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## ABOUT THE AUTHOR

### CA KHUSHBOO GIRISH SANGHAVI

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She, being from audit background, brings real life examples to classroom to help students understand intricacies conceptually.

She is the proprietor of Khushboo Girish Sanghavi and Co. & is the Co-founder & Director of "Eduveda Edtech Pvt Ltd." which provides online video lectures using 3D animation to retain and reproduce maximum. Currently, more than 25,000 students have benefited her lectures over YouTube and has more than 60,000 subscribers on the channel.

Being a speaker, she has been part of many regional & national conferences organized by ICAI and author of many other books for the students of CA field. She has also taken many motivational seminars for various institutions, trusts and colleges.

CA Khushboo G Sanghavi

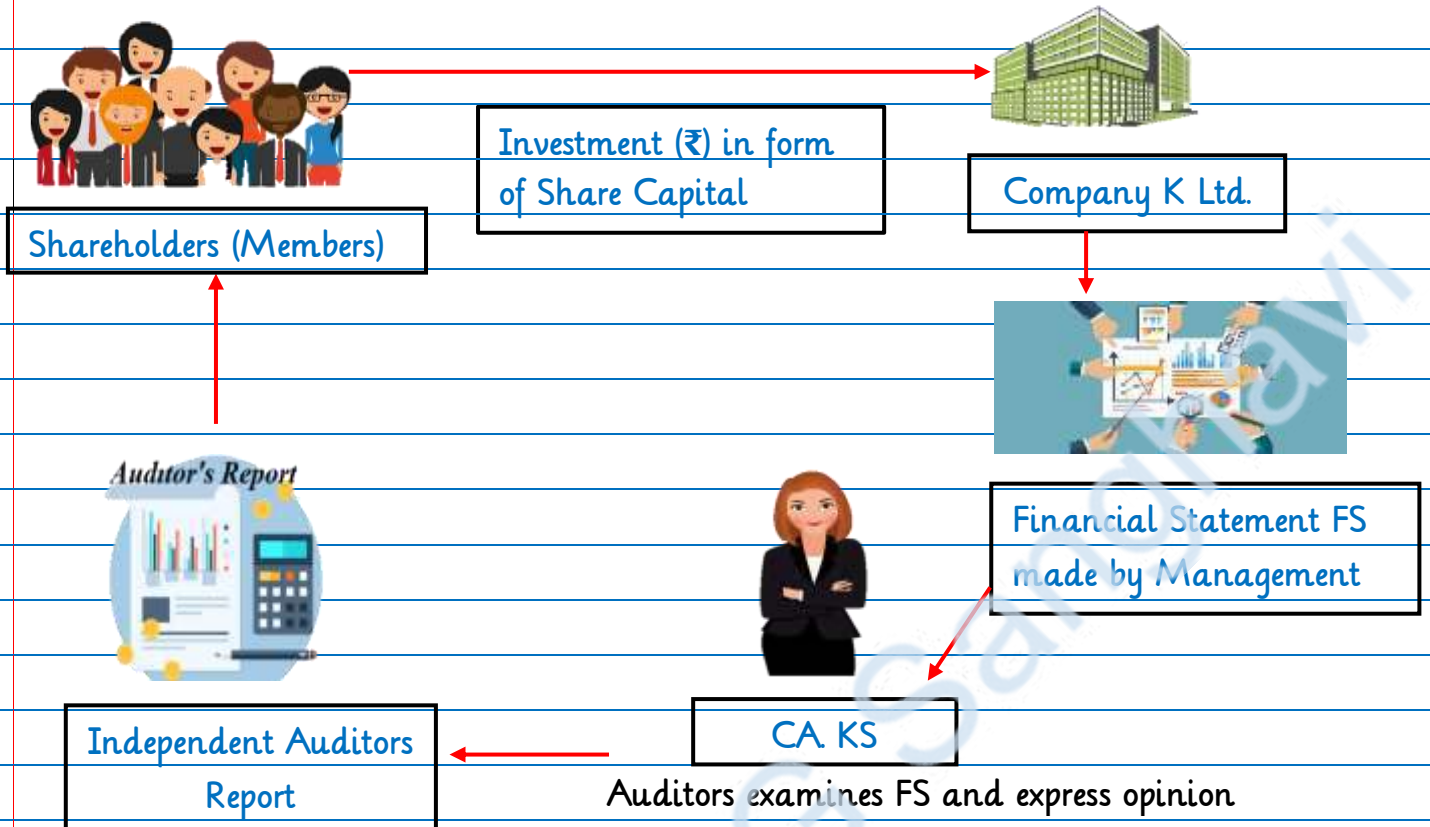
# INDEX

Sn.	Chapters	Page
A1	Introduction	1A.1 – 1A.2
1B.	Nature, Objective and Scope of Audit	1B.1 – 1B.11
2.	Audit Strategy, Audit Planning and Audit Programme	2.1 – 2.6
3.	Risk Assessment & Internal Control	3.1 – 3.21
4.	Audit Evidence	4.1 – 4.21
5.	Audit of Items of Financial Statement	5.1 – 5.42
6.	Audit Documentation	6.1 – 6.4
7.	Completion and Revision	7.1 – 7.14
8.	Audit Report	8.1 – 8.29
9.	Audit of Different Types of Entities	9.1 – 9.32
10.	Audit of Banks	10.1 – 10.19
11.	Ethics and terms of Audit Engagement	11.1 – 11.14



# CHAPTER 1A. INTRODUCTION

## → INTRODUCTION



1) What does auditor do?

Ans. An auditor examines financial statement (FS) of entity with the objective to express opinion that FS are free from Risk of Material Misstatement [RMM].

2) What do we mean by Misstatement?

Ans. Difference between reported FS and that required as per applicable financial reporting Framework (AFRF) i.e. if FS prepared and presented are different then how it had to be prepared and presented; such FS are known as Misstated FS.

3) When will auditor report such Misstatement?

Ans. If Misstatement is **Material** i.e. significant which influences economic decision of intended users.

4) What is included in FS? (PEQ)

Ans. As per Section 2(40) of Companies Act, 2013

FS includes: -

- Balance Sheet as at 31<sup>st</sup> March 20XX (B/F);
- Statement of Profit & Loss for the Y/E 20XX (P/L);
- Cash Flow statement for the Y/E 20XX (C/F);
- Note to accounts and (Disclosures)
- Statements of changes in equity if any.

5) How are FS prepared and by whom?

Ans. FS are prepared by management as per applicable financial reporting Framework (AFRF)  
(Eg: - As per Ind AS & Presentation of FS as per Schedule - III)

6) How does auditor audits the FS?

Ans. Auditor performs all the procedures and conduct audit in accordance with all relevant SA's [Standards on Auditing issued by Auditing and Assurance Standard Board (AASB), ICAI]

7) Who can act as an auditor, his qualification and his term?

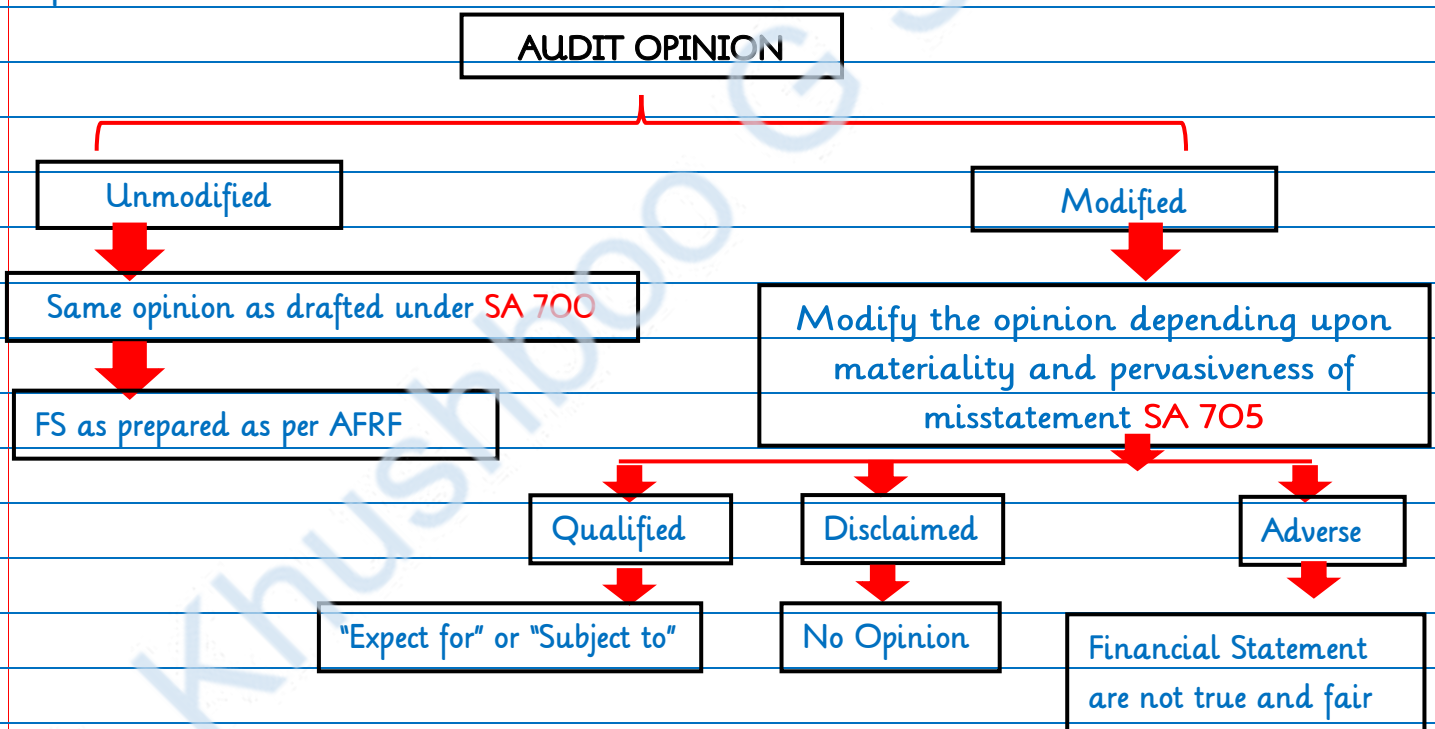
Ans. A practicing CA can be appointed as an Auditor

8) Can Management restrict scope of auditor or contain his duties?

Ans. No, Management cannot force or restrict the scope of auditor; If manager does so then Auditor can withdraw from the engagement or can express modified opinion (a kind of negative remark in the auditor's report).

9) What do we understand by modified audit opinion? (Types of audit report)

Ans. Auditor express his opinion on the basis of sufficient and appropriate audit evidence (SAAE) obtained by him during the course of audit. Hence, depending on evidence auditor can express.



Note: - This will be discussed in detail under chapter - "Audit Report"

10) Is Opinion Expressed by an auditor is 100% correct and absolute?

Ans. Owing to inherent limitations to audit can never express absolute assurance rather can only express REASONABLE assurance i.e. high level of surety but not 100% such limitation are discussed in detail under chapter "Nature, Objective & Scope of Audit".

## CHAPTER 1B. NATURE, OBJECTIVE & SCOPE OF AUDIT

→

WHAT TO STUDY?

- I) Meaning of Assurance Engagement & Engagement and Quality control standards
- II) Meaning of Independent of auditor
- III) What is an engagement? – External audit engagement
- IV) Types of audits
- V) Benefits of audit – Why audit is needed?
- VI) Who appoints of auditor? & Qualities of auditor
- VII) Interdisciplinary nature of auditing
- VIII) Objective
- IX) Scope of Audit
- X) Inherent Limitations of audit
- XI) To whom report is submitted by an auditor

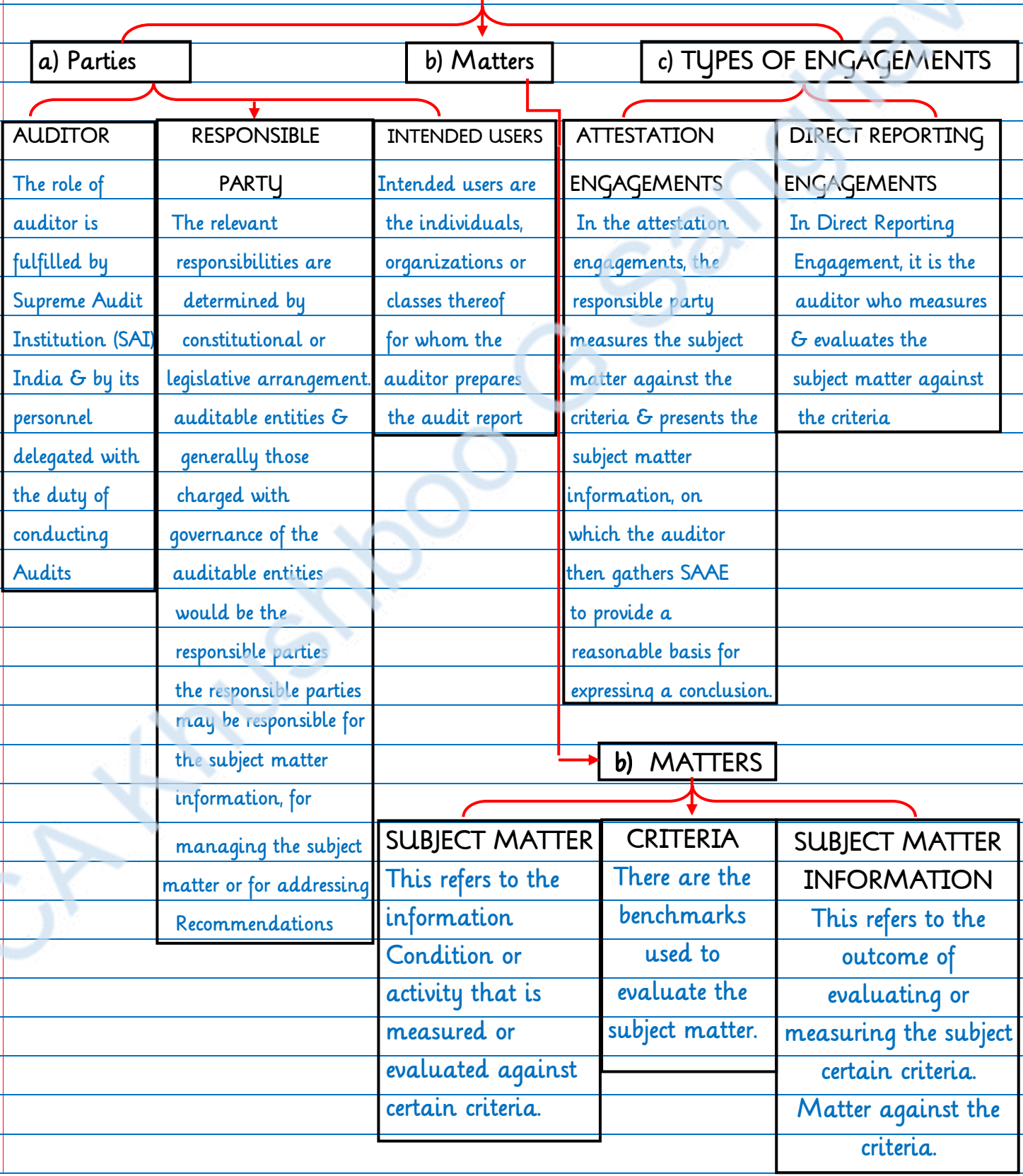




I] MEANING OF ASSURANCE ENGAGEMENT & ENGAGEMENT AND QUALITY CONTROL STANDARDS

"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.

1) BASIC ELEMENT



2) Meaning of Review; Audit Vs. Review

- a) Audit is a reasonable assurance engagement – High but not 100% assurance
- b) Review is a limited assurance engagement – Lower level of assurance

3) Types of Assurance Engagements- Reasonable assurance engagement vs. Limited assurance engagement

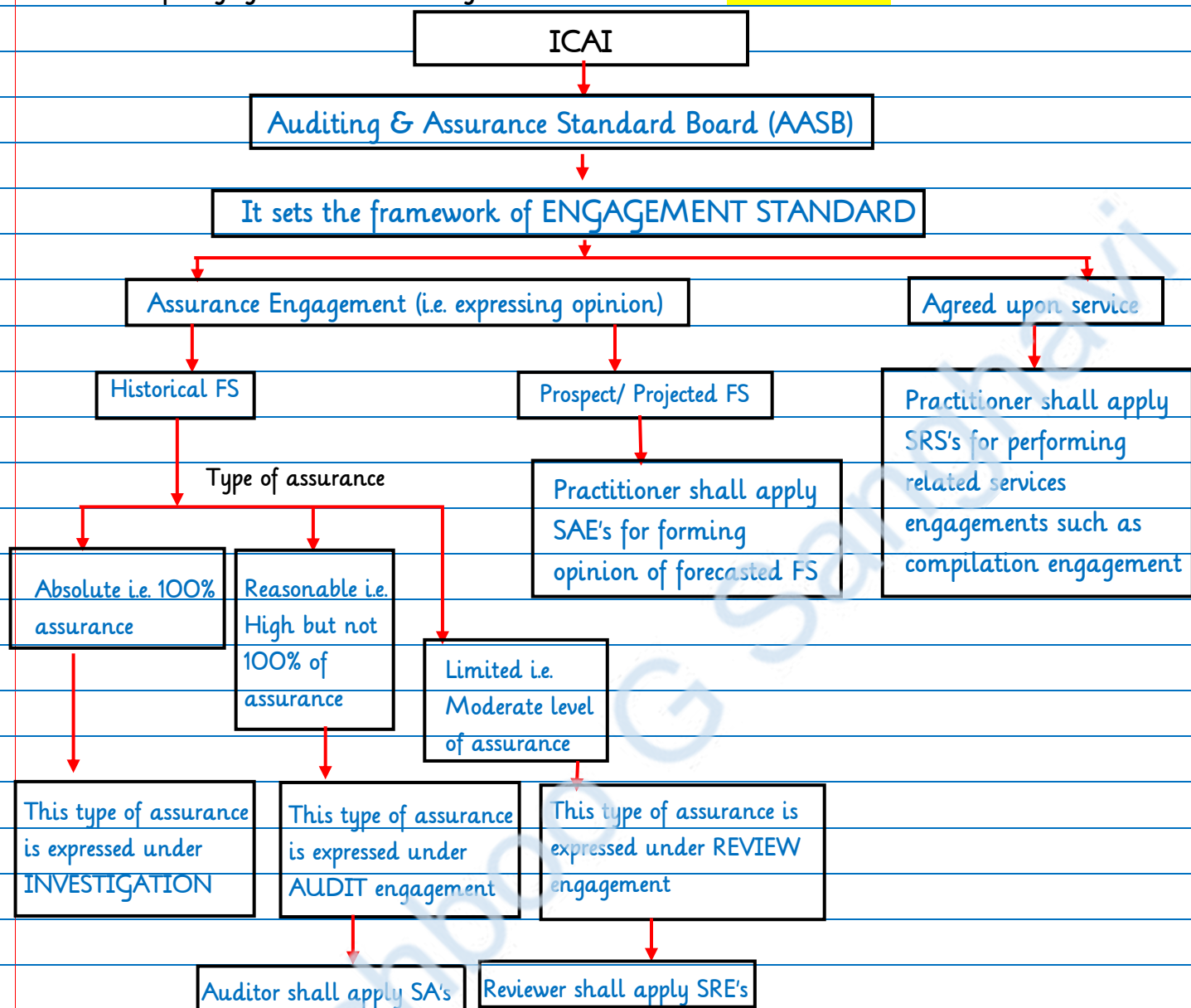
	Reasonable assurance engagement	Limited assurance engagement
a)	Reasonable assurance engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
b)	It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement
c)	It draws reasonable conclusions on the basis of sufficient appropriate evidence	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
d)	Example of reasonable assurance engagement is an audit engagement.	Example of limited assurance engagement is review engagement.

4) Why are Standards needed?

- a) Standards ensure carrying out of audit against established benchmarks at par with global practices.
- b) Standards improve quality of financial reporting thereby helping users to make diligent decisions.
- c) Standards promote uniformity as audit of financial statements is carried out following these Standards.
- d) Standards equip professional accountants with professional knowledge and skill.
- e) Standards ensure audit quality.

Students Note

5) Overview of Engagement & Quality Control Standard (PEQ Nov'22)



SRE → Standard on Review Engagement (SRE 2000-2699)

Examples:

- 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

SAE → Standard on Assurance Engagement (SAE 3000-3699)

Examples:

- 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

SRS → Standards on Related Services (SRS 4000-4699)

Examples:

- a) SRS 4400 Engagements to perform agreed-upon procedures regarding financial

information

b) SRS 4410 (Revised) Compilation engagements

SQC → Standards on Quality Control (SQC - 1)

Standard on Auditing (SA 100-999) aspects covered in series:

Introductory Matters SA 100-199

General Principles and Responsibilities SA 200-299

Risk Assessment and Response to Assessed Risk SA 300-499

Audit Evidence SA 500- 599

Using Work of others SA 600-699

Audit Conclusions and Reporting SA 700-799

Specialised Areas SA 800-899

## II] MEANING OF INDEPENDENT OF AUDITOR

"An audit is an **INDEPENDENT EXAMINATION** of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon".

In order to be assured that FS are not misleading, we must ensure that: -

- 1) FS are as per BOA
- 2) BOA are supported by SAAE
- 3) No Entries are omitted
- 4) Information stated in FS are clear
- 5) FS are properly classified, described and disclosed. As per Applicable Financial Reporting Framework (AFRF)
- 6) FS presents true & fair picture of affairs of operation of business

Note:

- a) No Business or Institution can effectively carry on its activities without the help of proper **Records & Accounts**.
- b) 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.

## III] WHAT IS AN ENGAGEMENT? – EXTERNAL AUDIT ENGAGEMENT

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.

**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

#### IV] TYPES OF AUDITS

Audit is not legally obligatory for all types of business organisations or institutions. On this basis audits may be of two broad categories i.e., audits required under law and voluntary audits.

- 1) **Audit required under law:** The organisations which require audit under law are the following:  
E.g companies governed by the Companies Act; banking companies; other statutory bodies required by their regulators or by specific Act.
- 2) In the voluntary category are the audits of the accounts of proprietary entities, partnership firms, Hindu undivided families, etc. In respect of such accounts, there is no basic legal requirement of audit. Many of such enterprises as a matter of internal rules require audit. Some may be required to get their accounts audited on the directives of Government for various purposes like sanction of grants, loans, etc. But the important motive for getting accounts audited lies in the advantages that follow from an independent professional audit. This is perhaps the reason why large numbers of proprietary and partnership business firms get their accounts audited. Government companies have some special features which will be discussed later.

#### V] ADVANTAGES/BENEFITS OF AUDIT OF FS [Case Study Expected]

- 1) It safeguards the financial interest of stakeholders  
Eg. Partners, Members, Bank, Government, FI's etc.
- 2) It act as moral check on employees.
- 3) Helpful in setting liability for taxes
- 4) Useful in settling trade dispute
- 5) Help in the detection of wastage of losses
- 6) Government may require audit & certified statement.

#### VI] WHO APPOINTS OF AUDITOR? & QUALITIES OF AUDITOR

- 1) Who appoints the auditor?



a) Generally, an auditor is appointed by owners or in some cases by constitutional or government authorities in accordance with applicable laws and regulations.  
e.g i) in case of companies, auditor is appointed by members (shareholders) in Annual General Meeting (AGM).

ii) Shareholders are owners of a company and auditor is appointed by them in AGM.

b) An auditor is appointed by Comptroller and Auditor General of India (CAG), in case of government companies

## 2) Qualities of Auditor

a) Tact

d) Caution

g) Clear Headedness

b) Integrity

e) Discretion

h) Firmness

c) Patience

f) Reliability

i) Good Temper

According to Justice Lindley, "an auditor must be honest i.e. he must not certify what he does not believe to be true as must take reasonable care as skill before he believes that what he certifies is true "

## 3) Requirement to have Professional Skepticism: -

Being alert

Possessing questioning mind

Critical assessment of evidence obtained

Examples:

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 may indicate possible fraud

d) Circumstances that suggest the need for audit procedures in addition to those required by the SAs.

e) Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:

- Overlooking unusual circumstances
- Over generalising when drawing conclusions from audit observations
- Using inappropriate assumptions in determining the nature, timing and extent of the audit procedures and evaluating the result thereof.

## 4) Professional Judgement: - Auditor must exercise his judgement (experience) in situation and while taking decision regarding (Key - MANS - C - Judgement)

a) Materiality

b) Audit Risk

c) Nature, timing & extent of audit procedures

d) Sufficiency & appropriation of evidence

- e) **Conclusion:** The drawing of **conclusions** based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.
- f) **Judgement:** The evaluation of **management's judgments** in applying the entity's applicable financial reporting framework.

## VII] INTERDISCIPLINARY NATURE OF AUDITING

- 1) Auditing is interdisciplinary in nature.
- 2) It draws from diverse subjects including accountancy, law, behavioural science, statistics, economics and financial management and makes use of these subjects.
- 3) 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.
- 4) Knowledge of subject like economics helps auditor to be familiar with overall economic environment in which specific business is operating.
  - a) **Auditing & Accounting:** Auditing reviews the financial statements which are nothing but a result of the overall accounting process.
  - b) **Auditing & Law:** An auditor should have a good knowledge of business laws affecting the entity.
  - c) **Auditing & Economic:** Auditor is expected to be familiar with the overall economic environment of the client.
  - d) **Auditing & Behavioural Science:** Knowledge of human behaviour is essential for an auditor to effectively discharge his duties.
  - e) **Auditing and Statistics & Mathematics:** Auditor is also expected to have the knowledge of Statistical sampling for meaningful conclusions & mathematics for verification of Inventories.
  - f) **Auditing & Data Processing:** EDP auditing in itself is developing as a discipline in itself.
  - g) **Auditing & Financial Management:** The auditor is expected to have knowledge about various financial techniques such as working capital management, funds, flow, ration analysis, capital budgeting etc.
  - h) **Auditing & Production:** Good auditor is one who understands the client & his business functions such as production, cost system, marketing etc.

## VIII] OBJECTIVE

As per SA 200 Overall objective of an independent auditor and conduct of audit in accordance with SA: -

## OBJECTIVE

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.

### An Overview of Objectives of Audit

Checkbox	Objectives of audit
✓	Obtaining a reasonable assurance that financial statements as a whole are free from material misstatement due to fraud or error
✓	Gaining a reasonable assurance leads to formation of opinion whether financial statements are prepared, in all material respects, in accordance with applicable financial reporting framework
✓	To report on the financial statements
✓	Reporting of opinion in accordance with audit findings

## IX] SCOPE OF AUDIT

- 1) Scope refers to range or reach of something.
- 2) 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
  - a) Audit should be **cover all aspects** of entity. (Explained in below)
  - b) Auditor should be satisfied that information and **records are reliable**
  - c) Auditor should assess **reliability** of information & source of data by
 

Evaluating accounting & Internal Control System
AND
By carrying out other verification procedures
  - c) Auditor should decide that financial information are **disclosed properly**
  - d) Auditor should verify disclosures by:
 

Comparing FS with records
AND
Considering Judgments made by management
  - e) Auditor should perform duties with competence
  - f) If scope of audit is restricted or constrained, auditor should express qualified or disclaimed opinion (will be discussed in chapter Audit Report)

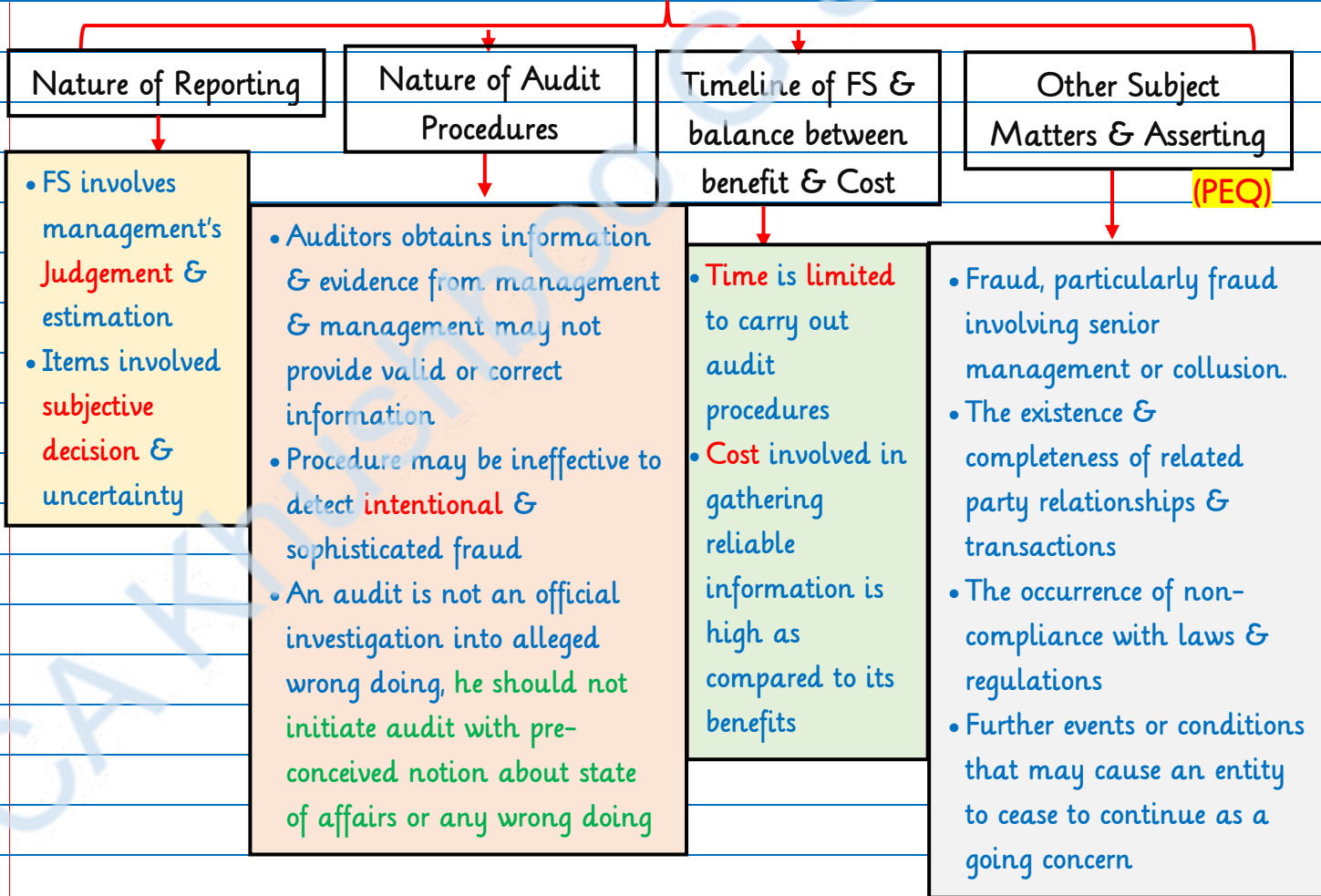
3) Aspects to be covered in Audit (PEQ)

- a) Examination of system of accounting & internal control
- b) Verification of authenticity & validity of transaction
- c) Comparison of items of FS with records
- d) Verification of title, existence & value of assets & liabilities
- e) Checking the results of P/L
- f) Reporting

X] INHERENT LIMITATIONS OF AUDIT

SA 200 "Overall objectives of an: Independent auditor and conduct of audit in accordance with SA.

Inherent Limitation of Audit: - The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are Inherent Limitation of an audit. The inherent limitation of an audit arises from:



**Note:** - 1) In any case these are not excuse for omitting any audit procedures based on the above limitations

2) Evidence obtained by an auditor are persuasive and **NOT CONCLUSIVE.**

3) Owing to above inherent limitative auditor express **REASONABLE ASSURANCE.**

XI] TO WHOM REPORT IS SUBMITTED BY AN AUDITOR?

- 1) The outcome of an audit is written audit report in which auditor expresses an opinion.
- 2) The report is submitted to person making the appointment
- 3) In case of companies, these are shareholders- in case of a firm, to partners who have engaged him.

Students Note



## CHAPTER 2. AUDIT STRATEGY, AUDIT PLANNING & AUDIT PROGRAMME

### → WHAT TO STUDY?

- I] Auditor's Responsibility to Plan an Audit of Financial Statements
- II] Planning Process – Elements of planning
- III] Relationship Between Audit Strategy & Plan
- IV] Overall Audit Strategy & Audit Plan
- V] Changes to planning decisions during the course of audit
- VI] Planning supervision and review of work of engagement team members
- VII] Documentation
- VIII] Audit Programme



(1) Develop Overall Strategy

(2) Develop Detailed Plan based on Strategy

(3) Program

Interlinked concept change in one will lead to consequential change in other

### I] AUDITOR'S RESPONSIBILITY TO PLAN AN AUDIT OF FINANCIAL STATEMENTS

**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.

#### Why Planning an audit is necessary? - Its Benefits

planning benefits the audit of financial statements in several ways, including the following: -

- a) Helping the auditor to devote appropriate attention to important areas of the audit
- b) Helping the auditor identify and resolve potential problems on a timely basis.
- c) Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
- d) Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
- e) Facilitating the direction and supervision of engagement team members and the review of their work.
- f) Assisting, where applicable, in coordination of work done by others such as experts

## II] PLANNING PROCESS – ELEMENTS OF PLANNING

The elements of planning can be categorized as under: -

- a) Preliminary engagement activities
- b) Planning activities

## III] RELATIONSHIP BETWEEN AUDIT STRATEGY & PLAN (PEQ)

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. 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 other.

## IV] OVERALL AUDIT STRATEGY AND AUDIT PLAN

### → Overall Audit Strategy (PEQ)

It sets scope, timing and direction of audit and guides the development of more detail Audit plan

Auditor may establish audit strategy and determine matters such as,

- a) Resources to be deployed
- b) High risk area or involvement of expert for complex matter
- c) Amount of resources to be deployed
- d) When this resource is to be deployed
- e) How such resources are managed, directed and supervised. (When briefing, debriefing meeting is held)
- f) How engagement partner reviews are expected to take place establishment of over all
- g) audit strategy

The Audit shall,

- i.) Identify the characteristics of the engagement and define scope
- ii.) Ascertain objective of engagement
- iii.) Consider the factors that are significant in directing engagement team by exercising professional judgement
- iv.) Consider results of preliminary engagement activity (i.e. results of SA- 315)
- v.) Ascertain N.T.E. of resource necessary to perform engagement

**NTE = Nature, Timing & Extent**

→ Audit Plan

A) Audit plan to conduct Effective Audit

Auditor should plan his work to enable him to conduct effective audit in an efficient any timely manner

1. Acquiring knowledge about client business, accounting system, I.C.,
2. Establishing degree of reliance to be placed on I.C. System
3. Determining N.T.E of audit procedure
4. Co-ordinating the work to be performed.

IC = Internal Control

B) Benefits of Audit Plan [Key – CA - DSPT]

1. Co-ordination of work done by auditor
2. Appropriate Attention to important areas
3. Direct supervise review engagement team member
4. Selection of engagement team
5. Proper organisation and management of engagement team
6. Timely completion of audit

C) Audit Plan, A Continuous Process (PEQ)

Audit plan is not a discrete phase but it is a continuous process and iterative process because 1. It often begins shortly after the completion of previous audit and

2. Continuous until the completion of current engagement

Under following circumstances auditor may revise audit plan [Change to planning decisions]

- |                                    |   |
|------------------------------------|---|
| 1. Inability to obtain SAAE        | 2. Suspicion of fraud                         |
| 3. Inability to perform procedures | 4. Involvement of expert                      |
| 5. Changes in AFRF                 | 6. Changes in determined level of materiality |

D) Development of Audit Plan

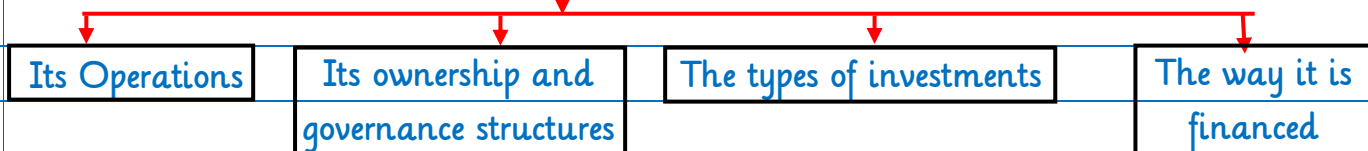
Auditor develops audit plan that shall include description of,

- i. N.T.E of risk assessment procedures as given under, SA - 315
- ii. N.T.E of further audit procedure as given under SA - 330.
- iii. Other audit procedures that are required to be planned and perform as per relevant SAS.

E) Auditor shall gain the knowledge of client's business (As per SA- 315)

- a) Relevant industry, regulatory and other external factors including the applicable financial reporting framework

b) The nature of the entity, including



c) Objectives, Strategies and related Business Risk

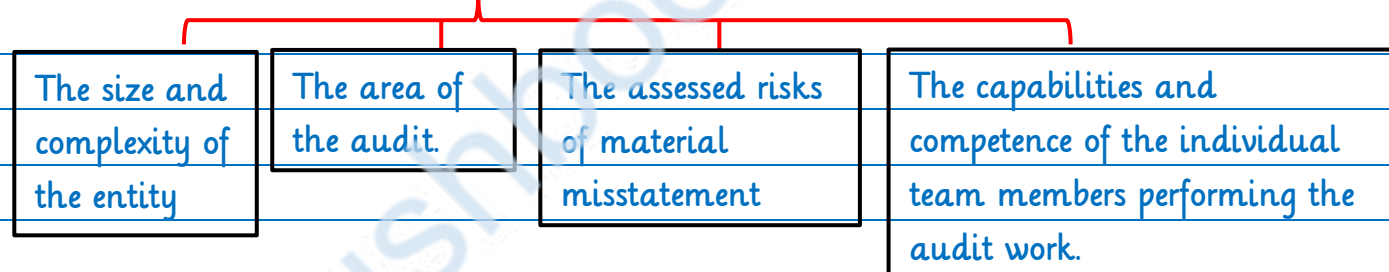
d) Entity's selection and application of accounting policies and reasons for changes thereto

## V] CHANGES TO PLANNING DECISIONS DURING THE COURSE OF AUDIT

- i) The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit
- ii) The auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks.
- iii) This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures.

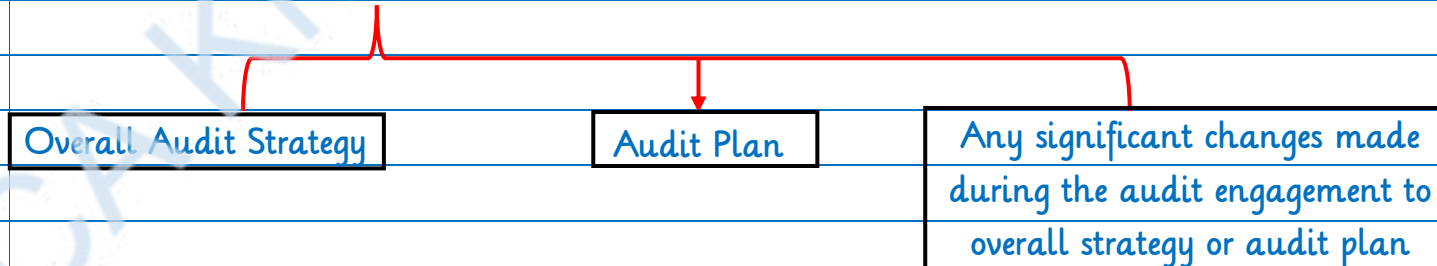
## VI] PLANNING SUPERVISION AND REVIEW OF WORK OF ENGAGEMENT TEAM MEMBERS

Direction, supervision and review



## VII] DOCUMENTATION

Documentation of Audit Plan



Example: - i) The following things should form part of auditor's documentation: (PEQ)

- ii) A summary of discussion with the entity's key decision makers.
  - iii) Documentation of audit committee pre-approval of services, where required
- Audit documentation access letters

- iv) Other communications or agreements with management or those charges with governance regarding the scope, or charges in scope, of our services
- v) Auditor's report on the entity's financial statements
- vi) Other reports as specified in the engagement agreement (e.g. debt covenant compliance letter)

## VIII] AUDIT PROGRAMME

### A) Meaning:

An audit programme consists of series of **procedures** to be applied to FS. B.OA of a given company for the purpose of **obtaining SAAE** and to **express opinion** on Financial Statement.

Note: -

- 1) Single audit programme **does not** practically apply to all the business (RTP / May 21)
- 2) Assistant engaged should be encourage to keep an **open mind**
- 3) Auditor must **periodically review** the audit programme
- 4) Constructing & implementer an Audit Programme (PEQ)
  - a) Stay within the scope and limitation of an assignment
  - b) **Prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.**
  - c) Determine the evidence reasonable available and identify best evidence
  - d) Apply only useful steps
  - 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.**
    - a) Consider all the possibility of error
    - b) Co-ordinate the procedure

### B) Benefits of Audit Programme

- It provides total and **clear set of instruction**
- It provides **perspective** of work
- Without predetermined programme auditor **may face danger** of ignoring or overlooking
- Principal can **control progress** of various audits
- It **serves as a guide** for audit assistant
- It serves as evidence when auditor is charged with negligence



### C) Disadvantages of Audit Programme

- Work may become mechanical as engagement team may carry out procedures without understanding
- Programme may become rigid & inflexible (Operation of entity is changed but Programme is still same)
- Inefficient assistants may take shelter behind the programme
- A hard & fast audit programme may kill the initiative of efficient assistants

Note: - Above mentioned disadvantages may be eliminated by: - Imaginative supervision of work

- Encouraging assistants to observe matters objectively (Keep open Mind) → 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. Similarly, if any work originally provided for proves beyond doubt to be unnecessary or irrelevant, it may be dropped. 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.
- Assistants should bring significant matters to the notice of principal

### IV] Quality control for audit work- delegation and supervision of Audit work (SA 220)

The audit complies with Professional Standards and regulatory and legal requirement; and

The auditor's report issued is appropriate in the circumstances.

Space for Student Notes: -

→ What to Study?

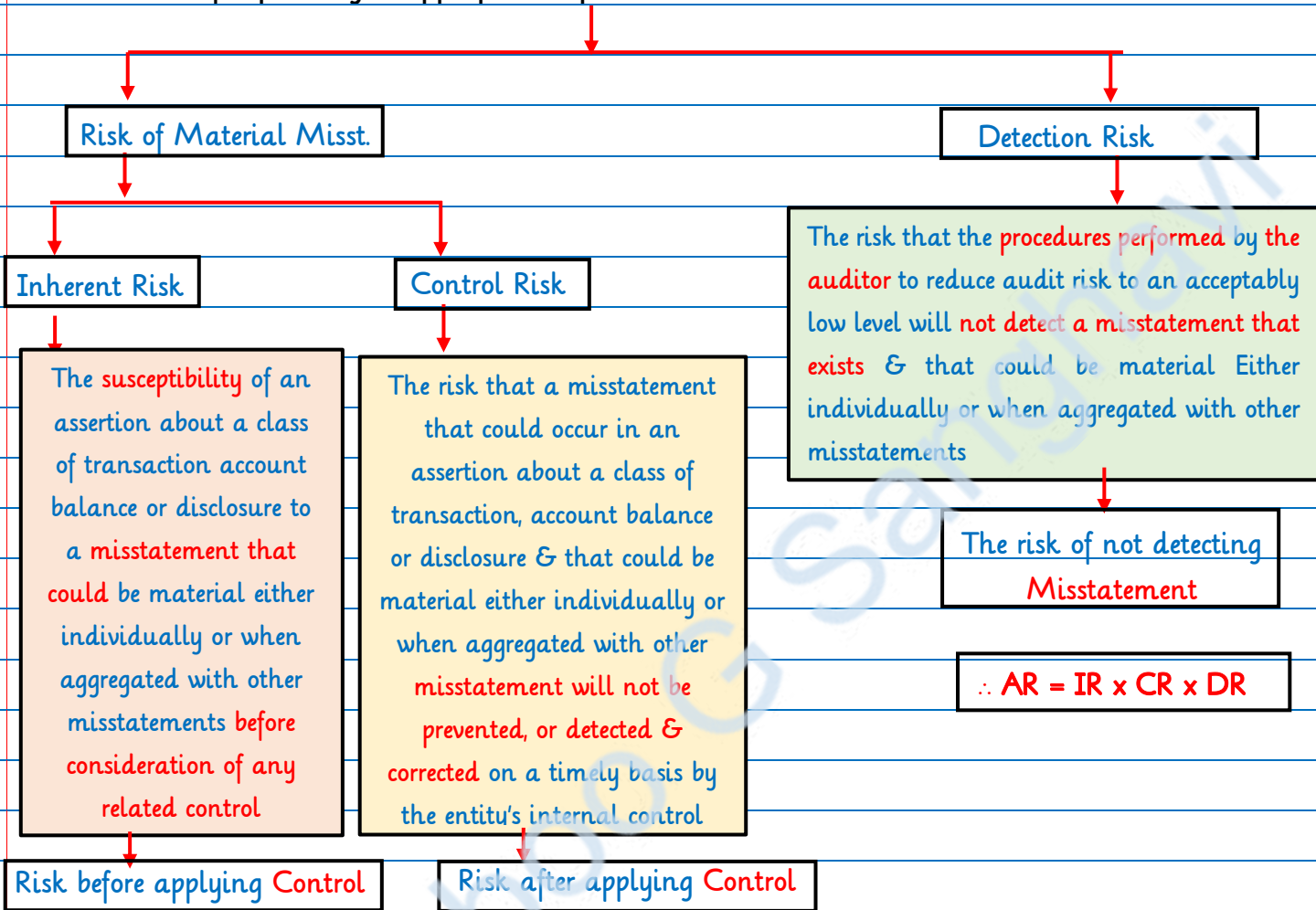
- I] Audit Risk
- II] Concept of Materiality
- III] Internal Control
- IV] Evaluation of Internal Control System
- V] Testing of Internal Control
- VI] What is of an Automated Environment?
- VII] Audit Approach in an Automated Environment
- VIII] Data Analytics for audit
- IX] Internal Financial Control as per Regulatory requirement
- X] Documentation the Risk
- XI] Assess and Report Audit Findings

Internal Controls

**Risk Assessment**

# 1] AUDIT RISK

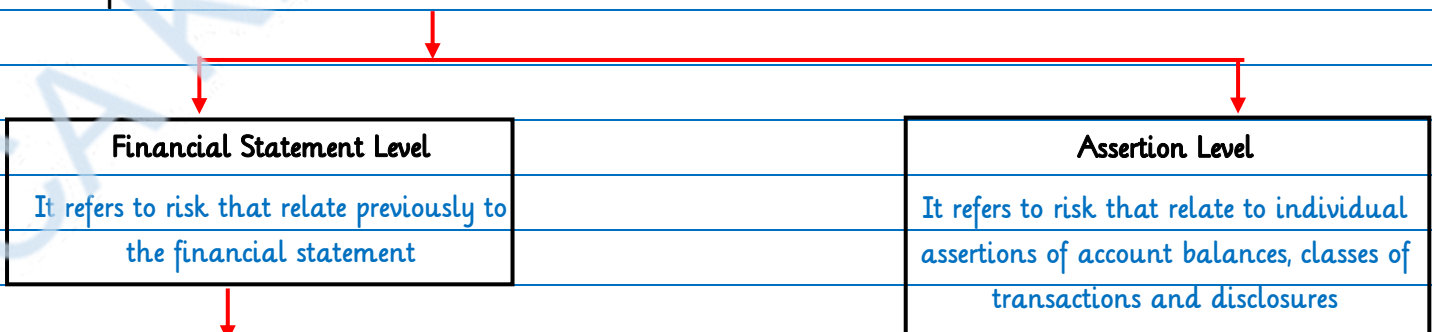
1) It is the risk of expressing inappropriate opinion



Note: - 1) Auditor Assess RMM & manage detection risk in order to reduce audit risk acceptable lower level and thereby expressing reasonable assurance

2) SA's do not ordinarily refer inherent risk & control risk separately, but rather to a combined assessment of "Risk of Material Misstatement" (RMM)

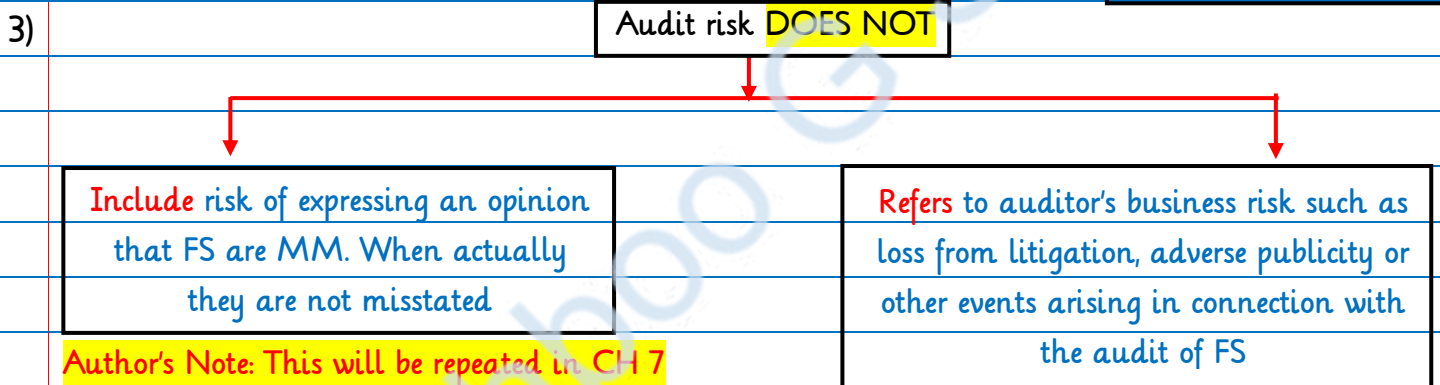
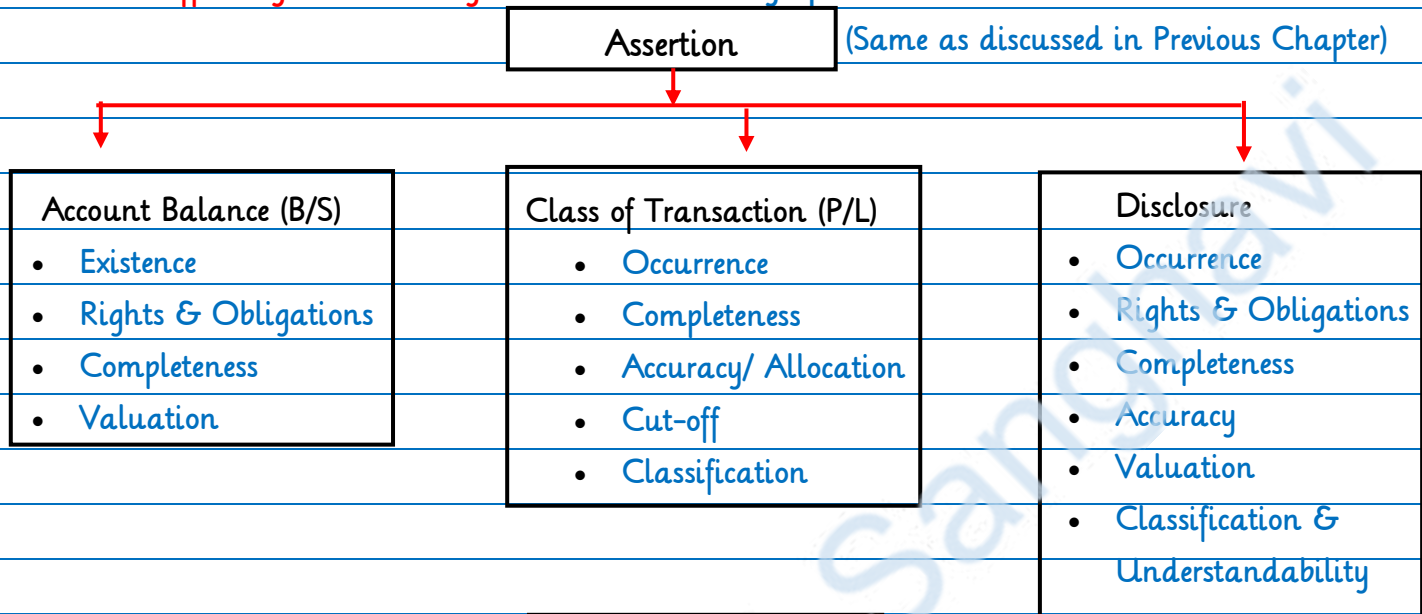
2) Risk of Material Misstatement



→ Following factors will be considered for determination of audit risk at Financial statement level

a) Integrity of Management

- b) Unusual pressure on management
- c) Nature of entity's business
- d) Management experience, knowledge & changes during the period
- e) Factors affecting the industry in which the entity operates



4) When auditor assess control risk, he must consider:

- The control environment which influences over internal control & effectiveness of controls over significant class of transaction (SCOTS)
- IT – dependent manual controls and related IT processes that supports application
- Auditor's own testing approach over SCOTS
- Expectation of the operating effectiveness of controls

5) SA-315: Identify & Assessing RMM Through Understanding Entity and Its Environment

- a) Objective of Auditor as per SA 315: - To identify & assess RMM due to fraud or error at FS level or at assertion level through understanding entity and its environment for the above purpose auditor shall: - (PEQ July 21)
- Identify risk throughout the process of obtaining an understanding the entity & its environment.
  - Assess the identified Risk & evaluate the pervasiveness

- Relate the identified risk to "What can go Wrong" at assertion level
- Consider the likelihood of misstatement (i.e. magnitude of potential misstatement)

b) Risk Assessment Procedures (RAP)

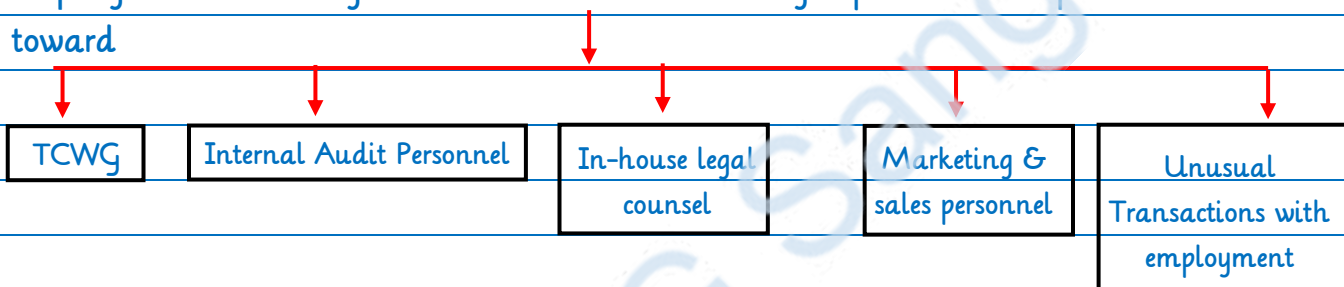
- RAP is a basis for identification & assessment of RMM at FS level & assertion level
- Auditor uses the information obtained via RAP as audit evidence

c) Risk Assessment Procedures

Includes: -

- **I - Inquiries** of Management & others (PEQ)

Inquiry is a method by which auditor obtains many information Inquiries directed toward



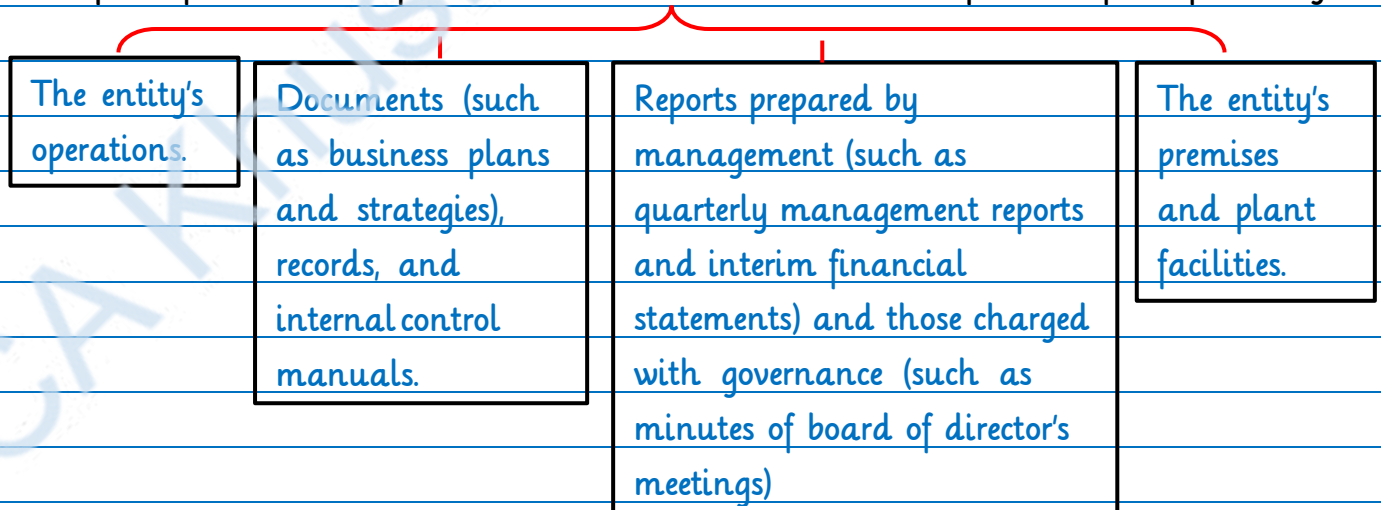
- **A - Analytical Procedures**

It may help identifying the existence of unusual transaction or events

- **O - Observation** and **I - 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:



- **Re - Related Activities**

Related activities such as: -

- Considering correctness of information obtained



- b. If the auditor uses the information obtained from previous years auditor or his own past experience, he shall determine whether changes have occurred since previous audit that may affect its relevance to current audit
- c. Discussing the susceptibility of material misstatements
- d. Engagement partner should share their insights based on their knowledge of the entity.

d) Understanding Entity is a continuous process?

