING OF CONTROL AND SIGNIFICANT INFLUENCE IN REFERENCE TO RELATED PARTY:

Many financial reporting frameworks discuss the concepts of control and significant influence. They generally explain that:

a. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities; and
b. Significant influence (which may be gained by share ownership, statute or agreement) is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies.
c. The existence of the following relationships may indicate the presence of control or significant influence:
   i. Direct or indirect equity holdings or other financial interests in the entity.
   ii. The entity's holdings of direct or indirect equity or other financial interests in other entities.
   iii. Being part of those charged with governance or key management (i.e., those members of management who have the authority and responsibility for planning, directing and controlling the activities of the entity).
   iv. Being a close family member of any person referred to in subparagraph (iii).
   v. Having a significant business relationship with any person referred to in subparagraph (iii).

MEANING OF RELATED PARTIES WITH DOMINANT INFLUENCE:

Related parties, by virtue of their ability to exert control or significant influence, may be in a position to exert dominant influence over the entity or its management. Consideration of such behaviour is relevant when identifying and assessing the risks of material misstatement due to fraud.

MEANING OF SPECIAL-PURPOSE ENTITIES AS RELATED PARTIES:

In some circumstances, a special-purpose entity may be a related party of the entity because the entity may in substance control it, even if the entity owns little or none of the special-purpose entity's equity.

Q.NO.2. WRITE ABOUT NATURE OF RELATED PARTY RELATIONSHIPS AND TRANSACTIONS?

ANSWER:

1. Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties.
2. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.
   For example:
   a. Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
   b. Information systems may be ineffective at identifying or summarising transactions and outstanding balances between an entity and its related parties.
   c. Related party transactions may not be conducted under normal market terms and conditions. For example, some related party transactions may be conducted with no exchange of consideration.

Q.NO.3. WRITE ABOUT UNDERSTANDING THE ENTITY'S RELATED PARTY RELATIONSHIPS & TRANSACTIONS BY AN AUDITOR?

ANSWER:

1. The auditor shall inquire of management regarding:
   a. The identity of the entity's related parties, including changes from the prior period.
   b. The nature of the relationships between the entity and these related parties and
   c. Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.
2. The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to:
   a. Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework.
   b. Authorise and approve significant transactions and arrangements with related parties. and
   c. Authorise and approve significant transactions and arrangements outside the normal course of business.

Q.NO.4. WRITE ABOUT CONSIDERATIONS SPECIFIC TO SMALLER ENTITIES BY THE AUDITOR FOR EVALUATING RELATED PARTY TRASNSACTIONS?

ANSWER:

1. Control environment in smaller entities is likely to be different from larger entities. In particular those charged with governance may not include an outside member, and the role of governance may be undertaken directly by the owner-manager where no other owner exists.
2. Control activities in smaller entities are likely to be less formal and smaller entities may have no documented processes for dealing with related party relationships and transactions.

3. An owner-manager may mitigate some of the risks arising from related party transactions, or potentially increase those risks, through active involvement in all the main aspects of the transactions.
4. For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, through inquiry of management combined with other procedures, such as observation of management's oversight and review activities, and inspection of available relevant documentation.

Q.NO.5. HOW CAN AN AUDITOR VERIFY THE EXISTENCE OF RELATED PARTY RELATIONSHIPS AND TRANSACTIONS?

ANSWER:

During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the following records or documents that may provide information about related party relationships and transactions, for example:

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and those charged with governance.
5. Records of the entity's investments and those of its pension plans.
6. Contracts and agreements with key management or those charged with governance.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Specific invoices and correspondence from the entity's professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.
11. Internal auditors' reports.
12. Documents associated with the entity's filings with a securities regulator e.g, prospectuses)

SA 520 ANALYTICAL PROCEDURES

Q.NO.1. WRITE ABOUT MEANING AND OBJECTIVE OF ANALYTICAL PROCEDURES?

ANSWER:

Since routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like comparisons, trend and ratio analysis in addition to reasonable tests. These collectively are known as overall tests. With the passage of tests, analytical procedures have acquired lot of significance as substantive audit procedure. SA-520 on Analytical Procedures discusses the application of analytical procedures during an audit.

A. MEANING OF ANALYTICAL PROCEDURES:

1. As per the Standard on Auditing (SA) 520 "Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.
2. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with *other relevant information* or *that differ from expected values* by a significant amount.

B. OBJECTIVES: The objectives of the auditor are:

1. To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
2. To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

EXAMPLE 1:

CA Amar wants to verify the payments made by XYZ Ltd. on account of building rent during the FY 2020-21. The rent amounts to Rs.50,000/- per month for the year. The monthly rent payments are consistent with the rent agreement. However, the other companies in the similar industry are paying rent of Rs. 10,000/- per month for a similar location. How will applying the analytical procedures impact the verification process of such rental payments by XYZ Ltd.?

If CA Amar checks in detail the monthly rent payments, he may find that such payments are consistent with the rent agreement i.e., XYZ Ltd. paid Rs. 50,000/- per month as rent and the same is getting reflected in the rent agreement. Here, CA Amar may not be able to find out the inconsistency in the rent payment with respect to rent payment prevalent in the similar industry for rent of the similar location. If CA Amar applies analytical procedure i.e., compares the rent payment by XYZ Ltd. with the similar payments made by companies in similar industry and similar area, he will notice an inconsistency in such rent payments as the other companies are paying a very less monthly rent in similar industry for similar area.

However, if CA Amar does not make such comparison and only checks the monthly payments and rent agreement of XYZ Ltd., he would not have found such inconsistency and as such the misstatement may remain undetected.

EXAMPLE 2:

Analytical procedure involves analysis of relationship among financial and non financial data. Explain with the help of an example as to how, the statutory auditor of ABC Ltd. will analyse such relationship with respect to the total wages paid by ABC Ltd. during the FY 2020-21.

As per SA 520, Analytical Procedures means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.

The following example explains the analysis of relationship between financial and non-financial data while applying analytical procedures.

The statutory auditor of ABC Ltd. has to verify the total wages paid by the company having factories in various states. He can verify the same by analysing the relationship between wages per worker and total number of workers across all the factories.

i.e., Total wages = Wages per worker x Total number of workers.

Here wages per worker is financial data i.e., in Rs. and total number of workers is a number which is a non-financial data. Thus, the statutory auditor of ABC Ltd. is evaluating financial information i.e., total wages paid (in Rs.) by analysing the relationship between wages per worker (in Rs.) which is financial data and number of workers which is a non-financial data.

Q.NO.2. ANALYTICAL PROCEDURES INCLUDE THE CONSIDERATION OF COMPARISONS OF THE ENTITY'S FINANCIAL INFORMATION WITH AS WELL AS CONSIDERATION OF RELATIONSHIPS. GIVE SOME EXAMPLES.

ANSWER:

Examples of Analytical Procedures having consideration of comparisons of the entity's financial information are:

1. Comparable information for prior periods.

   Example:

   CA Brijesh, while verifying the travelling expenses of PRT Ltd., may compare the travelling expenses of current year amounting to Rs. 2.50 lakhs with previous year travelling expense of PRT Ltd. amounting to Rs. 2 lakhs and infer that there has been an increase of 25% in the travelling expense incurred by the company. CA Brijesh may compare such percentage increase with the trend of the earlier several years.

   Thus, CA Brijesh, can use comparable information for prior periods of PRT Ltd. while applying analytical procedure with respect to the expenses incurred by the company.
2. Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
3. Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry
4. **Examples of Analytical Procedures having consideration of relationships are:**
   1. Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
   2. Between financial information and relevant non-financial information, such as payroll costs to number of employees.
   3. Various methods may be used to perform analytical procedures.
   4. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques.
   5. Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

Thus, we can say that Analytical Procedures may be segregated into the following major types:

1. As comparison of client and industry data,
2. Comparison of client data with similar prior period data,
3. Comparison of client data with client-determined expected results,
4. Comparison of client data with auditor-determined expected results and
5. Comparison of client data with expected results, using non-financial data.

Q.NO.3. WRITE ABOUT PURPOSE OF ANALYTICAL PROCEDURES?

ANSWER:

1. Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. These are helpful in the detection of unusual state of affairs and mistakes in accounts.
2. Thus, it is important to note that Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.
3. For instance:
    a. Establishing the relationship that exists between certain balances included in the Balance Sheet and the Statement of Profit and Loss and comparing them with those that existed between the same set of balances in the previous year,
    b. Reconciling the physical balances of assets with the relevant financial record.
    c. Obtaining of account from the bankers, account receivables and account payables and reconciling with relevant balances in books of account.
    d. Confirming amounts of outstanding income and expenses by preparing reconciliation statements, etc.

EXAMPLES:

1. In XYZ Ltd., after applying analytical procedures as comparison of the gross profit ratio with that of the previous year, it is discovered that there has been fall in the ratio. Therefore, it became necessary for the auditor to make further enquiries as it may be due to pilferage of inventories/ misappropriation of a part of the sale proceeds/ a change in the cost of sales without a corresponding increase in the sales price.
2. On verifying the balances of sundry account receivables by obtaining the confirmation of their statements of account, it will be possible for the auditor to find out whether the discrepancy in the balance of an account receivable is due to the failure to debit his account with the cost of goods supplied to him or is the result of non-adjustment of a remittance received from him.
3. Also, whether in the case of account payable, the discrepancy is due to failure to afford him credit for one or more consignments of goods supplied by him or failure to debit him with an amount of remittance.
4. In case of inventories of raw materials and stores at the end of the year any excesses or shortages therein shall be detected. The investigation of their causes might disclose that the shortages were the result of a misappropriation of inventory or that the excess were due to requisitions having been entered before the inventories were issued.
5. By reconciling the amounts of interest and dividends collected with the amounts which had accrued due and that which are outstanding for payment, the mistake, if any, in the adjustment of such an income would be detected.
6. The overall tests can be extended for making inter-firm and intra-firm comparison of trading results.
7. If balances included in the Statement of Profit and Loss of an entity are compared with those contained in the Statement of Profit and Loss for the same period of another entity engaged in the same trade and working under similar circumstances, it would be possible to find out the cause of the variation in the rate of profitability that exists.

8. Similarly, it would also be possible to compare the balances on the Statement of Profit and Loss with that of the previous period, it would be possible to find out the reasons for increase or decrease in the amount of profits of those years.
9. By setting up certain expense's ratios on the basis of balances included in the Statement of Profit and Loss, for the year under audit, comparing them with the same ratios for the previous year, it is possible to ascertain the extent of increase or decrease in various items of expenditure in relation to sales and that of trading profit in relation to sales. If differences are found to be material, the auditor would ascertain the reasons thereof and assess whether the accounts have been manipulated to inflate or suppress profits.
10. An abnormal fall in the cost of manufacture or that in the administrative cost, apart from economy in expenses, there could be no provision or less provision for expenses incurred in the year. When it is suspected, the auditor should compare the entries in the outstanding book with those in the previous year. He must also check the vouchers for one month immediately before the close of the following years. To verify that none of the expenses in the accounts under audit have been charged to the accounts of the following years.
11. Often it is possible to independently verify the correctness of some of the items of expenses included in the Statement of Profit and Loss. For instance, the cost of importing goods which are subjected to an ad-valorem duty at uniform rate can be verified from the amount of duty paid. Similarly, a quantity of sugar sold by sugar mill can be verified independently from the amount of GST paid.

Q.NO.4. WRITE ABOUT TIMING OF ANALYTICAL PROCEDURES. ESPECIALLY DURING THE PLANNING PHASE?

ANSWER:

Analytical Procedures are used in three stages:

1. Planning Phase
2. Testing Phase
3. Completion Phase

DURING PLANNING PHASE:

1. In the planning stage, analytical procedures help the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he is previously unaware.
2. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures.
3. Analytical procedures in planning the audit use both financial data and non-financial information.

Q.NO.5. WRITE A SHORT NOTE ON SUBSTANTIVE ANALYTICAL PROCEDURES AND FACTORS TO BE CONSIDERED TO CARRYOUT THEM?

ANSWER:

1. Substantive procedure includes Test of Details and Analytical Procedures. Therefore, analytical procedures are one of the substantive audit procedures.
2. When to use substantive analytical procedures: It is based on the auditor's judgment so as to reduce audit risk to an acceptably low level.
3. The auditor may inquire of management as to the availability and reliability of information needed to apply substantive analytical procedures, and also inquire the results of any such analytical procedures performed by the entity.

4. The auditor may inquire of management as to the availability and reliability of information needed to apply substantive analytical procedures, and the results of any such analytical procedures performed by the entity.
5. It may be effective to use analytical data prepared by management, provided the auditor is satisfied that such data is properly prepared.
6. The auditor should consider the following factors for Substantive Audit Procedures:
   a. **AVAILABILITY OF DATA:** The availability of reliable and relevant data will facilitate effective analytical procedures.
   b. **DISAGGREGATION:** The degree of disaggregation in available data can directly affect the degree of its usefulness in detecting misstatements.
   c. **ACCOUNT TYPE:** Substantive analytical procedures are more useful for certain types of accounts than for others. Income statement accounts tend to be more predictable because they reflect accumulated transactions over a period, whereas balance sheet accounts represent the net effect of transactions at a point in time or are subject to greater management judgment.
   Example: We can analyse data to understand the relationship to another account and through this, disaggregate the transactions flowing to and from the balance sheet account (e.g., sales and cash receipts flowing through trade receivables), or to compare ratios over time as this enhances our ability to obtain audit evidence for balance sheet accounts.
   d. **SOURCE:** Some classes of transactions tend to be more predictable because they consist of numerous, similar transactions, (e.g., through routine processes). Whereas the transactions recorded by non-routine and estimation SCOTs (Significant Classes of Transactions) are often subject to management judgment and therefore more difficult to predict.
   Example:
   Transactions of routine nature like transactions related to sales and purchases are predictable and repetitive in nature. Therefore, on such data analytical procedures can be efficiently applied. However, Significant Classes Transactions are those classes of transactions in a company's operations that are key to the financial statements and are not frequent in nature.
   Example: Expenditure on Research & Advertisement is not of routine nature and are subject to management judgement and therefore more difficult to predict.
   e. **PREDICTABILITY:** Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable (e.g., between sales and cost of sales or between trade receivables and cash receipts). A predictable relationship is one that may reasonably be expected to exist and continue over time.
   f. **NATURE OF ASSERTION:** Substantive analytical procedures may be more effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations). Predictive analytical procedures using data analytics can be used to address completeness, valuation/measurement and occurrence.
   g. **INHERENT RISK OR "WHAT CAN GO WRONG":** When we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. When inherent risk is higher, we may design tests of details to address the higher inherent risk. *When*

significant risks have been identified, *audit evidence obtained* solely from substantive analytical procedures is unlikely to be sufficient.

Example:

When side agreements with respect to revenue recognition have been identified as a significant or fraud risk, it is unlikely that an analysis of sales compared to cash receipts or cost of sales would be appropriate to respond to that risk.

Q.NO.6. WHAT ARE THE TECHNIQUES AVAILABLE AS SUBSTANTIVE ANALYTICAL PROCEDURES?

ANSWER:

The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Substantive analytical procedures generally take one of the following forms:

1. **TREND ANALYSIS:**
    a. Trend analysis is a commonly used technique. It is the comparison of current data with the prior period balance or with a trend in two or more prior period balances.
    b. The auditor evaluates whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.
    c. In other words, trend analysis implies analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years.
    d. **Example:**
    The auditor may compare the salary paid by the company during the year under audit with the salary paid by the company for several earlier years. There may be some percentage increase in the salary expense over the years. However, an unusual increase in such expense amount may indicate that fraudulent payments are being made to fake employees.
2. **RATIO ANALYSIS:**
    a. Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry.
    b. Example of Financial ratios may include:
        i. Trade receivables or inventory turnover
        ii. Freight expense as a percentage of sales revenue
    c. **Example:**
    The statutory auditor can review the Gross profit ratio of the company for the year under audit. The auditor can further compare such GP ratio with the GP ratio of the company in the earlier years or the GP ratio of the other companies in the same industry for the year under audit.
3. **REASONABLENESS TESTS:** Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts. In other words, these tests are made

by reviewing the relationship of certain account balances to other balances for reasonableness of amounts.

Example:

a. Interest expense against interest bearing obligations
b. Raw Material Consumption to Production (quantity)
c. Wastage & Scrap % against production & raw material consumption (quantity)
d. Work-in-Progress based on issued of materials & Sales (quantity)
e. Sales discounts and commissions against sales volume
f. Rental revenues based on occupancy of premises

4. **STRUCTURAL MODELLING:** A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression).

Q.NO.7. CAN ANALYTICAL PROCEDURES BE USED AS SOLE SUBSTANTIVE AUDIT PROCEDURES?

ANSWER:

When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall:

1. Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions.
2. Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation.
3. Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated and
4. Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

Q.NO.8. EXPLAIN SUITABILITY OF PARTICULR ANALYTICAL PROCEDURE FOR A GIVEN ASSERTION?

ANSWER:

1. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.
2. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.
3. In some cases, even an unsophisticated predictive model may be effective as an analytical procedure.

   Example: If an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognized trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

4. Different types of analytical procedures provide different levels of assurance.
   EXAMPLES:
   Analytical procedures involving, for example, the prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified.
   In contrast, calculation and comparison of gross margin percentages as a means of confirming a revenue figure may provide less persuasive evidence, but may provide useful corroboration if used in combination with other audit procedures.
5. The determination of the suitability of particular substantive analytical procedure is influenced by the nature of the assertion and the auditor's assessment of the risk of material misstatement.
   For example, if controls over sales order processing are weak, the auditor may place more reliance on tests of details rather than on substantive analytical procedures for assertions related to receivables.
6. Particular substantive analytical procedures may also be considered suitable when tests of details are performed on the same assertion.
   For example, when obtaining audit evidence regarding the valuation assertion for accounts receivable balances, the auditor may apply analytical procedures to an aging of customers' accounts in addition to performing tests of details on subsequent cash receipts to determine the collectability of the receivables.

Q.NO.9. WRITE ABOUT THE FACTORS THAT ARE RELEVANT WHEN DETERMINING WHETHER DATA IS RELIABLE FOR PURPOSES OF DESIGNING SUBSTANTIVE ANALYTICAL PROCEDURES?

ANSWER:

The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:

1. **Source** of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity.
2. **Comparability** of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products.
3. **Nature and relevance** of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved and
4. **Controls over the preparation of the information** that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.
   a. The auditor may consider testing the operating effectiveness of controls, if any, over the entity's preparation of information used by the auditor in performing substantive analytical procedures in response to assessed risks. When such controls are effective, the auditor generally has greater confidence in the reliability of the information and, therefore, in the results of analytical procedures.
   b. The operating effectiveness of controls over non-financial information may often be tested in conjunction with other tests of controls.

For example, in establishing controls over the processing of sales invoices, an entity may include controls over the recording of unit sales. In these circumstances, the auditor may test the operating effectiveness of controls over the recording of unit sales in conjunction with tests of the operating effectiveness of controls over the processing of sales invoices.

Q.NO.10. WRITE A SHORT NOTE ON MATTERS RELEVANT TO THE AUDITOR'S EVALUATION OF RISK OF MATERIAL MISSTATEMENTS WHILE USING EXPECTATIONS UNDER ANALYTICAL PROCEDURES?

ANSWER:

Matters relevant to auditor for evaluating whether the expectations developed using analytical procedures may detect material misstatements depends on the following factors:

1. The accuracy with which the expected results of substantive analytical procedures can be predicted.
   Example: The auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.
2. The degree to which information can be disaggregated.
   Example: Substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity rather when applied to the financial statements of the entity as a whole.
3. The availability of the information, both financial and non-financial which depends upon reliability of underlying data.
   Example: The auditor may consider whether financial information, such as budgets or forecasts, and non-financial information, such as the number of units produced or sold, is available to design substantive analytical procedures. If the information is available, the auditor may also consider the reliability of the information.

Q.NO.11. HOW TO DEAL WITH INVESTIGATING RESULTS OF ANALYTICAL PROCEDURES?

ANSWER:

If the auditor identifies fluctuations or relationships that are inconsistent with expected values by significant amounts, then he shall investigate such differences by:

1. **INQUIRING OF MANAGEMENT:** Requesting the management to provide additional information regarding why there are such huge differences. Further evaluate the response provided by management with audit evidence obtained.
2. **PERFORMING ADDITIONAL AUDIT PROCEDURES:** If management is unable to provide an appropriate explanation, then the auditor may perform additional procedures to identify any material misstatements, if available.

Note: The auditor's determination of the amount of difference from the expectation that can be accepted without further investigation is influenced by materiality and the consistency with the desired level of assurance, taking account of the possibility that a misstatement, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

Q.NO.12. HOW ANALYTICAL PROCEDURES ASSISTS THE AUDITOR WHILE FORMING OVERALL CONCLUSIONS?

ANSWER:

1. The conclusions drawn from the results of analytical procedures designed and performed in accordance with, are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements.
2. This assists the auditor to draw reasonable conclusions on which to base the auditor's opinion.
3. The results of such analytical procedures may identify a previously unrecognised risk of material misstatement. In such circumstances, SA 315 requires the auditor to revise the auditor's assessment of the risks of material misstatement and modify the further planned audit procedures accordingly.

Q.NO.13. WRITE ABOUT CONSIDERATIONS SPECIFIC TO PUBLIC SECTOR ENTITIES WHILE APPLYING ANALYTICAL PROCEDURES?

ANSWER:

1. The relationships between individual financial statements items traditionally considered in the audit of business entities may not always be relevant in the audit of governments or other non-business public sector entities.
2. For example, in many public sector entities there may be little direct relationship between revenue and expenditure.
3. In addition, because expenditure on the acquisition of assets may not be capitalized, there may be no relationship between expenditures on, for example, inventories and fixed assets and the amount of those assets reported in the financial statements.
4. Also, industry data or statistics for comparative purposes may not be available in the public sector. However, other relationships may be relevant, for example, variations in the cost per kilometre of road construction or the number of vehicles acquired compared with vehicles retired.

7. AUDIT OF DIFFERENT TYPES OF ENTITIES

GOVERNMENT AUDIT

Q.NO.1 BACKGROUND FOR GOVERNMENT AUDIT?

ANSWER:

1. Government Audit is as old as organised governments and has fairly long pedigree even in developing countries. The concept, content and scope of government audit have developed in tune with the political, social and economic development of the countries. It has also responded to the needs of the administration.
2. It aims to ensure accountability of the executive in respect of public revenue and expenditure. Primarily, the Parliament and in case of States, the State legislatures control all government expenditure through insistence upon demand for grants. The main idea underlying this control is that no expenditure can be incurred unless it has been voted upon by the Parliament or State Legislatures and funds for every such expenditure must be provided from out of the Consolidated Fund of India or of the State.
3. As per Article 266, the Consolidated Fund of India consists of all the revenue received from direct and indirect taxes, all the loans taken by the Govt. of India and all the amount of repayment of loans received by the Govt. of India.
4. After the expenditure has been incurred and the accounts are closed, the Appropriation Accounts are prepared which are scrutinised by the Public Accounts Committee (The Public Accounts Committee (PAC) is a committee of selected members of parliament, constituted by the Parliament of India, for the purpose of auditing the revenue and the expenditure of the Government of India).
5. Thus, Parliamentary or Legislative control is exercised before spending and after the expenditure is actually incurred. Initially, government auditing in India as elsewhere was primarily expenditure- oriented. Gradually, audit of receipts-tax and non-tax was taken up.
6. With the rapid growth of public enterprises, another major area of specialisation, i.e., commercial audit, came into being. There are also a large number of non-commercial autonomous bodies financed by government in diverse fields of development and of academic study and scientific or social research which are also required to be audited from the viewpoint of public accountability.
7. Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession.

Q.NO.2 WHAT IS GOVERNMENT AUDIT AND STATE ITS OBJECTIVES?

ANSWER:

A. DEFINITION:

1. The U.N. Handbook on Government Auditing and Developing Countries defines government auditing in a comprehensive manner which is as follows:
2. Government auditing is
   a. The objective, systematic, professional, and independent examination
   b. of financial, administrative, and other operations
   c. of a public entity
   d. made subsequently to their execution
   e. for the purpose of evaluating and verifying them,

f. presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions
g. by the responsible officials
h. and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

B. OBJECTIVES:

1. **ACCOUNTING FOR PUBLIC FUNDS:** Government audit serves as a mechanism or process for public accounting of government funds.
2. **APPRAISAL OF GOVERNMENT POLICIES:** It also provides public accounting of the operational, management, programme, and policy aspects of public administration as well as accountability of the officials administering them.
3. **BASE FOR CORRECTIVE ACTIONS:** Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.

C. ADMINISTRATIVE ACCOUNTABILITY: Government audit is neither equipped nor intended to function as an investigating agency, to pursue every irregularity or misdemeanors to its logical end. The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration. In India, the function of Government Audit is discharged by the independent statutory authority of the Comptroller and Auditor General through the agency of the Indian Audit and Accounts Department.

Audit is a necessary function to ensure accountability of the executive to Parliament, and within the executives of the spending agencies to the sanctioning or controlling authorities. The purpose or objectives of audit need to be tested at the touchstone of public accountability. The Comptroller and Auditor General (C&AG), in the discharge of his functions, watches that the various authorities act in regard to financial matters in accordance with the Constitution and the laws made by Parliament and conform to the rules or orders made thereunder.

Q.NO.3 WRITE ABOUT LEGAL FRAMEWORK AND COMPTROLLER & AUDITOR GENERAL ?

ANSWER:

The Constitution of India contains specific provisions regarding the appointment, salary and duties and powers of the C&AG.

1. APPOINTMENT & REMOVAL:

a. The Constitution guarantees the independence of the C&AG of India by prescribing that he shall be appointed by the President of India and shall not be removed from office except on the ground of proven mis-behaviour or incapacity.
b. As in the case of a Judge of the Supreme Court, he can be removed only when each House of Parliament decides to do so by a majority of not less than 2/3rd of the members of the House present and voting.
c. The Parliament is competent to make laws to determine salary and other conditions of service and they cannot be varied to his disadvantage after his appointment.
d. The Constitution further provides that the conditions of service of person serving in the Indian Audit and Accounts Department and the administrative powers of the C&AG shall be determined by the President after consultation with him.

2. **TENURE:** The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 passed in pursuance of the provisions of the Constitution lays down a fixed tenure of the office prescribing that he shall be paid a salary which is equal to the salary of the Judge of the Supreme Court thereby further strengthening his independence.
3. **VARIOUS CONSTITUTIONAL PROVISIONS**
   a. **Article 149** states that the C&AG shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by the Parliament. The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 defines these functions and powers in detail.
   b. **Article 150** of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C&AG prescribe.
   c. **Article 151** requires that the reports of the C&AG relating to the accounts of the Union/State shall be submitted to the President/Governor who shall cause them to be laid before House of Parliament/State Legislature.

Q.NO.4 WHAT ARE THE DUTIES OF COMPTROLLER AND AUDITOR GENERAL'S?

ANSWER:

The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 lays down duties of the C&AG as under:

1. **Compile and submit Accounts of Union and States:**
   a. The C&AG shall be responsible for compiling the accounts of the Union and of each State and union territory from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account.
   b. The Comptroller and Auditor General shall, from the accounts compiled by him or [by the Government or any other person responsible in that behalf] prepare in each accounts (including, in the case of accounts compiled by him, appropriation accounts) showing under the respective heads the annual receipts and disbursements for the purpose of the Union, of each State and of each Union Territory having a Legislative Assembly, and shall submit those accounts. The accounts prepared should be submitted to:
      i. In the case of Central Government / Union, to the President of the Country.
      ii. In the case of state, to the Governor of each State.
      iii. In the case of Union Territory, to the Chief Administrator
2. **The C&AG Act of 1971 has provisions for relieving him of this responsibility to give information and render assistance to the Union and States:** The Comptroller and Auditor General shall, in so far as the accounts, for the compilation or keeping of which he is responsible, enable him so to do, give to the Union Government, to the State Government or to the Governments of Union Territories having Legislative Assemblies, as the case may be, such information as they may, from time to time, require and render such assistance in the preparation of the annual financial statements as they may reasonably ask for.
3. **General Provisions Relating to Audit:** It shall be the duty of the C&AG –
   a. To audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory.
   b. To audit and report all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;

c. To audit and report on all trading, manufacturing profit and loss accounts and balance sheets and other subsidiary accounts kept in any department of the Union or of a State.

4. **Audit of Receipts and Expenditure:** Where anybody or authority is substantially financed by grants or loans from the Consolidated Fund of India or of any State or of any Union Territory, the CAG shall audit all receipts and expenditure of that body or authority and to report.

   Meaning of Substantially financed: Where the grant or loan to a body or authority from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly in a financial year is not less than Rs. 25 lakhs and the amount of such grant or loan is not less than 75% of the total expenditure of that body or authority, such body or authority shall be deemed, for this purpose to be substantially financed by such grants or loans as the case may be.

5. **Audit of Grants or Loans:** Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory to any authority or body, not being a foreign State or international Organisation, the CAG shall verify the procedures and the conditions under which the grant is sanctioned.

6. **Audit of Receipts of Union or States:** It shall be the duty of the CAG to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union Territory and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and report thereon.

7. **Audit of Accounts of Stores and Inventory:** The CAG shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State.

8. **Audit of Government Companies and Corporations:**
   a. The duties and powers of the CAG in relation to the audit of the accounts of Government Companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013.
   b. The Comptroller and Auditor- General of India shall appoint the auditor under section 139(5) or 139(7) (i.e. appointment of First Auditor or Subsequent Auditor) and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

Q.NO.5 WHAT ARE THE POWERS OF C&AG?

ANSWER:

The C & AG Act gives the following powers to the C&AG in connection with the performance of his duties:

a. To inspect any office of accounts under the control of the Union or a State Government including office responsible for the creation of the initial or subsidiary accounts.

b. To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.

c. To put such questions or make such observations as he may consider necessary to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which is his duty to prepare.

d. In carrying out the audit, the C&AG has the power to dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transactions as he may determine.

Q.NO.6 WRITE ABOUT AUDIT OF GOVERNMENT EXPENDITURE?

ANSWER:

The audit of Government Expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are as follows:

A. AUDIT AGAINST RULES & ORDERS:

1. The auditor has to see that the expenditure incurred confirms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority. Audit of expenditure against regularity is of a quasi-judicial type of work performed by the audit authorities.
2. It involves interpretation of the Constitution, statutes, rules, regulations and orders. The final power of interpretation of these, however, does not vest with the C&AG. These rules, regulations and orders against which regularity audit is conducted mainly fall under the following categories:
    a. Rules and orders regulating the powers to incur and sanction expenditure from the Consolidated Fund of India or of a State (and the Contingency Fund of India or of a State);
    b. Rules and orders dealing with the mode of presentation of claims against government, withdrawing moneys from the Consolidated Fund, Contingency Fund and Public Accounts of the Government of the India and of the States, and in general the financial rules prescribing the detailed procedure to be followed by government servants in dealing with government transactions; and
    c. Rules and orders regulating the conditions of service, pay and allowances, and pensions of government servants.
3. It is the function of the executive government to frame rules, regulations and orders, which are to be observed by its subordinate authorities. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be.
4. But it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that:
    a. They are not inconsistent with any provisions of the Constitution or any laws made thereunder.
    b. They are consistent with the essential requirements of audit and accounts as determined by the C&AG.
    c. They do not come in conflict with the orders of, or rules made by, any higher authority; and
    d. In case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power

B. AUDIT OF SANCTIONS: The auditor has to ensure that each item of expenditure is covered by a sanction and authorised by the competent authority, authorizing such expenditure. The audit of sanctions is directed both in respect of ensuring that the expenditure is properly covered by a sanction, and also to satisfy that the authority sanctioning it is competent for the purpose by virtue of the powers vested in it by the provisions of the Constitution and of the law, rules or orders made thereunder, or by the rules of delegation of financial powers made by an authority competent to do so. Generally, these expenses are sanctioned from consolidated fund of India or State.

C. **AUDIT AGAINST PROVISION OF FUNDS:** It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.

D. **PROPRIETY AUDIT:** The auditor aims to bring out cases of improper, avoidable expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.

E. **PERFORMANCE AUDIT:** This involves that the various programmes, schemes and projects in which huge expenditure has been incurred, are being run economically and are yielding expected results. It is an objective examination of the financial and operational performance of an Organisation or programme and is oriented towards identifying opportunities for greater economy, and effectiveness.

Q.NO.7 AUDIT AGAINST THE PROPRIETY SEEKS TO ENSURE THAT EXPENDITURE CONFIRMS TO CERTAIN PRINCIPLES. COMMENT.

ANSWER:

A. **OBJECTIVE OF THE AUDIT:** To identify improper, avoidable, or wasteful expenditure.

1. Regularity audit alone was not sufficient to protect properly the public interest in the spending of money because even though expenditure has been incurred in conformity with the existing rules and regulations but still it may be highly wasteful.
2. Therefore, the Auditor should look into the financial propriety of the transaction with respect to reasonableness, faithfulness and economy of expenditure.

B. **GENERAL PRINCIPLES OR GUIDELINES FOR JUDGING PROPRIETY:** It is difficult to frame any precise rules for regulating the course of audit against propriety. It purely depends on the common sense and logic applied by the auditor depending on the circumstances.

1. However, some general principles have been laid down as follows:
2. The expenditure should not be prima facie more than the occasion demands. Every public officer is expected to exercise the same prudence in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.
3. No authority should pass an order for sanctioning an expenditure which will be directly or indirectly to its own advantage.
4. Public moneys should not be utilized for the benefit of a particular person or section of the community.
5. **Exceptions:**
    a. The amount of expenditure involved is insignificant.
    b. A claim for the amount could be enforced in a court of law; or
    c. The expenditure is in pursuance of a recognized policy or custom
    d. The amount of allowances granted to meet expenditure of a particular type should be so regulated that the allowances are not become sources of profit to the recipients.
6. The expenditure should:
    a. Pass down to the beneficiary without corruption.
    b. Bring out optimum, enduring benefits instead of mere spending the public money on meeting day to day needs.
    c. Should not exceed the benefits derived from the expenditure.

d. Should not become profits when it is only compensatory in nature.

Q.NO.8 WRITE A SHORT NOTE ON PERFORMANCE AUDIT.

ANSWER:

A. OBJECTIVE OF THE AUDIT: To ensure that that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. It is an objective examination of the financial and operational performance of a programme or a project and is oriented towards identifying opportunities for greater economy and effectiveness.

B. COMPONENTS OF PERFORMANCE AUDIT: It includes the following:

1. **Efficiency audit:** It looks into whether the various schemes/projects are executed and their operations conducted economically and whether they are yielding the results expected of them, i.e.,
    a. The relationship between goods and services produced and resources used to produce them; and
    b. Examination aimed to find out the extent to which operations are carried out in an efficient manner.
2. **Economy audit:** It looks into whether the entity has acquired the financial, human and physical resources in an economical manner, and whether the sanctioning and spending authorities have observed economy.
3. **Effectiveness audit:** It is an appraisal of the performance of programmes, schemes, projects with reference to the overall targeted objectives as well as efficiency of the means adopted for the attainment of the objectives.

C. The procedure for conducting performance audit covers:

1. Identification of topic,
2. Preliminary study,
3. Planning and execution of audit, and
4. Reporting.

Q.NO.9 WRITE A SHORT NOTE ON AUDIT OF GOVERNMENT RECEIPTS.

ANSWER:

A. OBJECTIVE OF THE AUDIT: It aims to ensure that there is no leakage of revenue which should legally come to the Government. The basic principle of audit of receipts is that it is more important to look at the general than on the particular, though individual cases of assessment, demand, collection, refund, etc. are important within the area of test check.

B. ASPECTS TO BE COVERED IN AUDIT OF GOVERNMENT RECEIPTS:

1. **Proper assessment and realization:** Whether all revenues or other debts due to Government have been correctly assessed, realised and credited to Government account by the authorities.
2. **Adequate rules and procedures:** Whether adequate rules and procedures have been designed, by the concerned department to ensure an effective check on assessment, collection and proper allocation of cases.
3. **Adequate controls:** Whether adequate controls are imposed for prompt detection of irregularities regarding double refunds, fraudulent or forged refund vouchers or other loss of revenue.
4. **Actual implementation:** Whether such regulations and procedures are actually being carried out.
5. **Review of assessment orders:**
    a. Review of systems and procedures to see that the internal procedures adequately secure correct and regular accounting of demands collection and

refunds and pursuant of dues up to final settlement and to suggest improvement.

b. The basic principle of audit of receipts is that it is more important to look at the general than on the particular, though individual cases of assessment, demand, collection, refund, etc. are important within the area of test check.

c. A review of the judicial decisions taken by tax authorities is done to judge the effectiveness of the assessment procedure.

C. EXTENT OF CHECKING:

1. The extent and quantum of audit required to be done under each category of audit are determined by the C&AG. These are neither negotiable nor questioned.
2. The prescribed extent and quantum of audit are structured in accordance with the design of test check, random sampling, general review, in-depth study of specified areas, etc. as may be warranted by the nature of transactions, its importance in the scheme of activities of a department and the totality of its transactions, the frequency of check and total plan of audit to be executed during a period.
3. Institutional mechanism provides for primary check by the auditor, test check by the supervisor and control and direction by the group leader.
4. Planning, executing and reporting of work is directed and monitored at middle and top levels of the audit hierarchy.
5. There are built-in arrangements within the C&AG to ensure that the work assigned to each employee is carried out as prescribed. The audit is conducted both centrally where accounts and original vouchers are kept and locally where the drawing and disbursing functions are performed depending on the organisational and institutional arrangements obtaining.

Q.NO.10 WRITE A SHORT NOTE ON AUDIT OF STORES AND INVENTORIES IN THE CONTEXT OF GOVERNMENT AUDITING.

ANSWER:

A. OBJECTIVE OF AUDIT: To ensure that purchases of stores and inventories are properly sanctioned, made economical and in accordance with the Rules for purchase laid down by the competent authority. Audit of the accounts of stores and inventories has been developed as a part of expenditure audit.

B. ASPECTS TO BE COVERED IN AUDIT OF STORES AND INVENTORIES:

1. To ascertain whether the Regulations governing purchase, receipt and issue, custody, sale and inventory taking of stores are well devised and properly carried out.
2. To ensure that the prices paid are reasonable and are in agreement with those shown in the contract for the supply of stores, and that the certificates of quality and quantity are furnished by the inspecting and receiving units.
3. Cases of uneconomical purchase of stores and losses attributable to defective or inferior quality of stores are specifically brought to the notice by the auditor.
4. Accounts of receipts, issues and balances are checked regarding accuracy, correctness and reasonableness of balances in inventories with particular reference to the specified norms for level of consumption of inventory holding.
5. Any excess or idle inventory is specifically mentioned in the report and periodical verification of inventory is also conducted to ensure their existence.
6. The valuation of the inventories is seen carefully so that the value accounts tally with the physical accounts and that adjustment of profits or losses due to revaluation, inventory taking or other causes is carried out.

Q.NO.11 WITH REFERENCE TO GOVERNMENT AUDIT WHAT DO YOU UNDERSTAND BY 'AUDIT OF COMMERCIAL ACCOUNTS'.

ANSWER:

1. The Government also engages in commercial activities and for the purpose it may incorporate following types of entities:
   a. Departmental enterprises engaged in commercial and trading operations, which are governed by the same regulations as other Government departments such as defense factories, mints, etc.
   b. Statutory corporations created by specific statues such as LIC, Air India, etc.
   c. Government Companies set up under the Companies Act, 2013.
2. All aforesaid entities are required to maintain accounts on commercial basis.
   a. The audit of departmental entities is done in the same manner as any Government department, where commercial accounts are kept.
   b. Audit of statutory corporations depends on the nature of the statute governing the corporation. Financial / accounts audit is conducted by the C&AG, and where compilation of accounts is vested with the C&AG, functions, norms and standards of works usually followed by the professional auditors are adopted mutatis mutandis.
   c. In respect of Government Companies, the relevant provisions of Companies Act, 2013 are applicable. In addition, the C&AG conducts a supplementary test audit of the accounts, as well as periodical financial audit and appraisal of performance. The C&AG also issues direction to the company auditors for reporting on specific aspects of their audit work. These are reviewed, and condensed in the audit reports to the government/legislatures. C&AG has adopted the mechanism of an Audit Board- comprising of representatives of the audit and nominees of government including functional specialists to process reviews or appraisals on performance.

Q.NO.12 WHAT ROLE IS PLAYED BY CAG IN THE AUDIT OF A GOVERNMENT COMPANY AS PER COMPANIES ACT, 2013?

ANSWER:

A. APPOINTMENT OF AUDITORS U/S 139:

1. The CAG has the power to appoint First Auditor u/s 139(5) or Subsequent Auditor u/s 139(7) and
2. He can also direct such auditor the manner in which the accounts of the Government Company are required to be audited and later on, the auditor so appointed shall submit a copy of the audit report to the CAG. [section 143(5)].

B. SUPPLEMENT THE STATUTORY AUDIT U/S 143(6): The Comptroller and Auditor-General of India shall within 60 days of receipt of the audit report have a right to:

1. Conduct a Supplementary Audit of the financial statement of the company by any persons authorized by him. And he can ask for any additional information for the purposes of such audit from such person appointed.
2. CAG can comment on supplement audit report and it any comments given by the CAG upon, or supplement to, the audit report shall be
   a. Sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e.,
      i. Every member of the company,
      ii. To every trustee for the debenture-holder of any debentures issued by the company, and
      iii. To all persons other than such member or trustee, being the person so entitled and

b. Be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

Note: Supplementary audit is not a separate audit but an extension to original audit carried under Sec.139 of the act. The statutory auditors shall submit a copy of their audit report to the C&AG who shall have a right to comment upon or supplement the audit report submitted by the statutory auditors in such manner as he may think fit.

Section 134(3) of the Companies Act, 2013 imposes a duty on the board of directors of a company to give an explanation or comments on every reservation, or adverse remarks or disclaimer contained in the auditors' report and secretarial audit report of the Company Secretary in practice.

In the absence of similar provisions requiring the company to give reply on the reservation made by the C&AG, the board of directors of such a company is not bound to give information or explanation in respect of such comments.

C. TEST AUDIT [SEC. 143(7)]: If CAG considers necessary, it may order test audit to be conducted on the accounts of the Government Company.

1. The provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.
2. It is done by the CAG himself.

Thus, it is seen that there is a two-layer audit of a government company, by the statutory auditors, being qualified chartered accountants, and by the C&AG.

Note: The general standards, principles, techniques and procedures for audit adopted by the C&AG are a mixture of government audit and commercial audit as known and practiced by professional auditors. The concepts of autonomy and accountability of the institution / bodies / corporations / companies have influenced the nature and scope of audit in applying the conventional audit from the angle of economy, efficiency and effectiveness.

Q.NO.13 WRITE ABOUT REPORTING PROCEDURES IN CASE OF GOVERNMENT AUDIT?

ANSWER:

1. The effectiveness of an audit depends on reporting results to the proper authority so that appropriate action may be taken to rectify the irregularities or impropriety where possible or to prevent re-occurrence.
2. The right as also the obligation to report on the results of audit findings is inherent to the institution of the Auditor General and is usually safeguarded in the Constitution and related enactments.
3. Article 151 of the Indian Constitution enjoins that the C&AG shall report on the accounts of the Union and of each of the States to the President or the Governor concern and the latter shall cause the report to be laid before the legislatures.
4. The reports should not only be presented to the legislatures but thereafter also publicised adequately in order to create a proper climate of public opinion for taking remedial action where necessary, on the findings of the Auditor General.
5. This may also constitute a more effective safeguard in the future. In India, the reporting is factual and the conclusions are left to be drawn by the reader. This is presumably to ensure total objectivity.
6. Nothing debars C&AG from making recommendations in the audit report but traditionally this has been left to be done by the Public Accounts Committee.

AUDIT OF LOCAL BODIES

Q.NO.1 WRITE ABOUT BACKGROUND OF LOCAL BODIES?

ANSWER:

1. **DEFINITION OF A MUNICIPALITY:** A municipality can be defined as a unit of local self-government in an urban area.
   LOCAL SELF-GOVERNMENT: By the term 'local self-government' is ordinarily understood as
   a. The administration of a locality – a village, a town, a city or any other area smaller than a state
   b. By a body representing the local inhabitants,
   c. Possessing fairly large autonomy,
   d. Raising at least a part of its revenue through local taxation and spending its income on services which are regarded as local and, therefore, distinct from state and central services.
2. **TYPES OF LOCAL BODIES:** Municipal government in India covers 5 distinct types of urban local authorities:
   a. The municipal corporations,
   b. The municipal councils,
   c. The notified area committees,
   d. The town area committees and
   e. The cantonment committees.
3. **FUNCTIONS:** Municipal authorities are endowed with specific local functions covering:
   a. Regulatory,
   b. Maintenance and
   c. Development activities.
4. **EXPENDITURE:** Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads:
   a. General administration and revenue collection,
   b. Public health,
   c. Public safety,
   d. Education,
   e. Public works, and
   f. Others such as interest payments, etc.
5. **REVENUES:**
   a. Property taxes and octroi are the major sources of revenue of the municipal authorities;
   b. Other municipal taxes are profession tax, non-mechanised vehicles tax, taxes on advertisements, taxes on animals and boats, tolls, show-tax, etc.
   c. The taxation powers of the corporations are confined to a few items and are of a generally compulsive nature.
   d. On the other hand, the tax powers of other types of urban local authorities cover a wider range, optional in nature and subject to a procedure for their imposition requiring the final sanction of the state governments.
6. **GRANTS:** Local bodies may receive different types of grants from the state administration as well. Broadly, the revenue grants are of three categories:
   a. **General purpose grants:** These are primarily intended to substantially bridge the gap between the needs and resources of the local bodies.

b. **Specific purpose grants:** These grants which are tied to the provision of certain services or performance of certain tasks.

c. **Statutory and compensatory grants:** These grants, under various enactments, are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state government from local government.