Yes! because auditor exercises professional judgement throughout the audit for establishing a frame of reference

E.g.: - 1. For assessing RMM

2. For determining Materiality

3. For considering appropriateness of accounting policies

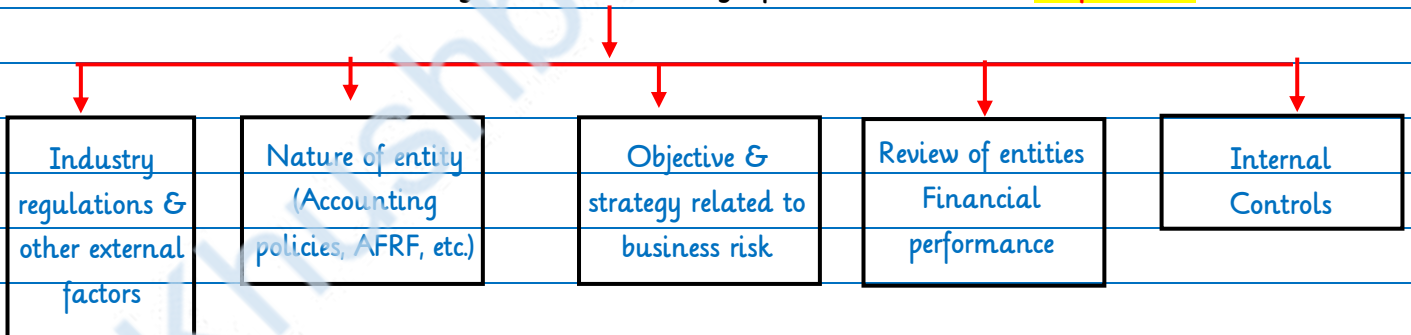
4. For identifying special areas

5. For developing expectations for use of analytical procedures

6. For evaluating SAAE

Q. The auditor of ABC Textiles Ltd. chalks out an audit plan without understanding the entity's business. Since he has carried out many audits of textile companies, there is no need to understand the nature of business of ABC Ltd. Advise the auditor how he should proceed

e) Auditor shall obtain knowledge/ understanding of client's business (Important)



## II] CONCEPT OF MATERIALITY

There is an **inverse** relationship between **Materiality and the degree of audit risk**. Higher the materiality level the lower the audit risk and vice-versa. After the auditor has assessed the inherent and control risks, he should consider the level of detection risk that he is prepared to accept and based upon his judgment, select appropriate substantive audit procedures. If the auditor does not perform any substantive procedures, detection risk, that is, the risk that the auditor will fail to detect a misstatement, will be high.

The auditor's assessment of audit risk may change during the course of an audit according

to the need and development of the circumstances.

III] INTERNAL CONTROL (IC) (PEQ Nov22)

a) Definition: - It is a process designed implemented & maintained (DIM) by TCWG to provide reasonable assurance about the achievement of an entity's objective with respect to: - (Key - RESA)

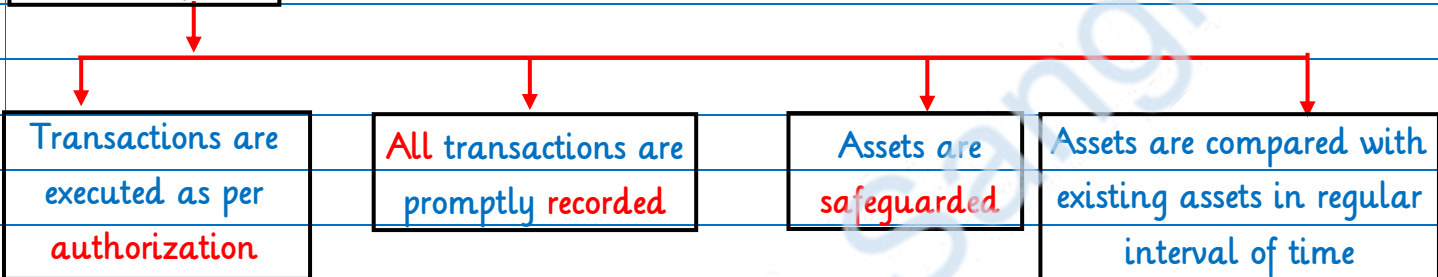
R - Reliability of FS

E - Effectiveness & Efficiency of operation

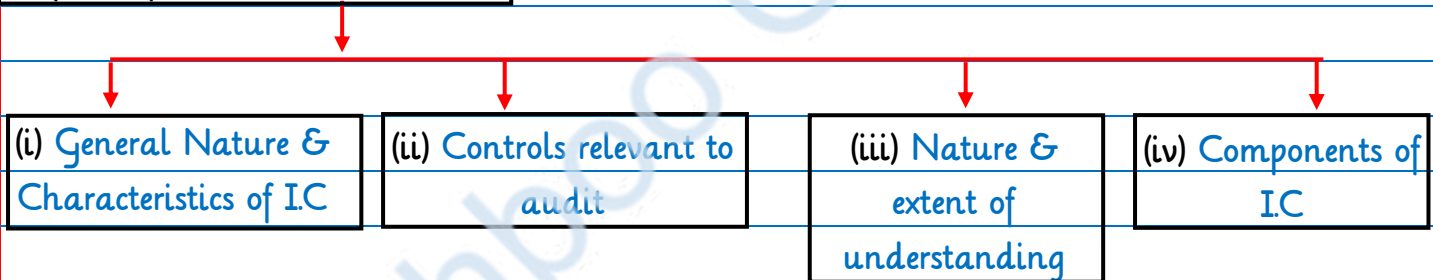
S - Safeguarding of assets

A - Compliance with Application Laws & regulation

b) Objective of IC

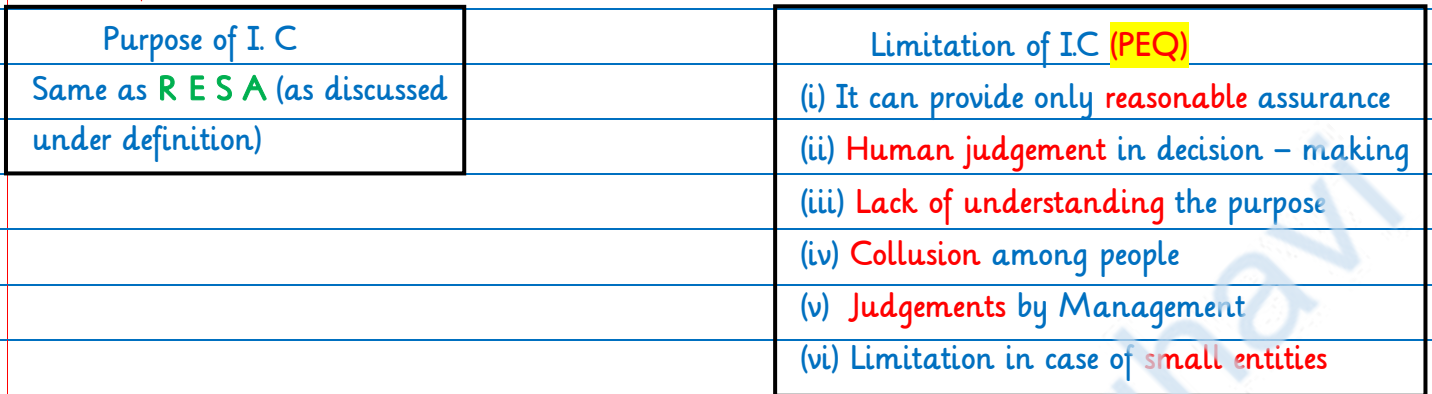


c) Aspects of Internal Controls (IC)



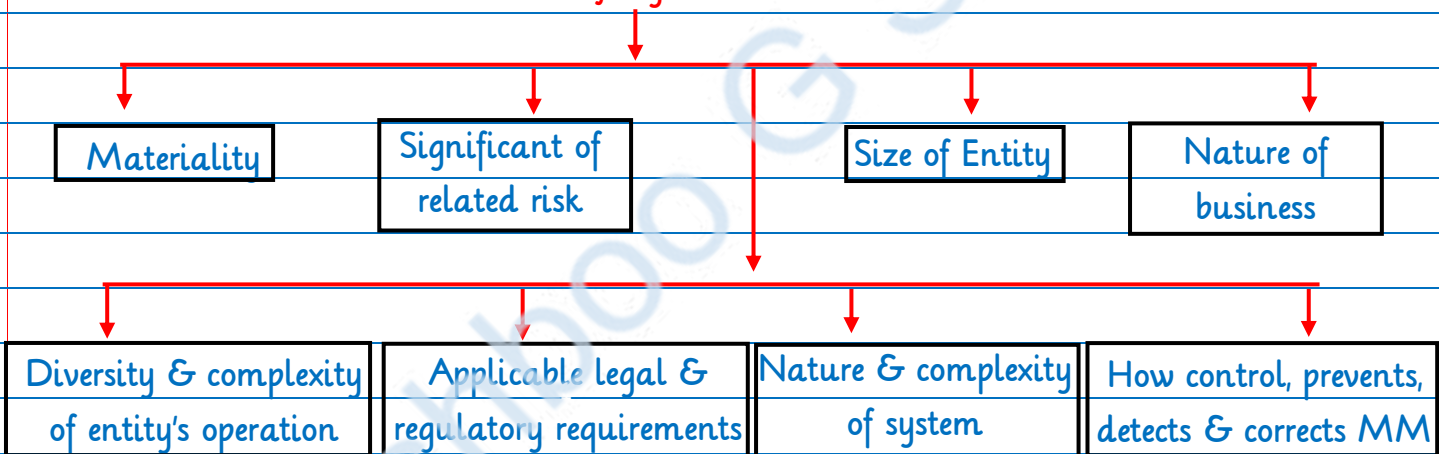
Students Note:

(i) General Nature & Characteristic of I.C

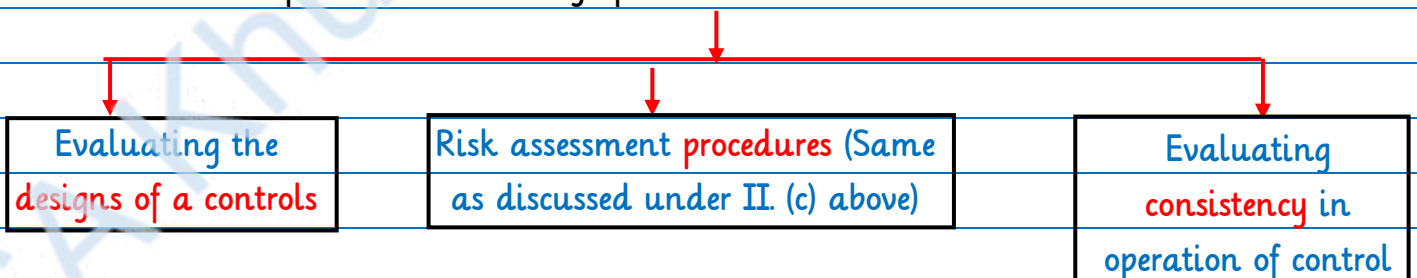


(ii) Controls relevant to Audit

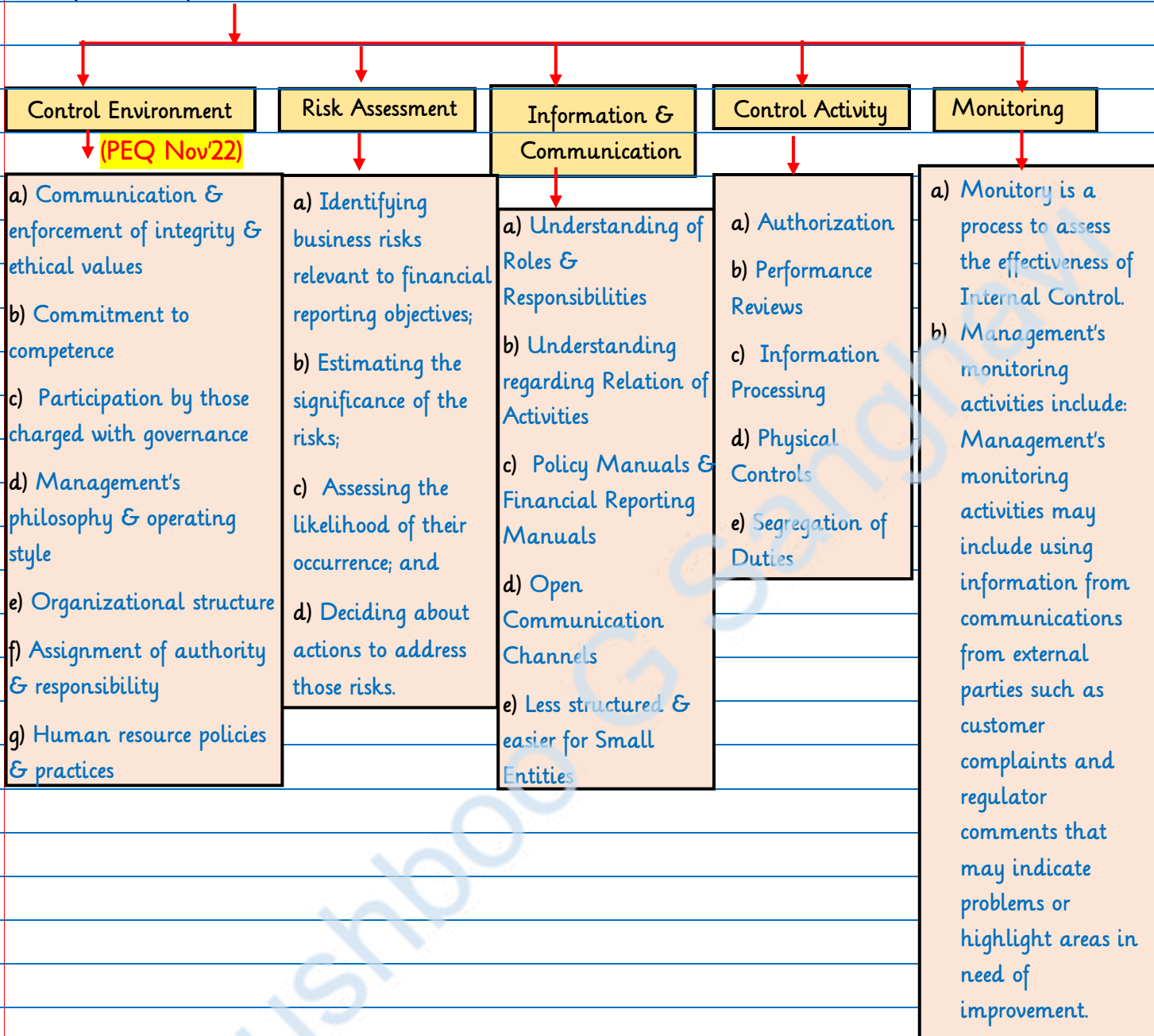
- There is **DIRECT RELATIONSHIP** between an entity's objectives & the control implemented
- Factors relevant to the auditor's judgement about **CONTROL**



(iii) Nature & Extent of the understanding of Relevant Controls:



(iv) Components of I.C



Note: - A) Auditor should consider following as to determine which risk are significant

OR

Risk that require special audit consideration

- a. Risk of fraud
- b. Complexity of transactions
- c. Risk of unusual transactions with related person
- d. Degree of subjectivity in the measurement of financial statements
- e. Risk due to involvement of uncertainty
- f. Risk relating to recent significant economic, accounting or other developments

B) Satisfactory control environment is not an absolute deterrent to fraud (Correct/ Incorrect Que.)

Explanation: - Existence of controls can reduce the risk of fraud but cannot mitigate such risk to zero; hence it is not an absolute deterrent to fraud.

C) Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following

Greater management intervention to specify the accounting treatment.

Greater manual intervention for data collection and processing.

Complex calculations or accounting principles.

The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

#### IV] EVALUATION OF I.C BY AUDITOR

a) Benefits of evaluation of I.C: - It will help the auditor to know (PEQ Nov'22)

Whether **Error & Frauds** are likely to be located

Whether an adequate **I.C System** is in use

Whether an **effective internal audit department** is operating

Whether any **administrative control** has a bearing on his work

The controls are adequate

The reports are **reliable**

The event & depth of **examination**

What audit technique & **procedures** to be followed

What are the areas where **controls** are **weak**

**Suggestion** that can improve control system

b) Formulate Audit Program after understanding I.C

1. Obtain understanding of Internal Control Systems

2. Know whether the Internal Control Systems is actually in operation

3. Check whether it is in operation & throughout the period or operate only partially

4. Assimilate the controls and its implications

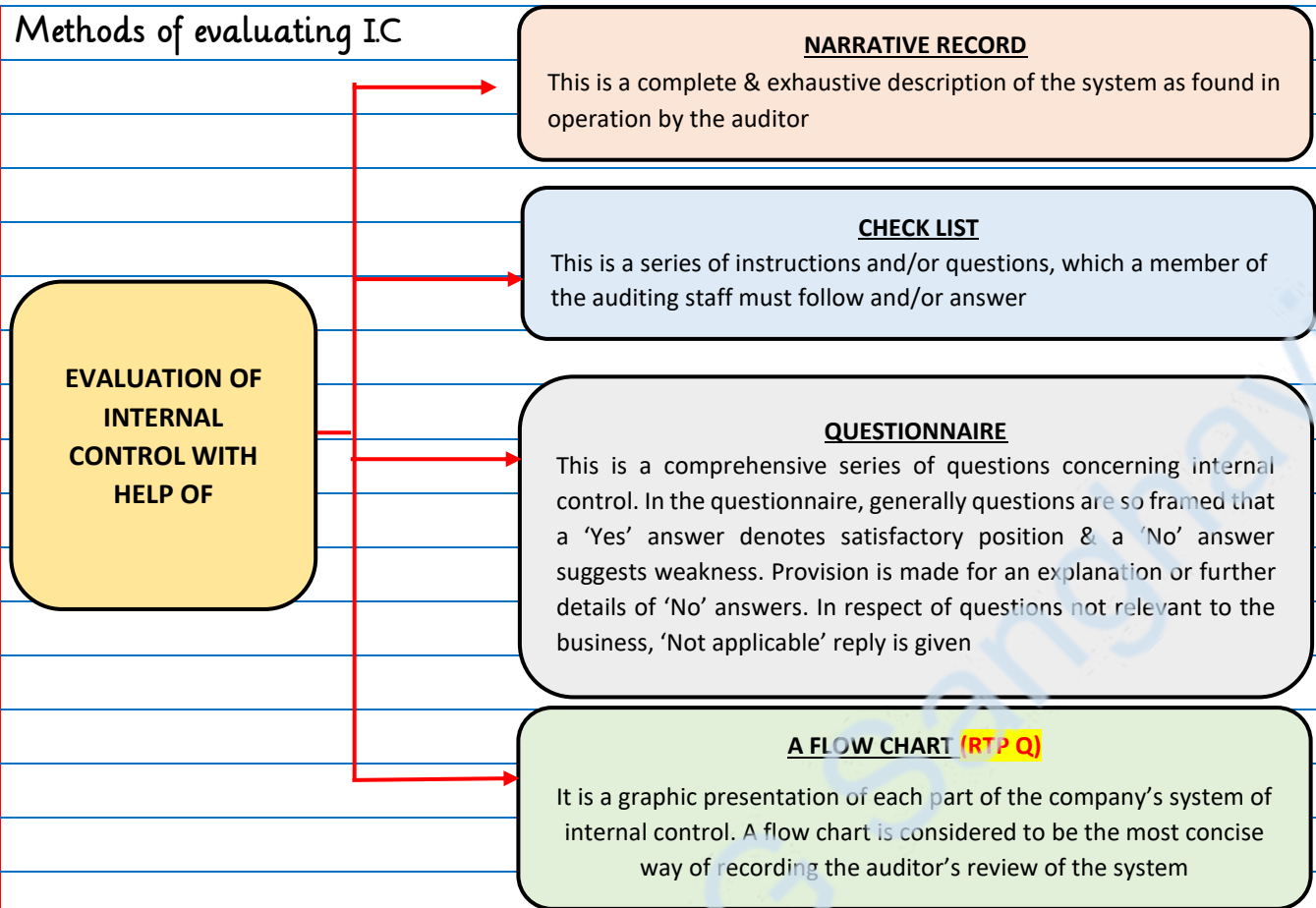
5. Ascertain how far the weaknesses have been removed

6. Proper understanding will help the auditor to decide upon the appropriate audit procedure

7. In case IC is weak 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



c) Methods of evaluating IC



VII] TESTING OF INTERNAL CONTROL

- It is performed to obtain SAAE about the effectiveness of DIM of internal controls, Whereby auditor can evaluate control risk.
- It include :-
  - 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 authorised.
  - Inquiries about, and observation of, internal controls which leave no audit trail, for example, determining who actually performs each function and not merely who is supposed to perform it.
  - Re-performance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control, for example, reconciliation of bank accounts, to ensure they were correctly performed by the entity.
  - Testing of internal control operating on specific computerised applications or over the overall information technology function, for example, access or program change controls.

Note :- 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.

## V] WHAT IS AN AUTOMATED ENVIRONMENT?

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.

### a) 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.

- (i) Enable **faster** business operations
- (ii) **Accuracy** in data processing and computation
- (iii) Ability to process **large volumes** of transactions
- (iv) **Integration** between business operations
- (v) **Better security** and controls
- (vi) **Less prone to human errors**
- (vii) Provides **latest information**
- (viii) **Connectivity** and **networking** capability

### b) Understanding and Documenting Automated Environment

Understanding the entity and its automated environment involves understanding how IT department is organised, IT activities, the IT dependencies, relevant risks and controls.

Given below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment:

- Information systems being used (one or more application systems and what they are).
- Their purpose (financial and non-financial).
- Location of IT systems - local vs global.
- Architecture (desktop based, client-server, web application, cloud based).
- Version (functions and risks could vary in different versions of same application).
- Interfaces within systems (in case multiple systems exist).
- In-house vs Packaged.
- Outsourced activities (IT maintenance and support).
- Key persons (CIO, CISO, Administrators).

### c) Risk arising from use of IT Systems

The understanding of a company's IT environment that is obtained should be documented

Having a summarized document helps the auditor in determining the areas considered in scope of audit as can be seen from the last column. In this illustration, it can be seen that two applications have been considered as in scope for audit based on the purpose and financial relevance to the audit. 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:

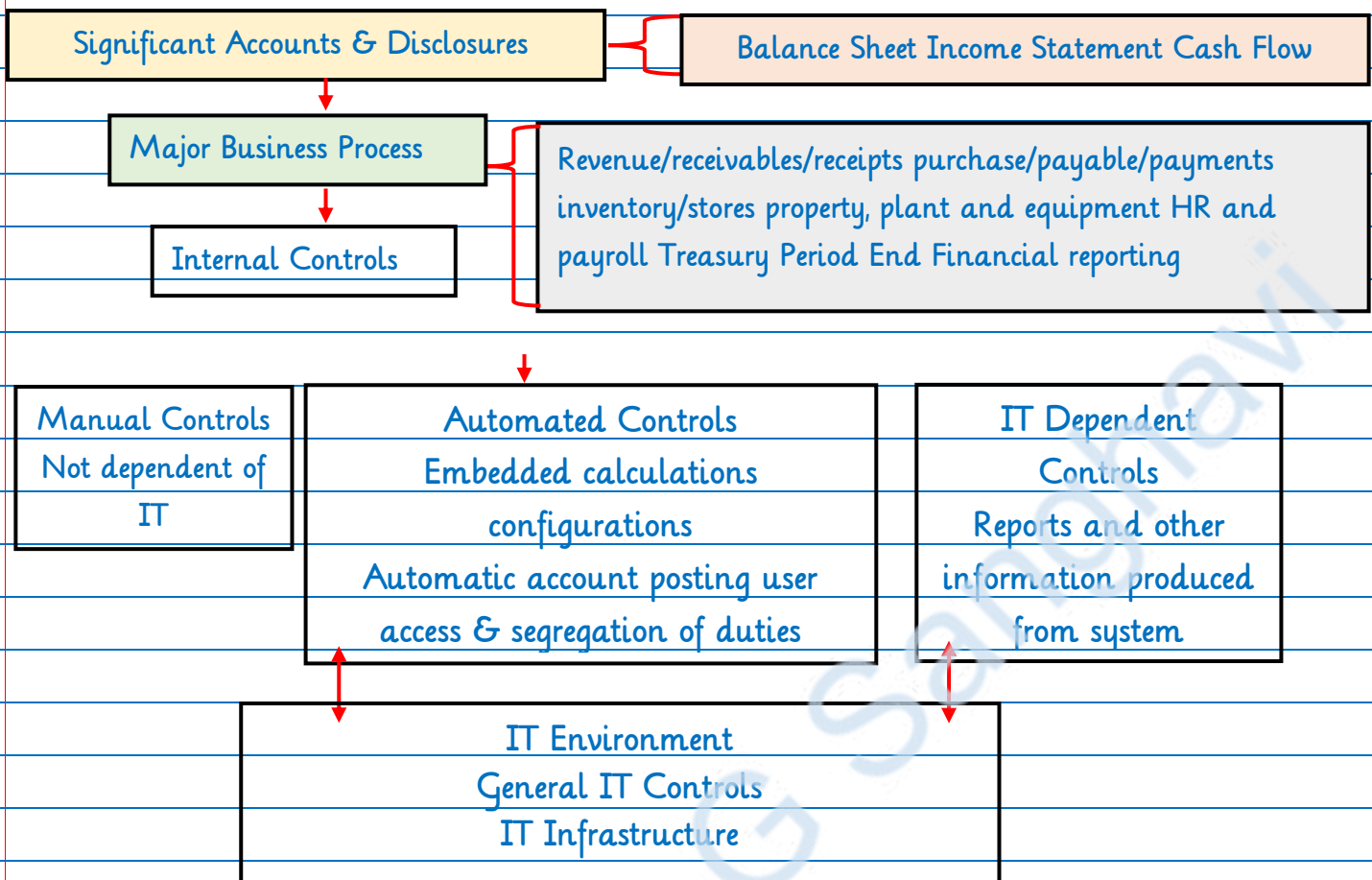
- Inaccurate processing of data, processing inaccurate data, or both.
- Unauthorized access to data.
- Direct data changes (backend changes).
- Excessive access / Privileged access (super users).
- Lack of adequate segregation of duties.
- Unauthorized changes to systems or programs.
- Failure to make necessary changes to systems or programs.
- Loss of data

#### d) Impact of IT Related Risk

- (i) **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.
- (ii) **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.
- (iii) **Impact on reporting**  
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.

#### e) Types Of Controls in an Automated Environment

- General IT Controls
- Application Controls
- IT-Dependent Controls



• GENERAL IT CONTROLS (correct/incorrect Nov'22)

"General IT controls" are policies and procedures that relate to many applications & support the effective functioning of application controls. They apply to mainframe, & end-user environments.

General IT-controls that maintain the integrity of information and security of data commonly include controls over the following: (SA 315)

Data centre and network operations

Program change

Access security

Application system acquisition, development, and maintenance (Business Applications)

These are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes. Hence, General IT controls are known as "pervasive" controls or "indirect" controls.

Data centre and network operations

Objective: To ensure that production systems are processed to meet financial reporting objectives.

Activities:

- (i) Overall Management of Computer Operations Activities

- (ii) Batch jobs – preparing, scheduling and executing
- (iii) Backups – monitoring, storage & retention
- (iv) Performance Monitoring – operating system, database and networks
- (v) Recovery from Failures – BCP, DRP
- (vi) Help Desk Functions – recording, monitoring & tracking
- (vii) Service Level Agreements – monitoring & compliance
- (viii) Documentation – operations manuals, service reports

### Program Change

Objective: To ensure that **modified systems continue** to meet financial reporting objectives.

Activities:

- (i) Change Management Process – definition, roles & responsibilities
- (ii) Change Requests – record, manage, track
- (iii) Making Changes – analyze, design, develop
- (iv) Test Changes – test plan, test cases, UAT
- (v) Apply Changes in Production
- (vi) Emergency & Minor Changes
- (vii) Documentation – user/technical manuals
- (viii) User Training

### Access Security (PEQ Nov'22)

Objective: To ensure that access to **programs and data is authenticated and authorized** to meet financial reporting objectives.

Activities:

- (i) Security Organization & Management
- (ii) Security Policies & Procedures
- (iii) Application Security
- (iv) Data Security
- (v) Operating System Security
- (vi) Network Security – internal network, perimeter network
- (vii) Physical Security – access controls, environment controls
- (viii) System Administration & Privileged Accounts – Sysadmins, DBAs, Super users

### Application System Acquisition, Development, and Maintenance

(PEQ July' 21) (Correct/ Incorrect)

Objective: To ensure that systems are **developed, configured and implemented** to meet financial reporting objectives.



#### Activities:

- (i) Overall Mgmt. of Development Activities
- (ii) Project Initiation
- (iii) Analysis & Design
- (iv) Construction
- (v) Testing & Quality Assurance
- (vi) Data Conversion
- (vii) Go-Live Decision
- (viii) Documentation & Training

- 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. Examples of automated applications include edit checks and validation of input data, sequence number checks, user limit checks, reasonableness checks, mandatory data fields.

- IT DEPENDENT CONTROLS

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. In this case, even though the control is performed manually, the design and effectiveness of such controls depends on the reliability of source data.

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.

#### f) General It Controls Vs. Application Controls

These two categories of control over IT systems are interrelated.

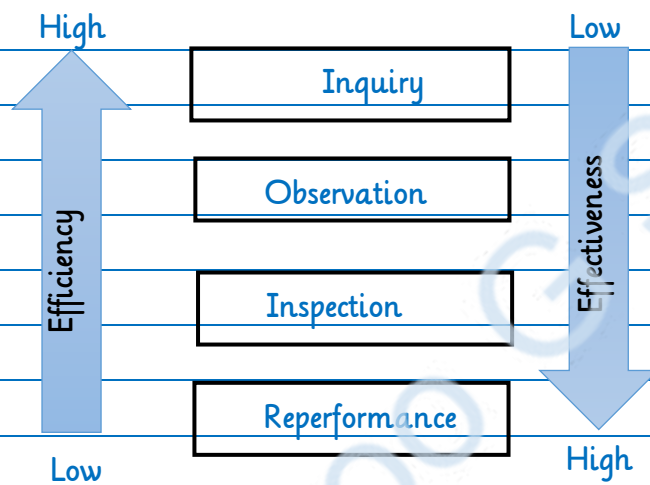
The relationship between the application controls and the General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems.

#### g) Testing Methods

Having learnt about the various IT risks and controls, let us understand the different ways testing is performed in an automated environment. There are basically four types of audit tests that should be used. They are inquiry, observation, inspection and reperformance. As shown in the illustration below, inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of

the other audit testing methods. Inquiry alone is not sufficient.

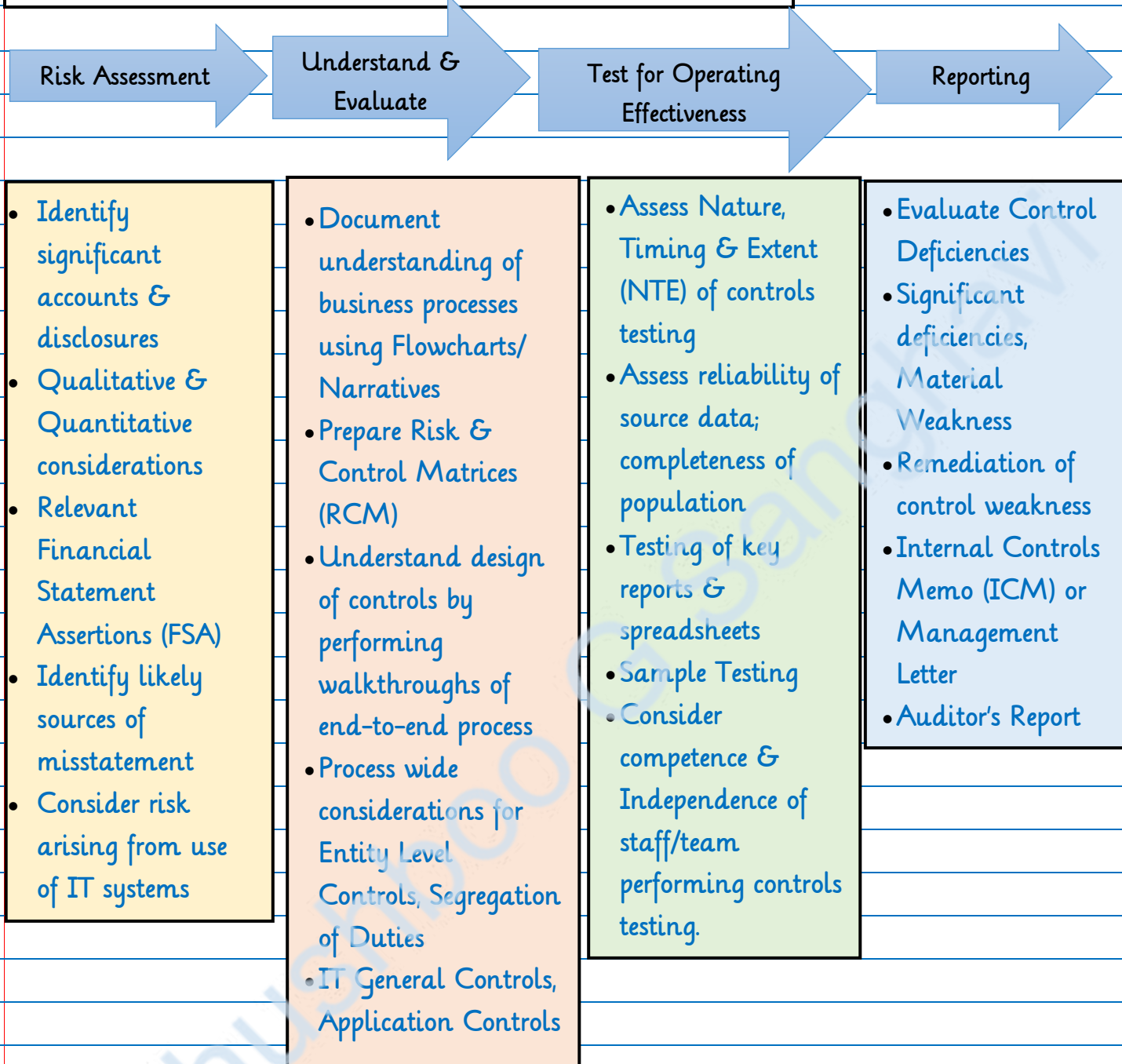
Re-performance is most effective as an audit test and gives the best audit evidence. However, testing by re-performance could be very time consuming and least efficient most of the time. Generally, applying inquiry in combination with inspection gives the most effective and efficient audit evidence. However, which audit test to use, when and in what combination, is a matter of professional judgment and will vary depending on several factors including risk assessment, control environment, desired level of evidence required, history of errors/mis-statements, complexity of business, assertions being addressed, etc. The auditor should document the nature of test (or combination of tests) applied along with the judgments in the audit file as required by SA 230.



When testing in an automated environment, some of the more common methods are as follows: (PEQ Jan 21)

- Obtain an understanding of how an automated transaction is processed by doing a walkthrough of one end-to-end transaction using a combination of inquiry, observation & inspection.
- Observe how a user processes transactions under different scenarios.
- Inspect the configuration defined in an application.
- Inspect the system logs to determine any changes made since last audit testing.
- Inspect technical manual/user manual of systems and applications.
- Carry out a test check (negative testing) and observe the error message displayed by the application.

## VI] AUDIT APPROACH IN AN AUTOMATED ENVIRONMENT



## VII] DATA ANALYTICS FOR AUDIT

Data Analytics can be used in testing of electronic records & data by use of spread sheet & specialised audit tool like IDEA & ACL to perform following

- Check **completeness of data** and population that is used in **either test of controls** or substantive audit tests.
- Selection of audit samples – **random sampling**, systematic sampling.
- Re-computation of balances – reconstruction of trial balance from transaction data.
- Reperformance of mathematical calculations – depreciation, bank interest calculation.
- Analysis of **journal entries** as required by SA 240.

- **Fraud** investigation.
- Evaluating impact of **control deficiencies**

## VIII] INTERNAL FINANCIAL CONTROLS AS PER REGULATORY REQUIREMENTS

a) What is Internal Financial Control (IFC) [SEC 134] [Key – SA – POT] (PEQ Jan 21)

As per Section 134 of the Companies Act, 2013, the term IFC means the policies & procedures adopted by the company for ensuring:

**S** = Safeguarding of its assets;

**A** = Accuracy & completeness of the accounting records &

**P** = Prevention & detection of frauds / errors;

**O** = Orderly & efficient conduct of its business including adherence to Company's policies;

**T** = Timely preparation of reliable financial information.

b) What is Internal Financial Control Over Financial Reporting (ICFR)

(PEQ Jan 21)

As per Guidance Note issued by ICAI on Guidance Note on Audit of Internal Financial Controls over Financial Reporting, ICFR shall mean:

"A Process designed to provide reasonable assurance regarding the reliability of financial reporting & the preparation of financial statements for external purposes in accordance with generally accepted accounting principles".

c) Which Provisions of Companies Act Requires Such IFC & Reporting

Reporting requirements:

Reference	Who is responsible	Applicability
Sec 134(5)(e)	Board of Directors	Listed Companies
Rule 8(5) of Companies (Accounts) Rules	Board of Directors	All Companies
Sec 149(8) and Schedule IV	Independent Directors	All companies having Independent Directors
Sec 177	Audit Committee	All companies having Audit Committee
Sec 143(3)(i)	Statutory Auditors	All Companies (Except Exempted companies)

i) Section 134(5)(e) of the In case of Listed Companies, the **Directors' responsibility**

	Act	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.
ii)	Section 143(3)(i) of the Act	The Auditor's report shall state whether the company has adequate Internal Financial Controls system in place & 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 anybody corporate at any point of time during the Financial Year less than ₹ 25 crore.
iii)	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.
iv)	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.


Difference Between Internal Financial Control & Internal Financial Control Over Financial Reporting (PEQ Jan 21)

Internal Financial Control as per Section 134(5)(e), "the policies and procedures adopted by the Company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information."

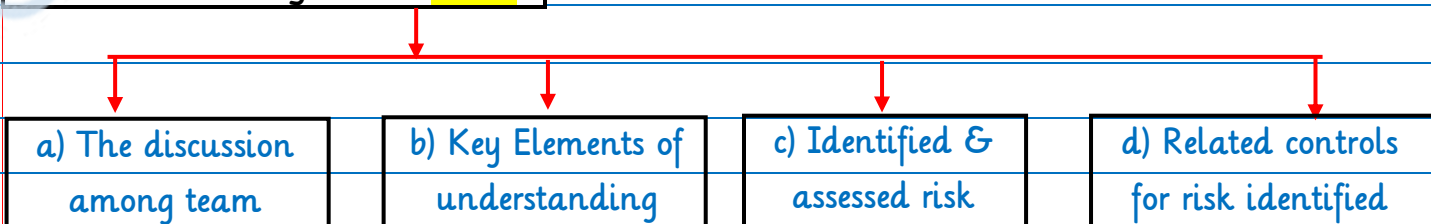
On the other hand, Internal controls over financial reporting is required where auditors are



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.

Internal Control as per SA 315 (PEQ Nov'22)	Internal Financial control u/s 134(5)(e)	Internal Financial control over financial reporting u/s 143(3)(i)
"Risk hain..... toh control hain!....." It is a process designed implemented & maintained (DIM) by TCWG to provide reasonable assurance about the achievement of an entity's objective with respect to:	[Key - SA POT] (PEQ Jan 21) As per Section 134 of the Companies Act, 2013, the term IFC means the policies & procedures adopted by the company for ensuring: <b>S = Safeguarding of its assets;</b>	As per Guidance Note issued by ICAI on Guidance Note on Audit of Internal Financial Controls over Financial Reporting, ICFR shall mean: "A Process designed to provide reasonable assurance regarding the reliability of financial reporting & the preparation of financial statements for external purposes in accordance With generally accepted accounting principles".
- (Key - RESA) <b>R = Reliability of FS</b> <b>E = Effectiveness &amp; Efficiency of operation</b> <b>S = Safeguarding of assets</b> <b>A = Compliance with Application Laws &amp; regulation</b>	<b>A = Accuracy &amp; completeness of the accounting records &amp;</b> <b>P = Prevention &amp; detection of frauds / errors;</b> <b>O = Orderly &amp; efficient conduct of its business including adherence to Company's policies;</b> <b>T = Timely preparation of reliable financial information.</b>	
	<div style="border: 1px solid black; padding: 5px; display: inline-block;">SA POT</div> <span style="font-size: 2em; color: blue;">➔</span>	

IX] DOCUMENTARY RISK (PEQ)



X] ASSESS AND REPORT AUDIT FINDINGS

Are there any weaknesses in IT controls?

What is the impact of these weaknesses on overall audit?

Report deficiencies to management – Internal Controls Memo or Management Letter.

Communicate in writing any significant deficiencies to Those Charged With Governance.

Students Note:

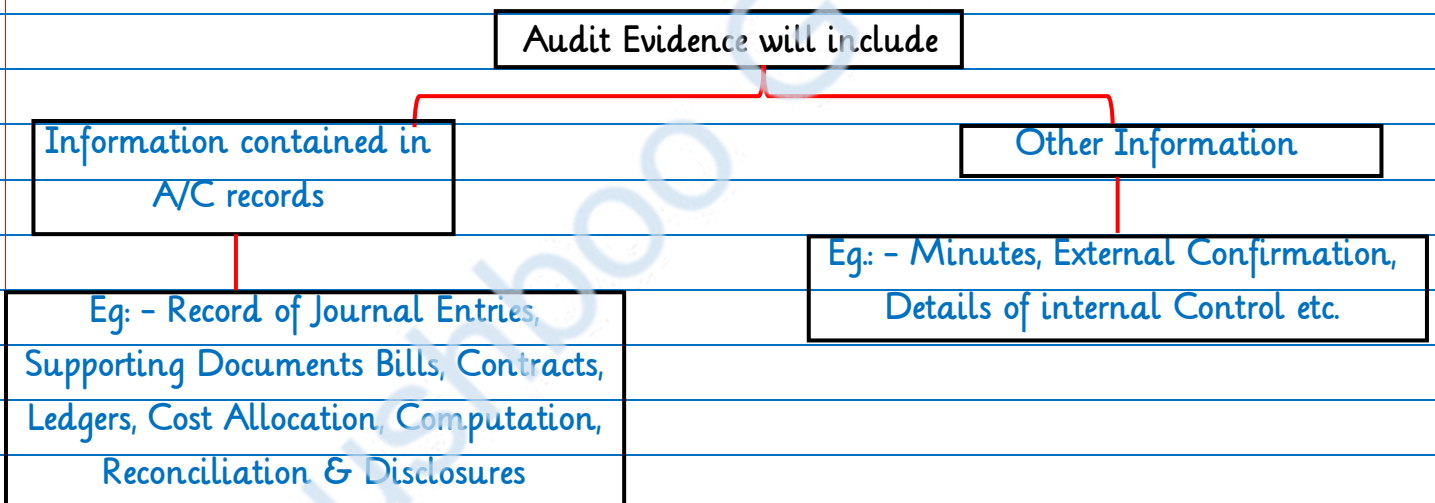
# CHAPTER 4. AUDIT EVIDENCE

## WHAT TO STUDY?

- A] SA 500: Audit Evidence
- B] SA 501: Audit Evidence-Specific Considerations for Selected Items
- C] SA 505: External Confirmations
- D] SA 510: Initial Audit Engagements – Opening Balances
- E] SA 520: - Analytical Procedure
- F] SA 530: Audit Sampling
- G] SA 550: Related Parties
- H] SA 610: Using the Work of Internal Auditor

## A] SA 500 AUDIT EVIDENCE

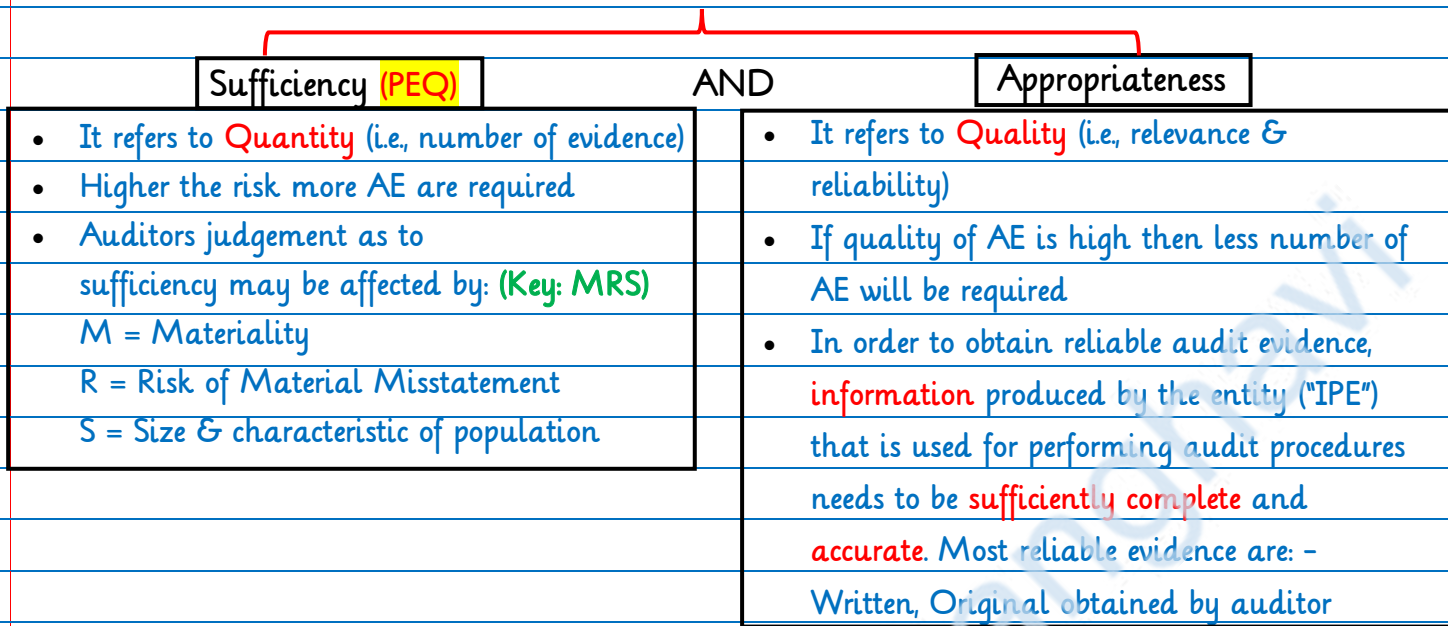
- 1) Meaning: - Audit evidence may be defined as the information used by the auditor in Arriving at the conclusion on which the auditor's opinion is based



Students Note

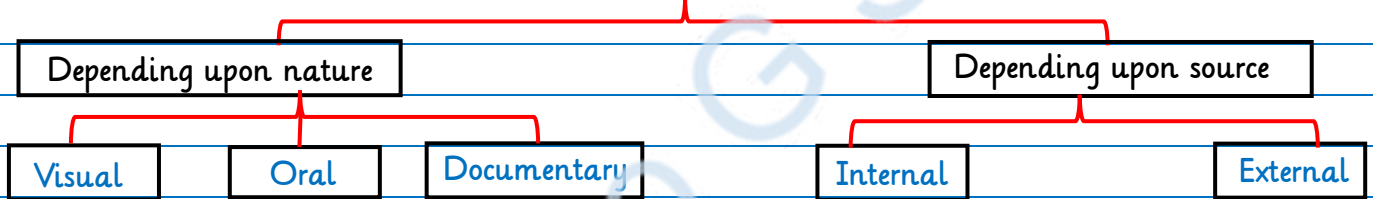
2) The Sufficiency & Appropriateness of audit evidence are interrelated

Audit Evidence (AE)



3)

Type of Audit Evidence



Eg., Internal Evidence:

Sales invoice, Copies of sales challan and forwarding notes, goods received note, inspection report, copies of cash memo, debit and credit notes, etc.

Eg., External evidence:

Purchase invoice, supplier's challan and forwarding note, debit notes and credit notes coming from parties, quotations, confirmations, etc.

4) Methods of obtaining Audit evidence

i) **Observation**  Process

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

[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.(C/I)]

Example: The auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities.

ii) **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.

### iii) **Re<sub>2</sub> - Recalculation**

Recalculation consists of checking the mathematical accuracy of documents or records.

Recalculation may be performed manually or electronically.

### iv) **I - Inspection** → Documents, books of account, inventory, cash, minute book, etc.

Inspection involves examination of records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

[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:** of inspection used as a test of controls is inspection of records for evidence of authorisation.

### v) **C - Confirmation** → Third party confirmation as per (SA 505)

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.

[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:** a) 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 are the relevant details are. External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions.

b) The absence of a "side agreement" that may influence revenue recognition.]

### vi) **A - Analytical Procedures (SA 520)** → Current Ratio, GP ratio, etc.

Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data.

Analytical procedures also includes the investigation of identified fluctuations and relationships that are inconsistent with other relevant information (actuals not matching with budgeted) or deviate significantly from predicted amounts. In other words, It means Analysis of Significant Ratios and trends & Resulting Investigation into the fluctuations/ variations from the predicted results.



vii) **I – Inquiry** → Employee, employer, and managements expert  
 Inquiry consists of obtaining information (both financial and non-financial) from knowledgeable persons, within the entity or outside the entity.  
 Inquiry is used extensively throughout the audit in addition to other audit procedures.

viii) **Written Representation:**  
 It is a written statement or clarification given by the management to confirm certain matters or to support other evidence .

5) **Relevance & Reliability of AE**

i) **Relevance:** - It deal with **logical connection** with or bearing upon the purpose of audit procedures.

Different set of **audit procedures** are performed to obtain **evidence relevant** for verifying specific assertion.

Eg :- a) **Inspection** of documents will help the auditor verify **existence & valuation** but not necessarily cut-off.

b) **TOC** are designed to identify **performance of controls** & deviation, if any.

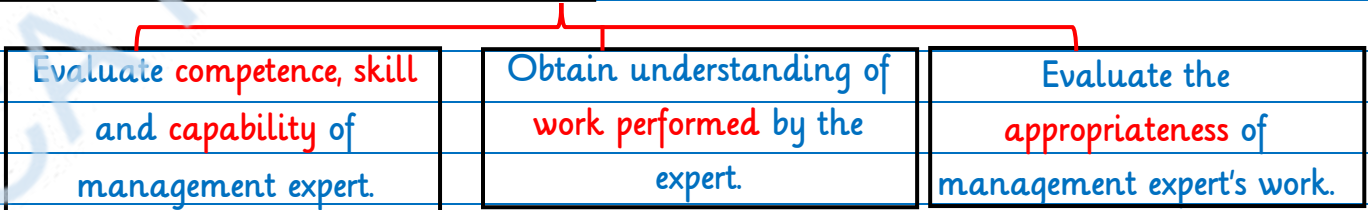
c) **TOD** is performed for identifying conditions relevant to the purpose of the test i.e., misstatement at assertion level.

ii) **Reliability:** It means auditor can rely-over such evidence and draw conclusion  
 Reliability of audit evidence depends upon: - (**Key - WODIE**)

- W** - Written
- O** - Original Document
- D** - Directly obtained by auditor
- I** - Independent source
- E** - Effectiveness of Internal Control

Note: - A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of test of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only form substantive procedures.

6) **Using the work of Management Expert**



• Matters which may affect the NTE of audit procedures to be applied by auditor in relation to use of management expert's work

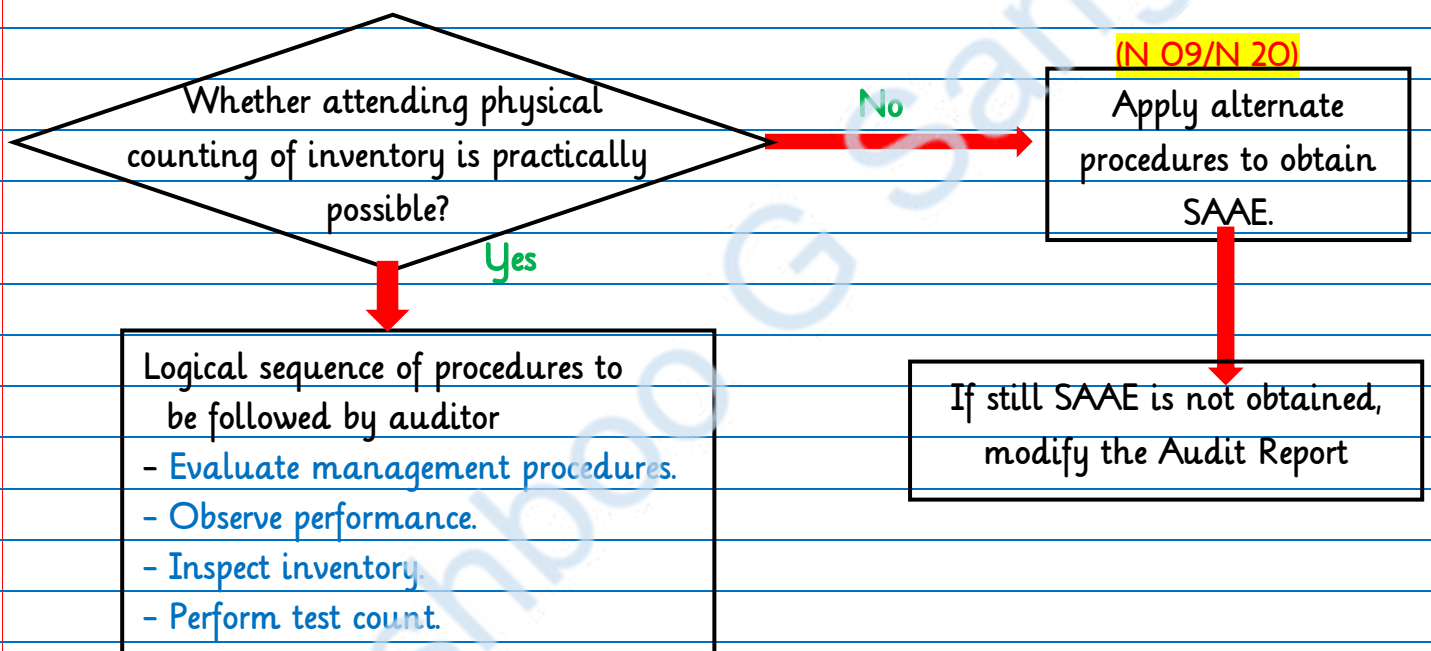
- 1) **Risk of material misstatement in the matter (RMM).**
- 2) **Nature and complexity of matter**

- 3) Availability of **alternate evidences**
- 4) Previous **experience** of auditor
- 5) **Control** and influence of **management** over expert's work
- 6) Nature, scope & objectives of managements expert's work
- 7) Whether expert's work is subject to **technical performance standard** or industry requirement
- 8) Relevance and reasonableness of **source of data, assumptions methods & findings**

## B] SA 501 AUDIT EVIDENCE-SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS

### I] INVENTORY - EXISTENCE & CONDITIONS (M 18, 13 N 15)

When the inventory is material to financial statements, the auditor should obtain SAAE regarding existence of Inventory.



1) The auditor shall perform alternative audit procedures to obtain – SAAE

Example of alternative audit procedures: Inspection of documents of the subsequent sale of inventory items acquired or purchased prior to the physical inventory counting, may provide SAAE about the existence and condition of inventory

The attendance at physical inventory counting may be impracticable due to various 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, however, is not sufficient to support a decision by the auditor that attendance is impracticable

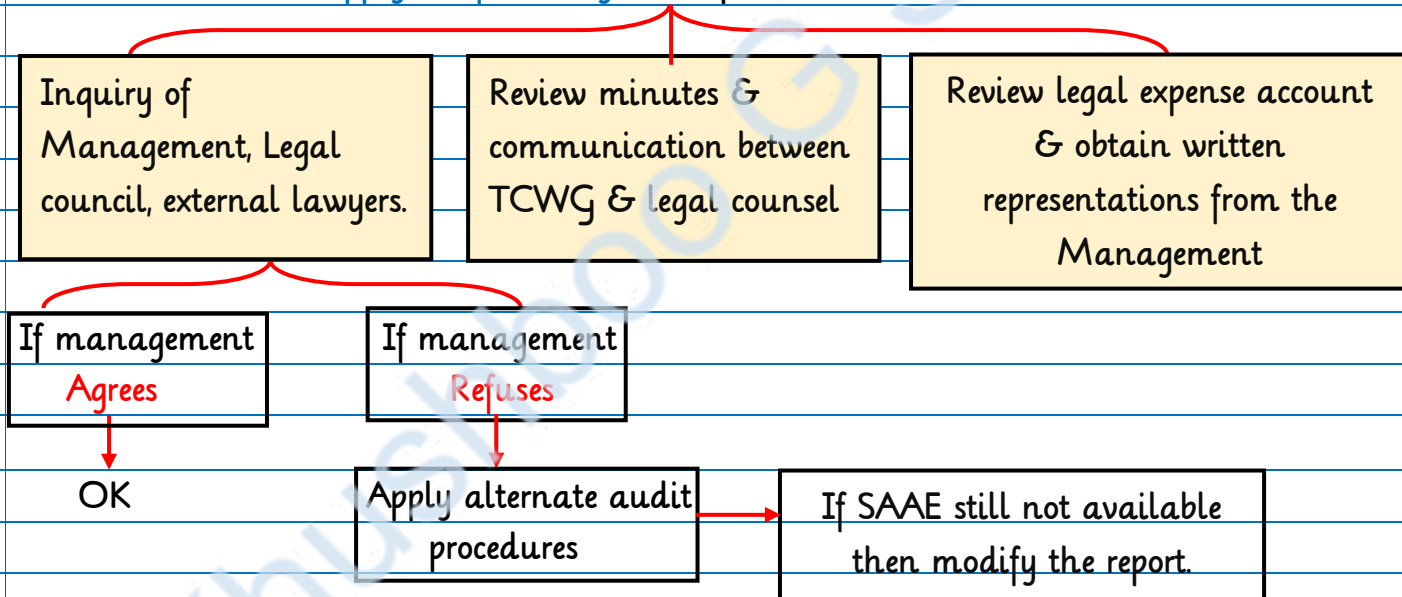
Further, as explained in SA 200, the matter of difficulty, time or cost involved is not in itself a valid basis for the auditor to omit and audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

- 1) Existence & Condition of inventory lying with the third party – (RTP N 19)
  - i) Ask for confirmation as per SA 505.
  - ii) Apply other audit procedures.
- 2) Factors to be considered for planning physical verification of inventory – (IMPORTANT)
  - i) Nature of inventory
  - ii) Stages of completion of work in progress
  - iii) The RMM related to inventory
  - iv) The nature of IC related to inventory
  - v) The timing of physical verification
  - vi) Maintenance of perpetual inventory system
  - vii) Location of inventory
  - viii) Need of an expert

Note: Valuation of inventory is not considered for planning physical verification of inventory

## II] LITIGATION & CLAIMS - COMPLETENESS

The auditor should apply the following audit procedures -



If auditor assesses a ROMMS regarding L & C

- i) The auditor shall:
  - a) Send a general letter of inquiry (prepared by the management) to the entity's external legal counsel and
  - b) Request for a direct Communication with him .
- ii) If the professional body (to which the external legal counsel belongs) prohibits him from communicating directly with the auditor, the auditor shall perform alternative audit procedures.
- iii) In certain circumstances, the auditor may also decide to meet with the entity's external legal counsel to discuss the likely outcome of the L&C.

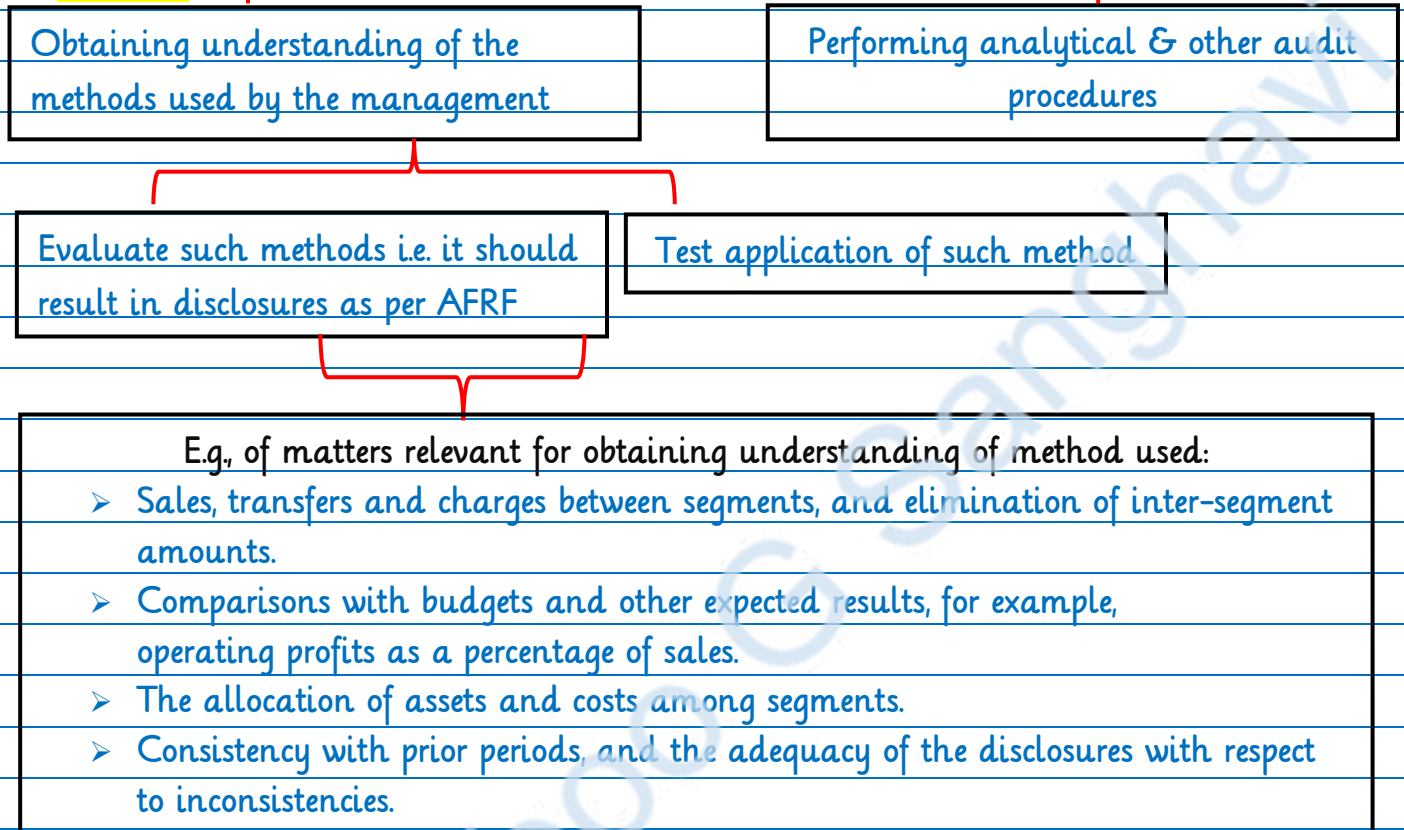
This may be the case, for example, where:

The auditor determines that the matter is a significant risk

### III] SEGMENT REPORTING

Obtain SAAE that financial statements are prepared as per AFRF by:

PEQ Jan'21



### C] SA 505 EXTERNAL CONFIRMATION

#### I] PROCESS OF OBTAINING & EVALUATION AUDIT EVIDENCE THROUGH DIRECT COMMUNICATION FROM A THIRD PARTY AFTER OBTAINING PRIOR APPROVAL OF MANAGEMENT

- 1) If management request not to perform External Confirmation (M 18, 11, 13, O5; RTP N 12)
  - i) Auditor should evaluate the response of management for non-performance of external confirmation (reason is legal), auditor must evaluate the reasons for denial.
  - ii) then he should apply alternative test but if auditor is restrained without sufficient cause then Reservation / Disclaimer of opinion
- 2) Process of External Confirmation
  - i) Select the item.
  - ii) Design the format.Factors to be considered: - (RTP N 18)
  - a) Form of confirmation, Mode of Communication
  - d) Nature of information

b) Reliability of confirmation

e) Assertion regarding item & RMM

c) Past experience of auditor

f) Ability of TP to confirm request.

iii) Communicate the request.

iv) Obtaining the response.

v) Evaluate response & no response.

### 3) Form & Format of EC (RTP N 18)

i) Positive Confirmation: - An auditor requests for positive confirmation transaction is material or chance of fraud is high. Its 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.

ii) Negative Confirmation: - An auditor requests for positive confirmation when transaction is immaterial or chance of fraud is low. Its a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. (RTP M 18)

Factors to be considered while seeking negative confirmation (M 19)

a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate evidence regarding the operating effectiveness of relevant to the assertion;

b) The population of items subject to negative confirmation procedures comprises a large number of small, homogenous, 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.

iii) Non-response: - A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered. (RTP)

iv) Exceptional - 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 analysing the reason for difference. (RTP)

Note: - EC depends on auditor's personal judgement to use or not, but generally the following area require EC:

a) Confirmation of bank balance.

b) Stock/Assets held by third party and

c) Debtors/ Creditors.

d) Documents mortgaged with bank.

Follow up confirmation requests: - The auditor may send an additional confirmation request when a reply to a previous request has been not received within a reasonable time. For example, the auditor may, having re-verified the accuracy of original address, send an additional or



follow up request.

EC is more reliable audit evidence when:

It is obtained from **independent sources** outside the entity.

It is obtained **directly** by the auditor rather than audit evidence obtained indirectly or by Inference (assumptions/guessing).

It is in **documentary** form, whether paper, electronic or other medium.

## D] SA 510 INITIAL AUDIT ENGAGEMENT (OPENING BALANCE)

### I] MEANING OF INITIAL AUDIT

An engagement in which the financial statements of previous year were -

Not Audited

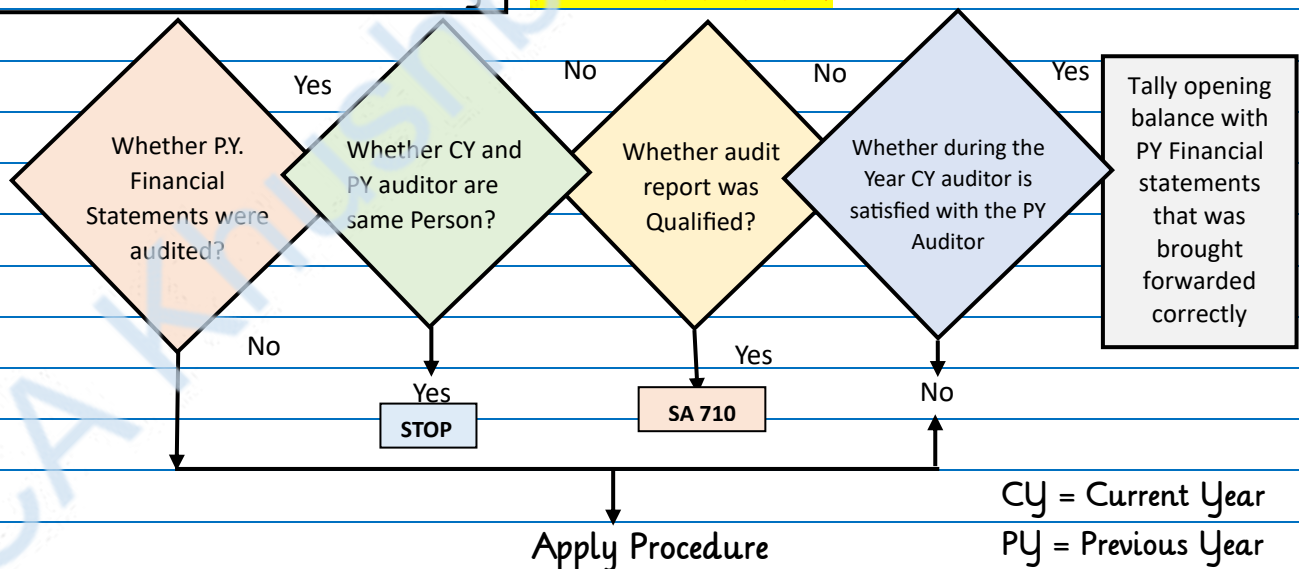
OR

Audited by predecessor Auditor

### II] OBJECTIVE

- 1) The Opening balances contain MMS in the current year's FS and
- 2) The Accounting policies (reflected in the opening balances) have been consistently applied, and any changes in them are :
  - (i) Properly accounted for and
  - (ii) Adequately presented and disclosed as per applicable FRF.

### III] VERIFICATION & REPORTING (RTP N 13, 14, 15, 17, 18)



#### IV] AUDIT PROCEDURES

<p>Audit procedures w.r.t (Opening Balance)</p>	<ol style="list-style-type: none"> <li>1. In order to obtain SAAE as to whether the opening balances in the current year's FS contains MMS the auditor shall :               <ol style="list-style-type: none"> <li>i) Read the PY's audited FS (&amp; other relevant docs), if any, and</li> <li>ii) Read the predecessor(previous) auditor's report , if any, (for information relevant to opening balances, including disclosures)</li> <li>iii) Check whether the closing balances of the PY have been correctly brought forward to the CY.</li> <li>iv) Check whether any adjustments have been shown as prior period items in the CY's Statement of P &amp; L)</li> <li>v) Read the Acc. Policies of LY's closing balances and Determine (Check) whether they are consistently applied in the opening balances of CY.</li> <li>vi) Perform audit procedures in the CY and Evaluate whether it provides evidence regarding the op. balances</li> <li>vii) Perform specific audit procedures to obtain evidence regarding the opening balances.</li> </ol> </li> <li>2. If the auditor obtains SAAE that the opening balances contains MMS, the auditor shall perform such additional audit procedures. [to determine it's effect (pervasive / not pervasive) on the CY FS]</li> <li>3. If the auditor concludes that such MMS exists in the CY's FS also, then the auditor shall communicate with the management and TCWG as per SA 450.</li> </ol>
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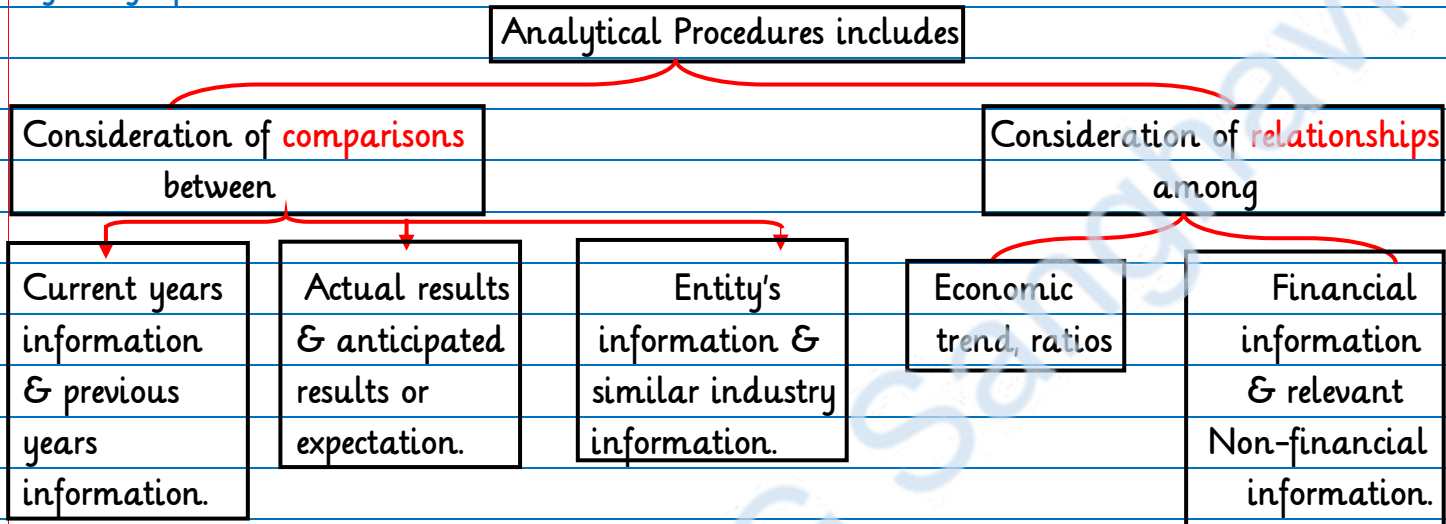
#### V] AUDITOR'S CONCLUSIONS & REPORTING

<p>If the auditor is unable to obtain SAAE regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, as per SA 705.</p>	<p>If the auditor obtains SAAE that the opening balances contains MMS in the CY's FS, and (the effect of the MS is not properly accounted for or not adequately presented or disclosed,) the auditor shall express a qualified opinion or an adverse opinion, as appropriate, as per SA 705.</p>
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## E] SA 520. ANALYTICAL PROCEDURE

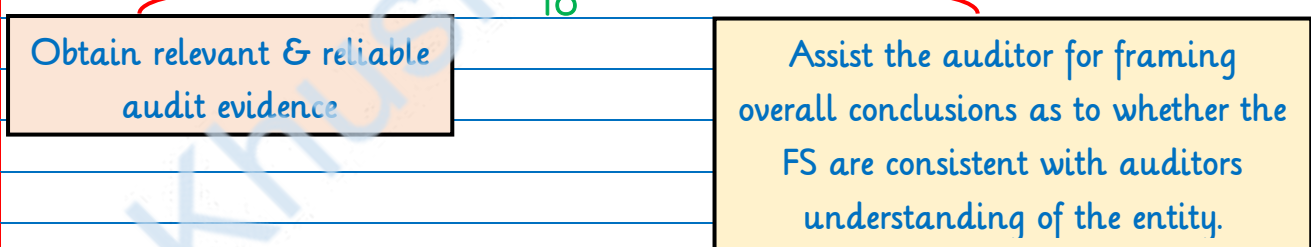
### I] MEANING

- It means evaluation of financial information through **analysis of plausible** (linked) **relationships** among financial & non-financial data.
- It 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.



Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to **performing complex analyses** using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, components are individual elements of information.

### II] PURPOSE/ OBJECTIVE OF ANALYTICAL PROCEDURES

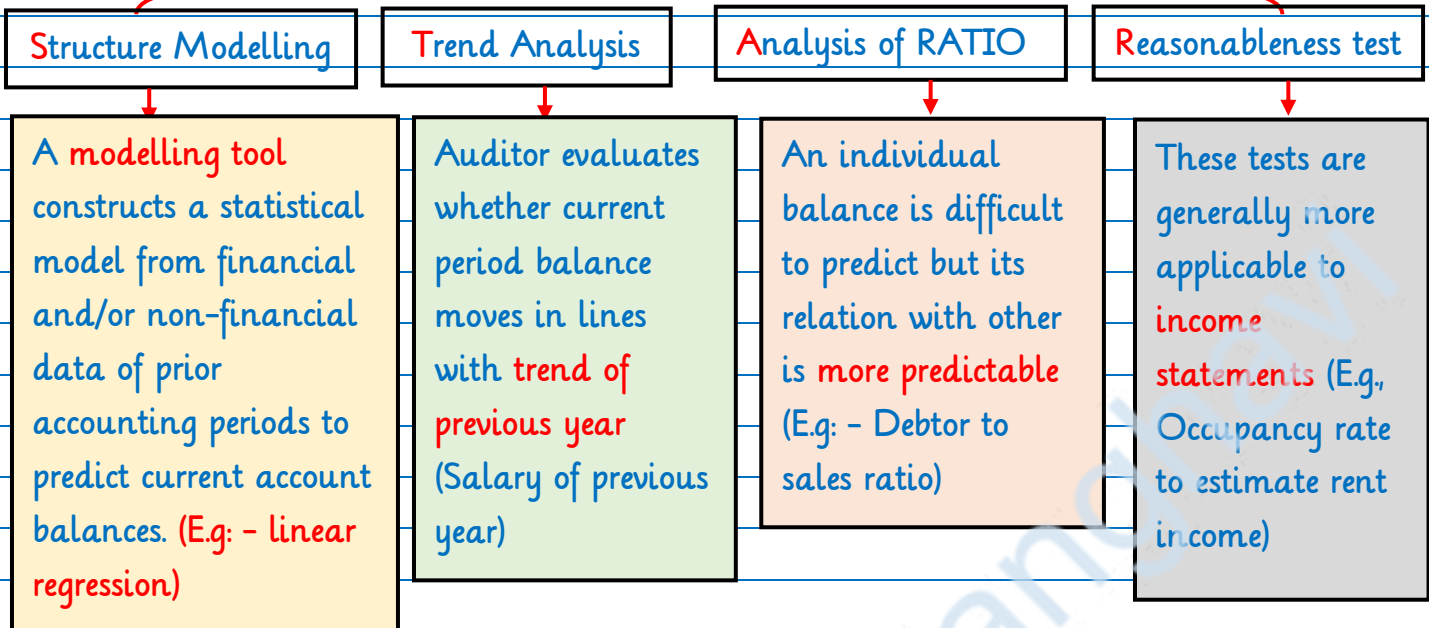


Example: - If balances included in the Statement of Profit and Loss of an entity are **compared** with those contained in the Statement of Profit and Loss for the same period of another entity **engaged in the same trade** and working under **similar circumstances**, it would be possible to find out the cause of the variation in the rate of profitability that exists.

### III] TIME OF ANALYTICAL PROCEDURES When to perform AP: - (PEQ)



#### IV] TECHNIQUES AVAILABLE AS SUBSTANTIVE ANALYTICAL PROCEDURE (Key - STAR)



Note: - As discussed in above points, let me remind you that design of substantive analytical procedures is limited only by the availability of reliable data, the experience & creativity of the audit team.

#### V] ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TEST

→ While designing & performing SAP either alone or in combination with TOD as per SA 330, auditor shall take into consideration following funds :- (Key :- SRED)

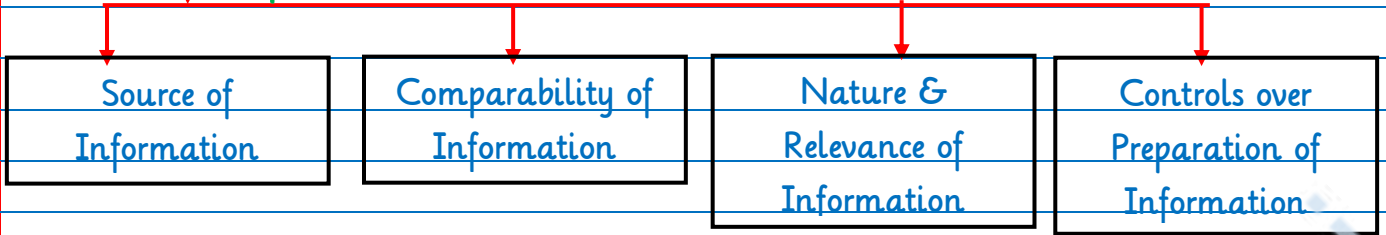
##### 1) S - Suitability of particular AP (MCQ)

Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist & continue in the absence of known conditions to the contrary.

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 misstatement, may cause the financial statements to be materially misstated. In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. 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. Particular substantive analytical procedures may also be considered suitable when tests of details are performed on the same assertion.

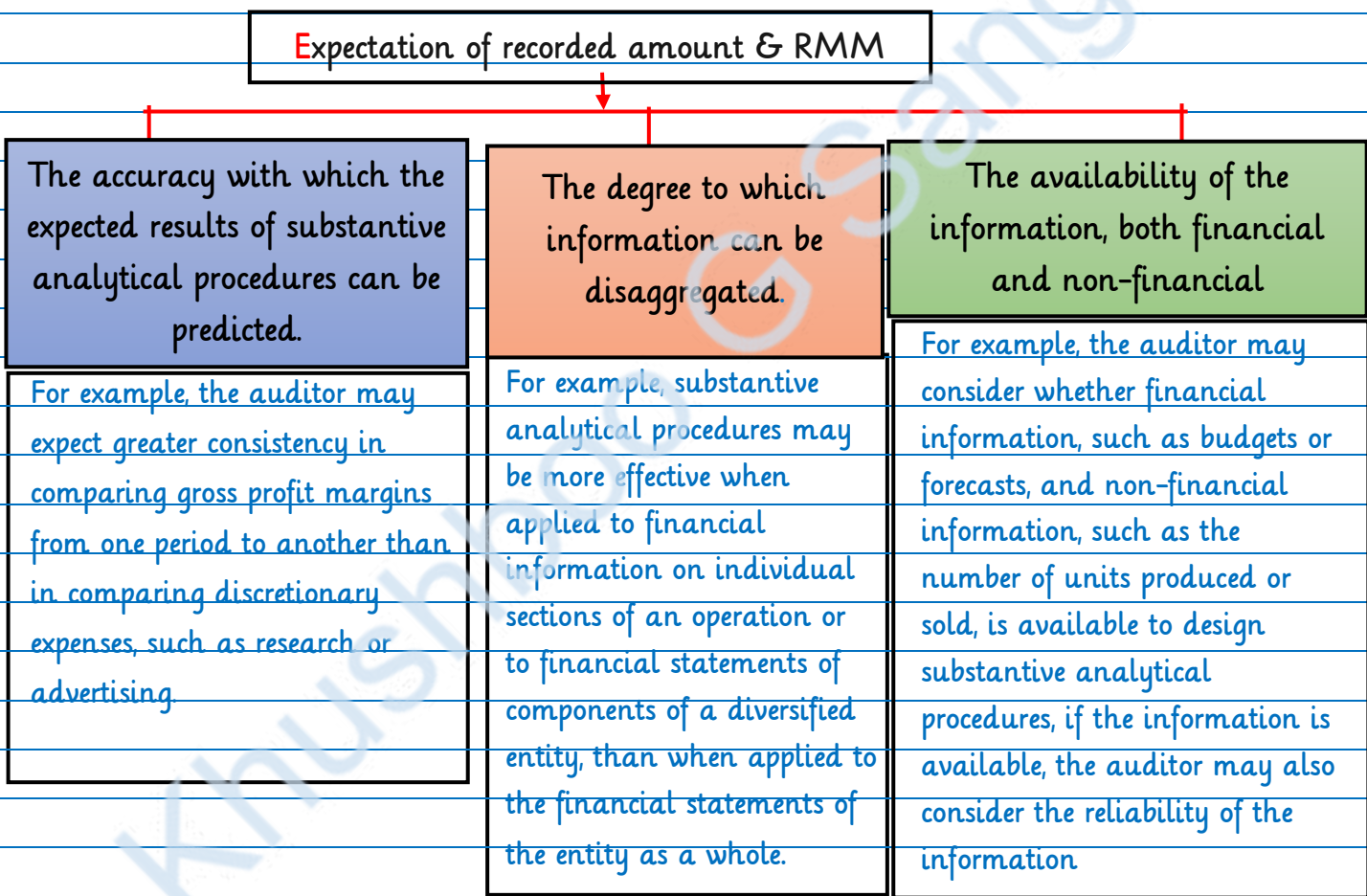
2) **R - Extent of Reliance on AP**

Depend on



3) **E - Expectation of recorded amount & RMM**

Matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, include :-



4) **D - Difference of recorded amount from expected value that are acceptable without investigation**

Investigation Results of AP (MCQ)

If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, then:



The Auditor shall Investigate such differences by

PEQ

Inquiry with Management

Perform other Audit Procedures

- (i) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses: Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.
- (ii) Performing other audit procedures as necessary in the circumstances: The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

#### VII] AP AT CONCLUSION STAGE

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. The assists the auditor to draw reasonable conclusions on which to base the auditor's opinion.

#### VIII] CONSIDERATIONS FOR PSU (IMPORTANT)

→ Auditor may not always be able to compare or analyse the relationship between financial information of PSU because, FS of PSU are not comparable with profit oriented entities.

Eg :- i) Expenses incurred by PSU are for public hence there is a very less relation between expenses incurred & revenue earned.

ii) PSU may treat acquisition of asset as revenue item where as other may capitalise it :

→ However other relationship may be relevant too.

Eg :- i) Variations in Cost/Km of road construction

ii) Number of vehicle purchased compared with Number of vehicle retired.

The above examples/information's are comparable for PSU and other profit oriented private Sector units

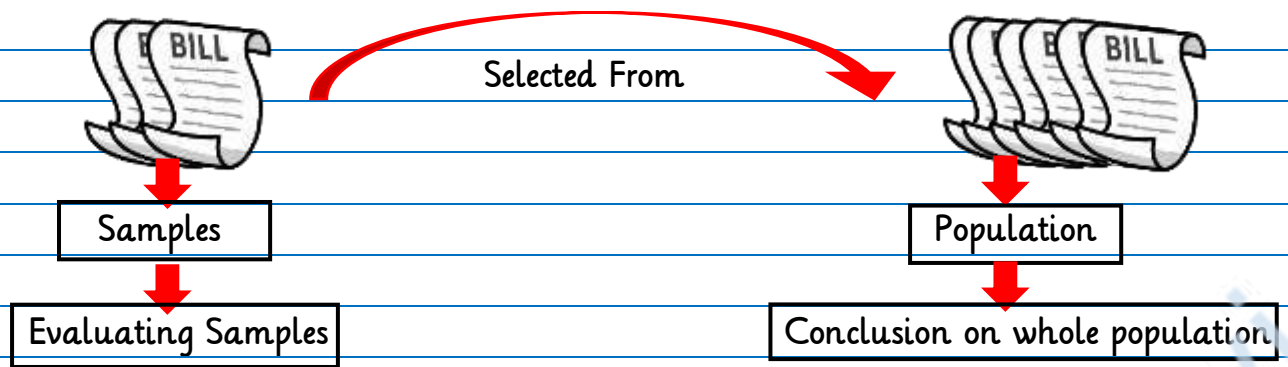
→ Hence, auditor must wisely apply AP while auditing financials of public units (PSU).

#### F] SA 530. AUDIT SAMPLING

##### I] MEANING – SA 530 AUDIT SAMPLING

- 1) As per SA 530 "Audit Sampling" means applying audit procedures to less than 100% of items & drawing conclusions on the whole population.





## 2) Characteristics of Population (Key - CAR)

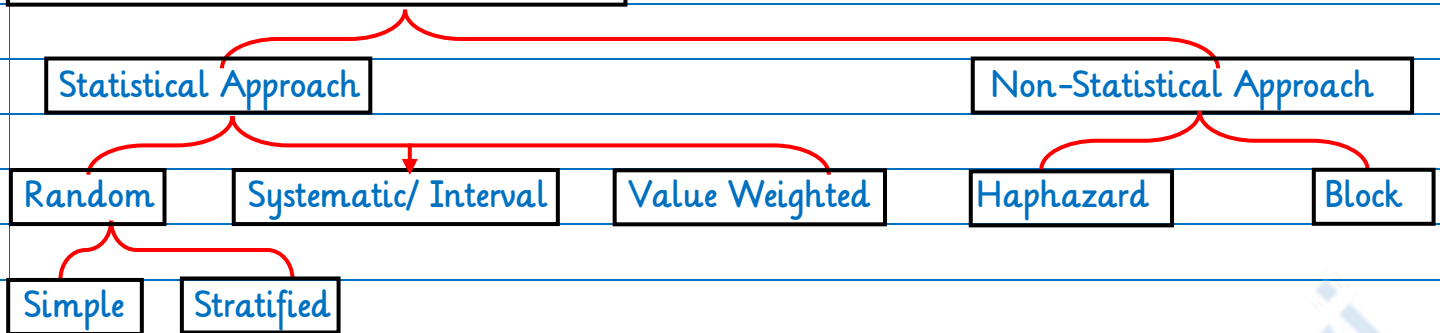
Completeness	Appropriateness	Reliable
The population also needs to be <b>complete</b> , which means that if the auditor intends to use the sample to draw conclusions about whether a control activity operated effectively during the financial reporting period, the population needs to <b>include all relevant items from throughout the entire period.</b>	The auditor will need to determine that the population from which the sample is drawn is <b>appropriate</b> for the <b>specific audit objective.</b>	When performing the audit sampling, the auditor performs audit procedures to ensure that the information upon which the audit sampling is performed is <b>sufficiently complete and accurate.</b>

## II] APPROACHES TO SAMPLING

### Approaches to Sampling

Statistical – More Scientific	Non-Statistical
<ul style="list-style-type: none"> <li>An approach that has <b>RANDOM SELECTION</b> of Sample</li> <li>It uses <b>Probability</b> theory to evaluate results</li> <li>It includes measurement of <b>Sampling Risk</b></li> </ul>	<ul style="list-style-type: none"> <li>It is based on auditors <b>experience</b>, judgement &amp; knowledge</li> <li>It is a <b>Common Practice</b> to check large number of samples towards year end.</li> <li>It is criticised on the grounds that it is neither objective nor scientific</li> </ul>

### III] METHODS OF SAMPLE SELECTION



### IV] FACTORS AFFECTING SAMPLE SIZE

For Test of Control	For Test of Details
1) Level of assurance auditor intends to obtain while assessing RMM – <b>DIRECT RELATION</b>	1) Assessment of RMM – <b>DIRECT RELATION</b>
2) Tolerable rate of deviation – <b>INVERSE RELATION</b>	2) Auditor is relying on other substantive procedures hence auditor will be require to perform less sampling – <b>INDIRECT RELATION</b>
3) Expected rate of deviation – <b>DIRECT RELATION</b>	3) Desired level of assurance – <b>DIRECT RELATION</b>
4) RMM – <b>DIRECT RELATION</b>	4) Tolerable level of misstatement – <b>INDIRECT RELATION</b>
5) For larger population, change in size of population will have minute or negligible change in sample size	5) Expected rate of misstatement – <b>DIRECT RELATION</b>

Note: a) **Direct Relation** means if there is increase in such factor, **sample size will also increase**

b) **Indirect Relation** means if there is increase in factor then **Sample Size decreases**.

c) **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 misstatement is the application of performance materiality, as defined in SA 320, to a particular sampling procedure. Tolerable misstatement may be the same amount.

d) **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.

V]

RISK

MM = Material Misstatement

Sampling Risk  
Risk of expressing inappropriate  
Opinion based on sample

(RTP M 17, 16)

Non-Sampling Risk  
It includes use of  
inappropriate  
procedures,  
misinterpretation  
or any reason not  
related to sampling

Test of Control Stage

Test of Details Stage

Controls  
are more  
effective  
then they  
actually are,  
will leads  
to audit risk

Controls are  
less effective  
then they  
actually are,  
which will  
leads to  
additional  
work burden.

MM does  
not exist when  
it in fact does,  
will leads to  
Audit risk.

MM exists  
when in fact  
it does not will  
leads to additional  
work burden.

This is not Audit Risk

→ Precautions should be taken by the auditor while applying, Test Check Techniques

- i) Thorough study of accounting system should be done before adopting sampling.
- ii) Proper study of internal control systems.
- iii) Areas which are not suitable for sampling should be carefully considered. Eg: compliance with statutory provisions, transactions of unusual nature etc.
- iv) Proper planning for sampling methods to be used and explaining the staff.
- v) Transactions and balances have to be properly classified (stratified)
- vi) Sample size should be appropriately determined.
- vii) Sample should be chosen in unbiased way,
- viii) Errors located in the sample should be analysed properly.

G] SA 550 Related Parties (RP)

I] MEANING & OBJECTIVE

RP as defined in AFRF (Applicable Financial Reporting Framework) auditor is required to obtain an understanding of RP transaction and relationship; whether they are properly Identified and Disclosed

→ Meaning: A party that is

RP as defined in AFRF

OR

Where AFRF does not established RP, then

Note: - Entities that are under common control by a state government (i.e. national, regional or local government) are NOT considered as RELATED, unless they engage in significant transactions or share resources to a significant extent with one another (PEQ Nov 19)

- 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: common controlling ownership, owners who are close family member or common key management.

## II] RISK ASSESSMENT PROCEDURES AND RELATED PARTIES

Understand entity and RP transaction

Maintain alertness for RP info

Sharing RP info with engagement team

(N 19, 15, 12, O2 / M 06)

Apply SA 315 and SA 240

Exercise professional scepticism and inspect document

## III] RESPONSE TO RMM ASSOCIATED WITH -

1. Newly identified RP (i.e. not previously identified)

2. Significant RP transaction outside the entity's normal course of business

(N 14, RTP M 11, 14)

- i) Promptly communicate to engagement team
- ii) Inquire as to why entity controls failed to identify RP transaction.
- iii) Evaluate indication of fraud
- iv) Perform additional audit procedure

- Inspect the identified contracts or agreements and valueate: -
- i) Who Authorised such transactions
  - ii) Business rationale
  - iii) Consistency with mgt explanations
  - iv) Disclosure as per AFRF

## Examples of ONCB: - (PEQ Nov 20)

- i) Complex equity transactions like corporate restructuring or acquisitions;
- ii) Transactions with offshore entities in jurisdictions with weak corporate law;
- iii) Sales transactions with large discounts or returns;
- iv) Transactions with circular arrangements like sale and repurchase agreements
- v) Ensure RP transactions are at **Arm's Length Price (ALP)**
- vi) Obtain written representation relating to accounting treatment and disclosure
- vii) Potential inherent limitation with respect to RP **(Important)**

Management may be **unaware** of the existence of **all RP**

i.e. Newly identified RP by auditor

RP relationships may present a greater opportunity for **collusion, concealment or manipulation** by management

## Important Question: -

How can an auditor verify the existence of related party relationships and transactions?

- i) Entity income tax returns.
- ii) Information supplied by the entity to regulatory authorities.
- iii) Shareholder registers to identify the entity's principal shareholders.
- iv) Statements of conflicts of interest from management and those charged with governance.
- v) Records of the entity's investments and those of its pension plans.
- vi) Contracts and agreements with key management or those charged with governance.
- vii) Significant contracts and agreements not in the entity's ordinary course of business.
- viii) Specific invoices and correspondence from the entity's professional advisors.
- ix) Life insurance policies acquired by the entity.
- x) Significant contracts renegotiated by the entity during the period.
- xi) Internal auditors' reports.
- xii) Documents associated with the entity's filings with a securities regulator e.g, prospectuses.

→ Reporting for incorrect RP disclosure:

- i) Inquiry of, and discussion with management and those charge with governance.
- ii) Inquiries of the related party.
- iii) Inspection of significant contracts with the related party.
- iv) Appreciate background research such as through the internet or specific external business information databases.
- v) Review of employee whistle-blowing reports where these are retained.

**Author's Note:** Auditor consider reporting responsibilities under 3(xiii) of CARO, 2020



H] SA 610 (REVISED) USING THE WORK OF INTERNAL AUDITORS

I] **OBJECTIVE** If an entity has an Internal Audit function & its relevance to the External Auditor's work, then external Auditor should determine.

A. If the specific work of the internal Auditor can be used & if so, to what extent	B. Whether, such work is adequate for the audit purpose
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II] IN ORDER TO DECIDE EXTENT OF WORK TO BE USED, (M 2018)

External Auditor should determine:

a) If the Internal auditor's work is adequate for audit purpose & evaluate : - (Key - OC<sub>3</sub>)

Objective of internal audit function	Internal Auditors technical Competence	Internal Auditor's work is carried out with professional Care	Effective Communication between the internal auditor & external auditor
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b) Plan effect of Internal auditor's work on the N T E of External auditor's procedures & Consider : -

Nature & scope of Specific work performed or to be performed	Assessed risk of material misstatement at the assertion level for a particular class of Transaction, account balance & disclosure	The degree of subjectivity involved in evaluating the audit evidence to support the relevant assertions
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c) Determining Nature & Extent of Work that can be assigned to IA (RTP M 19, 18, 17/PEQ N 22)

IA shall not be used to provide Direct Assistance to perform procedures that:

1. Involve making significant judgements in the audit, it includes following: -
  - i. Assessing the risks of material misstatement:
  - ii. Evaluating: -
    - The sufficiency of tests performed;
    - Appropriateness of management's use of going concern assumption;
    - Significant accounting estimates;
    - The adequacy of disclosures in the FS.
2. Relate to higher assessed risks of material misstatement;
3. Relate to work with which internal auditors have been involved; or
4. Relate to decisions, external auditor makes in accordance with this SA



d) Evaluating adequacy of work of IA (N 15, M 15 / 12)

1. The work of the function had been properly planned, performed, supervised, reviewed & documented;
2. Sufficient appropriate evidence had been obtained to enable the function to draw reasonable conclusions; &
3. Conclusions reached are appropriate in the circumstances & the reports prepared by the function are consistent with the result of the work performed.

e) Using Direct Assistance of Internal Auditor (M 18)

- 1 Prior to using the internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:
  - Obtain written agreement that the IA will be allowed to follow the external auditor's Instructions.
  - Obtain written agreement the IA will keep confidential specific matters as instructed by the external auditor and inform any threat to their subjectivity.
  - External auditor shall direct, supervise and review the work performed by IA. IA shall be sufficient so that external auditor is satisfied that the IA have obtained SAAE to support the conclusions based on that work.

Author's Note: - Each and every sub-heading (i.e. from a-e) can be asked separately as a single 4 marks question.

Students Note:

# CHAPTER 5. AUDIT OF ITEMS OF FINANCIAL STATEMENT

## → WHAT TO STUDY

I] Introduction

II] How to audit items of Balance Sheet

III] How to audit items of P/L

IV] How to audit/ check presentation & disclosure in FS [There are lots of changes in disclosure: thoroughly study Schedule III from accounts also]

## I] INTRODUCTION

In the earlier chapters we have disclosed about specific **assertions** relating to Account Balances, Class of transactions and disclosures.

\* **assertions** are implicit or explicit claims made by company's management just to recall.

### Assertion

(PEQ Nov'21)

Account Balance (B/S)	Class of Transaction (P/L)	Disclosure
<ul style="list-style-type: none"> <li>• Existence</li> <li>• Rights &amp; Obligations</li> <li>• Completeness</li> <li>• Valuation</li> </ul>	<ul style="list-style-type: none"> <li>• Occurrence</li> <li>• Completeness</li> <li>• Accuracy/ Allocation</li> <li>• Cut-off</li> <li>• Classification</li> </ul>	<ul style="list-style-type: none"> <li>• Occurrence</li> <li>• Rights &amp; Obligations</li> <li>• Completeness</li> <li>• Accuracy</li> <li>• Valuation</li> <li>• Classification &amp; Understandability</li> </ul>

Explanation: -

- 1) Existence – Assets/ Liability & equity **exist** as at the period.
- 2) Right & Obligation – Entity has the right **ownership** or use of the asset.
- 3) Completeness – a) **All** assets, liabilities & equity balances are recognised (B/S)  
b) **All** transactions that were supposed to be recorded are recognized by the company (P/L).
- 4) Valuation – Assets & Liabilities have been **valued appropriately**.
- 5) Accuracy/ Measurement – Transactions, events balances are **measured and disclosed correctly** at their appropriate values
- 6) Occurrence – Transaction & events have **occurred & relate** to the entity
- 7) Cut-off/ Classification – Amounts are for the year & 31st March is the last day for recording expenses & income.
- 8) Presentation as Disclosure: – Whether particular items in FS are properly **classified, disclosed and described**.

## II] HOW TO AUDIT ITEMS OF BALANCE SHEET

### 1) Share Capital

	Assertions	Audit Procedures
a)	Existence	<ul style="list-style-type: none"> <li>Auditor should examine "Authorized Capital" as designed u/s 2(8) of Companies Act.</li> <li>Verify it with MOA of company</li> <li>Verify Capital Register</li> <li>Verify stamp duty paid on issue of shares</li> </ul>
b)	Completeness	<ul style="list-style-type: none"> <li>Examine "Issued Capital" as defined u/s 2(50) of Companies Act.</li> <li>Verify share capital includes the shares allotted for consideration of cash &amp; other than cash.</li> </ul>
c)	Valuation	<ul style="list-style-type: none"> <li>Tally authorised, issued paid up share capital with previous year audited Financial Statement</li> <li>In case of change obtain WR.</li> <li>Obtain &amp; verify copies of forms filed with MCA                             <ol style="list-style-type: none"> <li>Form SH 7 – Increase in authorised share capital</li> <li>Form PAS 3 – Increase in paid-up capital</li> </ol> </li> <li>Verify paid-up is within authorised share capital</li> <li>Verify calculation of stamp duty</li> <li>If shares are issued at Premium – Verify compliance with Sec 52, of Companies Act, (Regarding utilisation of premium amount)</li> <li>If shares are issued at discount – verify compliance with Secs 53 &amp; 54 which states that no company can issue shares at discount except issuance of sweat equity</li> </ul>
	SP can be used for following: -	
	(i) Issuance of fully paid up Bonus shares	
	(ii) w/off preliminary expenses	
	(iii) w/off discount & expense on issue of shares or debentures of Company	
	(iv) Paying premium on Redeem then of pref. shares or debentures	
	(v) Buy back u/s 68	
		<div style="text-align: center;"> <div style="border: 1px solid black; padding: 5px; width: fit-content; margin: 0 auto;">Penalty for Contravening Sec 53</div> <div style="display: flex; justify-content: space-around; align-items: center; margin-top: 10px;"> <div style="border: 1px solid black; padding: 5px;">Company</div> <div style="border: 1px solid black; border-radius: 50%; padding: 5px;">AND</div> <div style="border: 1px solid black; padding: 5px;">Office in default</div> </div> <div style="border: 1px solid black; padding: 5px; width: fit-content; margin: 10px auto;">Amount raised through issued of share at discount or ₹ 500,000 whichever is less.</div> </div>

Company shall also be liable to refund the monies @12% p.a.

**Sec 54:- Issue of sweat**

equity means equity shares issued by the Co. to employees/directors at discount for providing know-how or making available right in nature of intellectual property, rights

- Auditor should verify reduction in capital by: -

  1. Checking compliance with sec 66
  2. Verifying SR passed
  3. Verifying AOA, MOA
  4. Examine order of NCLT
  5. Inspecting registrar certificate
  6. Vouching accounting entries
  7. Confirming the revaluation of assets & disclosures
  8. Verifying adjustments made in members A/c
  9. Confirm the words "and reduced"

**Conditions for Issuing Sweat Equity Shares**

- i) SR passed by Co.
- ii) SR specifies number amount, consideration issued once in a year only Co. has issued of equity shares.
- iii) Omitted
- iv) Where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.
- v) 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.

**d) Presentation & Disclosure**

Auditor must ensure disclosure as per requirement of Ind AS & Schedule III [Note: - A Performa of Schedule III format of P/L & B/S is annexure to the chapter for practical knowledge & clear understanding]

**2) Reserves & Surplus (Called as other equity under Ind AS)**

Reserves	Provisions
Reserves are amounts appropriated out of profits that are not intended to meet any liability, contingency, commitment or diminution in the value of assets known to exist as at the date of the Balance Sheet.	Provisions are amounts charged against revenue to provide for:
	(i) Renewal or diminution in the value of assets; or
	(ii) A known liability, the amount whereof could only be estimated and cannot be

determined with accuracy; or  
(iii) A claim which is **disputed**.

Assertion	Audit Procedures
a) Existence	<ul style="list-style-type: none"> <li>Tally the <b>opening balance</b> with previous years audited FS</li> </ul>
b) Completeness	<ul style="list-style-type: none"> <li>Trace the <b>movement</b> in Reserve Bank i.e. adjustment for dividend cross verify it by examining: - DDT, <b>resolution</b> passed etc.</li> </ul>
c) Valuation	<ul style="list-style-type: none"> <li>Auditor should verify that <b>proposed dividend</b> should <b>not</b> be recognised as <b>liability</b> as on balance sheet date.</li> <li>Examine utilisation of security premium (discussed earlier)</li> </ul> <p>Note: - Students are advised to link AS 4/ Ind AS 10 &amp; Secs 52, 68 etc.</p>
d) Presentation Disclosure	<p>Auditor must ensure disclosure as per requirement of <b>Ind AS &amp; Schedule III</b> [Note : - A Performa of Schedule III format of P/L &amp; B/S is annexure to the chapter for practical knowledge &amp; clear understanding]</p>

### 3) Borrowings

Liabilities are the financial obligation of an enterprise other than owners funds. Liabilities include loans/ borrowings, trade payables and other current liabilities, deferred payment credits and provisions.

Auditor shall verify liabilities that no liability is omitted or overstated.

Assertion	Audit Procedures
a) Existence	<ul style="list-style-type: none"> <li>Review <b>Board minutes</b> for approval of new lending agreements.</li> <li>Verify <b>loan agreements</b> for checking interest terms, nature of loans etc.</li> <li>Obtain Bank Confirmation, agree details of lease &amp; hire purchases <b>trust deed</b>.</li> <li>If the transaction is Outside Normal Course of Business (<b>ONCB</b>) or includes Newly Identified Related Party (<b>NIRP</b>) apply procedures mentioned under <b>SA 550</b></li> </ul>
b) Completeness	<ul style="list-style-type: none"> <li>Obtain a schedule of <b>short-term &amp; long-term schedule</b></li> <li>Reconcile the balance at the beginning &amp; closing of F.U</li> </ul>

		<ul style="list-style-type: none"> <li>Consider <b>additional evidence</b></li> </ul>
		<ul style="list-style-type: none"> <li>Apply direct confirmation procedures as per <b>SA 505</b></li> </ul>
c)	Valuation	<ul style="list-style-type: none"> <li>Determine <b>a/c policies</b> &amp; methods of recording debts</li> <li>Recalculate <b>interest</b></li> <li>Check computation of <b>amortisation</b></li> <li>For foreign exchange loan test <b>translation calculation</b></li> </ul>
d)	Presentation & Disclosure	Determine all appropriate disclosures in compliance with Ind AS & relevant sections of Companies Act, 2013.

#### 4) Trade Receivables (TR) (PEQ Nov'22)

Trade Receivable are an **essential part** of any organisation's balance sheet. Often referred to as debtors, these are **monies which are owed to an organisation by a customer.**

a)	Distance	<ul style="list-style-type: none"> <li>Reconcile <b>ledgers</b>, calculate the receivable report <b>total</b>.</li> </ul>
	<b>MCQ</b>	<ul style="list-style-type: none"> <li>See whether realization is recorded invoice wise</li> </ul>
	Q. Direct confirmation Procedures are performed during audit of accounts receivable balances to address the following balance sheet assertion:	<ul style="list-style-type: none"> <li>Obtain <b>external confirmation</b> by applying <b>SA 505</b></li> <li>Apply <b>SA 520</b>, perform trend analysis</li> <li>Examine sales with related party, i.e. evaluate collectability from <b>related party receivables</b>.</li> </ul>
	a. Rights & Obligation	
	b. Existence	
	c. Valuation	
	d. Completeness	
b)	Completeness	<ul style="list-style-type: none"> <li>Examine appropriate <b>cut off</b> procedures are followed for invoices issued for last few days close to year end.</li> <li>Test invoices listed in receivable report</li> <li>Match invoices to shipping/ dispatch log. Match <b>invoices dates</b> to the shipment dates for those items in the shipping/<b>dispatch log</b>, to see if sales are being recorded in the correct accounting period- <ul style="list-style-type: none"> <li>Assess bill and hold sales</li> <li>Review receiving log. Review the receiving log to see if the Company has recorded an inordinately large amount of customer returns after the audit period.</li> </ul> </li> <li>Study the system of giving discounts and check the following:</li> </ul>



		(a) Whether the same is being given as per the <b>Company policy</b> / general industry trends;
		(b) Whether cash discount is given on the basis of date of realization of cheque or on the basis of date of receipt of cheque.
		<ul style="list-style-type: none"> <li>Review credit memos</li> <li>Credit memos issued during the audit period to see if they were properly <b>authorized</b>, whether they were issued in the <b>correct period</b>, and whether the circumstances of their issuance indicate <b>other problems</b>.</li> </ul>
c)	Valuation (PEQ July 21) (MCQ) Obtaining trade Receivables ageing report & analysis & Identification of doubtful debts is performed during audit of accounts receivable balances to address the following balance sheet assertion:	<ul style="list-style-type: none"> <li>Assess the <b>allowance</b> for doubtful account.</li> <li>Obtain the <b>ageing report</b></li> <li>Review the <b>process</b> followed by the company to allow RDD – is it <b>Consistent</b></li> <li>Scrutinize the analysis &amp; identify debts which <b>appears doubtful</b>, check whether write-off &amp; <b>reductions are done</b> or not.</li> </ul>
	a. <b>Valuation</b> ✓	
	b. <b>Rights &amp; Obligations</b>	
	c. <b>Existence</b>	
d)	Presentation & Disclosures	<ul style="list-style-type: none"> <li>Check that the <b>foreign currency</b> are disclosed properly.</li> <li>Presentation is in accordance with GAAP i.e. Ind AS in compliance with Schedule III.</li> </ul> <p>Note: - Transactions with <b>Related party</b> u/s 189 are required to be reported properly in CARO.</p>

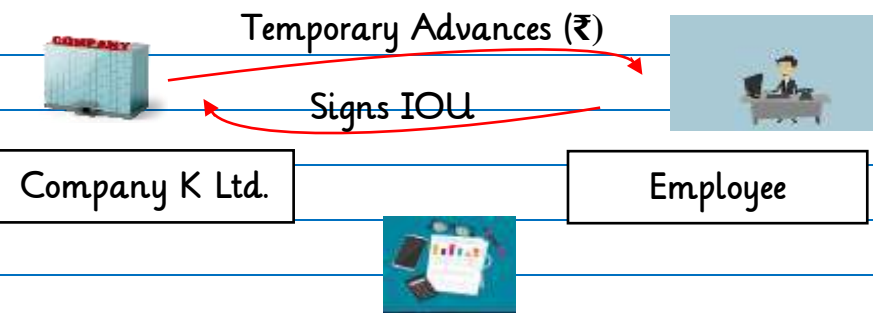
## 5) Cash & Cash Equivalents

It represents most liquid assets of an enterprise.

Utmost **professional skepticism** need to be exercised while auditing such balances.