Q.NO.2 WRITE ABOUT FINANCIAL ADMINISTRATION OF LOCAL BODIES?

ANSWER:

It would be important on the part of the auditor to understand financial administration of local bodies before embarking upon the audit. Some of the aspects are as under:

a. BUDGETARY PROCEDURE:

- This is geared to subserve the twin considerations of financial accountability and control of expenditure. The main objective is to ensure that funds are raised and moneys are spent by the executive departments in accordance with the rules and regulations and within the limits of sanction and authorisation by the legislature or council.
- Budget preparation is usually the occasion for determining the levels of taxation and rates and the ceilings on expenditure. Municipal budget formats and heads of accounts vary from state to state. There are variations between the corporation and municipalities.
- One important feature of the municipal budgets is that there is no strict separation between revenue and capital items. Usually there is a 'head' called extraordinary items which cover most of the capital transactions.
- There are, however, a number of special funds (e.g., roads) or in some cases separate budgets for specific municipal functions (e.g., education) or enterprise activities (e.g., water supply and sanitation, transport, electricity, etc.)

b. EXPENDITURE CONTROL:

- The system of financial control existing in the state and central government level is conditioned by the fact that there is a clear demarcation between the legislature and executive.
- The integration of legislation and executive powers in the municipal council makes it difficult for its executive to function as its inquisitorial body as well.
- Moreover, the separation of executive powers and functions in municipal government cannot accommodate the existence of an independent finance officer responsible to the municipal council or its executive committee.

This leaves the system of external audit by state government as the only instrument of controlling municipal expenditure.

c. **ACCOUNTING SYSTEM:** Municipal accounting and budget format have been criticised as neither simple nor comprehensible, sometimes providing inadequate information and at other times a surfeit of information. Both these situations are not conducive to a proper system of management information.

Q.NO.3 WHAT ARE THE OBJECTIVE OF AUDIT OF LOCAL BODIES?

ANSWER:

The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. The municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit. The important objectives of audit are to report on

1. The fairness of the content and presentation of financial statements.

2. The strengths and weaknesses of systems of financial control.
3. The adherence to legal and/or administrative requirements.
4. Whether value is being fully received on money spent and
5. Detection and prevention of error, fraud and misuse of resources.

Q.NO.4 WRITE ABOUT AUDIT PROGRAMME FOR AUDIT OF LOCAL BODIES?

ANSWER:

Audit is another method of financial control on local governments. This provision is coupled with the privilege of ultra vires. An action of the local authority if it is beyond legal authority can result in 'surcharge' by audit. This procedure is a legacy of colonial days and even in England it is being resorted to less and less. This may well be because of the increasing competence of the local government authorities.

In addition to the external audit, it is also opined by the learned author that there should be a system of internal audit in all municipal institutions. Internal audit should be provided by the institutions' own staff. It should be performed on a continuous basis according to a well-defined programme.

The external auditor should be able to rely upon the work of the internal audit as forming part of a complete system of internal financial control. Where there is no internal audit, as may happen in the case of small or poorly staffed municipalities, the external auditor himself has to do detailed checking.

As described under government audit above, increasing attention is being given, to what is described as 'value for money' audit. This kind of audit focuses upon assessment of whether urban institutions are fulfilling their responsibilities with efficiency, economy and effectiveness (sometimes known as 'the three Es').

AUDIT PROGRAMME:

i. **APPOINTMENT**: The Local Fund Audit Wing of the State Govt. is generally in-charge of the audit of municipal accounts. Sometimes bigger municipal corporations e.g., Delhi, Mumbai etc. have power to appoint their own auditors for regular external audit. So, the auditor should ensure his appointment.

ii. **AUDITOR'S CONCERNS**: The auditor while auditing the local bodies should report on the
   a. Fairness of the contents and presentation of financial statements,
   b. The strengths and weaknesses of system of financial control,
   c. The adherence to legal and/or administrative requirements;
   d. Whether value is being fully received on money spent.

   His objective should be to detect errors and fraud and misuse of resources.

iii. **RULES & REGULATIONS**:-The auditor should ensure that the expenditure incurred conforms to the relevant provisions of the law and is in accordance with the financial rules and regulations framed by the competent authority.

iv. **AUTHORISATIONS**: He should ensure that all types of sanctions, either special or general, accorded by the competent authority.

v. **PROVISIONING**: He should ensure that there is a provision of funds and the expenditure is incurred from the provision and the same has been authorized by the competent authority.

vi. **PERFORMANCE**: The auditor should check that the different schemes, programmes and projects, where large financial expenditure has been incurred, are running economically and getting the expected results.

AUDIT OF NON - GOVERNMENTAL ORGANISATION (NGO'S)

Q.NO.5 WRITE ABOUT BACKGROUND OF NGO's?

ANSWER:

1. NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situations.
2. Therefore, this definition of NGO would include religious organisations, voluntary health and welfare agencies, charitable organisations, hospitals, old age homes, research foundations etc.
3. The scope of services rendered by NGOs is extremely wide and as such cannot be covered in a small definition. Some examples of NGOs operating in India include Child Relief and You (CRY), NORAD, UNICEF, Godhuli, Vidya, Concern India Foundation., etc.
4. Non-Governmental Organisations are generally incorporated as societies under the Societies Registration Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Laws enforced in any part of India.
   NGOs can also be incorporated as a company under section 8 of the Companies Act, 2013.
5. None of the above-mentioned Act warrant a mandatory registration under them for an NGO. But if an NGO is created as a trust and trust relates to immovable property worth more than one hundred rupees, the provision of Section 17(1) of the Registration Act, 1908 read with Section 123 of the Transfer of Property Act, 1882 must be complied with and the registration of trust becomes mandatory.
6. In some states, such as the states of Maharashtra and Gujarat, where Public Trusts Acts have been passed, such as the Bombay Public Trusts Act 1950, all charitable trusts have to be registered under these specific Public Trusts Acts.
7. Registration under the Income Tax Act, 1961 and the Foreign Contribution (Regulation) Act, 2010 would also be invoked in many cases.
8. NGOs registered under the Companies Act, 2013 must maintain their books of account under the accrual basis as required by the provisions of section 128 of the said Act. If the accounts are not maintained on accrual basis, it would amount to non-compliance of the provision of the Companies Act, 2013.
9. The NGOs which are not registered under the Companies Act, 2013 are allowed to maintain accounts either an accrual basis or cash basis.

Q.NO.6 WHAT ARE THE SOURCES AND APPLICATIONS OF FUNDS OF NGO's?

ANSWER:

1. The main sources of funds include grants and donations, fund raising programmes, advertisements, fees from the members, technical assistance fees / fee for services rendered, subscriptions, gifts, sale of produce or publications, etc.
   a. **PROMOTERS CONTRIBUTIONS:**
      - Donations and grants received in the nature of promoter's contribution are in the nature of capital receipts and shown as liabilities in the Balance Sheet of NGO.
      - These may either be in the form of corpus contribution or a contribution towards revolving fund.

- A contribution made towards the capital or the corpus of an NGO is known as corpus contribution. The donors are generally required to specify whether the donation/grant given by him shall form part of the corpus of the NGO. Such contributions are generally given with reference to the total funds required by an NGO.
- Section 11(1)(d) of the Income Tax Act 1961 also states that income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the computation of total income.
- The objective of a contribution or grant towards a Revolving Fund is to rotate the amount by giving temporary loans from the fund to other NGO or beneficiaries for their projects and then recover the loan so as to give temporary loans again and so on. However, any interest earned from the beneficiary on such temporary loans from the revolving fund could be either added back to the fund or credited to the Income and Expenditure Account depending on restrictions laid down by the authority providing the contribution (for the revolving fund) or by the rules and regulations laid down by the concerned NGO in this regard.

b. **DONATIONS AND GRANTS:** Donations and grants received for acquisition of specific fixed assets are those grants whose primary condition is that an NGO accepting them should purchase, construct or otherwise acquire the assets for which the grant is given.

c. **NON-MONETARY DONATIONS:** Many a times NGOs receive contributions in kind. These contributions include assets such as land, buildings, vehicles, office equipment, etc. and articles related to programmes / projects such as food, books, building materials, clothes, beds, and raw material for training purposes, e.g., Wool, reeds, cloth, etc.

2. **APPLICATION OF FUNDS:** The areas of application of funds for an NGO include Establishment Costs, Office and Administrative Expenses, Maintenance Expenses, Programme / Project Expenses, Charity, Donations and Contributions given, etc.

Q.NO.7 WRITE ABOUT PROVISIONS RELATING TO AUDIT OF NGO's?

ANSWER:

1. The auditors of an NGO registered under the Societies Registration Act, 1860 (or under any law corresponding to this Act, in force in any part of India) or the Indian Trusts Act 1882 are normally appointed by the Management of the Society or Trust.
2. The auditors of NGO registered under section 8 of the Companies Act, 2013 are appointed by the members of the company.
3. Some of the statues such as the Companies Act, 2013, Foreign Contribution (Regulation) Act 2010, Income Tax Act 1961 required that the accounts of the NGO be audited and submitted to the prescribed authorities and failure to do so could lead to forfeiture of certain exemptions and benefits.
4. In the case of NGO/PDA's different statutes have specified certain audit reports. The Foreign Contribution (Regulation) Act 2010 has prescribed the format and requires that the same be furnished to the Ministry of Home Affairs within 60 days from the close of the financial year i.e., by May 30 each year.
5. **While planning the audit, the auditor may concentrate on the following:**
   a. Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operate.

b. Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 2010, Societies Registration Act, 1860, Income Tax Act 1961 etc. and the Rules related to the statutes.
c. Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.
d. Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
e. Examination of minutes of the Board/Managing Committee/Governing Body/ Management and Committees thereof to ascertain the impact of any decisions on the financial records.
f. Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
g. Setting of materiality levels for audit purposes.
h. The nature and timing of reports or other communications.
i. The involvement of experts and their reports.
j. Review the previous year's Audit Report.

Q.NO.8 WRITE ABOUT AUDIT PROGRAMME OF AN AUDIT OF NGO?

ANSWER:

A. AUDIT PROGRAMME:

The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material item is omitted:

1. **Corpus fund:** The contributions/grants received towards corpus are vouched with reference to the letters from the donor(s). The interest income on investment of corpus is checked with investment Register and physical investments in hand.
2. **Reserves:** Vouch transfers from projects/programmes with donor's letters and board resolutions of NGO. Also check transfers and adjustments made during the year.
3. **Ear-marked Funds:** Check requirements of donor's institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds.
4. **Loans:** Vouch loans with loan agreements receipt counterfoil issued.
5. **Fixed Assets:** Vouch all acquisitions/sale or disposal of assets including depreciation and the authorizations for the same. For immovable property, check title, etc.
6. **Investments:** Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and dis-investments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.
7. **Cash in Hand:** Physically verify the cash in hand and imprest balance, at the close of the year and whether it tallies with the books of accounts.
8. **Bank Balance:** Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.
9. **Inventory in Hand:** Verify inventory in hand and obtain certificate from the management for the quantities and valuation of the same.

10. **Programme and Project Expenses:** Verify agreement with donor/contributor (s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project.

11. **Establishment Expenses**: Verify that provident fund, life insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.

B. AUDIT OF RECEIPTS OF NGO:

1. **Contribution and Grants:**
    a. All grant donations and contributions received should be checked with reference to the agreement with donors, grant letter, bank statements.
    b. Additionally, foreign contributions received should be checked to ensure that all such contributions are
    c. Received as per RBI guidelines and
    d. Are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976.
2. **Examination of internal controls:**
    a. To ascertain the persons who are responsible for collection of funds.
    b. To verify the mode of receipt and
    c. To ensure that they are properly accounted and all collections are counted and deposited in the bank daily.
3. **Membership Fees:**
    a. Check fees received with membership register;
    b. To ensure proper classification is made between entrance and annual fees and life membership fees.
    c. Reconcile fees received with fees to be received during the year.
4. **Subscription**:
    a. Check receipts issued with subscription register and subscription rate schedule.
    b. Reconcile subscription received with printing and dispatch of corresponding magazine / circulars / periodicals.
5. **Interest and Dividends**: Check the interest and dividends received and receivable with investments held during the year.

AUDIT OF SOLE TRADER

1. A sole trader is under no legal obligation to have his accounts audited. However, many such individuals get their financial statement audited due to regulatory requirements, such as inventory brokers or on a specific instructions of the bank for approval of loans, etc.
2. **APPOINTMENT OF AUDITOR:**
   a. Auditors of sole- proprietary concern shall be appointed by the sole proprietor himself.
   b. In case of change of auditor, it would be duty of incoming auditor to communicate with the previous auditor. As such, sole proprietor can determine the scope of the audit as well as the conditions under which it will be carried out.

   Example: He can stipulate that only a partial audit shall be carried out, that certain parts of the accounts shall not be checked or that the auditor also shall prepare the final statements of account. He can also decide whether the audit shall be carried out continuously or at the end of the year.
3. On these considerations, it is desirable that the contract of appointment of auditor in such a case should be in writing, also that it should clearly define the scope of the work which the auditor is expected to carry out.
4. This helps to prevent misunderstanding. If the appointment of the auditor is not in writing, the auditor should write to his client explaining the scope of his duties. While doing so, he should state the limitations, if any, placed upon his work to obtain the client's confirmation.
5. The advantages and audit procedure in case of partnership firm would be similar in case of proprietorship.

AUDIT OF PARTNERSHIP FIRM's

A. SPECIAL POINTS IN AUDIT OF A PARTNERSHIP FIRM:

1. **Letter of appointment:** Confirming that the letter of appointment,
   a. signed by a duly authorized partner,
   b. Clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.
2. **Partnership deed:** Examine the partnership deed to confirm,
   a. Whether it is signed by all partners and
   b. Whether it its registered with the registrar of firms and also
   c. To ascertain from the partnership deed about capital contribution, profit sharing ratios, interest on capital contribution, powers and responsibilities of the partners, etc.
3. **Reading the minutes:** Studying the minute book, if any, maintained to record the policy decision taken by partners relating to
   a. Authorization of extraordinary and capital expenditure,
   b. Raising of loans,
   c. Purchase of assets,
   d. Extraordinary contracts entered into and other such matters which are not of a routine nature.
4. **Business authorization:** Verifying that the business in which the partnership is engaged is authorized by the partnership agreement; or by any extension or modification thereof agreed to subsequently.

5. **Adequacy of books of account:** Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.
6. **No effect on interest of any partner:** Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorized to do under the partnership deed or by any violation of a provision in the partnership agreement.
7. **Compliance with provisions of income tax Act:**
   a. Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners.
   b. Also see various requirements of legislations applicable to the partnership firm like Section 44(AB) of the Income-tax Act, 1961 have been complied with.
8. **Sharing of profits and losses:** Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

B. MATTERS TO BE CONSIDERED BEFORE STARTING AUDIT: Also, before starting the audit, he should examine the partnership agreement and note the provisions therein as regards the following matters:

1. The name and style under which the business shall be conducted.
2. The duration of the partnership, if any, that has been agreed upon.
3. The amount of capital that shall be contributed by each partner—whether it will be fixed or could be varied from year to year.
4. The period at the end of which the accounts of the partnership will be closed periodically and the proportions in which the profit shall be divided among the partners or losses shall have to be contributed by them.
5. Whether the losses shall be borne by the partners or whether any of the partners will not be required to do so.
6. The provisions as regards maintenance of books of account and the matters which must be taken into account for determining the profits of the firm available for division among the partners e.g., creation of reserves, provision for depreciation, etc. also the period within which accounts can be reopened for correcting a manifest error.
7. Borrowing capacity of the partnership (when it is not implied as in the case of non-trading firms).
8. The rate at which interest will be allowed on the capitals and loans provided by partners and the rate at which it will be charged on their drawings and current accounts.
9. Whether any salaries are payable to the partners or withdrawals are permitted against shares of profits and, if so, to what extent?
10. Duties of the partners as regards the management of business of the firm; also, the partners who shall act as managing partners.
11. Who shall operate the bank account of the firm? How will the surplus funds of the partnership be invested?
12. Limitations and restrictions that have been agreed upon, the rights and powers of partners and on their implied authority to pledge the firm's credit or to render it liable.

C. ADVANTAGES OF AUDIT OF A PARTNERSHIP FIRM: On broad considerations, the advantages of audit of accounts of a partnership could be stated as follows:

1. **DISPUTES:** Audited accounts provide a convenient and reliable means of settling accounts between the partners and, thereby, the possibility of occurrence of a dispute among them

is mitigated. On this consideration, it is usually provided in and accepted by the partners, shall be binding upon them, unless some manifest error is brought to light within a specified period subsequent to the accounts having been signed.

2. **DISSOLUTION:** On the retirement or death of a partner, audited accounts, which have been accepted by the partners, constitute reliable evidence for computing the amounts due to the retiring partner or to the representative of the deceased partner in respect of his share of capital, profits and goodwill.
3. **RELIABLE:** Audited statement of accounts are relied upon by the banks when advancing loans, as well as by prospective purchasers of the business, as evidence of the profitability of the concern and its financial position.
4. **ADMISSION:** Audited statements of account can be helpful in the negotiations to admit a person as a partner, especially when they are available for a number of past years.
5. **CONTROL:** An audit is an effective safeguard against any undue advantage being taken by a working partner or partners especially in the case of those partners who are not actively associated with the working of the firm.

AUDIT OF LLP's

A. OVERVIEW OF LLP ACT:

1. LLP is governed by Limited Liability Partnership Act, 2008. It is a form of business organisation which enshrines in itself the advantages of both the Company and Partnership forms of Organisation.
2. Minimum of 2 Partners can form an LLP and at least 2 partners would be Designated Partners who would be required to take DPIN (Designated Partner Identification Number).
3. The Partners in an LLP and their rights and duties are governed by way of an agreement between them.
4. It defines a Small Limited Liability Partnership to denote any LLP:
   a. The Contribution of which, does not exceed twenty-five lakh rupees (INR 25,00,000) or such higher amount, not exceeding 5 crore rupees, as may be prescribed; and
   b. The Turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed forty lakh rupees (INR 40,00,000) or such higher amount, not exceeding 50 crore rupees, as may be prescribed.

B. BOOKS OF ACCOUNTS:

LLP's are required to maintain books of accounts which shall contain-

1. Particulars of all sums of money received and expended by the LLP.
2. A record of the assets and liabilities of the LLP,
3. Statements of costs of goods purchased, inventories, work-in-progress, finished goods and costs of goods sold,
4. Any other particulars which the partners may decide.

C. REQUIREMENT OF AUDIT:

1. The accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009.
2. **Exceptions:** Any LLP, whose turnover does not exceed, in any financial year, 40 lakh rupees, or whose contribution does not exceed 25 lakh rupees, is not required to get its accounts audited.

3. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, then the accounts shall be audited.

D. APPOINTMENT OF AUDITOR:

1. **Authority for appointment:**
   a. The appointment of auditors of LLP, whether first or subsequent auditors including filling of casual vacancy, may be made by the designated partners of the LLP.
   b. The other partners may appoint the auditors if the designated partners have failed to appoint them.
2. **Time limit for appointment:**
   a. **First auditor:** At any time for the first financial year but before the end of first financial year,
   b. **Subsequent auditor:** At least 30 days prior to the end of each financial year (other than the first financial year).

E. ADVANTAGES / PURPOSE / NEED OF AUDIT: Refer Partnership Firm advantages

F. AUDITOR'S DUTY REGARDING AUDIT OF LLP:

1. The auditor should get definite instructions in writing as to the work to be performed by him.
2. The auditor should mention
   a. Whether the records of the firm appear to be correct & reliable.
   b. Whether he was able to obtain all information & explanation necessary for his work.
   c. Whether any restriction was imposed upon him.
3. The auditor should read the LLP agreement & note the following provisions
   a. Nature of the business of the LLP.
   b. Amount of capital contributed by each partner.
   c. Interest – in respect of additional capital contributed.
   d. Duration of partnership.
   e. Drawings allowed to the partners.
   f. Salaries, commission etc payable to partners.
   g. Borrowing powers of the LLP.
   h. Rights & duties of partners.
   i. Method of settlement of accounts between partners at the time of admission, retirement, admission etc.
   j. Any loans advanced by the partners.
   k. Profit sharing ratio
4. If partners maintain minute book, he shall refer it for any resolution passed regarding the accounts

G. REPORTING: The auditor should mention:

a. Whether the records of the firm appear to be correct & reliable.
b. Whether he was able to obtain all information & explanation necessary for his work.
c. Whether any restriction was imposed upon him.

AUDIT OF CHARITABLE INSTITUTION

In the case of the audit of a charitable institution, attention should be paid to the following matters:

A. GENERAL:

1. Studying the constitution under which the charitable institution has been set up. It may be registered as a society under the Societies Registration Act, 1860, as a company limited by guarantee or as a trust.
2. Verifying whether the institution is being managed in compliance with the law under which it has been set up.

B. SUBSCRIPTIONS AND DONATIONS:

1. The auditor should obtain all receipt books covering the period under review and check whether that adequate control is imposed over unused receipt books.
2. Obtaining the and agreeing them with the total collections shown in the accounts with reference to the,
   a. Acknowledgment receipts issued.
   b. Entries made in the in-cash book.
   c. Printed list of subscriptions and donations, if any and
   d. Any figures published in reports, etc, if any issued by the charity.
3. Examine the internal controls over collections and ensure that all collections have been fully accounted for and deposited in the bank regularly and promptly.
4. Ascertaining, if any, the changes made in amount of annual or life membership subscription during the year.

C. LEGACIES AND GRANTS:

1. Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.
2. Vouching the amount received with the relevant correspondence, receipts and minute books.

D. INVESTMENTS INCOME:

1. Vouching the amounts received with the counterfoils of dividend and interests and schedule of investments by making special enquiries into any investments held for which no dividend or interest has been received. And also inspect securities physically.
2. Checking that the appropriate dividend has been received subsequently where any investment has been sold ex-dividend or purchased cum-dividend.

E. RENTS:

1. Examining the Register of rents and tenancy agreements to verify the amounts of the rents, and the due dates.
2. Vouching the rents received with reference to Rent register, counterfoils of receipt books and entries in the cash book.

F. SPECIAL FUNCTIONS:

1. Vouching gross receipts and outgoings in respect of any special functions, e.g. concerts, dramatic performance, etc., held in aid of the charity with such vouchers and cash statements as are necessary.
2. In particular, verifying that the proceeds of all tickets issued have been accounted for, after making the allowance for returns.

G. **INCOME TAX REFUNDS:** Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.

H. **EXPENDITURE:**

1. **Vouching payment of grants:**
    a. Verifying that the grants have been paid only for a charitable purpose or purposes falling within the purview of the objects for which the charitable institution has been set up and
    b. No trustee, director or member of the Managing Committee has benefited there from either directly or indirectly.
2. Verifying the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test-basis.
3. Verifying the cash and bank balances.
4. Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.

AUDIT OF EDUCATIONAL INSTITUTIONS (SCHOOL, COLLEGE OR UNIVERSITY)

A. **GENERAL:**

1. **Examination of the basic documents:** Verify the Trust Deed or Regulations in the case of school or college and in the case of a university, refer to the Act of Legislature and the Regulations framed there under.
2. **Reading the minutes:** Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see
    a. That these have been duly complied with,
    b. Specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

B. **FEE RECEIVED FROM STUDENTS:**

1. Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged.
2. Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
3. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
4. Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
5. See that free studentship and concessions have been granted by a person authorized to do so, having regard to the prescribed Rules.
6. Verify that there operates a system of internal check which ensures that demands against the students are properly raised.
7. Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.

8. Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
9. Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.
10. Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.

C. LEGACIES, GRANTS AND DONATIONS:

1. Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.
2. Vouching the amount received with the relevant correspondence, receipts and minute books.
3. Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilized for the same purpose.

D. INVESTMENTS INCOME:

1. Vouching the amounts received with the counterfoils of dividend and interests and schedule of investments by making special enquiries into any investments held for which no dividend or interest has been received. And also inspect securities physically.
2. Checking that the appropriate dividend has been received subsequently where any investment has been sold ex-dividend or purchased cum-dividend.
3. See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.

E. ASSETS AND LIABILITIES:

1. Report any old heavy arrears on account of fees, dormitory rents, etc. to the Managing Committee.
2. Confirm that caution money and other deposits paid by students on admission, have been shown as liability in the balance sheet not transferred to revenue, unless they are not refundable.
3. See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
4. Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
5. Verify the inventories of furniture, stationery, clothing, provision and all equipment etc. These should be checked by reference to Inventory Register or corresponding inventories of the previous year and values applied to various items should be test checked.

F. COMPLIANCES:

1. **INCOME TAX / TDS:** Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
2. Finally, verify the annual statements of account and, while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of staff, etc.

G. EXPENDITURE:

1. Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
2. Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.
3. See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
4. Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorized and passed before payment.

5. Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.
6. Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference

AUDIT OF HOSPITAL

The special steps involved in such an audit are stated below:

1. **REGISTER OF PATIENTS:**
   a. Vouch the Register of patients with copies of bills issued to them.
   b. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared.
   c. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
2. **COLLECTION OF CASH**: Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
3. **INCOME FROM INVESTMENTS, RENT ETC**: See with reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected.
4. **LEGACIES AND DONATIONS**: Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
5. **RECONCILIATION OF SUBSCRIPTIONS**: Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
6. **AUTHORISATION AND SANCTIONS**: Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
7. **GRANTS AND TDS**: Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
8. **BUDGETS**: Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
9. **INTERNAL CHECK**: Examine the internal check as regards the receipt and issue of stores;

medicines, linen, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.

10. **DEPRECIATION**: See that depreciation has been written off against all the assets at the appropriate rates.
11. **REGISTERS**: Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
12. **INVENTORIES**: Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.
13. **MANAGEMENT REPRESENTATION AND CERTIFICATE**: Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

AUDIT OF CLUB

1. **ENTRANCE FEE**: Vouch the receipt on account of entrance fees with members' applications, counterfoils issued to them, as well as on a reference to minutes of the Managing Committee.
2. **SUBSCRIPTIONS**: Vouch members' subscriptions with the counterfoils of receipt issued to them, trace receipts for a selected period to the Register of Members; also reconcile the amount of total subscriptions due with the amount collected and that outstanding.
3. **ARREARS OF SUBSCRIPTIONS**: Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
4. **ARITHMETICAL ACCURACY**: Check totals of various columns of the Register of members and tally them across.
5. **IRRECOVERABLE MEMBER DUES**: See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery; the amount considered irrecoverable should be mentioned in the Audit Report.
6. **PRICING**: Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests, as well as, with the fees chargeable for the special services rendered, such as billiards, tennis, etc.
7. **MEMBER ACCOUNTS**: Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.
8. **PURCHASES**: Vouch purchase of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.
9. **MARGINS EARNED**: Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale price so as to confirm that the normal rates of gross profit have been earned on their sales. The inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.
10. **INVENTORIES**: Check the inventory of furniture, sports material and other assets physically with the respective inventory registers or inventories prepared at the end of the year.
11. **INVESTMENTS**: Inspect the share scrips and bonds in respect of investments, check their current values for disclosure in final accounts; also ascertain that the arrangements

for their safe custody are satisfactory.

12. **MANAGEMENT POWERS:** Examine the financial powers of the secretary and, if these have been exceeded, report specific case for confirmation by the Managing Committee.

AUDIT OF CINEMA

A. AUDIT OF RECEIPTS FROM DAILY SHOW COLLECTIONS:

1. Verify:
   a. That entrance to the cinema hall is only through printed tickets;
   b. Tickets are serially numbered and bound into books;
   c. That the number of tickets issues for each show and class are different;
   d. That for advance booking a separate series of tickets is issued and
   e. Inventory of tickets is kept in proper custody.

2. If tickets are issued through computer - audit the system to ensure its reliability and authenticity of data generated by it.
3. System should provide that at the end of each show a proper statement should be prepared and cash collected be tallied.
4. Vouch the entries in the Cash Book in respect of cash collected on sale of tickets for different shows on a reference to Daily Statements with record of tickets issued for the different shows held.
5. Cash collected is deposited in banks partly on the same day and rest on the next day depending upon the banking facility available.
6. Verify that proper record is kept for free passes issued and the same are issued under proper authority.
7. Reconcile the amount of Entertainment Tax collected with the total number of tickets issued for each class.

B. INCOME FROM ADVERTISEMENT: Verify the charges collected for advertisement slides and shorts by reference to the Register of Slides and Shorts Exhibited kept at the cinema as well with the agreements, entered into with advertisers in this regard.

C. RESTAURANT INCOME:

1. The arrangement for collection of the share in the restaurant income should be enquired into either a fixed sum or a fixed percentage of the taking may be receivable annually.
2. In case the restaurant is run by the Cinema, its accounts should be checked.
3. The audit should cover sale of various items of foodstuffs, purchase of foodstuffs, cold drink, etc. as in the case of club.
4. Verify the basis of other incomes earned like car and scooter parking and display windows etc.

D. EXPENDITURE:

1. Vouch the expenditure incurred on advertisement, repairs and maintenance. No part of such expenditure should be capitalized.
2. Vouch the expenditure incurred on publicity of picture, electricity expenses etc.
3. Confirm that depreciation on machinery and furniture has been charged at appropriate rates which are higher, as compared to those admissible in the case of other businesses, in respect of similar assets.
4. Vouch payment of film hire with reference to agreement with distributor or producer.
5. Examine unadjusted balance out of advance paid to the distributors against film hire contracts to see that they are good and recoverable. If any film in respect of which an

advance was paid has already run, it should be enquired as to why the advance has not been adjusted. The management should be asked to make a provision in respect of advances that are considered irrecoverable.

AUDIT OF HIRE PURCHASE COMPANIES

A. **HIRE PURCHASE:** A Hire-purchase agreement means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which:

i. possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments,

ii. the property in the goods is to pass to such person on the payment of the last of such instalments, and

iii. such person has a right to terminate the agreement at any time before the property so passes.

Hirer means the person who obtains or has obtained possession of goods from an owner under a hire- purchase agreement and owner means the person who lets or has let, delivers or has delivered possession of goods to a hirer under a hire- purchase agreement in order to complete the purchase of, or the acquisition of property in the goods of which the agreement relates; and includes any sum so payable by the hirer under the hire- purchase agreement by way of a deposit or other initial payment.

B. **AUDIT PROCEDURE:** While checking the hire- purchase transaction, the auditor may examine the following:

i. Hire purchase agreement is in writing and is signed by all parties.

ii. Hire purchase agreement specifies clearly:

a. The hire-purchase price of the goods to which the agreement relates.

b. The cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash.

c. The date on which the agreement shall be deemed to have commenced.

d. The number of instalments by which the hire- purchase price is to be paid, the amount of each of those instalments, and the date, or the mode of determining the date, upon which it is payable, and the person to whom and the place where it is payable and

e. The goods to which the agreement relates, in a manner sufficient to identify them.

iii. Ensure that instalment payments are being received regularly as per the agreement.

AUDIT OF LEASING ENTITIES

1. In **a lease agreement**, a party (called '**lessee**') acquires the right to use an asset for an agreed period of time in consideration of payment of rent to another party (called '**lessor**').

a. **FINANCE LEASE:** In certain lease agreements, the legal ownership of the asset remains with the lessor (the leasing company), but in substance, all the risks and rewards of ownership of the asset are transferred to the lessee. In other words, the lease is, in effect, a financing arrangement. Such leases are termed as finance leases.

b. **OPERATING LEASE:** An operating lease, on the other hand, is a simple arrangement where, in return for rent, the lessor allows the lessee to use the asset for a certain period.

2. A normal finance lease transaction usually goes through the following modality:
   i. The lessee will select the equipment, and satisfy himself about its functional fitness and specifications, the lessor has no participation at this stage.
   ii. Having chosen the equipment, the lessee approaches a lessor, either directly or through a lease-broking agency.
   iii. The lease agreement is broadly negotiated and the rates are finalised. The lessor places an order on the manufacturer as chosen by the lessee.
   iv. The manufacturer delivers the equipment at the site of the lessee, and the latter gives notice of acceptance to the lessor.
   v. The lease agreement giving detailed terms of contract is signed between the parties. Leases will normally be full pay-out, with term varying as per requirements.
   vi. During the lease period, the lessee:
      - Will pay rentals regularly at periods agreed-upon, which are usually each calendar month;
      - Will keep the equipment in good repair and working condition, etc.
      - Will be entitled to any manufacturer's warranties or after-sales services.
   vii. At the end of the lease period, the equipment shall retreat to the lessor. The lessee may, however, be given a renewal right, or may be allowed to participate in purchase of the equipment when the lessor intends to sell it. No purchase option shall be given to the lessee in the lease agreement itself.
3. **AUDITOR'S PROCEDURES:** In respect of leasing transaction entered into by the leasing company, the following procedures may be adopted by the auditor:
   a. The object clause of leasing company to see that the goods like capital goods, consumer durables etc. in respect of which the company can undertake such activities. Further, to ensure that whether company can undertake financing activities or not.
   b. Whether there exists a procedure to ascertain the credit analysis of lessee like lessee's ability to meet the commitment under lease, past credit record, capital strength, availability of collateral security, etc.
   c. The lease agreement should be examined and the following points may be noted:
      i. The description of the lessor, the lessee, the equipment and the location where the equipment is to be installed. (The stipulation that the equipment shall not be removed from the described location except for repairs. For the sake of identification, the lessor may also require plates or markings to be attached to the equipment).
      ii. The amount of tenure of lease, dates of payment, late charges, deposits or advances etc. should be noted.
      iii. Whether the equipment shall be returned to the lessor on termination of the agreement and the cost shall be borne by the lessee.
      iv. Whether the agreement prohibits the lessee from assigning the subletting the equipment and authorises the lessor to do so.
   d. Examine the lease proposal form submitted by the lessee requesting the lessor to provide him the equipment on lease.
   e. Ensure that the invoice is retained safely as the lease is a long-term contract.
   f. Examine the acceptance letter obtained from the lessee indicating that the equipment has been received in order and is acceptable to the lessee.

g. See the Board resolution authorising a particular director to execute the lease agreement has been passed by the lessee.
h. See that the copies of the insurance policies have been obtained by the lessor for his records.

4. TYPES OF LEASES:

a. **Finance Lease:** An arrangement with the following attributes qualifies as a Finance Lease:
   i. The lease arrangement transfers ownership of the asset to the lessee at the end of the lease term.
   ii. The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised.
   iii. The lease term is for the major part of the economic life of the asset even if title is not transferred.
   iv. At the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset and
   v. The leased assets are of such a specialized nature that only the lessee can use them without major modifications.

b. **Operating Lease:** An arrangement that does not transfer substantially all the risks and rewards incidental to ownership qualifies as an Operating Lease. In other words, an operating lease is a lease arrangement "Other than finance lease".

	Operating Lease	Financial Lease
Common examples	Lease of Projector, Computers, Laptops, Coffee Dispensers etc.	Lease of Plant and Machinery, Land, Office Building etc.
Ownership	Ownership of the asset remains with the lessor for the entire period of lease.	Ownership transfer option at the end of the lease period is with the lessee. Title may or may not be eventually transferred.
Accounting treatment	Operating lease is generally treated like a renting arrangement. That means, the lease payments are treated as operating expenses and the asset does not appear as an asset on lessee's balance sheet.	Financial lease is treated like loan arrangement. Hence, the asset ownership is considered of that of the lessee and thus appears on the balance sheet of the lessee.
Purchase Option	Under operating lease, the lessee does not have any option to buy the asset during the lease period.	Financial lease allows the lessee to have a purchase option at less than the fair market value of the asset.
Lease Term	Lease term generally extends to less than 75% of the projected useful life of the leased asset.	Lease term is generally more than or equal to estimated economic life of the asset under thelease arrangement.

Operating/ running expenses	Lessee pays only the monthly lease payments. No running or administration costs are to be borne for example: registration, repairs etc. since it gives only right to use the asset.	Lessee generally bears insurance, maintenance and taxes.
Tax benefit	Since operating lease is as good as renting, lease payment is considered as expense. No depreciation can be claimed by the lessee.	Lessee can claim both interest and depreciation expense as financial lease is treated like a loan.

AUDIT OF HOTELS

A. INTERNAL CONTROL: Pilferage is one of the greatest problems in any hotel and it is extremely important to have a proper internal control to minimize the leakage. The following points should be checked:

1. Effectiveness of arrangement regarding receipts and disbursements of cash.
2. Procedure for purchase and inventory stocking of various commodities and provisions.
3. Procedure regarding billing of the customers in respect of room service, telephone, laundry, etc.
4. System regarding recording and physical custody of edibles, wines, cigarettes, crockery and cutlery, linen, furniture, carpets, etc.

B. ROOM SALES AND CASH COLLECTIONS:

1. The charge for room sales is made from the guest register, and tests are to be carried out to ensure that the correct numbers of guests are charged for the exact period of stay.
2. The total sales reported with the total bills issued at various sales points have to be reconciled.
3. Special care must be taken in respect of bills issued to customers who are staying in the hotel, because they may not be required to pay the bills immediately in cash but at a future date or by credit cards.
4. Billing is to be done room-wise. It must be ensured that all customers pay their bills on leaving the hotel or within specified dates.
5. The auditor should verify the restaurant bills with reference to KOT (Kitchen order Ticket).
6. The occupancy rate should be worked out, and compared with other similar hotels, and with previous year. Material deviations should be investigated.
7. The compliance with all statutory provisions and compliance with the Foreign Exchange Regulations must also be verified by the auditor, especially because hotels offer facility of conversion of foreign exchange to rupees.

C. RECEIPTS FROM FUNCTION HALLS: Special receipts on account of letting out of auditorium, banquet hall, spaces for shops, boutiques, and special shows should be verified with the arrangements made.

D. SHARING INCOME FROM TRAVEL AGENTS: It is common that hotels get their bookings done through travel agents. The auditor should ensure that the money is recovered from the travel agents as per credit terms allowed. Commission paid to travel agents should be checked by reference to the agreement on that behalf.

E. INVENTORY: The inventories in a hotel are all saleable item like food and beverages. Therefore, following may be noted in this regard:

1. All movement and transfer of inventories must be properly documented.
2. Areas where inventories are kept must be kept locked and the key retained by the departmental manager. The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.
3. The auditor should ensure that all inventories are valued at the year end and that he should himself be present at the year-end physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories
4. Apart from control over inventory of edibles, control over issue and physical inventory of linen crockery, cutlery, glassware, silver, toilet items, etc. should be verified.

F. FIXED ASSETS: The fixed assets should be properly depreciated, and the Fixed Assets Register should be updated.

G. CASUAL LABOUR: In case the hotel employs a casual labour, the auditor should consider, whether adequate records have been maintained in this respect and there is no manipulation taking place. The wages payment of the casual labour must also be checked thoroughly.

H. EXPENDITURE:

1. Consumption shown in various physical inventory accounts must be traced to the customers' bills to ensure that all issues to the customers have been billed.
2. All payments to the foreign collaborator, it any, are to be checked.
3. Expenses and receipts are to be compared with figures of the previous year, having regard to the average occupancy of visitors and changes in rates.
4. Expenses for painting, decoration, renovation of building, etc. are to be properly checked.
5. Computation and payment of salaries and wages vis-a-vis number of employees must be checked.

AUDIT OF TRUSTS & SOCIETIES

A. LEGAL FRAMEWORK:

1. There are 3 basic legal forms of charitable entities under Indian law, trusts, societies, and section 8 companies.
2. The legal framework governing the charitable institution will depend on the form of business organization the charitable institution takes.
3. If the charitable institution is formed as a Public Trust, it will be governed by the Public Trust Act applicable in the relevant State. However, if no Public Trust Act exists in that state, then the applicable legislation will be the Indian Trusts Act, 1882.
4. If the charitable institution is formed as a Society, it will be governed by the Societies Registration Act, 1860.
5. The charitable institution can also be formed as a non-profit company under section 8 of the Companies Act, 2013.
6. Apart from the above legislations, the Income Tax Act 1961 will be applicable to charitable institutions.
7. In the case of foreign contributions to these charitable institutions, the Foreign Contribution (Regulation) Act, 2010 will be applicable.

B. BOOKS OF ACCOUNT: Charitable and religious trusts should maintain regular books of account. This will enable management to demonstrate due discharge of responsibilities they assume. The Auditor is required to report whether the Trust has maintained proper books of accounts, including the following, namely:

a. Cash book.
b. Ledger.
c. Journal.
d. Copies of bills, whether machine numbered or otherwise serially numbered, wherever such bills are issued by the trust, and copies or counterfoils of machine numbered or otherwise serially numbered receipts issued by the trust.
e. Original bills wherever issued to the person and receipts in respect of payments made by the person.
f. Any other book that may be required to be maintained in order to give a true and fair view of the state of the affairs of the person and explain the transactions effected;

C. **FINANCIAL STATEMENTS**: Every year the trust has to prepare financial statements like the Balance sheet and Income and expenditure statements based on its books of accounts. The format for preparation and presentation of financial statements is prescribed under respective state laws. Charitable Organisations are governed by different laws as well as different forms of organisations also necessitate different accounting aspects to be complied.

D. **AUDITOR'S RESPONSIBILITY:**

a. The auditor should obtain the list of the books and records maintained by the Trust. The list should be matched with the above requirement for maintaining mandatory books and records as may be applicable in each case.
b. The auditor should then verify the records for the purpose of its audit.
c. He has to comply with the Accounting Standards (AS) and Standards on Auditing (SA) prescribed and made mandatory by the Institute of Chartered Accountants of India.

d. In giving his report the auditor will have to use his professional skill and expertise and apply such audit tests as the circumstances of the case may require, considering the contents of the audit report. He will have to conduct the audit by applying the generally accepted auditing procedures, which are applicable for any other audit. He can apply the test checks depending on the evaluation of internal control procedures followed by the assessee.
e. The auditor will also have to keep in mind the concept of materiality depending upon the circumstances of each case.
f. He should keep detailed notes about the evidence on which he has relied upon while conducting the audit and also maintain all his working papers. Such working papers should include his notes on the following, amongst other matters:
    i. Work done while conducting the audit and by whom.
    ii. Explanation and information given to him during the course of the audit and by whom.
    iii. Decision on the various points taken.
    iv. The judicial pronouncements relied upon by him while drafting the audit report; and
    v. Certificates issued by the client / management letters.
g. **It is important that the audit working papers prepared and/or obtained by the**

auditor provide evidence that:

i. The opinion expressed by the auditor is based on the examination made by him.
ii. In arriving at his opinion, the auditor has given due cognizance to the information and explanations given by the assessee and that his opinion is not arbitrary.
iii. The information and explanations obtained were full and complete that is, the auditor has called for all the information and explanations which were necessary to be considered before arriving at his opinion and
iv. The auditor did not merely rely upon the information or explanations given by the assessee but that he subjected such information and explanations to reasonable tests to verify their accuracy and completeness

E. TRUSTS: In case of trusts, the auditor has to ascertain:

1. Whether accounts are maintained regularly and in accordance with the provisions of the applicable Act and the rules;
2. Whether receipts and disbursements are properly and correctly shown in the accounts and money received in the form of donations is being applied as per the objects of the trust and as per the specific direction by the donor, if any.
3. Whether the cash balance and vouchers in the custody of the manager or trustee on the date of audit were in agreement with the accounts;
4. Whether all books, deeds, accounts, vouchers or other documents or records required by the auditor were produced before him;
5. Whether a register of movable and immovable properties is maintained, the changes therein are communicated from time to time to the regional office, and the defects and inaccuracies mentioned in the previous audit report have been duly complied with and rectified.
6. Whether the manager or trustee or any other person required by the auditor to appear before him did so and furnished the necessary information required by him;
7. Whether any property or funds of the Trust were applied for any object or purpose other than the object or purpose of the Trust;
8. The amounts of outstanding for more than one year and the amounts written off, if any;
9. Whether any money of the public trust has been invested contrary to the provisions of applicable Act which have come to the notice of the Auditor
10. All cases of irregular, illegal or improper expenditure, or failure or omission to recover monies or other property belonging to the public trust or of loss or waste of money or other property thereof, and whether such expenditure, failure, omission, loss or waste was caused in consequence of breach of trust or misapplication or any other misconduct on the part of the trustees or any other person while in the management of the trust
11. Whether the maximum and minimum number of the trustees is maintained;
12. Whether the meeting are held regularly as provided in such instrument
13. Whether the minute books of the proceedings of the meeting is maintained
14. Whether any of the trustees has any interest in the investment of the trust
15. Whether any of the trustees is a debtor or creditor of the trust.
16. Whether anonymous donations received are properly accounted for and donations in cash are not received by the Trust over and above the prescribed limit of accepting cash donations.
17. Whether the irregularities pointed out by the auditors in the accounts of the previous year have been duly complied with by the trustees during the period of audit

18. Any special matter which the auditor may think fit or necessary to bring to the notice of the Deputy or Assistant Charity Commissioner

F. SOCIETIES: In case of Societies, the auditor's considerations shall include:

1. The auditor should ascertain governing legislation of society i.e., Societies Registration act, 1860 or any applicable state law under which it has been registered.
2. Object of society needs to be ascertained from its memorandum of association/bye laws. Its activities may include charitable, social, cultural or educational activities.
3. Ascertain whether society has obtained registration under Foreign Contribution (Regulation) Act, 2010 in case foreign contributions are received.
4. Ascertain whether it is also registered under relevant provisions of Income Tax Act which may make it eligible for tax exemption on its income.
5. Obtain an understanding of internal control to design audit procedures with special reference to donations and various expenditures incurred in relation to achievements of objects of society.
6. Evaluate appropriateness of accounting policies with special reference to donations and grants. Also evaluate accounting policies in relation to specific grants.
7. In case some expenses incurred by society are reimbursed by donors, ascertain how these are recognized in financial statements.
8. Ascertain, if any inquiry has been held by Registrar under applicable law in the working or financial condition of society and its implications for auditor's opinion.
9. Ascertain all cases of irregular, illegal or improper expenditure or failure or omission to recover monies or other property belonging to society or of loss or waste of money or other property thereof.
10. Ascertain whether such expenditure or waste was caused in consequence of breach of trust or misapplication or any other misconduct on the part of governing body.

AUDIT OF CO-OPERATIVE SOCIETIES

Q.NO.1. WRITE A BRIEF OVER VIEW AND BACKGROUND ABOUT COOPERATIVE SOCIETIES AUDIT AND ROLE OF CHARTERED ACCOUNTANTS THEREOF?

ANSWER:

A. BACKGROUND:

1. Cooperative (also known as co-operative, co-op, or coop) is "an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned enterprise".
2. The Co-operative Societies Act, 1912, a Central Act, contains the fundamental law regarding the formation and working of the co-operative societies in India and is applicable in many states with or without amendments. In many states, viz., Maharashtra, West Bengal, Orissa, the co-operative societies are governed by specific state Acts.
3. An auditor of a co-operative society should be familiar with the provisions of the particular Act governing the society under audit.
4. Co-operative society is a business organisation with a special mode of doing business, by pulling together all the means of production co-operatively, elimination of middlemen and exploitation from outside forces.

B. ROLE OF AUDITOR W.R.T. SOCIETIES: A chartered accountant has to play a significant role in the development of cooperative organisations on scientific lines. Apart from audit, some other professional services could be rendered by chartered accountants such as:

a. Guidance in Accounts Writing,
b. Installation of Accounting System,
c. Internal Audit,
d. Management Accounting services,
e. Taxation etc.

Q.NO.2. WRITE ABOUT AUDIT OF COOPERATIVE SOCIETIES AS PER SEC 17 OF COOPERATIVE SOCIETIES ACT, 1912?

ANSWER:

1. The Registrar shall audit or cause to be audited by some person authorised by him by general or special order in writing in this behalf the accounts of every registered society once at least in every year.
2. The audit shall include an examination of overdue debts, if any, and a valuation of the assets and liabilities of the society.
3. The Registrar, the Collector or any person authorised by general or special order in writing shall:
   a. At all times have access to all the books, accounts, papers and securities of a society, and
   b. Every officer of the society shall furnish such information in regard to the transactions and working of the society as the person making such inspection may require.

   "Registrar" means a person appointed to perform the duties of a Registrar of Co-operative Societies under this Act.

Q.NO.3. WRITE ABOUT MULTISTATE COOPERATIVE SOCIETIES UNDER MSCS ACT, 2002 AND ACCOUNTS TO BE MAINTAINED BY THEM?

ANSWER:

A. OVERVIEW OF MSCS:

1. The Multi-State Co-operative Societies Act, 2002, which came into force in August, 2002 applies to co-operative societies whose objects are not confined to one State.
2. The Act contains detailed provisions regarding registration, membership and management of such societies.
3. The funds of a multi-State co-operative society cannot be utilised for any political purpose.
4. The Act contains detailed provisions regarding the investment of funds and restrictions on loans, borrowings, etc.

B. BOOKS OF ACCOUNTS: As per Multi-State Co-operative Society Rules 2002, every Multi-State Co-operative society shall keep books of account with respect to:

1. All sum of money received and expended and matters in respect of which the receipt and expenditure take place.
2. All sale and purchase of goods.
3. The assets and liabilities.
4. In the case of a multi-state co-operative society engaged in production, processing and manufacturing, particulars relating to utilization of materials or labour or other items of cost as may be specified in the bye-laws of such a society.

Q.NO.4. WRITE ABOUT QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS OF MULTI STATE COOPERATIVE SOCIETY?

ANSWER:

A. QUALIFICATION OF AUDITORS: Section 72 of the Multi-State Co-operative Societies Act, 2002 states that a person who is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 can only be appointed as auditor of multi-State co-operative society.

B. DISQUALIFICATION OF AUDITORS: The following persons are not eligible for appointment as auditors of a multi-State co-operative society-

1. A body corporate.
2. An officer or employee of the multi-State co-operative society.
3. A person who is a member or who is in the employment, of an officer or employee of the multi-State co-operative society.
4. A person who
   a. is indebted to the multi-State co-operative society or
   b. has given any guarantee or
   c. has provided any security in connection with the indebtedness of any third person to the multi-State co-operative society for an amount exceeding Rs.1000.

C. VACATION OF OFFICE: If an auditor becomes subject, after his appointment, to any, of the disqualifications specified above, he shall be deemed to have vacated his office as such.

D. APPOINTMENT OF FIRST AUDITORS (SEC. 70):

1. **Authority to appoint:**
   a. By the board within one month of the date of registration of such society.
   b. If the board fails to exercise its powers under this sub-section, the multi-State co-operative society in the general meeting may appoint the first auditor.

2. **Tenure of first auditor:** Till the conclusion of the first annual general meeting.

E. APPOINTMENT OF SUBSEQUENT AUDITORS (SEC. 70):

1. **Authority to appoint:** by the members of the multi-State co-operative society, at each annual general meeting.
2. **Tenure of subsequent auditor:** from the conclusion of that meeting until the conclusion of the next annual general meeting.

Q.NO.5. WHAT ARE THE POWERS OF AUDITOR OF MULTI- STATE CO-OPERATIVE SOCIETY?

ANSWER:

1. He shall have a right of access at all times to the book's accounts and vouchers of the multi-State co-operative society, whether kept at the head office of the multi-State co-operative society or elsewhere, and
2. He can inquire the officers or other employees of the multi-State co-operative society and require such information and explanation as the auditor may think necessary.

Q.NO.6. WHAT ARE THE DUTIES OF AUDITOR OF MULTI STATE CO-OPERATIVE SOCIETY?

ANSWER:

A. DUTY OF AUDITORS TO MAKE INQUIRY (SEC. 73(2)): The auditor shall make following inquiries:

1. Whether loans and advances made by the multi-State co-operative society on the basis of security.
   a. Have been properly secured and
   b. Whether the terms on which they have been made are not prejudicial to the interests of the multi-State cooperative society or its members,
2. Whether transactions which are represented merely by book entries are not prejudicial to the interests of the multi-State co-operative society,
3. Whether personal expenses have been charged to revenue account, and
4. Where it is Stated in the books and papers of the multi-State co-operative society that any shares have been allotted for cash,
   a. Whether cash has actually been received in respect of such allotment, and if no cash has actually been so received,
   b. Whether the position as stated in the account books and the balance sheet is correct regular and not misleading.

B. DUTY TO REPORT U/S SEC. 73(3):

1. The auditor shall make a report to the members of the multi-State co-operative society on
   a. The accounts examined by him and
   b. On every balance-sheet and profit and loss account including notes to account.
2. The report shall state whether, in his opinion and to the best of his information and according to the explanation given to him, the said accounts give the information required by this act in the manner so required, and give a true and fair view of:
   a. The state of affairs of the multi-State co-operative society's affairs as at the end of its financial year (Balance sheet); and
   b. The profit or loss for its financial year (profit and loss a/c).

C. DUTY TO STATE SOME MATTERS REQUIRED U/S SEC. 73(4): The auditor's report shall also state:

1. Whether he has obtained all the information and explanation which to the best of his knowledge and belief were necessary for the purpose of his audit.

2. Whether, in his opinion, proper books of account have been kept by the multi-State co-operative society and proper returns adequate for the purpose of his audit have been received from branches or offices of the multi-State co-operative society not visited by him.
3. Whether the report on the accounts of any branch office audited by a person other than the multi-State co-operative society's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.
4. Whether the Multi-State co-operative society's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and return.

Where any of the matters referred above is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

Q.NO.7. EXPLAIN THE POWER OF CENTRAL GOVERNMENT TO DIRECT SPECIAL AUDIT IN CASE OF AUDIT OF MULTI-STATE CO-OPERATIVE SOCIETY.

ANSWER:

POWER OF CENTRAL GOVERNMENT TO DIRECT SPECIAL AUDIT (SECTION 77):

A. PASSING AN ORDER BY CG:

1. **CIRCUMSTANCES NECESSITATING THE NEED FOR SPECIAL AUDIT:**
   a. That the affairs of any multi-State co-operative society are not being managed in accordance with co-operative principles or prudent commercial practices or
   b. That any Multi-State co-operative society is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or
   c. That the financial position of any multi-State co-operative society is such as to endanger its solvency.
2. **CONDITION FOR PASSING AN ORDER:** However, Central Government shall order for special audit only if that Government or the State Government either by itself or both hold 51 % or more of the paid-up share capital in such multi-State co-operative society.

B. PROCEDURE FOR CONDUCTING SPECIAL AUDIT:

1. **APPOINTING SPECIAL AUDITOR:** The Central Government may direct that a special audit of the multi-State co-operative society's accounts shall be conducted and appoint either a chartered accountant or the multi-State co-operative society's auditor himself to conduct the special audit.
2. **POWERS OF SPECIAL AUDITOR:** The special auditor shall have the same powers and duties in relation to the special audit as an auditor of a multi-State co-operative society has under section 73.
3. **REPORTING BY SPECIAL AUDITOR:** The special auditor shall make the report to the Central Government. The report of the special auditor shall, include all the matters required to be included in the auditor's report under section 73 and any other matter as directed by the Central Government.
4. **Action taken by CG:** On receipt of the report of the special auditor the Central Government may take such action on the report as it considers necessary in accordance with the provision of the Act or any law for the time being in force.
5. **Situation where no action is taken by CG:** if the Central Government does not take any action on the report within 4 months from the date of its receipt,

a. That Government shall send to the Multi-State Co- operative society, the report with its comments thereon and
b. Require the Multi-State Co-operative society either to circulate that copy or those extracts to the members or to have such copy or extracts read before the Multi-State Co-operative society at its next general meeting.

6. **EXPENSES PERTAINING TO THE SPECIAL AUDIT:** The expenses of, and incidental to, any special audit under this section (including the remuneration of the special auditor) shall be determined by the Central Government which determination shall be final and paid by the Multi-State Co-operative society and in default of such payment, shall be recoverable from the Multi-State Co-operative society as an arrear of land revenue.

Q.NO.8. EXPLAIN THE POWERS OF CENTRAL REGISTRAR TO MAKE AN INQUIRY U/S 78 AND INSPECTION U/S 79 OF MULTI-STATE CO-OPERATIVE SOCIETIES ACT, 2002.

ANSWER:

INQUIRY (U/S.78) AND INSEPCTION (U/S 79) BY CENTRAL REGISTRAR:

A. ELIGIBILITY TO MAKE AN APPLICATION FOR INQUIRY / INSPECTION:

1. A Creditor or
2. Not less than 1/3rd of the members of the board or
3. Not less than 1/4th of the total number of members of a multi-state co-operative society

B. AUTHORITY TO WHOM THE APPLICATION IS TO BE MADE: The Central Registrar.

C. INQUIRY BY WHOM:

1. Either by the registrar himself or
2. Some other person authorized by him

D. NOTICE TO THE SOCIETY: However, before holding such inquiry fifteen days' notice must be given to the multi-State co-operative society.

E. POWERS OF THE PERSON MAKING THE INQUIRY / INSPECTION:

1. **To Access to the books:** Right of access to the books, accounts, documents, and other properties belonging to and may require any person in possession or responsible for the custody of any such books, accounts, documents securities, cash or other properties to produce the same at any place specified by him.
2. **To call general meeting:**
   a. He may require the officers of the society to call a general meeting of the society by giving notice of not less than seven days at such time and place at the headquarters of the society to consider such matters as may be directed to him, and
   b. Where the officers of the society refuse or fail to call such a meeting, he shall have power to call it himself.
3. **To issue summons:** He may summon any person who is reasonably believed by him to have any knowledge of the affairs of the multi-State co-operative society to appear before him at any place at the headquarters of the society or any branch thereof and may examine such person on oath.

F. SENDING THE INQUIRY / INSPECTION REPORT BY CENTRAL REGISTRAR: The Central Registrar shall, within a period of 3 months of the date of receipt of the report, communicate the report of inquiry

1. To the Multi-State co-operative society, and
2. To the person or authority, if any at whose instance the inquiry is needed.

Q.NO.9. WHAT ARE THE SPECIAL FEATURES OF AUDIT OF CO-OPERATIVE SOCIETY?

ANSWER:

A. EXAMINATION OF OVERDUE DEBTS:

1. **Classification:** Overdue debts for a period from 6 months to 5 years and more than 5 years must be classified and shall have to be reported by an auditor.
2. **Comparison with previous year:** The auditor should compare the amount of current year's overdue debts and its ratio to total working capital with the previous year.
3. **Assessing the recovery:** A further analysis of these overdue debts from the viewpoint of chances of recovery must be made, and they must be classified as good or bad.
4. **Ensuring making of provisions:** The auditor must ascertain whether proper provisions for doubtful debts are made and whether the same is satisfactory.

B. OVERDUE INTEREST:

1. **Meaning:** Overdue interest is interest accrued or accruing in accounts, the amount of which the principal is overdue.
2. **Accounting Treatment:**
   a. Overdue interest should be excluded from Recognition of Interest Income while calculating profit.
   b. Such interest will be credited to overdue interest reserve and transferred to profit and loss a/c when realised.

C. CERTIFICATION OF BAD DEBTS: Check the authority for writing off the bad debts.

1. **Authorisation by auditor:** Some state acts may require that the Bad debts can be written off only when they are certified as bad by the auditor. For example, Maharashtra State Co-operative Rules, 1961.
2. **Authorisation by the managing committee:** Where no such requirement exists, the managing committee of the society must authorise the write-off.

D. VALUATION OF ASSETS AND LIABILITIES:

1. **Assets:**
   a. Ascertain existence, ownership and valuation of assets.
   b. Fixed assets should be valued at cost less adequate provision for depreciation.
   c. The incidental expenses incurred in the acquisition and the installation expenses of assets should be properly capitalised.
   d. The current assets should be valued at cost or market price, whichever is lower.
2. **Liabilities:** The auditor should see that all the known liabilities are brought into the account, and the contingent liabilities are stated by way of a note.

E. ADHERENCE TO CO-OPERATIVE PRINCIPLES:

1. **Ensure the Functioning of society towards achieving objectives:** The auditor must ascertain how far the objectives, for which the co-operative organisation is set up, have been achieved in the course of its working.
2. **Criteria for assessment:** The assessment is not necessarily in terms of profits, but in terms of extending of benefits to members who have formed the society.

3. **Principle of Propriety:** While auditing the expenses, the auditor should see that they are economically incurred and there is no wastage of funds. Middlemen commissions are, as far as possible, avoided and the purchases are made by the committee members directly from the wholesalers. The principles of propriety audit should be followed for the purpose.

F. ENSURING COMPLIANCE WITH THE PROVISIONS OF THE ACT AND RULES: An auditor of a co-operative society is required to identify the non-compliance with the provisions of Co-operative Societies Act and Rules and bye-laws.

G. VERIFICATION OF MEMBER'S REGISTER AND EXAMINATION OF THEIR PASS BOOKS: Examination of entries in members pass books regarding the loan given and its repayments, and confirmation of loan balances in person. Specifically in the rural and agricultural credit societies, members are not literate and as such this is a good safeguard on their part.

H. SPECIAL REPORT TO THE REGISTRAR: During the course of audit, if the auditor notices the following serious irregularities in the working of the society, then he may report these special matters to the Registrar, drawing his specific attention to the points.

1. Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.
2. Detection of fraud relating to expenses, purchases, property and stores of the society.
3. Specific examples of mis-management i.e., decisions of management against cooperative principles like cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party

I. AUDIT CLASSIFICATION OF SOCIETY: After a judgement of an overall performance of the society, the auditor has to award a class to the society. This judgement is to be based on the criteria specified by the Registrar. It may be noted here that if the management of the society is not satisfied about the award of audit class, it can make an appeal to the Registrar, and the Registrar may direct to review the audit classification. The auditor should be very careful, while making a decision about the class of society

J. DISCUSSION OF DRAFT AUDIT REPORT WITH MANAGING COMMITTEE: On conclusion of the audit, the auditor should ask the Secretary of the society to convene the managing committee meeting to discuss the audit draft report. The audit report should never be finalised without discussion with the managing committee.

Q.NO.10. WRITE ABOUT POINTS TO BE KEPT IN MIND WHILE AUDIT OF A COOPERATIVE SOCIETY AS PER COOPERATIVE SOCIETIES ACT, 1912?

ANSWER:

A. QUALIFICATIONS OF AUDITORS: Apart from a chartered accountant within the meaning of the Chartered Accountants Act, 1949, some of the State Co-operative Acts have permitted:

1. Persons holding a government diploma in co-operative accounts or in co-operation and accountancy and also
2. A person who has served as an auditor in the co-operative department of a government to act as an auditor.

B. APPOINTMENT OF THE AUDITOR:

1. An auditor of a co-operative society is appointed by the Registrar of Co-operative Societies and the auditor so appointed conducts the audit on behalf of the Registrar and submits his report to him as also to the society.
2. The audit fees are paid by the society on the basis of statutory scale of fees prescribed by the Registrar, according to the category of the society audited.

C. BOOKS, ACCOUNTS AND OTHER RECORDS OF CO-OPERATIVE SOCIETIES:

1. Under section 43(h) of the Central Act, a state government can frame rules prescribing the books and accounts to be kept by a co-operative society. For example, in Maharashtra, the co-operative societies are required to maintain books of account in terms of the instructions of the Registrar as following:
   a. All sums of money received and expended by the society and the matters in respect of which receipts and expenditure take place.
   b. All sales and purchases of goods by the society.
   c. Assets and liabilities of the society.
2. In order to maintain proper financial accounting records so as to disclose full financial results of working of the society, the statutory or mandatory provisions provide a directive, but they are not conclusive. The society is at liberty to maintain such additional records according to its convenience and which it thinks more useful for clarity and detailed explanation. Ultimately the financial transactions and the results thereof must be presented very clearly and in the best possible manner.
3. In case of large-scale co-operative organisation, different subsidiary books and registers shall be maintained and the daily summary totals will be transferred to main Cash Book. For example:
   a. Daily cash sales summary register.
   b. A register of collection from debtors if credit sales are allowed by bye-laws of society.
   c. A register of recovery of loans from salaries and directly by receipts from members in case of credit society.
   d. Loan disbursement register in case of credit society.
   e. Any other columnar subsidiaries depending upon the nature and functions of society.

D. RESTRICTIONS ON SHAREHOLDINGS (Sec. 5):

1. In the case of a society where the liability of a member of the society is limited, **no member of a society** other than a registered society can hold such portion of the share capital of the society as would exceed
   a. a maximum of 20% of the total number of shares or
   b. of the value of shareholding to ₹ 1,000/-.

2. The auditor of a co-operative society will be concerned with this provision so as to watch any breach relating to holding of shares.
3. The State Acts may provide limits as to the shareholding, other than that provided in the Central Act.

E. RESTRICTIONS ON LOANS (Sec. 29):

1. Society shall not make a loan to any person other than a member.
2. However, with the special sanction of the Registrar, a registered society may make a loan to another registered society.

F. RESTRICTIONS ON BORROWINGS (Sec. 30): A society shall not accept loans and deposits from persons who are not members unless otherwise provided by the bye-laws of the society.

G. INVESTMENT OF FUNDS (Sec. 32): A society may invest its funds in any one or more of the following:

1. In the Central or State Co-operative Bank.
2. In any bank, other than a Central or State co-operative bank, as approved by the Registrar on specified terms and conditions.
3. In any of the securities specified in section 20 of the Indian Trusts Act, 1882.
4. In the shares, securities, bonds or debentures of any other society **with limited liability**.
5. In any other moneys permitted by the Central or State Government.

H. APPROPRIATION OF PROFITS TO RESERVE FUND (Sec. 33): Every society shall transfer prescribed percentage of the profits to Reserve Fund, before distribution as dividends or bonus to members.

I. CONTRIBUTIONS TO CHARITABLE PURPOSES (Sec. 34): A society may, with the sanction of the Registrar, contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund for any charitable purpose.

J. INVESTMENT OF RESERVE FUND OUTSIDE THE BUSINESS OR UTILISATION AS WORKING CAPITAL: Some of the State Acts provide that a society may use the Reserve Fund:

1. In the business of a society, as working capital (subject to the rules made in this behalf).
2. May invest as per provisions of the Act.
3. May be used for some public purposes likely to promote the object of the society.

K. CONTRIBUTION TO EDUCATION FUND: Some of the State Acts provide that every society shall contribute annually towards the Education Fund of the State Federal Society, at the prescribed rates. Contribution to Education Fund is a charge on profits and not an appropriation.

L. ANY OTHER APPROPRIATIONS: Apart from statutory provisions relating to Reserve Fund, the auditor may have regard to the provisions in bye-laws and Rules and Regulations of the society regarding the appropriation of profits:

1. Transfers to other reserves, dividends to members etc. are the other appropriations.
2. Appropriations of profits must be approved by the General Body of the society, which is the supreme authority in the co-operative management.
3. Further, it may be noted that necessary accounting entries for the appropriation of profits must be passed after the date of approval by the General Body.
   Note: Here there is a departure from corporate accounting practice, where entries are passed for proposed appropriations, subject to approval of Annual General Meeting.

4. According to certain State Acts, transfers to Dividend Equalization Reserve and Share Capital Redemption Fund are stated as charges against profits. According to the generally accepted principles of accountancy these items are not charges, but appropriation of profits.
5. The auditor should point out such spots where statutory provisions of any law are in contradiction with the generally accepted accounting principles.

8. AUDIT STRATEGY, AUDIT PLANNING AND AUDIT PROGRAMME

Q.NO.1 WHY PLANNING AN AUDIT IS NECESSARY? - ITS BENEFITS. ADEQUATE PLANNING BENEFITS THE AUDIT OF FINANCIAL STATEMENTS IN SEVERAL WAYS?

ANSWER:

Planning an audit is necessary to carry out it effectively in a timely manner. Besides ensuring compliance with professional standards, it helps in performing audit engagement effectively. Adequate planning benefits the audit of financial statements in several ways, including the following:

1. Helping the auditor to Focus and attentive on important audit areas.
2. Helping the auditor identify and resolve potential problems on a timely basis.
3. Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
4. Assisting in the selection of engagement team members with appropriate levels of capabilities and competence.
5. Facilitating the direction and supervision of engagement team members and the review of their work.
6. Assisting in coordination of work done by auditors of components and experts.

Therefore, planning an audit ensures that audit risk is reduced to an acceptable low level. When audit work is adequately and properly planned, it reduces the risk of inappropriate opinion by the auditor.

Note: SA 300 Planning an audit of financial statements deals with the auditor's responsibility to plan an audit of financial statements. It states that objective of the auditor is to plan the audit so that it will be performed in an effective manner.

Q.NO.2 AUDIT PLANNING IS A CONTINUOUS PROCESS. EXPLAIN?

ANSWER:

1. Planning is not a discrete (specific) phase of an audit, but rather a continual and iterative (repetitive) process.
2. Planning begins after the completion of the previous audit and continues until the completion of the current audit engagement.
3. Further the audit plan shall be reviewed periodically to ensure that it covers new audit areas identified if any during the course of audit, making it up to date.

PLANNING INCLUDES CONSIDERATION OF FOLLOWING MATTERS:

a. Understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
   For example: Telecom companies and Banks. Such entities operate in different legal and regulatory frameworks. TRAI (Telecom Regulatory Authority of India) and RBI (Reserve Bank of India) are regulators for telecom and banking industry respectively.
b. The analytical procedures to be applied.
c. The determination of materiality as per SA 320.
d. The need of expert's assistance.
e. The performance of other risk assessment procedures.

Therefore, planning includes consideration of matters such as obtaining knowledge about legal framework in which entity is operating.

Planning also includes need to consider determination of material or significant matters. It also involves considering whether experts need to be involved taking into account complexity of business. Further, it also involves considering need to perform risk assessment procedures for identifying and assessing risks of material misstatement.

Q.NO.3 WRITE ABOUT INVOLVEMENT OF ENGAGEMENT TEAM IN PLANNING PROCESS?

ANSWER:

The overall audit strategy and the audit plan remain the auditor's responsibility. It is the auditor who is responsible for establishing overall audit strategy and developing audit plan. However, the auditor may discuss elements of planning with entity's management without compromising effectiveness of audit.

INVOLVEMENT OF KEY ENGAGEMENT TEAM MEMBERS:

1. The engagement partner and other key members of the engagement team shall be involved in planning the audit including planning and participating in the discussion among engagement team members.
2. The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process.

DISCUSSION OF ELEMENTS OF PLANNING WITH ENTITY'S MANAGEMENT:

1. The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement.
2. When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit.
3. The matters related to surprise checks shall not be included in the discussion with client.

Q.NO.4 WRITE ABOUT ELEMENTS OF PLANNING?

ANSWER:

The elements of planning can be categorized as under:

a. **Preliminary engagement activities:**
    i. Performing procedures related to acceptance and continuation of client relationship.
    ii. Procedures related to compliance with ethical requirements.
    iii. Establishing an understanding of terms of engagement.

b. **Planning activities:**
    i. Establishing the overall audit strategy.
    ii. Developing an audit plan

Q.NO.5 WRITE ABOUT PRELIMINARY ENGAGEMENT ACTIVITIES?

ANSWER:

PRELIMINARY ENGAGEMENT ACTIVITIES: The auditor considers whether relationship with client should be continued and whether ethical requirements including independence continue to be complied with. It includes:

1. **ACCEPTANCE AND CONTINUATION OF CLIENT RELATIONSHIP:** The firm should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client:
    a. Integrity of principal owners and key management
    b. Competence of engagement team to perform the audit engagement
    c. Implications of matters that have arisen during current and previous audit engagement may need to be considered

d. Besides, in case of initial engagements, communication with predecessor auditor should be made, where there has been a change of auditors.

2. **RELEVANT ETHICAL REQUIREMENTS:**
   a. The auditor shall continuously evaluate compliance with ethical requirements including independence.
   b. "Independence" means that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.
   c. Throughout the audit engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team.
   d. If matters come to the engagement partner's attention that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, shall determine the appropriate action.
   e. The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall:
      i. Obtain relevant information from the firm to identify and evaluate circumstances and relationships that create threats to independence
      ii. Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement and
      iii. Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation.
      iv. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

3. **ESTABLISH TERMS OF ENGAGEMENT:** Establishing an understanding of terms of engagement. It is in the interests of both the entity and the auditor that the auditor sends an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the audit. It ensures that there is no confusion with the client regarding terms of the engagement.

Note: Performing preliminary engagement activities assists the auditor in identifying and evaluating events or circumstances that may affect auditor's ability to plan and perform audit engagement.

Q.NO.6 HOW ESTABLISHING OVERALL AUDIT STRATEGY ASSISTA THE AUDITOR?

ANSWER:

Overall audit strategy sets the scope timing and direction of the audit and guides the development of the more detailed audit plan. The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as:

1. The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high-risk areas or the involvement of experts on complex matters
2. The amount of resources to allocate to specific audit areas, such as the number of team

members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas

3. When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates.
4. How such resources are managed, directed and supervised, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews

Q.NO.7 WHAT ARE THE FACTORS TO BE CONSIDERED WHILE ESTABLISHING OVERALL AUDIT STRATEGY?

ANSWER:

The auditor shall take following factors into consideration while establishing audit strategy:

a. **IDENTIFY THE CHARACTERISTICS OF THE ENGAGEMENT THAT DEFINE ITS SCOPE:** It is important for auditor to identify scope of the engagement. Only a well identified scope can lead to establishment of a sound audit strategy. There are many characteristics of engagement defining its scope. Some of characteristics are as under:
   a. Applicable financial reporting framework applicable to the entity
   b. Nature of business segments to be audited including the need for specialized knowledge
   c. Industry specific reporting requirements required by industry regulators
   d. Expected use of audit evidence obtained in previous audits
b. **ASCERTAIN THE REPORTING OBJECTIVES OF THE ENGAGEMENT:** The ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications. Some of the instances are given under:
   a. The entity's timetable for reporting
   b. Organization of meetings to discuss of nature, timing and extent of audit work with management
   c. Discussion with management regarding the expected type and timing of reports to be issued including the auditor's report
   d. Discussion with management regarding the expected communications on the status of audit work throughout the engagement.
   e. Expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed.
c. **SIGNIFICANT FACTORS IN DIRECTING THE ENGAGEMENT TEAM'S EFFORTS:** The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant. Preliminary identification of material classes of transactions, account balances and disclosures help auditor in establishing overall audit strategy. More energies need to be devoted to significant matters to obtain desired outcomes. Few examples are listed as under:
   a. Volume of transactions which may determine whether it is more efficient for the auditor to rely on internal control
   b. Significant industry developments such as changes in industry regulations and new reporting requirements.
   c. Significant changes in the financial reporting framework, such as changes in accounting standards.
   d. Other significant relevant developments, such as changes in the legal environment affecting the entity.

d. CONSIDER THE RESULTS OF PRELIMINARY ENGAGEMENT ACTIVITIES:
Considering results of preliminary engagement activities and knowledge gained from similar engagements goes a long way in establishing sound audit strategy. Examples are listed as under:

a. Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them.
b. The manner in which the auditor emphasizes to engagement team members the need to maintain a questioning mind and to exercise professional skepticism in gathering and evaluating audit evidence.

e. NATURE, TIMING AND EXTENT OF RESOURCES NECESSARY: Selection of engagement team and assignment of audit work to team members is a significant factor in establishing overall audit strategy. Experienced team members may be assigned in areas where there is higher risk of material misstatement. Similarly, engagement budgeting and devotion of more time to areas of higher risk of material misstatement are to be kept in mind.

Q.NO.8 WRITE ABOUT DEVELOPMENT OF AUDIT PLAN AFTER ESTABLISHING AN OVERALL AUDIT STRATEY?

ANSWER:

Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.
Understanding client's business is one of the important principles in developing an audit plan. In fact, without adequate knowledge of client's business, a proper audit is not possible. Gaining knowledge of client's business is, therefore, one of the foremost requirements to develop audit plan.
SA-300 states that auditor shall develop an audit plan that shall include description of:

1. The nature, timing and extent of planned risk assessment procedures.
2. The nature, timing and extent of planned further audit procedures at assertion level.
3. Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.
4. The auditor plans what type of audit procedures are to be performed, their timing and how much work should be done taking into account sample size etc.

The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.
For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures.
In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

Q.NO.9 WRITE ABOUT RELATIONSHIP BETWEEN OVERALL AUDIT STRATEGY AND AUDIT PLAN?

ANSWER:

1. Audit strategy sets the broad overall approach to the audit whereas audit plan addresses the various matters identified in the overall audit strategy.
2. Audit strategy determines scope, timing and direction of audit. Audit plan describes how strategy is going to be implemented.
3. The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members.
4. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.
5. Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.
6. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.

Q.NO.10 A WELL-DESIGNED AUDIT PLAN NEED NOT BE CHANGED DURING THE COURSE OF AUDIT. COMMENT.

ANSWER:

1. The auditor shall update and change the overall audit strategy and the audit plan as and when necessary.
2. **Reasons for change:**
   a. Unexpected events.
   b. Changes in conditions.
   c. Information comes to the auditor's knowledge during the audit which is different from the information available at the time of planning.
3. Therefore, the auditor may need to change the overall audit strategy and audit plan based on revised circumstances so as to make the audit effective.
4. In other words, the audit plan should be dynamic and offer flexibility that enables modifications.

For example, audit evidence obtained through on detailed checking may contradict the audit evidence obtained through testing internal controls.

Q.NO.11 EXPLAIN DIRECTION, SUPERVISION AND REVIEW OF THE AUDIT BY THE AUDITOR OR REVIEWER?

ANSWER:

A. INCLUSION IN PLANNING:

1. While developing overall audit strategy and audit plan, the auditor shall also include periodical review of audit procedures performed by the engagement team.
2. This ensures whether the engagement team members are complying with relevant auditing standards and whether the audit is going on in a planned manner.
3. This review may be carried out by the engagement partner or independent reviewer who also belongs to the auditor's firm. [This Point Not covered in New ICAI SM]

B. FACTORS INFLUENCING EXTENT OF DIRECTION, SUPERVISION AND REVIEW:

1. The size and complexity of the entity.
2. The areas of the audit.
3. The assessed risks of material misstatement.

4. The capabilities and competence of the individual team members performing the audit work.

Meaning of reviewer: Reviewer is another person from the same audit firm but doesn't belong to engagement team.

Q.NO.12 WRITE ABOUT DOCUMENTATION OF OVERALL AUDIT STRATEGY AND AUDIT PLAN?

ANSWER:

NEED FOR DOCUMENTATION:

1. It is a record of the key decisions regarding planning of the audit and to communication with the engagement team of significant matters.
2. The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

THE AUDITOR SHALL DOCUMENT:

1. The overall audit strategy.
2. The audit plans.
3. Any significant changes to the overall audit strategy or the audit plan along with the reasons for such changes. A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit.
4. A summary of discussions with the entity's key persons.
5. Other communications or agreements with management or those charged with governance w.r.t any other services.

Q.NO.13 DEFINE AUDIT PROGRAMME AND IS ONE AUDIT PROGRAMME SUITABLE FOR ALL CLEINTS?

ANSWER:

A. DEFINITION: An audit programme consists of a series of verification procedures to be applied to the financial statements and accounts of a given company for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on such statements. In other words, an audit programme is a detailed plan of applying the audit procedures in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.

B. EVOLVING ONE AUDIT PROGRAMME – NOT PRACTICABLE FOR ALL BUSINESSES:

1. Businesses vary in nature, size and composition.
2. Work which is suitable to one business may not be suitable to others.
3. Efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment.

On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable. However, it becomes a necessity to specify in detail in the audit programme the nature of work to be done so that no time will be wasted on matters not pertinent to the engagement and any special matter or any specific situation can be taken care of.

Q.NO.14 ASSISTANTS MUST KEEP AN OPEN MIND TO RESPOND FOR CHANGED CIRCUMSTANCES TO UPDATE AUDIT PROGRAMME AS AND WHEN NECESSARY. COMMENT.

ANSWER:

1. **STANDARD PROGRAMME:** To start with, an auditor having regard to the nature, size and composition of the business and the dependability of the internal control and the given scope of work, should frame a programme which should aim at providing for a minimum essential work which may be termed as a standard programme.
2. As experience is gained by actually carrying out the work, the programme may be altered to take care of situations which were left out originally, but are found relevant for the particular concern.
3. Similarly, if any work originally provided for proves beyond doubt to be unnecessary or irrelevant, it may be dropped.
4. The assistant engaged in the job should be encouraged to keep an open mind beyond the programme given to him. He should be instructed to note and report significant matters coming to his notice, to his seniors or to the partners or proprietor of the firm engaged for doing the audit.

Q.NO.15 WRITE ABOUT PERIODIC REVIEW OF THE AUDIT PROGRAMME?

ANSWER:

1. There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions.
2. Unless this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an obsolete programme and, for this negligence, the whole audit may be held as negligently conducted and the auditor may have to face legal consequences.

   Example: If the audit programme for the audit of a branch of a financing house, drawn up a number of years ago, fails to take into consideration that the previous policy of financing of a vehicle has been changed to financing of real estate acquisition, the whole audit conducted thereunder would be entirely misdirected and may even result into nothing more than a farce. [Pacific Acceptance Corporation Ltd. v. Forsyth and Others.]
3. The utility of the audit programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed.
4. However, as a basic feature, audit programme not only lists the tasks to be carried out but also contains a few relevant instructions, like the extent of checking, the sampling plan, etc.
5. So long as the programme is not officially changed by the principal, every assistant deputed on the job should unfailingly carry out the detailed work according to the instructions governing the work.
6. Many persons believe that this brings an element of rigidity in the audit programme. This is not true provided the periodic review is undertaken to keep the programme as up-to-date as possible.

Q.NO.16 WHAT ARE THE POINTS TO BE KEPT IN MIND WHILE CONSTRUCTING AN AUDIT PROGRAMME?

ANSWER:

1. The audit planning ideally commences at the conclusion of the previous year's audit, and along with the related programme, it should be reconsidered for modification as the audit

progresses. Such consideration is based on the auditor's review of the internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures.

2. While developing an audit programme, the auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence.
3. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts.
4. Further, the auditor normally has flexibility in deciding when to perform audit procedures. However, in some cases, the auditor may have no discretion as to timing, for example, when observing the taking of inventories by client personnel or verifying the securities and cash balances at the year-end.
5. For the purpose of programme construction, the following points should be kept in mind:
   a. Stay within the scope and limitation of the assignment.
   b. Prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.
   c. Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
   d. Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
   e. Include the audit objectives for each area and sufficient details which serve as a set of instructions for the assistants involved in audit and help in controlling the proper execution of the work.
   f. Consider all possibilities of error.
   g. Co-ordinate the procedures to be applied to related items.

Q.NO.17 MAIN OBJECTIVE OF AUDIT PROGRAMME DESIGNED IS TO PROVIDE AUDIT EVIDENCE. COMMENT.

ANSWER:

What is best evidence for testing the accuracy of any assertion is a matter of expert knowledge and experience. This is the primary task before the auditor when he draws up the audit programme. Transactions are varied in nature and impact. Procedures to be prescribed depend on prior knowledge of what evidence is reasonably available in respect of each transaction.

Example:

1. Sales are evidenced by:
2. Invoices raised by the client;
3. Price list;
4. Forwarding notes to client;
5. Inventory-issue records;
6. Sales managers' advice to the inventory section;
7. Acknowledgements of the receipt of goods by the customers; and
8. Collection of money against sales by the client.

An auditor picks up evidence from a variety of fields and it is generally of the following broad types:

1. Documentary examination,
2. Physical examination,
3. Statements and explanation of management, officials and employees,

4. Statements and explanations of third parties,
5. Arithmetical calculations by the auditor,
6. State of internal controls and internal checks,
7. Inter-relationship of the various accounting data,
8. Subsidiary and memorandum records,
9. Minutes,
10. Subsequent action by the client and by others.

Examples:

1. For cash in hand, the best evidence is 'count'
2. For investment pledged with a bank, the banker's certificate.
3. For verifying assertions about book debts, the client's ledger invoices, debit notes, credit notes, monthly accounts statement sent to the customers are all evidence: some of these are corroborative, other being complementary. In addition, balance confirmation procedure is often resorted to, to obtain greater satisfaction about the reliability of the assertion.

The auditor, however, has to place appropriate weight on each piece of evidence and accordingly should prescribe the priority of verification. It is true that in all cases one procedure may not bring the highest satisfaction and it may be dangerous for the auditor to ignore any evidence that is available. By the word "available" we do not mean that the evidence available with the client is the only available evidence. The auditor should know what normally should be available in the context of the transaction having regard to the circumstances and usage.

Q.NO.18 WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF AUDIT PROGRAMME?

ANSWER:

A. ADVANTAGES:

1. It provides the assistant carrying out the audit with total and clear set of instructions of the work generally to be done.
2. It is essential, particularly for major audits, to provide a total perspective of the work to be performed.
3. Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.
4. Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, such danger is significantly less and the audit can proceed systematically.
5. The assistants, by putting their signature on programme, accept the responsibility for the work carried out by them individually and, if necessary, the work done may be traced back to the assistant.
6. The principal can control the progress of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
7. It serves as a guide for audits to be carried out in the succeeding year.
8. A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of professional auditor.

B. DISADVANTAGES:

1. The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.

2. The programme often tends to become rigid and inflexible following set grooves.
3. The business may change in its operation of conduct, but the old programme may still be carried on.
4. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.
5. Inefficient assistants may take shelter behind the programme i.e., defend deficiencies in their work on the ground that no instruction in the matter is contained therein.
6. A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.

C. PRECAUTIONS:

1. All these disadvantages may be eliminated by imaginative supervision of the work carried on by the assistants.
2. The auditor must have a receptive attitude as regards the assistants.
3. The assistants should be encouraged to observe matters objectively and bring significant matters to the notice of supervisor/principal.

Extract of Sample audit programme pertaining to sales of an entity

Name of concern	Fine Industries
Financial year	2021-22
Prepared by	P (with date)
Reviewed by	Q (with date)
Approved by	R (with date)

Serial number	Nature of Procedure	Extent of Check	Basis of sample	Done by
(a)	Vouch few sales invoices from copies available in record of the concern.			
(b)	Trace these invoices into the account books of the concern.			
(c)	Verify few invoices with e-way bills generated on the e- way bill portal.			
(d)	Trace few sales invoices into the stock records to ensure that sold quantities have been reduced from stocks.			
(e)	Trace also few sales invoices into accounts of buyers			

9. RISK ASSESSMENT AND INTERNAL CONTROL

SA 315, 330 AND 320

Q.NO.1 DEFINE AUDIT RISK? WHAT ARE THE COMPONENTS OF AUDIT RISK? WRITE ABOUT INTER RELATIONSHIP BETWEEN COMPONENTS OF AUDIT RISK?

ANSWER:

A. MEANING OF AUDIT RISK AND CONSEQUENCES:

a. **MEANING:** The risk of expressing an inappropriate opinion when the financial statements are materially misstated is termed as audit risk. In other words, expression of unmodified opinion in a situation where modified opinion would be suitable.

b. **CONSEQUENCES:**

   i. In such a case, not only reputation of auditor would be damaged, but he could also invite regulatory action from professional body and could face probable legal action by intended users.

   ii. To avoid such unpleasant consequences, the auditor will plan and perform the audit in such a way that audit risk is reduced to an acceptably low level.

   Consider, for example, that profits of a company have been increased artificially by showing fake revenues of sizeable amounts in its financial statements. In such a case, financial statements are materially misstated. The probability, that auditor in such a case, expresses an inappropriate audit opinion is referred to as audit risk. It is the possibility that auditor expresses an unmodified opinion even when financial statements are materially misstated.

c. **EXCLUDES:** It DOES NOT include

   i. Risk of expressing a modified opinion when financial statements are not materially misstated.

   ii. Further, audit risk is a technical term related to the process of auditing and it does not refer Business risk faced by auditor.
   Example: Loss from litigations, adverse publicity, Loss of clients or reputation is not considered as audit risk.

B. **COMPONENTS OF AUDIT RISK:** Audit risk is a function of the risks of material misstatement and detection risk.

Audit Risk = Risk of Material Misstatement x Detection Risk

1. **RISK OF MMS:** The risk that the financial statements are materially misstated prior to audit. It simply means that there is a probability of frauds or errors in financial statements before audit.
2. Few examples of misstatements could be:
   a. Charging of an item of capital expenditure to revenue or vice-versa
   b. Difference in disclosure of a financial statement item vis-à-vis its requirement in applicable financial reporting framework
   c. Selection or application of inappropriate accounting policies
   d. Difference in accounting estimate of a financial statement item vis-à-vis its appropriateness in applicable financial reporting framework
   e. Intentional booking of fake expenses in statement of profit and loss

f. Overstating of receivables in financial statements by not writing off irrecoverable debts
g. Overstating or understating inventories

3. The risks of material misstatement may exist at 2 levels:
   a. **FINANCIAL STATEMENT LEVEL:** The Overall Financial Statement Level risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
   b. **ASSERTION LEVEL:** The assertion level for classes of transactions, account balances, and disclosures. These are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

Q.NO.2 WRITE ABOUT COMPONENTS OF RISK OF MATERIAL MISSTATEMENTS?

ANSWER:

COMPONENTS OF RISK OF MMS: This consists of 2 components namely inherent risk and control risk. Both inherent risk and control risk are the entity's risks and they exist independently of the audit of financial statements. Inherent risk and control risk are influenced by the client. These are entity's risks and are not influenced by the auditor.

1. **INHERENT RISK:**
   i. Inherent risk is the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements before consideration of any related controls as described in SA-200.
   ii. There is always a risk that before considering any existence of internal control in an entity, a particular transaction, balance of an account or a disclosure required to be made in the financial statements of an entity have a chance of being misstated and such misstatement can be material. This risk is known as inherent risk.
   iii. Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations.
   iv. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete.
   v. Factors in the entity and its environment may also influence the inherent risk related to a specific assertion.
   vi. Inherent risk factors are considered while designing tests of controls and substantive procedures. Category of auditor's assessment, lower or higher, each category covers a range of degrees of inherent risk.
   vii. Auditor may assess the inherent risk of two different assertions as lower while recognizing that one assertion has less inherent risk than the other, although both have been assessed as lower.
   viii. It is important to consider the reason for each identified inherent risk even if the risk is lower, when the auditor designs tests of controls and substantive procedures.

   Examples:
   a. An accounting standard provides guidance on some complex issue which might not be understood by the management. Therefore, recording of this issue in financial statements carries inherent risk of being misstated.
   b. There are large number of business failures in an industry. Therefore, assertions in financial statements of an entity operating in such an industry carry an inherent risk of

being misstated.

2. **CONTROL RISK:**
   a. In accordance with SA-200, control risk is the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.
   b. The risk that the internal control system, would not be efficient enough to stop from happening, or find and then rectify in an appropriate time, any material misstatement relating to a transaction, balance of an account or disclosure required to be made in the financial statements of that entity.
   c. Therefore, in a way, it can be said that there exists an inverse relation between control risk and efficiency of internal control of an entity.