	Assertion	Audit Procedures
a)	Existence	<ul style="list-style-type: none"> <li>Existence must be checked by <b>surprise testing</b>.</li> <li><b>Special care</b> is necessary for verification of cash</li> </ul>
b)	Completeness	<ul style="list-style-type: none"> <li>If there is any rough cash book check entries</li> </ul>

- Evaluate IOU (I Owe You)



- Perform cash sensitivity analysis
- Verify balances regularly
- Obtain Bank Reconciliation statement. (BRS) & verify the same by tallying the balance & obtain bank confirmation also check material reconciling item included under "Cheques deposited but not credited by Bank"
- Check items debited/ credited by bank not accounted for
- Direct confirmation procedures
- Obtain bank confirmation
- Ask PFI & banks to confirm the amounts held in current A/C, CC A/C, escrow A/C etc.

c) Valuation

Ensure & Verify forex conversion process.

d) Presentation &

Ensure whether the disclosures as required under Ind AS Complaint

Disclosure

Schedule III

Student Note: -



- Review collateral agreements, consignment agreement, purchase Agreement

d) Valuation

Management may value inventory

using

As per GAAP

FIFO

OR

LIFO

OR

Weighted average system

Inventory

Raw Material

- Calculate cost
- Enquire into basis of standards
- Test check invoices
- Value damaged goods or obsolete inventories

W/P (PEQ)

- Ascertain stage of completion
- Ascertain the elements of cost included & compare the available cost & financial data with the basis on which such cost are incurred
- Ensure that material costs exclude any abnormal wastage factors

FG

- Enquire into cost included.
- Ensure valuation as per AS - 2
- Follow up for obsolete goods
- Perform inventory ageing
- Apply procedure as per SA 501
- Compare recorded cost with replacement
- Examine vendor price list
- Calculate inventory turnover rate

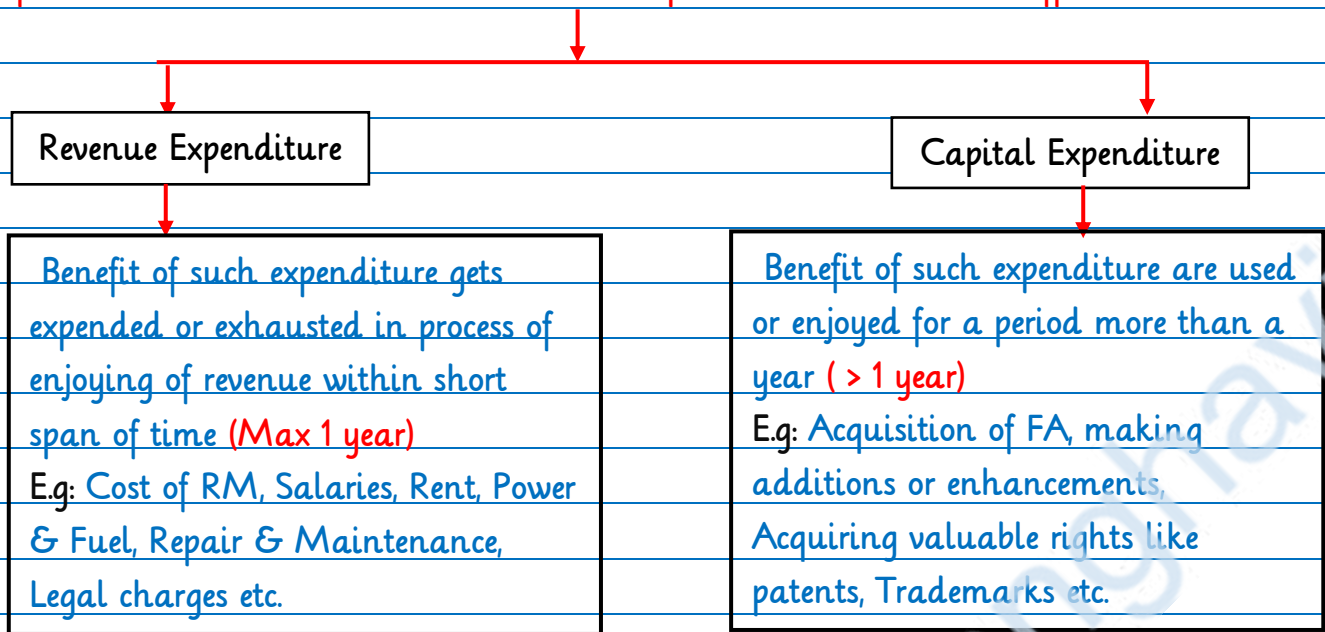
e) Presentation &

Disclosure (PEQ)

Ensure whether disclosures as required under Ind AS complaint Schedule III to Companies Act, 2013 have been made.

## 7) FIXED TANGIBLE ASSETS (referred to as property, plant & equipment PPE)

Before we understand Fixed Asset (FA) it is important to understand difference between: -



### Important

There are **expense**, which are essentially of a **revenue nature** but **regarded as capital expenditure (PEQ)**

E.g.: -

- i. Material and Wages: - Capital expenditure when expended on the construction of a building or erection of machinery;
- ii. Legal expenses: - Capital expenditure when incurred in connection with the purchase of land or building;
- iii. Freight: - Capital expenditure when incurred in respect of purchase of plant and machinery;
- iv. Repair: - Major repairs of a fixed asset that increases its productivity;
- v. Wages: - Wages paid on installation costs incurred in Plant & machinery;
- vi. Interest: - Interest incurred during the eligible period as defined under Ind AS 23 i.e. during the period of construction of the asset.

	Assertion	Audit Procedure
a)	Existence	<ul style="list-style-type: none"> <li>• Review managements plan for physical verification (Note Physical verification shall be done <b>at least once in 3 years</b>)</li> <li>• Evidence of appropriate <b>supervision</b></li> <li>• Obtain <b>verification report</b> backed by working sheet</li> <li>• Perform following procedures:               <ul style="list-style-type: none"> <li>- Assess all items are <b>tagged</b></li> <li>- Reconcile items with register</li> </ul> </li> </ul>

		<ul style="list-style-type: none"> <li>- Verify the <b>discrepancies</b> noted based on physical verification and how it is dealt in BOA</li> </ul>
b)	<p>Completeness</p> <p>[Note:- Students are Advised to thoroughly Study <b>AS - 10: PPE</b> from Accounts Syllabus]</p>	<ul style="list-style-type: none"> <li>• Verify <b>movement</b> in the PPE i.e. Opening + Addition - Deletion = Closing</li> <li>• Check arithmetical <b>accuracy</b></li> <li>• For every addition verify probable <b>future economic benefit</b></li> <li>• Ensure expenditure incurred are reasonable <b>measured &amp; are capital</b> in nature</li> <li>• Examine cost of item as per <b>Ind AS 16 / AS 10</b></li> </ul>
c)	Valuation	<ul style="list-style-type: none"> <li>• As value of FA/PPE depreciates due to efflux of time, use &amp; obsolescence</li> <li>• Auditor must verify that entity charges <b>depreciation</b> on all Item (<b>Except</b> free hold <b>LAND</b>)</li> <li>• <b>Method of depreciation</b> reflects the pattern in which the assets future economic benefits are expected. (E.g. SLM, WDV Method)</li> <li>• Verify <b>impairment assessment</b> done by management, by verifying compliance with <b>AS 28/ Ind AS 36</b>, also checking that whether <b>recoverable values</b> are correctly derived.</li> </ul>
d)	Right & Obligation	<ul style="list-style-type: none"> <li>• While performing physical verification, cross verification <b>ownership</b> by examining <b>purchase invoices</b></li> <li>• Auditor should insist &amp; verify the original <b>title deed</b></li> <li>• In case title deed of immovable property are not available with management i.e. provided as security against borrowing then obtain <b>external confirmation</b></li> </ul>
e)	Presentation & Disclosure	Ensure whether disclosures as required under Ind AS complaint Schedule III to Companies Act, 2013 have been made.

## 8) FIXED ASSETS: – INTANGIBLE ASSETS

→ It is an identifiable non-monetary asset **without physical substance**, held for use in the production or supply or for renting

E.g. Computer Software, Patents, Copyrights, Goodwill, Motion Picture Films, Licenses etc.



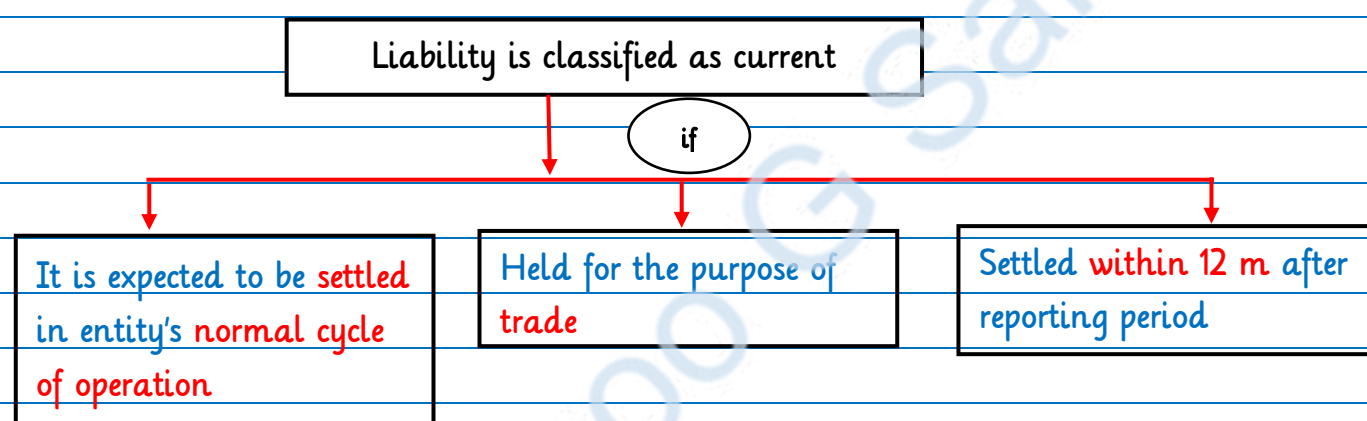
→ Note: - Some intangible assets may be contained in or on a **physical** substance such as a **compact disk**.

→ Intangible assets are valued as per **AS-26/ Ind AS 38**

Assertions	Audit Procedures			
a) Existence	<ul style="list-style-type: none"> <li>Auditor should verify, whether such intangible asset is in <b>active use</b>. In case any intangible asset is not in active use, verify that such assets are appropriately <b>deleted from BOA</b></li> </ul>			
b) Completeness	<ul style="list-style-type: none"> <li>Verify <b>movement</b> in intangible assets</li> <li>Check <b>arithmetical accuracy</b></li> <li>Assess internally generated IA</li> <li>Examine treatment of expenditure is different depending on phase during which it is incurred</li> </ul>			
<p>Note:- Internally generated IA. such as brands, mast/head publishing titles, <b>cannot</b> be recognized as asset; However purchased. Goodwill can be recorded in Books of Account if it represents future economic benefits</p>	<p>Phases</p> <pre> graph TD     Phases[Phases] --&gt; Research[Research]     Phases --&gt; Development[Development]         </pre>			
	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 50%; text-align: center;">Research</th> <th style="width: 50%; text-align: center;">Development</th> </tr> </thead> <tbody> <tr> <td style="vertical-align: top;"> <ul style="list-style-type: none"> <li>1) Expenditure are <b>not capitalise</b> rather expensed out i.e. debited to P/L</li> <li>E.g. a) Expense to gain knowledge</li> <li>b) Search for alternative material, device, product</li> <li>c) Evaluation &amp; trials</li> </ul> </td> <td style="vertical-align: top;"> <ul style="list-style-type: none"> <li>1) Expenditure during this phase can be capitalized only if</li> <li>a) Technical <b>feasibility</b> is <b>completed</b></li> <li>b) Its able to <b>use or sell</b></li> <li>c) Able to generate probable <b>future economic benefits</b></li> <li>d) Able to <b>reliable measure</b> expenditure attributable to IA</li> <li>e) <b>Availability</b> of <b>technical, financial &amp;</b> resources to complete the development</li> </ul> </td> </tr> </tbody> </table>	Research	Development	<ul style="list-style-type: none"> <li>1) Expenditure are <b>not capitalise</b> rather expensed out i.e. debited to P/L</li> <li>E.g. a) Expense to gain knowledge</li> <li>b) Search for alternative material, device, product</li> <li>c) Evaluation &amp; trials</li> </ul>
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	<ul style="list-style-type: none"> <li>Verify certificate/ report/ similar document</li> <li>Verify approval for additions</li> <li>Verify process followed to discard on asset E.g. By inviting tenders, quotes etc.</li> </ul>			

c)	Valuation (PEQ July 21)	<ul style="list-style-type: none"> <li>Verify amortisation &amp; diminution in value of asset</li> <li>Also ensure impairment assessments has been taken by management</li> <li>Verify compliance with AS 28/ Ind AS 36</li> </ul>
d)	Rights & Obligation	Scrutinise all expense invoice/ purchase contracts are in the name of entity
e)	Presentation & Disclosure	Ensure whether disclosures as required under Ind AS complaint Schedule III to Companies Act, 2013 have been made.

## 9) TRADE PAYABLE & OTHER CURRENT LIABILITIES



Note:- The entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counter party, result in its settlement by the issue of equity instruments does not affect its classification.

	Assertion	Audit Procedures
a)	Existence	<ul style="list-style-type: none"> <li>Check Internal Control</li> <li>Ensure that trade payable ledger reconcile with general ledger</li> <li>Calculate payable totals</li> <li>Review justification for larger amounts</li> <li>Obtain direct confirmation as per SA 505</li> <li>Perform trend analysis as per SA 520</li> <li>Ensure appropriate authorisation for transaction with related party, apply procedures as per SA 550</li> </ul>

b)	Completeness	<ul style="list-style-type: none"> <li>• Auditor needs to satisfy himself of correct &amp; proper cut-offs.</li> <li>• For invoices recorded during days closer to year end ensure goods are received or risk &amp; records are transferred in favour of company</li> <li>• All goods are recorded &amp; received</li> <li>• Match purchase vouchers to gate entry register</li> <li>• Test Purchase/ Expense Vouchers listed in account payable report</li> <li>• Match vouchers to gate entry register/ log [i.e. goods register]</li> <li>• Review all material expense vouchers</li> <li>• Obtain list of customers along with its ageing</li> <li>• Enquire about disputes with customers, if any</li> <li>• Verify if advances have been adjusted subsequently post sale of goods (SA – 560)</li> <li>• Verify statutory dues like TDS, GST, Luxury Tax etc. &amp; Obtain challans for the deposits of such statutory dues.</li> </ul>
c)	Valuation	<ul style="list-style-type: none"> <li>• Assess old outstanding liability by reviewing companies process to identify the amount required to be written back</li> <li>• Obtain ageing report; split between less than 30 days, 30-60 days old, 60-180 days, 180 days - 365 days or more</li> <li>• Check that write backs in the liability balances are assess</li> <li>• Check foreign currency conversion (AS-11)</li> <li>• Identify amount to be paid to (MSME) Micro, Small &amp; Medium Enterprises at the end of the year</li> </ul>
d)	Presentation & Disclosure	Ensure whether disclosures as required under Ind AS complaint Schedule III to Companies Act, 2013 have been made.

## 10) LOANS & ADVANCES AND OTHER CURRENT ASSETS

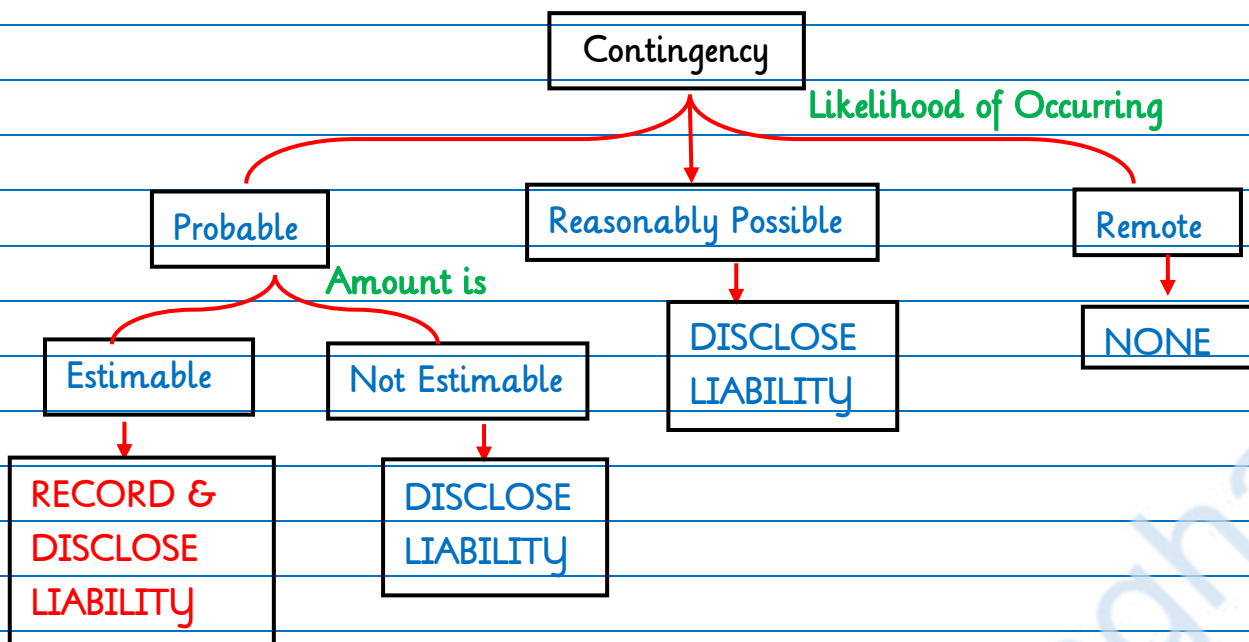
It means money advanced to related or other parties with or without interest & include amounts recoverable either in cash or in kind.

	Assertions	Audit Procedures
a)	Existences	<ul style="list-style-type: none"> <li>• Perform same procedures as performed for Trade receivable</li> </ul>

b)	Completeness	<ul style="list-style-type: none"> <li>Obtain a list of <b>all</b> advances &amp; other current assets</li> <li>Inspect loan agreements.</li> <li>Confirm the <b>provision of AOA</b></li> <li>Inspect <b>minutes</b> of BOD meeting</li> <li>Verify loan has been acknowledged by the party &amp; inspect security, if any</li> <li>Ascertain loans &amp; advances given to related party are at Arm's Length price</li> <li>Verify Statutory balances with authorities &amp; Obtain copies return</li> </ul>
c)	Valuation	<ul style="list-style-type: none"> <li>Assess <b>allowance</b> for doubtful account</li> <li>Obtain <b>ageing report</b> of loan</li> <li>Discuss with management regarding <b>recoverability</b> of loan &amp; provision thereof</li> <li>Check whether <b>write-offs</b> or other reductions are appropriately <b>approved</b></li> <li>Check foreign currency conversion rate &amp; calculation</li> </ul>
d)	Presentation & Disclosure	Ensure whether disclosures as required under Ind AS complaint Schedule III to Companies Act, 2013 have been made.

## 11) PROVISIONS & CONTINGENT LIABILITIES

	Provision	Contingent Liabilities
(i)	A Known Liability, amount where of cannot be determined with substantial accuracy or	(i) 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
(ii)	A claim which is disputed.	(ii) A present obligation that arises from past events but is not recognized because: <ul style="list-style-type: none"> <li>It is not probable that an outflow of resources embodying economic benefits will be required to settled the obligation; or</li> <li>The amount of the obligation cannot be measured with sufficient reliability.</li> </ul>



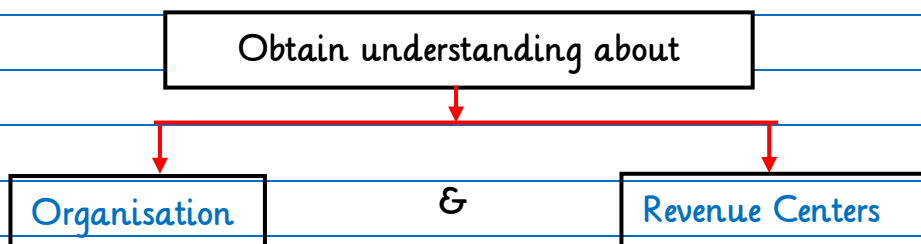
	Assertions	Audit Procedures
a)	Existence	<ul style="list-style-type: none"> <li>Obtain a list of <b>all provisions</b> &amp; compare them</li> </ul>
b)	Completeness	<ul style="list-style-type: none"> <li>Inspect agreement</li> </ul>
c)	Valuation	<ul style="list-style-type: none"> <li>Obtain expert report, calculations &amp; underlying working for provision amount</li> <li>Apply <b>SA-500</b> while using the work of managements expert</li> </ul>
d)	Presentation & Disclosure	Ensure whether disclosures as required under Ind AS complaint Schedule III to Companies Act, 2013 have been made.

III) **How to audit items of P/L**

1. Sales

(i) Auditor must ensure that **transactions are not materially misstated** by performing test check as a part of year end procedures & also evaluate internal controls over those transaction.

(ii)





Assertion	Audit Procedure
a) Occurrence (PEQ July 21)	<ul style="list-style-type: none"> <li>• Ensure it is not over stated by checkings :-               <ul style="list-style-type: none"> <li>- Whether a single invoice is <b>not recorded twice</b></li> <li>- Fictitious → Customer &amp; sales</li> <li>- Shipments document</li> <li>- Unearned revenue</li> <li>- Substantial uncertainty</li> <li>- Customer Obligation</li> <li>- J.E. of unusual item</li> <li>- Supporting documents</li> <li>- Ratios of Sales return to sales</li> </ul> </li> </ul>
b) Completeness	<ul style="list-style-type: none"> <li>• Perform cut-off test</li> <li>• Evaluate "<b>Credit Notes</b>"</li> <li>• Trace <b>shipping documents</b> to the sales journal</li> <li>• Check whether <b>quantity</b> in register matches in financial record &amp; GST register</li> <li>• Review <b>GST returns</b></li> </ul>
c) Measurement	<ul style="list-style-type: none"> <li>• Consider <b>forex calculation</b></li> <li>• Recalculate prices &amp; <b>extension</b> on sales</li> <li>• Compare the <b>sales</b> &amp; check transaction with related party are at <b>Arm's Length price</b></li> </ul>
d) Presentation & Disclosure	Ensure whether disclosures as required under Ind AS complaint Schedule III to Companies Act, 2013 have been made

2. Other Income: Like interest, dividend gain/loss on sale of investment.

(i) Auditor must precisely check **timing for recognising** such revenues as per AS 9/ Ind AS 18

(ii) As per Ind AS, income from debt instrument is recorded using "**Present value of future Inflow**" method

(iii) Entity should estimate the expected cash flows by considering all contractual terms.

(iv)

Dividend are recognized only when

Right to receive is established

It is probable the benefit will flow to the Co.

Amount is reasonably measured

	Assertion	Audit Procedures
a)	Occurrence, Completeness	<ul style="list-style-type: none"><li>For dividend, Verify right to receive is establish</li><li>Obtain a listing of fixed deposits opened during the period</li><li>Obtain confirmation from Bank</li><li>Cross verify with the copy of 26AS (TDS statement)</li></ul>
b)	Measurement	<ul style="list-style-type: none"><li>Verify arithmetical accuracy</li><li>Calculate interest &amp; reconcile with recognised amount</li><li>Verify Interest Rate</li><li>Verify the amount with gain/(loss) register</li></ul>
c)	Presentation & Disclosure	Ensure whether disclosures as required under Ind AS complaint Schedule III to Companies Act, 2013 have been made.

### 3. Purchases

Auditor must follow almost the same procedure as explained under procedures to verify sales.

(i) An Auditor needs to identify the control points over purchases such as

- Who authorisations, approvals
- Who specification of goods received
- Who acknowledge the receipt
- Who approves vendor invoice
- Who prepares GRN (Goods Receipt Note)
- Who/How purchase are recognised in system

(ii) Perform substantive Analytical Procedures

(iii) Select vouchers on the basis of random sampling

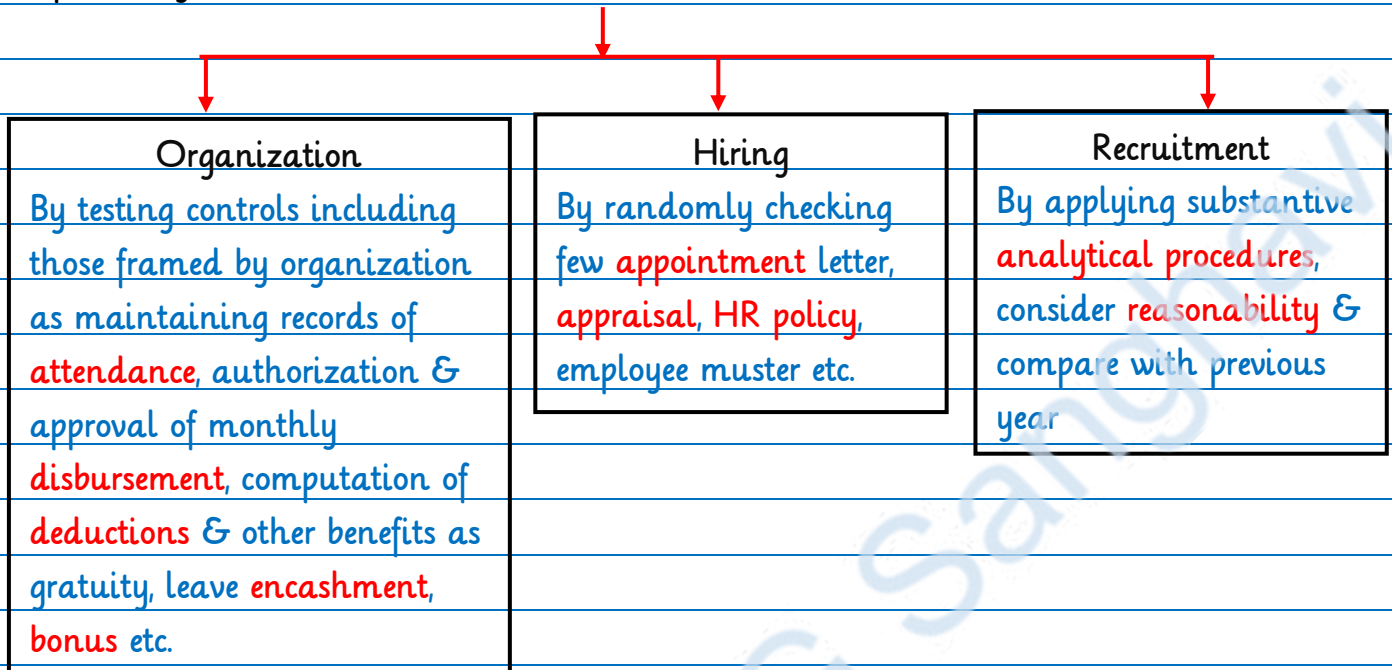
Assertions	Audit Procedures
a) Occurrence	<ul style="list-style-type: none"> <li>• Ensures purchases are <b>not under or overstated</b> by checking whether :-               <ul style="list-style-type: none"> <li>There is fictitious vendor, if any</li> <li>- Goods are <b>received</b> at factory gate</li> <li>- <b>Quality</b> inspection is done</li> <li>- <b>Goods receipt invoice</b> approved (GRN)</li> <li>- Stock record is updated</li> </ul> </li> <li>Verify <b>risk &amp; reward incidental</b> to goods purchases is transferred               <ul style="list-style-type: none"> <li>• Check <b>input tax credit</b></li> <li>• Check terms of delivery [CIF or FOB]</li> <li>• Diligently verify purchases from <b>related party</b></li> </ul> </li> </ul>
b) Completeness	<ul style="list-style-type: none"> <li>• Perform <b>cut-off</b> procedures</li> </ul> <p>Specially check the goods purchased <b>within last few days</b> of year end</p>
c) Measurement	<ul style="list-style-type: none"> <li>• Ensure correct accounting treatment</li> <li>• Perform analytical procedures</li> </ul> <div style="text-align: center; margin-top: 10px;"> <pre> graph TD     A[Perform analytical procedures] --&gt; B[Consumption analysis]     A --&gt; C[Stock Consumption analysis]     A --&gt; D[Ratio analysis]           </pre> </div>
d) Presentation & Disclosure	<p>Ensure whether disclosures as required under Ind AS complaint Schedule III to Companies Act, 2013 have been made.</p>

**Student Note: -**

#### 4. Employee Benefits Expenses (PEQ)

(i) It is commonly called as "Payroll Expenses"

(ii) Auditor needs to obtain a clear understanding about the organisation, hiring, recruitment in following manner:-



	Assertions	Audit Procedures
a)	Occurrence	<ul style="list-style-type: none"> <li>Understand the process of capturing attendance</li> <li>To address the risk of fake/ fictitious employees auditor may physically present</li> </ul>
b)	Completeness	<ul style="list-style-type: none"> <li>Auditor randomly can hold inquiry about department, salary etc.</li> </ul>
c)	Measurement	<ul style="list-style-type: none"> <li>Obtain list of employees at the period end</li> <li>Obtain monthly salary register for all 12 months</li> <li>Also apply procedures as stated above with respect to hiring &amp; recruitment of employee.</li> <li>Examine provision for gratuity, bonus, leave encashment etc.</li> <li>Ensure PF, ESIC, if applicable are deposited on timely basis.</li> </ul>
d)	Presentation & Disclosure	Ensure whether disclosures as required under Ind AS complaint Schedule III to Companies Act, 2013 have been made.

## 5. Depreciation and Amortisation

→ i. It is a systematic reduction in the value of asset over a period of its useful assets life due wear & tear and efflux of time.

ii. Auditor needs to verify following:

- Understand accounting policy of depreciation
- Ensure policy are complying Companies Act & AFRF & it is valid.
- Depreciation is often making adjustment of residual value
- Each component of PPE is identified.

	Assertion	Audit Procedures
a)	Completeness	<ul style="list-style-type: none"> <li>• Obtain the fixed asset register</li> </ul>
b)	Measurement	<ul style="list-style-type: none"> <li>• There is a risk that company may capitalise revenue item, hence auditor must physically verify the asset</li> <li>• Obtain the list of additions/ deletions</li> <li>• Ensure authorisation was granted for additions/ deletions</li> </ul>
c)	Occurrence	<ul style="list-style-type: none"> <li>• Ensure compliance with AS 10/ Ind AS → 16 &amp; Sec 32 of Income-tax Act, 1961</li> </ul>
d)	Presentation & Disclosure	<p>Ensure whether disclosures as required under Ind AS complaint Schedule III to Companies Act, 2013 have been made.</p> <div style="text-align: center;"> <pre> graph TD     A[Disclose (PEQ)] --&gt; B[Policy]     A --&gt; C[Useful lives as per Sch II]     A --&gt; D[Residual Value]     A --&gt; E[Method]             </pre> </div>

## 6. Other Expenses (PEQ Nov'22)

(Like Power & Fuel, Rent, Repair to Building, Plant & Machinery, Insurance, Travelling, Legal & Professional, Miscellaneous expenses → Income Statement Captions

(i) Entity expends fund for other expenses also in order to run the business



(ii) Auditor must verify following attributes:

1. Whether the expenditure pertained to current period under audit;
2. Whether the expenditure qualified as a revenue and not capital expenditure;
3. Whether the expenditure had a valid supporting like travel tickets, insurance policy, third party invoices etc.
4. Whether the expenditure has been classified under the correct expense head;
5. Whether the expenditure was authorised as per the delegation of authority matrix;
6. Whether the expenditure was in relation to the entity's business and not a personal expenditure.

	Assertion	Audit Procedures
a)	Occurrence, Completeness & Measurement	<p>Rent Expense: -</p> <ul style="list-style-type: none"> <li>- Obtain a month wise expense schedule along with the rent agreements.</li> <li>- Verify if expense has been recorded for all 12 months and whether the rent amount is as per the underlying agreement</li> <li>- Specific consideration should be given to escalation clause in the agreement to verify if the rent was to be increase/adjusted during the period under audit.</li> <li>- 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</li> </ul> <p>Power and Fuel Expense</p> <ul style="list-style-type: none"> <li>- Obtain a month wise expense schedule along with the power bills.</li> <li>- Verify if expense has been recorded for all 12 months</li> <li>- 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.</li> <li>- Analyse the monthly power units consumed by linking it to units of finished goods produced and investigate reasons for variance in monthly trends.</li> </ul> <p>Insurance Expense: -</p> <ul style="list-style-type: none"> <li>- Obtain a summary of insurance policies taken along with their validity period</li> </ul>

		- Verify if the expense has been correctly classified between prepaid and expense for the period based on number of days.
		<b>Legal and Professional Expenses: -</b>
		- Obtain a month wise and consultant wise summary
		- In case of monthly retainership agreements, verify the expenditure 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 same may 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.
		<b>Travel, Repair and Maintenance, Printing and Stationery, Miscellaneous Expenses</b>
		- The auditor should select a sample and vouch for the attributes discussed above.
		- Wherever possible, the auditor try and prepare a summary of expenditure on monthly basis and then analytically compare the trends.
		- Obtain audit evidence as to overall reasonableness of other expense which may include expenditure per unit produced analysis
		- Auditor should analyse expense per unit produced and compare the same with previous years and prevent industry trends and ask for the reasons from Management if any significant variations are found.
b)	<b>Presentation &amp; Disclosure</b>	Ensure other expense have been classified under :
		- Rent
		- Insurance
		- Power & fuel
		- Repairs & Maintenance Building, Plant & Machinery, others.
		- Legal & Professional
		- Printing & Stationery
		- Travel expenses
		- Miscellaneous expenses.

**(Important Question) :** Name the assertions for the following audit procedures:

- (i) Year end inventory verification.
- (ii) Depreciation has been properly charged on all assets.
- (iii) The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company.
- (iv) All liabilities are properly recorded in the financial statements.
- (v) Related party transactions are shown properly.

- Ans. (i) Year end inventory verification: Existence Assertion.  
 (ii) Depreciation has been properly charged on all assets: Valuation Assertion.  
 (iii) Title deeds of the lands disclosed in the Balance Sheet are held in the name of the Company: Rights & Obligations Assertion.  
 (iv) All liabilities are properly recorded in the financial statements: Completeness.  
 (v) Related party transactions are shown properly: Presentation & Disclosure.

**IV] PRESENTATION & DISCLOSURE OF FINANCIAL STATEMENT AS PER SCHEDULE III**

**→ PART I — BALANCE SHEET**

Name of the Company.....  
 Balance Sheet as at.....

(Rupees in)

			<i>Particulars</i>	<i>Note No.</i>	<i>Figures as at the end of current reporting period</i>	<i>Figures as at the end of previous reporting period</i>
			1	2	3	4
1.			<b>EQUITY AND LIABILITIES</b>			
			<b>Shareholders' funds</b>			
	a		Share capital			
	b		Reserves and Surplus			
	c		Money received against share warrants			
2.			<b>Share application money pending allotment</b>			
3			<b>Non-current liabilities</b>			
	a		Long-term borrowings			
	b		Deferred tax liabilities (Net)			
	c		Other long-term liabilities			
	d		Long-term provisions			
4.			<b>Current liabilities</b>			
	a		Short-term borrowings			
	b		Trade Payables			
			(A) total outstanding dues of micro enterprises and small enterprises; and			
			(B) total outstanding dues of creditors other than micro enterprises and small			

1.	c	enterprises.			
	d	Other current liabilities			
		Short-term provisions			
		<b>Total</b>			
2.		<b>ASSETS</b>			
	a	<b>Non-current assets</b>			
		Property, plant and Equipment			
	i.	Intangible assets			
	ii.	Capital			
	iii.	Work-in-progress			
	b	Intangible assets under development			
	c	Non-current investments			
	d	Deferred tax assets (Net)			
	e	Long-term loans and advances			
		Other non-current assets			
		<b>Current assets</b>			
a	Current investments				
b	Inventories				
c	Trade receivables				
d	Cash and cash equivalents				
e	Short-term loans and advances				
f	Other current assets				
	<b>Total</b>				

See accompanying notes to Financial Statements

→ **PART II – STATEMENT OF PROFIT AND LOSS**

Name of the Company.....

Profit and loss statement for the year ended .....

(Rupees in)

	<i>Particulars</i>	<b>Note No.</b>	<b>Figures for the current reporting period</b>	<b>Figures for the previous reporting period</b>
	1	2	3	4
I.	Revenue from operations		XXX	XXX
II.	Other income		XXX	XXX
III.	Total Income (I + II)		XXX	XXX
IV.	Expenses:		XXX	XXX
	Cost of materials consumed		XXX	XXX
	Purchases of Stock-in-Trade		XXX	XXX
	Changes in inventories of finished goods work-in-progress and Stock-in-Trade		XXX	XXX
	Employee benefits expense		XXX	XXX
	Finance costs		XXX	XXX
	Depreciation and amortization expense		XXX	XXX
	Other expenses		XXX	XXX
	Total expenses		XXX	XXX
V.	Profit before exceptional and extraordinary items and tax (III-IV)		XXX	XXX
VI.	Exceptional items		XXX	XXX
VII.	Profit before extraordinary items and tax (V - VI)		XXX	XXX
VIII.	Extraordinary Items		XXX	XXX
IX.	Profit before tax (VII- VIII)		XXX	XXX

X	Tax expense:			
	(1) Current tax		XXX	XXX
	(2) Deferred tax		XXX	XXX
XI	Profit (Loss) for the period from continuing operations (VII-VIII)		XXX	XXX
XII	Profit/(loss) from discontinuing operations		XXX	XXX
XIII	Tax expense of discontinuing operations		XXX	XXX
XIV	Profit/(loss) from Discontinuing operations(after tax) (XII-XIII)		XXX	XXX
XV	Profit (Loss) for the period (XI + XIV)		XXX	XXX
XVI	Earnings per equity share:			
	(1) Basic		XXX	XXX
	(2) Diluted		XXX	XXX
			XXX	XXX

See accompanying notes to the financial statements.

## → GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET

### Notes

#### 1. An asset shall be classified as current when it satisfies any of the following criteria:

- it is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle;
- it is held primarily for the purpose of being traded;
- it is expected to be realized within twelve months after the reporting date; or
- it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

All other assets shall be classified as non-current.

2. An operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration of 12 months.

#### 3. A liability shall be classified as current when it satisfies any of the following criteria:

- it is expected to be settled in the company's normal operating cycle;
- it is held primarily for the purpose of being traded;
- it is due to be settled within twelve months after the reporting date; or
- the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

All other liabilities shall be classified as non-current.

4. A receivable shall be classified as a 'trade receivable' if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.

5. A payable shall be classified as a 'trade payable' if it is in respect of the amount due on account of goods purchased or services received in the normal course of business.

6. A company shall disclose the following in the notes to accounts:



## A. SHARE CAPITAL

For each class of share capital (different classes of preference shares to be treated separately):

- a) the number and amount of shares authorized;
- 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 percent 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:
  - Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.
  - Aggregate number and class of shares allotted as fully paid up by way of bonus shares.
  - 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)
- m) 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**	
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.

## B. RESERVES AND SURPLUS

- a) Reserves and Surplus shall be classified as:
  - Capital Reserves;
  - Capital Redemption Reserve;
  - Securities Premium;
  - Debenture Redemption Reserve;
  - Revaluation Reserve;
  - Share Options Outstanding Account;
  - Other Reserves – (specify the nature and purpose of each reserve and the amount in respect thereof);
  - Surplus i.e. balance in Statement of Profit & Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/from reserves etc.

(Additions and deductions since last balance sheet to be shown under each of the specified heads)

- b) A reserve specifically represented by earmarked investments shall be termed as a 'fund'.
- c) 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 of surplus, if any, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

### C. LONG-TERM BORROWINGS

- a) Long-term borrowings shall be classified as:
  - Bonds/debentures.
  - Term loans
    - From banks.
    - From other parties
  - Deferred payment liabilities.
  - Deposits.
  - Loans and advances from related parties.
  - Long term maturities of finance lease obligations
  - Other loans and advances (specify nature).
- b) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.
- c) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.
- d) 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.
- e) Particulars of any redeemed bonds/ debentures which the company has power to reissue shall be disclosed.
- f) Terms of repayment of term loans and other loans shall be stated.
- g) Period and amount of continuing default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

### D. OTHER LONG TERM LIABILITIES

Other Long-term Liabilities shall be classified as:

- a) Trade payables
- b) Others

### E. LONG-TERM PROVISIONS

The amounts shall be classified as:

- a) Provision for employee benefits.
- b) Others (specify nature).

### F. SHORT-TERM BORROWINGS

- a) Short-term borrowings shall be classified as:
  - Loans repayable on demand
    - From banks
    - From other parties
  - Loans and advances from related parties.

- Deposits.
- b) Other loans and advances (specify nature).
- c) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.
- d) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.
- e) Period and amount of default as on the balance sheet date in repayment of loans and interest shall be specified separately in each case.
- f) current maturities of Long term borrowings shall be disclosed separately.

#### FA. Trade Payables

The following details relating to Micro, Small and Medium Enterprises shall be disclosed in the notes:

- (a) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year;
- (b) the amount of interest paid by the buyer in 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;
- (c) the amount of interest due and payable for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without adding the interest specified under the Micro, Small and Medium Enterprises Development Act, 2006;
- (d) the amount of interest accrued and remaining unpaid at the end of each accounting year; and
- (e) the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues above are actually paid to 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.

#### FB. Trade payables due for payment

The following ageing schedule shall be given for Trade payables due for payment:-

Trade Payables ageing schedule

(Amount)

Particulars	Outstanding for following periods from due date of payment#				Total
	Less than 1 year	1-2 years	2-3years	More than 3years	
(i) MSME					
(ii) Others					
(iii) Disputed dues – MSME					
(iv) Disputed dues – Others					
(v) 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;

Explanation: The terms 'appointed day', 'buyer', 'enterprise', 'micro enterprise', 'small enterprise' and 'supplier', shall have the same meaning assigned to those under clauses (b), (d), (e), (h), (m) and (n) respectively of section 2 of the Micro, Small and Medium Enterprises Development Act, 2006.

## G. OTHER CURRENT LIABILITIES

The amounts shall be classified as:

- a) Current maturities of finance lease obligations;
- b) Interest accrued but not due on borrowings;
- c) Interest accrued and due on borrowings;
- d) Income received in advance;
- e) Unpaid dividends
- f) Application money received for allotment of securities and due for refund and interest accrued thereon. Share application 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 be disclosed whether the company has sufficient authorized 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 document inviting application for shares along with the 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'
- g) Unpaid matured deposits and interest accrued thereon
- h) Unpaid matured debentures and interest accrued thereon
- i) Other payables (specify nature);

## H. SHORT-TERM PROVISIONS

The amounts shall be classified as:

- a) Provision for employee benefits.
- b) Others (specify nature).

## I. Property, Plant and Equipment

- a) Classification shall be given as:
  - Land.
  - Buildings.
  - Plant and Equipment.
  - Furniture and Fixtures.
  - Vehicles.
  - Office equipment.
  - Others (specify nature).
- b) Assets under lease shall be separately specified under each class of asset.
- c) 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 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.
- d) 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.

## J. INTANGIBLE ASSETS

a) Classification shall be given as:

- Goodwill.
- Brands /trademarks.
- Computer software.
- Mastheads and publishing titles.
- Mining rights.
- Copyrights, and patents and other intellectual property rights, services and operating rights.
- Recipes, formulae, models, designs and prototypes.
- Licenses and franchise.
- Others (specify nature).

b) 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 to revaluation (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 or reversals shall be disclosed separately.

c) 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.

## K. NON-CURRENT INVESTMENTS

a) Non-current investments shall be classified as trade investments and other investments and further classified as:

- Investment property;
- Investments in Equity Instruments;
- Investments in preference shares
- Investments in Government or trust securities;
- Investments in debentures or bonds;
- Investments in Mutual Funds;
- Investments in partnership firms
- Other non-current investments (specify nature)

Under each classification, details shall be given of names of the bodies corporate [indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities] in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid).

In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

b) Investments carried at other than at cost should be separately stated specifying the basis for valuation thereof.

c) The following shall also be disclosed:

- Aggregate amount of quoted investments and market value thereof;
- Aggregate amount of unquoted investments;
- Aggregate provision for diminution in value of investments.



## L. LONG-TERM LOANS AND ADVANCES

- a) Long-term loans and advances shall be classified as:
- Capital Advances;
  - Loans and advances to related parties (giving details thereof);
  - Other loans and advances (specify nature).
- b) The above shall also be separately sub-classified as:
- Secured, considered good;
  - Unsecured, considered good;
  - Doubtful.
- c) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.
- d) 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.

## M. OTHER NON-CURRENT ASSETS

Other non-current assets shall be classified as:

- a) Long Term Trade Receivables (including trade receivables on deferred credit terms);
- aa) Security Deposits;
- b) Others (specify nature);
- c) Long term Trade Receivables, shall be sub-classified as:
- • Secured, considered good;
  - Unsecured considered good;
  - Doubtful
- Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
- Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.
- d) For trade receivables outstanding, following ageing schedule shall be given:

### Trade Receivables ageing schedule

Particulars	Outstanding for following periods from due date of payment#					Total
	Less than 6 months	6 months - 1 year	1-2 years	2-3 years	More than 3 years	
(i) Undisputed Trade receivables –considered good						
(ii) Undisputed Trade Receivables – 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 from the date of the transaction.

Unbilled dues shall be disclosed separately.



## N. CURRENT INVESTMENTS

a) Current investments shall be classified as:

- Investments in Equity Instruments;
- Investment in Preference Shares
- Investments in government or trust securities;
- Investments in debentures or bonds;
- Investments in Mutual Funds;
- Investments in partnership firms
- Other investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate [indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities] in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

b) The following shall also be disclosed:

- The basis of valuation of individual investments
- Aggregate amount of quoted investments and market value thereof;
- Aggregate amount of unquoted investments;
- Aggregate provision made for diminution in value of investments.

## O. INVENTORIES

a) Inventories shall be classified as:

- Raw materials;
- Work-in-progress;
- Finished goods;
- Stock-in-trade (in respect of goods acquired for trading);
- Stores and spares;
- Loose tools;
- Others (specify nature).

c) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.

d) Mode of valuation shall be stated.

## P. TRADE RECEIVABLES

a) For trade receivables outstanding, the following ageing schedules shall be given:

**Trade Receivables ageing schedule (Amount in `)**

Particulars	Outstanding for following periods from due date of payment#					Total
	Less than 6 months	6 months -1 year	1-2 years	2-3 years	More than 3 years	
(i) Undisputed Trade receivables – considered good						
(ii) Undisputed Trade Receivables – 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 from the date of the transaction.

Unbilled dues shall be disclosed separately.

- b) Trade receivables shall be sub-classified as:
  - Secured, considered good;
  - Unsecured considered good;
  - Doubtful.
- c) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
- d) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

#### **Q. CASH AND CASH EQUIVALENTS**

- a) Cash and cash equivalents shall be classified as:
  - Balances with banks;
  - Cheques, drafts on hand;
  - Cash on hand;
  - Others (specify nature).
- b) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.
- c) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
- d) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.
- e) Bank deposits with more than 12 months maturity shall be disclosed separately.

#### **R. SHORT-TERM LOANS AND ADVANCES**

- a) Short-term loans and advances shall be classified as:
  - Loans and advances to related parties (giving details thereof);
  - Others (specify nature).
- b) The above shall also be sub-classified as:
  - Secured, considered good;
  - Unsecured, considered good;
  - Doubtful.
- c) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.
- d) 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.

#### **S. OTHER CURRENT ASSETS (SPECIFY NATURE).**

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories.

#### **T. CONTINGENT LIABILITIES AND COMMITMENTS (TO THE EXTENT NOT PROVIDED FOR)**

- a) Contingent liabilities shall be classified as:
  - Claims against the company not acknowledged as debt;
  - Guarantees;
  - Other money for which the company is contingently liable

b) Commitments shall be classified as:

- Estimated amount of contracts remaining to be executed on capital account and not provided for;
- Uncalled liability on shares and other investments partly paid
- Other commitments (specify nature).

**U. The amount of dividends proposed to be distributed to equity and preference shareholders for the period and the related amount per share shall be disclosed separately. Arrears of fixed cumulative dividends on preference shares shall also be disclosed separately.**

**V. 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 unutilized amounts have been used or invested.**

**VI. Where the company has not used the borrowings from banks and financial institutions for the specific purpose for which it was taken at the balance sheet date, the company shall disclose the details of where they have been used.**

**W. If, in the opinion of the Board, any of the assets other than Property, Plant Equipment, “Intangible assets and non-current investments do not have a value on realization in the ordinary course of business at least equal to the amount at which they are stated, the fact that the Board is of that opinion, shall be stated.**

**X. Additional Regulatory Information**

a) **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 indicate if in dispute
Investment property	Land Building					
PPE retired from active use and held for disposal others	Land Building					

#Relative here means relative as defined in the Companies Act, 2013.

\*Promoter here means promoter as defined in the Companies Act, 2013.

- b) 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.
- c) Following disclosures shall be made where Loans or Advances in the nature of 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:
- repayable on demand or
  - 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		

- d) Capital-Work-in Progress (CWIP)
- For Capital-work-in progress, following ageing schedule shall be given:

**CWIP aging schedule**

CWIP	Amount in CWIP for a period of				Total*
	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.

- For capital-work-in progress, whose completion is overdue or has exceeded its cost compared to its original plan, following

**CWIP completion schedule shall be given\*\*:**

CWIP	To be completed in			
	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.

- e) Intangible assets under development:
- For Intangible assets under development, following ageing schedule shall be given:

**Intangible assets under development aging schedule**

Intangible assets under development	Amount in CWIP for a period of				Total*
	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.

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\*\*:

Intangible assets under development	To be completed in			
	Less than 1 year	1-2 years	2-3 years	More than 3 years
Project 1				
Project 2				

f) **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:-

- Details of such property, including year of acquisition,
- Amount thereof,
- Details of Beneficiaries,
- If property is in the books, then reference to the item in the Balance Sheet,
- If property is not in the books, then the fact shall be stated with reasons,
- Where there are proceedings against the company under this law as an abetter of the transaction or as the transferor then the details shall be provided,
- Nature of proceedings, status of same and company's view on same.

g) **Where the Company has borrowings from banks or financial institutions** on the basis of security of current assets, it shall disclose the following:-

- 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.
- if not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.

h) **Wilful Defaulter\***

Where a company is a declared wilful defaulter by any bank or financial Institution or other lender, following details shall be given:

- Date of declaration as wilful defaulter,
- 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.

i) **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, the Company 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 outstanding Balances (to be specified)		

j) **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.

k) **Compliance with number of layers of companies**

Where the company has not complied with the number of layers prescribed under clause (87) of section 2 of the Act read with Companies (Restriction on number of Layers) Rules, 2017, the name and CIN of the companies beyond the specified layers and the relationship/extent of holding of the company in such downstream companies shall be disclosed.

l) Following Ratios to be disclosed:-

**Current Ratio,**

- Debt-Equity Ratio,
- Debt Service Coverage Ratio,
- Return on Equity Ratio,
- Inventory turnover ratio,
- Trade Receivables turnover ratio,
- Trade payables turnover ratio,
- Net capital turnover ratio,
- Net profit ratio,
- Return on Capital employed,
- 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 change in the ratio by more than 25% as compared to the preceding year.

m) **Compliance with approved Scheme(s) of Arrangements**

Where any Scheme of Arrangements has been approved by the Competent Authority in terms of sections 230 to 237 of the Companies Act, 2013, the Company shall disclose that the effect of such Scheme of Arrangements have been accounted for in the books of account of the Company 'in accordance with the Scheme' and 'in accordance with accounting standards' and deviation in this regard shall be explained



n) **Utilisation of Borrowed funds and share premium:**

- 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
  - 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 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 (15 of 2003).
- Where a company has received any fund from any person(s) or entity(ies), including foreign entities (Funding Party) with the understanding (whether recorded in writing or otherwise) that the company shall
  - 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, 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 alongwith 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 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).

→ **GENERAL INSTRUCTIONS FOR PREPARATION OF STATEMENT OF PROFIT AND LOSS**

1. The provisions of this Part shall apply to the income and expenditure account referred to in sub-clause (ii) of Clause (40) of Section 2 in like manner as they apply to a statement of profit and loss.
2. **(A)** In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from
  - Sale of products;
  - Sale of services;
  - "Grants or donations received (relevant in case of section 8 companies only)";
  - Other operating revenues; Less:
  - Excise duty.

**(B)** In respect of a finance company, revenue from operations shall include revenue from

- Interest; and
- Other financial services

Revenue under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable.

### 3. Finance Costs

Finance costs shall be classified as:

- Interest expense;
- Other borrowing costs;
- Applicable net gain/loss on foreign currency transactions and translation.

### 4. Other income

Other income shall be classified as:

- Interest Income (in case of a company other than a finance company);
- Dividend Income;
- Net gain/loss on sale of investments
- Other non-operating income (net of expenses directly attributable to such income).

### 5. Additional Information

A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items:

- a) Employee Benefits Expense [showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), (iv) staff welfare expenses].
- b) Depreciation and amortization expense;
- c) Any item of income or expenditure which exceeds one per cent of the revenue from operations or ` 1,00,000, whichever is higher;
- d) Interest Income;
- e) Interest Expense;
- f) Dividend Income;
- g) Net gain/ loss on sale of investments;
- h) Adjustments to the carrying amount of investments;
- i) Net gain or loss on foreign currency transaction and translation (other than considered as finance cost);
- j) Payments to the auditor as
  - auditor,
  - for taxation matters,
  - for company law matters,
  - for management services,
  - for other services,
  - for reimbursement of expenses;
- k) In case of companies covered u/s 135, amount of expenditure incurred on corporate social responsibility activities.
- l) Details of items of exceptional and extraordinary nature;
- m) Prior period items;

- a) In the case of manufacturing companies,
    - Raw materials under broad heads.
    - goods purchased under broad heads.
  - b) In the case of trading companies, purchases in respect of goods traded in by the company under broad heads.
  - c) In the case of companies rendering or supplying services, gross income derived from services rendered or supplied under broad heads.
  - d) In the case of a company, which falls under more than one of the categories mentioned in (a), (b) and (c) above, it shall be sufficient compliance with the requirements herein if purchases, sales and consumption of raw material and the gross income from services rendered is shown under broad heads.
  - e) In the case of other companies, gross income derived under broad heads.
- In the case of all concerns having works in progress, works-in-progress under broad heads.
  - a) The aggregate, if material, of any amounts set aside or proposed to be set aside, to reserve, but not including provisions made to meet any specific liability, contingency or commitment known to exist at the date as to which the balance-sheet is made up.
  - b) The aggregate, if material, of any amounts withdrawn from such reserves.
- a) The aggregate, if material, of the amounts set aside to provisions made for meeting specific liabilities, contingencies or commitments.
  - b) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.
- Expenditure incurred on each of the following items, separately for each item: -
    - a) Consumption of stores and spare parts.
    - b) Power and fuel.
    - c) Rent.
    - d) Repairs to buildings.
    - e) Repairs to machinery.
    - f) Insurance.
    - g) Rates and taxes, excluding, taxes on income.
    - h) Miscellaneous expenses,
- a) Dividends from subsidiary companies.
  - b) Provisions for losses of subsidiary companies.
- The profit and loss account shall also contain by way of a note the following information, namely:
    - a) Value of imports calculated on C.I.F basis by the company during the financial year in respect of –
      - Raw materials;
      - Components and spare parts;
      - Capital goods;
    - b) Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters;
    - c) Total value if all imported raw materials, spare parts and components consumed during the financial year and the total value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;

- d) The amount remitted during the year in foreign currencies on account of dividends with a specific mention of the total number of non-resident shareholders, the total number of shares held by them on which the dividends were due and the year to which the dividends related;
- e) Earnings in foreign exchange classified under the following heads, namely:
  - Export of goods calculated on F.O.B. basis;
  - Royalty, know-how, professional and consultation fees;
  - Interest and dividend;
  - Other income, indicating the nature thereof
- 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 books of account during the year.
- Corporate Social Responsibility (CSR)
 

Where the company covered under section 135 of the companies act, the following shall 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 into a contractual obligation, the movements in the provision during the year should be shown separately.
- Details of Crypto Currency or Virtual Currency
 

Where the Company has traded or invested in Crypto currency or Virtual Currency during 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, deposits or advances from any person for the purpose of trading or investing in Crypto Currency/ virtual currency.

**Note: Broad heads shall be decided taking into account the concept of materiality and presentation of true and fair view of financial statements.**

**Note: - Auditor must verify presentation and disclosure of B/S items & P/L items as per above Mentioned format of Sch-III**

**Students Note:**

# CHAPTER 6. SA 230 AUDIT DOCUMENTATION

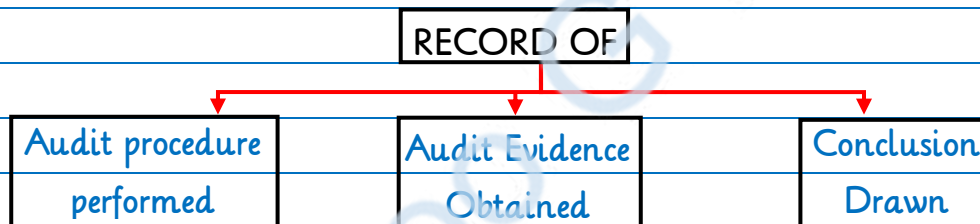
What to Study?