   Examples of control risk could include:
   a. A company has devised control that cash and cheque books should be kept in a locked safe and access is granted to authorized personnel only. There is risk that control is not being followed.
   b. An entity has devised a control that fire extinguishers and smoke detectors are in place and are in working condition at all times to reduce the risk of damage to inventories caused by fire. There is a risk that fire extinguishers in place are expired and are not being refilled. Similarly, there is a possibility that smoke detectors are not working.
   c. A company has devised a control relating to petty cash that items of expenditure of only less than Rs.10000 should be routed through imprest system of petty cash. There is a risk that control is not being followed.

Q.NO.3 WRITE ABOUT DETECTION RISK?

ANSWER:

1. SA 200 defines detection risk as the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements. For example, auditor of a company uses certain audit procedures for the purpose of obtaining audit evidence and reducing audit risk, but still there will remain a risk that audit procedures used by the auditor may not be able to detect a misstatement which by nature is material, then that risk is known as detection Risk.
2. Detection risk **comprises sampling and non-sampling risk**.
   a. Sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. It simply means that the sample was not representative of the population from which it was chosen.
   b. Non-sampling risk is the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. Like an auditor may reach an erroneous conclusion due to application to some inappropriate audit procedure.
3. **Examples of detection risk could include:**
   a. Sizeable work-in-progress inventories are expected in financial statements of a company. However, auditor of the company does not devote time to attending inventory count. Instead, he chooses to rely upon alternative audit procedures.
   b. The auditor of a company has audited revenue of a company by taking a sample. However, there is a risk that sample of revenue is not representative of overall revenue.

4. The auditor can only influence detection risk. Inherent risk and control risk belong to the entity and are influenced by the entity. Therefore, auditor must reduce detection risk in order to keep audit risk at low level. Detection risk may be reduced by increasing area of checking, testing larger samples and by including competent and experienced persons in the engagement team.

Q.NO.4 ASSESSMENT OF RISKS IS A MATTER OF PROFESSIONAL JUDGMENT. COMMENT?

ANSWER:

1. **MATTER OF PROFESSIONAL JUDGMENT:**
   a. Audit risk is a function of the risks of material misstatement and detection risk. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.
   b. The distinguishing feature of the professional judgment expected of an auditor is that it is exercised by an auditor whose training, knowledge and experience have assisted in developing the necessary competencies to achieve reasonable judgments.
2. **COMBINED ASSESSMENT OF RISK OF MMS:** The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.
3. **INTERRELATIONSHIP BETWEEN COMPONENTS:**
   a. There exists an INVERSE RELATIONSHIP between Risk of MMS and Detection risk.
   b. For Example: If the Risk of MMS is high, the auditor will conduct an in-depth audit, resultantly he can detect MMS.

   Audit risk = Inherent risk X Control risk X Detection risk

Q.NO.5 WRITE ABOUT IDENTIFYING AND ASSESSING RISK OF MATERIAL MISSTATEMENT UNDER SA 315?

ANSWER:

SA 315 - IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT:

1. As per SA 315, The objective of auditor is:
   a. To identify the risk of MMS at 2 levels:
      i. Financial statement level.
      ii. Assertion level.
   b. To assess (analyse) the risk of MMS for determining its significance.
   c. To minimise the audit risk to an acceptably low level by properly planning and performing audit (audit procedures) based on risk assessment process.
2. For the purpose of identifying and assessing the risks of material misstatement, the auditor shall:
   a. Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements

b. Evaluate whether the risks identified are impacting financial statements at a pervasive level and affect many assertions potentially.
c. Relate the identified risks to What Can Go Wrong (WCGR) by considering related controls at assertion level taking account of relevant controls that the auditor intends to test.
d. Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

Q.NO.6 WHAT IS RISK ASSESSMENT PROCEDURES AND WHAT ARE INCLUDED THERE IN?

ANSWER:

1. **DEFINITION:** The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels are defined as risk assessment procedures.
2. The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels.
3. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.
4. The risks to be assessed include both those due to error and those due to fraud.

RISK ASSESSMENT PROCEDURES INCLUDES:

1. **INQUIRIES OF MANAGEMENT AND OF OTHERS WITHIN THE ENTITY:** Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority.

   Examples:
   a. Inquiries with those charged with governance may enable the auditor to understand the environment in which financial statements are prepared.
   b. Inquiries with internal audit personnel may provide information about internal audit procedures performed during the year relating to the design and effectiveness of the entity's internal control and whether management has satisfactorily responded to findings from those procedures.
   c. Inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
   d. Inquiries with in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contract.
   e. Inquiries with marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
   f. Inquiries with risk management function (or those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.

g. Inquiries directed to information systems personnel may provide information about system changes, system or control failures, or other information system- related risks.

2. ANALYTICAL PROCEDURES:

a. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between profit and number of employees i.e., profit generated per employee. Another example, the relationship between sales and square footage of selling space or volume of goods sold.

b. Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships identified by the auditor may help in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

c. However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures.

d. Analytical procedures include:

   i. Ratio Analysis
   ii. Trend Analysis
   iii. Reasonableness test
   iv. Structural modeling (A Statistical tool. Eg; Regression theorem)

3. OBSERVATION AND INSPECTION: Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment. Examples of such audit procedures include observation or inspection of the following:

a. Observing Entity's operations. E.g., Production, Accounting etc.,

b. Inspecting Documents, records, internal control manuals may provide supporting information in addition to inquiries. E.g., Reading Standard Operating Manuals (SOP).

c. Inspecting Reports prepared by management and those charged with governance. E.g., Minutes, MIS reports.

d. Observing client's premises like factory, offices etc.,

INFORMATION OBTAINED BY PERFORMING RISK ASSESSMENT PROCEDURES - USED AS AUDIT EVIDENCE: Information obtained by performing risk assessment procedures and related activities may be used by the auditor as audit evidence to support assessments of the risks of material misstatement. In addition, the auditor may obtain audit evidence about classes of transactions, account balances, or disclosures and related assertions and about the operating effectiveness of controls, even though such procedures were not specifically planned as substantive procedures or as tests of controls. The auditor also may choose to perform substantive procedures or tests of controls concurrently with risk assessment procedures because it is efficient to do so.

Q.NO.7 WRITE ABOUT THE CONCEPT OF MATERIALITY?

ANSWER:

1. Financial statements should disclose all 'material items, i.e., the items the knowledge of which might influence the decisions of the user of the financial statement.
2. Materiality is not always a matter of relative size.
   For example, a small amount lost by fraudulent practices of certain employees can indicate a serious flaw in the enterprise's internal control system requiring immediate attention to avoid greater losses in future.
3. In certain cases, quantitative limits of materiality is specified. A few of such cases are given below:
   a. A company should disclose by way of notes additional information regarding any item of income or expenditure which exceeds 1% of the revenue from operations or Rs.1,00,000 whichever is higher (Schedule III to the Companies Act, 2013).
   b. A company should disclose in Notes to Accounts, shares in the company held by each shareholder holding more than 5 % shares specifying the number of shares held.
4. Standard on Auditing (SA) -320 on "Materiality in Planning and Performing an Audit" deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements. SA 450 explains how materiality is applied in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements on the financial statements.
5. **MATERIALITY IF FRFW DO NOT CONTAIN ANY REFERENCE THERETO:** Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:
   a. Misstatements are material if expected to influence the economic decisions of users taken on the basis of the financial statements.
   b. Judgments about materiality are affected by the size or nature of a misstatement or combination of both.
   c. Judgments about matters that are material are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

   If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred above provide the auditor with such a frame of reference.

Q.NO.8 DETERMINATION OF MATERIALITY IS A MATTER OF PROFESSIONAL JUDGMENT OF AUDITOR. COMMENT.

ANSWER:

The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:

1. Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence.
2. Understand that financial statements are prepared, presented and audited to levels of materiality.
3. Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events and
4. Make reasonable economic decisions on the basis of the information in the financial statements.

Q.NO.9 THE CONCEPT OF MATERIALITY IS APPLIED BY THE AUDITOR BOTH IN PLANNING AND PERFORMING THE AUDIT, AND IN EVALUATING THE EFFECT OF IDENTIFIED MISSTATEMENTS ON THE AUDIT AND OF UNCORRECTED MISSTATEMENTS, IF ANY, ON THE FINANCIAL STATEMENTS AND IN FORMING THE OPINION IN THE AUDITOR'S REPORT. COMMENT.

ANSWER:

1. Materiality is an important consideration for an auditor to evaluate whether the financial statements reflect a true and fair view or not.
2. SA 320 on "Materiality in Planning and Performing an Audit" requires that an auditor should consider materiality and its relationship with audit risk while conducting an audit.
3. When planning the audit, the auditor considers what would make the financial information materially misstated.
4. The auditor's preliminary assessment of materiality related to specific account balances and classes of transactions helps the auditor decide such questions as what items to examine and whether to use sampling and analytical procedures.
5. This enables the auditor to select audit procedures that, in combination, can be expected to support the audit opinion at an acceptably low degree of audit risk.
6. It may be noted that the auditor's assessment of materiality and audit risk may be different at the time of initially planning of the audit as against at the time of evaluating the results of audit procedures.
7. At the planning stage, the auditor needs to consider the materiality for the financial statements as a whole. The auditor has to carry out a preliminary identification of significant components and material classes of transactions, account balances and disclosure which he plans to examine.
8. What could be considered material for all situations cannot be defined precisely and an amount or transaction material in one situation may not be material in other situation. For example, Rs. 5,000 may be material for a small entity, but even Rs. 100,000 may not be material for a large entity.
9. The auditor has to apply his professional judgement in determining materiality, choosing appropriate benchmark and determining level of benchmark.
10. Materiality forms the basis for determination of audit scope and the levels of testing the transactions.
11. If there is any statutory requirement of disclosure, it is to be considered material irrespective of the value of amount.

Example:

As per new Division I schedule III of Companies Act, 2013, any item of income or expenditure which exceeds one percent of the revenue from operations or Rs. 1,00,000, whichever is higher, needs to be disclosed separately.

Q.NO.10 WRITE ABOUT PERFORMANCE MATERIALITY?

ANSWER:

1. When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole.
2. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

3. Practically, it is difficult for auditors to design tests to identify individual misstatements. It is likely that misstatements are material in aggregate. It takes us to the concept of "performance materiality
4. **PERFORMANCE MATERIALITY:** Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to *reduce to an appropriately low level* the probability that the aggregate of uncorrected and undetected misstatements *exceeds materiality for the financial statements as a whole.*
   If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.
   Performance materiality is set at a value lower than overall materiality. It lowers the risk that auditor will not be able to identify misstatements that are material when added together

Q.NO.11 WRITE ABOUT USE OF BENCHMARKS IN DETERMINING MATERIALITY FOR THE FINANCIAL STATEMENTS AS A WHOLE?

ANSWER:

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

Factors that may affect the identification of an appropriate benchmark include the following:

1. The elements of the financial statements.
   Example: Assets, liabilities, equity, revenue, expenses;
2. Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused
   Example: For the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets
3. The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates
4. The entity's ownership structure and the way it is financed
   Example: If an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings;
5. The relative volatility of the benchmark.
   Example: Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues.

Q.NO.12 WRITE ABOUT EXAMPLES OF BENCHMARKS THAT HELPS IN DETERMINGING MATERIALITY?

ANSWER:

Examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include categories of reported income such as:

1. Profit before tax,
2. Total revenue,
3. Gross profit and total expenses,
4. Total equity or net asset value.

SELECTION OF CHOOSEN BENCHMARK: In relation to the chosen benchmark, relevant financial data ordinarily includes:

1. Prior periods' financial results and financial positions,
2. The period to-date financial results and financial position, and
3. Budgets or forecasts for the current period,

Adjusted for significant changes in the circumstances of the entity (for example, a significant business acquisition) and relevant changes of conditions in the industry or economic environment in which the entity operates.

EXAMPLE: When, as a starting point, the materiality for the financial statements as a whole is determined for a particular entity based on a percentage of profit before tax from continuing operations, circumstances that give rise to an exceptional decrease or increase in such profit may lead the auditor to conclude that the materiality for the financial statements as a whole is more appropriately determined using a normalized profit before tax from continuing operations figure based on past results.

APPLY A PERCENTAGE ON CHOOSEN BENCHMARK: Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment. There is a relationship between the percentage and the chosen benchmark, such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue.

Q.NO.13 WRITE ABOUT MATERIALITY LEVEL OR LEVELS FOR PARTICULAR CLASSES OF TRANSACTIONS, ACCOUNT BALANCES OR DISCLOSURES?

ANSWER:

Factors that may indicate the existence of one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements include the following:

1. Whether law, regulations or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items.
   Example: Related party transactions, and the remuneration of management and those charged with governance.
2. The key disclosures in relation to the industry in which the entity operates.
   Example: Research and development costs for a pharmaceutical company.
3. Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements.
   Example: A newly acquired business.

Q.NO.14 WRITE ABOUT REVISION AND DOCUMENTATION OF MATERIALITY?

ANSWER:

REVISION IN MATERIALITY LEVEL:

The overall materiality and performance materiality may need to be changed as the audit progresses in the following cases:

1. A change in circumstances that occurred during the audit.
2. Availability of additional information.
3. A change in actual financial results than the anticipated results at the beginning of the audit.
4. Increase in estimated risk than the original prediction resulting in revision of materiality level.
5. A change in auditor's knowledge of client's business and understanding of the same.

EXAMPLE:

If during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality.

If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.

DOCUMENTATION OF MATERIALITY:

The auditor shall document the following:

1. Materiality for the financial statements as a whole (Overall materiality);
2. If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures;
3. General Performance materiality; and
4. Any revision of the above.

Q.NO.15 THE CONCEPT OF MATERIALITY AND AUDIT RISKS ARE THORUGH OUT THE AUDIT. COMMENT?

ANSWER:

1. The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.
2. In conducting an audit of financial statements, the overall objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework and to report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.
3. The auditor obtains reasonable assurance by obtaining sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.
4. Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.
5. Materiality and Audit Risk are considered throughout the audit, in particular, when:
    a. Identifying and assessing the risks of material misstatement;
    b. Determining the nature, timing and extent of further audit procedures and
    c. Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

Q.NO.16 WRITE ABOUT UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT?

ANSWER:

SA 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment states that the auditor shall obtain an understanding of the following:

a. **RELEVANT INDUSTRY, REGULATORY, AND OTHER EXTERNAL FACTORS INCLUDING THE APPLICABLE FINANCIAL REPORTING FRAMEWORK:**
    a. **Relevant industry factors include:**
        i. Industry conditions such as the competitive environment, supplier and customer relationships, and technological developments. Examples of matters the auditor may consider include market and competition, whether entity is engaged in seasonal activities, product technology relating to the entity's products.
        ii. The industry in which the entity operates may give rise to specific risks of material misstatement arising from the nature of the business or the degree of

regulation.

b. **Relevant regulatory factors include:**
   i. the regulatory environment. The regulatory environment includes, among other matters, the applicable financial reporting framework and the legal and political environment.
   ii. Examples of matters the auditor may consider include:
      i. Accounting principles and industry specific practices,
      ii. Regulatory framework for a regulated industry, legislation and
      iii. Regulation that significantly affect the entity's operations, including direct supervisory activities, taxation, government policies currently affecting the conduct of the entity's business, environmental requirements affecting the industry and the entity's business.

c. **Other external factors affecting the entity:** For Example, that the auditor may consider:
   i. The general economic conditions,
   ii. Interest rates and
   iii. Availability of financing, and inflation etc.

b. **NATURE OF ENTITY:** An understanding of nature of entity enables the auditor to understand whether entity has a complex structure for example, whether it has subsidiaries. Complex structures often introduce issues that may give rise to risks of material misstatement. It also helps in understanding matters relating to the ownership, and relations between owners and other people or entities. This understanding assists in determining whether related party transactions have been identified and accounted for appropriately. This includes
   i. Its operations.
   ii. Its ownership and governance structures.
   iii. The types of investments that the entity is making and plans to make, including investments in special-purpose entities. and
   iv. The way that the entity is structured and how it is financed enables the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.
   v. Examples of matters that the auditor may consider while obtaining understanding of nature of entity include:
      i. Business operations such as nature of revenue sources, products or services, conduct of operations, location of production facilities, key customers and suppliers of goods and services
      ii. Investment and investment activities such as capital investment activities and planned or recently executed acquisitions
      iii. Financing and financing activities such as major subsidiaries, debt structure etc.
      iv. Financial reporting such as accounting principles and revenue recognition practices

c. **THE ENTITY'S SELECTION AND APPLICATION OF ACCOUNTING POLICIES, INCLUDING THE REASONS FOR CHANGES THERETO:**
   The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.

d. **THE ENTITY'S OBJECTIVES AND STRATEGIES, AND THOSE RELATED BUSINESS**

RISKS THAT MAY RESULT IN RISKS OF MATERIAL MISSTATEMENT:

a. The entity conducts its business in the context of industry, regulatory and other internal and external factors. To respond to these factors, the entity's management define objectives, which are the overall plans for the entity.
b. Strategies are the approaches by which management intends to achieve its objectives. The entity's objectives and strategies may change over time.
c. Business risk is broader than the risk of material misstatement of the financial statements, though it includes the latter. Business risk may arise from change or complexity.
d. An understanding of the business risks facing the entity increases the likelihood of identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the financial statements.
e. However, the auditor does not have a responsibility to identify or assess all business risks because not all business risks give rise to risks of material misstatement.
f. Examples of matters that the auditor may consider when obtaining an understanding of the entity's objectives, strategies and related business risks that may result in a risk of material misstatement of the financial statements include:
    i. Industry developments (a potential related business risk might be, for example, that the entity does not have the personnel or expertise to deal with the changes in the industry).
    ii. New products and services (a potential related business risk might be, for example, that there is increased product liability).
    iii. Expansion of the business (a potential related business risk might be, for example, that the demand has not been accurately estimated).

e. THE MEASUREMENT AND REVIEW OF THE ENTITY'S FINANCIAL PERFORMANCE:

a. Management and others will measure and review those things they regard as important. Performance measures, whether external or internal, create pressures on the entity. These pressures, in turn, may motivate management to take action to improve the business performance or to misstate the financial statements.
b. Accordingly, an understanding of the entity's performance measures assists the auditor in considering whether pressures to achieve performance targets may result in management actions that increase the risks of material misstatement, including those due to fraud.
c. Examples for measuring and reviewing financial performance which may be used by an auditor may include:
    a. Key performance indicators (financial and non-financial) and key ratios, trends and operating statistics.
    b. Period-on-period financial performance analyses.
    c. Budgets, forecasts, variance analyses, and departmental or other level performance reports.
    d. Credit rating agency reports

Q.NO.17 WHY UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT IS SIGNIFICANT AND IS IT A ONE TIME PROCESS?

ANSWER:

NEED: Understanding the entity and the environment in which it operates is very significant. It helps the auditor in planning the audit and in identifying areas requiring special attention. Gaining knowledge about client's business is one of the important principles in developing an overall audit plan. In fact, without adequate knowledge of client's business, a proper audit is not possible.

UNDERSTANDING THE ENTITY IS A CONTINUOUS PROCESS:

Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when:

1. Assessing risks of material misstatement of the financial statements Determining materiality in accordance with SA 320
2. Considering the appropriateness of the selection and application of accounting policies
3. Identifying areas where special audit consideration may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions
4. Developing expectations for use when performing analytical procedures Evaluating the sufficiency and appropriateness of audit evidence obtained such as the appropriateness of assumptions and of management's oral and written representations.

Q.NO.18 WRITE ABOUT MEANING AND BENEFITS OF INTERNAL CONTROLS?

ANSWER:

A. MEANING OF INTERNAL CONTROL: As per SA-315, The internal control may be defined as the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to

1. Reliability of financial reporting,
2. Effectiveness and efficiency of operations,
3. Safeguarding of assets, and
4. Compliance with applicable laws and regulations.

The term "controls" refers to any aspects of one or more of the components of internal control." The way in which internal control is designed, implemented and maintained varies with an entity's size and complexity.

B. BENEFITS OF UNDERSTANDING INTERNAL CONTROLS: An understanding of internal control assists the auditor in:

1. Identifying types of potential misstatements;
2. Identifying factors that affect the risks of material misstatement, and
3. Designing the nature, timing, and extent of further audit procedures.

Q.NO.19 WRITE ABOUT INHERENT LIMITATIONS OF INTERNAL CONTROLS?

ANSWER:

Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. Due to various inherent limitations the objectives may not be achieved fully. The limitations are as below:

A. HUMAN JUDGMENT IN DECISION-MAKING:

a. Judgment in decision-making can be faulty and that leads to failure in the internal control because of human error.
b. There may be an error in the design of a control.

B. LACK OF UNDERSTANDING THE PURPOSE:

a. The person responsible to review the control may not understand the basic purpose of such control.
b. This leads to ineffective utilisation of exception reports and taking a wrong course of action.

C. COLLUSION AMONG PEOPLE:

a. Controls can be overridden by the collusion of two or more people or inappropriate management override of internal control.
b. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition.

D. JUDGEMENTS BY MANAGEMENT: Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.

E. LIMITATIONS IN CASE OF SMALL ENTITIES:

a. Smaller entities often have fewer employees due to which segregation of duties is not practicable.
b. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity.
c. This oversight may limit opportunities for segregation of duties.
d. Further the owner-manager may override controls because the system of internal control is less structured.
e. The auditor shall take into account the above factors while assessing risks in case of small entities.

Q.NO.20 WRITE ABOUT COMPONENTS OF INTERNAL CONTROLS?

ANSWER:

The division of internal control into the following five components provides a useful framework for auditors to understand how different aspects of an entity's internal control may affect the audit. The following are components of control environment:

1. The control Environment (Governance, management structure and Culture of honesty).
2. Entity's risk assessment process (Identification of risk to design a control to mitigate it).
3. Information system, including related business process, relevant to financial reporting.
4. Control activities (Implement and Review of policies to be implemented).
5. Monitoring of controls (Testing of controls to update them).

Q.NO.21 THE AUDITOR OF MARUT LTD, ENGAGED IN MANUFACTURING OF SMART MOTOR BIKES, OBTAINS AN UNDERSTANDING OF THE CONTROL ENVIRONMENT. AS PART OF OBTAINING THIS UNDERSTANDING, THE AUDITOR EVALUATES WHETHER:

a) MANAGEMENT HAS CREATED AND MAINTAINED A CULTURE OF HONESTY AND ETHICAL BEHAVIOUR.

b) THE STRENGTHS IN THE CONTROL ENVIRONMENT ELEMENTS COLLECTIVELY PROVIDE AN APPROPRIATE FOUNDATION FOR THE OTHER COMPONENTS OF INTERNAL CONTROL.

ADVISE WHAT IS INCLUDED IN CONTROL ENVIRONMENT. ALSO EXPLAIN THE ELEMENTS OF CONTROL ENVIRONMENT.

(OR)

WHAT IS INCLUDED IN CONTROL ENVIRONMENT AND ALSO EXPLAIN ITS ELEMENTS?

ANSWER:

A. CONTROL ENVIRONMENT INCLUDES:

The control environment includes:

1. The governance and management functions.

2. The attitudes, awareness, and actions of those charged with governance and management.
3. The control environment sets the tone of an organization, influencing the control consciousness of its people.

B. ELEMENTS OF CONTROL ENVIRONMENT: Elements of control environment may be relevant to obtain an understanding of control environment which includes the following:

1. **Communication and enforcement of integrity and ethical values:**
   - **a.** The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them.
   - **b.** Integrity and ethical behaviour are the product of the entity's ethical and behavioural standards, how they are communicated, and how they are reinforced in practice.
   - **c.** The enforcement of integrity and ethical values includes, for example, management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts.
   - **d.** The communication of entity policies on integrity and ethical values may include the communication of behavioural standards to personnel through policy statements and codes of conduct and by example.
2. **COMMITMENT TO COMPETENCE:** Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.
3. **PARTICIPATION BY THOSE CHARGED WITH GOVERNANCE:** Attributes of those charged with governance such as:
   - a. Their independence from management.
   - b. Their experience and stature.
   - c. The extent of their involvement and the information they receive, and the scrutiny of activities.
   - d. The appropriateness of their actions, including the degree to which difficult questions are raised and pursued with management, and their interaction with internal and external auditors.
4. **MANAGEMENT'S PHILOSOPHY AND OPERATING STYLE:** Management's philosophy and operating style encompass a broad range of characteristics such as management's:
   - a. Approach to taking and managing business risks.
   - b. Attitudes and actions toward financial reporting.
   - c. Attitudes toward information processing and accounting functions and personnel reflects upon management's philosophy and operating style.
   - d. Matters such as approach of management to taking and managing business risks.
5. **ORGANISATIONAL STRUCTURE:** The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed. Establishing a relevant organisational structure includes considering key areas of authority and responsibility and appropriate lines of reporting. The appropriateness of an entity's organisational structure depends, in part, on its size and the nature of its activities.
6. **ASSIGNMENT OF AUTHORITY AND RESPONSIBILITY:** Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established.

7. **HUMAN RESOURCE POLICIES AND PRACTICES:** Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions. For example:
   a. standards for recruiting the most qualified individuals – with emphasis on educational background, prior work experience, past accomplishments, and evidence of integrity and ethical behaviour – demonstrate an entity's commitment to competent and trustworthy people.
   b. Training policies that communicate prospective roles and responsibilities and include practices such as training schools and seminars illustrate expected levels of performance and behaviour.
   c. Promotions driven by periodic performance appraisals demonstrate the entity's commitment to the advancement of qualified personnel to higher levels of responsibility.

Q.NO.22 SATISFACTORY CONTROL ENVIRONMENT NOT AN ABSOLUTE DETERRENT TO FRAUD. EXPLAIN.

ANSWER:

1. The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. However, although it may help reduce the risk of fraud, a satisfactory control environment is not an absolute deterrent to fraud.
2. Conversely, deficiencies in the control environment may undermine the effectiveness of controls, in particular in relation to fraud.
3. For example, management's failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or to data, or unauthorized transactions to be processed.
4. The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement.

Q.NO.23 WRITE ABOUT ENTITY'S RISK ASSESSMENT PROCESS WHICH IS A COMPONENT OF CONTROL ENVIRONMENT?

ANSWER:

The auditor shall obtain an understanding of whether the entity has a process for:

1. Identifying business risks relevant to financial reporting objectives. (E.g., Doctor Prescription vs Bill)
2. Estimating the significance of the risks.
3. Assessing the likelihood of their occurrence and
4. Deciding about actions to address those risks.

The entity's risk assessment process helps to identify the basis for the risks to be managed. If that process is appropriate, it would assist the auditor in identifying risks of material misstatement. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment.

Q.NO.24 ONE OF THE COMPONENTS OF INTERNAL CONTROLS IS "THE INFORMATION SYSTEMS AND RELATED BUSINESS PROCESS WHICH ARE RELEVANT FOR FINANCIAL REPORTING AND COMMUNICATION". EXPLAIN IN DETAILED?

ANSWER:

The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following:

1. The classes of transactions in the entity's operations which are significant to the financial statements.
2. The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements.
3. The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions.
4. How the information system captures events and conditions that are significant to the financial statements. (Bill to Accounts recordings)
5. The financial reporting process used to prepare the entity's financial statements.
6. Controls surrounding journal entries. (E.g., Voucher Controls)

E.g., Price Mapping to product and possibility of price changes.

Q.NO.25 WRITE ABOUT CONTROL ACTIVITIES WHICH IS A COMPONENT OF INTERNAL CONTROL SYSTEM?

ANSWER:

1. **MEANING OF CONTROL ACTIVITIES:** The policies and procedures that help ensure that management directives are carried out. E.g., Authorisations, SOD, Physical controls and performance reviews.
2. Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels.
3. An audit requires an understanding of only those control activities related to significant class of transactions, account balance, and disclosure in the financial statements which the auditor finds relevant in the risk assessment process.
4. Control activities related to audit are determined as below:
   a. Control activities that relate to items of financial statements where auditor finds significant risks and where substantive procedures alone do not provide sufficient and appropriate audit evidence or
   b. These are relevant in the professional judgment of the auditor.

   E.g., Internal Checks employed by management such as Day end counting, Product Count for Material items.

Q.NO.26 WRITE ABOUT MONITORING OF CONTROLS WHICH IS A FINAL COMPONENT OF INTERNAL CONTROL?

ANSWER:

The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting: (IFCOFR)

1. Monitoring of controls is a process to assess the effectiveness of internal control performance over time. (E.g., Internal Audit) (E.g., Walk through test).
2. It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.
3. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.
4. Management's monitoring activities may include using information from communications from external parties.

   For Example, customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.

Q.NO.27 ARE ALL CONTROLS RELEVANT TO THE AUDIT. DESCRIBE?

ANSWER:

1. **CONTROLS RELEVANT TO AUDIT:** The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit.
2. **PROFESSIONAL JUDGMENT:** It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit.
3. **FACTORS:** Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:
   a. Materiality.
   b. The significance of the related risk.
   c. The size of the entity.
   d. The nature of the entity's business, including its organisation and ownership characteristics.
   e. The diversity and complexity of the entity's operations.
   f. Applicable legal and regulatory requirements.
   g. The circumstances and the applicable component of internal control.
   h. The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
   i. Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.
4. **CONTROLS NOT RELEVANT TO AUDIT:** An entity generally has controls relating to objectives that are not relevant to an audit and therefore need not be considered.
   For example, an entity may rely on a sophisticated system of automated controls to provide efficient and effective operations (such as an airline's system of automated controls to maintain flight schedules), but these controls ordinarily would not be relevant to the audit.
   Further, although internal control applies to the entire entity or to any of its operating units or business processes, an understanding of internal control relating to each of the entity's operating units and business processes may not be relevant to the audit.

Q.NO.28 WRITE ABOUT CONTROLS OVER THE COMPLETENESS AND ACCURACY OF INFORMATION?

ANSWER:

1. Controls over the completeness and accuracy of information produced by the entity may be relevant to the audit if the auditor intends to make use of the information in designing and performing further procedures.
2. For example, in auditing revenue by applying standard prices to records of sales volume, the auditor considers the accuracy of the price information and the completeness and accuracy of the sales volume data.
3. Another example, Purchase order register control will ensure whether all purchases are correctly recorded or not.
4. Controls relating to operations and compliance objectives may also be relevant to an audit if they relate to data the auditor evaluates or uses in applying audit procedures.
   E.g., For Purchases transactions P.O.'s will be the source data to check accuracy and completeness, Bank statement is the source data to check completeness of recorded payments.

Q.NO.29 WRITE ABOUT INTERNAL CONTROLS OVER SAFEGUARDING OF ASSETS?

ANSWER:

1. Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives.
2. **FINANCIAL REPORTING OBJECTIVE:** The auditor's consideration of such controls is generally limited to those relevant to the reliability of financial reporting. For example, use of access controls, such as passwords, that limit access to the data and programs that process cash disbursements may be relevant to a financial statement audit. (E.g., For material assets valued more than 5000/- will be considered generally)
3. **OPERATIONAL OBJECTIVE:** Conversely, safeguarding controls relating to operations objectives, such as controls to prevent the excessive use of materials in production, generally are not relevant to a financial statement audit. (E.g., Targets related to input output ratio may not be related to auditor.)
   E.g., Asset tagging, Physical verification at reasonable interval.

Q.NO.30 WRITE ABOUT NATURE AND EXTENT OF THE UNDERSTANDING OF RELEVANT CONTROL?

ANSWER:

1. Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements.
2. Implementation of a control means that the control exists and that the entity is using it. The design of a control is considered first. An improperly designed control may represent a significant deficiency in internal control.
3. Risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls may include:
   a. Inquiring of entity personnel.
   b. Observing the application of specific controls.
   c. Inspecting documents and reports.
   d. Tracing transactions through the information system relevant to financial reporting.
   Note: Inquiry alone, however, is not sufficient for such purposes.
4. Obtaining an understanding of an entity's controls is not sufficient to test their operating effectiveness, unless there is some automation that provides for the consistent operation of the controls.
   Example: Obtaining audit evidence about the implementation of a manual control at a point in time **does not provide audit evidence** about the operating effectiveness of the control at other times during the period under audit. However, because of the inherent consistency of IT processing, performing audit procedures to determine whether an automated control has been implemented may serve as a test of that control's operating effectiveness, depending on the auditor's assessment and testing of controls such as those over program changes.

Q.NO.31 AS PART OF THE RISK ASSESSMENT, THE AUDITOR SHALL DETERMINE WHETHER ANY OF THE RISKS IDENTIFIED ARE, IN THE AUDITOR'S JUDGMENT, A SIGNIFICANT RISK. EXPLAIN WHAT IS SIGNIFICANT RISK?

ANSWER:

Significant risks are inherent risks with both a higher likelihood of occurrence and a higher magnitude of potential misstatement. The auditor assesses assertions affected by a significant risk as higher inherent risk. The following are always significant risks:

1. Risks of material misstatement due to fraud.
2. Significant transactions with related parties that are outside the normal course of business for the entity.

In exercising judgment as to whether the risks identified in risk assessment process are significant risk, the auditor shall consider the following factors:

1. Whether the risk is a risk of fraud.
2. Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention.
3. The complexity of transactions
4. Whether the risk involves significant transactions with related parties.
5. The degree of subjectivity in the measurement of financial information.
6. Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

Note:

1. Significant risks often relate to significant non- routine transactions or judgmental matters.
2. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently.
3. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty.

Q.NO.32 RISK OF MATERIAL MISSTATEMENT IS GREATER FOR NON-ROUTINE TRANSACTIONS. GIVE SOME EXAMPLES?

ANSWER:

Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

1. Greater management intervention to specify the accounting treatment.
2. Greater manual intervention for data collection and processing.
3. Complex calculations or accounting principles.
4. The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

Q.NO.33 RISK OF MATERIAL MISSTATEMENT IS GREATER FOR JUDGMENTAL MATTERS. GIVE SOME EXAMPLES?

ANSWER:

Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:

1. Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
2. Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

Q.NO.34 WRITE ABOUT BENEFITS OF INTERNAL CONTROL EVALUATION? OR WRITE ABOUT UNDERSTANDING OF INTERNAL CONTROLS AND ITS BENEFITS?

ANSWER:

The examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded.

Internal control normally contributes to such assurance. The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operations of these internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

BENEFITS OF EVALUATION OF INTERNAL CONTROL TO THE AUDITOR: The review of internal controls will enable the auditor to know:

1. Whether an adequate internal control system is in use and operating as planned by the management;
2. Whether an effective internal auditing department is operating;
3. Whether the controls adequately safeguard the assets;
4. How management is discharging its function for correct recording of transactions;
5. How reliable the reports, records and the certificates to the management can be;
6. The extent and the depth of the examination that he needs to carry out in the different areas of accounting;
7. What would be appropriate audit technique and the audit procedure in the given circumstances;
8. What are the areas where control is weak; and
9. Whether any suggestions can be given to improve the control system to management by auditor.

Q.NO.35 AN AUDIT PROGRAMME CAN BE DEVELOPED AFTER A SATISFACTORY UNDERSTANDING OF INTERNAL CONTROLS. COMMENT

ANSWER:

The auditor can formulate his entire audit programme only after satisfactorily understanding of the internal control systems and their actual operation.

1. It is also important for him to know whether the system is actually in operation. Often, after installation of a system, no proper follow up is there by the management to ensure compliance.
2. It would be better if the auditor can undertake the review of the internal control system of client. This will give him enough time to assimilate (understand) the controls and implications and will enable him to be more objective in the framing of the audit programme.
3. A proper understanding of internal controls will enable the auditor to apply appropriate audit procedure in different areas of audit.
4. In deciding upon a plan of test checking, the existence and operation of internal control system is of great significance.
5. In a situation where the internal controls are considered weak in some areas, the auditor might choose an auditing procedure or test that otherwise might not be required; he might extend certain tests to cover a large number of transactions or other items than he otherwise would examine and at times he may perform additional tests to bring him the necessary satisfaction.

   Example: Normally the distribution of wages is not observed by the auditor. But if the internal control over wages is so weak that there exists a possibility of dummy workers being paid, the auditor might include observation of wages distribution in his programme in order to find out the workers who do not turn up for receipt of wages.

   On the other hand, if he is satisfied with the internal control on sales and trade receivables, the auditor can get trade receivables' balances confirmed at almost any time reasonably close to the balance sheet date. But if the control is weak, he may feel that he should get the confirmation exactly on the date of the year closing so that he may eliminate the risk of errors and frauds occurring between the intervening period. Also, he may in that situation, decide to have a large coverage of trade receivables by the confirmation procedure.

Q.NO.36 EXPLAIN METHODS FOR EVALUATION OF INTERNAL CONTROLS BY THE AUDITOR.

ANSWER:

1. The first step involves determination of the control and procedures laid down by the management. By reading company manuals, studying organisation charts and flow charts and by making suitable enquiries from the officers and employees, the auditor may ascertain the character, scope and efficacy of the control system.
2. To acquaint himself about how all the accounting information is collected and processed and to learn the nature of controls that makes the information reliable and protect the company's assets, calls for considerable skill and knowledge.
3. In many cases, very little of this information is available in writing; the auditor must ask the right people the right questions if he is to get the information he wants.
4. It would be better if he makes written notes of the relevant information and procedures contained in the manual or ascertained on enquiry.
5. To facilitate the accumulation of the information necessary for the proper review and evaluation of internal controls, the auditor can use one of the following to help him to know and assimilate the system and evaluate the same:
   a. **NARRATIVE RECORD:** This is a complete and exhaustive description of the system as found in operation by the auditor. Actual testing and observation are necessary before such a record can be developed. It may be recommended in cases where no formal control system is in operation It would be more suited to small business. The basic disadvantages of narrative records are:
      i. To comprehend the system in operation is quite difficult.
      ii. To identify weaknesses or gaps in the system.
      iii. To incorporate changes arising on account of reshuffling of manpower, etc.

   b. **CHECK LIST:** This is a series of instructions or questions which a member of the auditing staff must follow or answer.
      i. The Instructions and Questions are framed according to the desirable elements of control.
      ii. When he completes instruction, he shall mark the space against the instruction.
      iii. Answers to the check list instructions are usually Yes, No or Not Applicable.

   Example: Checklist for purchases:
   1. Are tenders called before placing orders?
   2. Are the purchases made on the basis of a written order?
   3. Is the purchase order form standardized and pre-numbered?
   4. Are the inventory control accounts maintained by persons who have nothing to do with Receipt of inventory, Inspection of inventory and Purchase of inventory?

   c. **INTERNAL CONTROL QUESTIONNAIRE (ICQ):**
      i. This is a comprehensive series of questions concerning internal control. This is the most widely used form for collecting information about the existence, operation and efficiency of internal control in an organisation.
      ii. An important advantage of the questionnaire approach is that *oversight or omission of significant internal control review* procedures is less likely to occur *with this method.*

iii. With a proper questionnaire, all internal control evaluation can be completed at one time or in sections. The review can more easily be made on an interim basis.
iv. The questionnaire form also provides an orderly means of disclosing control defects. It is the general practice to review the internal control system annually and record the review in detail.
v. In the questionnaire, generally questions are so framed that a 'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness. Provision is made for an explanation or further details of 'No' answers. In respect of questions not relevant to the business, 'Not Applicable' reply is given.
vi. The questionnaire is usually issued to the client and the client is requested to get it filled by the concerned executives and employees.
vii. If on a review of the answers, inconsistencies or apparent weaknesses are noticed, the matter is further discussed by auditor's staff with the client's employees for a clear picture. The concerned auditor then prepares a report of deficiencies and recommendations for improvement.

d. **FLOWCHARTS:**
i. It is a graphic presentation of each part of the company's system of internal control such as the nature of its activities and various channels of goods and materials as well as cash, both inward and outward.
ii. A flowchart is considered to be the most concise i.e. briefest way of recording the auditor understanding and evaluation of the internal control system in the correct perspective.
iii. It minimizes the amount of narrative explanation.
iv. It gives bird's eye view of the entire process of manufacturing, trading and administration.
v. The flow of transactions through various stages can be easily spotted and improvements can be suggested.

Examples of Extracts of Internal Control Questionnaire in respect of purchases, creditors, inventories and fixed assets

A. PURCHASES:

1. Are purchases centralised in the Purchase Department?
2.
   a. Are purchases made only from approved suppliers?
   b. Is a list of approved suppliers maintained for this purpose?
   c. Does the master list contain more than one source of supply for all important materials?
3. Are the purchase orders based on valid purchase requisitions duly signed by authorised persons in this behalf?
4. Are purchases based on competitive quotations from two or more suppliers?
5. Are purchase orders pre-numbered?
6. Are purchase orders signed only by employees authorized in this behalf?
7. Are all materials received only in the Receiving Department?
8. Are persons connected with receipt of materials and the keeping of receiving records denied authority to issue purchase orders or to approve invoices?
9. Are materials inspected and counted, weighed or measured in the Receiving

Department?

10. Are receipt of materials evidenced by pre-numbered Goods Received Note?

B. CREDITORS:

1.
   a. Are suppliers' invoices routed direct to the Accounts Department?
   b. Are they entered in a Bill register before submitting them to other departments for check and/or approval?
   c. Are advance and partial payments entered on the invoices before they are submitted to other departments?
2. Does the system ensure that all invoices are duly processed?
3. In respect of raw material and supplies, are reconciliations made of quantities and/or values received as shown by purchase invoices with receipt into stock records?
4. Does the Accounts Department match the invoices of supplies with Goods Received Notes and purchase orders?
5. Do all invoices bear evidence of being checked for prices, freight, terms etc.?
6. Are all advance payments duly authorized by persons competent to authorize such payments?
7. Are duplicate invoices marked immediately on receipt to avoid payment against them?
8. Are all supplier's statements compared with ledger accounts?
9. Is there any follow-up action to investigate difference, if any, between the suppliers' statements and the ledger accounts?
10. Is a list of unpaid creditors prepared and reconciled periodically?

C. INVENTORIES:

1. Are stocks stored in assigned areas?
2. Are stocks insured comprehensively against different risks? If some risk is not insured, whether it is due to specific decision taken by a senior official?
3. Is a record maintained for the insurance policies?
4. Is the record reviewed periodically?
5. Is there an official who decides on the value for which stocks are to be insured?
6. Is the adequacy of insurance cover reviewed periodically?
7. Are perpetual stock records kept for raw materials, work-in-progress, finished goods and stores?
8. Are stock records periodically reconciled with accounting records?
9. Where there is a system of perpetual inventory count:
   a. Is there a periodical report of shortages/excess?
   b. If so, are these differences investigated?
   c. Are these differences adjusted in the stock records and in the financial accounts?
   d. Is written approval obtained from a responsible official to adjust these differences?
10. Are there norms for stock levels to be held?

D. FIXED ASSETS:

1. Are budgets for capital expenditure approved?
2. Is the authority to incur capital expenditure restricted to specified officials?
3. Are purchases of capital expenditure subject to same controls as applicable to purchases of raw materials, stores etc.?
4. Is there proper check to see that amounts expended do not exceed the amount authorized?

5. Are fixed assets verified periodically?
6. Is there a written procedure for such verification?
7. Are reports prepared on such verification?
8. Do such reports indicate damaged/obsolete items of fixed assets?
9. Are discrepancies disclosed by such reports investigated?
10. Are the records and financial accounts corrected with appropriate authority?

Q.NO.37 WHY TESTS OF CONTROL ARE PERFORMED? ALSO EXPLAIN WHAT DOES IT INCLUDES.

ANSWER:

1. After understanding the internal control system, the auditor needs to examine whether and how far the same is actually in operation. For this, he resorts to actual testing of the system in operation. This he does on a selective basis.
2. He can plan this testing in such a manner that all the important areas are covered in a period of, say, 3 years.
3. Test of controls are performed to obtain audit evidence about the effectiveness of the:
   a. Design of the accounting and internal control system
   b. Operation of the internal control throughout the period
4. Test of controls include tests of elements of the control environment where strengths in the control environment are used by auditors to reduce control risk.
5. Some of the procedures performed to obtain the understanding of the accounting and internal control systems may not have been specifically planned as tests of control but may provide audit evidence about the effectiveness of the design and operation of internal controls relevant to certain assertions and, consequently, serve as tests of control.
6. **For example, the procedure for sales requires the following:**
   a. Before acceptance of any order the position of inventory of the relevant article should be known to ascertain whether the order can be executed in time.
   b. An advice under the authorisation of the sales manager should be sent to the party placing the order, internal reference number, and the acceptance of the order. This advice should be prepared on a standardised form and copy thereof should be forwarded to inventory section to enable it to prepare for the execution of the order in time.
   c. The credit period allowed to the party should be the normal credit period. For any special credit period a special authorisation of the sales manager would be necessary.
   d. The rate at which the order has been accepted and other terms about transport, insurance, etc., should be clearly specified.
   e. Before deciding upon the credit period, a reference should be made to the credit section to know the creditworthiness of the party and particularly whether the party has honoured its commitments in the past.
7. **TESTS OF CONTROL MAY INCLUDE:**
   a. **Inspection** of documents supporting transactions and other events to gain audit evidence that internal controls have operated properly. For example, verifying that a transaction has been authorized.
   b. **Inquiries** about internal controls and observation of internal controls. For example, determining who actually performs each function and not merely who is supposed to perform it.

c. **Re-performance** of internal controls. For example, reconciliation of bank accounts, to ensure that they were correctly performed by the entity.
d. **Testing** of internal control operating on specific computerised applications or over the overall information technology function. For example, access or program change controls.

8. It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Procedural tests simply mean testing of the compliance with the procedures laid down by the management in respect of initiation, authorisation, recording and documentation of transaction at each stage through which it flows.
9. **DEVIATIONS FROM PRESCRIBED CONTROLS:**
   a. In case of deviations from the prescribed accounting and internal control systems, the auditor would make specific inquiries to consider their implications.
   b. Where, on the basis of such inquiries, the auditor concludes that the deviations are such that the preliminary assessment of control risk is not supported, he would amend the same unless the audit evidence obtained from other tests of control supports that assessment.
   c. Where the auditor concludes that the assessed level of control risk needs to be revised, he would modify the nature, timing and extent of his planned substantive procedures.

Q.NO.38 WHAT IS AN AUTOMATED ENVIRONMENT? EXPLAIN ITS KEY FEATURES?

ANSWER:

1. An automated environment basically refers to a business environment where the processes, operations, accounting and even decisions are carried out by using computer systems – also known as Information Systems (IS) or Information Technology (IT) systems. Nowadays, it is very common to see computer systems being used in almost every type of business.
2. **KEY FEATURES OF AN AUTOMATED ENVIRONMENT:** The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven. The complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be more complex. Key features of an automated environment are as under: -
   a. Enables faster business operation
   b. Accuracy in data processing and computation
   c. Ability to process large volume of transactions
   d. Integration amongst business operations
   e. Better security and controls
   f. Less prone to human errors
   g. Provides latest information
   h. Connectivity and networking capability
3. If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.

Q.NO.39 WRITE ABOUT UNDERSTANDING AND DOCUMENTING AUTOMATED ENVIRONMENT BY AN AUDITOR?

ANSWER:

1. In an audit of financial statements, an auditor is required to understand the entity and its business, including IT. Understanding the entity and its automated environment involves

understanding how IT department is organised, IT activities, the IT dependencies, relevant risks and controls.

2. Given below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment:
    a. Information systems being used (one or more application systems and what they are)
    b. Their purpose (financial and non-financial)
    c. Location of IT systems - local vs global
    d. Architecture (desktop based, client-server, web application, cloud based)
    e. Version (functions and risks could vary in different versions of same application).
    f. Interfaces within systems (in case multiple systems exist).
    g. In-house vs Packaged.
    h. Outsourced activities (IT maintenance and support).
    i. Key persons (CIO, CISO, Administrators).
3. The understanding of a company's IT environment that is obtained should be documented.

Information Systems being used	Version	Purpose	Location- Local vs. global	Architecture	Interfaces within systems	In-House vs. Packaged	Outsourced Activities	Key Persons	In-Scope
SAP	ECC 6.0, EHPS	Accounting, Supply chain, Production	Texas, USA	Client/Server, Unix, AIX 5.3, MS-SQL Server 2008	Paymaster	Packaged		CIO, Administrators	Yes
Budget King	1	Management MIS Budgeting	Hyderabad, India	Web-based, Windows, Apache, Oracle 11 g	None	In-house	-	-	No

Q.NO.40 WHAT ARE THE RISKS ARISING FROM USE OF IT SYSTEMS?

ANSWER:

1. Having obtained an understanding of the IT systems and the automated environment of a company, the auditor should now understand the risks that arise from the use of IT systems. Given below are some such risks that should be considered:
    a. Inaccurate processing of data, processing inaccurate data, or both.
    b. Unauthorized access to data.
    c. Direct data changes (backend changes).
    d. Excessive access / Privileged access (super users).
    e. Lack of adequate segregation of duties.
    f. Unauthorized changes to systems or programs.
    g. Failure to make necessary changes to systems or programs.
    h. Loss of data.
2. **IMPACT OF IT RELATED RISKS:** The above risks have to be mitigated. If not mitigated, such risks, could have an impact on audit in different ways discussed as under: -
    a. **IMPACT ON SUBSTANTIVE CHECKING:** Inability to address above discussed risks may lead to non-reliance of data obtained from systems. In such a case, all information, data, and reports would have to be tested thoroughly for their completeness and accuracy. It could lead to increased substantive checking i.e., detailed checking.
    b. **IMPACT ON CONTROLS:** It can lead to non-reliance on automated controls, system calculations and accounting procedures built into applications. It may result in additional audit work.

c. **IMPACT ON REPORTINSG:** Due to regulatory requirements in respect of internal financial controls (discussed in subsequent paras) in case of companies, it may lead to modification of auditor's report in some instances.

Q.NO.41 WRITE ABOUT DIFFERENT TYPES OF CONTROLS IN AN AUTOMATED ENVIRONMENT?

ANSWER:

The Controls in IT Environment are broadly classified into the following categories:

A. General IT Controls
B. Application Controls
C. IT Dependent Controls

A. GENERAL IT CONTROLS:

1. **Meaning:** These are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, mini-frame, and end-user environments.
2. General IT-controls that maintain the integrity of information and security of data.
3. These controls will generally cover the following aspects:
   a. **Data center and network operations controls:**
      i. The objective of controls over Data centre and network operations is to ensure that production systems are processed to meet financial reporting objectives.
      ii. These include activities such as overall management of computer operation activities, preparing, scheduling and executing of batch jobs, monitoring, storage and retention of backups.
      iii. Such controls also help in performance monitoring of operating system, database and networks.
      iv. Matters such as BCP (Business continuity plan) and DRP (Disaster recovery plan) which deal with recovery from failures are also taken care of by such type of controls.
   b. **Program change controls:** The objective of program change controls is to ensure that modified systems continue to meet financial reporting objectives. It includes activities such as change management process, recording, managing and tracking change requests, making and testing changes etc.
   c. **Access security controls:** The objective of controls over access security is to ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives. It includes activities such as security organization & management, security policies & procedures, application security, data security, operating system security, network security, physical security etc.
   d. **Application system acquisition, development, and maintenance controls:** The objective of such controls is to ensure that systems are developed, configured and implemented to meet financial reporting objectives. It includes overall management of development activities, project initiation, analysis & design, construction, testing & quality assurance etc.
4. General IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes.
5. General IT controls are known as "pervasive" controls or "indirect" controls.

B. APPLICATION CONTROLS:

Application controls include both automated or manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems.

C. IT – DEPENDENT CONTROLS:

1. IT dependent controls are basically manual controls that make use of some form of data or information or report produced from IT systems and applications.
2. In this case, even though the control is performed manually, the design and effectiveness of such controls depends on the reliability of source data.
3. Due to the inherent dependency on IT, the effectiveness and reliability of Automated application controls and IT dependent controls require the General IT Controls to be effective.

D. INTERRELATION BETWEEN GENERAL AND APPLICATION IT CONTROLS:

1. General IT Controls and Application Controls are Interrelated.
2. The relationship between the application controls and the General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems.

Q.NO.42 WRITE A SHORT NOTE ON: TESTING METHODS USED IN AN AUTOMATED ENVIRONMENT.

ANSWER:

A. METHODS:

1. **INQUIRY:** It is the most efficient audit test but should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient. Generally, applying inquiry in combination with inspection gives the most effective and efficient audit evidence.
2. **REPERFORMANCE:** It is effective and gives the best audit evidence. However, testing by reperformance could be very time consuming. Carry out a test check (negative testing) and observe the error message displayed by the application.
3. **INSPECTION:** It involves inspection of the configuration defined in an application, system logs to determine any changes made since last audit testing or Inspection of technical manual / user manual of systems and applications.
4. **OBSERVATION:** It involves observing how a user processes transactions under different scenarios.

B. PROFESSIONAL JUDGEMENT:

1. Which audit test to use, when and in what combination to use, is a matter of Professional Judgement and will vary depending on several factors including risk assessment, control environment, desired level of evidence required, history of errors / misstatements, complexity of business, etc.
2. Generally, Inquiry in combination with Inspection gives the most efficient and effective audit evidence.
3. When testing in an automated environment, few common points to be examined are:
   a. Obtain an understanding of how an automated transaction is processed by doing a walkthrough of one end-to-end transaction.
   b. Inspect the configuration defined in an application.
   c. Inspect the system logs to determine any changes made since last audit testing
   d. Inspect technical manual / user manual of systems and applications.
   e. Carry out a test check (negative testing) and observe the error message displayed by the application.

Q.NO.43 WRITE ABOUT CHARACTERISTICS OF MANUAL AND AUTOMATED ELEMENTS OF INTERNAL CONTROL RELEVANT TO THE AUDITORS RISK ASSESSMENT.

ANSWER:

1. An entity's system of internal control contains manual elements and often contains automated elements. The characteristics of manual or automated elements are explained hereunder:
2. The use of manual or automated elements in internal control affects the manner in which transactions are initiated, recorded, processed, and reported:
   a. Controls in a manual system may include such procedures as approvals and reviews of transactions, and reconciliations and follow-up of reconciling items.
   b. Alternatively, an entity may use automated procedures to initiate, record, process, and report transactions, in which case records in electronic format replace paper documents.
   c. Further, manual controls may be independent of IT, may use information produced by IT, or may be limited to monitoring the effective functioning of IT and of automated controls.
3. **IMPACT OF MANUAL ELEMENTS IN AUTOMATED ENVIRONMENT:**
   a. Manual elements in internal control may be more suitable where judgment and discretion are required such as for the following circumstances:
      i. Large, unusual or non-recurring transactions.
      ii. Circumstances where errors are difficult to define, anticipate or predict.
      iii. In changing circumstances that require a control response outside the scope of an existing automated control.
      iv. In monitoring the effectiveness of automated controls.
   b. Generally manual elements in internal control are less reliable than automated elements because they can be more easily bypassed, ignored, or overridden and they are also more prone to simple errors and mistakes. Consistency of application of a manual control element cannot therefore be assumed. They are less suitable in the following circumstances:
      i. High volume or recurring transactions, or in situations where errors that can be anticipated or predicted can be prevented, or detected and corrected, by control parameters that are automated.
      ii. Control activities where the specific ways to perform the control can be adequately designed and automated.
4. The extent and nature of the risks to internal control vary depending on the nature and characteristics of the entity's information system. The entity responds to the risks arising from the use of IT or from use of manual elements in internal control by establishing effective controls in light of the characteristics of the entity's information system.

Q.NO.44 WRITE ABOUT AUDIT APPROACH IN AN AUTOMATED ENVIRONMENT?

ANSWER:

Risk Assessment
- Identify significant accounts and disclosures
- Qualitative and Quantitative considerations
- Relevant financial statement assertions (FSA)
- Identify likely sources of misstatement
- Consider risk arising from use of IT systems

Understand and Evaluate
- Document understanding of business processes using Flowcharts/Narratives
- Prepare Risk and Control Matrices (RCM)
- Understanding design of controls by performing walkthroughts of end to end process
- Process wide considerations for Entity Level Controls, Segregation of duties
- It General controls, Application controls

Test for Operating Effectiveness
- Assess Nature, Timing and Extent (NTE) of controls testing
- Assess reliabilty of source data; completeness of population
- Testing of key reports and spreadsheets
- Sample testing
- Consider competence and independence of staff / team performing controls testing

Reporting
- Evaluate control deficiencies
- Significant deficiencies, Material weaknesses
- Remediation of control weaknesses
- Internal controls Memo (ICM) or Management Letter
- Auditor's report

Q.NO.45 WRITE A SHORT NOTE: DATA ANALYTICS FOR AUDIT.

ANSWER:

A. MEANING:

1. The combination of Processes, Tools and Techniques that are used to tap vast amounts of electronic data to obtain meaningful information is called data analytics.
2. Such tools and techniques the auditors use in audit for analysing the data in electronic form to obtain audit evidence is known as Computer Assisted Auditing Techniques (CAATs).
3. Companies can benefit immensely from the use of data analytics in terms of increased profitability, better customer service, gaining competitive advantage, more efficient operations, etc.

B. SIGNIFICANCE OF DATA ANALYTICS FOR AUDITOR:

The auditors can make use of similar tools and techniques in the audit process and obtain good results. Data analytics can be used, in testing of electronic records and data residing in IT systems, to perform the following:

1. Check completeness of data and population that is used in either test of controls or substantive audit tests.
2. Selection of audit samples - random sampling, systematic sampling.
3. Re-computation of balances - reconstruction of trial balance from transaction data.
4. Reperformance of mathematical calculations - depreciation, bank interest calculation.
5. Analysis of journal entries as required by SA 240.

6. Fraud investigation.

Q.NO.46 WHAT IS DIGITAL AUDIT. DESCRIBE BRIEFLY?

ANSWER:

1. Entities are embracing digitization as part of their operations to keep pace with changing times.
2. New technologies are helping companies revamp their operations and rethink the way business is conducted.
3. Companies are restructuring their business models driven by technology. Automation is key to digitization.
4. In such a business environment, use of digital technology is being made by auditors right from planning to expression of final opinion.
5. Auditors are making use of artificial intelligence, data analytics and other latest technologies to help understand business processes in a better way. By using such tools, auditors can conduct audit in a better way and devote more attention to areas requiring greater focus.
6. Digital audit is helping auditors to better identify risks making use of technology.

Q.NO.47 WRITE ABOUT INTERNAL FINANCIAL CONTROLS WITH REFERENCE TO FINANCIAL STATEMENTS AND THEIR REPORTING REQUIREMENTS?

ANSWER:

OBJECTIVE AND PURPOSE OF INTERNAL FINANCIAL CONTROLS: Internal financial controls are the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies,

1. The safeguarding of its assets.
2. The prevention and detection of frauds and errors.
3. The accuracy and completeness of the accounting records.
4. The timely preparation of reliable financial information.
5. Compliance with applicable laws and regulations.

The directors and management have primary responsibility of implementing and maintaining an effective internal controls framework and auditors are expected to evaluate, validate and report on the design and operating effectiveness of internal financial controls.

The Companies Act, 2013 has placed a greater emphasis on the effective implementation and reporting on the internal controls for a company.

The term "internal financial controls" is used at some places in Companies Act, 2013 casting responsibilities as under:

Relevant provision of Companies Act,2013	Nature of Responsibility
Section 134 (5)(e)	In case of listed Companies, the Directors' responsibility statement shall state that the Directors had laid down Internal financial controls to be followed by the company and that such Internal financial controls are adequate and were operating effectively.

Section 143(3)(i) of the Act	The auditor's report shall state whether the company has adequate Internal financial controls system in place and also on the operating effectiveness of such controls. This requirement shall not apply to a private company which – **i.** is One Person Company or a small company or **ii.** has turnover less than ₹ 50 crore as per latest audited Financial Statements; and which has aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial Year for less than ₹25 crore.
Section 177(4)(vii) of the Act	Every audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include - evaluation of internal financial controls and risk management systems.
As per Section 149(8) of the Act	The company and independent directors shall abide by the provisions specified in Schedule IV which lays down the Code for independent Directors. As per this code, the role and functions of independent directors include that they shall satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible.

Q.NO.48 DISTINCTION BETWEEN INTERNAL FINANCIAL CONTROL AND INTERNAL CONTROL OVER FINANCIAL REPORTING?

ANSWER:

1. The term Internal Financial Controls (IFC) refers to the policies and procedures put in place by companies for ensuring reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws and regulations, safeguarding of assets and prevention and detection of frauds.
2. On the other hand, Internal controls over financial reporting is required where auditors are required to express an opinion on the effectiveness of an entity's internal controls over financial reporting, such opinion is in addition to and distinct from the opinion expressed by the auditor on the financial statements.
3. Therefore, "internal financial control" is a wider term where as "internal controls over financial reporting" is a narrower term restricted to entity's internal controls over financial reporting only.

Q.NO.49 WRITE ABOUT DOCUMENTING THE RISKS?

ANSWER:

The auditor shall document:

a. The discussion among the engagement team and the significant decisions reached

b. Key elements of the understanding obtained regarding each of the aspects of the entity and its environment and of each of the internal control components, the sources of information from which the understanding was obtained; and the risk assessment procedures performed

c. The identified and assessed risks of material misstatement at the financial statement level and at the assertion level and

d. The risks identified, and related controls about which the auditor has obtained an understanding.

Q.NO.50 WRITE ABOUT ASSESS AND REPORT AUDIT FINDINGS TO MANAGEMENT?

ANSWER:

1. At the conclusion of each audit, it is possible that there will be certain findings or exceptions in IT environment and IT controls of the company that need to be assessed and reported to relevant stakeholders including management and those charged with governance viz., Board of directors, Audit committee.
2. Evaluation and assessment of audit findings and control deficiencies involves applying professional judgement that include considerations for quantitative and qualitative measures. Each finding should be looked at individually and in the aggregate by combining with other findings/deficiencies.
3. Some points to consider are as follows:
    a. Are there any weaknesses in IT controls?
    b. What is the impact of these weaknesses on overall audit?
    c. Report deficiencies to management – Internal controls memo or Management letter.
    d. Communicate in writing any significant deficiencies to those Charged with governance.
4. The auditor needs to assess each finding or exception to determine impact on the audit and evaluate if the exception results in a deficiency in internal control.

Note: A deficiency in internal control exists if a control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis or the control is missing.

SA 330 - The Auditor's Responses to Assessed Risks

A. SCOPE AND OBJECTIVE:

1. SA 330 deals with the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with SA 315, "Identifying and Assessing Risks of Material Misstatement Through Understanding the Entity and Its Environment" in a financial statement audit.
2. The objective of the auditor is to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks.
3. **SA 330 states that:**
    a. The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.
    b. The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.

B. IN DESIGNING THE FURTHER AUDIT PROCEDURES TO BE PERFORMED, THE AUDITOR SHALL:

a. Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including:

i. The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (i.e., the inherent risk) and

ii. Whether the risk assessment takes into account the relevant controls (i.e., the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures) and

b. Obtain more persuasive audit evidence the higher the auditor's assessment of risk.

C. THE AUDITOR SHALL DESIGN AND PERFORM TESTS OF CONTROLS TO OBTAIN SUFFICIENT APPROPRIATE AUDIT EVIDENCE AS TO THE OPERATING EFFECTIVENESS OF RELEVANT CONTROLS WHEN:

1. The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures) or
2. Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.
3. In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control.
4. A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular, where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

D. NATURE AND EXTENT OF TEST OF CONTROLS: In designing and performing test of controls, the auditor shall:

1. Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:
   a. How the controls were applied at relevant times during the period under audit.
   b. The consistency with which they were applied.
2. By whom or by what means they were applied.
3. Determine whether the controls to be tested depend upon other controls (indirect controls), and if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls.
4. Inquiry alone is not sufficient to test the operating effectiveness of controls. Accordingly, other audit procedures are performed in combination with inquiry.
5. In this regard, inquiry combined with inspection or reperformance may provide more assurance than inquiry and observation, since an observation is pertinent only at the point in time at which it is made.
6. The nature of the particular control influences the type of procedure required to obtain audit evidence about whether the control was operating effectively.
   For example, if operating effectiveness is evidenced by documentation, the auditor may decide to inspect it to obtain audit evidence about operating effectiveness.
7. When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls.

E. MATTERS THE AUDITOR MAY CONSIDER IN DETERMINING THE EXTENT OF TEST OF CONTROLS INCLUDE THE FOLLOWING:

1. The frequency of the performance of the control by the entity during the period.
2. The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
3. The expected rate of deviation from a control.
4. The relevance and reliability of the audit evidence to be obtained regarding the

operating effectiveness of the control at the assertion level.
5. The extent to which audit evidence is obtained from tests of other controls related to the assertion.

F. TIMING OF TEST OF CONTROLS:

1. The auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls in order to provide an appropriate basis for the auditor's intended reliance.
2. Audit evidence pertaining only to a point in time may be sufficient for the auditor's purpose, for example, when testing controls over the entity's physical inventory counting at the period end.
3. If, on the other hand, the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate. Such tests may include tests of the entity's monitoring of controls.

G. USING AUDIT EVIDENCE OBTAINED IN PREVIOUS AUDITS: In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:

1. The effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process
2. The risks arising from the characteristics of the control, including whether it is manual or automated.
3. The effectiveness of general IT-controls.
4. The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control
5. Whether the lack of a change in a particular control poses a risk due to changing circumstances and
6. The risks of material misstatement and the extent of reliance on the control

If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor shall establish the continuing relevance of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to the previous audit.

H. EVALUATING THE OPERATING EFFECTIVENESS OF CONTROLS:

1. When evaluating the operating effectiveness of relevant controls, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively.
2. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective.
3. A material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control.

I. SPECIFIC INQUIRIES BY AUDITOR WHEN DEVIATIONS FROM CONTROLS ARE DETECTED: When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

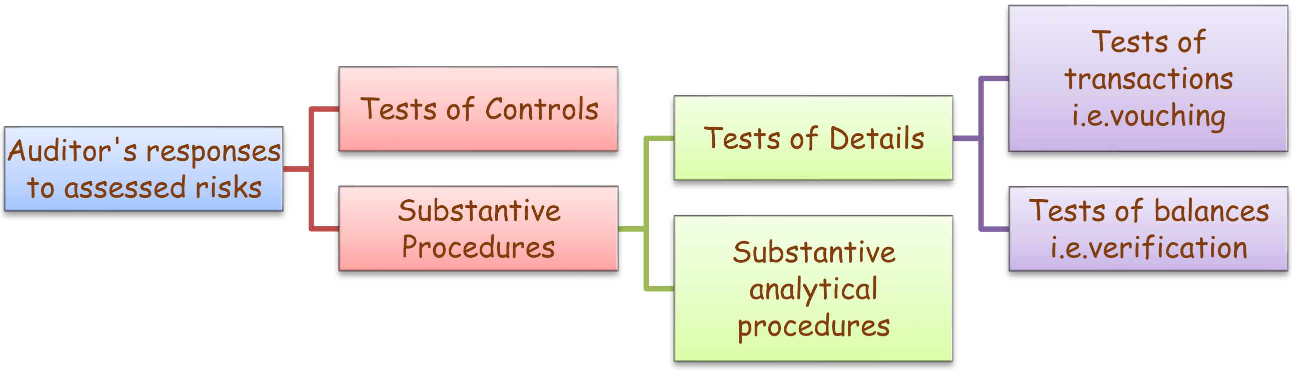
1. The test of controls that have been performed provide an appropriate basis for reliance on the controls
2. Additional test of controls are necessary or
3. The potential risks of misstatement need to be addressed using substantive procedures.

J. SUBTANTIVE PROCEDURES:

1. Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure. This requirement reflects the facts that:
   a. The auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement and
   b. There are inherent limitations to internal control, including management override.
2. Substantive procedures are audit procedures designed to detect material misstatements at the assertion level. Substantive procedures comprise:
   a. Tests of details (of classes of transactions, account balances, and disclosures), and
   b. Substantive analytical procedures.
3. **TESTS OF DETAILS:** Tests of details are further classified into tests of transactions i.e., vouching and tests of balances i.e., verification.
   For example, a purchase transaction may be verified by examining the related purchase invoice, goods received note, inward gate entry register. Such tests of transactions help in establishing the authenticity of transactions recorded in books of accounts.
   Tests of balances consist of verification of assets as well as liabilities. Verification of an item of fixed asset, for example, would help in establishing existence of that asset as on date of balance sheet.
   This may be obtained by reviewing entity's plan for performing physical verification of fixed assets and obtaining evidence for performance of physical verification of fixed assets by management.
4. **SUBSTANTIVE ANALYTICAL PROCEDURES:**
   a. Substantive analytical procedures refer to analytical procedures used as substantive procedures by auditor. The term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.
   b. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.
   c. The use of widely recognised ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.
   d. Analytical procedures involving, for example, the prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details.
   e. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.
5. **NATURE AND EXTENT OF SUBSTANTIVE PROCEDURES:** Depending on the

circumstances, the auditor may determine that:

a. Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level.
b. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls, only tests of details are appropriate.
c. A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.
d. Because the assessment of the risk of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from test of controls are unsatisfactory.
e. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing.



10. AUDIT OF BANKS

Q.NO.1. WHAT ARE THE PECULIARITIES INVOLVED IN BANKS?

ANSWER:

Peculiarities involved:

1. Huge volumes and complexity of transactions.
2. Wide geographical spread of banks' network.
3. Large range of products and services offered.
4. Extensive use of technology.
5. Strict vigilance by the banking regulator etc.

Q.NO.2. WHAT ARE THE VARIOUS TYPES OF BANKING ENTITIES?

ANSWER:

A. **COMMERCIAL BANKS:** Commercial banks are the widest spread banking institutions in India, that provide a number of products and services to general public and other segments of economy. Two of its main functions are:
   a. Accepting deposits and
   b. Granting advances.

B. **REGIONAL RURAL BANKS:** Regional Rural Banks known as RRBs are the banks that have been set up in rural areas in different states of the country to cater to the basic banking and financial needs of the rural communities.
   Examples: Punjab Gramin Bank, Tripura Gramin Bank, Allahabad UP Gramin Bank, Andhra Pradesh Grameen Vikas Bank, etc.

C. **CO-OPERATIVE BANKS:** Co-operative Banks function like Commercial Banks only but are set up on the basis of Cooperative Principles and registered under the Cooperative Societies Act of the respective state or the Multistate Cooperative Societies Act and usually cater to the needs of the agricultural and rural sectors.
   Examples: The Gujarat State Co-operative Bank Ltd., Chhatisgarh Rajya Sahakari Bank Maryadit , etc.

D. **PAYMENTS BANKS:** Payments Banks are a new type of banks which have been recently introduced by RBI. They are allowed to accept restricted deposits but they cannot issue loans and credit cards. However, customers can open Current & Savings accounts and also avail the facility of ATM cum Debit cards, Internet-banking & Mobile banking.
   Examples: Airtel Payments Bank, India Post Payments Bank, Paytm Payments Bank, etc.

E. **DEVELOPMENT BANKS:** Development Banks had been conceptualized to provide funds for infrastructural facilities important for the economic growth of the country.
   Examples: Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), Small Industries Development Bank of India (SIDBI), etc.

F. **SMALL FINANCE BANKS:** Small Finance Banks have been set up by RBI to make available basic financial and banking facilities to the unserved and unorganised sectors like small marginal farmers, small & micro business units, etc.
   Examples: Equitas Small Finance Bank, AU Small Finance Bank, etc.

Q.NO.3. WRITE ABOUT RESERVE BANK OF INDIA AND ITS FUNCTIONS AND RESPONSIBILITES?

ANSWER:

1. The functioning of banking industry in India is regulated by the Reserve Bank of India (RBI) which acts as the Central Bank of our country.

2. RBI is responsible for:
   a. Development and supervision of the constituents of the Indian financial system (which comprises banks and non-banking financial institutions)
   b. Determining, in conjunction with the Central Government, the monetary and credit policies keeping in with the need of the hour.
3. Important functions of RBI are:
   a. Issuance of currency.
   b. Regulation of currency issue.
   c. Acting as banker to the central and state governments and
   d. Acting as banker to commercial and other types of banks including term lending institutions.
   e. Responsibility of regulating the activities of commercial and other banks.
4. No bank can commence the business of banking or open new branches without obtaining license from RBI. The RBI also has the power to inspect any bank.
5. **Banking Operations:**
   a. Banking operations are conducted only at the branches, while other offices act as controlling authorities or administrative offices that lay down policies, systems and internal control procedures for conduct of business, in compliance with the statutory/ regulatory impositions and in compliance of accepted accounting principles and practices that cover all transactions and economic events.
   b. These controlling/ administrative offices also stipulate the delegation of powers and fix responsibilities and accountability and these are involved generally in effective supervision, monitoring and control over the business activities and operations, including seeking faithful compliance of the bank's laid down policies/ procedures /controls and deal with deviations therefrom.

Q.NO.4. WRITE ABOUT THE REGULATORY FRAMEWORK FOR BANKING COMPANIES?

ANSWER:

1. RBI Act 1934
2. Banking Regulation Act, 1949. State Bank of India Act, 1955.
3. Companies Act, 2013. State Bank of India (Subsidiary Banks) Act 1959.
4. Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970.
5. Regional Rural Banks Act, 1976.
6. Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.
7. Information Technology Act, 2000.
8. Prevention of Money Laundering Act, 2002.
9. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
10. Credit Information Companies Regulation Act, 2005.
11. Payment and Settlement Systems Act, 2007.

Q.NO.5. WHAT ARE THE AUDIT REPORTS THAT CENTRAL STATUTORY AUDITORS FURNISH IN CASE OF AUDIT OF BANKS?

ANSWER:

The Statutory Central Auditors (SCAs) have to furnish the following reports in addition to their main audit report:

1. Report on adequacy and operating effectiveness of Internal Controls over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report.

2. Long Form Audit Report. (LFAR)
3. Report on compliance with SLR requirements.
4. Report on whether the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time.
5. Report on whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI from time to time.
6. Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention.
7. Report on status of the compliance by the bank with regard to the implementation of recommendations of the Ghosh Committee relating to frauds and malpractices and of the recommendations of Jilani Committee on internal control and inspection/credit system.
8. Report on instances of adverse credit-deposit ratio in the rural areas.

Q.NO.6. WRITE ABOUT AN OVERVIEW OF BANKS ACCOUNTING SYSTEM?

ANSWER:

1. The transactions in banks have become voluminous and it needs to be ensured that in the system of recording, transmission and storage of information/ data, integrity thereof is optimally maintained and control systems ensure that the same is free of errors, omissions, irregularities and frauds. Considering the challenges of technology, bank managements continuously endeavour to make their internal control systems robust, safe and secure as well as convenient and expeditious for the customers.
2. Banks may be divided into 3 board categorises based on the level of computerisation:
   a. **Non-computerised banks:** Transactions can be done only at bank branches during working hours using paper and pen.
   b. **Partially computerised banks:** Some transactions are computerised while major is non-computerised.
   c. **Fully computerised banks:**
      i. Core banking allows inter-connectivity between branches of the same bank and with CBS, customers can operate their accounts as well as avail banking services from any branch of the bank over the network
      ii. In the computerized environment, it is imperative that the auditor is familiar with and satisfied that all the norms/parameters as per the latest applicable RBI guidelines are incorporated and built into the system that generates information/data having a bearing on the classification/ provisions and income recognition.
      iii. The auditor should not go by the assumption that the system generated information is correct and can be relied upon without evidence that demonstrates that the system driven information is based on the required parameters. He should use Professional Scepticism and Prudence wherever he feels that something manually needs to be performed to check the authenticity and consistency of the information obtained from the systems and document the results of such activities performed.
3. Difference between Computerised and Non computerised Banks:

COMPUTERISED BANKS	NON-COMPUTERISED BANKS
1. All Banking Activities are done through computer.	1. Banking is done Manually.
2. Can Transact – Anywhere, Any time	2. Can Transact only in working hours
3. Shortest processing time.	3. Takes Long time to process transactions.

4. More Productivity and efficiency	4. Less Productivity and Less Efficiency.

Q.NO.7. WHAT ARE THE POINTS TO BE KEPT IN MIND WHILE DRAWING AN AUDIT PLAN OF A BANK?

ANSWER:

An audit plan should be drawn up based on:
1. The Nature and Level of operations,
2. Nature of Adverse Features,
3. Level Of Compliance based on previous reports and
4. Audit Risks Based on Inadequacy in Or Breach of Internal Controls and the familiarization exercise carried out.

Q.NO.8. WRITE ABOUT CONTROL ENVIRONMENT IN A BANK?

ANSWER:

A bank should have appropriate controls to mitigate its risks, including:
1. Effective segregation of duties (particularly, between front and back offices),
2. Accurate measurement and reporting of positions,
3. Verification and approval of transactions,
4. Reconciliation of positions and results,
5. Setting up limits,
6. Reporting and approval of exceptions,
7. Physical security and contingency planning.

The following are certain common questions /steps, which have to be kept in mind while undertaking/ performing control activities:

Nature of Questions	Questions to be considered / answered
Who	1. Who performs the control?
	2. Does the above person have requisite knowledge and authority to perform the control?
What	What evidence is generated to demonstrate /prove that the control is performed?
When	1. When and with what frequency is the control performed?
	2. Is the frequency enough to prevent, detect and correct Risk of Material Misstatements?
Where	1. Where is the evidence of performance of the control retained?
	2. For how long is the evidence retained?
	3. Is the evidence accessible for / available for audit?
Why	Why is the control being performed?
	What type of errors are prevented or detected through the performance of the control?
How	1. How is the control performed?
	2. Can these activities be bypassed?
	3. Can the bypass, if any, be detected?
	4. How are exceptions / deviations resolved on identification?
	5. What is the time frame for resolving the exceptions / deviations?

Q.NO.9. WHILE CONDUCTING BANK AUDIT, THE ENGAGEMENT TEAM SHALL DISCUSS AND DOCUMENT ABOUT UNDERSTANDING OF AUDIT OF BANK. EXPLAIN.

ANSWER:

A. ENGAGEMENT TEAM DISCUSSIONS: The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control.

1. They should assess the potential for material misstatements of the financial statements.
2. These discussions are ordinarily done at the planning stage of an audit. All these discussions should be appropriately documented for future reference.

B. MATTERS TO BE DISCUSSED IN GENERAL: The engagement team discussion ordinarily includes a discussion of the following matters:

1. Errors that may be more likely to occur;
2. Errors which have been identified in prior years;
3. Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures.
4. Need to maintain professional skepticism throughout the audit engagement.
5. Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks.
6. Need to alert for information or other conditions that indicates that a material misstatement may have occurred.

C. ADVANTAGES OF DISCUSSIONS:

1. Specific emphasis should be provided to the susceptibility of the bank's financial statements to material misstatement due to fraud, that enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
2. It further enables the audit engagement partner to delegate the work to the experienced engagement team members, and to determine the procedures to be followed when fraud is identified.
3. Audit engagement partner may review the need to involve specialists to address the issues relating to fraud.

Q.NO.10. PROCEDURE FOR CONDUCTING A BANK AUDIT.

ANSWER:

A. INITIAL CONSIDERATION BY THE STATUTORY AUDITOR:

1. **Communication with Previous Auditor:** As per Clause (8) of the Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice cannot accept position as auditor previously held by another chartered accountant without first communicating with him in writing.
2. **Acceptance & Continuance:** Performing procedures required by SA 220, "Quality Control for Audit Work" regarding the acceptance of the client relationship and the specific audit engagement (Assessing Engagement risk); and
3. **Declaration of Indebtedness:** Banks should obtain a declaration of indebtedness before appointing their auditors that he has not availed credit facilities from any other bank (or) credit facilities, if any, availed have not become NPA.
4. **Terms of Audit Engagements:** SA 210 requires that for each period to be audited, the auditor should agree on the terms of the audit engagement and they should be documented, in order to prevent any confusion.
5. **Internal Assignments:** The audit firms should not undertake statutory audit assignment, if they are associated with internal assignments in the bank during the same year.
6. **Establish the Engagement Team:** The assignment of qualified and experienced professionals of engagement team should be done on the basis of size, nature, and complexity of the bank's operations.

B. **UNDERSTANDING THE BANK AND ITS ENVIRONMENT INCLUDING ACCOUNTING PROCESS:**
SA 315 lay downs that the auditor should obtain an understanding of the entity and its environment, including its internal control and accounting process,
1. To identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, and
2. To design and perform further audit procedures.

C. **ENGAGEMENT TEAM DISCUSSIONS:** The engagement team should hold discussions to gain better understanding of banks and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements.

D. **DEVELOP THE AUDIT PLAN:** SA 300 deals with the auditor's responsibility to plan an audit of financial statements in an effective manner. It requires the involvement of all the key members of the engagement team while planning an audit.

E. **DETERMINE AUDIT MATERIALITY:** The auditor should consider the relationship between the audit materiality and audit risk when conducting an audit. The determination of audit materiality is a matter of professional judgment.

F. **CONSIDER GOING CONCERN:** In obtaining an understanding of the bank, the auditor should consider whether there are events and conditions which may cast significant doubt on the bank's ability to continue as a going concern.

G. **MAINTAINING PROFESSIONAL SCEPTICISM:** As per SA 240, the attitude of professional scepticism should be maintained by the auditor so as to recognise the possibility of misstatements due to fraud.

H. **STRESS TESTING:** RBI has required that all commercial banks shall put in place a Broad approved 'Stress Testing framework' to suit their individual requirements which would integrate into their risk management systems.

I. **BASEL III FRAMEWORK:** In the document titled '**Basel III**', A global regulatory framework for more resilient in banks and banking systems', released by the BCBS in December 2010, it has proposed certain minimum set of criteria for inclusion of instruments in the new definition of regulatory capital.
BCBS: Basel Committee on Banking Supervision.

J. **RELIANCE ON / REVIEW OF OTHER REPORTS:** The auditor should take into account the adverse comments, if any, on advances appearing in the following:
1. Previous audit reports.
2. Latest internal inspection reports of bank officials.
3. Reserve Bank's latest inspection report.
4. Concurrent / Internal audit report.
5. Report on verification of security.
6. Any other internal reports specially related to particular accounts.
7. Manager's charge-handing-over report when incumbent is changed.

Q.NO.11. EXPLAIN ABOUT UNDERSTANDING OF RISK MANAGEMENT PROCESS WHILE CONDUCTING AUDIT OF A BANK.

ANSWER:

Management develops controls and uses performance indicators to aid in managing key business and financial risks. An effective risk management system in a bank generally requires the following:

1. **INVOLVEMENT IN THE CONTROL PROCESS BY THOSE CHARGED WITH GOVERNANCE:** Those charged with governance (BOD/Chief Executive Officer) should

approve written risk management policies. The policies should be consistent with the bank's business objectives and strategies, regulatory requirements etc.

2. **IDENTIFICATION, MEASUREMENT AND MONITORING OF RISKS:** Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria.
3. **CONTROL ACTIVITIES:** A bank should have appropriate controls to manage its risks, including effective segregation of duties, verification and approval of transactions, physical security and contingency planning etc.
4. **MONITORING ACTIVITIES:** Risk management models, methodologies used to measure and manage risk should be regularly assessed and updated.
5. **RELIABLE INFORMATION SYSTEMS:** Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis.

Q.NO.12. EXPLAIN THE PROVISIONS RELATING TO APPOINTMENT OF AUDITOR FOR BANKS.

ANSWER:

A. ELIGIBILITY, QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITOR: Same as auditor of company as prescribed under section 141 of the Companies Act, 2013.

B. AUTHORITY TO APPOINTMENT:

1. **Auditor of a BANKING COMPANY:** Appointed by shareholders of the bank at the AGM. (Approval of the Reserve Bank of India is required before the appointment is made.)
2. **Auditor of a NATIONALISED BANK:** By BOD subject to certain approvals from RBI. (Approval of the Reserve Bank of India is required before the appointment is made.)
3. **Auditors of the SBI:** Appointed by the CAG of India in consultation with CG. The subsidiaries of SBI are to be appointed by SBI itself.
4. **Auditors of REGIONAL RURAL BANKS:** By BOD of the bank with approval of Central Government.

C. REMUNERATION OF AUDITOR:

1. **Auditor of a banking company:** Fixed in accordance with the provisions of section 142 of the Companies Act, 2013 (i.e., by the company in general meeting).
2. **Auditors of nationalised banks, SBI and RRBs:** Fixed by the Reserve Bank of India in consultation with the Central Government.

D. POWERS OF AUDITOR: Same powers as those of a company auditor prescribed in companies act, 2013 like access to the books, accounts, documents and vouchers etc

Q.NO.13. WRITE A SHORT NOTE ON: REPORTING BY AUDITOR OF A BANK.

ANSWER:

A. REPORTING TO CG:

In the case of a nationalised bank, the auditor is required to make a report to the Central Government in which he must state the following:

1. Whether the balance sheet and profit and loss containing all the necessary particulars and is properly drawn up so as to exhibit a true and fair view of the affairs and Profit or loss of the bank.
2. Whether he has been given any explanation or information requested, and whether it is satisfactory;
3. Whether the transactions of the bank, which have come to his notice, have been within the powers of that bank.

4. whether the returns received from the offices and branches of the bank have been found adequate for the purpose of his audit.

B. FORMAT OF REPORT:

1. **Compliance with SA'S:** The auditors, central as well as branch, should also ensure that the audit report issued by them complies with the requirements of relevant Standards on Auditing.
2. **Additional disclosure by Central Auditor:** The auditor should ensure that not only information relating to number of unaudited branches is given but quantification of advances, deposits, interest income and interest expense for such unaudited branches has also been disclosed in the audit report. (SA 600 requirement)
3. **Matters to be stated as per Sec. 143:** It may be noted that, in addition to the aforesaid, the auditor of a banking company is also required to state in his report in respect of matters covered by Section 143 of the Companies Act, 2013.
4. **CARO applicability:** The reporting requirements relating to the Companies (Auditor's Report) Order, 2020 is not applicable to a banking company.

C. LONG FORM AUDIT REPORT:

1. The terms of appointment of auditors of public sector banks, private sector banks and foreign banks (as well as their branches), require the auditors to also furnish a long form audit report (LFAR).
2. The matters in the long form audit report have been specified by the Reserve Bank of India.
3. The LFAR is to be submitted before 30th June every year.
4. To ensure timely submission of LFAR, proper planning for completion of the LFAR is required.
5. While the format of LFAR does not require an executive summary to be given, members may consider providing the same to bring out the key observations from the whole document.

D. REPORTING TO RBI (or) REPORTING OF FRAUD:

1. **As per RBI Circular:** The RBI issued a Circular relating to Legal Aspects of Bank Frauds applicable to all scheduled commercial banks (excluding Regional Rural Banks).
2. The said circular provided as under: "If an accounting professional, whether in the course of internal or external audit, finds anything susceptible to be fraud or fraudulent activity or act of excess power or smell any foul play in any transaction, he should refer the matter to the regulator. Any deliberate failure on the part of the auditor should render himself liable for action".
3. **As per SA 240:** Also, if the auditor while performing his normal duties comes across any fraud, he should report the matter to the RBI in addition to Chairman/Managing Director/Chief Executive of the concerned bank.
4. It must be noted that auditor is not expected to look into each and every transaction but to evaluate the system as a whole. Therefore, if the auditor while performing his normal duties comes across any instance, he should report the matter to the RBI in addition to Chairman/Managing Director/Chief Executive of the concerned bank.

E. DUTY TO REPORT ON FRAUDS UNDER SECTION 143(12) OF THE COMPANIES ACT, 2013: Same as company auditors appointed under section 139 of the company's act, 2013. This is in addition to reporting to RBI.

Q.NO.14. WRITE ABOUT AUDIT OF ADVANCES OF A BANKING COMPANY?

ANSWER:

1. Advances are amount of money or credit, given as a loan from a bank to another party with an agreement that the money will be repaid. All Bank Loans are made at interest which is a compensation for borrowing. Advances, generally, constitute the largest item on the assets side of the balance sheet of a bank and are major source of its income. Audit of advances is one of the most important areas covered by auditors in bank audit. It is necessary that auditors should have adequate knowledge of the banking industry and the regulations governing the banks. Auditors must be aware of the various functional areas of the bank/branches, its processes, procedures, systems and prevailing internal controls with regard to advances.
2. The auditor should examine all large advances while other advances may be examined on a sampling basis:
   i. An advance may be considered to be a large advance if the year-end balance is in excess of Rs. 2 crore or 5% of the aggregate year end advances of the branch, whichever is less.
   ii. Remaining advances are known as other advances.
3. **TYPES OF ADVANCES:**
   i. **FUNDED:** Funded loans are those loans where there is an actual transfer of funds from the bank to the borrower. Examples of funded loans are Term loans, Cash credits, Overdrafts, Demand Loans, Bills Discounted and Purchased, Participation on Risk Sharing basis, Interest-bearing Staff Loans.
   ii. **NON-FUNDED:** Non-funded facilities are those which do not involve such transfer. Examples of non-funded loans are Letters of credit, Bank guarantees, etc.
   iii. Advances generally comprises of:
      i. Term loans.
      ii. Cash credits, Overdrafts, Demand Loans.
      iii. Bills Discounted and Purchased.
      iv. Participation on Risk Sharing basis.
      v. Interest-bearing Staff Loans.
4. **Disclosures in Balance sheet:**
   a. Bills purchased and discounted
   b. Cash credits, Overdrafts and loans repayable on demand
   c. Term Loans
      i. The above advances shall further be disclosed with Secured by tangible assets, Covered by Guarantees and Unsecured.
      ii. These advances shall be again sub divided into:
         Advances In India:
         1. Priority sectors
         2. Public sector
         3. Banks
         4. Others

         Advances Outside India:
         1. Due from banks
         2. Due from Others:
            a. Bills purchased and discounted
            b. Syndicated loans
            c. Others.

Q.NO.15. WRITE ABOUT CLASSIFICATION OF ADVANCES OF A BANK SECTOR WISE AND SECURITY WISE?

ANSWER:

A. BASED ON SECTOR WISE: RBI issues common guidelines for lending to Priority Sector which banks are required to follow. These guidelines cover rate of interest; service charges, receipt, sanction, rejection, disbursement Register; issue of Loan Application Acknowledgement. RBI also issues targets for bank's for lending to Priority Sector. Examples of Priority Sectors are Agriculture, MSME, Education, Housing, etc.

B. BASED ON SECURITY:

1. Primary security refers to the security offered by the borrower for bank finance. This security is the principal security for an advance.
2. Collateral security is an additional security.