## I] Audit Documentation

- 1) Meaning
- 2) Objective of the auditor
- 3) Purpose of Audit Documentation
- 4) Form, Content and Extent of Audit Documentation
- 5) Examples of Audit Documentation
- 6) Assembly of the Final Audit File
- 7) Documentation of Significant matters and Related Significant Professional Judgements
- 8) Completion Memorandum or Audit Documentation Summary
- 9) Ownership of Audit Documentation

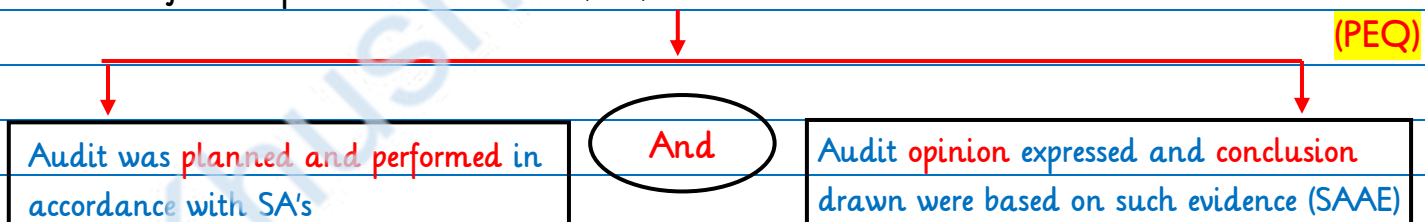
## I] AUDIT DOCUMENTATION

### 1) Meaning

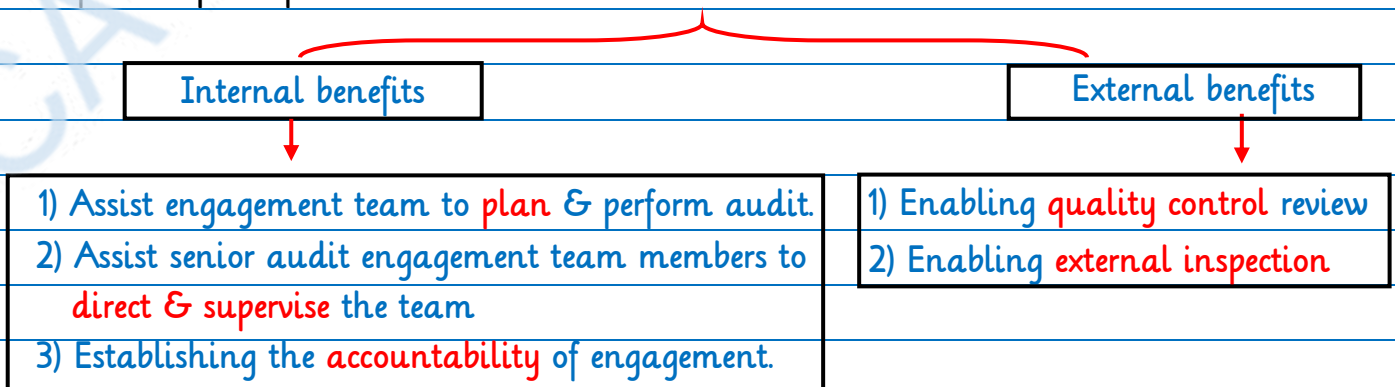


**Note:** - Audit documents are sometimes referred as "Working papers" or "Work Papers"

### 2) Nature/Objective of Audit Documents (AD) Provides Evidence That



### 3) Benefits/ Purpose of Audit Documentation

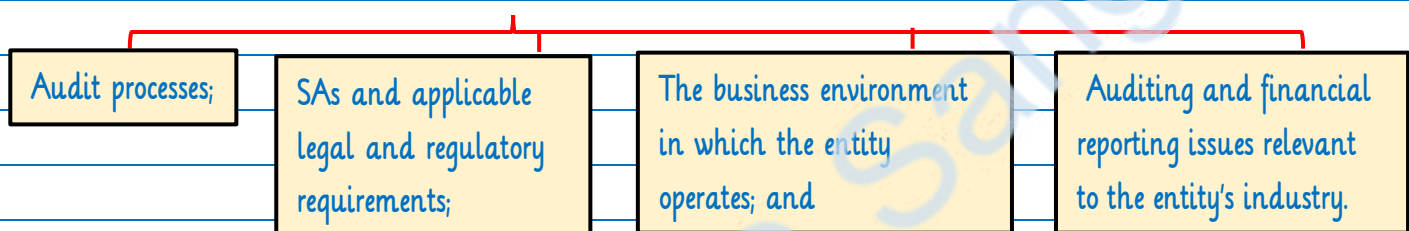


4) Form & content of audit documents depends on: - (N 15)

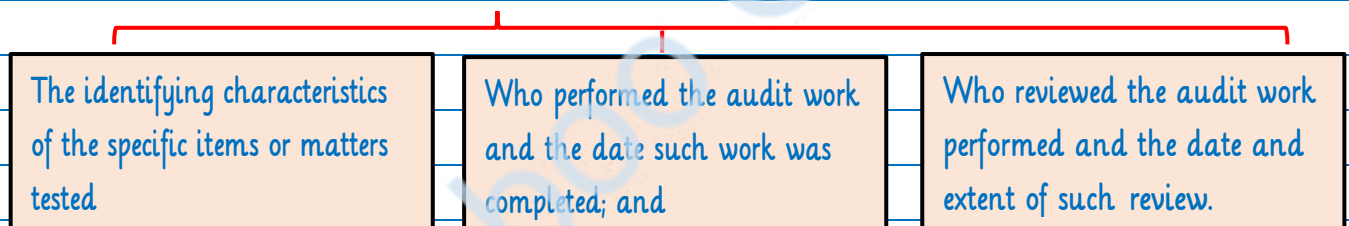
- a) The size and complexity of the entity.
- b) The nature of the audit procedures to be performed.
- c) The identified risks of material misstatement.
- d) The significance of the audit evidence obtained.
- e) The nature & extent of exceptions identified.
- f) The need to document a conclusion or the basis for a conclusion not readily
- g) determinable from the documentation of the work performed or audit evidence obtained.

Note: - 1) Auditor should prepare audit documentation that is sufficient for an experienced auditor to understand procedures, evidence & conclusion.

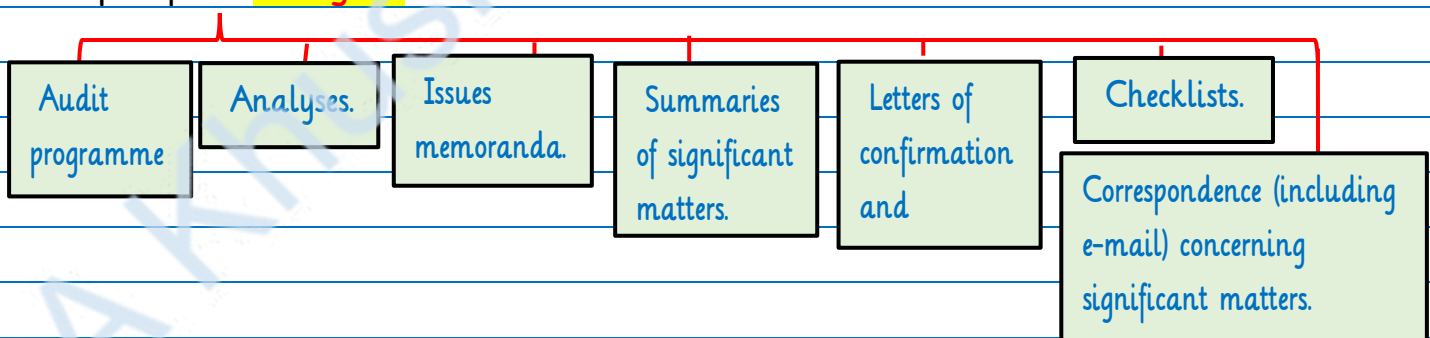
2) Experience auditor is an individual (internal/external) who has practical audit experience and a reasonable understanding of



Documenting the nature, timing and extent of audit procedures includes



5) Example of AD (MAY 22)



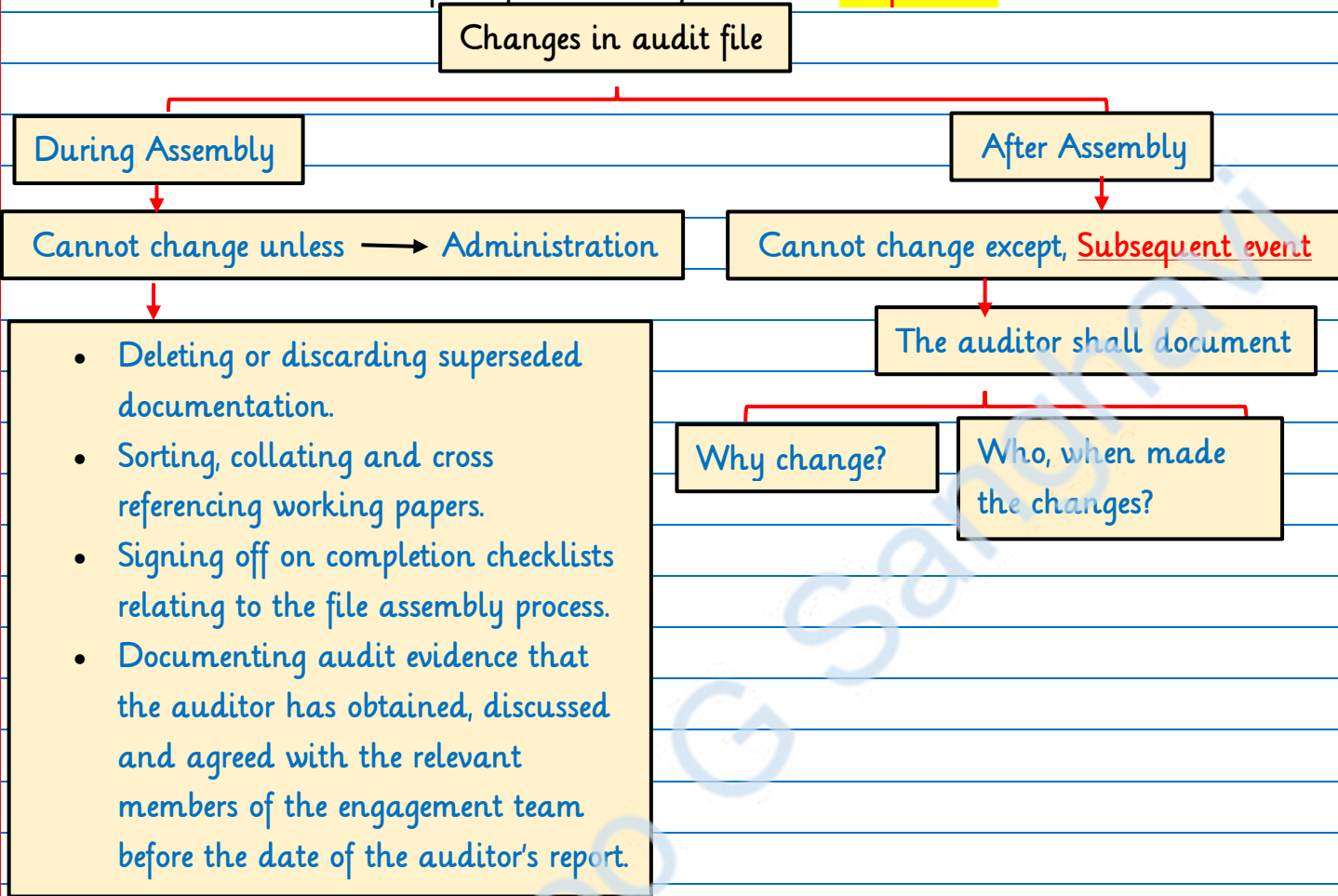
6) Assembly of the Final Audit File

1. Working papers are property of auditor
2. He can make available copy of working paper to client on request at this discretion
3. Preserve up to 7 yrs. of date of audit report or group audit report, whichever is later
4. Audit file should be prepared within 60 days after the date of audit report
5. Auditor shall not delete discard audit documentation but he can modify → explain reason for modification and when and by whom they were made or reviewed?



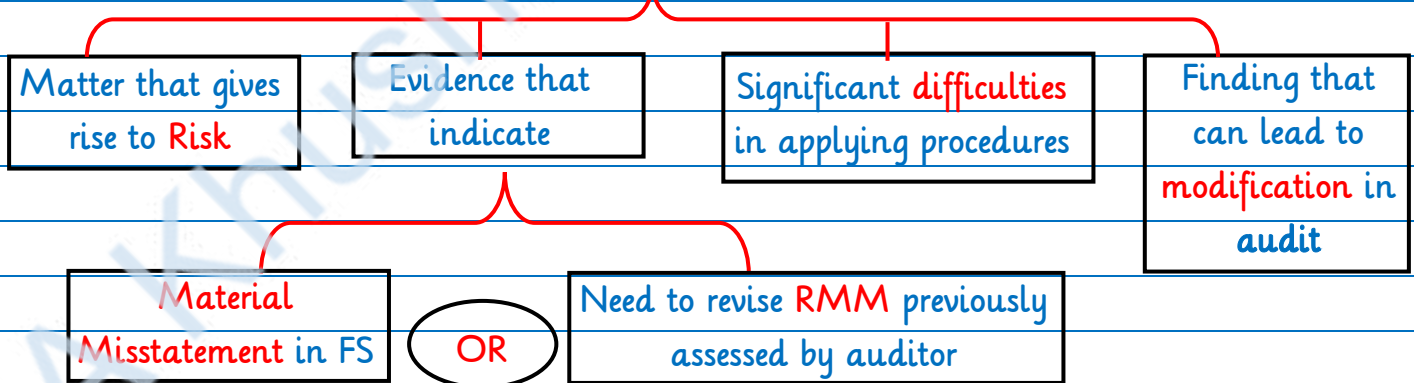
Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature

Examples of such changes include: **(Important)**

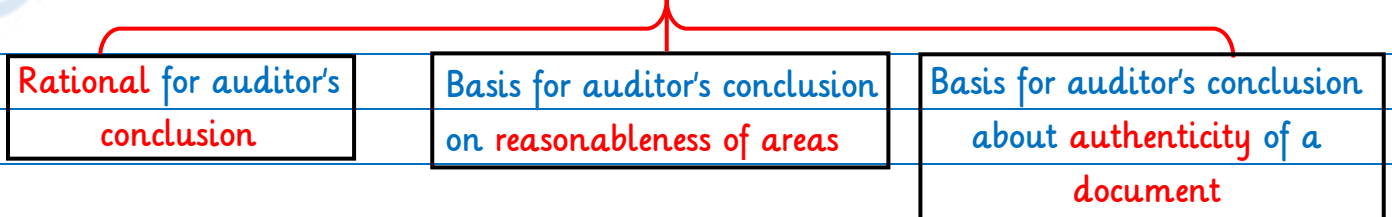


7) Documentation of Significant Matters & Related Significant Professional Judgement :-

a) Auditor should document following significant matters: - **(Important)** **(May 22)**



b) Documentation relating to professional judgement



c) Matters not to be documented **(May 22)**

- The auditor need not include in audit documentation superseded drafts of working

papers

- Financial statements, notes that reflect incomplete or preliminary thinking,
- Previous copies of documents corrected for typographical or other errors,
- Duplicates of documents.

## 8) Completion Memorandum or Audit

Documentation Summary (PEQ):

a) The auditor may prepare & retain a summary that describes

The significant matters identified

AND

How are they addressed

b) It is not mandatory to prepare

c) Summary will help in reviewing & inspecting audit documentation

## 10) Ownership of Audit Documentation (Important)

As per SQC – 1 "Audit documentation is the property of an auditor, he may at his discretion make portions and extract and make it available to client, unless required by law or regulation, provided validity of work, assurance & auditors Independence is not compromised or undetermined."

Therefore, AD is auditor's property, question of exercising lien does not rise

Students Note:

# CHAPTER 7. COMPLETION AND REVIEW

WHAT TO STUDY?

A] SA 560: Subsequent Events

B] SA 570: Going Concern

C] SA 580: Written Representations

D] SA 260: Communication with TCWG

E] SA 265: Communicating Deficiencies in Internal Control with TCWG & MGT

F] SA 450: Evaluation of Misstatements Identified During the Audit

A] SA 560 SUBSEQUENT EVENTS (SE)

I] MEANING

Events occurring between -

1) Date of financial statements and date of audit report.

(+)

2) Facts that become known to auditor after the date of auditor's report.

→ FOR EVENTS OCCURRING BETWEEN DATE OF FINANCIAL STATEMENTS AND DATE OF AUDIT REPORT.

1) Auditor shall perform following procedures in order to obtain SAAE (N 09, M 01)(Nov, 2020)

Review procedures of management to identify & disclose SE.	Inquire* the management as to the occurrence of SE.	Read latest: - minutes - Interim FS - Available cash flows, budgets & forecast.	Inquire about the latest position of legal cases.	Obtain written representations from management that all SE are identified.
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Important

\*Specific Inquires to be made from management whether: - (M 19)

i) Any new commitments, borrowing or guarantees have been entered into.

ii) Sale or acquisition of assets have occurred or planned.

iii) There are developments regarding contingencies.

iv) There is increase / decrease in the share capital.

v) Any assets have been appropriated by government or destroyed.

vi) Any events have occurred that are relevant to -

a) The measurement of estimate or provision.

b) The recoverability of asset.

vii) Any unusual accounting adjustment have been made or completed.

2) No need to check already checked areas: However, The auditor is not required to perform additional audit procedures in those areas where he has previously applied audit procedures and have obtained satisfactory conclusions. (i.e. No need to check again those areas which have been already checked in the regular audit procedures and the auditor is satisfied with their conclusions.)

3) Nature and Extent of audit procedures depends on Risk Assessment: The auditor shall assess the risk to determine the nature, timing and extent of audit procedures to be adopted to identify SE.

→ FACTS THAT BECAME KNOWN TO THE AUDITOR AFTER THE DATE OF THE AUDIT REPORT

1) Common procedures in case of significant matter, before and after the issue of FS.

i) Discuss with the management.

ii) Determine need to amend the financial statements.

iii) Inquire how management intends to address the matter in financial statements.

2) After audit report date but before the financial statements are issued (N 18)

Step 1: Common procedures as discussed before.

Step 2: Whether management amends FS w.r.t.

i) Yes management agrees to amend it

a) Auditor should carry out procedures necessary on the amendment.

b) Extend the audit procedures referred (to in Point 1,2,3 of Part A) to the date of the new auditor's report and Provide a new auditor's report on the amended financial statements. (The new auditor's report shall not be dated earlier than the date of approval of the amended FS)

ii) If the mgmt. does Other Amendments too (i.e. other than SE)

If law does not prohibit management from doing other amendments (i.e. other than SE), the auditor can restrict it's checking only to Subsequent events.

In such cases, the auditor shall either:

a) Include an additional date indicating that the auditor's procedures were restricted to subsequent events only. (Concept of Dual dating) or

b) Include an Emphasis of Matter paragraph or Other Matter(s) paragraph indicating that the auditor's procedures were restricted to subsequent events only.

iii) If the mgmt. does not amend FS w.r.t

- a) If the auditor's report has not yet been provided to the entity, the auditor shall modify the opinion as per SA 705 and then provide the auditor's report;
- b) If the auditor's report has already been provided to the entity, the auditor shall notify the management and TCWG (if all of TCWG are not involved in managing the entity,) not to issue the FS to third parties before making the necessary amendments.  
If the financial statements are still subsequently issued without the necessary amendments, the auditor shall **take appropriate action, to seek to prevent reliance on the auditor's report.**

3) After audit report date and after the financial statements are issued to public

Step 1: Common procedures as discussed above

Step 2: Whether management amends FS w.r.t.

i) If the mgmt. amends FS w.r.t SE

- a) Carry out the audit procedures necessary on the amendment.
- b) Review the steps taken by management to ensure that anyone in receipt of the previously issued FS and the auditor's report is informed of the situation.

Unless restricted by law the auditor shall:

- Extend the audit procedures referred (to in Point 1,2,3, of Part A) to the date of the new auditor's report; and
- Provide a new auditor's report on the amended financial statements.

(The new auditor's report shall not be dated earlier than the date of approval of the amended FS)

ii) If the mgmt. does Other Amendments too

If law does not prohibit management from doing other amendments (i.e. other than SE), the auditor can restrict it's checking only to Subsequent events.

In such cases, the auditor shall either:

- a) Include an additional date indicating that the auditor's procedures were restricted to subsequent events only . (Concept of Dual dating) or
- b) Include an Emphasis of Matter paragraph or Other Matter(s) paragraph that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier audit report

iii) If the mgmt. does not amend FS w.r.t S.E

If management does not take the necessary steps to ensure that anyone in receipt of the previously issued FS is informed of the situation and does not amend the FS , the auditor shall notify management and those charged with governance [unless all of those charged with governance are involved in managing the entity], that the auditor

will seek to prevent future reliance on the auditor's report.

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.

B]

## SA 570 GOING CONCERN

I] OBJECTIVES (RTP N 17/N 15)

To obtain SAAE about the appropriateness of management's use of Going Concern assumption in preparation of FS

To conclude whether a material uncertainty exists related to events or conditions that may cast significant doubt on entity's ability to continue as a going concern.

To report in accordance with SA's

II] MANAGER'S ASSESSMENT OF THE ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN INVOLVES MAKING A JUDGEMENT ABOUT INHERENTLY UNCERTAIN FUTURE OUTCOMES OF EVENTS OR CONDITIONS.

What are relevant factors to that judgement?

Ans. 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:

→ The **degree of uncertainty** associated with the outcome of an event or condition increases significantly into the future event or condition or the outcome occurs. For that reason, most financial reporting frameworks that require an explicit management assessment specify the period for which management is required to take into account all available information.

→ 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.

→ 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 they were made.

**Author's Note:**

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. If management's assessment of the entity's ability to continue as a going concern covers less than twelve months from the date of the financial statements as defined in SA 560, the auditor shall request management to extend its assessment period to at least twelve months from that date.

**III] EVENTS OR CONDITIONS**

Events or conditions that may cast significant doubt on entity's ability to continue as a going concern

(FOO)

(NO8,01)

(M 19/ N 17, 05)

F - Financial	O - Operating	O - Others
a. Consistent losses	a. Management intention to liquidate or cease operation.	a. Non-Compliance with laws.
b. Erosion of net worth	b. Loss of KMP.	b. Pending litigation.
c. Loss of credibility	c. Loss of Market, franchise.	c. Change in Government policies.
d. Negative cashflow	d. Labour strikes.	d. Any other reason.
e. Discontinuance of dividend	e. Shortage of supplies	
f. Adverse key ratios	f. Emergence of competitor.	
g. Withdrawal of financial support by creditor.	g. Technological difficulties.	
h. Inability to pay creditors.		

**IV] AUDITOR MUST PERFORM ADDITIONAL AUDIT PROCEDURES WHEN EVENTS OR CONDITIONS ARE IDENTIFIED.**

i.e. procedures for consideration of mitigating factors (RTP M15, N 20, PEQ N 16)

- 1) Analysing and discussing cash flows & relevant future forecasts.
- 2) Analysing latest available interim financial statements.
- 3) Reading the terms of debentures & loan agreement, minutes of meetings.

4) Evaluate plan to fulfil orders

5) Survival strategy

Evaluate assumptions.

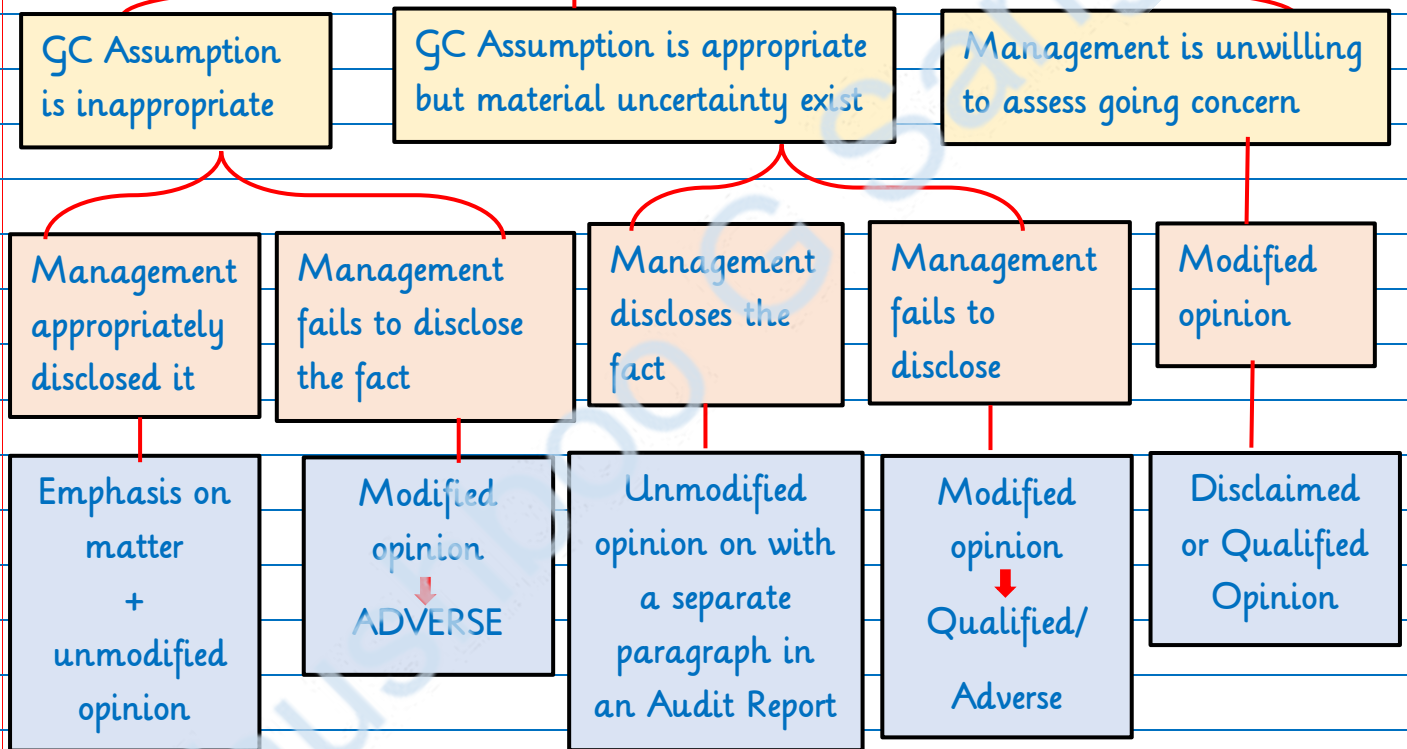
Evaluate reliability.

6) Performing procedures regarding subsequent event (SE) to identify mitigating factors.

7) Request written representations from management regarding future action plans & virtual certainty of plan.

V]

### REPORTING



Author's Note: Also refer the reporting requirement under 3 (xix) of CARO, 2020

C]

### SA 580 WRITTEN REPRESENTATION

I] MEANING

Clarification, confirmation, explanation given by management to auditor during the course of his audit to confirm certain matters or to support other audit evidence.

## Objective of the auditor regarding WR

PEQ Jan, 21

To obtain WR from management, as the **management believes** that it has fulfilled its responsibility w.r.t. preparation of FS & completeness of information provided to auditor

To **support other evidence** relevant to specific assertion in FS

To **respond appropriate** if management does not provide WR or it is not consistent with other evidence

## II] FEATURES OF WRITTEN REPRESENTATION (M O2)

- 1) It is **not a substitute** for normal procedures.
- 2) Auditor should seek corroborative evidence to support written representations.
- 3) It should be consistent with other audit evidence.
- 4) Person providing evidence must be well informed.
- 5) Written representation may constitute of **sole evidence** where matter is principally of intention.

## III] THE AUDITOR SHALL REQUEST MANAGEMENT TO PROVIDE A WRITTEN REPRESENTATION THAT

It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement.

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 (oral or written) and audit evidence in general.

## IV] IF MANAGEMENT REFUSES TO GIVE WRITTEN REPRESENTATIONS THEN

(M 10, RTP N 13)

- 1) Discuss the matter with the management.
- 2) Re-evaluate the integrity and reassess RMM.
- 3) Take appropriate action, including determining the possible effect on opinion.
- 4) Express disclaimer of opinion.

V] REASSESS THE RELIABILITY OF WRITTEN REPRESENTATION ALREADY RECEIVED IF-

(RTP N 13)

- 1) Management denied to provide WR on any other matter.
- 2) If the person providing WR appear to be fake.
- 3) If the person providing WR is found in fraud.
- 4) If WR is inconsistent with the other evidence.

VI] DATE & PERIOD COVERED BY WRITTEN REPRESENTATION (RTP M 19)

The date of WR shall be as near as practicable to, but not after, the date of the auditor's report on the FS. The WR are for all periods referred to in the auditor's report. 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 WR because they were not in place during the period. This fact, however, does not diminish such person's responsibility for the FS as a whole. Accordingly, the requirement for the auditor to request from them WR that cover the whole of the relevant period(s) still applies.

VII] THE AUDIT MAY ASK MANAGEMENT TO RECONFIRM ITS ACKNOWLEDGEMENT UNDERSTANDING; WHEN

Those who signed the terms of engagement, no longer have that responsibility

Terms of engagement were prepared in previous year

There is an indication that management has misunderstood its responsibility

There are any change in circumstances

Students Note

# D] SA 260 COMMUNICATION WITH TCWG

I] WHAT TO COMMUNICATE? (matter to be communicated) (Key - IFRS) (N O6)

I - Auditors Independence

F - Significant Findings

R - Responsibility relating to audit of financial statements.

S - Planned Scope & timings.

Significant findings - An auditor can give value added suggestions to TCWG about:

a) Significant qualitative aspect of entities accounting practice including

Accounting Policies

Accounting Estimates

Disclosures

b) Significant difficulties in performing audit (Key word for this answer "UN")

- Unavailability of personnel & information.
- Unwillingness to evaluate Going concern.
- Unreasonable time to complete audit.
- Unnecessary efforts required to obtain sufficient & appropriate audit evidence.
- Significant delay in giving information.
- Restriction imposed.

Author's Note: Auditor may select any matter from these matter as per his professional Judgement & communicate it to shareholders as Key Audit Matters, as per SA 701

c) If TCWG and Management are different: -

Significant matters arising during audit or subject to correspondence with management

(Key - ABCDE)

A - Accounting practice

B - Business conditions

C - Consultancy

D - Dispute with management.

E - Any other significant Event or transaction

d) Circumstances affecting form & content of report → SA 705 / SA 706.

e) Any other significant matter.

→ Communication with a Subgroup of Those Charged with Governance

- The respective responsibilities of the subgroup and the governing body.
- The nature of the matter to be communicated.
- Relevant legal or regulatory requirements.
- Whether the subgroup has the authority to take action in relation to the information communicated, and can provide further information and explanations the auditor may need.

## II] WHOM TO COMMUNICATE

Sub-Group of TCWG & also evaluate need to communicate with the Governing Body

When all TCWG are involved in management  
If such matter is communicated to management then there is NO need to communicate with Governing Body

## III] HOW TO COMMUNICATE? (Factors affecting form of communication) (Important)

- Whether such discussion will be included in Independent auditor's report (as KAM).
- Was the matter resolved.
- Structure of organization.
- Expectation of TCWG.
- Ongoing dialogues & contract between auditor and TCWG.
- Previous communication.
- Changes in membership of governing body.
- Legal requirements.
- Special purpose financial statements.

## IV] WHEN TO COMMUNICATE?

In adequate interval of time.

## V] IMPORTANCE OF COMMUNICATING KEY AUDIT MATTERS TO TCWG (RTP N 18)

Communication with TCWG enables them to be made aware of the key audit matters that the auditor intends to communicate in the auditor's report, & provides them with an opportunity to obtain further clarification where necessary. The auditor may consider it useful to provide TCWG with a draft of the auditor's report to facilitate this discussion.

Communication with TCWG recognizes their important role in overseeing the financial reporting process, & provides the opportunity for TCWG to understand the basis for the auditor's decisions in relation to key audit matters & how these matters will be described in the auditor's report. It also enables TCWG to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.

**Students Note:**

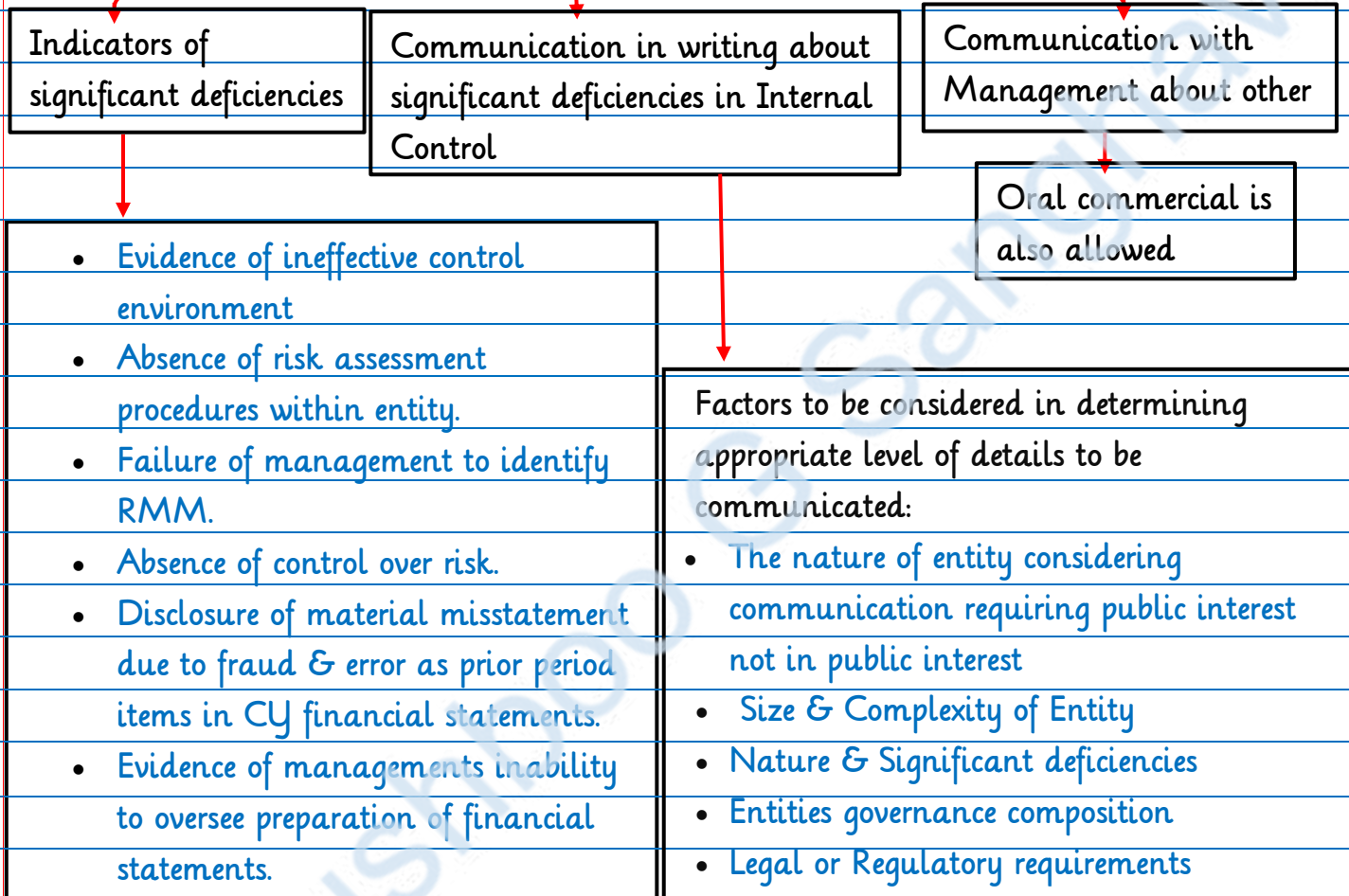


E] SA 265 COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL WITH TCWG & MGMT

I] MEANING OF DEFICIENCY IN INTERNAL CONTROL

- a) Inability of internal control to prevent, detect & correct misstatement or
- b) Absence of control necessary to prevent, detect & correct misstatements.

II] AUDITOR'S OBLIGATION REQUIREMENT



III] DETERMINE SIGNIFICANT OF INTERNAL CONTROL DEFICIENCIES ARE INCLUDES CONSIDERING:

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process

- The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.
- The interaction of the deficiency with other deficiencies in internal control.

#### IV] CONTENTS OF REPORT (RTP M/N 18) (Key – PILU)

**P** – Potential effect: -

It contains description of deficiencies & an explanation of their potential effects.

**I** – Scope of Improvement: -

It list down the area of weakness & offers suggestions for improvement.

**L** – Minimise legal Liability: -

The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.

**U** – Users: -

This letter is a valuable reference document for management for the purpose of revising the system.

**Students Note:**

# F] SA 450 EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

## I] MEANING OF MISSTATEMENTS

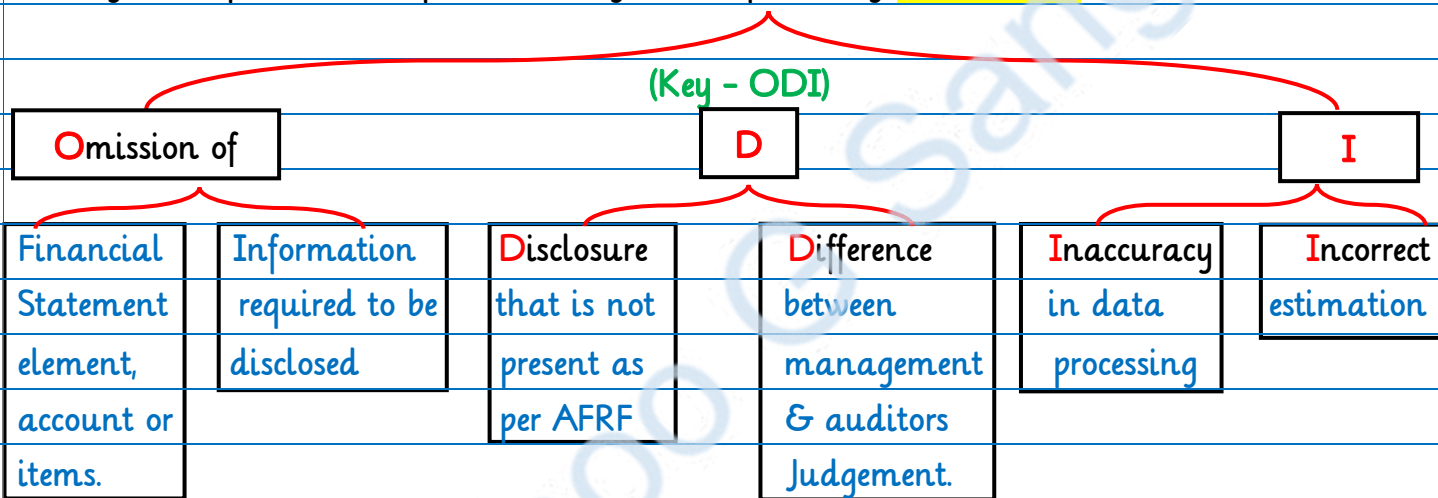
Difference between:

- The amounts, classification, presentation or disclosure of a reported financial statement item, and
- The amount, classification, presentation or disclosure that is required for the item to be in accordance of financial reporting framework.

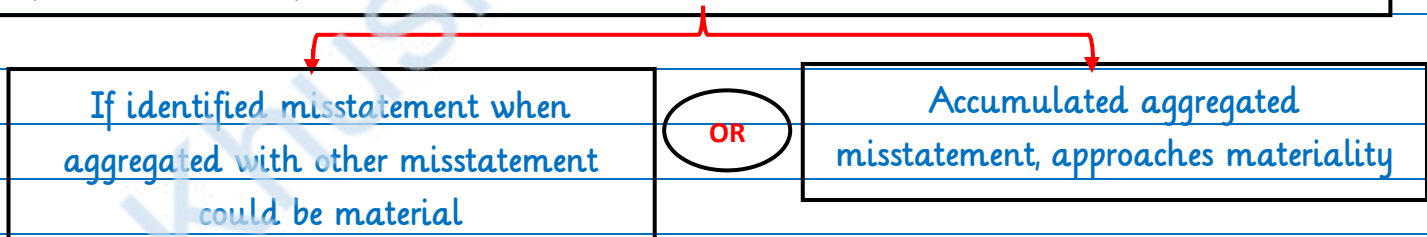
Uncorrected Misstatement are the misstatements accumulated by auditor but not corrected.

## → SOURCES OF MISSTATEMENT (Important)

It may result from error or fraud & may consist following (RTP N 18, 12)



## II] THE AUDITOR SHALL DETERMINE WHETHER THE OVERALL STRATEGY OR PLAN NEEDS TO BE REVISED



## III] IDENTIFICATION / ACCUMULATION OF MISSTATEMENTS

- Communicate to management and request them to correct.
- If management corrects, perform additional procedures to determine whether misstatements remain.
- If management refuses, understand the reason for not making the corrections, also determine the materiality. If material, communicate uncorrected misstatement and their effect on his opinion to TCWG with a request that uncorrected misstatements be corrected. If not corrected, obtain written representation from management / TCWG w.r.t.

their believing that effect of uncorrected misstatements are immaterial.

- Determine whether any revision required in Audit Strategy Plan.

#### IV] DOCUMENTATION SHALL INCLUDE

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

Note: - Trivial means → not worth considering, of little importance

#### V] TYPES OF MISSTATEMENT

- 1) Factual misstatements are misstatements about which there is no doubt
- 2) Judgmental misstatements are differences arising from the judgments of management concerning accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies that the auditor considers inappropriate
- 3) Projected misstatements are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn. Guidance on the determination of projected misstatements and evaluation of the results is set out in SA 530

Students Note:

# CHAPTER 8. REPORTING

## WHAT TO STUDY?

- A] SA 700: Forming an Opinion and Reporting on Financial Statements
- B] SA 701: Communicating Key Audit Matters in the Independent Auditor's Report
- C] SA 705: Modifications to the Opinion in the Independent Auditor's Report
- D] SA 706: Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
- E] SA 710: Comparative Information: - Corresponding Figures & Comparative FS
- F] Sec 143: Duties of Auditor
- G] CARO 2020: Reporting on Additional Matters

## A] SA 700. AUDIT REPORT

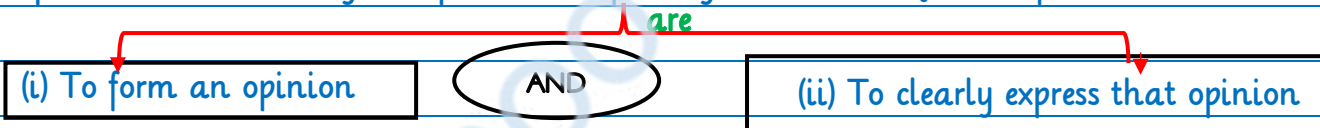
### I] FORMING AN OPINION

1) Now, we have understood that following are the responsibilities of management

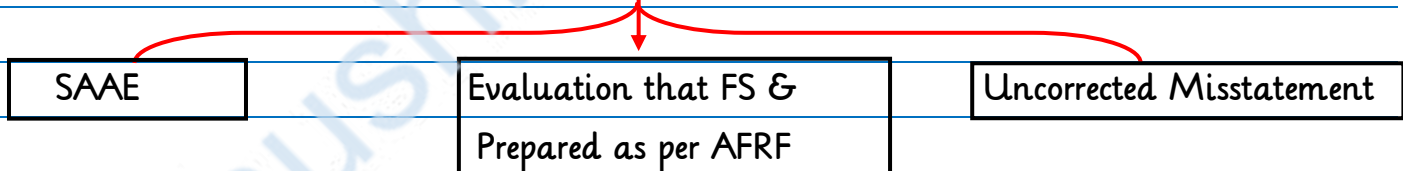
Preparation of FS	Prevention of fraud & error
Implementation of I.C.	Safeguarding assets etc.

2) The main purpose of audit is to enhance the degree of confidence of intended users of FS.

3) As per SA 700 "Forming an opinion & reporting on FS" the objective of auditor



4) In order to draw conclusion, auditor shall take into account:



Evaluation shall include **QUALITATIVE ASPECTS** of entity's Accounting policies/practices i.e. evaluations of: - **(Important)**

1. Management Judgements about amount & disclosure
2. Discussion of qualitative aspect of accounting practice (SA 260)
3. Indicators of possible management bias i.e. lack of neutrality, including:
  - a) Selective correction of misstatement

Eq. I. correcting misstatement that increases 1

**SPECIFIC EVALUATION:** - In Particular, the auditor shall evaluate whether: -

1. FS adequately discloses accounting
2. Accounting policies are as per AFRF
3. Estimates as reasonable
4. Disclosures are adequate to enable intended users to understand effect of material transaction & event.
5. Terminology used in FS are appropriate

earning & not correcting other

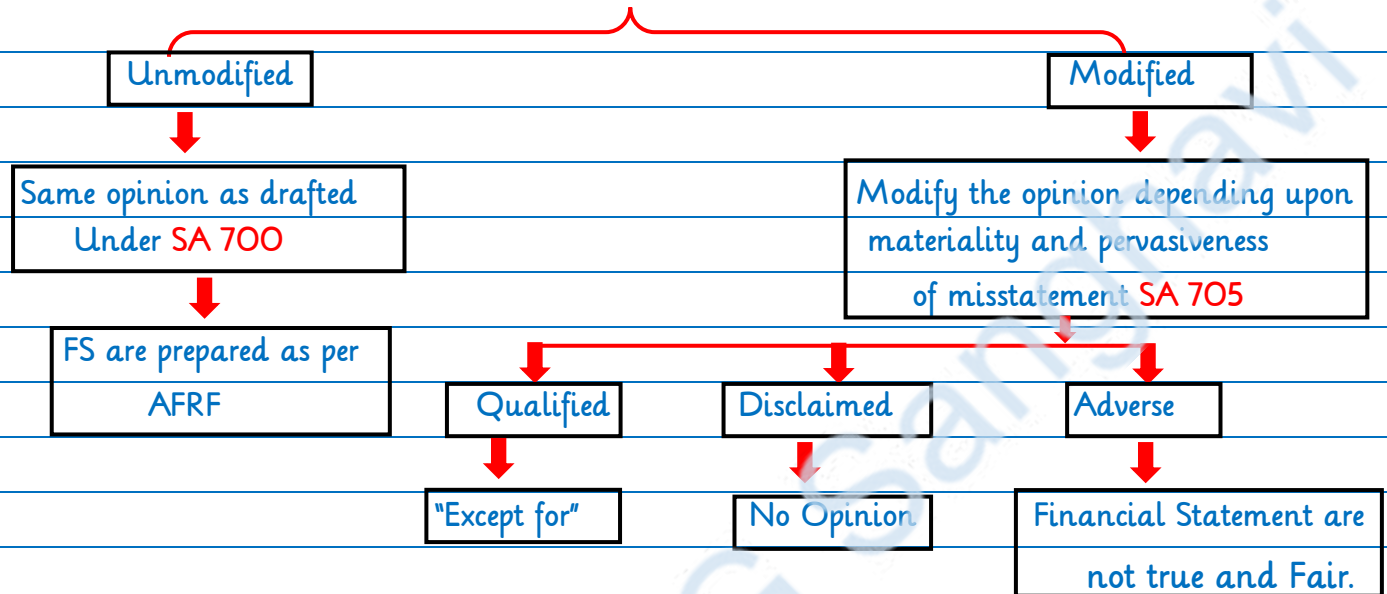
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II. Several deficiencies affecting the same account on disclosure

b) Bias in making accounting estimate

## II] TYPES OF OPINION

### AUDIT OPINION



## III] CONTENT OF AUDITOR REPORT

Basic elements of an Audit Report are given below: -

- 1) Title - "Independent Auditor Report" (IAR)
- 2) Address - The IAR is addressed to **Members**
- 3) Auditors Opinion: - It includes: -
  - (i) Identify the **entity** whose financial statements have been audited;
  - (ii) State that the financial statements have been **audited**;
  - (iii) Identify the **title of each statement** comprising the financial statements;
  - (iv) **Refer to the notes**, including the summary of significant accounting policies; and
  - (v) **Specify the date of, or period covered by, each** financial statement comprising the financial statements.
- 4) Basis for opinion: - It includes that:
  - (i) States that the audit was conducted accordance with **Standards on Auditing**;
  - (ii) **Refers** to the section of the auditor's report that describes the **auditor's responsibilities** under the SAs;
  - (iii) 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.
  - (iv) 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



- 6) Key Audit Matters: - Matters as per SA 701 are included under this para.
- 7) Management Responsibilities: - This section of the auditor's report shall describe: -
- Preparing the financial statements
  - Assessing the entity's ability to continue as a going concern

- 8) Auditors Responsibilities: - This section of audit report shall state that :
- (i) The objectives of auditor are to: -

Obtain Reasonableness

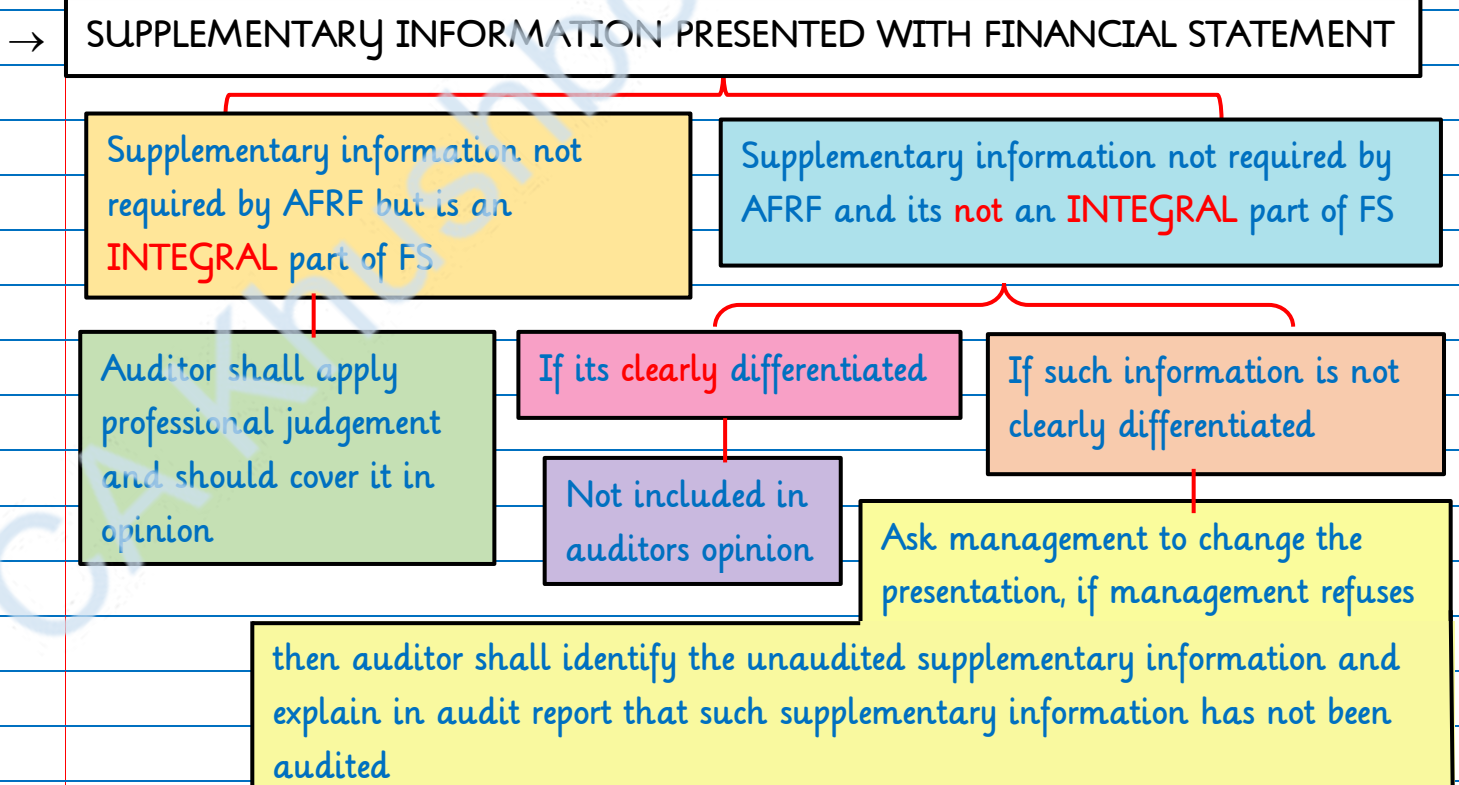
AND

Issue a Report

- Reasonable assurance is a high level of assurance but not a guarantee
  - Misstatement can arise from fraud or error
- Further it shall include: -
- (Key - P R I A G S T)**
- P** = i) Auditor exercises Professional Judgement & maintains Professional Skepticism
- i** Auditors responsibilities are: -
- R** = (a) To identify & assess RMM
- I** = (b) To obtain understanding of Internal control
- A** = (c) To evaluate appropriateness of Accounting policies used
- G** = (d) To conclude on the appropriateness of management use of Going Concern
- This section shall also state
- S T** = (i) The planned scope & timing
- That the auditor has complied with relevant ethical requirement
  - Auditor describes KAM in accordance with SA 701 unless law or regulation precludes public disclosures.
- 9) Location of description of the auditor's responsibilities for the audit of FS: -
- Here auditor refers to the location of auditors responsibility
- Within the body of the auditor's report
  - 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
  - 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 the auditing standards expressly permit the auditor to do so.
- 10) Other legal & 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 section in the auditor's report with a heading titled - "Report on Other Legal and Regulatory Requirements".

- 11) **Signature of the Auditor:** - The auditor's report shall be signed. The report is signed by the auditor (i.e. the engagement partner) in his personal name. 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. 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) **Auditor's Address:** - The auditor's report shall 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 the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that:
- (i) All the statements that comprise the financial statements, including the related notes, have been prepared; and
  - (ii) 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 of events and transactions after the date of the auditor's report is addressed in SA 560. (MCQ)



→ Auditor can use International Standards on Auditing (ISA) only if

There is no conflict between the requirements in ISA

+

The auditor report includes each of the element sets which are required by laws & regulation

## B] SA 701 KEY AUDIT MATTER

### I] MEANING OF KAM



Communications as per SA 260/ 265



TCWG

KAM are those matters, in auditors professional judgement, were of most significances in the audit of the FS and are selected from above matters. i.e. from communication made to TCWG.

### II] DETERMINATION OF KEY AUDIT MATTER (M'19)

Areas of high-risk as per SA 315

Areas involving judgements & estimates having high estimates uncertainty

Effect of significant event/ transaction.

### III] DETERMINING MATTERS OF MOST SIGNIFICANCE

- 1 Matters enquiry significant comm. with TCWG performed.
- 2 Important for users
- 3 Nature Complexity or Subjectivity involved
4. Nature & extent of procedures
5. Severity of difficulties involved
6. Severity of Control deficiency.

→ Auditor must add description regarding EACH KAM and shall include a reference to the related disclosures. It shall address the following: - (N'18)

Why the matter is considered to be most significant.

How the matter was addressed in the audit.

### IV] PURPOSE OF COMMUNICATING KAM (RTP N 18)

- 1) It enhances and communicates the value of audit report
- 2) It provides greater transparency about the audit procedures performed
- 3) It provides additional information regarding matters which were of most significance as per auditor's professional judgement
- 4) It assists intended user in understanding the entity and area of significant management judgment

V] NO KAM TO BE COMMUNICATED, IF

Law/ Regulation preclude such disclosure.

OR

Such communication outweigh public interest benefit (i.e. do more harm than good) However if company discloses such matter, then auditor can also communicate

Note: - KAM is not a substitute for: -

- a) Expressing modified opinion
- b) Reporting Going concern
- c) Separate opinion on individual matters
- d) Disclosure in FS

VI] ILLUSTRATION OF AUDIT REPORT IF AUDITOR HAS DETERMINED THAT THESE ARE NO KAM

→ Key Audit Matters (Illustration for drafting Question)

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

Note :- 1) KAM para is mandatory for Listed Companies

2) KAM para is not to be added if auditor disclaims his opinion.

C] SA 705. MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

I] DETERMINING TYPE OF MODIFICATION TO AUDITOR'S REPORT

Nature of matter giving rise to the modification	Auditor's Judgement about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Financial Statements are materially misstated	Material but not Pervasive (M 06) Qualified opinion (True and fair except for the effect of...)
Inability to obtain SAAE (M 19)	Qualified opinion (True and fair except for the POSSIBLE effect of...)	Disclaimer of opinion (Not in position to express and opinion)

II] DEFINITION OF PERVASIVE:

Pervasive effects on FS are those that in auditor judgement: -

- 1) Are not confined to specific elements, accounts or items of the financial statements;
- 2) If so confined, represent or could represent a substantial proportion of the financial

statements; or

- 3) In relation to disclosures, are fundamental to users understanding of the financial Statements.