Examples of most common types of securities accepted by banks are the following.

a. Goods/Stocks/Debtors /Trade Receivables
b. Gold Ornaments and Bullion
c. Immovable Property
d. Plantations (For Agricultural Advances)
e. Life Insurance Policies
f. Stock Exchange Securities and Other Instruments

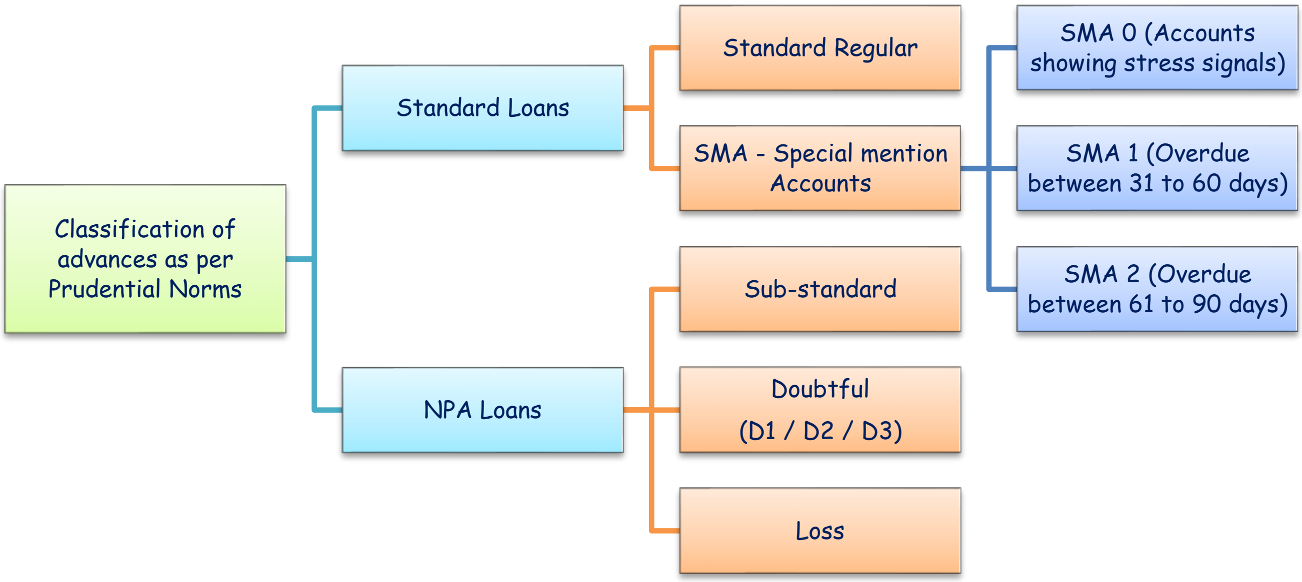
C. MODE OF CREATION OF SECURITY:

1. **MORTGAGE:** Mortgages are of several kinds but the most important are the Registered Mortgage and the Equitable Mortgage.
   a. A Registered Mortgage can be affected by a registered instrument called the 'Mortgage Deed' signed by the mortgagor. It registers the property to the mortgagee as a security.
   b. Equitable Mortgage, on the other hand, is affected by a mere delivery of title deeds or other documents of title with intent to create security thereof.
2. **PLEDGE:**
   a. A pledge involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a security for the advance.
   b. The legal ownership of the goods remains with the pledger while the lending banker gets certain defined interests in the goods.
3. **HYPOTHECATION:**
   a. Neither ownership nor possession is transferred to the bank and the borrower holds the physical possession of the goods as an agent/trustee of the bank.
   b. The borrower periodically submits statements regarding quantity and value of hypothecated assets (stocks, debtors, etc.) to the lending banker on the basis of which the drawing power of the borrower is determined.
4. **ASSIGNMENT:** Assignment represents a transfer of an existing or future debt, right or property belonging to a person in favour of another person. Only actionable claims (i.e., claim to any debt other than a secured debt) such as book debts and life insurance policies are accepted by banks as security by way of assignment.
5. **SET-OFF:**
   a. The 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 in the same right (i.e., the capacity of the account holder in both the accounts should be the same).
   b. For the purpose of set-off, all the branches of a bank are treated as one single entity.
   c. The right of set-off can be exercised in respect of time-barred debts also.

6. **LIEN:** 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.

Q.NO.16. WRITE ABOUT PRUDENTIAL NORMS CLASSIFICATION OF ADVANCES AND PROVISIONING PERTAINING TO ADVANCES?

ANSWER:



A. NON-PERFORMING ASSETS:

An asset becomes NPA when it ceases to generate income for the Bank. A non-performing asset (NPA) is a loan or an advance where -:

1. Interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan.
2. The account remains 'out of order' in respect of an overdraft/cash credit (OD/ CC).
3. The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.

Note:

1. Classification as NPA should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise.
2. Asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

For Example: Mr. Raman has availed two Loan facilities - a Car Loan as well as a Housing Loan from XYZ Bank Ltd. He is regular in depositing the Housing loan EMI but has not deposited the last 4 EMI's of the Car Loan due to paucity of funds. Hence, in this case, not only the Car loan but the Housing Loan would also be treated as an NPA, although it is going well and there are no irregularities because the NPA classification is Borrower wise (Mr. Raman) and not Facility wise (Car & Housing Loan individually).

B. OUT OF ORDER:

An account should be treated as 'out of order' if:

1. The outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
2. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of balance sheet or

3. Credits are there but are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

Example: A Ltd. has been sanctioned a Cash Credit Facility by ADB Bank Ltd. for INR 50 lacs but as per the Stock Statements furnished for the last quarter, the Bank has calculated the Drawing power to be INR 42 Lakhs. In this case, the account would be termed as OUT OF ORDER if:

1. The outstanding balance remains continuously in excess of the INR 50 lacs/42 lacs whatever the case may be or
2. The outstanding balance in the account is less than INR 42 lacs but there are no credits, or any payments deposited into this account continuously for 90 days as on the date of Balance Sheet or
3. Credits are there up to say INR 2 lakhs but are not enough to cover the interest debited during the same period which is around INR 5 lakhs.

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. The following provisioning shall be followed:

CATEGORIES OF NON-PERFORMING ASSETS	PROVISION REQUIRED	
A. Substandard Assets: Would be one, which has remained NPA for a period less than or equal to 12 months.	15%	
B. Doubtful Assets: Would be one, which has remained in the substandard category for a period of 12 months.		
Sub Categories:	*Secured Portion*	*Unsecured Portion*
1. Doubtful up to 1 Year (D1)	25%	100%
2. Doubtful 1 to 3 Years (D2)	40%	100%
3. Doubtful more than 3 Years (D3)	100%	100%
C. Loss Assets: Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.	100%	

Q.NO.17. WRITE ABOUT SPECIAL NPA NORMS FOR VARIOUS KINDS OF ADVANCES?

ANSWER:

A. ACCOUNTS REGULARIZED NEAR ABOUT THE BALANCE SHEET DATE:

1. These are the accounts with few credits received just before the date of balance sheet.
2. The asset classification of such accounts should be handled with care. If the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA.

B. GOVERNMENT GUARANTEED ADVANCES:

1. Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets, but regarded as NPA for Income Recognition purpose.
2. The situation would be different if the advance is guaranteed by State Government, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

In other words, provisioning norms do not apply and interest is recognised only if it is realised i.e., cash basis. [This relaxation is not applicable for State Government Guaranteed

Advances]

C. ADVANCES UNDER CONSORTIUM:

1. Consortium advances mean advancing loans to a borrower by 2 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.
2. Consortium advances should be based on the record of recovery of the respective individual member banks.
3. Where the remittances by the borrower under consortium lending arrangements are received by the lead bank and the lead bank is not transferring the share of other member banks, the account should be deemed to be NPA as per respective provisions.
4. The banks participating in the consortium, therefore, 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.
5. **Drawing Power Allocation in case of Consortium Cash Credit Account:** The Lead Bank would be responsible for computing the drawing power (DP) of the borrower and allocate the same to member banks. In certain special circumstances, at the request of the Borrower, the Lead Bank may allot a higher or lower share of drawing power to the member bank, as against their share of advances.

Illustrative Drawing Power for December 2022 as per Stock Statement November, 2022

			(Rs. in Crores)
Description of Stocks	**Market Value**	**Margin**	**Advance Value**
Raw Materials	636.27	25	477.20
Finished Goods	372.75	25	279.56
Stock in process	659.35	25	494.51
Stores and Spares	124.51	25	93.38
Book Debts (Upto 120/180 days)	37379.90	35	24296.94
Stock in Transit	52.31	25	39.23
Total	39225.09		25680.82
Less: Unpaid Stocks under LC	0.00	100	0.00
Total	39225.09		25680.82

		(Rs. in Crores)
BANKS	**Share %**	**LIMIT/D.P.**
State Bank of India	32.25	500.00
Bank of Baroda	2.58	40.00
Bank of India	6.45	100.00
Canara Bank	5.16	80.00
Standard Chartered Bank	9.03	140.00
Union Bank of India	6.45	100.00
HSBC	13.87	215.00
Citi Bank	6.45	100.00

Bank of America	1.29	20.00
BNP Paribas	1.94	30.00
Punjab National Bank	6.45	100.00
ICICI Bank	4.84	75.00
IDBI Bank	3.23	50.00
Unallocated		
TOTAL	**100.00**	**1550.00**

D. ACCOUNTS WHERE THERE IS EROSION IN THE VALUE OF SECURITY / FRAUDS COMMITTED BY BORROWERS:

1. Erosion means the gradual destruction or diminution of something not prudent to follow stages of asset classification. It should be straight-away classified as doubtful or loss asset as appropriate as follows:
    a. **As Doubtful asset:** If the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, Such assets may be straight-away classified under doubtful category and provisioning should be made as applicable to doubtful assets.
    b. **As Loss asset:** If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrower accounts, then the existence of security should be ignored and the asset should be straight-away classified as loss asset. It shall be fully written off.

E. ADVANCES AGAINST TERM DEPOSITS, NSCS, and KVPS: Advances against Term Deposits, NSCs, and KVP/IVP need not be treated as NPAs, provided adequate margin is available in the accounts.

F. AGRICULTURAL ADVANCES AFFECTED BY NATURAL CALAMITIES:

1. Master Circular issued by the RBI deals elaborately with the classification and income recognition issues due to impairment caused by natural calamities.
2. Banks may decide on their own relief measures.
   E.g., They may convert a short-term production loan into a term loan or re-schedulement of the repayment period and the sanctioning of fresh short-term loan.
3. In such cases, the NPA classification would be governed by such rescheduled terms.

G. ADVANCES TO STAFF:

1. Interest on staff advances should be included as part of advances portfolio of the bank.
2. In the case advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards.
3. Such loans/advances should be classified as NPA only when there is a default in repayment of instalment on the respective due dates for beyond 90 days.

Note: However, the staff advances by a bank as an employer and not as a banker are required to be included under the sub-head 'Others' under the schedule of Other Assets. (Salary advance)

H. AGRICULTURAL ADVANCES:

1. Agricultural Advances are of two types,
    a. Agricultural Advances for "long duration" crops (LDC) and
    b. Agricultural Advances for "short duration" crops (SDC)
2. The following NPA norms would apply to agricultural advances:

a. **SDC:** A loan will be treated as NPA, if the instalment remains overdue for two crop seasons.
b. **LDC:** A loan will be treated as NPA, if the instalment remains overdue for one crop season.

Note: The "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops.

Q.NO.18. WRITE ABOUT COMPUTATION OF DRAWING POWER?

ANSWER:

1. **DRAWING POWER:** Drawing Power generally addressed as "DP" is an important concept for Cash Credit (CC) facility availed from banks and financial institutions. Drawing power is the limit up to which a firm or company can withdraw from the working capital limit sanctioned.
2. **SANCTIONED LIMIT:** The 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. On the other hand, Drawing Power refers to the amount calculated based on primary security less margin as on a particular date.
3. **RULES FOR DP / SL:**
   a. All accounts should be kept within both the drawing power and the sanctioned limit at all times. The accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be brought to the notice of the Management/Head Office regularly.
   b. Banks should ensure that drawings in the working capital account are covered by the adequacy of the current assets.
   c. Drawing power is required to be arrived at based on current stock statement.
   d. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than 3 months.
   e. The outstanding in the account based on drawing power calculated from stock statements older than 3 months is deemed as irregular.
   f. **Computation of DP:** It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors.
   g. Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power.
4. **AUDIT REQUIREMENTS:**
   a. The stock statements, quarterly returns and other statements submitted by the borrower to the bank should be scrutinized in detail.
   b. The audited Annual Report submitted by the borrower should be scrutinized properly.
   c. The 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.
   d. **Stock Audit:**
      i. The stock audit should be carried out by the bank for all accounts having funded exposure of more than 5 crores.
      ii. Auditors can also advise for stock audit in other cases if the situation warrants the same.

iii. Branches should obtain the stock audit reports from lead bank in the cases where the Bank is not leader of the consortium of working capital.

iv. The report submitted by the stock auditors should be reviewed during the course of the audit and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of drawing power.

DP CALCULATION: [ILLUSTRATION]

PARTICULARS	Rs.	Rs.	Rs.
A. STOCK:			
Stocks at NRV		1,000	
Less: Outstanding amount to suppliers			
- Sundry Creditors	(300)		
- Acceptances / Letter of Credits	(300)	(600)	
Paid Stock Value		400	
Less: Margin @25%		(100)	**300**
B. DEBTORS			
Total Debtors		1000	
Less: Ineligible Debtors		(200)	
Eligible Debtors		800	
Margin @40%		(320)	**480**
TOTAL DRAWING POWER			**780**

Q.NO.19. WRITE ABOUT AUDIT OF ADVANCES?

ANSWER:

1. **OBJECTIVES OF AUDIT:** In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:
    a. Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
    b. Advances represent amount due to the bank.
    c. Amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of advances.
    d. There are no unrecorded advances.
    e. The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.
    f. The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
    g. Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.
2. **EVALUATION OF INTERNAL CONTROLS OVER ADVANCES:** The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. In general, the internal controls over advances should include the following:

a. **CREDIT WORTHINESS:** The bank should make an advance only after satisfying itself as to the credit worthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank.
b. **DOCUMENTATION:** All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
c. **END USE OF FUNDS:** The compliance with the terms of sanction and end use of funds should be ensured.
d. **MARGIN OF SAFETY:** Sufficient margin as specified in the sanction letter should be kept against securities taken so as to cover for any decline in the value thereof. The availability of sufficient margin needs to be ensured at regular intervals.
e. **CREATION OF SECURITY:**
    i. If the securities taken are in the nature of shares, debentures, etc., the ownership of the same should be transferred in the name of the bank and the effective control of such securities be retained as a part of documentation.
    ii. All securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to give title to the bank.
    iii. In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipt.
    iv. The godowns should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.
f. **DRAWING POWER:**
    i. Drawing Power Register should be updated every month to record the value of securities hypothecated. These entries should be checked by an officer.
    ii. The accounts should be kept within both the drawing power and the sanctioned limit.
    iii. All the accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly.
g. The operation of each advance account should be reviewed at least once a year and at more frequent intervals in the case of large advances.

3. **AUDIT PROCEDURES:** The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of internal controls relating to advances, and by:
    a. Examining the validity of the recorded amounts.
    b. Examining loan documentation.
    c. Reviewing the operation of the accounts.
    d. Examining the existence, enforceability and valuation of the security.
    e. Checking compliance with RBI norms including appropriate classification and provisioning and
    f. Carrying out appropriate analytical procedures.
4. **SUBSTANTIVE PROCEDURES:**
    a. In carrying out his substantive procedures, the auditor should examine all large advances while other advances may be examined on a sampling basis.
    b. The accounts identified to be problem accounts, however, need to be examined in detail unless the amount involved is insignificant.

c. Advances which are sanctioned during the year or which are adversely commented by RBI inspection team, concurrent auditors, bank's internal inspection, etc. should generally be included in the auditor's review.

Q.NO.20. WRITE ABOUT AUDIT OF INCOMES OF A BANK?

ANSWER:

The following items are included under this head:

Interest Earned	Other Income
• Interest/ Discount on Advances/ Bills: • Interest Income on Investments: • Interest on Balances with RBI and Other Inter-bank Funds: • Others: This includes any other • interest/discount income not included in the above heads	• Commission, Exchange and Brokerage: This item comprises of the following: a. Commission on bills for collection. b. Commission/exchange on remittances and transfers, e.g. demand drafts, NEFT, RTGS, etc. c. Commission on letters of credit and guarantees, letter of comforts. d. Loan processing, arranger and syndication fees. e. Mobile banking fees. f. Credit/Debit card fee income including annual fee income, merchant acquiring income, interchange fees, etc. g. Rent from letting out of lockers h. Commission on Government business. i. Commission on other permitted agency business including consultancy and other services. j. Brokerage on securities. k. Fee on insurance referral. l. Commission on referral of mutual fund clients. m. Service/transaction banking charges including charges levied for transaction at other branches. n. Income from rendering other services like custodian, demat, investment advisory, cash management and other fee based services. o. Profit on Sale of Investments p. Profit/Loss on Revaluation of Investments Profit on sale of Land, Buildings and Other Assets: q. Profit/Loss on Revaluation of Fixed Assets Profit on exchange transactions: This includes revaluation gains/losses on forward exchange

	contracts and other derivative contracts, premium income/expenses on options, etc. r. Income earned by way of dividends, etc., from subsidiaries and joint ventures abroad/in India. s. Miscellaneous income.

A. AUDIT APPROACH:

1. **OBJECTIVE:** In carrying out audit of income, the auditor is primarily concerned with obtaining reasonable assurance that:
    a. The recorded income arose from transactions,
    b. It took place during the relevant period and pertained to the bank,
    c. There is no unrecorded income and
    d. The income is recorded at appropriate amount.
2. **ACCRUAL BASIS:** RBI has advised that in respect of any income which exceeds:
    a. 1% of the total income of the bank if the income is reckoned on a gross basis or
    b. 1% of the net profit before taxes if the income is reckoned net of costs,

    Should be considered on accrual basis.

    Note: If any item of income is not considered to be material as per the above norms, it may be recognised when received and the auditors need not qualify their report in that situation.
3. **REVENUE CERTAINTY:**
    a. Banks recognise income (such as interest, fees and commission) on accrual basis, i.e., as it is earned.
    b. It is an essential condition for accrual of income that it should not be unreasonable to expect its ultimate collection. In modern day banking, the entries for interest income on advances are automatically generated through a batch process in the CBS system.
    c. **UNCERTAINITY:**
        i. In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require that banks should not recognize income on non-performing assets until it is actually realised.
        ii. When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for. This will apply to Government guaranteed accounts also.
    d. However, Interest on advances against Term Deposits, National Savings Certificates (NSCs), Indira Vikas Patras (IVPs), Kisan Vikas Patras (KVPs) and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.
    e. **MEMORANDUM ACCOUNT:**
        i. On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account and stop further application of interest.
        ii. However, banks may continue to record such accrued interest in a Memorandum account in their books for control purposes.

iii. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

4. **BILLS PURCHASED:**
   a. In the case of bills purchased outstanding at the close of the year the discount received thereon should be properly apportioned between the two years. [The Unexpired discount/ rebate on bills discounted i.e., where part of receipt comprising discount charges on bills purchased relate to the period beyond the year-end, should be recorded as "Other Liabilities"].
   b. Interest (discount) component paid by Bank/Branch on rediscount of bills from other financial institutions, is not to be netted off from the discount earned on bills discounted.

5. **BILLS FOR COLLECTION:**
   a. In the case of bills for collection, the auditor should also examine the procedure for crediting the party on whose behalf the bill has been collected.
   b. The procedure is usually such that the customer's account is credited only after the bill has actually been collected from the drawee either by the bank itself or through its agents, etc.
   c. The commission of the branch becomes due only when the bill has been collected.

6. **RENEGOTIATIONS:**
   a. Fees and commissions earned by the banks as a result of re-negotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the re-negotiated or rescheduled extension of credit.
   b. Test check the interest earned by the banks for the sample selected.
   c. Test check the fees and commissions earned by the banks made for commission on bills for collection, letters of credit and bank guarantees.

7. **PARTIAL RECOVERIES IN NPA:**
   a. In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e., towards principal or interest due), banks are required to adopt an accounting policy and exercise the right of appropriation of recoveries in a uniform and consistent manner.
   b. The appropriate policy to be followed is to recognise income as per AS 9 when certainty attaches to realisation and accordingly amount reversed/derecognised or not recognised in the past should be accounted. Interest partly/fully realised in NPAs can be taken to income.
   c. However, it should be ensured that the credits towards interest in the relevant accounts are not out of fresh/additional credit facilities sanctioned to the borrowers concerned.

8. **OTHER INCOMES:**
   a. **INTEREST INCOME ON INVESTMENTS:**
      i. This includes all income derived from Government securities, bonds and debentures of corporates and other investments by way of interest and dividend, except income earned by way of dividends, etc., from subsidiaries and joint ventures abroad/in India.
      ii. Broken period interest paid on securities purchased and amortisation of premium on SLR investments is net off from the interest income on investments.

b. **PROFIT ON SALE OF INVESTMENTS:** Investments are dealt in the course of banking activity and hence the net profit or loss on sale of investments is taken to profit and loss account.

c. **PROFIT/LOSS ON REVALUATION OF INVESTMENTS:** In terms of guidelines issued by the RBI, investments are to be valued at periodical intervals and depreciation or appreciation in valuation should be recognised and taken to profit and loss account.

Q.NO.21. WRITE ABOUT REVERSAL OF INCOME?

ANSWER:

1. If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.
2. In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.
3. Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s).
4. Furthermore, the auditor should enquire if there are any large debits in the Interest Income account that have not been explained. It should be enquired whether there are any communications from borrowers pointing out differences in interest charge and whether appropriate action has been taken in this regard.
5. **ON LEASED ASSETS:** The component of finance income (as defined in AS 19 – Leases) on the leased asset which was accrued and credited to the income account before the asset became non-performing and remaining unrealised, should be reversed or provided for in the current accounting period.
6. **ON TAKE-OUT FINANCE:**
   a. A takeout loan is a method of financing whereby a loan that is procured later is used to replace the initial loan. More specifically, a takeout loan, or takeout financing, is long-term financing that the lender promises to provide at a particular date or when particular criteria for completion of a project are met. Takeout loans are commonly used in property development.
   b. In the case of take-out finance, if based on record of recovery, the account is classified by the lending bank as NPA, it should not recognize income unless realised from the borrower/taking-over institution (if the arrangement so provides).
   c. Objectives of Takeout Finance are:
      i. To expand sources of finance for Infra projects by facilitating participation of new entities.
      ii. To address sectorial / Group / Entity Exposure issues and credit mismatch concerns of lenders.
      iii. To boost availability of long tenure debt facility for various projects.

Q.NO.22. WRITE ABOUT AUDIT OF EXPENESES OF A BANK?

ANSWER:

Expenditure is to be shown under three broad heads:

1. Interest expense

2. Operating expense
3. Provisions and contingencies.

The following items are included under this head:

Interest Expense	Operating Expenses	Provisions and Contingencies
♦ Interest on Deposits	♦ Payments to and Provisions for Employees	♦ Provisions made in respect of the Non-performing assets.
♦ Interest on Reserve Bank of India/Inter-Bank Borrowings	♦ Rent, Taxes and Lighting ♦ Printing and Stationery	♦ Provisions for Taxation
♦ Others	♦ Advertisement and Publicity	♦ Provisions for Diminution in the value of investments
	Depreciation on Bank's Property	♦ Provisions for contingencies
	♦ Directors' Fees, Allowances and Expenses	
	♦ Auditors' Fees and Expenses	
	♦ Legal expenses	
	♦ Postage, Telegrams, Telephones, etc.	
	♦ Repairs and Maintenance	
	♦ Insurance	
	♦ Marketing Expenses	
	♦ Other Expenses	

A. AUDIT OF INTEREST EXPENDITURE:

1. In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense by analysing ratios of interest paid on different types of deposits and borrowings to the average quantum of the respective liabilities during the year. In modern day banking, the entries for interest expenses are automatically generated through a batch process in the CBS system.
2. The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter. From such information, the auditor may work out a weighted average interest rate. The auditor may then compare this rate with the actual average rate of interest paid on the relevant deposits as per the annual accounts and enquire into the difference, if material.
3. The auditor should also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyse any material differences.
4. The auditor should obtain general ledger break-up for the interest expense incurred on deposits (savings and term deposits) and borrowing each month/quarter.
5. The auditor should analyse month on month (or quarter on quarter) cost analysis and document the reasons for the variances as per the benchmark stated. He should examine whether the interest expense considered in the cost analysis agrees with the general ledger.

6. The auditor should understand the process of computation of the average balance and re-compute the same on sample basis. The auditor should, on a test check basis, verify the calculation of interest and ensure that:
   a. Interest has been provided on all deposits upto the date of the balance sheet.
   b. Interest rates are in accordance with the bank's internal regulations, the RBI directives and agreements with the respective deposit holder.
   c. Interest on savings accounts is in accordance with the rules framed by the bank/RBI in this behalf.
   d. Interest on inter-branch balances has been provided at the rates prescribed by the head office/RBI.
   e. The auditor should ascertain whether there are any changes in interest rate on saving accounts and term deposits during the period.
   f. The auditor should obtain the interest rate card for various types of deposits and analyse the interest cost for the period accordingly.
   g. The auditor should examine the completeness that interest has been accrued on the entire borrowing portfolio and the same should agree with the general ledgers.
   h. The auditor should re-compute the interest accrual i.e., by referring to the parameters like:
      i. Frequency of payment of interest amount,
      ii. Rate of interest,
      iii. Period elapsed till the date of balance sheet, etc. From the term sheet,
      iv. Deal ticket,
      v. Agreements, etc. And
      vi. Ensure that the recomputed amount is tallying with the amount as per books of accounts without any significant difference.

B. **AUDIT OF OPERATING EXPENSES:** For audit of operating expenses:
1. The auditor should study and evaluate the system of internal control relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit procedures.
2. The auditor should examine whether there are any divergent trends in respect of major items of expenses.
3. The auditor should perform substantive analytical procedures (proforma given below for reference) in respect of these expenses. e.g., assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years.
4. The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required.

C. **AUDIT OF PROVISIONS AND CONTINGENCIES:** For audit of Provisions and contingencies:
1. The auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled.
2. The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets.
3. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets.
4. The auditor may verify the loan classification on a sample basis.

5. The auditor should obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger.
6. **AUDIT OF PROVISION FOR TAX:** The auditor should obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation.
7. The other provisions for expenses should be examined with reference to the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

D. **DISCLOSURE OF THE PRIOR PERIOD ITEMS:** Since the format of the profit and loss accounts of banks prescribed in Form B under Third Schedule to the Banking Regulation Act, 1949 does not specifically provide for disclosure of the impact of prior period items on the current year's profit and loss, such disclosures, wherever warranted, may be given.

Q.NO.23. WRITE ABOUT FORM AND CONTENT OF FINANCIAL STATEMENTS?

ANSWER:

1. Sub-sections (1) and (2) of Section 29 of the Banking Regulations Act, 1949 deal with the form and content of financial statements of a banking company and their authentication. These sub-sections are also applicable to nationalised banks, State Bank of India, and Regional Rural Banks.
2. Every banking company is required to prepare a Balance Sheet and a Profit and Loss Account in the forms set out in the Third Schedule to the Act or as near thereto as the circumstances admit. Form A of the Third Schedule to the Banking Regulation Act, 1949, contains the form of Balance Sheet and Form B contains the form of Profit and Loss Account.
3. Every banking company needs to comply with the disclosure requirements under the various Accounting Standards, as specified under section 133 of the Companies Act, 2013, read with Rule 7 of the Companies (Accounts) Rules 2014, in so far as they apply to banking companies or the Accounting Standards issued by the ICAI.

11. AUDIT OF ITEMS OF FINANCIAL STATEMENTS

1. A financial statement audit comprises the examination of an entity's financial statements and accompanying disclosures by an independent auditor. The resultof this examination is a report by the auditor, attesting the truth and fairness of preparation and presentation of the financial statements and related disclosures.
2. The preparation and presentation of the financial statements is the responsibility of the management. Further, every financial statement contains an overall representation in addition to various specific assertions.
3. **DEFINITION OF ASSERTION:** It refers to the representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur. In preparing financial statements, company's management makes various implicit or explicit claims (i.e., assertions) regarding:
    a. Completeness.
    b. Cut-off.
    c. Existence /Occurrence.
    d. Valuation / Measurement.
    e. Rights and obligations and
    f. Presentation and disclosure

    of Assets, Liabilities, Equity, Income, Expenses and Disclosures in accordancewith the applicable accounting standards.
4. **Example:** If Company X's balance sheet shows Building with carrying amount of Rs.50 lakh, the auditor shall assume that the management has claimed/ asserted that:
    a. The building recognized in the balance sheet exists as at the period- end (existence assertion).
    b. Company X owns and controls such building (Rights and obligations assertion).
    c. The building has been valued accurately in accordance with the measurement principles (Valuation assertion).
    d. All buildings owned and controlled by Company X are included within the carrying amount of Rs.50 lakh (Completeness assertion).
5. The auditor then needs to draw an audit programme to verify the assertions made by the management by obtaining sufficient and appropriate audit evidence for each of the claims made on Account Balances, Class of Transactions and Related Disclosures.

INCOME STATEMENT CAPTIONS COMPRISING REVENUE AND EXPENSE BALANCES

Assertions	Explanation	Example: Employee benefit expenses and sales
Occurrence	Transactions recognized in the financial statements have occurred and relate to the entity.	i. Employee benefit expense has been incurred during the period in respect of the personnel employed bythe entity. Employee benefit expense does not include the cost ofany unauthorizedpersonnel. ii. Recorded Sales represent goods which were ordered by valid customers and were despatched and invoiced in the period.
Completeness	All transactions that were supposed to be recorded have been recognized in the financial statements. Transactions have not been omitted.	i. Employee benefit expenses in respect of all personnel have been fully accounted for. ii. All genuine Sales have been recorded.
Cut-off	Whether all income and expenses are reported in the- correct accounting period. Cut-off is a separate assertion because the substantiveprocedures to verify it are typically different from those applied to the other components of completeness.	i. Employee benefitexpenses recognized during the period relates to the currentaccounting period only. ii. Sales shall include the dispatch of goods made at the year-end as they belong to the relevant period.
Measurement	Transactions have been recorded accurately at their appropriate amounts in the financial statements. There have been no errors while preparing documents or in posting transactions to ledger. The figures and explanations are not misstated.	i. Employee benefit expense has been measured/ calculated accurately. Any adjustments such as tax deduction at source havebeen correctly reconciled and accounted for. ii. Sales are recorded correctly in the books based on the invoices. Discounts have been properly adjusted or accounted for.
Presentationand Disclosure	Transactions have been classified and presented fairly in the financial statements. Transactions and events are appropriately segregated or	A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items: 1. Employee Benefits Expense

	disaggregated. Presentation and disclosure assertions are considered during the course of the audit to determine that the disclosures are complete andaccurate. The disclosures that are most susceptible to material misstatement are those that require significant judgement and qualitative assessments. Audit teams assess the completeness and accuracy of disclosures by determining that the disclosures provide information in a manner that does not materially omit, distort or mislead the user. The description and disclosure of transactions are relevant and easy to understand.	[showing separately i. salaries and wages, ii. contribution toprovident and other funds, iii. expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), iv. staff welfare expenses]. 2. In respect of a company other than a finance company revenue from operations shall disclose separately in thenotes revenue from: a. Sale of products; b. Sale of services; c. Grants or donationsreceived (relevant in case of section 8 companies only),] d. Other operatingrevenues; **Less:** Excise duty / GST

BALANCE SHEET CAPTIONS COMPRISING ASSETS, LIABILITIES AND EQUITY BALANCES

Assertions	Explanation	Example: Inventory balance
Existence	Assets, liabilities and equity balances exist as at the period end.	Inventory recognized in the balance sheet actually existed as at the period end.
Completeness	All assets, liabilities and equity balances that were supposed to be recorded have been recognized in the financial statements.	All inventory units held by the entity that should have been recorded, have been recognized appropriately in the financial statements. Any inventory held by a third party on behalf of the entity has been included as part of the inventory balance. Inventory held by the entity as a Consignee (on behalf of third party i.e., Consignor) shall be excluded.
Cut-off	Whether all assets and liabilities are reported inthe appropriate period.	Inventory balance as at the year- end does not include any element of next financial year. All items of inventory pertaining to the relevant year shall be included regardless of thelocation.
Valuation	Assets, liabilities and equity balances have been valued appropriately i.e. theamounts at which they are recorded are appropriate. There has been no overstatement or understatement.	Inventory has been recognized atthe lower of • cost and • net realizable value in accordance with AS 2 - Inventories. Any costs that could not be reasonably allocated to the cost of production (e.g. general and administrative costs) and any abnormal wastage have been excluded from the cost of inventory. An acceptable valuation basis (eg. FIFO, Weighted average etc.) has been used tovalue inventory as at the period- end.
Rights & Obligations	Entity has the right to assets i.e. (whether theentity has ownership and legal title to assets) and the liabilities recognized in the financial statementsrepresent all the	The entity owns or controls the inventory recorded in the financial statements i.e. the purchase invoices have been made in the name of client. Any inventory held by the entity on behalf of another entity has not been

	entity's obligations to repayment as at a given date.	recognized as part of inventory of the entity. (Eg: Consignment agreements can be checked).
Presentation and Disclosure	Whether particular items in the financial statements are properly classified, described and disclosed. Presentation and disclosure assertions are considered during the course of the audit to determine that disclosures are complete and accurate. The disclosures that are most susceptible to material misstatement are those that requiresignificant judgement and qualitative assessments. Audit teams assess the completeness and accuracy of disclosures by determining that the disclosures provide information in a manner that does not materially omit, distort or mislead the user. The balances have been appropriately segregated or disaggregated. The related disclosures are understandable in accordance with applicable Financial Reporting framework.	**Example 1** Inventories i. Inventories shall beclassified as: a. Raw materials; b. Work-in-progress; c. Finished goods; d. Stock-in-trade (in respectof goods acquired for trading); e. Stores and spares; f. Loose tools; g. Others (specify nature). ii. Goods-in-transit shall be disclosed under the relevantsub-head of inventories. iii. Mode of valuation shall be stated. **Example 2:** For Share capital, a reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period is required to be disclosed in the notes to accounts of the company.

General Audit procedures for Share Capital

To establish the EXISTENCE of share capital as at the period- end:

1. Tally the period-end share capital balance- authorized, issued and paid up, to the previous year audited financial statements.
2. In case there in no change during the year, obtain a written confirmation/ representation from the Company Secretary that there were no changes to entity's capital structure during the year.
3. In case there is any change, verify whether the paid up capital as at the period-end is within the limits of authorised capital. Authorized capital should be verified by examining MOA.

Equity balances that were supposed to be Recorded have been Recognized in the financial statements. (COMPLETENESS):

1. Obtain the certified copies of relevant resolutions passed at the meetings of board of directors, shareholders authorising the increase/ decrease in authorised share capital, if required, or paid up share capital.
2. In case of Fresh issue made in the current year, check with compliance of Companies Act

2013 with regard to Return of Allotment, Minimum Subscription, minimum application money to be collected, maintenance of separate Bank account, payment of underwriting commission as per Sec 40 etc.

3. No shares have been issued at Discount (Sec. 53 of Companies Act)
4. Check if Shares are issued for cash or for Consideration other than cash. (Eg: To promoters for their services, underwriters for commission payable to them etc.)
5. Compliance with SEBI regulations and Guidelines.
6. Also, obtain and verify copies of forms filed with Ministry of Corporate Affairs (MCA) (Form SH-7, notice to Registrar of any alteration of share capital, Form PAS 3 company making allotment of shares/ securities required to file a return of allotment to the Registrar) and with Reserve Bank of India (Form FCGPR in case of Foreign Direct Investment (FDI) by a Non-resident shareholder) and verify the number of securities issued along with the issue price.
7. In case there was increase in share capital, verify whether the Company has accurately calculated the required fee and stamp duty payable to MCA.

Equity balances have been VALUED appropriately:

SHARES ISSUED AT PREMIUM:

In case a company has issued shares at a premium, that is, at amount in excess of the nominal value of the shares, whether for cash or otherwise, Section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received as premium to securities premium account and state the purpose for which the amount in the account can be applied.

There is no restriction or conditions prescribed in the Act for issue of shares at premium.

Application of securities premium account: The securities premium account may be applied by the Company for the following purposes:

a. towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
b. in writing off the preliminary expenses of the Company;
c. in writing off the expenses of, or the commission paid or discount allowed on,any issue of shares or debentures of the company;
d. in providing for the premium payableon the redemption of any redeemable preference shares or of any debentures of the company; or
e. for the purchase of its own shares orother securities under Section 68.(Buyback)

Prescribed Class of Companies are permitted to apply Securities Premium Account:

The securities premium account may be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under Section 133:

a. in paying up unissued equity shares of the company to be issued to members ofthe company as fully paid bonus shares; or
b. in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company; or
c. for the purchase of its own shares orother securities under section 68.

The auditor needs to verify: whether the premium received on shares, if any, has been transferred to a "securities premium account" and

whether the application of any amount out of the said "securities premium account" is only for the purposes mentioned above.

SHARES ISSUED AT A DISCOUNT:

According to Section 53 of the Companies Act, 2013,

1. A company shall not issue shares at a discount, except in the case of an issueof sweat equity shares given under Section 54 of the Companies Act, 2013.
2. Any share issued by a company at a discounted price shall be void.
3. Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.
4. Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or Rs. 5,00,000/-, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of 12%. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

The auditor needs to check

i. The movement in share capital duringthe year and wherever there is any issue,
ii. he should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price.
iii. Further, auditor should also verify that whether the company has issued shares at a discount to its creditors when its debt is converted into shares inpursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

ISSUE OF SWEAT EQUITY SHARES:

According to Section 54 of the Companies Act, 2013, the employees may be compensated in the form of 'Sweat Equity Shares".

"Sweat Equity Shares" mean equity shares issued by the company to employees or directors at a

i. discount or
ii. for consideration other than cash

for providing know-how or making available right in the nature of intellectual property rightsor value additions, by whatever name called.

The auditor needs to verify that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions have been complied with (as per Section 54):

a. The issue is authorized by a special resolution passed by the company;
b. The resolution specifies the number of shares, the current market price, consideration, if any, and the class orclasses of directors or employees to whom such equity shares are to be issued;
c. Where the equity shares of the company are listed on a recognised stockexchange, the sweat equity shares areissued in accordance with the regulations made by the securities and exchange board in this behalf and
d. If they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

Further, the rights, limitations, restrictions and provisions as applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank pari passu with other equity shareholders.

REDUCTION OF CAPITAL:

Section 66 deals with the reduction of share capital. For verifying reduction of capital, the auditor needs to examine whether the company has followed the specific requirements as required by Section 66 of the Companies Act, 2013.

Theauditor shall undertake the following audit procedures:

i. Verify that the meeting of the shareholders held to pass the special resolution was properly convened andthat the proposal was circularized in advance to all the shareholders;
ii. Verify that the Articles of Association authorises reduction of capital;
iii. Examine that there has been no default w.r.t repayment of deposits accepted by company or payment of interest on such deposits. Reduction of capital shall not beaffected if such default exists.
iv. Examine the order of the Tribunal confirming the reduction and verify that acopy of the order and the minutes have been registered and filed with the Registrar of Companies;
v. Check the Registrar's Certificate as regards to reduction of capital;
vi. Vouch the accounting entries recorded to reduce the capital and to write down theassets by reference to the resolution of shareholders and other documentaryevidence;
vii. Also check whether the requirements of Schedule III, Part I, have been complied with in relation to presentation;
viii. Confirm whether the revaluation of assets has been properly disclosed in the Balance Sheet;
ix. The company may reduce the capital by reduction in unpaid capital or cancellation of lost capital or paying off excess paid up capital. Verify the adjustment made in the members' accounts in the Register of Members and confirm that either the paid-up amount shown on the old share certificates has been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled;
x. Confirm that the words "and reduced", if required by the order of the Tribunal, have been added to the name of thecompany in the Balance Sheet.
xi. Check if the company have complied with all the terms and conditions imposed by the tribunal while confirming reduction ofshare capital.
xii. Verify that the Memorandum of Association of the company has been suitably altered.

Exemption to Buy-Back: According to Section 66 (6), nothing in this section shall apply to buy- back of its own securities by a company under Section 68.

If the Company has made any buyback of securities, ensure compliance of specific requirements as given under section 68 of Companies Act 2013.

REQUIRED DISCLOSURE FOR EQUITY HAVE BEEN APPROPRIATELY MADE

Ensure whether the following disclosure requirements of Schedule III (Part I) to Companies Act, 2013 have been complied with:

Share Capital

For each class of share capital (different classes of preference shares to be treated separately):

a. The number and amount of shares authorised;

b. The number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
c. Par value per share;
d. A reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;
e. The rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;
f. Shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;
g. Shares in the company held by each shareholder holding more than 5 per cent. Shares specifying the number of shares held;
h. Shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;
i. For the period of five years immediately preceding the date as at which the balance sheet is prepared:
   (A) Aggregate number and class of shares allotted as fully paid-up pursuant to contract(s) without payment being received in cash.
   (B) Aggregate number and class of shares allotted as fully paid-up by way of bonus shares.
   (C) Aggregate number and class of shares bought back.
j. Terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date;
k. Calls unpaid (showing aggregate value of calls unpaid by directors and officers);
l. Forfeited shares (amount originally paid-up).

A company shall disclose Shareholding of Promoters* as below:

Shares held by promoters at the end of the year % Change during the year***

S. No.	**Promoter Name**	**No. of shares**	**% of total shares****
S. No.	**Promoter Name**	**No. of shares**	**% of total shares****
Total			

* Promoter here means promoter as defined in the Companies Act, 2013.
** Details shall be given separately for each class of shares
*** percentage change shall be computed with respect to the number at the beginning of the year or if issued during the year for the first time then with respect to the date of issue.]

Where in respect of an issue of securities made for a specific purpose, the whole or part of the amount has not been used for the specific purpose at the balance sheet date, there shall be indicated by way of note how such unutilised amounts have been used or invested.

NOTES:

To be disclosed as Additional Regulatory Information Utilisation of Borrowed funds and share premium:

1. Where company has advanced or loaned or invested funds (either borrowed funds or share premium or any other sources or kind of funds) to any other person(s) or entity(ies), including foreign entities (Intermediaries) with the understanding (whether recorded in writing or otherwise) that the Intermediary shall
   a. directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company (Ultimate Beneficiaries) or
   b. provide any guarantee, security or the like to or on behalf of the Ultimate Beneficiaries;

   The company shall disclose the following:

i. date and amount of fund advanced or loaned or invested in Intermediaries with complete details of each Intermediary.
ii. date and amount of fund further advanced or loaned or invested by such Intermediaries to other intermediaries or Ultimate Beneficiaries along with complete details of the ultimate beneficiaries.
iii. date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries
iv. declaration that relevant provisions of the Foreign Exchange Management Act, 1999 and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002.

2. Where a company has received any fund from any person(s) or entity(ies), including foreign entities (Funding Party) with the understanding (whetherrecorded in writing or otherwise) that the company shall

a. directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party (Ultimate Beneficiaries) or
b. provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries, the company shall disclose the following:
    i. date and amount of fund received from Funding parties with complete details of each Funding party.
    ii. date and amount of fund further advanced or loaned or invested other intermediaries or Ultimate Beneficiaries along with complete details of the other intermediaries or ultimate beneficiaries.
    iii. date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries
    iv. declaration that relevant provisions of the Foreign Exchange Management Act, 1999 and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002.

AUDIT OF RESERVES AND SURPLUS

1. Reserves are the amounts appropriated out of profits that are not intended
    a. to meet any liability,
    b. contingency,
    c. commitment or
    d. diminution in the value of assets known to exist as at the date of the Balance Sheet.
2. Reserves are a vital source of financing by internal means. The company utilizes the reserves according to the nature and type of such reserve. The reserves can be segregated as revenue or capital reserves.
    a. **Revenue reserves** represent profits that are available for distribution to shareholders or below purposes such as:
        i. to supplement divisible profits in lean years,
        ii. to finance an extension of business,
        iii. to augment the working capital of the business or
        iv. to generally strengthen the company's financial position.
    b. **Capital Reserve** represents a reserve which does not include any amount regardedas free for distribution. They can be utilized only for certain limited purposes.
    Example, Securities premium, capital redemption reserve.
3. It may be noted that if a company appropriates revenue profit for being credited to the asset replacement reserve with the objective that these are to be used for a capital purpose, such a reserve shall also be in the nature of a capital reserve.
4. Capital Reserve is created from capital profits earned through sale of capital assets such as sale of fixed assets, profit on sale of shares.
5. A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realized.
6. But the amount of securities premium or capital redemption reserve account can be utilised only for the purposes specified in Sections 52 and 55 of the Companies Act, 2013, respectively.

The below table summarises the audit procedures generally required to be undertaken while auditing reserves and surplus:

Audit procedures
To establish the **EXISTENCE** ofreserves and surplus as at the period-end **Audit procedures** Trace and tally the opening balance of reserves and surplus to the previous year audited financial statements. For addition/utilization in current year, incase of:
Reserves and Surplus balances that were supposed to be recordedhave been recognized in the financial statements.(**COMPLETENESS**) **Profit and Loss balance:** • Trace the movement to surplus/ deficit as per the Statement of profit and loss for the year under audit. • The movement should be traced in the Statement of Changes in Equity. • Verify the resolution passed by the board of directors regarding therecommendation of

dividend,resolution passed by shareholders declaring the dividend.

Reserves and Surplus balances have been VALUED appropriately (VALUATION).

- As per AS-4 (Revised)or IND AS 10, if dividends to holders of equity instruments are proposed or declared after the balance sheet date, an entityshould not recognize those dividends as a liability as at the balance sheet date. It should, however, disclose the amount of dividends that were proposed or declared after the balance sheet date, but before the financial statements wereapproved for issue.

Securities Premium - It needs to be confirmed that the company has issued shares in excess of the nominal value of the shares and for the same,the auditor should obtain and verify the resolution passed by the board of directors.

As already discussed under the caption - 'share capital', the utilisation of securities premium account could be done only for limited purposes; auditor needs to ensure the same. (Sec 52 of Companies Act 2013)

Required **DISCLOSURES** forreserves and surplus have been appropriately made

Ensure whether the following disclosure requirements of Schedule III (Part I) to Companies Act, 2013 have been complied with:

i. Reserves and Surplus shall be classified as:
   a. Capital Reserves;
   b. Capital Redemption Reserve;
   c. Securities Premium.
   d. Debenture RedemptionReserve;
   e. Revaluation Reserve;
   f. Share Options OutstandingAccount;
   g. Other Reserves– (specify the nature and purpose of each reserve and the amount in respect thereof);
   h. Surplus i.e., balance in Statement of Profit and Lossdisclosing allocations and appropriations such asdividend, bonus shares andtransfer to/ from reserves, etc.;

   (Additions and deductions since last balance sheet to be shown under each of the specified heads);
ii. A reserve specifically represented by earmarked investments shall betermed as a "fund".
iii. Debit balance of statement of profit and loss shall be shown as a negative figure under the head "Surplus". Similarly, the balance of "Reserves and Surplus", after adjusting negative balance ofsurplus, if any, shall be shown under the head "Reserves and Surplus" even if the resulting figure is in the negative.

AUDIT OF BORROWINGS

The below table summarises the audit procedures generally required to be undertaken while auditing borrowings:

Audit procedures
All borrowings on the balance sheet represent valid claims by banks or other third parties. (EXISTENCE): • Review board minutes for approval of new lending agreements. During review, ensure that new loan agreements or bond issuances were authorized. Ensure that significant debt commitments were approved by the board of directors. • Agree details of loans recorded (interest rate, nature and repayment terms) to the loan agreement. Verify that borrowing limits, if any, imposed by agreements are not exceeded. • Roll out and obtain independent balance confirmations (SA 505) in respect of all the borrowings from the lender (banks/ financial institutions etc.). • Agree details of leases and hire purchase creditors recorded to underlying contracts/agreements. • In case of Debentures, examine trust deed for terms and dates of redemption, borrowing restrictions and compliance with covenants. • When debt is retired, ensure that a discharge is received on assets securing the debt. • Obtain Written Representation that all the liabilities which have been recorded represent a valid claim by the lenders.
That all borrowings have been accounted for in the books of the company on a timely basis (COMPLETENESS): • Obtain a schedule of short term and long term borrowings (including debts outstanding at the end of the previous year, as well as any new debt or renewal of debt) showing beginning and ending balances and borrowings taken and repaid during the year, and perform the following: a. Consider any evidence of additional debt obtained through examination of minutes of the board of directors, significant contracts, confirmations frombanks/ lenders, support for subsequent cash disbursements(when testing payables) etc. b. Trace the closing balances as per the schedules to the generalledger. • Review subsequent transactions after the end of the reporting period to determine if there are unrecorded liabilities at year- end and the transactions are recorded in the correct period. (Eg: Fresh loan taken near the balance sheet date) **Direct confirmation procedures** • Roll out and obtain independent balance confirmations in respect of all the borrowings from the lender (banks/ financial institutions etc.) and perform the following: a. Ascertain that the confirmation asks for all information likely to be relevant to the tests of debt andrelated interest balances (e.g., applicable interest rates, due dates, collateral and securityinterests). b. Send reminders for non-replies. c. Compare the balances are per the confirmations obtained to the books of the accounts. d. Ask for reconciliations, if there are anydifferences and test the supporting documents for the reconcilingitems on a test check basis.
That liability is recorded at the correct amount (VALUATION): • Determine that the accounting policies and methods of recording debt areappropriate and

applied consistently.

- Agree loan balance and loan payables to the loan agreement.
- Recompute the interest and discount or premium on redemption, if any.
- Check computation of the amortization of premium or discount, if any.
- For foreign currency loans, check the closing exchange rate(s) used and verify the computations of the restatements of foreign currency balances outstanding at year end. (As per AS 11)
- Read the provisions in loan and debt agreements and perform the following:
  a. Test that the entity is in compliance with loan covenants and other significant provisions of the agreements.
  b. If there are any provisions with which the entity is not in compliance, determine whether the debt should be classified as current. If enforcement of the provisions has been waived by the lender in case of breach of any covenant by the entity, obtain confirmation of the waiver from the lender.
- Examine the due dates on loans for proper classification between long-term and short-term.
- Where instalments of long-term loans falling due within the next twelve months have been disclosed in the financialstatements (e.g., in parentheses or by way of a footnote), verify the correctness of the amount of such instalments.
- Examine the debt agreements for any restrictive covenants. Review restrictive covenant and provisions relating to default and ensure disclosure thereof in the financial statements.
- Examine the important terms in the loan agreements and the documents, if any, evidencing charge in respect of such loans and advances. Examine whether the requirements of the applicablestatute regarding creation and registration of charges have been complied with including disclosure of the same to the extent mandated by statute and considered necessary for properunderstanding of the user of financial statements.
- In case the value of the security falls below the amount of the loan outstanding, examine whether the loan is classified as secured only to the extent of the market value of the security.
- Examine the hire purchase agreements for the purchase of assets by the entity and ensure the correctness of the amounts shown as outstanding in the accounts, and also examine the security aspect.
- He should carefully review the borrowings from related parties and ensure compliance with AS 18 or IND AS 24.
- Verify whether liabilities towards bank in respect of bills discounted, bills negotiated, cheques discounted, etc. are correctly reflected and disclosed in thefinancial statements.
- The auditor should also verify that theamount borrowed is within the borrowing powers of the company as laid down by the Articles of Association and Memorandum of Association.
- Verify that the company has not contravened the restrictions laid down by Section 180 (related to Restrictions on Powers of Board) of the Companies Act, in respect of the borrowings of the company. Also, check compliance of Sections 185 (related to Loans to Directors, etc.) and 186 (related to Loan and Investment by company) of theCompanies Act, 2013.
- Examine the purpose for which the amount is borrowed and ensure that the amount is not used against the interest of the company.

- Where the entity has accepted deposits, examine whether the directives issued by the

Reserve Bank of India or otherappropriate authority have beencomplied with.

That borrowings have been presented, classified and DISCLOSED in the financial statements in accordance with the requirements of applicable financial reporting framework i.e. Companies Act, 2013 and applicable Indian GAAP: Ensure whether the following disclosures as required under Schedule III (Part I) to Companies Act, 2013 are made for each amount disclosed under each of the following headings:

Long-Term Borrowings

i. Long-term borrowings shall be classified as:
   a. Bonds/debentures;
   b. Term loans:
      A. from banks.
      B. from other parties.
   c. Deferred payment liabilities;
   d. Deposits;
   e. Loans and advances from related parties;
   f. Long term maturities of finance leaseobligations;
   g. Other loans and advances (specifynature).

ii. Borrowings shall further be sub- classified as secured and unsecured. Nature of security shall be specified separately in eachcase.

iii. Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.

iv. Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be. Where bonds/debentures are redeemable by instalments, the date of maturity for this purpose must be reckoned as the date on which the first instalment becomes due.

v. Particulars of any redeemed bonds/debentures which the company haspower to reissue shall be disclosed.

vi. Terms of repayment of term loans and other loans shall be stated.

vii. Period and amount of continuing default as on the balance sheet date in repayment of loans and interest, shall be specified separatelyin each case.

Other Long term Liabilities

Other Long term Liabilities shall be classifiedas:

a. Trade Payables;
b. Others

Short Term Borrowings

i. Short-term borrowings shall be classifiedas:
   a. Loans repayable on demand;
      A. from banks.
      B. from other parties.
   b. Loans and advances from related parties;
   c. Deposits;
   d. Other loans and advances (specifynature).

ii. Borrowings shall further be sub- classified as secured and unsecured. Nature of security shall be specified separately in eachcase.

iii. Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.

iv. Period and amount of default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

v. current maturities of Long term borrowings shall be disclosed separately.

Where the company has not used the borrowings from banks and financial institutions for the specific purpose for whichit was taken at the balance sheet date, the company shall disclose the details of where they have been used.

Notes:

To be disclosed as Additional Regulatory Information:

1. **Where the Company has borrowings from banks or financial institutions on the basis of security of current assets, it shall disclose the following:**
   a. whether quarterly returns or statements of current assets filed by the Company with banks or financial institutions are in agreement with the books of accounts.
   b. if not, summary of reconciliation and reasons of material discrepancies,if any to be adequately disclosed.
2. **Wilful Defaulter***
   Where a company is a declared wilful defaulter by any bank or financial institution or other lender, following details shall be given:
   a. Date of declaration as wilful defaulter,
   b. Details of defaults (amount and nature of defaults),
   * **wilful** defaulter" here means a person or an issuer who or which is categorized as a wilful defaulter by any bank or financial institution (as defined under the Act) or consortium thereof, in accordance with the guidelines on wilful defaulters issued by the Reserve Bank of India.
3. **Registration of charges or satisfaction with Registrar of Companies**
   Where any charges or satisfaction yet to be registered with Registrar of Companies beyond the statutory period, details and reasons thereof shall be disclosed.
4. **Utilisation of Borrowed funds and share premium:**
   A. Where company has advanced or loaned or invested funds (either borrowed funds or share premium or any other sources or kind of funds) to any other person(s) or entity(ies), including foreign entities (Intermediaries) with the understanding (whether recorded in writing or otherwise) that the Intermediary shall
   i. directly or indirectly lend or invest in other persons or entities identifiedin any manner whatsoever by or on behalf of the company (Ultimate Beneficiaries) or
   ii. provide any guarantee, security or the like to or on behalf of the Ultimate Beneficiaries;

   The company shall disclose the following:
   i. date and amount of fund advanced or loaned or invested in Intermediaries with complete details of each Intermediary.
   ii. date and amount of fund further advanced or loaned or invested by such Intermediaries to other intermediaries or Ultimate Beneficiaries alongwith complete details of the ultimate beneficiaries.

iii. date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries

iv. declaration that relevant provisions of the Foreign Exchange Management Act, 1999 (42 of 1999) and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002;

B. Where a company has received any fund from any person(s) or entity(ies), including foreign entities (Funding Party) with the understanding (whetherrecorded in writing or otherwise) that the company shall:

i. directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party (Ultimate Beneficiaries) or

ii. provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries, the company shall disclose the following:

   i. date and amount of fund received from Funding parties with complete details of each Funding party.

   ii. date and amount of fund further advanced or loaned or invested other intermediaries or Ultimate Beneficiaries along with complete details of the other intermediaries' or ultimate beneficiaries.

   iii. date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries

   iv. declaration that relevant provisions of the Foreign Exchange Management Act, 1999 (42 of 1999) and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002 (15 of 2003).]

AUDIT OF TRADE RECEIVABLES

1. **TEST OF CONTROLS ON TRADE RECEIVABLES:** It is important to carry out Test of Controls for checking the effectiveness of internal control over sales as a part of the debtors' audit procedure. Following points need to be considered in respect of trade receivables:
   a. Only bona fide sales lead to trade receivables.
   b. All such sales are made to approved customers.
   c. All such sales are properly recorded in the books of accounts.
   d. Once recorded, the debtors can be settled only by receipt of cash or on the authority of a responsible official.
   e. Segregation of duties at every point in sales transaction. (accounting for debtors, collecting the payments, sending reminders etc.)
   f. Debtors are collected on time.
   g. In case debtors are not collected in time, sending reminders and taking legal actions if required.
   h. Balances are regularly reviewed.
   i. A proper system of follow up exists and if necessary, adequate provision for bad debt should be made by preparing adequate ageing schedule of the debtors.
2. After performing Test of Controls over sales, the auditor will decide upon the audit procedure to be applied to verify debtors balance.

The below table summarises the audit procedures generally required to be undertaken while auditing trade receivables:

Audit procedures

To establish the EXISTENCE of trade receivables as at the period- end

- Check whether there are controls in place to ensure that invoices cannot be recorded more than once and receivable balances are automatically recorded in the general ledgerfrom the original invoice.
- Ask for a period-end accounts receivable ageing report and trace the balance as per the report to the general ledger.
- Check whether realization is recordedinvoice-wise or not. If not, check that money received from debtors is adjusted chronologically invoice-wise and on FIFO basis i.e. previous bill is adjusted first. If realization is made on account, verify whetherthe Company has obtained confirmations from debtors in respect of the same.
- If any large balance is due for a long time, auditor should ask for reasons and justification for the same.

Direct confirmation procedures

- A significant and important audit activity is to contact customers directly and ask them to confirm the amounts of unpaid accounts receivable as of the end of the reportingperiod under audit. This should necessarily bedone for all significant account balances as atthe period- end while certain random customers having smaller outstanding invoices should also be selected.
- The auditor employs direct confirmation procedure with the consent of the entity under audit.
- There may be situations where the management of the entity requests the auditor not to seek confirmation from certaintrade receivables. In such cases, the auditor should consider whether there are valid grounds for such a request.
- In appropriate cases, the auditor may also need to reconsider the nature, timing and extent

of his audit procedures including the degree of planned reliance on management's representations.

- The trade receivables may be requested to confirm the balances either (a) as at the dateof the balance sheet, or (b) as at any other selected date which is reasonably close to thedate of the balance sheet. The date should be decided by the auditor in consultation with the Company.
- The form of requesting confirmation from thetrade receivables may be either

  (a) the form with balance outstanding amount as per the company, wherein the trade receivable is requested to respond whether or not he is inagreement with the balance shown, or

  (b) the form without any balance mentioned therein,wherein the trade receivable is requested to respond with the balance outstanding as perhis records.

  The use of the form without any balance is preferable.
- The method of selection of the trade receivables to be circularised should not be revealed to the Company until the trial balance of the trade receivables' ledger is handed over to the auditor.
- A list of trade receivables selected for confirmation should be given to the entity for preparing request letters for confirmation which should be properly addressed.
- The auditor should maintain strict control to ensure the correctness and proper despatch of request letters.
- It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not tothe client.
- Any discrepancies revealed by the confirmations received or by the additional tests carried out by the auditor may have a bearing on other accounts not included in the origsample. The Company should be asked to investigate and reconcile the discrepancies, if any.
- Where no reply is received, the auditor should perform alternate procedures regarding the balances. This could include:
  - Agreeing the balance to cash received subsequently;
  - Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred. (examination in depth for thosebalances)
- If there are any related party receivables, review them for collectability as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.
- Check that the receivables for other than sales or services are not included in the list.
- Review a trend line of sales and accounts receivable, or a comparison of the two over time, to check if there are any unusual trends i.e perform analytical procedures. This willenable the auditor to check the reasonableness of balances. Also, measurethe average collection period. Make inquiriesabout reasons for changes in trends with themanagement and document the same in audit work papers.

All Trade receivable balances that were supposed to be recorded have been recognized in the financial statements COMPLETENESS

- The auditor needs to satisfy himself of the cut-offs. Without a cut-off, sales could be understated or overstated, hence there is a need to perform the following cut off procedure:
  - ➢ For the invoices issued during the last few days (last 5 days of the reporting year) i.e. cut-off date and which have been included in the debtors; check that the goods should

have been dispatched and not lying with the Company;
- Ensure that all goods dispatched prior to the period/ year-end have been invoiced and included in debtors on a test check basis;
- Ensure that no goods dispatched after the year- end have been invoiced and included in debtors for the period under audit.

- Test invoices listed in receivable report. Select few invoices from the accounts receivable ageing report and compare them to supporting documentation to see if they were billed with the correct amounts, to the correct customers, and on the correct dates.
- Match invoices to shipping/ dispatch log.
- Match invoice dates to the shipment dates for those items in the shipping/ dispatch log, to see if sales are being recorded in the correct accounting period. This can include an examination of invoices issued subsequent to the period being audited, to see if they shouldhave been included in the period under audit.
- Assess bill and hold sales. If there is a situation where the Company is billingcustomers for sales despite still retaining thegoods on-site (known as "bill and hold"), examine supporting documentation to determine whether a sale has actually taken place or not.
- Review the receiving log to see if the Company has recorded an inordinately large amount of customer returns after the audit period, which would suggest that the Company may have shipped more goods near the end of the audit period than what the customers had authorized to inflate the profits of the company;
- Review the process of giving discounts/ incentives and check whether the same were given as per the Company's policy/ general industry trends.
- Review credit memos, on a sample basis, issued during the audit period to see if they were properly authorized and whether they were issued in the correct period. Also, reviewcredit memos issued after the period end to see if they relate to transactions belonging tothe period under audit. Where any deductionhas been made against a bill, check the reason and correspondence for the same.

Trade receivable balances have been VALUED appropriately.

- Review the process followed by the Company to derive an allowance for doubtful accounts. This will include a consistency comparison with the method used in the last year, and a determination of whether the method is appropriate for the underlying business environment.
- Obtain the ageing report of accounts receivable (both Dr/Cr balance).
- Also, obtain the list of debtors under litigation and compare with previous year.
- Scrutinize the analysis and identify those debtors which appear doubtful; discuss with management about reasons as to why these debtors are not included in the provision for bad debts. Perform further testing where anydisputes exist.
- He should check if provisions are made at appropriate rates considering therecoverability of amounts due.
- Prepare schedule of movements of bad debts
- Provision accounts and debts written off and compare the proportion of bad debtexpense to sales for the current year in comparison to prior years to see if the current expense appears reasonable.
- Check that write-offs of the receivable balances have been approved by an appropriate authority i.e. the Board of Directors in case of a company.

Required DISCLOSURE for trade receivables have been appropriately made

- Check that the restatement of foreign currency trade receivables has been doneproperly in accordance with AS 11.
- Proper disclosure of Related Party Transactions regarding receivables have beenmade as per AS 18 or IND AS 24.
- Ensure that the transactions with parties covered under Section 189 (Register of Contracts or Arrangements in which Directorsare interested) of the Companies Act, 2013 are reported properly in Companies Auditors'Report Order (CARO),2020.

Ensure whether the following disclosures as required under Schedule III (Part I) to Companies Act, 2013 are made for each amount disclosedunder the heading "Trade Receivables"

i. Trade Receivables ageing schedule

(Amount in Rs.)

Particulars	Outstanding for following periods from due date of payment#					
	Less than 6 months	6 months-1 year	1-2 years	2-3 years	More than 3 years	Total
i. Undisputed Trade receivables– considered good						
ii. Undisputed Trade Receivable- considered doubtful						
iii. Disputed Trade Receivables considered good						
iv. Disputed Trade Receivables considered doubtful						

similar information shall be given where no due date of payment is specified, in that case disclosure shall be fromthe date of the transaction.

Unbilled dues shall be disclosed separately.

ii. Trade receivables shall be sub-classified as:

a. Secured, considered good;

b. Unsecured, considered good;

c. Doubtful.

iii. Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

iv. Debts due by

- directors or other officers of the company or any of them either severally or jointly with anyother person or
- firms or private companies respectively in which any director is a partner or a director ora member should be separately stated.

CASH AND CASH EQUIVALENTS

The below table summarises the audit procedures generally required to be undertaken while auditing cash and cash equivalents:

Audit procedures
To establish the EXISTENCE of cash and cash equivalent balances as at the period- end AND Cash and cash equivalent balances that were supposed to be recorded have been recorded in the financial statements. COMPLETENESS
• Special care is necessary in regard to verification of cash balances. Unless they are checked by surprise, there can be no certainty that the cash produced for inspection was in fact held by the custodian. For this reason, the cash should be checked not only on the last day of the year, but also checked again sometime after the close of the year without giving notice of the auditor's visit either to the entity or to his staff. (Surprise check)
• If there are more than one cash balances,e.g., when there is a cashier, a petty cashier,a branch cashier and, in addition, there are imprest balances with employees, all of them should be checked simultaneously, as far as practicable so that the shortage in one balance is not made good by transfer of amount from the others.
• It is desirable for the cashier to be present while cash is being counted and he should be made to sign the statement prepared containing details of the cash balance counted along with denomination of cash.If he is absent at the time the cash is being verified, he may hold the auditor responsible for the shortage, if any, in cash.
• If there is any rough Cash Book or details of daily balance are separately kept, the auditor should test entries from the rough Cash Book with those in the Cash Book to prove that entries in the Cash Book are correct.
• If the auditor finds any slip, chit or L.O.U.s in respect of temporary advances paid to the employees included as part of the cash balance, he should check whether those are approved by an authorized official and recorded in the appropriate accounts.
• The auditor should also perform a cash sensitivity analysis by compiling a summaryof total cash receipts and payments each month and analyzing the trends to see if there have been variations in any specific month and request brief descriptions fromthe management.
• The auditor needs to obtain bank reconciliation statements (BRS) for all bank accounts maintained by the entity as at the reporting period and additionally need to understand the client's process andperiodicity of making the BRS.
The auditor should ensure that BRS is signed bythe authorized personnel so that he is able to assign responsibility in case of any errors.
• Verification of BRS shall entail the following: — Tallying the balance as per bank book to the bank confirmation/ statement. — Checking of all material reconciling items included under cheques issued but presented for payment to the underlying bank book forming part of books of account. In addition, the auditor should request for bank statements of subsequent period and should verify if the cheques issued have subsequently been cleared by the bank. For all cases where cheques have become stale i.e. 3 months or more have lapsed since the issue date, the same should not appear in the BRS andshould instead be taken back to liabilities. — Checking of all material reconciling items included under cheques deposited but not

credited by bank by requesting for bank deposit slips, duly acknowledged by bank and verifying if the balances were credited by bank subsequently by tallying to the bank statement of subsequent period. For any instances related to cheques not cleared beyond reasonable time, the auditor should seek brief descriptions from the management and in case such explanations are found to be unsatisfactory, the auditor should verify the revenue recognition related to such parties was in order and as per the Company's revenue recognitionpolicy.

— Checking of all material reconciling items included under amounts or charges debited/ credited by bank but not accounted for by requesting for bank statements for the period under audit and tallying the same. If the amounts are found to be material, the auditor should ensure that the management records the adjustments for the same in its books of account. If management does not adjust, the auditor shall consider to qualify his report.

Direct confirmation procedure

- A significant and important audit activity is to contact banks/ financial institutions directly and ask them to confirm the amounts held in current accounts, depositaccounts, EEFC account, cash creditaccounts, restrictive use accounts like dividend, escrow accounts as of the end of the reporting period under audit. This should necessarily be done for all account balances as at the period-end.
- The Company should be asked to investigate and reconcile the discrepancies, if any, including seeking written explanations/ clarifications from the banks/ financialinstitutions on any unresolved queries.
- The auditor should emphasize for confirmation of 100% of bank account balances. In remote situations, where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include:
  - — Agreeing the balance to bankstatement received by the Company or internet/ online login to account in auditor's personal presence;
  - — Sending the audit team member to the bank branch along with the entity's personal to obtain balance confirmation from the bank directly.

Cash and cash equivalent balances have been VALUED appropriately.

In addition to the procedures performed above,the auditor should ensure that all bank accounts holding foreign currency have been restated at the closing exchange rates as per applicable Financial Reporting Framework.

Required DISCLOSURES for cash and cash equivalents have been appropriately made

Ensure whether the following disclosures as required under Schedule III (Part I) to Companies Act, 2013 have been made:

Cash and cash equivalents

i. Cash and cash equivalents shall be classified as:
   a. Balances with banks;
   b. Cheques, drafts on hand;
   c. Cash on hand;
   d. Others (specify nature)

ii. Earmarked balances with banks (forexample, for unpaid dividend) shall be separately stated.

iii. Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

iv. Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated. v. Bank deposits with more than 12 months' maturity shall be disclosed separately

AUDIT OF INVENTORIES

Inventories are assets:

a. held for sale in the ordinary course of business;

b. in the process of production for such sale; or

c. in the form of materials or supplies to be consumed in the production process or in the rendering of services.

As per AS 2 – "Valuation of Inventories", Inventory is valued at lower of cost and net realisable value. The basis for valuation shall be applied consistently year on year. Any change in accounting policy shall have adequate disclosures in financial statements.

The below table summarises the audit procedures generally required to be undertaken while auditing inventories:

Audit procedures
To establish the EXISTENCE of Inventories as at the period- end. • Review entity's plan for performing inventory count. • Ensure that consigned goods have been segregated. • Auditor should participate in the inventory count with the management. • Test counts of inventory by auditorshould include: ➢ observing employees are adhering to the agreed plan. ➢ assuring that there is appropriate supervision on the count procedure. ➢ assuring that all items are properly tagged. ➢ observing that proper amounts are shown on tags. ➢ determining that tags and summary sheets are controlled andreconciled. ➢ reconciliation of test counts with tags and summary sheets and discrepancies noted, if any, are summarized and agreed with client personnel. ➢ staying alert at all times and specifically being cautious aboutempty boxes, etc. and obsolete items. ➢ performing cut-off testing bydocumenting last 5-10 receiving reports and shipping documents as of the period end. ➢ ensuring exclusion of third party stock and damaged or obsoletestock. ➢ ensuring the accounting of all stock sheets. ➢ investigating any significant differences between the physicalstock take and the stock records as per books. Further, the auditor should ask the entity's personnel to sign all stock count sheets and also agree the variances observed, ifany, to avoid any conflicts. • When the entity uses periodic system for inventory count, it should be undertaken at the end of the period. If the entity uses perpetual system with proper and adequate records, inventory may be counted at interim dates. • Confirm or investigate any inventory ofthe entity lying with a third party (specifically relevant for cases where the entity gets job work done in its process of production).
Only the inventories held by entity have been recorded inthe financial statements anddo not include any inventories that belong to third parties but does include inventories ownedby the entity and lying with athird party - COMPLETENESS:

- Perform analytical procedures(comparison tests with industry averages, budgets, prior years, trend analysis, etc.).
  - Compute inventory turnover ratio(COGS/ average inventory)
  - Perform vertical analysis(inventory/ total assets)
  - Compare budgetary expectationsvis-à-vis actuals
- Examine non-financial information related to inventory, such as weights and other measurements.
- Perform purchase and sales cut-off tests. Trace shipping documents (bills of lading and receiving reports, warehouse records, and inventory records) to accounting records immediately before and after year-end.
- With respect to tagged inventory, perform tests for omitted transactions and tests for invalid transactions.
- Verify the clerical and arithmetical accuracy of inventory listings.
- Reconcile physical inventory amounts with perpetual records.
- Reconcile physical counts with general ledger control totals.
- Reconcile inventories which belong to client but are held with third parties like transporters, warehouses, port authorities etc.
- Goods received on consignment basis have been properly segregated from other items of inventory.

The entity has valid legal **ownership rights**
over the inventories claimedto be held by the entity and recorded in the financial statements

- Vouch recorded purchases to underlying documentation (purchase requisition,purchase order, receiving report, vendor invoice and cancelled cheque or payment file).
- Evaluate the consigned goods.
- Examine client correspondence, sales and receivables records, purchase documents.
- Determine existence of collateral agreements.
- Review consignment agreements.
- Review material purchase commitment agreements.
- Examine invoices for evidence of ownership i.e. the invoices shall be in the name of the client.
- Auditor shall obtain confirmation for significant items of inventory.
- For instances of inventory held by third party, the auditor should insist on obtaining declaration from the third party on its business letterhead and signed byan authorized personnel of that third party confirming that the items of inventory belong to the entity and are being held by such third party on behalfof and for the benefit of the entity under audit.

Inventories have been VALUED appropriately and as per generally accepted accounting policies and practices

- Depending on how the business operates, the management may value inventory using First-in first-out (FIFO) or weighted average basis. Consider thereasonableness of the method adopted.
- For Raw materials and consumables
  - Ascertain what elements of cost are included e.g. carriage inward, non- refundable duties etc.
  - If standard costs are used, enquire into basis of standards; how these are compared with actual costs and how variances are analyzed andaccounted for/ treated in accounting records.

- Test check cost prices used with purchase invoices received in the month(s) prior to counting.
- Follow up valuation of all damaged or obsolete inventories noted during observance of physical counting with a view to establishing a realistic net realizable value.

- For Work in progress
  - Ascertain how the various stages of production/ value additions are measured and in case estimates are made, understand the basis for such estimates.
  - Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity.
  - Ensure that material costs exclude any abnormal wastage factors.
- For Finished goods and goods for resale
  - Enquire as to what costs are included, how these have been established and ensure that theoverheads included have been determined based on normal costs and appear reasonable in relation to the information disclosed in the financial statements.
  - Ensure that inventories are valued at net realizable value if they are likely to fetch a value lower than their cost. For any such items, also verify if the relevant semi/ partly processed inventories (work in progress) and raw materials have also been written down.

Follow up for items that are obsolete, damaged, slow moving and ascertain the possible realizable value of such items. Carefully examine the valuation of obsolete and damaged inventory. For the purpose, request the client to provide inventory ageing split and follow up for any inventories which at time of observance of physical counting were noted as being damaged or obsolete.

- Compare recorded costs with replacement costs.
- Examine vendor price lists to determine if recorded cost is less than current prices.
- Calculate inventory turnover ratio. Obsolete inventory may be revealed if ratio is significantly lower.
- In manufacturing environments, test overhead allocation rates and ensure that only direct labor, direct material and overhead have been included.
- Verify the correct application of lower-of- cost-or-net realizable value principles.

Required DISCLOSURES for inventories have been appropriately made

Ensure whether the following disclosures as required under Schedule III (Part I) to the Companies Act, 2013 have been made:

- Whether inventory has been classified as:
  - — Raw materials
  - — Work-in-progress
  - — Finished goods
  - — Stock-in-trade (goods acquired fortrading)
  - — Stores and spares
  - — Loose tools
  - — Others (specify nature).
- Whether goods-in-transit have been disclosed separately under each sub-head of inventories.
- Mode of valuation shall be stated.

AUDIT OF PROPERTY, PLANT AND EQUIPMENT (PPE)

1. Land, Building, Plant & Equipment, Furniture & Fixtures, Vehicles, Office Equipment, Computers etc. referred as PPE.
2. The Valuation of PPE becomes a very important aspect of consideration by the auditor in the course of his audit. The auditor should analyze the expenditure incurred on PPE, whether they are of Revenue or Capital in nature.
3. **Recognition Criteria for PPE**
    a. The cost of an item of PPE should be recognised as an asset if, and only if:
        i. It is probable that future economic benefits associated with the item will flowto the enterprise, and
        ii. The cost of the item can be measured reliably.
    b. An enterprise evaluates under this recognition principle all its costs on property, plant and equipment at the time they are incurred. These costs include costs incurred:
        i. initially to acquire or construct an item of property, plant and equipment; and
        ii. subsequently to add to, replace part of, or service it.
4. **Measurement at Recognition:** An item of property, plant and equipment that qualifies for recognition as an assetshould be measured at its cost.
5. **Elements of Cost:** The cost of an item of property, plant and equipment comprises:
    a. its purchase price, including import duties and non -refundable purchase taxes, after deducting trade discounts and rebates.
    b. any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intendedby management.
    c. the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as decommissioning,restoration and similar liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.
6. **Examples of directly attributable costs are:**
    a. Costs of employee benefits (as defined in AS 15, Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;
    b. Costs of site preparation;
    c. Initial delivery and handling costs;
    d. Installation and assembly costs;
    e. Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
    f. Professional fees.
7. **Examples of costs that are NOT costs of an item of property, plant and equipment are:**
    a. Costs of opening a new facility or business, such as, inauguration costs;
    b. Costs of introducing a new product or service (including costs of advertisingand promotional activities);
    c. Costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
    d. Administration and other general overhead costs.

8. The expenses have to be analysed and properly classified. The revenue expense like regular repairs on assets have to be charged off to the Statement of Profit and Loss.

The below table summarises the audit procedures generally required to be undertaken while auditing tangible fixed assets:

Audit procedures
To establish the EXISTENCE of PPE as at the period-end • Review entity's plan for performing physical verification of PPE i.e. whether performed by own staff or by a third party and the policy regarding periodicity i.e. whether physical verification shall be done on annual basis or once in two years/ three years. • Evidence of appropriate supervision of those performing physical verification of PPE should be examined. • Obtain PPE physical verification report backed by the working sheets from the entity and perform the following procedures: — Assess if all items of PPE are properly tagged and carry identification marks/ numbers and physical verification work papers do capture the asset identification numbers for assets physically verified. — Reconciliation of items of PPE as physically verified with the fixed asset register maintained by the entity as at the date/ period of undertaking physicalverification. Specifically verify if the PPEadditions up to the date of physicalverification have been updated in the fixed asset register. — Verify the discrepancies noted, based onphysical verification undertaken and themanner in which such discrepancies have been dealt with in the entity's books and financial statements. For example, any identified shortages/ assets not in working condition and/or active use should be accounted for as deletions in the books of account post approvals by the entity's management and depreciation should have ceased tobe charged after the date of deletion.
Additions to PPE during the period under audit have been recorded in the financial statements and do not include any PPE that belong to third parties but does include PPE owned and controlled by the entity although lying with a third party COMPLETENESS • Verify the movement in the PPE schedule (asset class-wise like building, Plant & machinery etc.) compiled by the management i.e. Opening balances + Additions during the period – Deletions during the period = Closing balances. Tally the closing balance to the entity's books of account. • Check the arithmetical accuracy of the movement in PPE schedule. Tally the opening balances to the previous year audited financial statements. For additions during the period under audit, obtain a listing of all additions from the management and perform the following procedures: — For all material additions, verify if such expenditure meets the criteria of PPEas per AS 10 (Revised). These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. — Verify that the cost of an item of property, plant and equipment is as per AS 10 (Revised). ➢ Items such as spare parts, stand-by equipment and servicing equipment are

recognised in accordance with AS 10 (Revised) when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory. Ensure that the entity is not recognizing costs of the day-to-day servicing in the carrying amount of an item of property, plant and equipment.

- Test the purchase invoice, installation certificate or report or other similar documentation maintained by the entity to verify the date of addition, for all additions samples of PPE during theperiod under audit.
- Verify whether the PPE additions have been approved by authorized personnel.
- Verify whether proper internal processes and procedures like inviting competitive quotations/ floating tenders etc. were followed prior to finalising the vendor for procuringitems of PPE/ awarding of work contract for capital projects by checking the supporting documents of the samples selected.

- In relation to deletions to PPE, understand from the management the reason and rationale for deletion (example could be new purchase of similar asset once the old asset was no longer fit to be used in production process) and the manner of disposal.
- Obtain the management approval and discard note authoring disposal of the asset from its active use. Verify the process followed for sale of discarded PPE, forexample - inviting competitive quotes, tenders and the basis of calculation of sales proceeds. Verify that the management has accurately recorded the deletion of PPE (original cost and accumulated depreciation up to the date of disposal) and the resultant gain/ loss on disposal of PPE item in theentity's books of account.

PPE have been VALUED appropriately and as per generally accepted accounting policies and practices

It is a common understanding that the value of fixed assets/ PPE depreciates due to efflux of time, use and obsolescence.

The diminution of the value represents an item of cost to the entity for earning revenue during a given period. Unless this cost in the form of depreciation is charged to the accounts, the profit or loss would not be correctly ascertained and the values of PPE would be shown at higher amounts. The auditor should:

- Verify that the entity has charged depreciation on all items of PPE unless any item of PPE is non- depreciable like freehold land;
- Assess that the depreciation method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. It could be Straight line method, diminishing value method, unit of production method, as applicable.
- The auditor should also verify whether the management has done an impairment assessment to determine whether an item of property, plant and equipment is impaired as per the requirements of AS 28 - Impairment of Assets.

The entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements (RIGHTS AND OBLIGATION)

- In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are inthe name of the entity that entitles legal title of ownership to the respective entity.
- For all additions to land and building in particular, the auditor should check the conveyance deed/ sale deed to verify whetherthe entity is the legal and valid owner or not.
- The auditor should insist and verify the original title deeds for all immoveable properties held as at the balance sheet date.

• In case the entity has given such immoveable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveableproperty as security. • In addition, the auditor should also verify the register of charges, available with the entity toassess that any charge has been created against the PPE.
Required DISCLOSURES for PPE have been appropriately made **Ensure whether the following disclosures as required under Schedule III (Part I) to Companies Act, 2013 have been made under the heading "Property, Plant and Equipment":** **i.** Classification shall be given as: **a.** Land; **b.** Buildings; **c.** Plant and Equipment; **d.** Furniture and Fixtures; **e.** Vehicles; **f.** Office equipment; **g.** Others (specify nature). **ii.** Assets under lease shall be separately specified under each class of asset. **iii.** A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions throughbusiness combinations, amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment) and other adjustments and the related depreciation and impairment losses/reversals shall be disclosed separately. **iv.** Where sums have been written-off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.

Notes: To be disclosed as Additional Regulatory Information

i. Title deeds of Immovable Property not held in name of the Company

The company shall provide the details of all the immovable property (other than properties where the Company is the lessee and the lease agreements are duly executed in favour of the lessee) whose title deeds are not held in the name of the company in format given below and where such immovable property is jointly held with others, details are required to be given to the extent of the company's share.

Relevant line item in the Balance sheet	Description of item of property	Gross carrying value	Title deeds held in the name of	Whether title deed holder is a promoter, director or relative# of promoter*/director or employee of promoter/director	Property held since which date	Reason for not being held in the name of the company**

PPE -	Land Building	-	-	-	-	**also indicateif in dispute
Investmen tproperty	Land Building					
PPE retired from activeuse and held for disposal-	Land Building					
Others						

#Relative here means relative as defined in the Companies Act, 2013.
*Promoter here means promoter as defined in the Companies Act, 2013.

ii. Where the Company has revalued its Property, Plant and Equipment, the company shall disclose as to whether the revaluation is based on the valuation by a registered valuer as defined under rule 2 of the Companies (Registered Valuers and Valuation) Rules, 2017.

iii. Capital-Work-in Progress (CWIP)

(a) For Capital-work-in progress, following ageing schedule shall be given:CWIP ageing schedule

(Amount in Rs.)					
	Amount in CWIP for a period of				Total *
CWIP	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Projects in Progress					
Projects temporarily suspended					

*Total shall tally with CWIP amount in the balance sheet.

(b) For capital-work-in progress, whose completion is overdue or has exceededits cost compared to its original plan, following CWIP completion schedule shall be given**:

(Amount in Rs.)				
	To be completed in			
CWIP	Less than 1 year	1-2 years	2-3 years	More than 3 years
Project 1				
Project 2				

**Details of projects where activity has been suspended shall be given separately.

AUDIT OF INTANGIBLE ASSETS
(comprising Goodwill, Brand/ Trademarks, Computer Software etc.)

1. An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.
2. Enterprises frequently spend resources on the acquisition, development, maintenance or enhancement of intangible assets such as scientific or technical knowledge, designand implementation of new processes or systems, licenses, intellectual property, market knowledge and trademarks (including brand names and publishing titles).
3. **Common examples of items encompassed by these broad headings are:**
    a. computer software,
    b. patents,
    c. copyrights,
    d. motion picture films,
    e. customer lists,
    f. mortgage servicing rights,
    g. fishing licenses,
    h. import quotas,
    i. franchises,
    j. customer or
    k. supplierrelationships,
    l. customer loyalty,
    m. market share and
    n. marketing rights.
    o. Goodwill is another example of an item of intangible nature which either arises on acquisitionor may be internally generated.
4. Not all the items described in above paragraph will meet the definition of an intangible asset, that is, identifiability, control over a resource and expectation of future economic benefits flowing to the enterprise. If an item covered by this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred.
5. As per AS 26 – Intangible Assets, internally generated goodwill should not be recognized as an asset.
6. Some intangible assets may be contained in or on a physical substance such as a compact disk (in the case of computer software), legal documentation (in the case of a licence or patent) or film (in the case of motion pictures). The cost of the physical substance containing the intangible assets is usually not significant. Accordingly, the physical substance containing an intangible asset, though tangible in nature, is commonly treated as a part of the intangible asset contained in or on it.
7. In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable. Judgement is required to assess as to which elementis predominant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral partof the related hardware and it is treated as a fixed asset. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

The below table summarises the audit procedures generally required to be undertaken while auditing intangible fixed assets:

Audit procedures
To establish the EXISTENCE of intangible fixed assets as at the period- end • Since an intangible asset is an identifiable non-monetary asset, without physical substance, for establishing the existence of such assets, the auditor should verify whether such intangible asset is in active use in the production or supply of goods or services, for rental to others or for administrative purposes. **Example**- for verifying the existence of software, the auditor should verifywhether such software is in active use by the entity and for the purpose, the auditorshould verify the sale of related services/ goods during the period under audit, in which such software has been used. **Example**- For verifying the existence of design/ drawings, the auditor shouldverify the production data to establish if such products for which the design/ drawings were purchased, are being produced and sold by the entity. In case any intangible asset is not in active use, deletion should have been recorded in the books of account post approvals by the entity's management and amortization charge should have ceased beyond the date of deletion.
All additions to Intangible assets during the period under audit have been recorded appropriately in the financial statements. **(COMPLETENESS)** ❑ Verify the movement in the intangible assets schedule (asset class wise like software, designs/ drawings, goodwill etc.)compiled by the management i.e. Opening balances + Additions – Deletions = Closing balances. Tally the closing balances to the entity's books of account. ❑ Check the arithmetical accuracy of the movement in intangible assets schedule. For additions during the period under audit,obtain a listing of all additions from the management and undertake the following procedures: ❑ For all material additions, verify whether such expenditure meets the criterion for recognition of an intangible asset as per AS 26. ❑ Ensure that no intangible asset arising from research (or from the research phaseof an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as anexpense when it is incurred. Check the certificate or report or other similar documentation maintained by the entity to verify the date of use of the intangible which could be linked to date of commencement of commercial production/ economic use to the entity, for all additions to intangible assets duringthe period under audit. ❑ Verify whether the additions (acquisitions)have been approved by appropriate entity's personnel. ❑ Verify whether proper internal processes and procedures like inviting competitive quotations/ proper tenders etc. werefollowed prior to finalizing the vendor for procuring item of intangible assets by testing those documents on a sample basis. ❑ In relation to deletions of intangible assets, understand from the managementthe reason and rationale for deletion and the manner of disposal. Obtain the management approval and disposal note authoring disposal of the asset from its active use. Verify the process followed for sale of discarded asset, example inviting competitive quotes, tenders and the basisof calculation of sales proceeds. Verify thatthe management has accurately recorded

the deletion of intangible asset (original cost and accumulated amortization up to the date of disposal) and the resultant gain/ loss on disposal in the entity's books of account.
Intangible assets have been VALUED appropriately and as per generally accepted accounting policies and practices The value of intangible assets may diminish due to efflux of time, use and/ or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period.Unless this cost in the form of amortization is charged to the accounts, the profit or loss wouldnot be correctly ascertained and the values of intangible asset would be shown at higher amounts. The auditor should: • Verify that the entity has charged amortization on all intangible assets; • Verify that the amortization method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. • The auditor should also verify whether themanagement has done an impairment assessment to determine whether anintangible asset is impaired. For thispurpose, the auditor needs to verifywhether the entity has applied AS 28 - Impairment of Assets for determining the manner of reviewing the carrying amountof its intangible asset, determining the recoverable amount of the asset to determine impairment loss, if any.
The entity has valid legal ownership rights over the Intangible Assets claimed to be held by the entity and recorded in the financial statements (RIGHTS AND OBLIGATION) • In addition to the procedures for verifyingcompleteness of additions to intangible assets during the period under audit, the auditor while performing testing of additions should also verify that all expense invoices/ purchase contracts are in the name of the entity that entitles legaltitle of ownership to the entity.
Required DISCLOSURES for Intangible Assets have been appropriately made **Ensure that the following disclosures as required under Schedule III (Part I) to Companies Act,** 2013 have been made **under the heading "Intangible Assets":** **i.** Classification shall be given as: **a.** Goodwill; **b.** Brands /trademarks; **c.** Computer software; **d.** Mastheads and publishing titles; **e.** Mining rights; **f.** Copyrights, and patents and other intellectual property rights, services and operating rights; **g.** Recipes, formulae, models, designs andprototypes; **h.** Licences and franchise; **i.** Others (specify nature). **ii.** A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due torevaluation (if change is 10% or more in the aggregate of the net carrying value of each class of intangible assets) and other adjustments and the related depreciation and impairment losses orreversals shall be disclosed separately. **iii.** Where sums have been written-off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to

date ofsuch write-off, or addition shall show the reducedor increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together withthe date thereof for the first five years subsequentto the date of such reduction or increase.

Notes: To be disclosed as Additional Regulatory Information.