**Author's Note:** - Pervasive Misstatements means it affects **ANY** or **MANY** assertions or element of FS.

III] **BASIS OF OPINION** (IMPORTANT)/ DEC 21

When auditor modifies his opinion, he has to amend the heading of this para as

- 1) Amend **HEADING** of modified opinion E.g: "Basis for Qualified Opinion", "Basis for Disclaimed Opinion", "Basis for Adverse Opinion"
- 2) i) If the misstatement relates to specific amounts including **QUANTITATIVE DISCLOSURE** then add a description & qualification, unless impracticable  
ii) If misstatement relates to narrative disclosure then include explanation of such disclosure
- 3) If material misstatement is due to **NON-DISCLOSURE** of information then describe nature of information omitted & include such information unless prohibited by law
- 4) If the opinion is "Qualified" or "Adverse" then describe the SAAE so obtained
- 5) If the opinion is "**disclaimed**", then auditor shall **not refer** to the section of the **auditor responsibility para** and **no SAAE** obtained shall be mentioned.

D] **SA 706 EMPHASIS ON MATTER (EOM) & OTHER MATTER (OM) PARAGRAPH IN INDEPENDENT AUDIT REPORT**

- I] **OBJECTIVE** The objective of an auditor is to **DRAW ATTENTION** by way of clear Communication in auditors report with respect to

A matter that is of such importance that is fundamental to user's understanding of the FS (EOM)

Any matter that is relevant to user's understanding of the audit, auditors responsibilities or the auditor's report (OM)

**Note:** -

- 1) Auditor shall include other matter paragraph in the report only if:

It is not prohibited by law or regulation

**AND**

The matter is not determined to be **KAM**

- 2) Auditor may decide placement of an EOM or OM in audit report depending upon Significance of such information to intended users on the basis of his professional judgement



II] MATTERS WHICH WOULD NOT REQUIRE MODIFICATION AND NOT DETERMINED AS KAM

EOM (M08)

OM

- |   |   |
|---|---|
| <p>1) Include the para within a separate section with an appropriate heading<br/><b>"Emphasis of Matter"</b></p> <p>2) Such para contains a <b>clear reference</b> to the relevant disclosure that fully describe the matter in FS</p> <p>3) Example (M 18/ N 19)</p> <ul style="list-style-type: none"> <li>• When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation. (SA 210).</li> <li>• To alert users that the financial statements are prepared in accordance with a special purpose framework (SA 800).</li> <li>• When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (SA 560).</li> <li>• An uncertainty relating to the future outcome of exceptional litigation or regulatory action.</li> <li>• A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.</li> <li>• Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.</li> <li>• A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.</li> </ul> | <p>1) Include the para within a separate section with an appropriate heading<br/><b>"Other Matter"</b></p> <p>2) <b>No such clear reference</b> is made</p> <p>3) Example:</p> <ul style="list-style-type: none"> <li>• Reason why auditor is unable to resign from the engagement even though there is a limitation on scope.</li> <li>• Law, regulation or generally accepted practice in a jurisdiction may require or permit the auditor to elaborate on matters that provide further Explanation.</li> <li>• Auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters.</li> <li>• An other set of financial statements has been prepared by the same entity in accordance with another general-purpose framework and that the auditor has issued a report on those financial statements.</li> <li>• Auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.</li> <li>• Law or regulation may require the auditor to communicate about planning and scoping matters in the auditor's report, or the auditor may consider it necessary to communicate about such matters in an other matter paragraph (SA 260).</li> </ul> |
|---|---|



E] SA 710 COMPARATIVE INFORMATION: - CORRESPONDING FIGURES & COMPARATIVE FS

I] MEANING

SA 710 Comparative Information-Corresponding Figures and Comparative Financial Statements deals with auditor's responsibility regarding comparative information in an audit of financial statement. There are two different broad approaches to the auditor's responsibilities in respect of comparative information: Corresponding figures and Comparative financial statement.

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.

II] OBJECTIVE

- a) To obtain SAAE about whether the comparative information included in FS has been presented in all material present in accordance with the requirements of AFRF
- b) To report with the auditors reporting responsibility

III] AUDIT PROCEDURES FOR COMPARATIVE INFORMATION: CORRESPONDING FIGURES & COMPARATIVES

- a) Perform Specific audit Procedure: For determining that the financial statement contains appropriately classified comparative information, the auditor should:
  - Ensure that comparative information agrees with the amount and other disclosure presented in the prior period.
  - The accounting policies applied are consistent with those applied in current period.
  - If there have been any changes in the application of accounting policies than they are properly disclosed and presented.
- b) Evaluating the impact on financial statement: If the auditor becomes aware of any possible misstatement in the comparative information, then:
  - He should perform the necessary audit procedures to obtain sufficient audit evidence.
  - If the auditor had audited the prior period's financial statement than he should follow the relevant requirements of SA 560.
- c) Written Representation: As required by SA 580, the auditor should also request written representation. He should also obtain a specific written representation regarding any prior period item that is disclosed in current year's financial statement.

## IV] AUDIT REPORTING

a) **With Reference to Corresponding Figures:** When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances:

- If the auditor's report of the previous period contains other than an unqualified opinion.
- If the auditor is of the opinion, and he has sufficient evidence in this regard, that a material misstatement exists in the financial statement of prior period, which was not addressed earlier.

If the prior period financial statement are not audited, than he should obtain sufficient audit evidence that the opening balance does not contain any material misstatement.

b) **With Reference to Comparative Financial Statement:** When comparative financial statement are presented -

- The auditor's opinion shall refer to each period for which the financial statements are presented.
- When reporting on current period's audit, if the auditor's opinion on such prior period financial statement differs from the opinion previously issued on such financial statement, the auditor shall disclose the substantive reason for the different opinion in other matter paragraph in his report.
- If the auditor concludes that a material misstatement is present in the previously audited figures of financial statement, he should report it to the appropriate level of the management and request that the predecessor auditor be informed. If then the prior years statements are amended with new report by the predecessor auditor, then the auditor shall report only on the current period.

c) **Reporting treatment common to both (for corresponding figures and comparative information):**

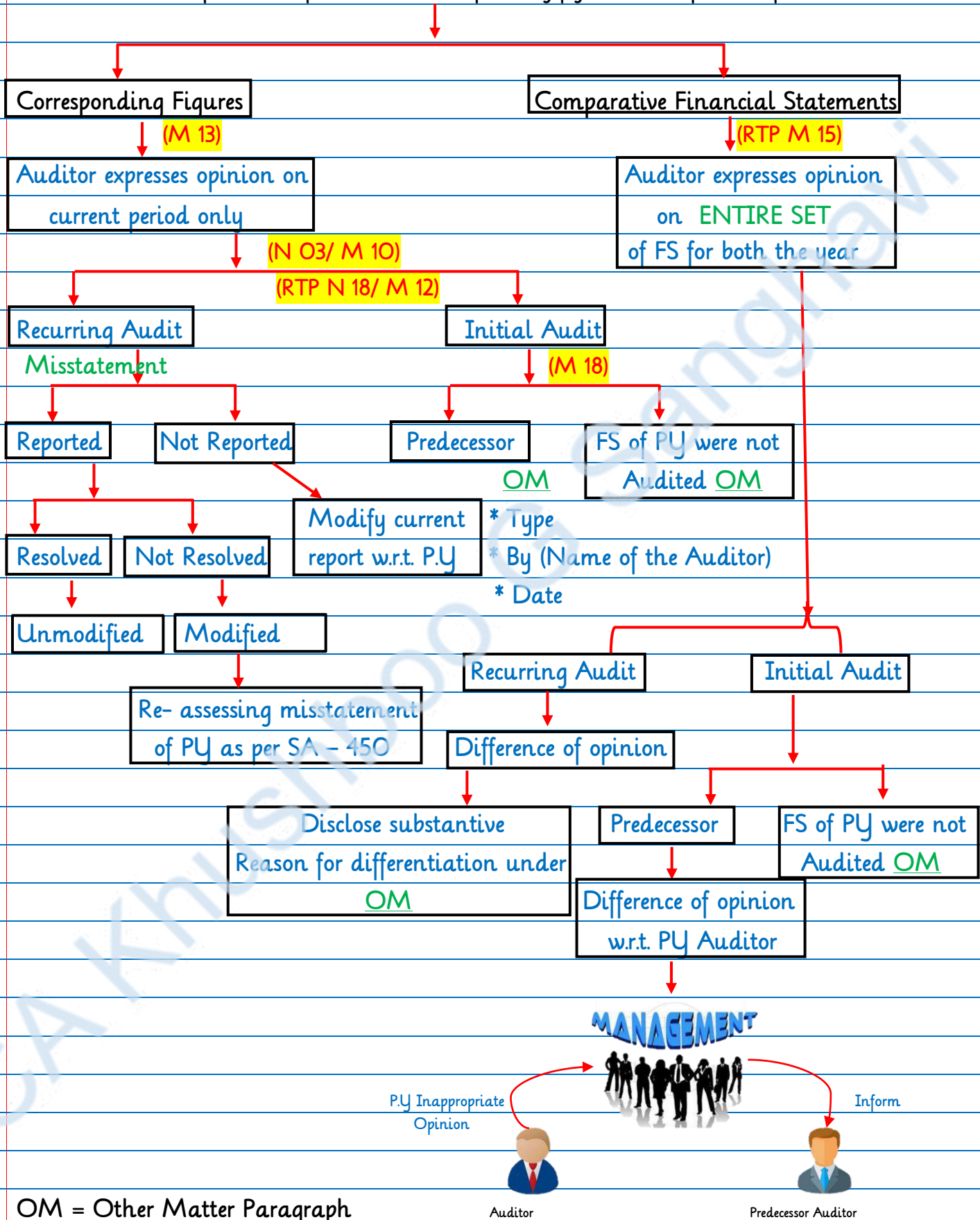
i) If the financial statement of the prior period were audited by a predecessor auditor, the auditor (is permitted by law or regulation to refer to the predecessor audit report - on case of corresponding figures and decides to do so) shall state in his audit report:

- That the financial statement of the prior period were audited by a predecessor auditor;
- The type of the opinion expressed by the predecessor auditor;
- The date of that audit report.

ii) If the prior period financial statement were not audited than he shall report the same in other matter paragraph in his audit report that the corresponding/comparative figures are unaudited. However, the disclosure does not relieve him from his responsibility of obtaining sufficient appropriate audit evidence

that the opening balances do not contain misstatements that materially affect the current period's financial statements.

SA 710 comparative information: - corresponding figures & comparative fs



OM = Other Matter Paragraph

Other matters paragraph

Apply SA 560 and Amend IAR

type and date & opinion of predecessor Auditor

## Section 143 of Companies Act, 2013: Duties of Auditor

### F] RIGHTS AND DUTIES OF AUDITOR [Section 143]

#### 1] Rights of Auditor

- i. Right to access BOA & Vouchers of all time
- ii. Right to obtain information & explanation
- iii. Right to lien BOA (lien = Holding lawful possession) (PEQ)  
Auditor can exercise lien only if his fees remain unpaid. Such lien can be exercised over BOA for the year for which fees is unpaid and on which he has worked.  
However, exercising this right is not practically possible because of: -
  - Virtue of section 128 which states that BOA are required to be kept at Registered Office &
  - In the opinion of council exercising lien attracts disrepute to ICAI and it's a Professional misconduct under clause 2 of Part IV of the First Schedule.
- iv. Right to read out qualification at General Meeting.
- v. Right to receive notice and to attend any General Meeting either in person or through representative (eligible to act as auditor)

#### 2] Duties of Auditor

Sections No.	Duty
Section 143(1)	Enquiry into certain facts
Section 143(2)	Reporting as True and Fair
Section 143(3)	Certain matter to be reported whether positive or negative
Section 143(4)	Reason for negative qualification
Section 143(5 - 7)	Duties (in regards to Government Company)
Section 143(8)	Audit of Branches
Section 143(9) & (10)	Compliance with Auditing Standards
Section 143(11)	Reporting CARO
Section 143(12 - 15)	Reporting of Fraud

- i] ENQUIRING 143(1): - If any transactions give negative results, then such transactions are required to be REPORTED.

The transactions to be enquired are -

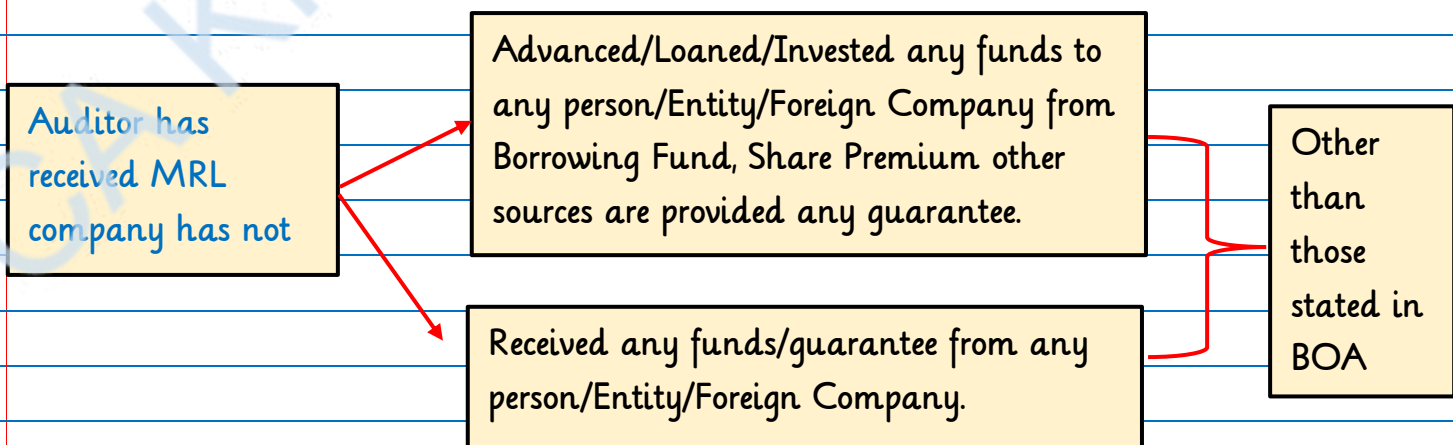
- a) Advance Term & conditions should not be prejudicial
- b) Book entries: Should not be prejudicial.
- c) Companies not being Investment Company & sold securities at a price < cost (i.e. loss).
- d) Loans and Advances shown as Deposits.
- e) Personal Expenses charged to revenue.
- f) Where any shares have been allotted for Cash, whether it has been received or not and the same has been accounted for.

ii] Reporting as to true and fair [Section 143(2)]

- Report that the financial statement is free from RMM either due to fraud or error.  
(True & Fair view = FS made as per AFRF & Schedule III)
- The report shall be made after taking into account the following: -
  - Provision of the Act
  - Accounting and Auditing Standards
  - Matters required to be including in the report

iii] REPORT 143 (3): - Whether the examination of transactions give positive or negative Results. In both the circumstances, the auditor needs to REPORT.

- Sought and obtained all information and explanations.
- Proper Books of Account.
- Report on accounts of Branch office.
- Financial statements are in agreement with the Books of Account.
- Financial statements comply with Accounting Standards/Ind AS.
- The observations or comments of the auditor on financial matters which have adverse effect on functioning of the company.
- Any director attracts any disqualifications u/s 164(2).
- Modification relating to maintenance of Books of Account.
- Operating effectiveness of Internal Financial controls with respect to financial statements.  
This is exempt to OPC, Small Company & Private Company whose -  
Turnover < ₹ 50 crores, & Borrowings < ₹ 25 crores & has not defaulted in return filing (sections 92 or 137) (MCQ)
- Any other matter as prescribed.
  - Pending Litigations on its financial position in its financial statement.
  - Foreseeable losses, if any, on long term contracts including derivative.
  - Delay in Investor Education and Protection Fund by the company.



MRL – Management Representation Letter

- Companies maintained account software for BOA levy feature of audit trail.



- Audit trail is operated throughout the year with no tampering thereof.

NOTE: - Auditor of **public company** should make a statement u/s 143(3) as to whether the Remunerations paid by the company are in accordance with **sec. 197 of Companies Act, 2013** will be reported u/s 143(3). **(MCQ)**

(iv) Reasons For Negative qualification **[Section 143(4)]**

- If the auditors have issued opinion as per **SA 705**, then he has to give reasons for such qualified, adverse or disclaimer of opinion.
- Qualification, Observations or comments on the Financial Transactions or matters mentioned in the Auditor's Report shall be -
  - Read before the company in its general meeting
  - Open for inspection by any member of the company

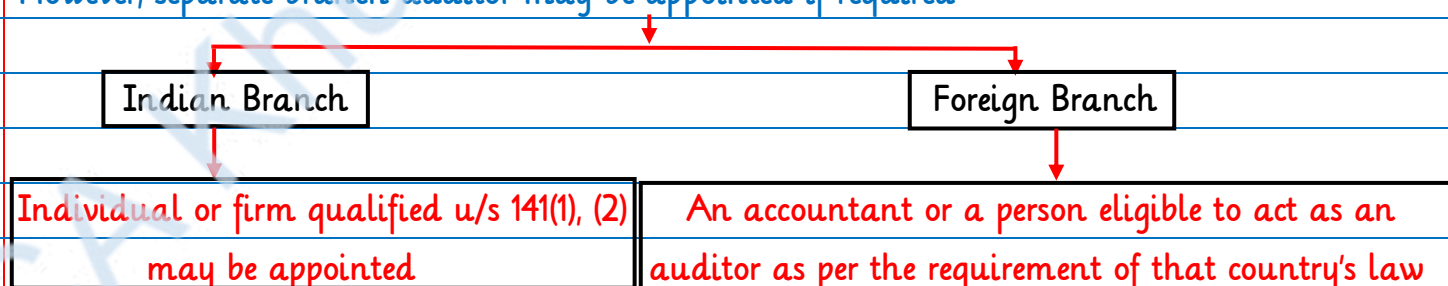
(v) Duties w.r.t. Audit of Government Companies **[Section 143(5), (6), (7)]**

- Duty to follow directions given by **CAG**
- Statutory Auditor must include the following in his report: -
  - a) Directions                      b) Actions                      c) Impact
- **Supplementary Audit** - within **60 days** from the receipt of above Audit report the **CAG** have right to conduct a supplementary audit. **(MCQ)**
- **Comments of CAG** - Comments are given by **CAG**, such comments and supplementary audit is then given to the company.

The company shall forward the same to every person entitled to copies of Financial statement u/s 136(1).

vi) Audit of Branches. **[Section 143(8)] (RTP)**

- Main Auditor can audit financial statement of branches.
- However, separate branch auditor may be appointed if required



(vii) Compliance With Auditing Standards **[Section 143(9), (10)]**

The Auditor has to comply with all the relevant Standards on Auditing (SA).

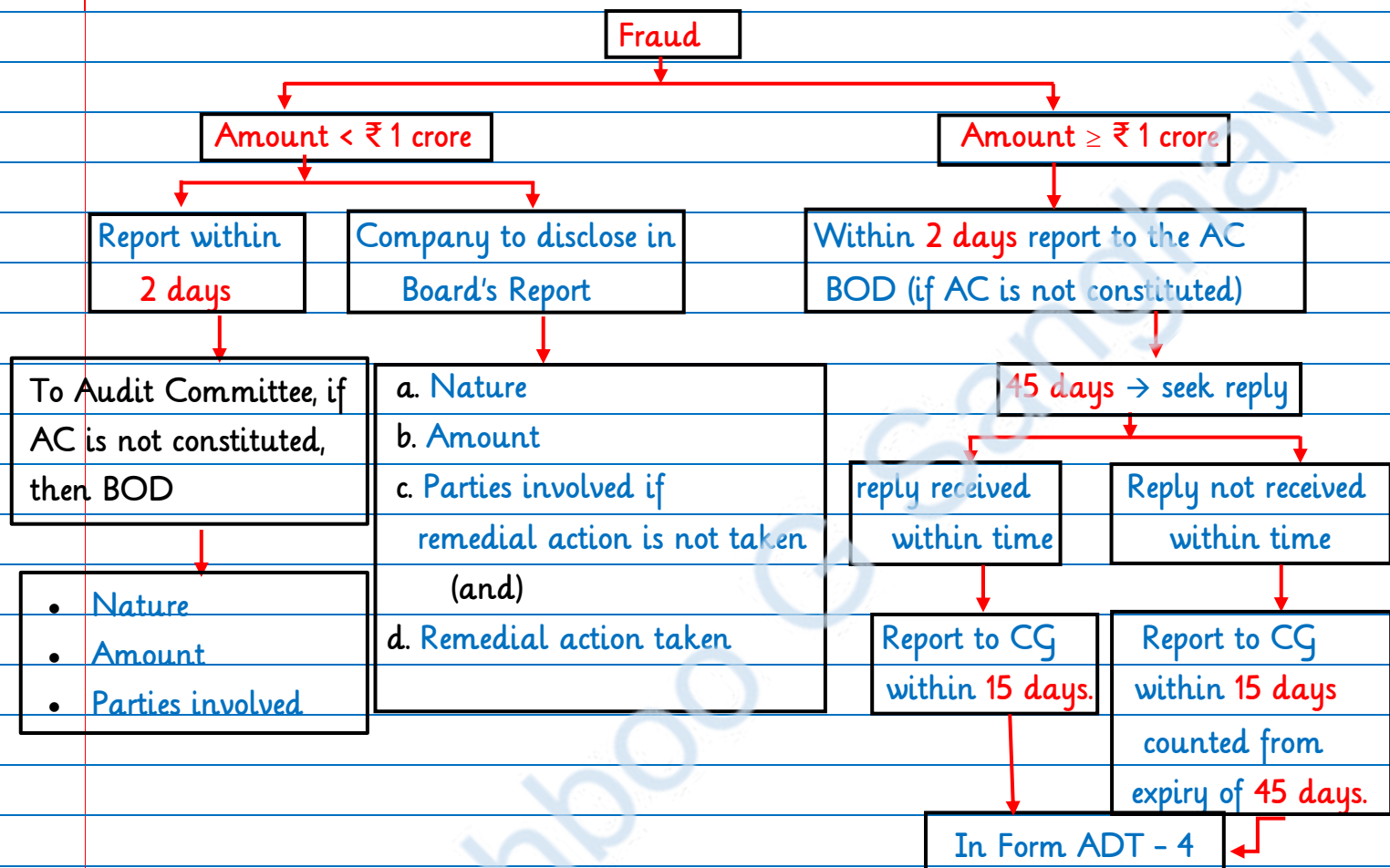
(viii) Additional Matters of Reporting **[Section 143(11)]**

The **CG** may order for inclusion of a statement on specified matters in auditor's report for specified class of companies **(CARO, 2020)**.



(ix) Reporting of Fraud [Section 143(12-15)] (MCQ)

If auditor has reason to believe that an offence involving fraud is being or has been committed against the company by officer or employees of the company then auditor must report such matter to Central Government in following manner:



Applicable to: Statutory, Cost, Branch & Compliance Auditor (PEQ)

→ Penalty for non-compliance

Listed Co. → Fine - ₹ 5,00,000/-

Others → Fine - ₹ 1,00,000/-

→ Also refer clause (xi) of para 3 of CARO, 2020.

→ Manner of Report: -

→ i. Report shall be sent to Secretary, MCA.

ii. In a Sealed cover by Registered post acknowledgement due followed by email.

iii. It should be on letter head containing

- a) Address
- b) Telephone No.
- c) E-mail
- d) Membership No.

Analysis By Author: -

Particular	CARO, 2020- 3(xi)		143(12)
	1) Fraud committed <b>BY</b> whom	Company ↓ against	Officer/ Employee ↓ against
2) Fraud committed <b>ON</b> whom	Third Party	Company	Company
3) Amount	No Limit		≥ ₹ 1 Crore
4) Reporting to	Member of the Company		Central Government
5) Grounds	Notice/Reported		Reasons to Believe
6) Reporting By Whom?	Statutory Auditor		Statutory Auditor, Branch Auditor, Compliance Auditor, Cost Auditor
7) Additional Reporting	Statutory Auditor is required to report over whistle blower complain and about the reports and forms filed under sec. 143(12)		

g) CARO, 2020: Reporting on Additional Matters

APPLICABILITY

REPORTING CLAUSES UNDER PARA 3

# Companies Auditor's Report Order (CARO), 2020

CARO, 2020

I.] APPLICABILITY

II.] REPORTING

I.] APPLICABILITY (PEQ May 07) (RTP Nov 17 /Nov 15)

It is applicable to **all** the companies including a foreign company, except-(key-BIPSO)

<b>B-Banking company</b>	Author's Note:	
<b>I-Insurance company</b> PEQ Nov 14	1. CARO Reporting does not apply to consolidated	
<b>P-Private limited company if:</b>	FS [except PARA 3(XXI)]	
PUSC + Reserve $\leq$ ₹ 1 crore	2. CARO will be equally applicable for branches	
(on B/S date);	3. But if the Private Co is a holding or subsidiary	
Total Borrowing $\leq$ ₹ 1 crore (any	of Public Co. irrespective of turnover/ borrowing it	
time of the year) & Total	is covered by CARO, 2020	
Turnover/Revenue, $\leq$ ₹	PUSC and Reserves = ESC + PSC All Reserves	
10 crores (on B/S Date)	(including Revaluation reserves) – P/L Dr Bal. It	
<b>S-Section 8 companies</b>	excludes Calls in arrears and Share application	
<b>O-OPC and Small Companies</b>	Money	
even if it falls under any criteria	Turnover: Turnover includes Sales, Services Other	
specified for private company	income like interest income, forex gain, sales return	
<b>Note:</b>	& IDT should be excluded.	
These statuses are checked as on the	Borrowings: It includes borrowing from bank &	
date of Balance Sheet	financial institutions even O/D, B/P, Interest due but	
Whether	not paid. It excludes, public deposits and debentures	
	and any loans from individuals.	
CARO Applicable to	Yes	No
a) Nationalised, Schedule, Regional Rural Bank		✓
b) Foreign Bank		✓
c) Bank during the year converted to NBFC	✓	
d) NBFC during the year converted to bank		✓
e) General Insurance Co.		✓
f) Life Insurance Co.		✓

## II] REPORTING CLAUSES UNDER PARA 3 OF THE ORDER

### (i) PROPERTY, PLANT & EQUIPMENTS (PPE)

Following matters shall be included in the auditor's report:

#### (a) Adequacy of Records:

- Whether the company is maintaining proper records showing full particulars including quantitative details and situation of PPE
- Whether the company is maintaining proper records showing full particulars of Intangible Assets.



#### (b) Physical Verification:

- Whether these PPE have been physically verified by the management at regular intervals.
- When annual verification is not possible than all assets must be verified at least once in every 3 years.
- Whether any material discrepancies were noticed on such verification and if so whether the same have been properly dealt in BOA.

#### (c) Title Deed: (PEQ May 17) (RTP May 17)

Whether the title deeds of all the immovable properties (Other than Properties where the company is the lessee).

disclosed in the financial statements are held in the name of the company.

↓ If not

Description of property	Gross Carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held- indicate range, where appropriate	Reason for not being held in name of the Company

also indicate if in dispute (not title deed is Registered sales/transfer deed)

#### (d) Revaluation of Property, Plant and Equipment:

- Whether the company has revalued its PPE/ROU/Intangible assets during the year and,

↓ If so

- Whether the Revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class PPE or intangible

(e) Proceedings for holdings of Benami Property:

➤ Whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 and rules made thereunder,

↓ If so

➤ Whether the company has appropriately disclosed the details in its Financial Statements.

(ii) INVENTORIES [PARA 3(ii)]

(a) Whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; 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) Whether during any point of time of the year, the company has been sanctioned working capital limits in excess of ₹ 5 crores, in aggregate, from banks or financial institutions on the basis of Security of current PPE; whether the quarterly returns or statements filed by the company with such banks or financial institution are in agreement with the books of account of the company,

↓ If not

Give details.

Author's Note:-Whether physical verification of inventory has been conducted at regular intervals by the management all material items must be verified at least once in year.

(iii) INVESTMENTS, GUARANTEE SECURITY, LOANS OR ADVANCES [PARA 3(iii)]

Whether during the year the company has made investment in

Any guarantee or security or granted any loans  
OR advances in the nature of loans, secured,  
OR unsecured



COMPANY



Companies, LLP,  
Firms, other parties

(a) 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 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

To parties other than subsidiaries,  
joint ventures and associated

- (b) 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) 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) if the amount is overdue, state the total amount overdue for more than 90 days, & whether reasonable steps have been taken by the company for recovery of the principal & interest;
- (e) 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 overdue of existing loans given to the same parties,

↓ if so,

specify the aggregate amount of such dues renewed or extended or settled by fresh loans & 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) 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,

specify the aggregate amount, percentage thereof to the total loans granted, aggregate of amount loans granted to Promoters, related parties as defined in Sec. 2(76) of the Companies Act, 2013.

(iv) COMPLIANCE OF PROVISIONS OF SECS. 185 & 186 – [PARA 3(iv)]

In respect of loans, investments, guarantees, and security whether provisions of Sections 185 and 186 of the Companies Act, 2013 have been complied with.

If not

Provide details thereof.

- **AUTHOR'S EXPLANATION:** As per section 185 a company cannot give: Loan/guarantee/security provided to Directors of a Co./Directors of Holding Co. of such lending Co. relative/partner/firm of the director or relative of such director in which firm in which the relative is a partner.



As per section 186 total of (Investments + loan + guarantee + security): past + proposed should not exceed higher of 60% of (SC + FR reserves + SP) or 100% of FR + SP.

(v) PUBLIC DEPOSITS [PARA 3(v)]

a) Whether provision of sections 73 to 76 or any other provision of Companies Act in relation to Public Deposit have been complied with

↓ If not,

the nature of such contraventions be stated;

b) If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal, whether the Same has been complied with or not?

Amendment in clause (v): Auditor to now submit a declaration in the form DPT3 which was earlier missing stating the fact he has audited it.

(vi) COST RECORDS [PARA 3(vi)]

Whether maintenance of cost records has been specified by the CG u/s 148(1) of the Companies Act, 2013 and whether such accounts and records have been so made and Maintained.

**Note:** 1) Reporting is only regarding maintenance of cost of records and not about cost audit.

2) Every company whose T.O. (goods and services) equal to or > ₹35 cr in the previous year has to maintain cost records.

3) Micro and small enterprises are excluded. Foreign Co. and branches of any Co. covered by this act is included in section 148(1).

(vii) STATUTORY DUES [PARA 3(vii)]

a) Whether the company is regularly depositing statutory dues including GST, PF, investors education and protection fund, employees state insurance fund, WT, sales tax, service tax, income tax, Excise duty and other statutory dues with the appropriate authorities. Also, the extent of arrears for more than 6 months as on 31/3/yyyy (B/S date) from the date they become payable.

➤ **AUTHOR'S EXPLANATION:** 1) Reporting under this clause is applicable when regular payments are made to a regulatory authority under a statute.

**Students Note:**

Payments made for		Reason
Municipal taxes/TDS/ professional tax/property tax etc.	Y	Paid mostly to state govt authorities
Turnover fees to SEBI/Stamp duties	Y	Paid to appropriate authorities
Bonus/Gratuity (Imp)	N	Contractual liability not due under a statute
PF	Y	It is paid to comply PF Act (approved fund)
Advance tax	Y	Tax dept. (it is due as and when profits earned)
Custom duty on imported goods kept at bonded warehouse	N	This duty is accrued but not due, it becomes due when goods are removed for home consumption
Interest and rent over goods kept at bonded WH	Y	It is a statutory due.
Electricity bill	N	Not a statutory due
Customs	Y	Paid to Government

2) Disputed Dues: The clause is applicable to undisputed dues. The clause is not applicable to disputed dues. Mere representation to the concerned department does not constitute the dispute.

3) Also see SA 250 "Consideration of Laws and Regulations".

4) Auditors duties and practices:

Auditor has to report two-fold – 1) default, 2) arrears of amount of default.

The auditor should get himself acquainted with all the governing acts and statutes. The auditor is just to report that the company is regularly paying undisputed dues. The auditor should get a statement from the company about the payment of tax or duties during the year and enquire into the facts that are there any undisputed dues not paid during the year.

The auditor has to report regarding the regularity of the deposits, he is not required to specify in detail each and every delay of payment.

5) Format for arrears of dues o/s for more than 6 months:

Name of the statute	Nature of dues	Rs.	Period to which amt. relates to	Due date	Date of payment
---------------------	----------------	-----	---------------------------------	----------	-----------------

**Author's Note: -**

Days of grace are allowed after the amount is due. Even if the amount falls due on public holiday and if payment is made in the next day then payments are said to be made regular. A bank guarantee is not payment of dues.

## b) Any Disputed Dues:

Format of disputed dues:

Name of the statute	Nature of dues	Rs.	Period to which amt. relates to	Forum where dispute is pending
---------------------	----------------	-----	---------------------------------	--------------------------------

**Author's Note:** - Mere Representation is not a dispute.

### (viii) UNRECORDED INCOME [PARA 3(viii)] (PEQ N22)

(a) Whether any income escaped tax in previous years under the Income-tax Act, 1961,  
↓ if so,

(b) whether the same is properly recorded in the books of account during the year,

### (ix) REPAYMENT OF DUES [PARA 3(ix)]

Whether the company has defaulted in repayment of dues to bank, financial institution, government and debenture holders, if yes then the period and amount of default to be reported.

**Dues:** It includes principal as well as interest amount due payable to bank, financial institution, government dues and debenture holders.

a) Whether defaulted in principal and interest. Yes (nature of loan, name of lender, period and amount)

b) Whether the company is declared wilful defaulter by bank or FI or any lender. Wilful defaulter means default although borrower have means to pay or no intention to pay.

c) Whether the funds are used for the purpose taken: (If no purpose and amount).

d) Whether short-term loan has been diverted for long-term purposes (if yes - the nature and amount).

e) Whether the company has taken any funds from any entity or person on account of or to meet the obligations of Subsidiary/Associate/Joint Venture (S/A/JV) [it means to fulfil requirements of S/A/JV]. (If yes - nature and amount).

**Author's Note:** - Payment of due is an obligation including expenses like salary

f) Whether the company has taken any funds from any entity or person by pledging securities of its S/A/JV. Further any default on such loans (provide details).

## ❖ AUDITOR'S PROCEDURES:

Auditor should obtain a schedule of repayment of dues to bank, financial institution and debenture holders.

The auditor should examine the agreement/document/debenture trust deed containing various terms and conditions for loans and borrowings.

The auditor should then verify whether the repayments as per books of account are in accordance with the agreement/document/debenture trust deed

If there is a dispute between the party and the company then the auditor should issue a disclaimer report.

(x) APPLICATION OF MONEY RAISED BY PUBLIC ISSUE AND PREFERENTIAL ALLOTMENT- [PARA 3(x)]

(a) Application of Money raised by public issue:

Whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised.

↓ if not

Report the following:

Nature of the fund Raised	Details of default (Reason/Delay)	Amount(₹)	Subsequently rectified(yes/no) and Details

(b) Preferential allotment:

➤ Whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the

↓ if so,

➤ Whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised,

↓ if not,

Report the following

Nature of Securities viz. Equity shares/ Convertible debentures	Purpose for which funds raised	Total Amount Raised/opening Unutilized Balance	Amount utilized for the other purpose	Unutilized balance as at Balance sheet Date	Remark, if any

**Author's Note:**

Funds raised for expansion used for repayment of loan will be reported under clause (x) not under clause (ix) as it is not used for the purpose for which it was raised.

(xi) FRAUD [PARA 3(xi)] **IMPORTANT (PEQ N22)**

(a) Whether any fraud by the company or any fraud on the Company has been noticed or reported during the year;

↓ If yes,

the nature and the amount involved is to be indicated.



- (b) Whether any report u/s 143(12) 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) Whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;

**Author's Note: -**

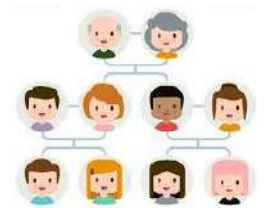
1. Also refer SA-240 & Sec. 143(12) for cross linkages.
2. Fraud committed by vendor against the company will be reporting under CARO, 2020 as well as sec. 143(12).
3. Fraud committed by company against customer will be reported under CARO, 2020.

(xii) NIDHI COMPANIES [PARA 3(xii)]

- a) In respect of nidhi/mutual benefit fund the Maximum Deposit liability should not exceed net owned funds by 20 times as per the last audited B/S. i.e net owned fund to deposit should be in the ratio of 1:20 to meet out liabilities 'Net owned funds' means SC and free reserves as reduced by accumulated losses and intangible assets. Free reserves mean reserves available for dividends. Also net owned funds exclude proceeds from PSC.
- b) **Liquidity maintenance:** Maintain Fixed Deposits 10% (it is for liquidity  $\geq$  Outstanding Deposits from members. Such unencumbered deposits should be kept in Schedule commercial bank other than regional rural bank/co-op. bank/post office bank. Unencumbered means free from any charge (no mortgage, no pledge).
- c) **No default** by Nidhi company on its FD repayments, any deposits repaid, Loans including interest  $\rightarrow$  If any report it.

(xiii) TRANSACTION WITH RELATED PARTIES- [PARA 3(xiii)]

- a) Whether all transactions with the related parties are in compliance with Secs. 177 and 188 of Companies Act, 2013 where applicable and
- b) The details have been disclosed in the Financial Statements etc. as required by the applicable accounting standards AS 18 or Ind AS 24
- a) Based on the procedures performed by the auditor, if auditor comes across any non-compliance, then, it should be duly reported. The following particulars may be incorporated:



Nature of the related party relationship and the underlying transaction	Amount involved (₹)	Remarks [details of non-compliance may be giving]



(xiv) INTERNAL AUDIT SYSTEM- [PARA 3(xiv)]

- (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.

Note: CARO does not require a company to necessarily have an internal audit system. However if such system does not exist then the Order requires the auditor to report the fact.

(xv) NON-CASH TRANSACTION WITH DIRECTORS- [PARA 3(xv)]

- a) Whether the company has entered into any non-cash transactions with directors or persons connected with him &

↓ if so,

- b) Whether provisions of Section 192 of Companies Act, 2013 have been complied with.

Note: But if the contract is entered at Fair value or if the Director/person compensates the company for loss on exchange then Section 192 is not applicable.



(xvi) REGISTRATION WITH RBI- [PARA 3(xvi)] **IMPORTANT**

- a) Whether NBFC/HFC is required to get registered with RBI and whether registration is obtained.
- b) Whether the Co. is CIC or exempted and whether the group contains more than 1 CIC.

➤ **AUTHOR'S EXPLANATION:**

1) **NBFC:**

- Applicable to NBFC (loans assets and investments is its major assets).
- Such NBFC Financial assets comprises of 50% of Total Assets and Income from financial assets should be 50% of Gross Income. Income comprises of dividends, interest, capital gains.
- Net owned fund maintained as per NBFC norms.
- Registration obtained as NBFC u/s 45-IA with RBI (if not reasons).
- Carrying its activities without obtaining certificate of registration (if yes reasons).

2) **HFC:**

- Registration obtained with RBI (if not→reasons).
- Carrying its activities without obtaining certificate of registration (if yes→ reasons).

3) **CIC:**

- It is a type of NBFC. It is a Company whose Investments assets  $\geq$  90% of Total Assets. Also investments in Equity Shares  $\geq$  60% of Total Assets. They are usually Parent Co. holding multiple Subsidiary Companies. Report whether it is CIC.....CARO, 2020 requirement.
- If the CIC is exempted CIC, whether it continues to fulfil such criteria.
- Registration obtained with RBI (if not reasons).



- Carrying its activities without obtaining certificate of registration (if yes - reasons).
- If the group company has more than 1 CIC, than indicate the numbers of CIC

(xvii) CASH LOSSES- [PARA 3(xvii)]

a) Whether the company has incurred cash losses in the financial year and in the immediately preceding financial year,

↓ if so,

b) State the amount of cash losses;



**Note:** Cash losses = Net loss + Depreciation and amortization.

(xviii) CONSIDERATION OF ISSUES RAISED BY OUTGOING AUDITOR- [PARA 3(xviii)]

(PEQ N22)

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



**Note:** 1) Reasons of retiring auditor can be compliances of Section 139 / 140, Fees, Qualified report  
2) Also refer Clause 8 of Part I of First Schedule.

(xix) EXISTENCE OF MATERIAL UNCERTAINTY AS TO COMPANY ABILITY TO PAY ITS LIABILITIES- [PARA 3(xix)]

a) Ratios: Whether the Company will be continued as Going concern based on following ratios:

Financial ratios like current ratio, quick ratio. Ageing analysis (Drs collection ratio)

b) Payment of liabilities (whether non-current liability is breached and become current liability)

c) Consider Management plans and Board Resolutions indications on going concern assumptions.

**[Author's Note: - SA - 570 on Going Concern for better understanding]**

❖ **Any material uncertainty :**

Under CARO, 2020 auditor should report any materiality uncertainty exists.

❖ **Capability of liability repayment:**

Auditor should assess whether the Company is able to repay all its liabilities falling within 1 year. Here liabilities includes not only loans, interest payable but also trade payables.

(xx) TRANSFER OF UNSPENT CSR AMOUNT- [PARA 3(xx)]



- 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 6 months of the expiry of the financial year in compliance with 2nd proviso to Sec. 135(5) of the said Act;
- b) Whether any amount remaining unspent u/s 135(5) of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of Sec. 135(6) of the said Act.

➤ **AUTHOR'S EXPLANATION:**

1) **Features of CSR:**

- Company having atleast - T.O. of ₹1000 cr, or NW of ₹ 500 cr or NP of ₹ 5 cr should follow CSR.
- Atleast 2% of NP (avg. of last 3 yrs.) to be spent as per Schedule VII.

2) **CARO, 2020 requirements:**

- If the Company has fully spent 2% of NP then no CARO will be applicable.
- If amount unspent on account of other than ongoing projects mentioned in Schedule VII the unspent amount will be transferred to Schedule VII - FUND (PM Care fund, Clean Ganga fund, PM National relief fund) within 6 months of F.Y.....Section 135(5). Also mention reasons in Board Report.
- If amount unspent on account of ongoing projects mentioned in a separate bank a/c in a Schedule Bank named "Unspent CSR a/c" under "Escrow A/c". Transfer the unspent funds within 30 days. If remains unutilized within 3 years then transfer in Schedule VII - Fund as above within 6 m from the end of F.Y. ....Section 135(6).  
Ongoing projects are long-term projects like constructing hospitals which is to be utilized 3 years
- Implications of not following CSR above requirements:
  - (i) Negative reporting;
  - (ii) Penalty u/s 135(7) of Companies Act.

(xxi) QUALIFICATIONS OR ADVERSE REMARKS IN CARO REPORT OF GROUP COMPANIES- [PARA 3(xxi)]

**Group CARO:**

- a) If any qualified or adverse remarks are given by the auditors of Subsidiary Company then the auditor of Parent Company is required to mention-
- (i) Details of Subsidiary Co.
  - (ii) CARO para No.
  - (iii) Remarks given by such auditors.

**Author's Note:** This clause is applicable to Parent CARO only.

### III] REASONS TO BE STATED FOR UNFAVOURABLE OR QUALIFIED REMARKS




- a) Where, in the auditor's report, the answer to any of the questions referred to in Para 3 is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.
- b) 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.

Students Note

## CHAPTER 9. AUDIT OF DIFFERENT TYPES OF ENTITIES

### → WHAT TO STUDY?

- I] Charitable Institution
- II] Educational Institution
- III] Audit of club
- IV] Audit of Hospital
- V] Audit of Cinema
- VI] Audit of Hotel
- VII] Audit of Hire Purchase
- VIII] Leasing Co.
- IX] Audit of LLP
- X] Audit of Cooperative Societies
- XI] Government Audit
- XII] Partnership Audit
- XIII] Audit of Local Bodies
- XIV] Audit of Sole Trader
- XV] NGO's
- XVI] Audit of Trusts & Societies

	Basis	I) Charitable Institution	II) Educational Institution	III) Audit of club
A] Preliminary Points				
(i) Legal Status		Studying the constitution under which, charitable institution has been set up	Studying the constitution under which, educational institution has been set up	Studying the constitution under which, club has been set up
(ii) Examine the Guiding Doc.		Examine Guiding document of the institution (Like Trust Deed)	Examine Trust Deed or Regulations Note: -All the provisions affecting accounts.	Examine the financial powers of secretary with the help of agreement or document
(iii) Evaluate the ICS		Examine the system of ICS, regarding → Accounting of amount collected. → Unused receipt book → Moneys received	—	Verify the internal check & ICS of the club.




		from box collections, flag days etc.		
(iv)	Review the minutes	Examine the <b>minutes</b> of the meeting, to note decision which may affect the audit work.	Read through the <b>minutes</b> of the meetings of the managing committee or governing body	Examine the <b>minutes</b> of the meeting, to note decision which may affect the audit work.
(v)	Accounting policies records	Followed Consistently	Followed Consistently	Followed Consistently
B]	Receipts	<b>Main Income</b> {Subscription, Donation & Grants} 1. Obtain all receipt books 2. Obtaining the printed list of subscriptions & <b>donation &amp; reconcile</b> with total collection show in the accounts with figure published in reports 3. Obtaining a <b>certificate</b> from a responsible official showing the amount of grant received <b>Ancillary Income</b> 1. <b>Investments Income</b> → Vouching the Interest/ Dividend Counter folio → Checking investment has been sold ex-dividend or purchase	<b>Main Income</b> 1. Fees - a) Check names entered in the students fee register for each month or term, with the respective class register. b) Verify <b>cash book</b> , tracing the collections in the fee register c) Check admission fee with admission slips signed by the head of the institution. 2. Confirm <b>hostel dues</b> were recovered before students accounts were closed. <b>Ancillary Income</b> 1. Verify rental income from land property which is rented 2. Vouch Income from: - Endowments & Legacies <b>Interest &amp; Dividend</b>	<b>Main Income</b> 1. Vouch the receipt on account of entrance fee subscriptions with member application 2. Reconcile the amount of total subscriptions. 3. Ensure that arrears of <b>subscriptions</b> for the previous year have been correctly forward & current year arrears have been correctly adjusted. 4. <b>Confirm</b> that the <b>account of every member</b> has been debited with amount recoverable from him.



		cum dividend.	3. Verify <b>Grant</b> from Govt./Local Authority with the memo of grant.	
		2. Rent: - Examine the rent received by inspecting <b>tenancy agreements</b>		
		3. Vouching Gross Receipts in respect of <b>Special functions</b> (i.e. <b>Concerts, Dramatic Performance</b> etc.)	4. Vouch <b>donation</b> , if any with the list published with the annual report.	
		4. Vouching the income <b>tax refund</b> with the income tax dept.	5. Vouching the income <b>tax refund</b> with the income tax dept.	
C]	Payments	1. Vouching payment of <b>Grant</b>	1. Vouch all capital Expenditure & <b>all exp. authorised</b> by the authority	1. Vouch <b>Purchase</b> of sports items, furniture, crockery & trace the entry with inventory register
		2. Grants used for the <b>object</b> of the institution	2. Vouch the payment of salaries, see the increase in the salaries of the staff have been <b>sanctioned</b> by the committee.	2. Vouch purchase of <b>Foods stuffs, Cigar.</b>
		3. Capital expenditures are <b>authorised</b> by the authority.		
D]	Assets	1. Verifying the <b>Cash &amp; Bank balance</b>	1. Verifying the <b>cash &amp; Bank balance</b>	1. Physical verification of inventories of furniture, sports materials & other assets
		2. Verifying the securities	2. <b>Verifying the securities</b>	2. Inspect the <b>share scrips &amp; bond</b> in respect of investments, check the current value for <b>disclosures</b> in final account
		- Inventories	<b>Inventories</b>	
		- Properties (Movable & Immovable)	- Properties (Movable & Immovable)	
		(Title deed/ Physical Verification)	(Title deed/Physical Verification)	
		3. Ascertaining that any funds contributed for a <b>special purpose</b> have been utilized for	3. Ascertaining that any funds contributed for a <b>special purpose</b> have been <b>utilized</b> for	



		the purpose.	the purpose.	
E]	Liabilities	Reconcile the amount of the <b>dues</b> & verify the tax return filed every month.	Confirm the <b>caution money</b> other deposits paid by students on admission, have been shown as liability in the balance sheet.	Verify the completeness of the liabilities & dues.
F]	Other Points	-	-	-

	Basis	IV) Audit of Hospital	V) Audit of Cinema	VI) Audit of Hotel
A]	Preliminary Points			
(i)	Legal Status	Ascertain the <b>legal status of Hospital</b> [i.e. whether it is trust/ firm or body corporation etc.]	Ascertain the legal status of the <b>cinema</b> [i.e. whether it is sole proprietor/ firm/ body corporation.]	Ascertain the legal status of the <b>hotel</b> [like whether it is sole proprietor/ partnership firm/ body corporation]
(ii)	Examine the Guiding Document	Examine the <b>AOA/ MOA/ Partnership Deed, Trust Deed, etc.</b>	Examine the <b>AOA/ MOA/ Partnership Deed, etc.</b>	Examine the <b>AOA/ MOA/ Partnership Deed, etc.</b>
(iii)	Evaluation the ICS	Examine the <b>internal control system</b> & internal check as regard the receipt & <b>issue of stores, medicines, lines, apparatus, clothing etc.</b>	Evaluate the ICS: <b>PEQ Nov22</b> (a) That entrance of cinema hall during show is only through printed ticket. (b) They are <b>serially numbered</b> & bound into books. (c) That the <b>No. of tickets</b> issued for each show. (d) That for advance	Evaluate the system of ICS with regards to <b>system billing</b> the <b>guests</b> from laundry, bar & restaurants etc.

			booking a <b>separate series</b> of tickets is issued.	
			(e) That the inventory of the <b>tickets</b> is kept in the <b>custody</b> of a responsible official.	
(iv)	Review the minutes	Examine the <b>minutes</b> of meeting, to note decision which may affect the audit work.	Examine the <b>minutes</b> of meeting, to note decision which may affect the audit work.	Examine the <b>minutes</b> of <b>BOD</b> to note decision which may affect the audit work.
(v)	Accounting Policies & Records	Ensure that A/c policies are applied consistently	Ensure that A/c policies are applied consistently	Ensure that A/c policies are applied consistently
B]	Receipts	<b>Main Income</b> 1. Vouch the register of patients with copies of <b>bills issued</b> to them also see that bills have been issued to all patients from whom an amount was resumable according to the rules of the hospital. 2. Check cash collection as entered in the cash book with the receipt	<b>Main Income</b> 1. Confirm that at the end of the show a <b>Statement of tickets sold</b> Is prepared & <b>cash</b> Collected is <b>agreed</b> with it. 2. Vouch the <b>entries</b> in Cash book in respect of Cash collected on sale of tickets.	<b>Main Income</b> 1. Verify the room sales collections with the guest register 2. If standard room rate changed from <b>various guests</b> then, it should be investigated to ensure that they have been properly authorised. 3. Test Check daily occupancy reports.
		<b>Ancillary Income</b> 1. Verify the investment register, that <b>rental income</b> , of property, <b>dividend &amp; interest</b> on security have been collected.	<b>Ancillary Income</b> 1. The arrangement for collection of the share in the <b>restaurant income</b> should be enquired into either a <b>fixed commission</b> or a	<b>Ancillary Income</b> 1. Examine the bills raised for <b>letting out</b> of <b>banquet hall</b> with reference to agreement, cash book, Bank statement & relevant

		2. Ascertain that <b>legacies &amp; donation</b> received for a specific purpose have been applied in their manner agreed upon.	<b>fixed %</b> of the taking may be receivable annually.	register. 2. Examine the <b>bills raised</b> to agencies issuing space & other facilities of hotel eg. Tour operator, Shopkeeper
		3. Trace all collections of subscription & donation from the cash book to the respective register.		
C]	Payments	1. Vouch <b>all purchase &amp; expenses</b> 2. Verify that capital expenditure was incurred only with the <b>prior sanction</b> of the trustees or the managing committee.	1. Vouch <b>all expenditure</b> incurred on the advertisement, repair & maintenance. 2. Vouch payments on account of <b>film hire</b> with bills of distributors in the process.	1. Ensure that wages paid to <b>casual labours</b> are shown properly. 2. Vouch the commission paid to agent. 3. Ensure that proper distinction is made between capital & revenue expenditure 4. Whether depreciation has been properly charged on furniture, which include other Assets
D]	Assets	1. <b>Depreciation</b> has been Written off against all the assets at the Appropriate rates. 2. Inspect the <b>Bond</b> , scrips, title deeds of the properties. 3. Obtain <b>inventories</b> , especially of stock & stores as at the end of	1. <b>Depreciation</b> has been Written off against all the assets at the Appropriate rates. 2. Inspect the <b>Bond</b> , scrips, title deeds of the properties. 3. Obtain <b>inventories</b> , especially of stock & stores as at the end of	1. Physical verify the fixed assets & find the discrepancies between the result of <b>physical verification</b> in the books of account 2. Examine whether all the <b>assets</b> are properly disclosed. 3. <b>Depreciation</b>

		the year. 4. Verify the Grants if any received from the government.	the year. 4. Verify the Grants if any received from the government.	has been written off against all the assets at the appropriate rates. 4. Inspect the Bond, scrips, title deeds of the properties. 5. Obtain inventories, especially of stock & stores as at the end of the year. 6. Verify the Grants if any received from the government.
E]	Liabilities	Verify the completeness of the liabilities	Reconcile the amount of entertainment tax collected with the total number of ticket issued for each class & vouch & verify the entertainment tax returns filed each month	Verify the completeness of the liabilities
F]	Other Points	Compare the total of various items of expenditure & income with the amount budget for them.		Verify whether various taxes like GST, etc. have been timely deposited.

Basis	VII) Audit of Hire Purchase	VIII) Leasing Co.
A] Preliminary Points		
(i) Legal Status		
(ii) Examine the Guiding Documents	<p>→ Examine HP agreement in writing &amp; is signed by all parties</p> <p>→ Hire Purchase (HP) agreement</p>	<p>→ Lease agreement should be examined.</p> <p>Following points may be noted</p>

		specifies clearly.	1. The descriptions of the lessor, the lessee, the equipment & the location, when the equipment is to be installed
		a. The HP price of the goods	2. The amount of revenue of lease, date of payment, late charges, deposit or advances, etc. should be noted.
		b. The cash price of the goods	3. Whether the equipment shall be returned to the lessor on termination of the agreement.
		c. Date of commencement of agreement	4. Whether the agreement prohibits the lessee from assigning the subletting the equipment authorise the lessor to do so.
		d. The number of instalment by which the HP price to be paid.	
		e. The goods to which the agreement relates in a manner sufficient to identify them.	
(iii)	Evaluation of procedure		→ Whether they exist a procedure to ascertain the credit analysis of lessee like lessee's ability to meet the commitment under lease, past credit records, capital Strength, etc.
B]	Receipts	Ensure that <b>instalment payments</b> are being received regularly as per the agreement.	Ensure that <b>instalment payments</b> are being received regularly as per the agreement.
<b>Difference Between (PEQ)</b>			
		<b>Operating Lease</b>	<b>Financial Lease</b>
(i)	Common examples	Lease of Projector, Computers, Laptops, Coffee Dispensers etc.	Lease of Plant & Machinery, Land, Office Building, etc.
(ii)	Ownership	<b>Ownership</b> 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. <b>Title may or may not be eventually transferred.</b>

(iii)	Accounting treatment	Operating lease is generally treated like a <b>renting arrangement</b> . That means the lease payments are treated as operating expenses and the asset does not appear as on lessee's balance sheet	Finance lease is treated like <b>loan arrangement</b> . Hence, the asset ownership is considered of that of the lessee and thus appears on the balance sheet of the lessee.
(iv)	Purchase Option	Under operating lease, the lessee <b>does not have any option to buy</b> the asset during the lease period.	Financial lease allows the lessee to have a <b>purchase option</b> at less than the fair market value of the asset
(v)	Lease Term	Lease <b>term</b> generally extends to <b>less than 75%</b> of the projected useful life of the leased asset.	Lease term is generally <b>more than or equal to estimated economy life</b> of the asset under the lease arrangement.
(vi)	Operating/ running expenses	Lessee pays only the <b>monthly lease payments</b> . 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 <b>insurance, maintenance &amp; taxes</b> .
(vii)	Tax Benefit	Since operating lease is as good as renting, lease payment is considered as expense. <b>No depreciation can be claimed</b> by the lessee.	<b>Lessee can claim both interest &amp; depreciation expenses</b> as financial lease is treated like a loan.

**Students Note:**



IX]

# Audit of LLP

(PEQ Nov'22)

A] LLP shall be under obligation to maintain annual accounts reflecting True & Fair view of its state of affair.

Limited Liability Partnership

A statement of Accounts & solvency in Form 8 shall be filled by LLP with ROC every year.



B] The accounts of every LLP

Shall be audited in accordance with Rule 24 of LLP Rules, 2009

It provides following LLP shall not get it account audited whose (in any FY)

T/o ≤ ₹40 Lakhs

OR

Contribution ≤ ₹25 Lakhs

C] i) As its difficult to assess insurance requirements of different types of sizes of LLP's, there is **no mandatory** requirement of **insurance** under this Act.



Every LLP to file

Annual Return  
In Form 11 within 60 days from closer of FY.



Statement of Account & Solvency in Form 8 within 30 days from the end of 6 months of FY>

ii)

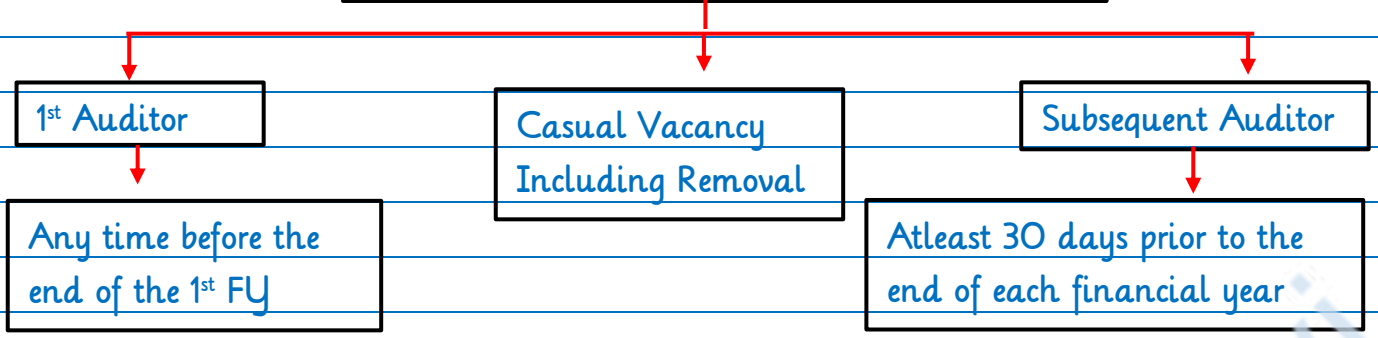
Default in filing

Upto 300 days  
Normal + Additional Late Fees

More than 300 days  
Normal + Additional Late Fees also liable for prosecution



D] Appointment of Auditor by Designated Partner



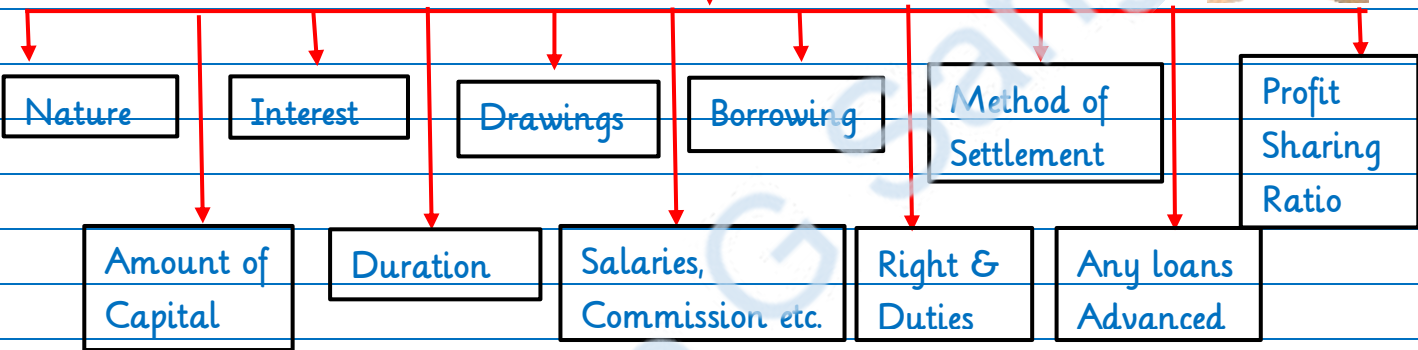
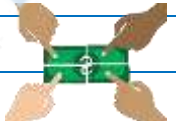
In case designated partner fails, other partner may appoint.

E] Duty of Auditor :- a) To obtain definite instruction in writing

b) To refer Minutes Book

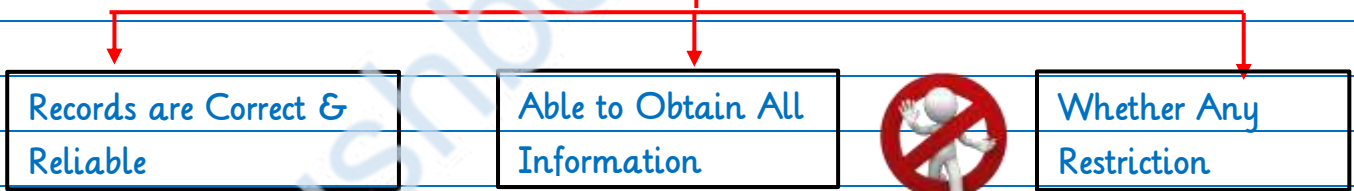
c)

To read LLP agreement

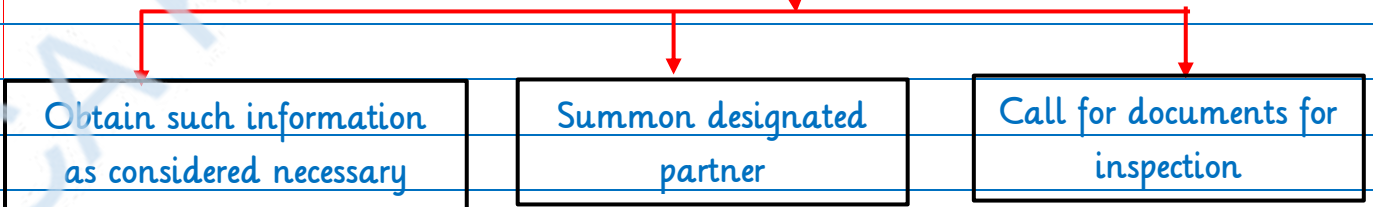


F] Reporting :-

Auditor should mention



G] Power of Registrar



## X] AUDIT OF COOPERATIVE SOCIETIES

### A] SPECIAL FEATURES

- (i) Overdue debits: - period from 6 months to 5 years and > 5 years shall be classified.
- (ii) Overdue interest: - such interest shall be excluded from interest outstanding.
- (iii) Classification of bad debts: - bad debts can be written off only where they are certified
- (iv) Committee in (case of company. → BOD)
- (v) Verification of assets and liabilities:- current assets should valued of lower of cost or market value. All known liabilities should be brought into accounts not merely and contingent
- (vi) Adhere to co-operative principles: - the auditor shall ensure that expenses are included economically and principles of property are followed.
- (vii) Observations of the provisions of act and rules → Cooperative Societies Act
- (viii) Restrictions on co-operative societies:
1. No member other than registered society can invest capital exceeding 20% or ₹1,000
  2. It can provide loan to members and for providing loans to other registered societies special sanction from registrar is required.
  3. It may accept loans or deposits from members as well as others subject to conditions specified in bye laws.
  4. Co-operatives societies may invest its fund in followings: -
    - Securities in any other societies
    - Specified securities mentioned u/s 20 of Indian Trust Act.
    - Central as state co-operative banks
    - Any other as permitted by govt.
- (ix) Special report to registered: - In all cases a special report may become necessary on receipt of which registered way take necessary actions:
- Personal profiteering
  - Fraud
  - Mismanagements
  - Disproportionate actions
  - Reckless advancing
- (x) Classifications of societies: - On the basis of overall performances of the society, the auditor shall award a class to the societies.
- (xi) Discussion of draft audit report will managing committee
- (xii) Distribution of profit: -
- (25%) of profit should be transferred to reserves before distribution
  - However, registrar way reduce it but atleast 10% will still be required.
- (xiii) Schedules to the report: -
- Transaction contrary to Act, rules and Bye-laws
  - Sums not brought into accounts.

- Material/property appearing as doubtful/bad.
- Material irregularity in expenses/realization of money.
- Any other matter specified by registrar.

(xiv) Contribution to education fund: -

- Some State Acts provide that every society should annually contribute towards education fund
- Also, transfer to Dividend equalisation reserve & CRR are treated as charge against profit.

## B] MULTI STATE CO-OPERATIVE SOCIETIES ACT, 2002

i) BOOKS OF ACCOUNT:

- All sum of money received & expended & matters of receipt/expenses.
- All sale & Purchase of goods.
- All assets & liabilities.
- For MSCOS engaged in production, processing & manufacturing, their utilization of materials or labour or other items of cost as may be specified in by-laws of society.



ii) QUALIFICATION OF AUDITORS (SEC. 72)

- A Chartered Accountant or as specified under State Co-operative Act. is qualified to be appointed as auditor: -
  - Disqualification:
    - Body corporate.
    - Officer/Employee of MSCOS.
    - Partner/Employee of Officer/Employee of MSCOS.
    - Indebted/Guarantor for amount > ₹ 1,000/-

iii) APPOINTMENT OF AUDITORS (SEC. 70)

- First auditor by board meeting within **one month of registration** date to hold office until conclusion of 1<sup>st</sup> AGM. If board fails to appoint, then in general meeting until conclusion of next AGM.]

iv) POWER & DUTIES OF AUDITORS (SEC. 73)

Right to access at all times to books, Accounts & Vouchers, to require information & explanation from employee/officers, to attend GM, to send representation on removal.

v) Following inquiries shall be made

Loans & **advances** made by MSCOS on basis of security, properly secured & whether terms aren't prejudicial to interest of MSCOS/members.

- Transaction of MSCOS represented merely by **book entries** are not prejudicial to interest of MSCOS.

- Whether personal **expenses** have been charged to revenue.
- In case it is stated in Books of MSCOS that **any shares** have been allotted for cash whether cash actually been received & if no cash has been so received, whether positions stated in books & B/S are correct & not misleading.

C] **SPECIAL AUDIT OF MSCOS (SEC. 77)** (PEQ CA Inter May 19)

(i) In case, Central Government or State Government either alone or both hold 51% more of paid-up share capital in such MSCOS.

(ii) Central Government may direct either a CA or MSCOS's auditor to conduct special audit & make a report to it.

(iii) If Central Government is of opinion that:

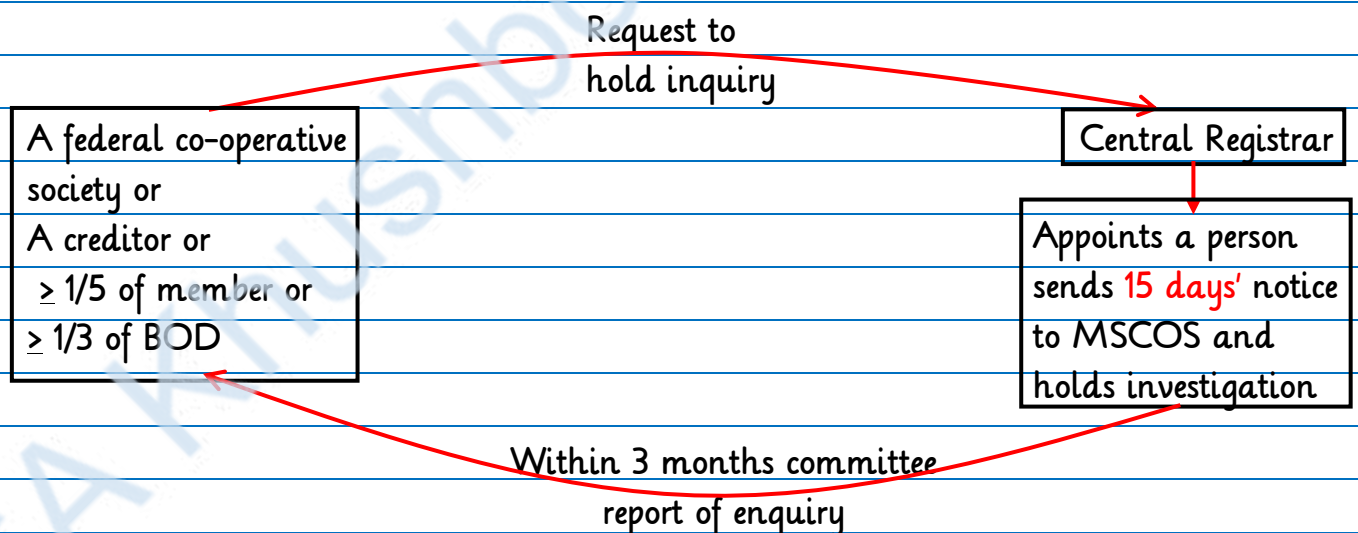
- Affairs of MSCOS aren't being managed in accordance with self-help & Co-operative principles or sound business principles or:
- MSCOS is managed in manner likely to cause serious injury/damage to interest of trade/industry or business to which it pertains or

The financial position of any MSCOS is such as to endanger its solvency.

(iv) Auditor has same powers & duties as in **Sec. 73**.

(v) On receipt of report of special audit, Central Government may take such action as it considers necessary.

D] **INQUIRY AND INSPECTION BY CG**





XI]

## GOVERNMENT AUDIT



A] DEFINITION &amp; OBJECTIVE OF GOVERNMENT AUDIT

(PEQ July' 21)

Government auditing is

- the objective, systematic, professional and independent examination
- of financial, administrative and other operations
- of a public entity
- made subsequently to their execution
- for the purpose of evaluating and verifying them,
- presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions
- by the responsible officials
- and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

Objectives :- (PEQ)

(i) Accounting for Public Funds :- Government audit serves as a mechanism or process for public accounting of government funds.

(ii) 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.

(iii) 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.

B] PURPOSE :

1. Mechanism or Process -> Public Accounting
2. Operational, Mgmt. Programme and Policy Aspects.
3. Factual data, serve to highlight lapses of lower hierarchy -> helps supervisory level officer to take corrective measures.
4. Neither equipped nor intended to function as investigating agency.

C] LEGAL FRAMEWORK AND CAG

1. Appointment & Removal

- Constitution guarantees the independence of the CAG by prescribing that he shall be appointed by **PRESIDENT of India.**



- He shall be removed only on the basis of proved misbehaviour or incapacity.
- He can be removed only when each House of Parliament decided to do so by MAJORITY (> 2/3 of members present & voting).

## 2. Various constitutional Provision

Article 148	Article 149	Article 150	Article 151
<ul style="list-style-type: none"> <li>• CAG shall be appointed by President of India</li> <li>• Tenure – 6 years or 65 years whichever is earlier</li> <li>• Remuneration – equivalent to that of a SC judge.</li> <li>• Removal – only on grounds of proven misbehaviour or incapacity</li> </ul>	Powers & duties- prescribed under CAG (Duties, Powers and Conditions of Service Act, 1971.)	Accounts of the Union and States will be maintained as per description given by President on advice of CAG.	Report of CAG shall be submitted to President/ Governor.

### D] DUTIES OF CAG :

#### 1. Compile and Submit Accounts :-

- (i) Who is responsible for Compiling :- The CAG of India. Accounts are compiled by him or by any other person responsible in that behalf.
- (ii) Accounts compiled are submitted to :- The President or the Governor of the State or Administration of Union Territory having legislative assembly as the case may be.
- (iii) When such accounts are submitted :- Such accounts are submitted on before the date as case may determined.
- (iv) Where CAG provide information & render assistance to Union & State :-  
The CAG shall, in so far as the accounts for compilation or keeping of which he is responsible, unable him so to do, give to Union Territory, State Government or Government of Union Territory as they may require from time to time in preparation of annual financial statements.

2.

General Provisions Relating to Audit & report

(Expected MCQ)

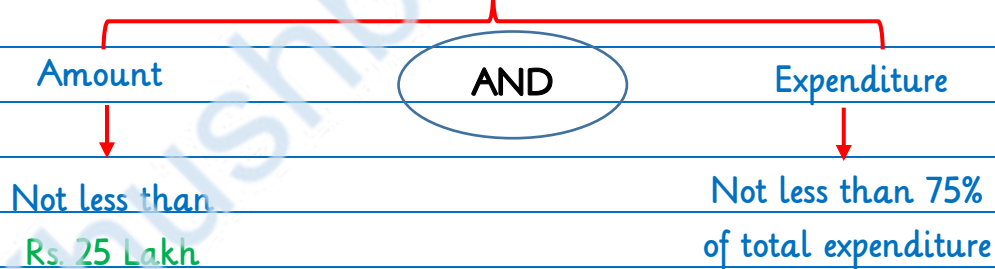
<p>a) on all expenditure          -&gt; Expenditure from :- the consolidated fund of India &amp; of each state &amp; of each Union Territory having a legislative assembly (will be denoted as # for further explanation)          -&gt; To ascertain :- Whether the money disbursed were legally available for &amp; applicable to service/ purpose to which they have been applied or charged.</p>	<p>b) to all transaction          -&gt; Transactions :- of the union and of the states relating to contingency funds &amp; public accounts.</p>	<p>c) on all trading, P/L, B/S, Manufacturing accounts &amp; other subsidiary accounts.</p>
--	---	---

3. Audit of Receipts & Expenditure

Audit receipts & expenditure of any Body or Authority [BA] substantially financed\* by loan or grant from fund (Refer Note B #)

Note A :-

\*Substantially financed



Note B :- # Consolidated fund of India and of each state and of each Union Territory having a legislative Assembly.

**Author's Note :-** Pictorial Presentation of Audit of Receipts & Expenditure for Understanding

# Fund      ₹ Substantial  
                   Financed

Body/Authority

CAG -> Audit of receipts and exp. of Body authority.  
 Subject to prov. of law

4. Audit of Grants & Loans

CAG shall scrutinise the procedures by which the sanctioning authority satisfied itself as to the fulfilment of the conditions subjects to which such grant or loans were given.

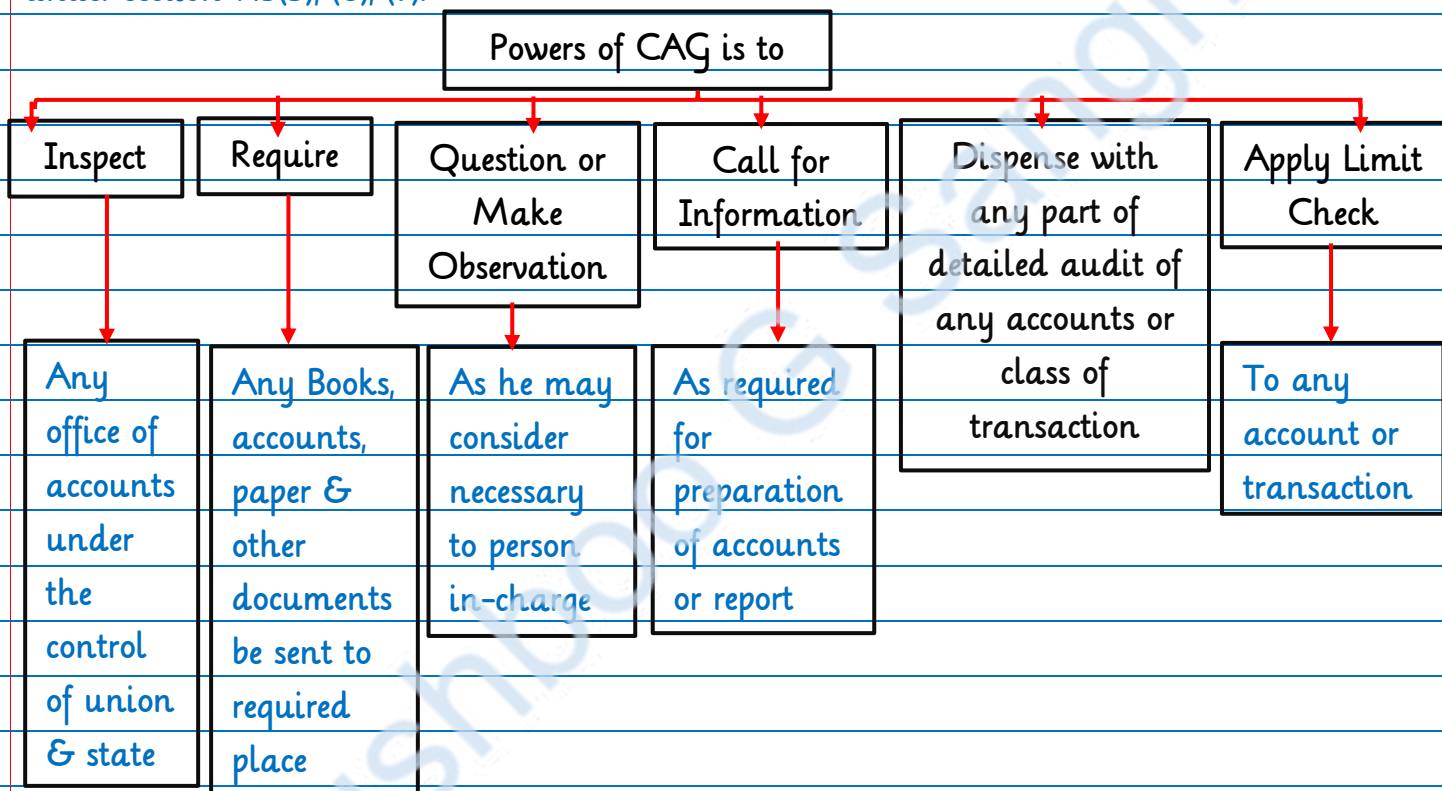
Grants or loan given to :- any Body or Authority [BA], not being foreign state or International organisation.

Grant or loan given from :- #

5. Audit of Receipts of Union or States

CAG shall appoint first auditor & subsequent auditor of Government Companies as explained under section 139(5) & 139(7).

The Auditor of Government Company shall submit his audit report to CAG as explained under section 143(5), (6), (7).



**Students Note**

E]

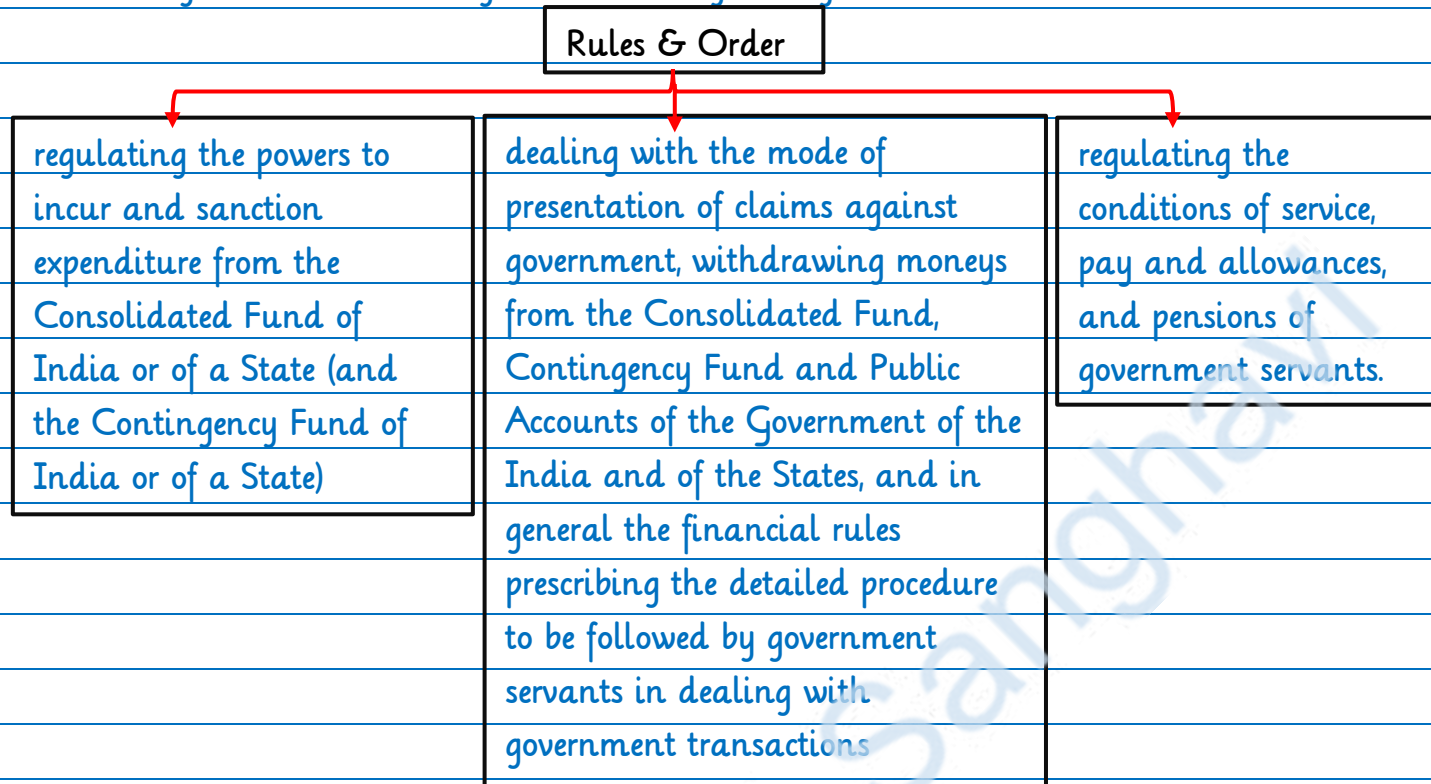
## AUDIT OF EXPENDITURE (Key - RS P<sub>3</sub>)

a) Audit against Rule & Order	b) Audit of Sanction	c) Audit against Provision	d) Propriety Audit	e) Performance
<p>The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment &amp; is in accordance with the financial rules &amp; regulations framed by the competent authority.</p>	<p>The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, such expenditure.</p>	<p>It contemplates that there is a provision of funds out of which expenditure can be incurred &amp; the amount of such expenditure does not exceed the appropriations</p>	<p>To ensure compliance with general principles of financial propriety &amp; to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules &amp; regulations.</p>	<p>This involves that the various programmes, schemes &amp; projects where large financial expenditure has been incurred are being run economically &amp; are yielding results expected of them.</p>

**Students Note**

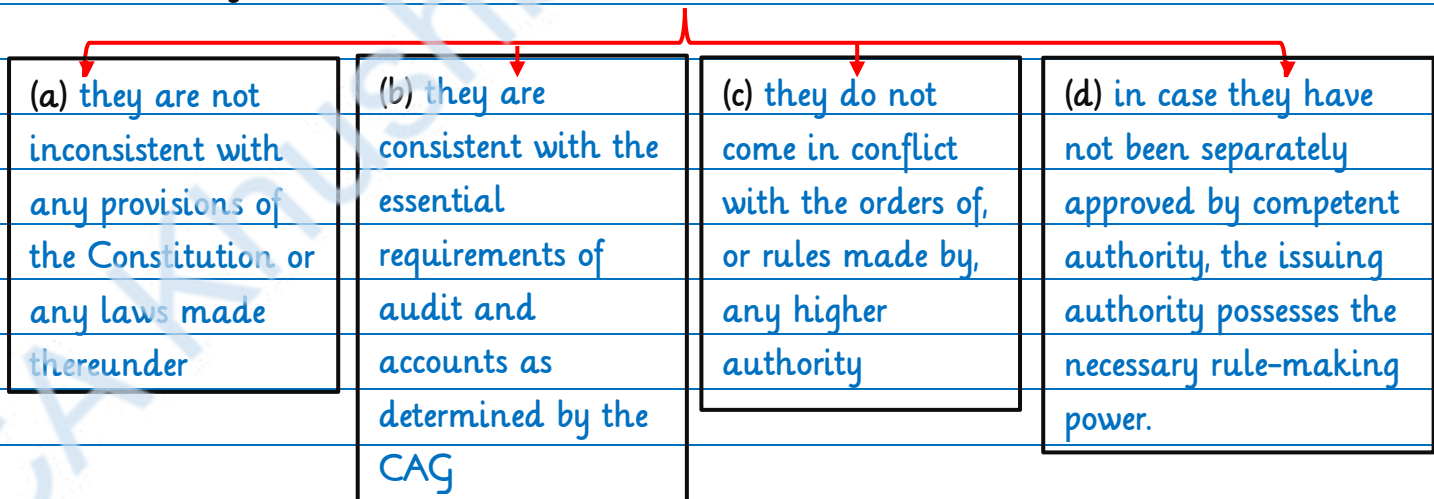
i) Audit against Rule & Order

→ Rule, Regulation & Order against which regulatory audit is conducted :



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.

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:



ii) Audit of Sanctions

The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, of the competent authority.

iii) Audit against Provision of Funds

It contemplates that there is a provision of funds out of which expenditure can be incurred & the amount of such expenditure does not exceed the appropriations made.

iv) Propriety Audit

Propriety Audit stands for verification of transaction on the tests of public

(i) Propriety Audit stands for verification of transaction on the **tests of public interest** commonly accepted customs and standards of conduct and particularly as applied to professional performance, requirements of law, government regulations and professional codes.

(ii) In 'Propriety audit', the auditors may try to **bring out cases of improper, avoidable, or infructuous expenditure** even though the expenditure has been incurred in conformity with the existing rules and regulations.

(iii) A transaction may satisfy all the requirements of regularity audit in so far as the various formalities regarding rules and regulations are concerned, but may still be **highly wasteful**.

(iv) Audit should, therefore, try to secure a reasonably high standard of public financial morality by **looking into the wisdom, faithfulness and economy of transactions**.

(v) Some general principles have been laid in the Audit Code

→ The expenditure  $\nless$  (should not be more than) occasion demand.

→ No authority should exercise its power of sanctioning expenditure to get any personal advantage.

→ Public money should not be utilised for the benefit of particular person or community unless

the amount of expenditure involved is insignificant

a claim for the amount could be enforced in a Court of law

the expenditure is in pursuance of a recognised policy or custom

the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients



v)

Performance audit (Key - E<sub>3</sub>)

ECONOMY	EFFICIENCY	EFFECTIVENESS
It is reducing the cost of inputs used for activity i.e. best price for appropriate quantity, quality of goods (Most economical)	It is reducing input to achieve maximum output How? a) Sound procurements Practice b) Maintaining & protecting Resources c) Optimum utilisation of Resources d) Best operating process e) Objectives are met cost effectively f) Programmes are managed regulated organised & executed efficiently	It is achieving the expected output with intended or qualities of input. How to assess effectiveness, assessing, checking, verifying : a) Whether objective are within legal frame. b) Programs set to achieve desired target c) Factors inhibiting satisfactory goal d) Effectiveness of Individual program e) Component

F]

## AUDIT OF RECEIPTS

(i) whether <b>all revenues</b> or other debts due to government have been <b>correctly assessed</b> , realised & credited to government account by the designated authorities.	(ii) whether adequate regulations & procedures have been framed by the department/agency concerned to secure an effective check on assessment, collection & <b>proper allocation of cases</b> .
(iii) whether such regulations & <b>procedures are actually being carried out</b> .	(iv) whether adequate checks are imposed to ensure the <b>prompt detection and investigation of irregularities, double refunds, fraudulent or forged refund vouchers</b> or other loss of revenue through fraud or <b>wilful omission</b> or negligence to levy or collect taxes or to issue refunds
(v) review of systems and procedures to see that the internal procedures adequately secure <b>correct &amp; regular accounting of demands</b> collection & refunds & pursuant of dues up to final settlement & to suggest improvement. 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. A review of the <b>judicial decisions taken by tax authorities is done to judge the effectiveness of the assessment procedure</b> .	
(vi) 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. 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. Institutional mechanism provides for primary check by the auditor, test check by the supervisor and control and direction by the group leader. Planning, executing and reporting of work is directed and monitored at middle and top levels of the audit hierarchy. There are built-in arrangements within the CAG 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.

### Students Note

## Audit is conducted to

ascertain whether the Regulations governing purchase, receipt and issue, custody, sale and inventory taking of stores are well devised and properly carried out.	bring to the notice of the government any deficiencies in quantities of stores held or any defects in the system of control.	verify that the purchases are properly sanctioned, made economical and in accordance with the Rules for purchase laid down by the competent authority.	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. Cases of uneconomical purchase of stores and losses attributable to defective or inferior quality of stores are specifically brought by the audit.	check the accounts of receipts, issues and balances regarding accuracy, correctness and reasonableness of balances in inventories with particular reference to the specified norms for level of consumption of inventory holding. Any excess or idle inventory is specifically mentioned in the report and periodical verification of inventory is also conducted to ensure their existence. When priced accounts are maintained, the auditor should see that the prices charged are reasonable and have been reviewed from time to time. 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.
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H]

## AUDIT OF COMMERCIAL ACCOUNTS

Govt. Department managed Undertaking E.g. Railways, Postal Services, Securities, Canteen etc.

Govt. Company  
u/s 2(45) of Companies Act, 2013

Corporation under specific Act E.g. LIC, UTI etc.

### Section 143(5)

Appointed of auditor by C&AG as per section 139(5) or 139(7).

+

Directions by C&AG, the manner in which accounts shall be audited.

+

Submission of Auditor's Report to C&AG including-

- Directions issued, if any
- Action taken thereon
- Impact on Accounts

### Section 143(6)

C&AG's right to -

- Conduct supplementary audit.
- Comment upon or supplement such audit report.

### Section 143(7)

Without prejudice to the provisions relating to audit & auditor, the C&AG of India may, in case of any Government Company, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company & the provisions of section 19A of the C&AG (Duties, Powers & Conditions of Service) Act, 1971, shall apply to the report of such test audit.

I]

## REPORTING

- (i) Introduction - Containing general view of working results of Govt. Co. deemed Govt. Co. & Corporation.
- (ii) Results of comprehensive appraisals of selected undertaking.
- (iii) Resume of company auditors, report submitted by them under their direction.
- (iv) Comments of CAG.
- (v) Significant results of audit of undertaking not taken for appraisal by the audit board.
- (vi) Article 151 of Constitutions enjoys that CAG shall reports on the states of the presidents on governor concern & the letter shall cause the report to be laid before legislature.
- (vii) The report is factual & conclusion are left on reader to be drawn.

XII] PARTNERSHIP AUDIT

A] APPOINTMENT OF AUDITORS

- |   |   |
|---|---|
| (i) The auditor to a firm is usually appointed by the partners either on the basis of a decision taken by them or to comply with a condition in the partnership agreement.                                    | (ii) His remuneration is also fixed by the partners.  |
| (iii) It is important that the letter of appointment should clearly state the nature & scope of audit which is to be carried out & particulars of limitations, if any, under which he would have to function. | (iv) In case of change of auditor, it would be duty of incoming auditor to communicate with the previous auditor.   |
| (v) The auditor may, particularly, ensure application of accounting standards prescribed by the Institute.  | (vi) In case the firm is required to get its accounts audited under the requirements of any statute, the auditor will have to qualify the report in case of non-compliance with the accounting standards. |
| (vii) Alternatively, only disclosure of non-compliance with the accounting standards, would be sufficient without making it a subject matter of qualification.  |   |

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:

- |  |  |
|--|--|
| (i) The <b>name and style</b> under which the business shall be conducted.   | (ii) The <b>duration</b> of the partnership, if any, that has been agreed upon.  |
| (iii) The amount of <b>capital</b> that shall be contributed by each partner whether it will be fixed or could be varied from year to year         | (iv) The period at the end of which the accounts of the partnership will be closed periodically & the proportions in which the <b>profit shall be divided</b> among the partners or losses shall have to be contributed by them; whether the losses shall be borne by the partners or whether any of the partners will not be required to do so. |
| (v) The provisions as regards <b>maintenance of books of account</b> & the matters which must be taken into account for determining the profits of | (vi) <b>Borrowing</b> capacity of the partnership (when it is not implied as in the case of non-trading firms).  |

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.

(vii) The **rate** at which **interest** will be allowed on the capitals and loans provided by partners & the rate at which it will be charged on their drawings & current accounts.

(ix) **Duties** of the partners as regards the management of business of the firm; also, the partners who shall act as managing partners.

(xi) **Limitations and restrictions** that have been agreed upon, the rights & powers of partners & on their implied authority to pledge the firm's credit or to render it liable.

(viii) Whether any **salaries** are payable to the partners or withdrawals are permitted against shares of profits and, if so, to what extent?

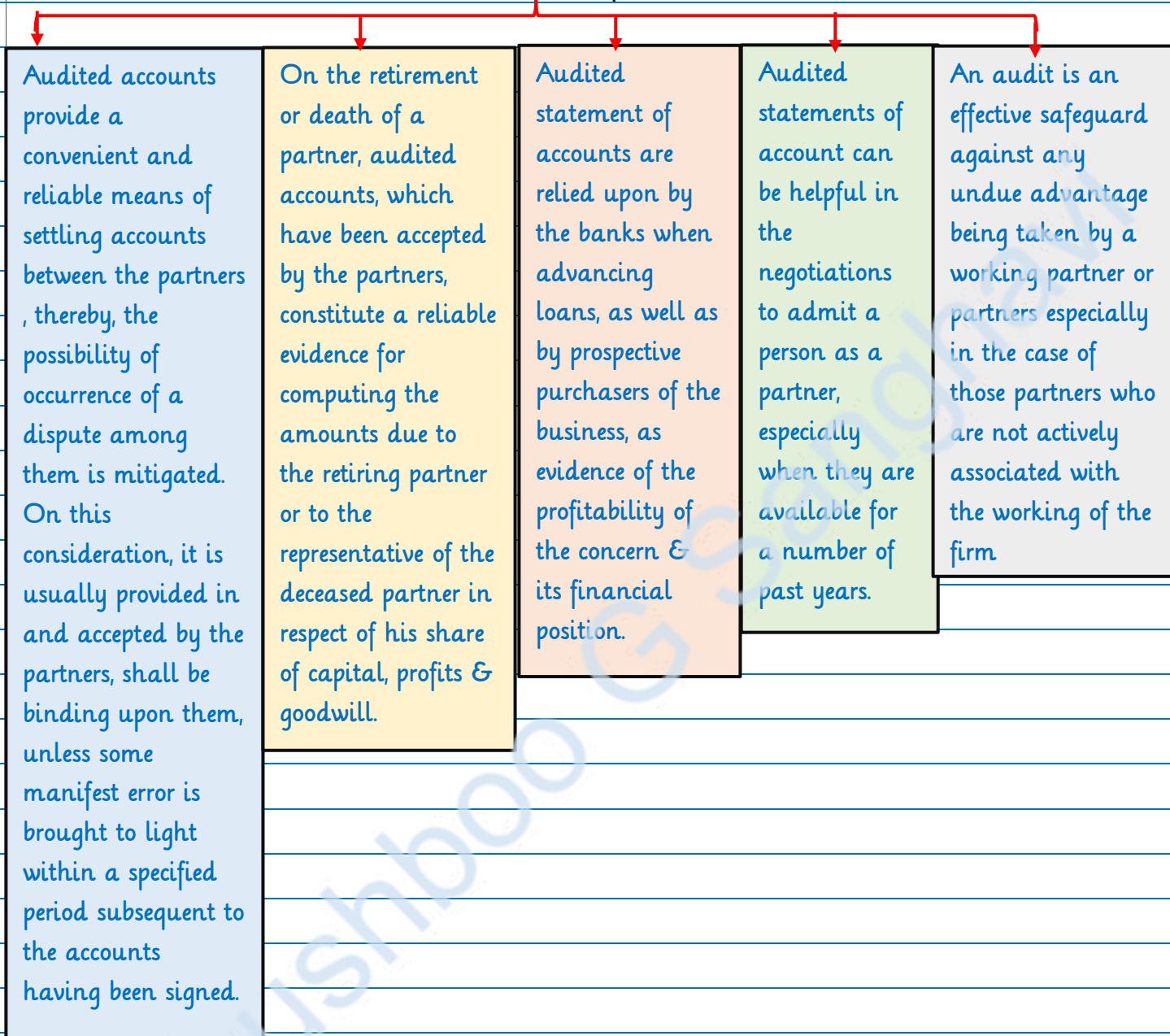
(x) Who shall operate the **bank account** of the firm? How will the surplus funds of the partnership be invested?

**Students Note**



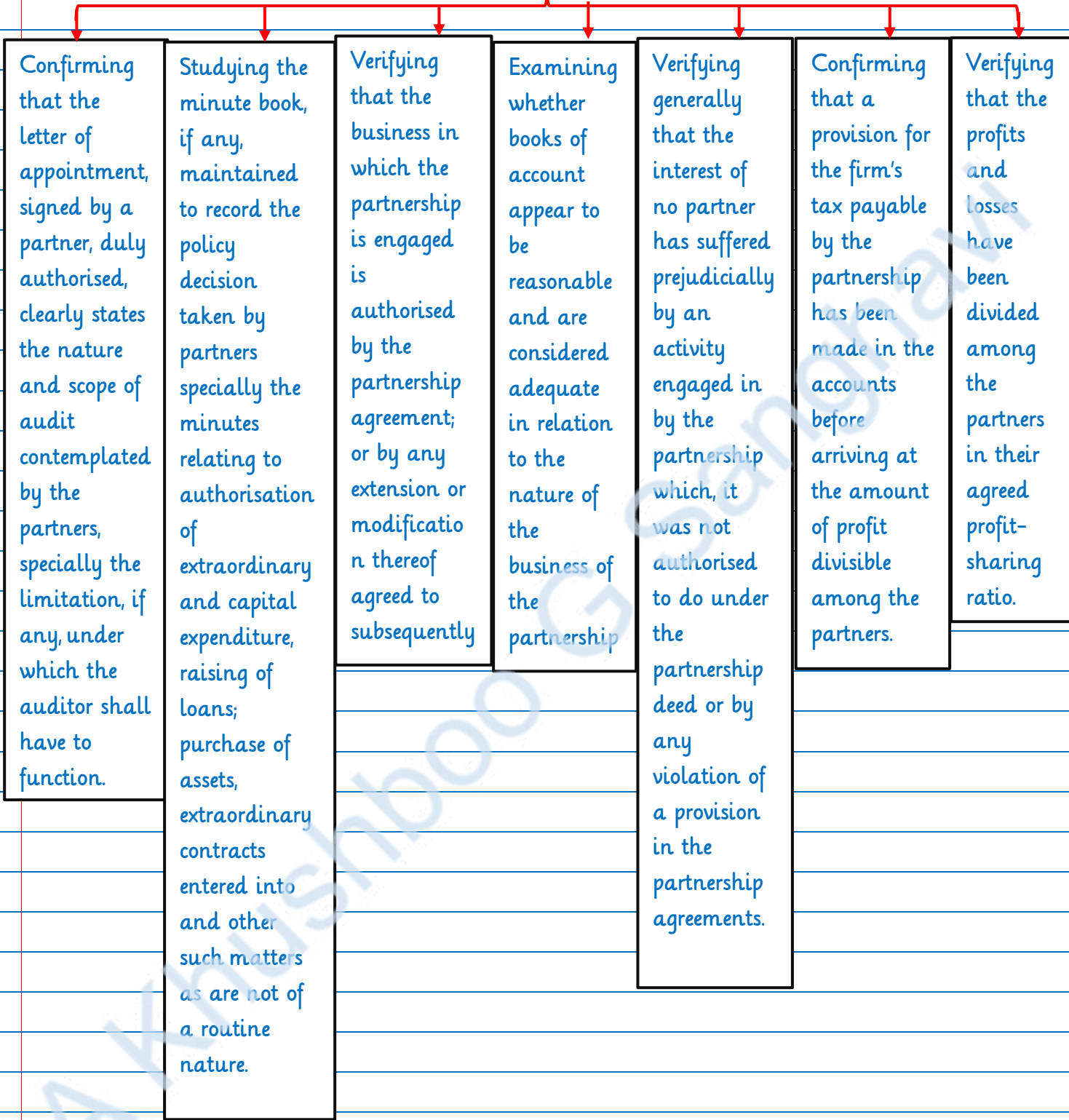
## C] ADVANTAGES OF AUDIT OF A PARTNERSHIP FIRM

On broad considerations, the advantages of audit of accounts of a partnership could be stated as follows:



**Students Note**

**MATTERS WHICH SHOULD BE SPECIALLY CONSIDERED IN THE AUDIT OF ACCOUNTS OF A PARTNERSHIP**



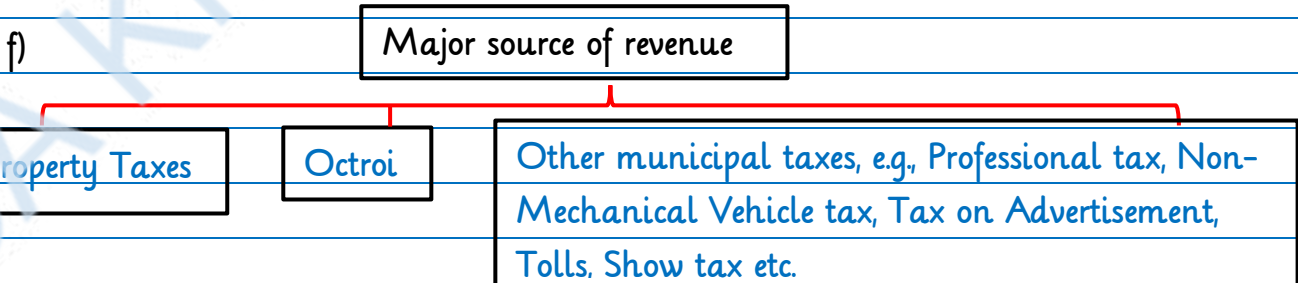
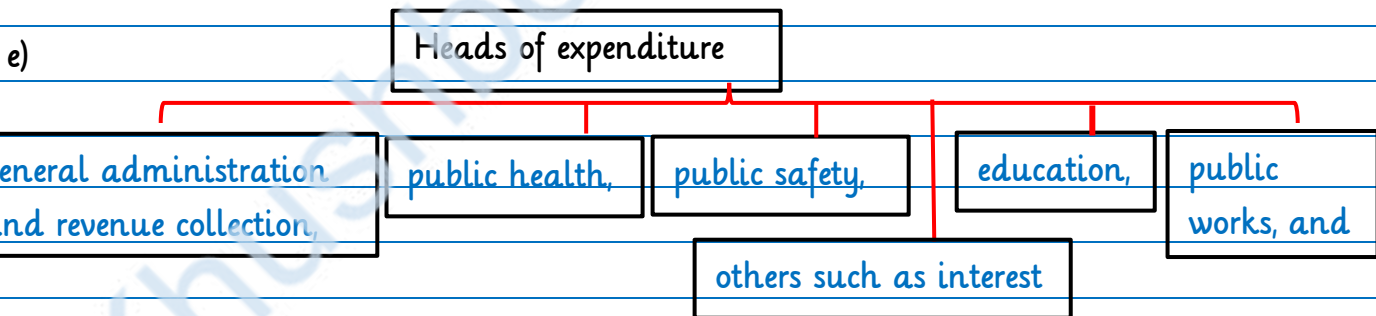
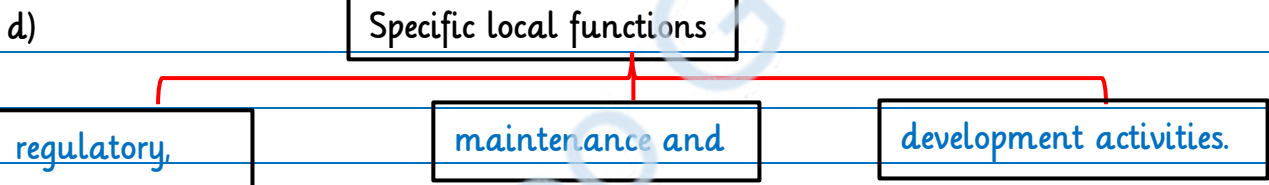


XIII]

A] MEANING & BACKGROUND: - (PEQ Nov'22)

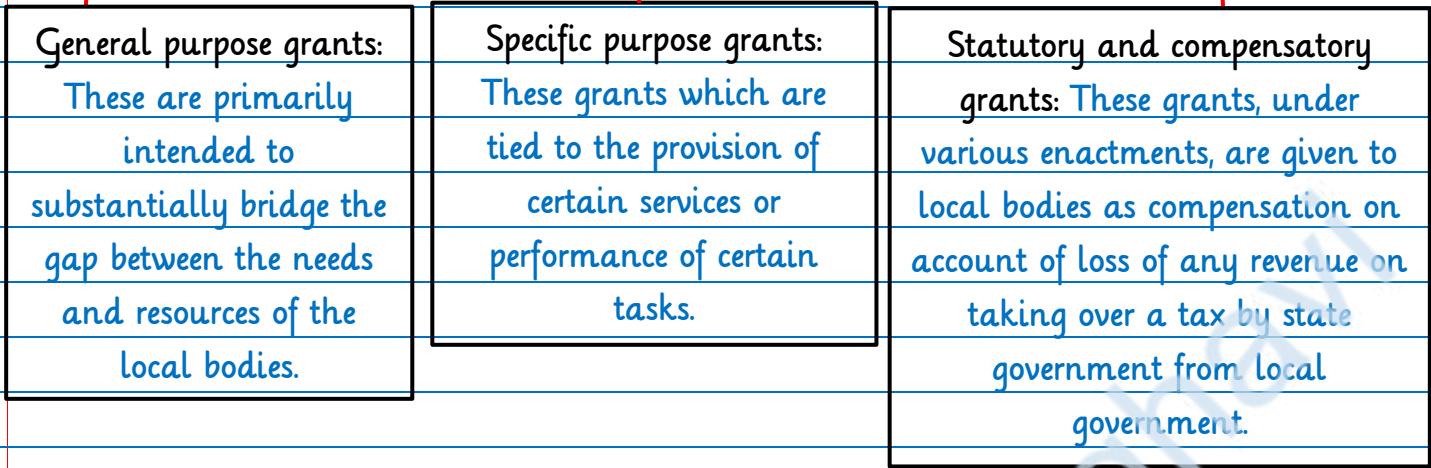
- a) A municipality can be defined as a unit of local self-government in an urban area.
- b) By 1947 almost every urban & semi urban area constituted local bodies & the services that local bodies rendered was restricted to education, public health, sanitation, medical relief, roads & few other public works. These bodies derived their revenues from a number of sources as taxes on property, person, licenses & other non-tax revenues.

c) Municipal government in India covers five distinct types of urban local authorities-



g) Local bodies may receive different types of grants from the state administration

Categories of grants



B] FINANCIAL ADMINISTRATION

It would be imminent 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:

Some financial aspects



→ **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.)

→ **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.

→ **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.

### C] IMPORTANT OBJECTIVE OF AUDIT

After knowing financial aspects, now let's know the objective local body audit:

- a) reporting on the fairness of the content and presentation of financial statements;
- b) reporting upon the strengths and weaknesses of systems of financial control;
- c) reporting on the adherence to legal and/or administrative requirements;
- d) reporting upon whether value is being fully received on money spent; and
- e) detection and prevention of error, fraud and misuse of resources.

### D] 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

- fairness of the contents and presentation of financial statements,
- the strengths and weaknesses of system of financial control,
- the adherence to legal and/or administrative requirements;

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.



## CHAPTER 10. AUDIT OF BANKS

### → WHAT TO STUDY?

- I] Introduction
- II] Understanding Accounting System in Bank
- III] Bank Audit
- IV] Form & Content of FS of Banks
- V] Conducting an Audit
- VI] Advances
- VII] Drawing Power Calculation
- VIII] Audit of Advances
- XI] Audit of Revenue Items

### I] Introduction

a) Banking sector is the backbone of any economy as it is essential for sustainable **socio-economy growth** & financial stability in economy.

For safe & sound banking sector, one of the **most important** factors is reliable **financial information** supported by quality bank audits.

### b) Types of Banks: -

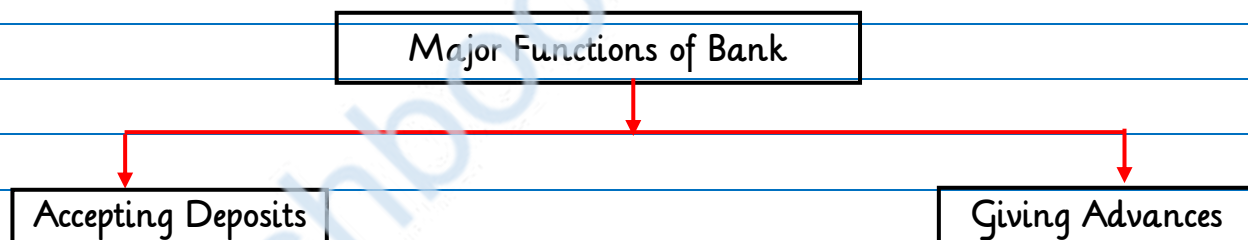
There are different types of banking institutions prevailing in India which are as follows:

1) Commercial Banks	are the most wide 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.
2) 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 are: The Gujarat State Co-operative Bank Ltd., Chhatisgarh Rajya Sahakari Bank Maryadit, etc.
3) Development Banks (more commonly known as 'Term-Lending Institutions').	Development Banks had been conceptualized to provide funds for infrastructural facilities important for the economic growth of the country. Examples are: - Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), Small Industries Development



	Bank of India (SIDBI), etc.
4) 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 are: - Punjab Gramin Bank, Tripura Gramin Bank, Allahabad UP Gramin Bank, Andhra Pradesh Grameen Vikas Bank, etc.
5) Payment 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 are: - Airtel Payments Bank, India Post Payments Bank, Paytm Payments Bank, etc.
6) 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 are: - Equites Small Finance Bank, AU Small Finance Bank, etc.

c)



RBI: - **Regulating Body**

Important Functions of RBI: -

- Issuance of **Currency** & its regulatory
- Acting as **banker to banks**
- **Regulating** the activities of commercial banks & other banks
- Issuance of **Licence**
- It has a power to **inspect bank**

d) Regulatory Framework

i.e. principal **enactments** governing Bank audit

a) RBI Act, 1934

e) Regional Rural Bank Act, 1976

b) Banking Regulation Act, 1949

f) Information Technology Act, 2000

c) Companies Act, 2013

g) Prevention of Money Laundering Act, 2002

d) SBI Act, 1955

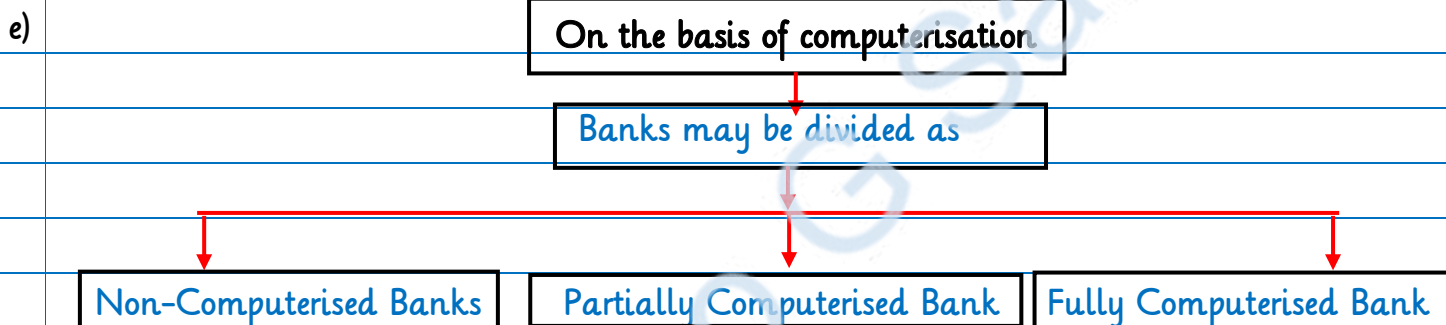
h) Payment and Settlement Systems Act, 2007

e) Peculiarities involved in functioning of Bank (PEQ)

- Huge volumes and complexity of transactions;
- Wide geographical spread of bank's network;
- Large range of products and services offered;
- Extensive use of technology;
- Strict vigilance by the banking regulator etc.