Intangible assets under development:

a. For Intangible assets under development, following ageing schedule shall be given:
Intangible assets under development ageing schedule

(Amount in Rs.)					
	Amount in CWIP for a period of				**Total***
Intangible asset under development	**Less than 1 year**	**1-2 years**	**2-3 years**	**More than 3 years**	
Projects in Progress					
Projects temporarily suspended					

* Total shall tally with the amount of Intangible assets under development in the balance sheet.

b. For Intangible assets under development, whose completion is overdue or has exceeded its cost compared to its original plan, following Intangible assets under development completion schedule shall be given**:

(Amount in Rs.)				
	To be completed in			
Intangible asset underdevelopment	Less than 1 year	1-2 years	2-3 years	More than 3years
Project 1				
Project 2				

**Details of projects where activity has been suspended shall be given separately.

AUDIT OF TRADE PAYABLES AND OTHER CURRENT LIABILITIES

The below table summarises the audit procedures generally required to be undertaken while auditing trade payables and other current liabilities:

Audit procedures
To establish the EXISTENCE of trade payables and other current liabilities as at the period-end • Check whether there are controls in place to ensure that any purchase/ expense invoice does not get recorded more than once and payable balances are automatically recorded in the general ledger at the time of recording of expense. • Obtain the accounts payable ageing report and trace its balances to the general ledger. If there are any differences, investigate reconciling items. Journal entries specially for large amounts should be carefully examined. **Direct confirmation procedure** An important audit activity is to contact vendors directly/independently and ask them to confirm the amounts of accounts payable as of the end of the reporting period under audit. This should necessarily be done for all significant account payable balances as at the period-end and for parties from whom material purchases have been made during the period under audit even if period-end balance of such parties is not significant. • The auditor employs direct confirmation procedure with the consent of the entity under audit. There may be situations where the management of the entity requests the auditor not to seek confirmation from certain trade payables. In such cases, the auditor should consider whether there are valid grounds for such a request. In appropriate cases, the auditor may also need to reconsider the nature, timing and extent of his audit procedures including the degree of planned reliance on management's representations. • The trade creditors may be requested to confirm the balances either (a) as at the date of the balance sheet, or (b) as at any other selected date which is reasonably close to the date of the balance sheet. The date should be decided by the auditor in consultation with the Company. • The form of requesting confirmation from the trade creditor may be either (a) the form with balance as at year end wherein the trade creditor is requested to respond whether or not he is in agreement with the balance shown, or (b) the form with no balance wherein the trade creditor is requested to respond the balance as per his records. The use of the form with no balance is preferable. • The method of selection of the trade creditors to be circularised should not be revealed to the Company until the trial balance of the trade payables' ledger is handed over to the auditor. A list of trade creditors selected for confirmation should be given to the entity for preparing request letters for confirmation which should be properly addressed. The auditor should maintain strict control to ensure the correctness and proper dispatch of request letters. In the alternative, the auditor may request the client to furnish duly authorised confirmation letters and the auditor may fill in the names, addresses and the amounts relating to trade creditors selected by him and mail the letters directly. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client. • Any discrepancies revealed by the confirmations received or by the additional tests carried out by the auditor, may have a bearing on other accounts not included in the original sample. The entity should be asked to investigate and reconcile the discrepancies.

Inaddition, the auditor should also consider what further tests he can carry out in order to satisfy himself as to the correctness of the amount of trade payables taken as a whole.

- Where no reply is received, the auditor shouldperform additional testing regarding the balances. This testing could include:
  - Testing of subsequent payments in respect of the trade payables to whom confirmations were rolled out but no replies received;
  - Agreeing the details of the respective balance to the underlying vendor invoices;

ANALYTICAL PROCEDURES:

- Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirmingthat these purchases/ expense transactions actually occurred. (examination in depth)
- If there are any related party payables, review whether they were properly authorized and the value of such transactions were reasonable and at arm's length.
- Review a trend line of purchases/ expenses and accounts payable, or a comparison of the two over time, to see if there are any unusual trends. Make inquiries about reasons for changes in trends from the management.

Trade payables and liability balances that were supposed to be recorded have been recognized in the financial statements. (COMPLETENESS)

- The auditor needs to perform the following cut off procedures:
  - For the last 5 invoices received/ recorded at the end of the reporting date (cut off date) and which have beenincluded in the trade payables; the goods should have been received/ risk and rewards of ownership in goods should have been transferred in favur of the entity;
  - All goods received prior to the period/ year- end should have been booked in the form of purchases and included in trade creditors.
- Test purchases/ expenses on a sample basis selecting the same from the accounts payable ledgers and checking their supportingdocuments to ensure that the purchases were recorded at the correct amounts and correct dates.
- Match purchase invoice dates to the gate entry (inward) dates to check whether the purchases are being recorded in the correct accounting period. This can include an examination of purchase/ expense invoicesreceived subsequent to the period being audited, to see if they should have been included in the period under audit.
- Review subsequent expense vouchers. Reviewall material expense vouchers recorded post the balance sheet date to see if they relate totransactions from within the audit period.
- For advance received from customers/ revenue received in advance, obtain the customer wise listing along with its ageing and the nature. Enquire from the entity's management if there has been any dispute with the customer and if there is any additional liability to be recorded. For all such advances, the auditor should verify the underlying documentation based on whichthe entity had received the advance.
- In relation to statutory dues liability like withholding tax (TDS) payable, GST payable, luxury tax payable, professional tax payable, PF and ESI payable etc., prepare a reasonability with respect to sales/ purchases/employee benefit expenses. **Example**- GST liability for last month may be calculated by applying the applicable rate to the sales made and in case of any variance with the GST liability recorded by the entity, reasons for variance should be requested from client andin case found satisfactory, the same should be maintained as part of audit documentation.

Similarly, Provident Fund liability for last month maybe calculated by applying the applicable rate to theemployee benefit expense and in case of any variance with the liability recorded by the entity, reasons for variance should be requested from clientand in case found satisfactory, the same should be maintained as part of audit documentation.

Further, the auditor should obtain and verify the challans for deposits made subsequent to the period-end for all statutory liabilities as at the balance sheet date and also analyse the reasons, if any, in consultation with the management for any variance between the amounts deposited subsequently vis-à-vis the liability recorded in booksof account.

- He shall prepare a complete list of all statutory dues and consider his reporting requirementsunder CARO,2020.

Trade payables and other liability balances have been VALUED appropriately.

- Review the process followed by the Company to identify if any old creditor balance/ liability needs to be written back. This will include a consistency comparison with the method used in the last year, and a determination of whether the method is appropriate for the underlying business environment.
- Obtain the ageing of payable balances, and the list of vendors with whom the Company has disputes and any claims from customers, under litigation and compare with previous year.
- Check that write backs in the liability balances assessed as no longer payable have been approved by an appropriate and authorised member of senior management, for example – CEO/MD.
- Check that the restatement of foreign currency trade payables has been doneproperly in accordance with AS 11.

Understand management's process to identifythe principal amount and the interest due thereon (if any) remaining unpaid to any Micro, Small and Medium Sized Enterprises suppliers at the end of accounting year. Test check the management process to assess if the auditor could rely on the management process.

Required **DISCLOSURES** for trade payables and other liabilities have beenappropriately made

Ensure whether the following disclosures as required under Schedule III (Part I) to Companies Act, 2013 have been made:

- Whether the Company has disclosed the following details relating to micro and small enterprises in the notes:
    - the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at theend of each accounting year.
    - the amount of interest paid by the buyerin terms of section 16 of the Micro,Small and Medium Enterprises Development Act, 2006, along with the amount of the payment made to the supplier beyond the appointed day during each accounting year.
    - the amount of interest due and payablefor the period of delay in making payment(which have been paid but beyond the appointed day during the year) but without adding the interest specifiedunder the Micro, Small and Medium Enterprises Development Act, 2006.
    - the amount of interest accrued and remaining unpaid at the end of each accounting year.
    - the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues above are actually paidto the small enterprise, for the purpose of disallowance of a deductible expenditure under section

23 of the Micro, Small and Medium Enterprises Development Act, 2006.

Trade payables due for payment: The following ageing schedule shall be given for Trade payables due for payment:-

Trade Payables ageing schedule

(Amount in Rs.)					
Particulars	Outstanding for following periods from due date of payment#				
	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
i. MSME					
ii. Others					
iii. Disputed Dues-MSME					
iv. Disputed Dues Others					

similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction.

Unbilled dues shall be disclosed separately.

Other Current Liabilities

Whether the amount disclosed under othercurrent liabilities are classified as below:

- Current maturities of finance leaseobligations
- Interest accrued but not due onborrowings
- Interest accrued and due on borrowings
- Income received in advance
- Unpaid Dividends

Application money received for allotmentof securities and due for refund and interest accrued thereon. Shareapplication money includes advances towards allotment of share capital. The terms and conditions including the number of shares proposed to be issued, the amount of premium, if any, and the period before which shares shall be allotted shall be disclosed. It shall also bedisclosed whether the company has sufficient authorised capital to cover the share capital amount resulting from allotment of shares out of such share application money. Further, the period for which the share application money has been pending beyond the period for allotment as mentioned in the documentinviting application for shares along withthe reason for such share application money being pending shall be disclosed.Share application money not exceeding the issued capital and to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable, i.e., the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under "Other current liabilities";

- Unpaid matured deposits/debenturesand interest accrued thereon
- Unpaid matured debentures and interestaccrued thereon
- Others (specify nature).

AUDIT OF LOANS AND ADVANCES AND OTHER CURRENT ASSETS

The below table summarises the audit procedures generally required to be undertaken while auditing loans and advances and other current assets:

Audit procedures
To establish the EXISTENCE of loans and advances and other current assets as at the period-end • For establishing existence of loans and advances, direct confirmation procedures, similar to those performed for Accounts receivable balances are should be performed with the only difference that while performing circularisation of direct confirmations, in addition to the principalamount, interest receivable, if any, as perthe agreed terms between the parties, may also be included as part of the balance tobe confirmed.
Loans and advances andother current asset balancesthat were supposed to berecorded have beenrecognized in the financialstatements. (**COMPLETENESS**) • Obtain a list of all advances and other current assets and compare them with balances in the ledger. Verify loan agreements and acknowledgements of parties in respect of outstanding loans. A loan or an advance, if material, is granted only if authorised by the Memorandum and Articles of Association in the case of Company. In addition, the auditor should confirm that the loans advanced were within the competence of persons who had advanced the same, directors in the case of a Company, partners in the case of a firm and trustees in the case of a trust. • Inspect the minutes of meeting of board of directors to confirm if all material loans and advances were approved by the board of directors. • Verify that the loan has been acknowledged by the party and in addition, inspect if any security has been deposited against due repayment of the loan. Ascertain if loans are being recovered regularly as per agreed instalments. • If there are any related party loans and advances, review whether they were properly authorized and the value of such transactions were reasonable and at arm's length. • In relation to balances with statutory authorities like GST input credit, prepare a reasonability with respect to purchases/ expenses by applying the applicable rate to the purchases/ expenses and in case of any variance with the asset recorded by the entity, reasons for variance should be requested from the entity. • Further, the auditor should obtain statutory returns filed with the authorities like GST returns and verify whether the amount recorded as per books of account tallies with the claim made with the authorities.
Loans and advances and other current asset balances have been **VALUED** appropriately. • Assess the allowance for doubtful accounts. Review the process followed by theCompany to derive an allowance for doubtful accounts. This will include a consistency comparison with the method used in the last year, and a determinationof whether the method is appropriate forthe underlying business environment. • Obtain the ageing report of loans and advances. Also, obtain the list of loans and advances under litigation and compare with previous year.

- Scrutinize the analysis and identify those loans and advances that appear doubtful;discuss with management about the reasons as to why these loans/ advancesare not included in the provision for doubtful balances.
- Assess bad loans/ advances write-offs. Prepare schedule of movements on Bad loans/ advances – Provision Accounts and loans/ advances written off.
- Check that write-offs or other reductions in the recoverable balances have been approved by the authorsied andappropriate senior authority
- Check that the restatement of foreign currency loans and advances/ other current assets has been done properly in accordance with AS 11

Required **DISCLOSURE** forloans and advances and othercurrent assets have been appropriately made

Ensure whether the following disclosures as required under Schedule III (Part I) to Companies Act, 2013 have been made:

Long Term loans & Advances

i. Long-term loans and advances shall beclassified as:
   - Capital Advances;
   - Loans and advances to related parties(giving details thereof);
   - Other loans and advances (specify nature).

ii. The above shall also be separately sub-classified as:
   a. Secured, considered good;
   b. Unsecured, considered good;
   c. Doubtful.

iii. Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

iv. Loans and advances due by
   - Directors or other officers of the company or any of them either severally or jointly with any other persons or
   - amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

Short-term loans and advances

i. Short-term loans and advances shall be classified as:
   a. Loans and advances to related parties (giving details thereof);
   b. Others (specify nature).

ii. The above shall also be sub-classified as:
   a. Secured, considered good;
   b. Unsecured, considered good;
   c. Doubtful.

iii. Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

iv. Loans and advances due by
   - directors or other officers of the company or any of them either severally or jointly with any other person
   - or amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.

Notes: To be disclosed as Additional Regulatory Information

i. Following disclosures shall be made where Loans or Advances in the natureof loans are granted to promoters, Directors, KMPs and the related parties (as defined under Companies Act, 2013,) either severally or jointly with any other person, that are:

a. repayable on demand or
b. without specifying any terms or period of repayment

Type of Borrower	Amount of loan or advance in the nature of loan outstanding	Percentage to the total Loans and Advances in the nature of loans
Promoters		
Directors		
KMPs		
Related Parties		

AUDIT OF PROVISIONS AND CONTINGENT LIABILITIES

1. A **provision** is a liability which can be measured only by using a substantial degree of estimation.
2. A provision is recognised when:
   a. an entity has a present obligation (legal or constructive) as a result of a pastevent;
   b. it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
   c. a reliable estimate can be made of the amount of the obligation.If the above conditions are not met, no provision is recognised.

   Example: Provision may include provision for litigation, provision for warranties etc.
3. A **contingent liability** is:
   a. a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
   b. a present obligation that arises from past events but is not recognized because:
      i. it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
      ii. the amount of the obligation cannot be measured with sufficient reliability.

The below table summarises the audit procedures generally required to be undertaken while auditing provisions and contingent liabilities:

Audit procedures
To establish the EXISTENCE of provisions as at the period- end **Provisions that were supposed to be recorded have been recognized in the financial statements COMPLETENESS** • Obtain a list of all provisions and compare them with balances in the ledger. • Inspect the underlying agreements like agreement with customers to assess warranty commitments, any legal and other claims on the entity i.e. litigations.
Provision balances have beenvalued appropriately. **VALUATION** • Obtain the underlying working and the basis for each of the provisions made, from the management and verifywhether the same is complete andaccurate. • Wherever required, obtain expert's report, calculation and underlying working for the provision amount, example for warranty involving complex calculations, some entities get that valued through an actuary. In such a case, the auditor may request the management to share the actuarial valuation report and in case of any matter under legal dispute, the auditor should request for assessment made by a legal expert in relation to likelihood of a liability devolving on the entity i.e. whether probable or possible or remote as defined above. The auditor should then verify the underlying assumptions used by the expert with the data shared by the management.

• As per SA 500 – "Audit Evidence", issued by ICAI, when using the work of a management's expert, audit evidence that the auditor should obtain include:
  ▫ Evaluate the competence, capabilities and objectivity of that expert:
    ▪ Whether the expert isemployed by the entity or is an outside party.
    ▪ Whether the expert isindependent in respect of the entity.
    ▪ Auditor's previous experience of the work of the expert.
    ▪ Knowledge of the expert, his qualification, membershipof a professional body or industry association, etc.

- Obtain an understanding of the work of that expert:
  - Whether the auditor has expertise to evaluate the work of the expert.
  - Evaluating the assumptionsand methods used by the management.
  - Evaluating the nature of internal or external data used by the expert.
- Evaluate the appropriateness of his work as audit evidence for the relevant assertion:
  - Relevance andreasonableness of the expert's findings or conclusions
  - Evaluating the relevance, completeness and accuracyof the source data used by the expert.
- The auditor shall obtain written representation from the managementthat it has made all the provisions which were required to be made as perthe recognized accounting principles.

Required **DISCLOSURE** forprovisions have been appropriately made

Ensure whether the following disclosures as required under Schedule III (Part I) to Companies Act, 2013 have been made:

Long-term provisions

The amounts shall be classified as:

a. Provision for employee benefits;
b. Others (specify nature).

Short-term provisions

The amounts shall be classified as:

a. Provision for employee benefits.
b. Others (specify nature).

Contingent liabilities and commitments (to the extent not provided for)

i. Contingent liabilities shall be classified as:
   a. Claims against the company notacknowledged as debt;
   b. Guarantees;
   c. Other money for which the company iscontingently liable.

ii. Commitments shall be classified as:
   a. Estimated amount of contracts remaining to be executed on capital account and not provided for;
   b. Uncalled liability on shares and other investments partly paid;
   c. Other commitments (specify nature).

In terms of AS 29, "Provisions, Contingent Liabilities and Contingent Assets", ensure whether following disclosures have been made:

- **For each class of provision, an enterprise shall disclose:**
  - the carrying amount at the beginning and end of the period;
  - additional provisions made in the period, including increases toexisting provisions;
  - amounts used (i.e. incurred and charged against the provision) during the period;
  - unused amounts reversed during the period.
- **An enterprise shall disclose the following for each class of provision:**
  - a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;
  - an indication of the uncertainties about the amount or timing of those outflows. Where necessaryto provide adequate information, an entity shall disclose the major assumptions made concerning future events; and

- the amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement.

- Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:
  - an estimate of its financial effect
  - an indication of the uncertainties relating to any outflow; and
  - the possibility of any reimbursement.

  Where any of the information requiredby above paragraph is not disclosed because it is not practicable to do so,that fact should be stated.

Notes: Other information as per requirement of Part I, Schedule III, to be disclosed as Additional Regulatory Information

1. Details of Benami Property held

Where any proceedings have been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, the company shall disclose the following:

a. Details of such property, including year of acquisition,
b. Amount thereof,
c. Details of Beneficiaries,
d. If property is in the books, then reference to the item in the Balance Sheet,
e. If property is not in the books, then the fact shall be stated with reasons,
f. Where there are proceedings against the company under this law as a beneficiary of the transaction or as the transferor then the details shall be provided,
g. Nature of proceedings, status of same and company's view on same.

2. Relationship with Struck off Companies

Where the company has any transactions with companies struck off under section 248 of the Companies Act, 2013 or section 560 of Companies Act, 1956, theCompany shall disclose the following details:-

Name of struck off Company	Nature of transactions with struck off Company	Balance outstanding	Relationship with the Struck off company, if any, to be disclosed
	Investments in securities		
	Receivables		
	Payables		
	Shares held by stuck off company		
	Other outstandingbalances (to be specified)		

3. Following Ratios to be disclosed:

a. Current Ratio,
b. Debt-Equity Ratio,
c. Debt Service Coverage Ratio,
d. Return on Equity Ratio,
e. Inventory turnover ratio,
f. Trade Receivables turnover ratio,

g. Trade payables turnover ratio,
h. Net capital turnover ratio,
i. Net profit ratio,
j. Return on Capital employed,
k. Return on investment.

The company shall explain the items included in numerator and denominator for computing the above ratios. Further explanation shall be provided for any changein the ratio by more than 25% as compared to the preceding year.

STATEMENT OF PROFIT AND LOSS CAPTIONS

AUDIT OF SALE OF PRODUCTS AND SERVICES

1. The sales and collections cycle in a business refers to the set of processes that begin when a customer purchases goods or services and ends when the entity receives complete payment against the sales. Sales is one of the most important item in the financial statements which will have a considerable effect on the profit generated, closing stock etc. As per SA 315, the risk of material misstatement in case of revenue items is generally high.
2. As part of the year-end audit of an entity's financial statements, auditors test sales transactions and the internal controls over those transactions to ensure that the entity is not materially misstating its revenues or accounts receivable.
3. Auditor needs to obtain a clear understanding about the organisation and itsrevenue centres.

   Example Type of services or products the entity provides, demand for the services or products, major selling product/service, introduction of new products/service line, discontinuance of products/services, major customers, sales term (Credit or cash sales).
4. An auditor needs to obtain an understanding of the management control(internal control) in respect of sales process.

   Example Whether segregation of duties exist, who checks the credit limit (if applicable), who authorizes sales orders, who raises sales invoice, when and how the goods are delivered/despatched or services are provided, who collects and records the amounts received from debtors, who ensures that the risks and rewards are transferred to the customer, how the sales have been recognised in the system.
5. An auditor tests the controls the entity has set up for the sales cycle to determine how strong and reliable they are. If they are strong and operating effectively, the auditor can reduce the extent of substantive testing. Any deficiencies in the internal control shall be communicated as per SA 265.

   Example, Common internal controls over the sales cycle include pre -numbered sales invoices, proper authority for approval of orders, execution of sales order, customer purchase order authorization over a certain limit and authorization over receivables write-offs.
6. The auditor selects a random sample of transactions and examines the related customer purchase orders, invoices and customer statements to ensure that the control being tested is a numbered sales invoice. This will enable the auditor to determine the nature, timing and extent of his substantive procedures to be applied.

   Example, The auditor ensures that all numbers in a section are accounted for and that none are missing.
7. Performing substantive analytical procedures is a must. Substantive analytical procedures will consist of sales trend analysis, comparison with previous accounting period, category-wise sales analysis, any analysis the auditor may find relevant and most important of all, building a sales expectation and comparing that with the client's sales records. The auditor will need to know the sales prices of the products or services over the year, monthly average sales price per product or service, discount policy.

   Example, For a manufacturing company, if the average sales price of product X is Rs. 10 and 1,500 units were sold in that month, the auditors expected sales will be Rs. 15,000. The auditor should compare this figure with the client's data and see what they have recorded against Product X. The auditor should consider discussing any variances (see if there were discounts or sales were wrongly booked in the system) between his expectations and client's records. The auditor will have to also identify and understand how the entity accounts for their sales discounts and sales return in the system and how those affect the gross sales.

The below table summarises the audit procedures generally required to be undertaken while auditing sales:

Audit procedures

Recorded sales represent goods shipped/ services performed during the period **(OCCURRENCE)**
• Ensure revenue is not overstated by performing following audit procedures:
  ▫ Check whether a single sales invoice is recorded twice or a cancelled sales invoice could also be recorded.
  ▫ Test check few invoices with their relevant entries in sales journal.
  ▫ Obtain confirmation from few customers to ensure genuineness of sales transaction
  ▫ Whether any fictitious customers and sales have been recorded.
  ▫ Whether any shipments were done without the consent and agreement of the customer, especially at the year end to inflate the sales figure
  ▫ Whether unearned revenue recorded as earned.
  ▫ Whether any substantial uncertainty exists about collectability.
  ▫ Whether customer obligations are contingent on other actions(financing, resale, etc.).
• Review sequence of sales invoices
• Review journal entries for unusual transactions
• Calculate the ratio of sales return to sales and compare it with previous year and enquire for the reasons for increase/ decrease.
• Check the sales return with sales invoice, challan, credit note, stock register, etc.

All sales made during the period were recorded and there is no understatement or overstatement. **(COMPLETENESS)** • Perform cut-off procedures to ensure that revenues are recognised in the current accounting period and sales were nottampered towards the period end. • Cut-off errors will usually arise when companies recognise revenue based on the date on which the sales invoices are generated rather than the date on whichthe risks and rewards are transferred to the buyer. In order to perform a robust sales cut-off test, auditors need to understandand consider the specific cut-off error riskof each engagement. • Auditors should also verify the credit notes issued after the accounting period. Sometimes sales team or sales personnel can make fictitious sales before the year- end to meet performance target and cancel out those sales with a post year end credit note. • Trace from the shipping documents to the sales journal. • Check whether quantity is appearing in sales register or not and check reconciliation of total sales/goods dispatched as per stock records and financial records and statutory records like GST. • Review GST tax and GST returns and ensure that the same are reconciled with revenue reported in the profit and loss account. Verify reasonability say of GST by applying the applicable rate to the gross sales value and compare the amount of GST as per statutory returns and analyze the reasons for variance, if any.

All sales are accurately measured as per applicableaccounting standards andcorrectly journalized,summarized, and posted **(MEASUREMENT)**

- Trace a few transactions from inception to completion. (Examination in depth)

  E.g: Take few sales transaction, and check from the receipt of sales order to the payment of receivable balance, every underlying document to ensure if it is properly recorded at every stage and measured accurately taking into consideration all the incentives, discounts,if any. The recognition shall be accordingto the revenue recognition policy of the entity.
- if the client is engaged in export sales, then compliance with AS 11 shall be ensured.
- Auditor must understand client'soperations and related GAAP issues e.g. point of sale revenue recognition vs. percentage of completion, whereverapplicable.
- Compare the rate of sales affected with related parties and review them for collectability, as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.

Required **DISCLOSURE** for sales have been appropriately made

Ensure whether the following disclosures as required under Schedule III (Part II) to Companies Act, 2013 have been made:

A. In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from—

a. Sale of products;

b. Sale of services;

ba. Grants or donations received (relevant in case of section 8 companies only),]

c. Other operating revenues;Less:

d. Excise duty.

B. In respect of a finance company, revenuefrom operations shall include revenue from—

a. Interest; and

b. Other financial services.

Revenue under each of the above heads shall bedisclosed separately by way of notes to accountsto the extent applicable.

- Whether brokerage and discount on sales other than usual trade discount has been disclosed.
- Whether the transactions with related parties are appropriately disclosed in notes to accounts.

AUDIT OF OTHER INCOMES

1. Any form of income earned by an entity which is not linked to the entity's core business operations is generally classified as other income.
   Examples: interest on excess funds parked in fixed deposits with banks (the entity not being a bank or financial institution), interest on loans given to third parties/ within the group, return on mutual fund investment etc.
2. Interest income on fixed deposits is recognized on a time proportion basis taking into account the amount outstanding and the applicable interest rate.
3. Dividends are recognised in the statement of profit and loss only when:
   i. the entity's right to receive payment of the dividend is established;
   ii. it is probable that the economic benefits associated with the dividendwill flow to the entity; and
   iii. the amount of the dividend can be measured reliably.
4. **Gain/(loss) on sale of investment** in mutual funds is recorded as other income on transfer of title from the entity and is determined as the difference between the redemption price and carrying value of the investments.

Audit procedures

Recorded other income was earned during the Period**(OCCURRENCE)**

Other income earned duringthe period was appropriatelyrecorded and there in no understatement oroverstatement. **(COMPLETENESS)**

Other income has beenmeasured appropriately as per the applicable accounting standards **(MEASUREMENT)**

- For verifying interest income on fixed deposits:
  - Obtain a listing of fixed deposits opened during the period under audit along with the applicable interest rate and the number of days for which the deposit wasoutstanding during the period.
  - Verify the arithmetical accuracy of the interest calculation made by the entity by recomputing i.e. multiplying the deposit amount with the applicable rate and number of days during the period under audit.
  - For deposits still outstanding as at the period- end, trace the same tothe direct confirmations obtained from the respective bank/ financial institution.
  - Obtain a confirmation of interest income from the bank and verify that the interest income as per bankreconciles to the calculation sharedby the entity.
  - Also, obtain a copy of Form 26AS (TDS withholding by the bank/financial institution) and reconcile the interest reflected therein to the calculation shared by client.
- For Dividends, verify that the same are recognised in the statement of profit and loss only when the entity's right toreceive payment of the dividend is established.
- Verify that Gain/(loss) on sale of investment in mutual funds is recorded as other income only on
  - transfer of title from the entity AND
  - is determined as the difference between the redemption price and carrying value of the investments.

For the purpose, obtain the mutual fund statement and trace the gain / loss as recorded in the books of account to the gain/ loss as reflected in the statement.

Required **DISCLOSURE** forother income have been appropriately made

Ensure whether the following disclosures asrequired under Schedule III (Part II) to Companies Act, 2013 have been made:

Other income

Other income shall be classified as:

a. Interest Income (in case of a company other than a finance company);
b. Dividend Income;
c. Net gain/loss on sale of investments;
d. Other non-operating income (net of expenses directly attributable to such income).

Note: To be disclosed as Additional Information Undisclosed income

The Company shall give details of any transaction not recorded in the books of accounts that has been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (such as, search or survey or any other relevant provisions of the Income Tax Act, 1961), unless there is immunity for disclosure under any scheme and also shall state whether the previously unrecorded income and related assets have been properly recorded in the booksof account during the year.

AUDIT OF PURCHASES

1. Purchases is another significant process of an entity. Similar to sales as discussed above, purchases and disbursement cycle in a business refers to the set of processes that begin when an order for buying goods or services is placed based on requirements of the production/ user department and ends when the entity receives the product and makes complete payment to the vendor.
2. As part of the year-end audit of an entity's financial statements, auditors test purchase transactions and the internal controls over those transactions to ensure that the entity is not materially misstating its purchases or accounts payables.
3. Auditor needs to obtain a clear understanding about the organisation and its production centres e.g.,
    a. Type of services or products they procure that are used in the production/ rendering of services,
    b. Sources of procurement whether domesticor overseas,
    c. General availability and terms and conditions of purchase of the service or products,
    d. Major vendors,
    e. Credit period,
    f. Quality checks,
    g. Purchase terms (credit or cash purchase) etc.
4. An auditor needs to identify the control points over purchases e.g.,
    a. whether segregation of duties exist,
    b. whether competitive quotes are invited,
    c. whethera purchase committee exists
    d. who authorises purchase price, issues and authorizes purchase orders,
    e. when and how the goods are received and acknowledged,
    f. who checks the quality, quantity and specifications of the goods received and prepares Goods Receipt Note (GRN),
    g. who approves the vendor invoice,
    h. whether a 2 way/ 3 way match process exists (i.e. tally between purchase order, GRN and vendor invoice),
    i. how the purchases have been recognised in the system.
5. An auditor tests the controls the entity has set up for the purchase cycle to determine whether they are effective or not. If the controls are effective, the auditor can reduce the extent of substantive testing.
6. Common internal controls over the purchase cycle include
    a. Inviting competitive quotations for shortlisting the vendors,
    b. Numbered purchase orders,
    c. Purchase order authorization over a certain limit,
    d. Generation of grn on receipt of goods,
    e. Quality inspection of goods,
    f. 2 way/ 3-way match,
    g. Authorization of purchase invoices,
    h. Appropriate authority to recognise the purchases in the system.
7. The auditor selects a random sample of transactions and examines the related purchase orders, GRN, purchase invoices, inward gate entry register and vendor reconciliation/ statements.

8. Performing substantive analytical procedures is must. Substantive analytical procedure will consist of purchase trend analysis, comparison with previous accounting period, category wise purchases, any analysis auditor may find relevant and most important of all setting a purchase expectation in relation to the sales made during the period under audit and compare that with the client's purchase records.
9. The auditor would need to know the purchase prices of the products or services over the year, monthly average purchaseprice per product or service etc. E.g: If the purchase price is 100 and if 15000 units were received under multiple orders during the year, the auditor expects the purchases to be 15,00,000. If there is a variance in the amount recorded in the books, he shall check for additional details like discounts received,change of purchase price for few orders due to excess demand etc.

The below table summarises the audit procedures generally required to be undertaken while auditing purchases:

<table>
<tr><th>Audit procedures</th></tr>
<tr><td>
Recorded purchases represent goods actually received/services availed during theperiod
(OCCURRENCE)

Ensure purchases are not understated/ overstated by performing following audit procedures:

Whether any fictitious vendors have been booked or purchases have beenrecorded by reviewing the vendor selection process followed by the entity and also performing procedures to ensure existence of the vendors.
Whether the goods were received at the factory gate and whether there exists an entry in the security gate inward register
Whether quality inspection of goods was done.
Whether a goods receipt note was prepared and signed by an appropriate client personnel.
Whether the purchase invoice was approved as per delegation of authority and whether a 3 or 2-way match (as discussed above) was done.
Whether stock record has been updated by the stores personnel.

Special considerations during audit of purchases

The purchase invoice received should be the "Original" copy (and notphotocopy/ carbon copy) against which the entity has recorded the purchase in its books of account.
Purchase invoice should have been booked only once risk and reward incidental to ownership has been transferred to the entity. Specific consideration for cases where the terms of delivery as agreed with vendor are F.O.B., C.I.F. etc.
Purchase invoice should be in the name of entity. However, in case of different branches, it should be addressed to the appropriate branch.
Input tax component should have been booked in the input tax ledger. The auditor should obtain tax returns filed with the authorities and tally the input tax as reflected in the books to the amount disclosed in the returns.
In case of purchases made from related parties or allied and associated concerns, the auditor needs to verify if requisite approval from Board of Directors (appropriate authority) has been obtained and should verify the selected samples and perform analytical procedures in relation to price of goods to confirm that the price charged is at arm's length.
The auditor should review whether purchases should be capitalized or expensed off in Statement of Profit and loss according to his professionaljudgement.

</td></tr>
</table>

- Review journal entries for unusual transactions.

All purchases made during theperiod were recorded andthere in no understatement or overstatement. **(COMPLETENESS)**

All purchases have beenmeasured appropriately **(MEASUREMENT)**

In addition to the procedures for establishing occurrence of purchases as discussed above, the auditor should:

Perform cut-off test to ensure thatpurchases are recognised in the correct accounting period. For the purpose, the auditor should examine material inward records, say, last 5 transactions at the period end to check that all corresponding invoices have been duly entered in the Purchases book and none have been omitted.

- Ensure correct accounting treatment of goods – in – transit as per the agreed terms with the vendor regarding transfer of risk and reward of ownership in goods.
- Obtain written representation from the management that all the purchases that took place during the year have been properly recorded in the books.

ANALYTICAL PROCEDURES:

- Perform analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantityand price which may include:
  - **Consumption Analysis:** Auditor should scrutinize raw material consumed as per manufacturing account and compare the same with previous years with closing stock and ask for the reasons fromthe management, if anysignificant variations are found.
  - **Stock Composition Analysis:** Auditor to collect the reports from management for composition of stock i.e. raw materials as a percentage of total stock and compare the same with previous year and ask for reasons from management in case of significant variations.
  - **Ratios:** Auditor should compare the creditors turnover ratios andstock turnover ratios of the current year with previous years.
  - Auditor should reviewquantitative reconciliation of closing stocks with opening stock, purchases and consumption.

Required **DISCLOSURES** forpurchases have beenappropriately made

Ensure whether the following disclosures as required under Schedule III (Part II) to Companies Act, 2013 have been made:

- Whether purchases of stock-in-trade have been specifically disclosed.
- Whether changes in inventories of finished goods, stock–in-trade and work- in-progress have been specifically disclosed
- Whether the transactions with related parties are appropriately disclosed in notes to accounts.

AUDIT OF EMPLOYEE BENEFITS EXPENSES

1. Employee benefits expenses or commonly called as payroll expenses represent the aggregate sum an entity pays as a consideration to its employees for their labour/ efforts along with associated expenses such as perquisites/ benefits, post- employment benefits like gratuity, superannuation, leave encashment, provident fund contribution etc. as well as towards their hiring, their welfare and training.
2. In many industries, employee benefits expense is the biggest expense category and hence it is critical for businesses to manage this expenditure shrewdly and for the auditors to verify and ensure that such expenditure is appropriate and has been accounted as per applicable accounting standards and generally accepted accounting principles.
3. Auditor needs to obtain a clear understanding about the organisation and its hiring, appraisal and retirement process in the following manner:
    a. An auditor tests the controls the entity has set around employee benefit payment process to determine how effective they are.
    b. If they are effective, the auditor can reduce the substantive testing.
    c. Common internal controls over the employee benefit payment cycle includes
        i. Maintaining of attendance records,
        ii. Employee master,
        iii. Authorisation and approval of monthly payroll processing and
        iv. Disbursement,
        v. Computation of employee deductions like payroll taxes,
        vi. Accrual of other benefits like gratuity, leave encashment, bonus etc.
4. The auditor selects a random sample of transactions and examines the related appointment letters, appraisal letters, attendance records, HR policies, employee master etc.
5. Performing substantive audit procedures is must. Substantive analytical procedure will consist of monthly expense reasonability, comparison with previous accounting period, any analysis auditor may find relevant and most important of all setting an expectation in relation to the expense incurred during the period under audit and compare that with the client's business operations and overall trend in the industry.

The below table summarises the audit procedures generally required to be undertaken while auditing employee benefits expenses:

Audit procedures
Recorded employee benefit expenses were actually incurredduring the period **(OCCURRENCE)** Employee benefit expensespertaining to the period have been recorded appropriately **(COMPLETENESS)** Employee benefit expenses havebeen measured appropriately. There in no understatement or overstatement. **(MEASUREMENT)** • Obtain an understanding of entity'sprocess of capturing employeeattendance. There is always a risk thatan entity could record expense for fictitious employees. To address this risk, the auditor may choose to meetthe employees in person, on a sample basis. Further, the auditor may choose to select a sample of employees andask the payroll department to share their bank details/ identity proofs of the employees. • Obtain a list of employees as at the period- end along with a monthly movement split between new hires,leavers and continuing employees. • For a sample (selected randomly) of new hires, obtain the appointment letter and verify whether the salary for first month and subsequent months was processed as per the

agreed terms.

- For a sample (selected randomly) of resigned employees, obtain their full and final computation and verify whether all their dues including post-retirement benefits like gratuity, leaveencashment have been paid and whether the respective employee's acknowledgement on final computation has been obtained.
- Obtain the monthly salary registers for all 12 months. Compile a monthly payroll reasonability by calculating the average salary per employee per month and compare with the previous year and preceding month and analyse the reasons for variance which could be attributable to annual increments, an employee at senior level joining/leaving the entity, bonus pay-out etc.
- Verify if accrual/ provision has been made for all employee benefits and obligations like bonus, gratuity, leave encashment, etc.
- In case provident fund (PF), employee state insurance (ESI) are applicable tothe entity, compile a reasonability by applying the rate to the basic wages and comparing to the amount recorded in books and analyse reasons for variance, if any. Also, obtain monthly deposit challans to verify if the month on month liability was subsequently deposited with the authorities and within the defined timelines.
- Perform analytical procedures to obtain audit evidence as to overall reasonableness of employee benefit expenses which may include production per employee analysis. Auditor should analyse units produced per employee and compare the same with previous years and present industry trends and ask for the reasons from the management, if any significant variations are found.

Required **DISCLOSURES** for employee benefit expenses have been appropriately made

Ensure whether the following disclosures as required under Schedule III (Part II) to Companies Act, 2013 have been made:

a. Employee Benefits Expense [showingseparately

i. salaries and wages,

ii. contribution to provident and otherfunds,

iii. expense on Employee Stock Option Scheme (ESOP) and Employee Stock PurchasePlan (ESPP),

iv. staff welfare expenses].

AUDIT OF DEPRECIATION AND AMORTISATION

1. Depreciation and amortisation generally constitute an entity's significant part of overall expenses and have direct impact on the profit/ loss of the entity, hence auditors need to verify and ensure that such expenditure is appropriate, accurately calculated and has been accounted as per applicable provisions of Companies Actor other statutes, to the extent applicable on the respective industry and as per generally accepted accounting principles.
2. Auditor needs to consider the following attributes while verifying for depreciation and amortisation expenses:
    a. Obtain the understanding of entity's accounting policy related to depreciation and amortisation.
    b. Ensure the Company policy for charging depreciation and amortisation is as per the relevant provisions of Companies Act/ applicable accounting standards.
    c. The accounting policy has been applied consistently year on year. Any change in the accounting policy has been adequately disclosed.
    d. Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.
    e. Whether depreciation and amortisation charges are valid.
    f. Whether depreciation and amortisation charges are accurately calculated and recorded.
    g. Whether all depreciation and amortisation charges are recorded in the appropriate period.
    h. Whether each part of an item of PPE with a cost that is significant in relationto the total cost of the item have been depreciated separately.

    Example: It may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.
3. Whether the most appropriate depreciation method for each separately depreciable component has been used.

The below table summarises the audit procedures generally required to be undertaken while auditing depreciation and amortization expense:

Audit procedures
Depreciation and amortization expenses pertaining to the period have been recorded appropriately and there in no understatement/overstatement **Depreciation and amortisation expenses have been measured appropriately.** **Recorded depreciation and amortisation expenses were actually incurred during the period** • Obtain an understanding of entity's process of charging depreciation and amortization. • Obtain the fixed asset register maintained by the entity. There is always a risk that an entity could capitalize expense of revenue nature to increase its profit or charge capital expenditure directly in income and expense statement to reduce its profit. To address this risk, the auditor may choose to check the nature of asset from fixed asset register and further, there is always a risk that fake asset has been capitalized in the books and to mitigate this risk, auditors should physically verify the fixed assets, at least the ones that are material in value. Obtain a list of all additions/ deletions along with their proper approval from the authorised person for the same. • Select the sample of assets from the Fixed Assets Register, on materiality considerations and verify the rates of depreciation and depreciation calculations.   ▪ Obtain the list of all the components identified by the management.

▪ Ensure Intangible assets like patents, goodwill, copy rights have been properly amortized over the period. ▪ Ensure depreciation is charged on the assets from the date when it is ready to use and not from the date of actual usage. In other words, depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capableof operating in the manner intended bythe management. ▪ Ensure depreciation on revalued amount has been properly accounted from revaluation reserve. • Depreciation computation as per Income tax Act, 1961- Ensure that additions are tallying with the additions as per Companies Act and the opening WDV to the Tax audit schedule for the assessment year preceding the previous year under audit. ▪ Perform analytical procedures to obtain audit evidence as to overall reasonableness of depreciation and amortisation expense - check the arithmetical accuracy of records and perform independent calculations. For example- Re-compute thedepreciation expense for the year. ▪ Ensure that the depreciation and amortization has been charged as per the useful lives of PPE and intangible assets. ▪ Ensure that residual values have been properly verified as that impacts the computation of depreciation. ▪ Ensure that the depreciation and amortization has been computedprospectively whenever there is any change in useful lives of PPE and intangible assets.
Required disclosures for depreciation and amortisationhave been appropriately made Ensure whether the following disclosures asrequired have been made: ▪ Accounting policy for depreciation and amortization. ▪ Useful lives of assets as per Schedule - II to the Companies Act, 2013. ▪ Residual value of assets. ▪ Depreciation method.

AUDIT OF OTHER EXPENSES

1. Other Expenses are Power and Fuel, Rent, Repair to Building, Plant and Machinery, Insurance, Travelling, Legal and Professional, Miscellaneous Expenses.
2. An entity in addition to making purchases and incurring employee benefit expenses, also incurs other expenditures like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to running of business operations.
3. While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes:
    a. Whether the expenditure pertained to current period under audit;
    b. Whether the expenditure qualified as a revenue and not capital expenditure;
    c. Whether the expenditure had a valid supporting documents like travel tickets, insurance policy, third party invoice etc.;
    d. Whether the expenditure has been classified under the correct expense head;
    e. Whether the expenditure was authorised as per the delegation of authority matrix;
    f. Whether the expenditure was in relation to the entity's business and not a personal expenditure.

The below table summarises the audit procedures generally required to be undertaken while auditing other expenses:

Audit procedures
Recorded other expenses were actually incurred during the period Other expenses pertaining to the period have been recorded appropriately andthere in no understatement or overstatement Other expenses have been measured appropriately **Rent expense-** • Obtain a month wise expense schedulealong with the rent agreements. • Verify if expense has been recorded for all 12 months and whether the rent amount is as per the underlying agreement. • Specific consideration should be given to escalation clause in the agreement to verify if the rent was required to be recorded ona straight-line basis during the periodunder audit. • Also, verify if the agreement is in the name of the entity and whether the expense pertains to premises used for running business operations of the entity. **Power and fuel expense -** • Obtain a month wise expense schedule along with the power bills. • Verify if expense has been recorded for all 12 months. • Also, compile a month wise summary of power units consumed and the applicable rate and check the arithmetical accuracy of the bill raised on monthly basis. • In relation to the units consumed, analyse the monthly power units consumed by linking it to units of finished goods produced and investigate reasons for variance in monthly trends.
Insurance expense - • Obtain a summary of insurance policies taken along with their validity period. • Verify whether the expense has been correctly classified between prepaid and expense for the period based on number of days. **Legal and professional expenses -** • Obtain a month-wise and consultant-wise summary. • In case of monthly retainership agreements, verify whether theexpenditure for all 12 months has been recorded correctly. • For non- recurring expenses, select a sample and vouch for the attributes discussed above. • The auditor should be cautious while vouching for legal expenses as the samemay highlight a dispute for which the entity may not have made any provision and the matter may also not have been discussed/ highlighted to the auditor for his specific consideration. **Travel, repair and maintenance, printing and stationery, miscellaneous expenses –** • The auditor should select a sample and vouch for the attributes discussed above. Wherever possible, the auditor should try to prepare a summary of expenditure on monthly basis and then analytically compare the trends. • Perform analytical procedures to obtain audit evidence as to overall reasonableness of

other expense which may include expenditure per unit of production analysis. • Auditor should analyse expense per unit produced and compare the same with previous years and present industry trends and ask for the reasons from the management, if any significant variations are found.
Required DISCLOSURE for other expenses have been appropriately made • Ensure other expense have been classified under: – Rent. – Insurance. – Power and fuel. – Repairs and maintenance- Building, Plant and machinery, others. – Legal and professional. – Printing and stationary. – Travel expenses. – Miscellaneous expenses.

Notes: To be disclosed as Additional Information

1. **Corporate Social Responsibility (CSR):** Where the company covered under section 135 of the companies act, the followingshall be disclosed with regard to CSR activities:
    a. Amount required to be spent by the company during the year,
    b. Amount of expenditure incurred,
    c. Shortfall at the end of the year,
    d. Total of previous years shortfall,
    e. Reason for shortfall,
    f. Nature of CSR activities,
    g. Details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant accounting standard,
    h. Where a provision is made with respect to a liability incurred by entering intoa contractual obligation, the movements in the provision during the yearshould be shown separately.
2. **Details of Crypto Currency or Virtual Currency:** Where the Company has traded or invested in Crypto currency or Virtual Currencyduring the financial year, the following shall be disclosed:-
    a. profit or loss on transactions involving Crypto currency or Virtual Currency
    b. amount of currency held as at the reporting date,
    c. deposits or advances from any person for the purpose of trading or investingin Crypto Currency/ virtual currency.