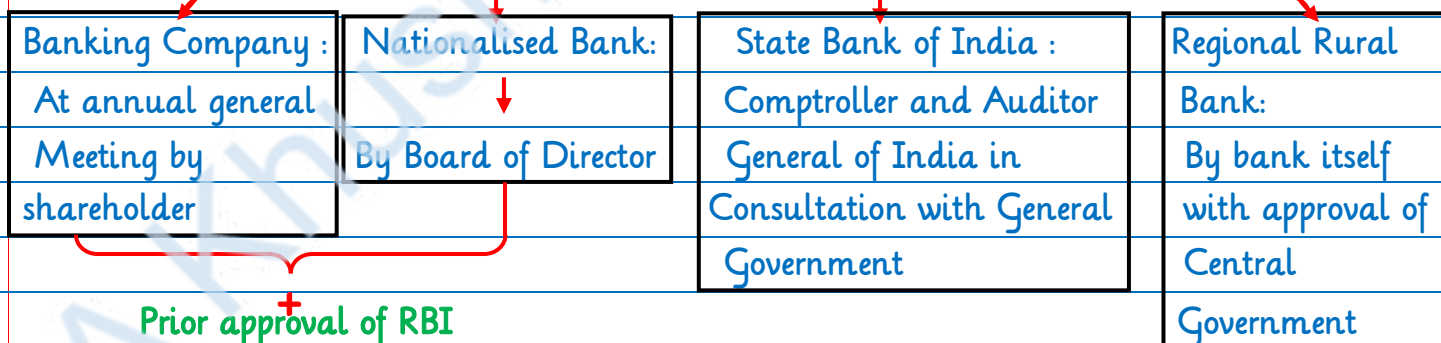
II] Understanding Accounting System in Bank

- a) Banks nowadays are providing the comfort of "anytime-anywhere-banking".
- b) Real-time access to information & mobile connectivity through E-banking.
- c) Banks have voluminous business & hence it needs to be ensured in the system of recording transmission & storage of information/data.
- d) Banks needs to maintain high as robust control systems to ensure that transactions are free from risk of errors, omissions, irregularities & frauds.

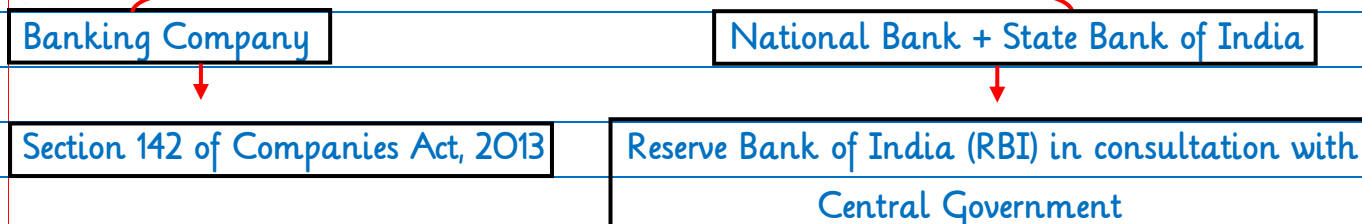


III] Bank Audit

a) APPOINTMENT OF AUDITORS



b) REMUNERATION OF AUDITORS



c)

## CONDUCTING BANK AUDIT

<p>a) Initial Consideration: -</p> <ul style="list-style-type: none"> <li>• Acceptances continuance</li> <li>• Declaration of Indebtness</li> <li>• Terms of Audit engagement</li> <li>• Commitment, Previous Audit</li> <li>• Establishment of team</li> </ul>	<p>b) Understanding Environment: -</p> <ul style="list-style-type: none"> <li>• Identify &amp; assess risk to develop plan</li> <li>• Understanding -                             <ul style="list-style-type: none"> <li>→ Accounting process</li> <li>→ Risk management process</li> <li>→ Control activities</li> <li>→ Involvement of TCWG</li> <li>→ Reliable Information system</li> </ul> </li> </ul> <p style="text-align: center; color: yellow;">(PEQ Nov 16)</p>	<p>c) Risk assessment: -</p> <ul style="list-style-type: none"> <li>• Apply Procedures of SA 315 &amp; 240</li> <li>• Assess Specific risk</li> <li>• Risk associated without sourced activities</li> </ul>	<p>d) Execution : -</p> <ul style="list-style-type: none"> <li>• Respond to Risk (SA 330)</li> <li>• Determine Materiality and assess G.C</li> </ul> <p style="text-align: center; color: red;">GC = Going Concern</p>	<p>e) Reporting : -</p> <ul style="list-style-type: none"> <li>• LFAR</li> <li>• Stress testing</li> <li>• Demonitisation</li> </ul>
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d)

### Common Steps & Questions while undertaking/performing control activities

<b>Who?</b>	<b>What?</b>	<b>When?</b>	<b>Where?</b>	<b>Why?</b>
Who performs control? Who does have requisite knowledge?	What evidence is generated that control is performed?	<ul style="list-style-type: none"> <li>• Frequency:</li> <li>• Is it enough to prevent, detect &amp; correct risk of MM ?</li> </ul>	<ul style="list-style-type: none"> <li>• Where is the evidence?</li> <li>• Is the evidence accessible</li> </ul>	<ul style="list-style-type: none"> <li>• Why is the control performed :</li> </ul>
<p style="color: red; font-weight: bold;">MM = Material Misstatement</p>				<p style="text-align: center; color: red;"><b>How?</b></p> <ul style="list-style-type: none"> <li>• How is control performed</li> <li>• Can control activities be by-passed, if yes can it be detected</li> </ul>

e)

→ Engagement Team Discussion Includes: (PEQ)

- Errors that may be more likely to occur;
- Errors which have been identified in prior years;
- Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
- Audit responses to Engagement Risk; Pervasive Risks, and Specific Risks;
- Need to maintain professional skepticism throughout the audit engagement;

- Need to **alert for information** or other conditions that indicates that a material misstatement may have occurred (e.g., the bank's application of accounting policies in the given facts and circumstances).

→ Advantages of Engagement Team Discussion (PEQ July' 21)

- 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.
- 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.
- Further, audit engagement partner may review the need to involve specialists to address the issues relating to fraud.

f) Powers of auditor – Same as discussed in Company Audit.

g) Audit Report -

#### STATUTORY AUDIT REPORT

- As per SA 700 / 705/ 706

#### LONG FORM AUDIT REPORT

- As per Requirements of RBI Circular

#### TAX AUDIT REPORT

- As per Income Tax Act, 1961

h) In case of a nationalised Bank

- Whether, in his opinion, the balance sheet is a **full and fair balance sheet containing** all the necessary particulars and is properly drawn up so as to exhibit a true and fair view of the affairs of the bank, and in case he had called for any explanation or information, whether it has been given and whether it is satisfactory;
- Whether or not the **transactions of the bank**, which have come to his notice, have been **within the powers** of that bank;
- Whether or not the **returns** received from the offices and branches of the bank have been **found adequate for the purpose** of his audit;
- Whether the profit and loss account shows a **true balance of profit or loss** for the period covered by such account; and
- Any **other matter** he considers should be brought to the notice of the Central Government.

**Note:** – CARO, 2020 is not applicable to bank audit.

- LFAR (Long form Audit Report) – This report is to be submitted before 30<sup>th</sup> June every year.
- Reporting to RBI – RBI issued a circular relating to implementation of recommendation of committee on legal aspects of Bank frauds applicable to all scheduled commercial bank.

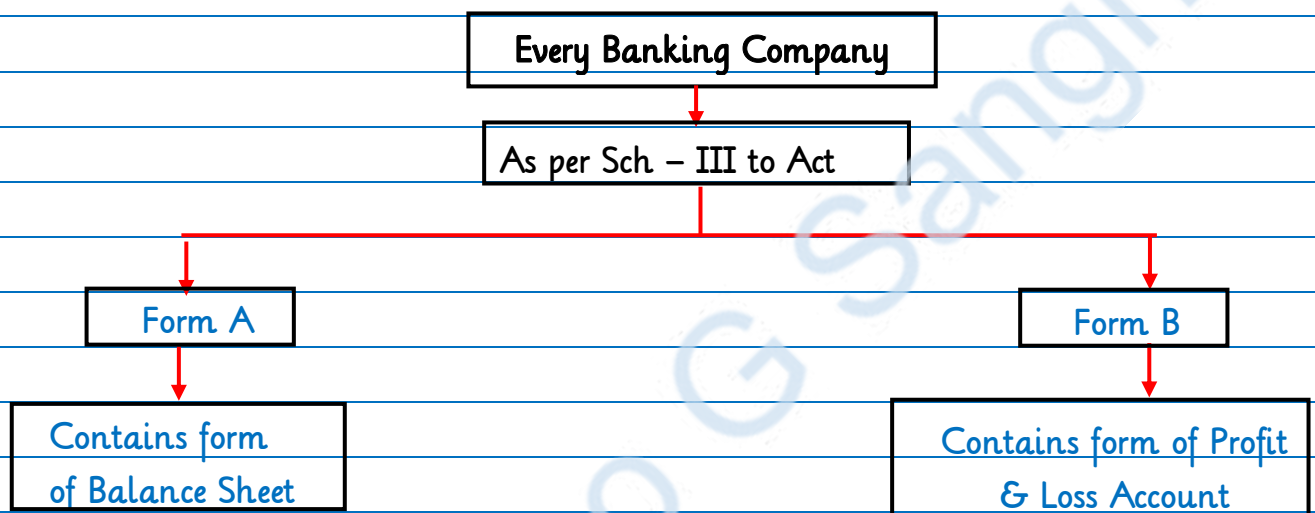
**Note:** - If an accounting professional (internal or external) in the process of audit finds Anything susceptible to fraud or any activity being fraudulent in nature, he should refer it to Authority. Any failure in reporting would make him liable for penal action.

\* Auditor should consider SA 250 & SA 240

**Note:** - Auditor is not expected to look into each & every transaction but to evaluate the system as whole, therefore if he comes across any irregularity he should report to RBI, in Addition to chairman/MD/CEO.

\* Reporting as per Sec 143(12) of Companies Act, 2013 shall apply.

#### IV] Sec 29(1), (2) - Form & Content of FS of Bank



Act → Banking Regulation Act, 1949.

Note :- Every Banking Company needs to comply with the disclosure requirement under various Accounting Standards as specified under Companies Act, 2013.

#### V] Conducting an Audit

1. Initial Consideration by the statutory auditor (PEQ)
  - (i) Declaration of Indebtedness
  - (ii) Internal Assignments in Banks by Statutory Auditors
  - (iii) Planning
  - (iv) Communication with Previous Auditor
  - (v) Terms of Audit Engagements
  - (vi) Initial Engagements
  - (vii) Assessment of Engagement Risk
  - (viii) Establish the Engagement Team
  - (ix) Understanding the Bank and its Environment
2. Identifying and Assessing the Risks of Material Managements



3. Understanding the Bank and its Environment including Internal Control
4. Understand the Bank's Accounting Process
5. Understanding the Risk Management Process (PEQ – May 19)
  - (i) Oversight and involvement in the control process by those charged with governance
  - (ii) Identification, measurement and monitoring of risks
  - (iii) Control activities
  - (iv) Monitoring activities
  - (v) Reliable information systems
6. Engagement Team Discussion
7. Establish the Overall Audit Strategy
8. Develop the Audit Plan
9. Audit Planning Memorandum
10. Determine Audit Materiality
11. Consider Going Concern
12. Assess the Risk of Fraud including Money Laundering (PEQ Jan 21)
 

Assess the Risk of Fraud including Money Laundering: As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor's objective is to identify and assess the risks of material misstatement in the financial statements due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately. The attitude of professional skepticism should be maintained by the auditor so as to recognise the possibility of misstatements due to fraud.

The RBI has framed specific guidelines that deal with prevention of money laundering and "Know Your Customer (KYC)" norms. The RBI has from time to time issued guidelines ("Know Your Customer Guidelines – Anti Money Laundering Standards"), requiring banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.
13. Assess Specific Risks
14. Risk Associated with Outsourcing of Activities
15. Response to the Assessed Risks
16. Stress Testing
17. BASEL III framework
18. Reliance on/ review of other reports



VI]

Advances

Funded

Non-Funded

Loan where there is actual transfer of fund  
E.g., Term loan, CC, OD, Demand Loan, Bills discounted & purchased, Adverse balances in deposit accounts, Interest bearing Staff Loan

Facilities are those which do not involve transfer of funds. E.g., Bank, Guarantees, Letter of Certificate etc.

b)

Classification

Sector Wise

Security Wise

Prudential Norm

Priority

Non-Priority

Secured

Unsecured

Standard

NPA

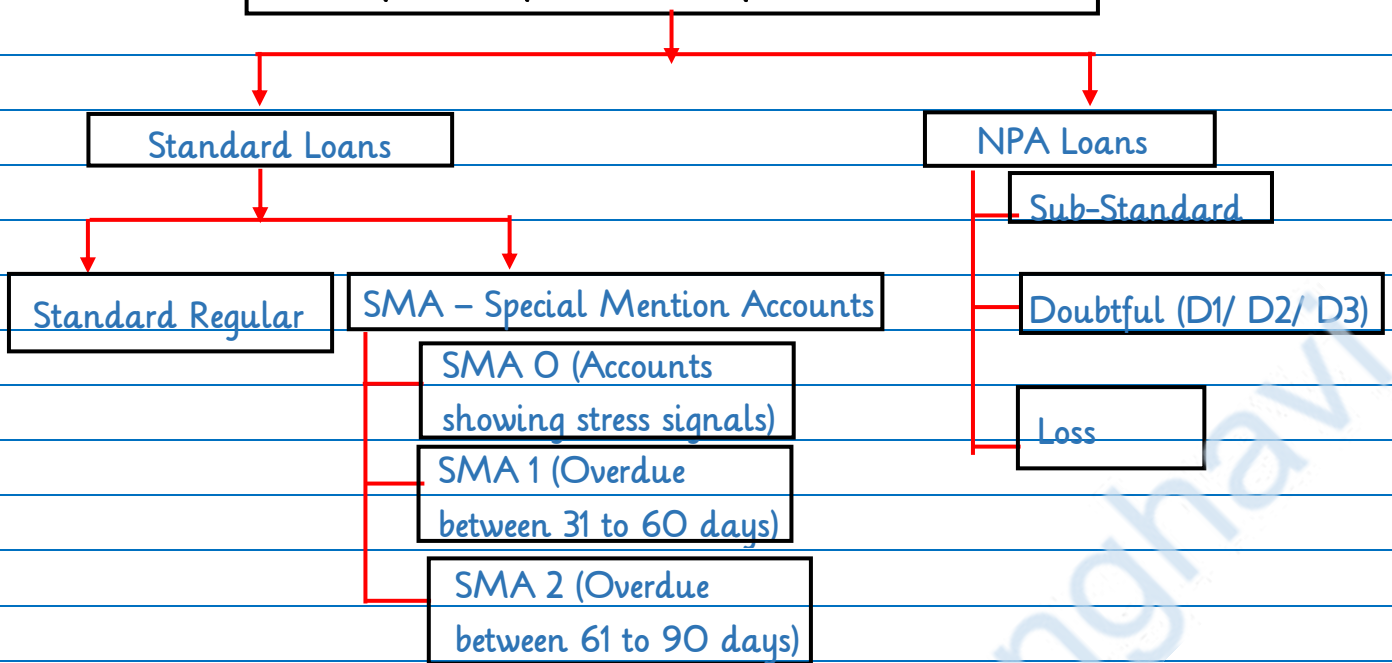
Primary Security

Collateral Security

Students Note:

c)

## Classification of Advances as per Prudential Norm



d)

## Mode of Security Creation

1) Mortgage are of several kinds but the most important are the Registered Mortgage and the Equitable Mortgage.

1a) 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.

1b) Equitable mortgage, on the other hand, is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof.

2) 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.

3) A pledge thus involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance. The legal ownership of the goods remains with the pledger while the lending banker gets certain defined interests in the goods. The pledge of goods constitutes a specific (or fixed) charge.

4) **Assignment** represents a transfer of an existing or future debt, right or property belonging to a person in favor of another person. Only actionable claims (i.e., claim to any debt other than a debt secured by a mortgage of immovable property or by hypothecation or pledge of moveable property) such as book debts and life insurance policies are accepted by banks as security by way of assignment.

5) **Set-off** is a statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor. The right of set-off enables a bank to combine two accounts (a deposit account and a loan account) of the same person provided both the accounts are in the same name and same right (i.e., the capacity of the account holder in both the accounts should be the same). For the purpose of set-off, all the branches of a bank are treated as one single entity. The right of set-off can be exercised in respect of time-barred debts also.

6) **Hypothecation** is the creation of an equitable charge (i.e., a charge created not by an express enactment but by equity and reason), which is created in favor of the lending bank by execution of hypothecation agreement in respect of the moveable securities belonging to the borrower. Neither ownership nor possession is transferred to the bank. However, the borrower holds the physical possession of the goods as an agent/trustee of the bank. 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 fixed.

e) Prudential norms on Income recognition Asset Classification & provisioning pertaining to Advances. (PEQ Nov'22)

(i) **NPA** :- An asset becomes NPA when it ceases to generate income for the Bank

(a) **Loan or Advance** becomes NPA if interest/ instalment of principal is **Overdue for > 90 days**

(b) **Bills** remains **Overdue for > 90 days**

(c) The account remains **out of order** in respect of an **OD/ CC account**

(ii) **Out of Order** - Account will be out of order if amount is over drawn and remains **outstanding for > 90 days** (i.e. there are no credits continuously for 90 days as on Balance Sheet date )

(iii) 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. Further, asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA. There are different provisioning requirements as regards to categories of NPA such as Sub-standard assets, Doubtful assets and loss assets which are given below:

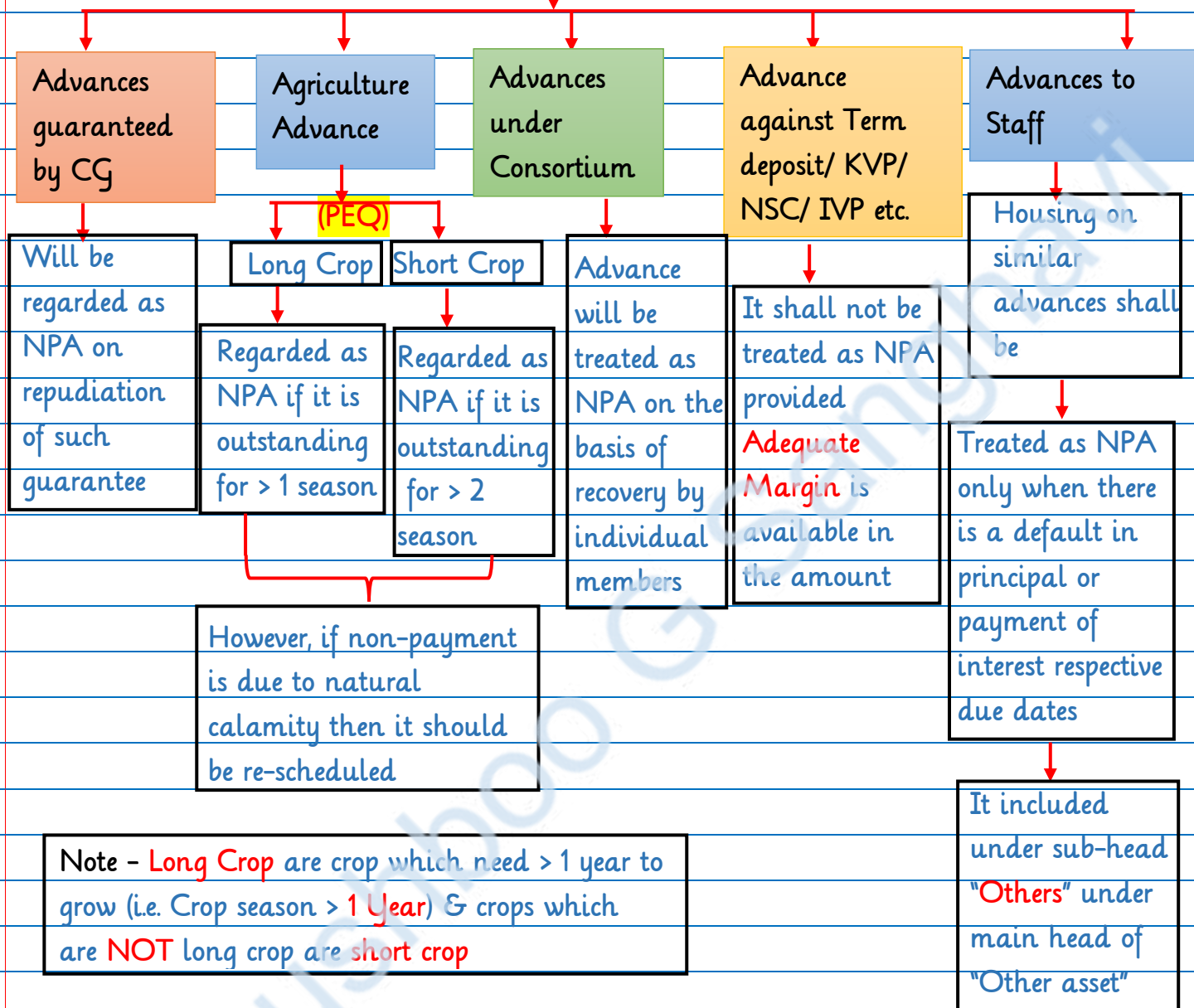
Categories of Non-Performing Assets :	Provision required (PEQ Nov'22)
<ul style="list-style-type: none"> <li>Sub-standard Assets :</li> </ul>	
Would be one, which has remained NPA for a period less than or equal to 12 months.	15%
<ul style="list-style-type: none"> <li>Doubtful Assets :</li> </ul>	
Would be one, which has remained in the Sub-standard category for a period of 12 months.	Secured + Unsecured

<ul style="list-style-type: none"> <li>Sub-categories :</li> </ul>	
Doubtful up to 1 Year (D1)	25% + 100%
Doubtful 1 to 3 Years (D2)	40% + 100%
Doubtful more than 3 Years (D3)	100% + 100%
<ul style="list-style-type: none"> <li>Loss Assets :</li> </ul>	
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%

(iv)

Usually Income on NPA are recorded on Cash basis

However in following cases they are considered as NPA on the basis of respected condition.



Note - Long Crop are crop which need > 1 year to grow (i.e. Crop season > 1 Year) & crops which are NOT long crop are short crop

(v) Accounts where there is Erosion/Reduction in value of security/ frauds committed by borrowers (PEQ)

Value of security eroded & is < 50% of value assessed by the bank or accepted by RBI at the time of last inspection.

Realizable value of securities is < 10% of outstanding in the borrow a/c

Such NPA's may be straight away classified as doubtful & provisioning should be made accordingly.

Existence of security should be ignored

Such asset should be classified as Loss asset & should be fully written off or fully provided by bank

VII] Drawing Power Calculation

(i) All accounts should be all the time kept within

Drawing Power

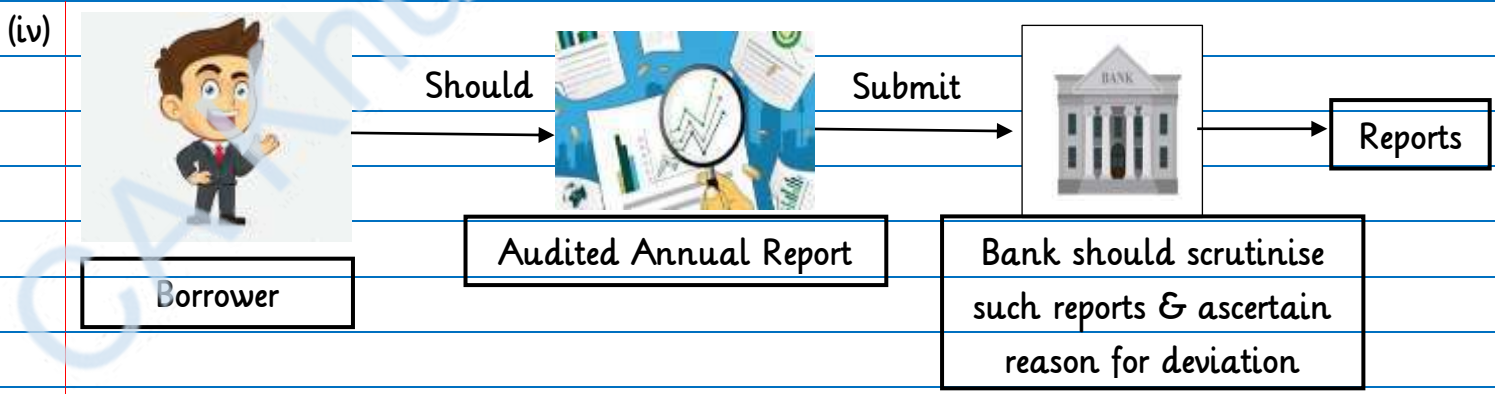
AND

Sanctioned Limit

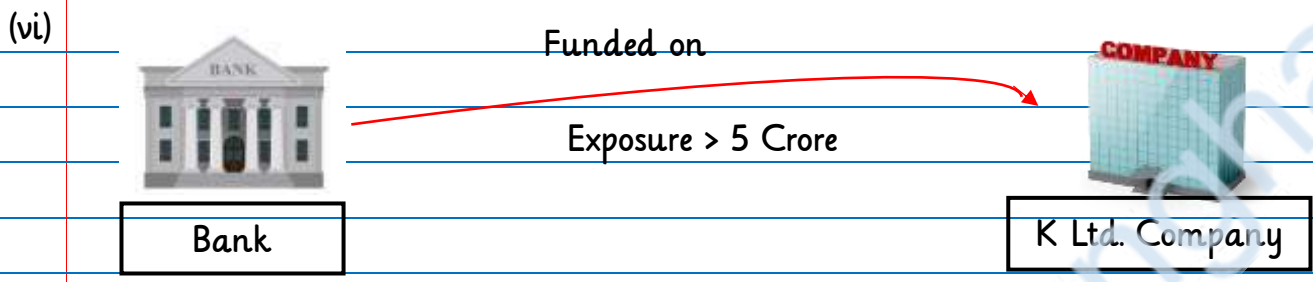
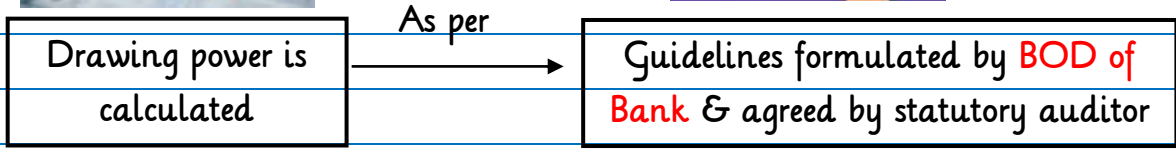
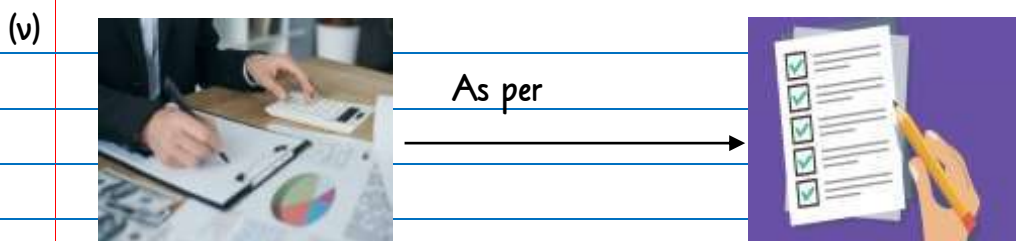
If account exceeds sanctioned limit it should be brought to the notice of management / Head office regularly.

(ii) Banks should ensure that drawings in working capital account are covered by current assets. Drawing power is required to be arrived based on current asset & statements (statements should not be older than 3 months); if drawing power are calculated of statement older than 3 months then such amount outstanding shall be treated as irregular.

(iii) Stock statements are submitted → Quarterly

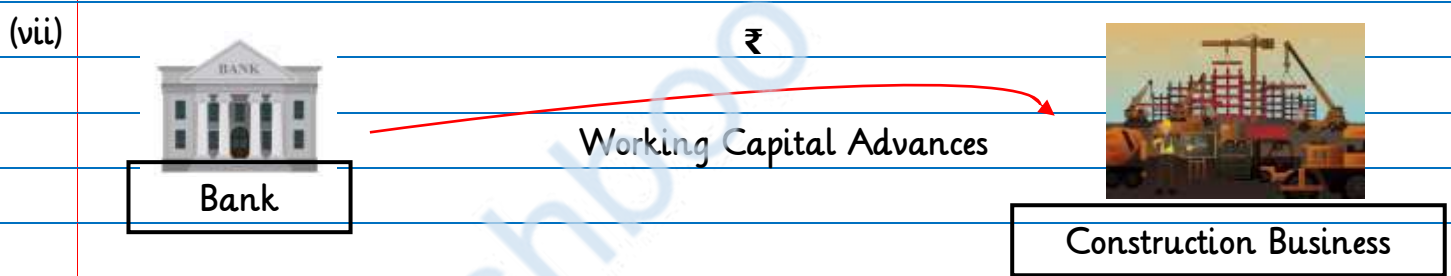






Lead Bank → will conduct Stock audit and shall give such report branches & the report shall be reviewed during the course of audit & special focus will be on comments given by stock auditor.

Author's Note :- Also refer reporting requirement under 3(ii) of CARO, 2020



- Drawing Power needs to be calculated carefully in case of working capital advances to companies engaged in construction business.
- While calculating drawing power, mobilization advance received by contractors should be Reduced.

→ Illustration for computation of DP

Particular for current asset	DP	Margin @ 25%	100	300
(A) Stock		(B) Debtors:		
Stock at realizable value	1000	Total Debtors	1000	
Less: Unpaid stock		Less: intangible debtors	200	
- Sunday creditor	300	Eligible Debtors	800	
- Acceptances/ LC's etc	300	Margin @ 40%	320	480
Paid for stock	400	Total DP		780

### Audit of Advances

(i) Auditor should obtain **SAAE** regarding

- Amounts are **outstanding** as on B/S date
- Amounts represent **due to bank**
- Amounts are supported by **loan documents & other documents**
- **No unrecorded** advances
- Advances are properly **disclosed, classified & described** in accordance with AFRF
- Appropriate **provisions** are made as per **RBI norms**

(ii) **SAAE** are obtained by -

- Examining the validity of the recorded amounts;
- Examining loan documentation;
- Reviewing the operation of the accounts;
- Examining the existence, enforceability and valuation of the security;
- Checking compliance with RBI norms including appropriate classification and provisioning; and
- Carrying out appropriate analytical procedures

(iii) Evaluation of **IC** over advances :- (Most Important) **(PEQ) (RTP) (MTP)**

- Bank makes advances only after checking **credit-worthiness**
- Advances are sanctioned on the basis of appropriate **documents & only after ensuring end use**
- Sufficient **margins** are kept
- **No advances** are provided against own shares
- Securities are **registered**
- **Good** in possession as security are checked from time to time.
- Drawing power register is updated every month
- Operation of each advance a/c should be viewed at least **once in a year**

### Audit of Revenue Items

(A) INCOMES

(B) EXPENSES

(A)

## INCOMES

(i)→

Interest Income	Other Income
a) Interest/ Discount on Advances/ Bills	a) Commission, Brokerage on - BOE, DD, NEFT, RTGS, Govt Business, LOC, guarantee Loan Processing, Mobile Banking Fees etc.
b) Interest on Investment	b) Rent on Lockers
c) Interest on CRR	c) Dividend, Profit on Sale of Investment
d) Interest on Inter Bank Loan	d) Profit on Revaluation
e) Other Income	e) Referral Income etc.

(ii)→ Audit Procedures & Approach

a) Auditor is primarily concerned with obtaining reasonable assurance that recorded income arose from transaction are

- For the Relevant Period
- Appropriately Calculated
- Recorded/ Disclosed under Proper Head

b)

RBI has advanced

To record income on accrual basis i.e. as per AS 9 if:

Income > 1 % of total income of the bank  
(If the income is calculated on a gross basis)

OR

Income > 1 % of net profit before tax i.e. NPBT (If the Income is calculated on net of cost basis)

c) Other than above mentioned Incomes i.e. Income not considered as MATERIAL → recognised as on receipt basis (Auditor need not qualify the report in such situation)

d) It is an essential condition for accrual of income that there should not be doubt on ultimate collection of such income

e) **Bank should record income on receipt basis: -**

In respect to **NPA**

AND

If there exist significant **uncertainty** regarding **ultimate collection**

f) **Important** **On advance against term deposit, NSC, KVP, IVP & life policies**

Record on **accrual basis**

Provided **adequate margins** are available

g) In case of BOE purchased at the close of the year. **Discount** must be appropriately **apportioned** between the two years.

h) Auditor must test-check fees & commission earned by bank.

(iii) **Reversal of Income**

If Income recognized on **accrual basis** & advance later was declared & considered as **NPA**

AND

If Banks has **wrongly recognized** income in the past

Then Bank should reserve the income so recorded.

Then, Bank must reverse such income or make a provision for an equivalent amount if it was recognized as income in the previous year(s)

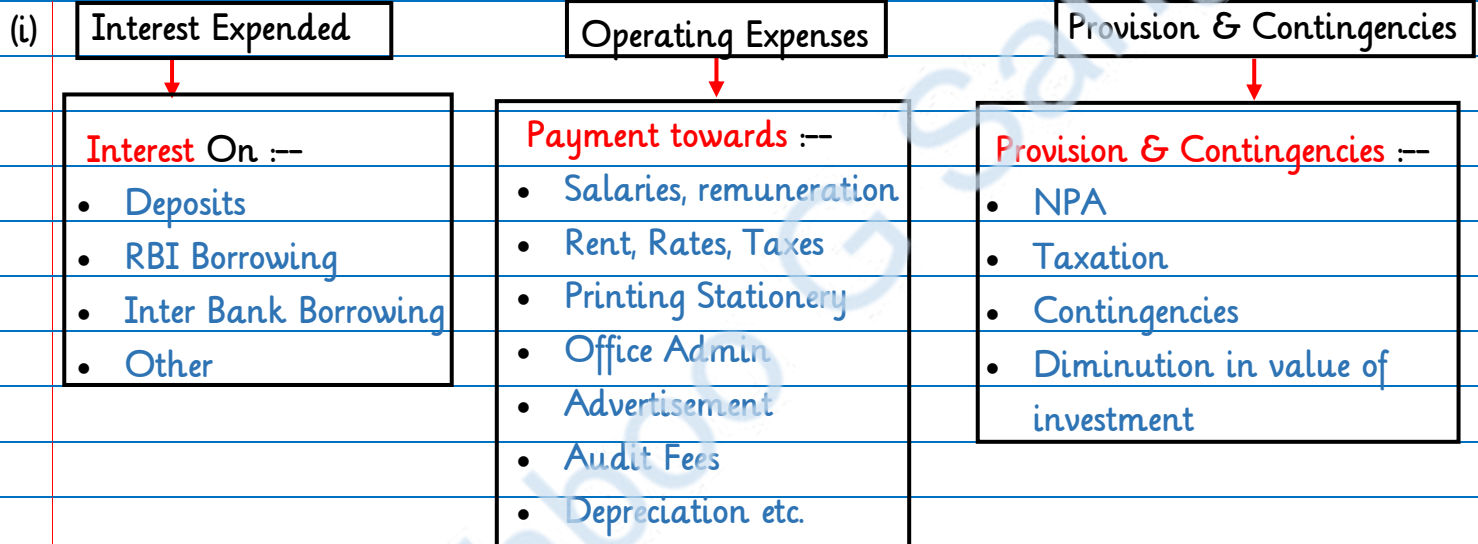
On further **partial recoveries** in NPA's, Bank must follow an appropriate policy to recognize income as per **AS - 9**

(iv) **Miscellaneous Points:** -

- a) **For Financial Lease:** - Income should be treated and recorded as per **AS 19** (Provided its not NPA)
- b) **On take - out finance:** - Record the income on receipt basis
- c) **Interest Income on Investments:** - Cost on investment ( e.g. Premium on SLR investments) is netted off from interest income on investment.
- d) **Profit on Sale of Investment:** - It is taken to P/L a/c as it is treated as banking activity.
- e) **P/L on revaluation of investments:** - As per RBI guidelines, investments must be valued in periodic interval & appreciation or depreciation is taken to P/L A/c.

(B)

**EXPENSES**



(ii) **Audit approach & procedure**

- a) Auditor must assess overall **reasonableness** of expense
- b) Auditor should obtain from the bank an **analysis** of various types of deposits & interest thereon.
- c) Auditor should obtain **general ledger a/c** at end of each quarter
- d) Auditor on test check basis verify calculation of interest **(PEQ) (Important)**
  - Interest has been **provided** on all deposits upto the date of the balance sheet; and verify whether there is any excess or short credit of material amount
  - Interest **rates** are in **accordance** with the **bank's internal regulations**, of the RBI directives, and agreements with the respective depositors;
  - In case of **Fixed Deposits** it should be **examined** whether the interest Rate in the accounting system are in accordance with the Interest Rate mentioned in the Fixed Deposit Receipt/ Certificate

- Interest on Saving Account should be checked on a test check basis in accordance with the rules framed by the bank in this behalf
- Interest on inter-branch balances has been provided at the rates prescribed by the head office
- Interest on overdue/ matured term deposits should be estimated and provided for

(iii) Disclosure of (PPI) Prior Period Items - There is no specific disclosure prescribed in Form B under Third Schedule, appropriate disclosure should be made by the bank wherever required

Space for Student Notes: -



# CHAPTER 11. ETHICS AND AUDIT TERMS OF AUDIT ENGAGEMENT S

WHAT TO STUDY?

A] INTRODUCTION TO **ENGAGEMENT & QUALITY CONTROL**

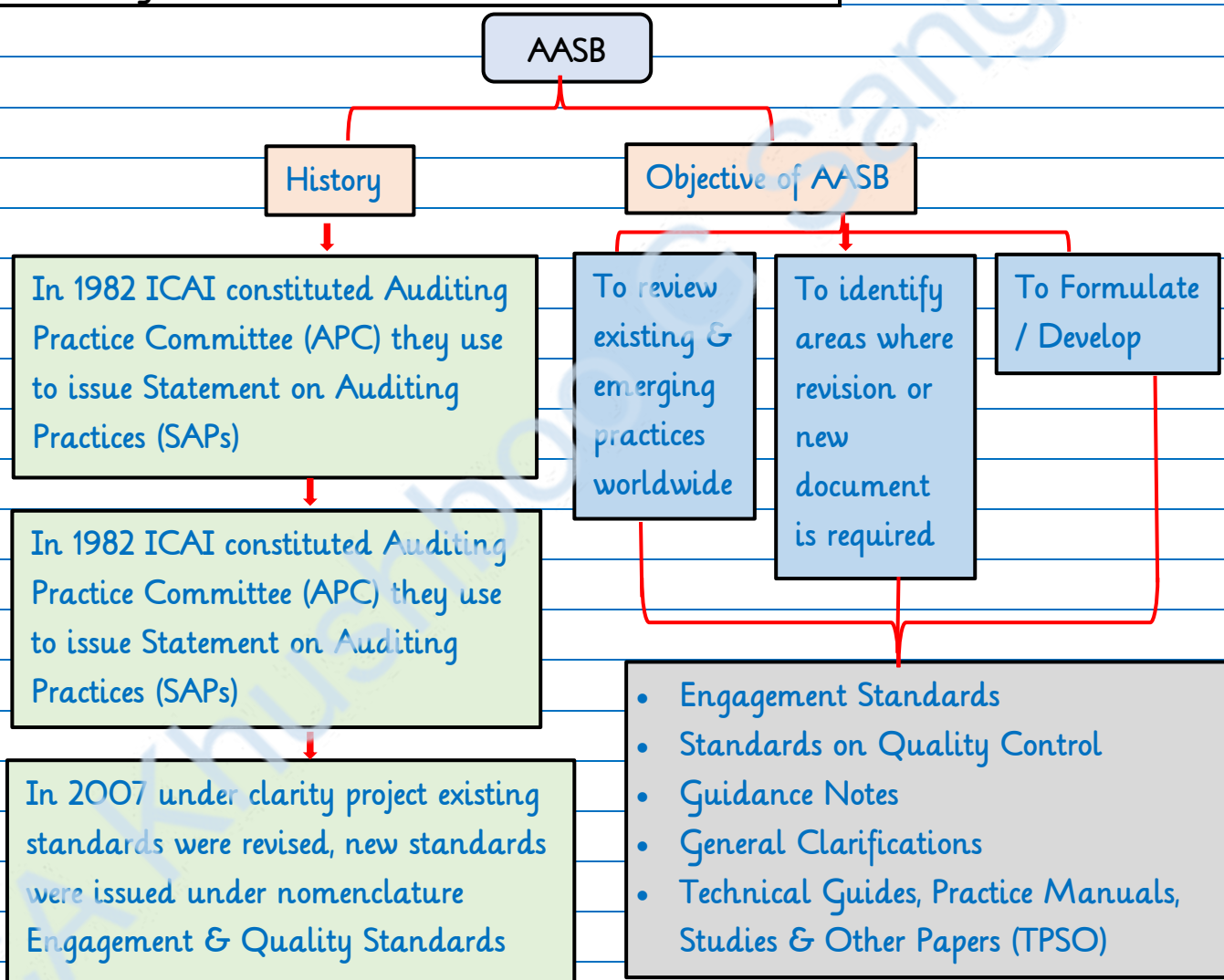
B] SQC - 1

C] SA 210

D] SA 220

A] INTRODUCTION TO ENGAGEMENT & QUALITY CONTROL

I] AUDITING & ASSURANCE STANDARD BOARD (AASB)



## Different terms

Standards - Mandatory in nature unless exempted.

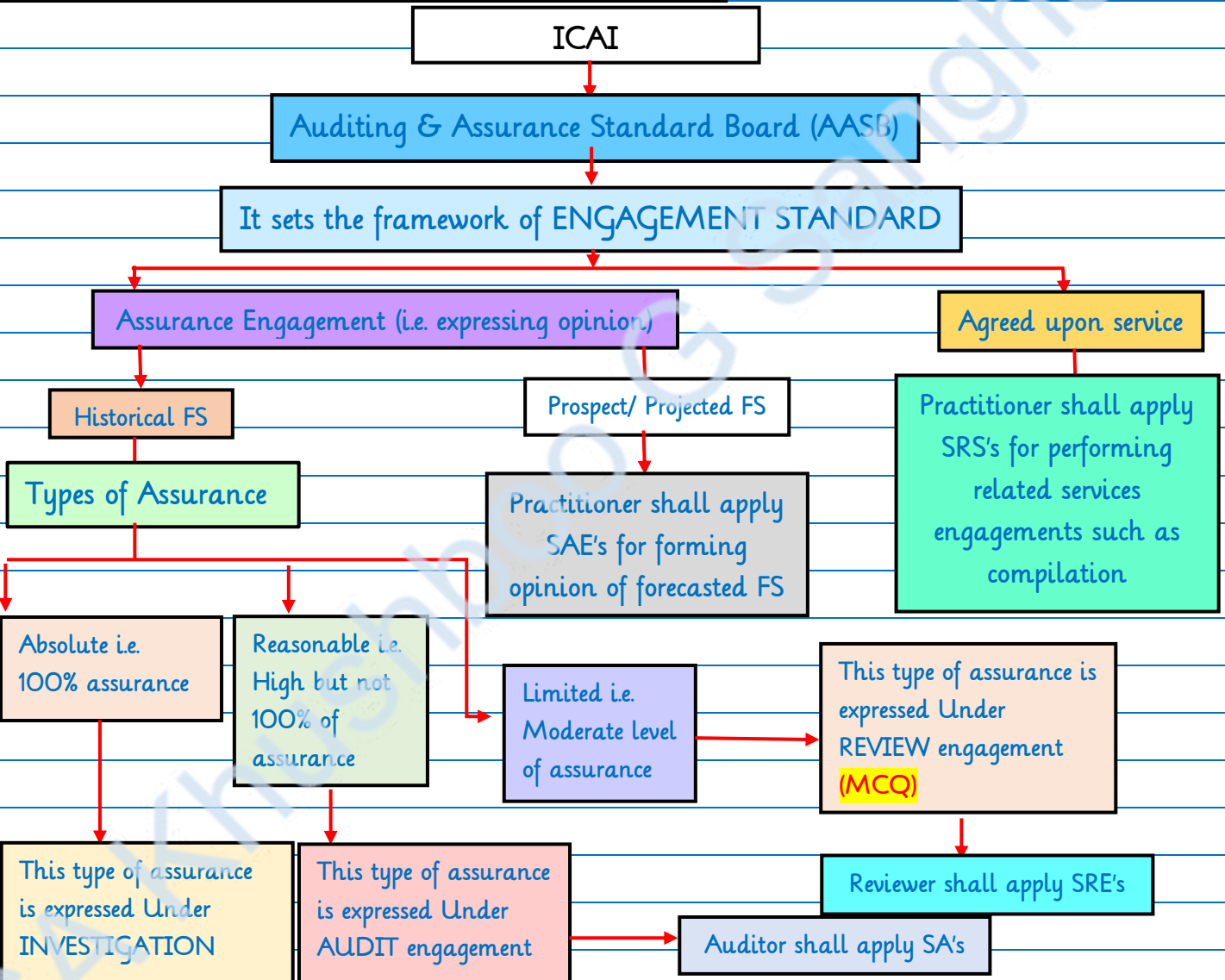
Statements - Statements and standards are same. Earlier we use to call them statements but now as per international trend, we call them standards. So we can say that statement is old name of standards

General Clarification - Issued to explain content given in Standards/Statements.

Guidance Notes - Recommendatory in nature we may not follow them if there are justified reasons. E.g., Guidance note on Bank Audit.

Technical Guides, Practice Manual, Studies and other papers (TPSO) - ICAI used to issue them to provide checklists and specimen working papers helpful for practicing chartered accountants. Now a days ICAI issues them in the name of Implementation Guide or Practitioners Guide.

### Overview of Engagement & Quality Control Standard



SA → Standard on Auditing (SA-100-999)

SRE → Standard on Review Engagement (SRE 2000-2699)

Examples of SRES:

- SRE 2400 Engagements to Review Historical Financial Statements
- SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity.

SAE → Standard on Assurance Engagement (SAE 3400-3402)

Examples of SAES

- SAE 3400 The Examination of Prospective Financial Information
- SAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus
- SAE 3402 Assurance Reports on Controls at a Service Organization

SRS → Standards on Related Services (SRS 4400-4410)

Examples of SRSS

- SRS 4400 Engagements to perform agreed-upon procedures regarding financial information
- SRS 4410 Compilation engagements

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

I] INTRODUCTION

The purpose of this SQC is to establish standards & provide guidance regarding a firm's responsibility for its system of quality control for audits & reviews of historical financial information & for other assurance & related service engagements.

The firm's system of quality control should include policies & procedures addressing each of the six elements of such system.

II] ELEMENT OF QUALITY CONTROL

1) Leadership responsibilities for quality within the firm

- i) Firm should promote internal culture recognising quality as essential in performing engagement
- ii) Firm's CEO (or equivalent) or firm's managing partner to assume ultimate responsibility for firm's system of quality control
- iii) If some other person(s) is assigned such operational responsibility, he should have sufficient & appropriate experience, ability & authority to assume that responsibility

2) Ethical Requirements

Firm's policies & procedures should

- (i) Assurance that the firm & its personnel comply with ethical requirements of: (Key COPPI)
  - a) Integrity;
  - b) Objectivity;

c) Professional competence & due care,

d) Professional behaviour

(ii) Emphasize the fundamental principles which are reinforced in particular by the leadership of firm, education & training, monitoring & process for dealing with non-compliance.

(iii) Provide it with reasonable assurance that the network firms maintain independence to:

a) Communicate its requirements to management

b) Identify & evaluate circumstances & relationship that create threats to independence & take appropriate action.

(iv) Provide it with reasonable assurance that it is notified of breaches of independence requirement & to enable it to take appropriate action.

3) Acceptance & Continuance of client relationships & specific engagements

(i) Firm's policies & procedures should provide it with reasonable assurance that it will undertake or continue relationships & engagements only when it:

has considered the integrity of the client.

is competent & has capabilities, time & resources

can comply with ethical requirements

For consideration the integrity of the client consider following

a) The identity and business reputation of the client's principal owners, key management, related parties and those charge with governance

b) The nature of the client's operations, including its business practices

c) Indications of an inappropriate limitation in the scope of work.

d) 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.

e) The reasons for the proposed appointment of the firm and non-reappointment of the previous firm. The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client

f) Indications that the client might be involved in money laundering or other criminal activities

g) Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.

(ii) When the firm obtains information that would have caused it to decline an engagement if that information had been available earlier, the firms policies & procedures should consider

a) The professional & legal responsibilities

- b) The possibility of withdrawing from the engagement & client relationship
- (iii) Policies & procedures for withdrawal include:
  - a) Discussing with appropriate level for appropriate action & the reasons for withdrawal
  - b) Considering professional, or legal regulatory
  - c) Documenting significant issues, consultations, conclusions & the basis for conclusion

#### 4) Human Resources

- (i) Firm's policies & procedures should provide it with reasonable assurance that:
  - a) it has sufficient personnel with the capabilities, competence, commitment to ethical principles.
  - b) enable the firm to issue appropriate reports.
- (ii) Firm's performance evaluation, compensation & promotion procedures give due recognition & reward to the development & maintenance of competence & commitment to ethical principles
- (iii) The firm should assign responsibility for each engagement to an engagement partner.
- (iv) The firm should also assign appropriate staff with capabilities, competence & time to perform engagements

#### 5) Engagement performance

- (i) Firm's policies & procedures should provide it with reasonable assurance that:
  - a) Engagements are performed in accordance with professional standards, legal & regulatory requirements
  - b) That the firm issue appropriate report
- (ii) Firm should establish policies & procedures w.r.t.
  - a) Consultation
  - b) Resolving differences of Opinion
  - c) Engagement quality control review & its documentation.
  - d) Confidentiality, safe custody, accessibility & retrieval, retention, ownership of engagement documentation.

Engagement quality control review (EQCR): The firm should establish policy and procedures For reviewing audit engagement **listed entities**. Such review provides an objective revaluation of significant judgement and conclusion reached.

Areas of review under EQCR: **(PEQ Nov 22)**

- (i) The engagement team's evaluation of the firm's independence in relation to the specific engagement.
- (ii) Significant risks identified during the engagement and the responses to those risks.
- (iii) Judgments made, particularly with respect to materiality and significant risks.



- (iv) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
- (v) The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
- (vi) The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
- (vii) Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.
- (viii) The appropriateness of the report to be issued.

### Documentation of system of quality control

Establish policies & procedures requiring appropriate documentation for

Evidence of operation of each element of its system.

Retention for period of time sufficient to permit those performing monitoring procedures to evaluate firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

Complaints, allegations & responses to them.

Depending upon the size of firm, number of office, nature & complexity of firm.

Large firms may use electronic databases to document matters like independence confirmations, performance evaluations & the results of monitoring inspections.

Smaller firms may use more informal methods in documentation such as manual notes, checklists & forms.

### 6) Monitoring

- (i) Firm's policies & procedures should provide it with reasonable assurance that:
  - a) the policies & procedures relating to the system of quality control are relevant, adequate and operating effectively.
  - b) it includes an ongoing consideration & evaluation of firm's system of quality control, including a periodic inspection of a selection of completed engagements.
- (ii) Firm should evaluate the deficiencies noted as a result of monitoring process & should communicate to relevant engagement partners & other appropriate personnel.
- (iii) Firm should also design policies & procedures to appropriately address the complaints & allegations.



## Concept of allegation & claim PEQ Jan'21

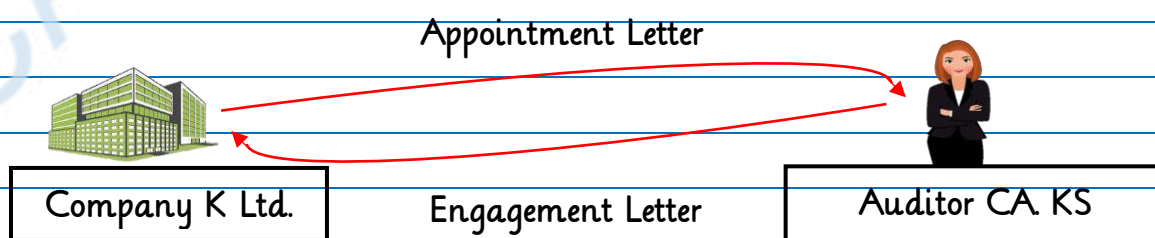
- (i) The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:
- (a) Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and
  - (b) Allegations of non-compliance with the firm's system of quality control.
- (ii) Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.
- (iii) As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.
- (iv) The firm investigates such complaints and allegations in accordance with established policies and procedures. The investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them are documented.
- (v) Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action.

**Note:** - As per para A27 of SQC 1, auditor of listed entity should have to be internally rotated within a span of 7 years (PEQ May 22)

## C] SA 210 AGREEING THE TERMS OF ENGAGEMENT

In order to have a clear understanding between auditor & auditee.

It is important both auditor & client to be clear about nature & scope of engagement



## OBJECTIVE

Establishing whether the preconditions for an audit are present

AND

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.

II]

## PRECONDITIONAL

RTP Nov 19

Acceptability of FRF

Management acknowledges responsibility

Preparation of FS

Design,  
Maintenance of  
IC

To provide  
unrestricted access  
all the time

FRF: Financial Reporting Framework

BOA

all Info.

Persons to provide  
Further explanation

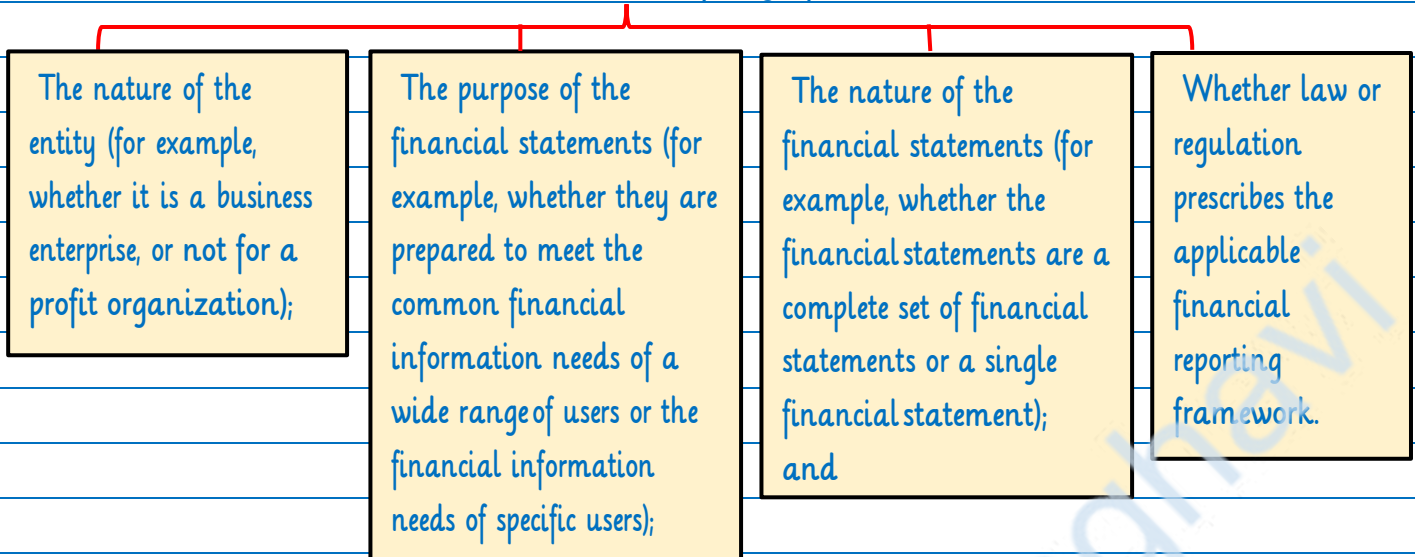
- Where FRF is unacceptable but for the fact that it is prescribed by law or regulation the auditor shall accept the engagement only if: -
- Management agrees to disclose it.
  - Management agrees to allow the auditor to disclose the matter under 706 (EOM).
  - Unless the auditor is required by law or regulation to express the auditor's opinion on the financial statements by using the phrases "present fairly, in all material respects", or "give a true and fair view" in accordance with the applicable financial reporting framework, the auditor's opinion on the financial statements will not include such phrases.
- If above conditions are not present then auditor should evaluate

Evaluate the effect of the misleading nature of the financial statements on the auditor's report; and

Include appropriate reference to this matter in the terms of the audit engagement.

Students Note

→ Factors relevant to auditors determine the accepting of FRF



- Note :- 1) Terms of Engagement can be stated in **any written** form or engagement letter.  
2) If the terms are clearly **mentioned in law** then there is **no need** of any **other written form**.  
3) **Terms** of engagement shall **not override** the **scope** of audit.

III] **RECURRING AUDIT (RA) (M 13)**

In case of RA, generally auditor is **NOT required to issue Engagement Letter. (EL)**

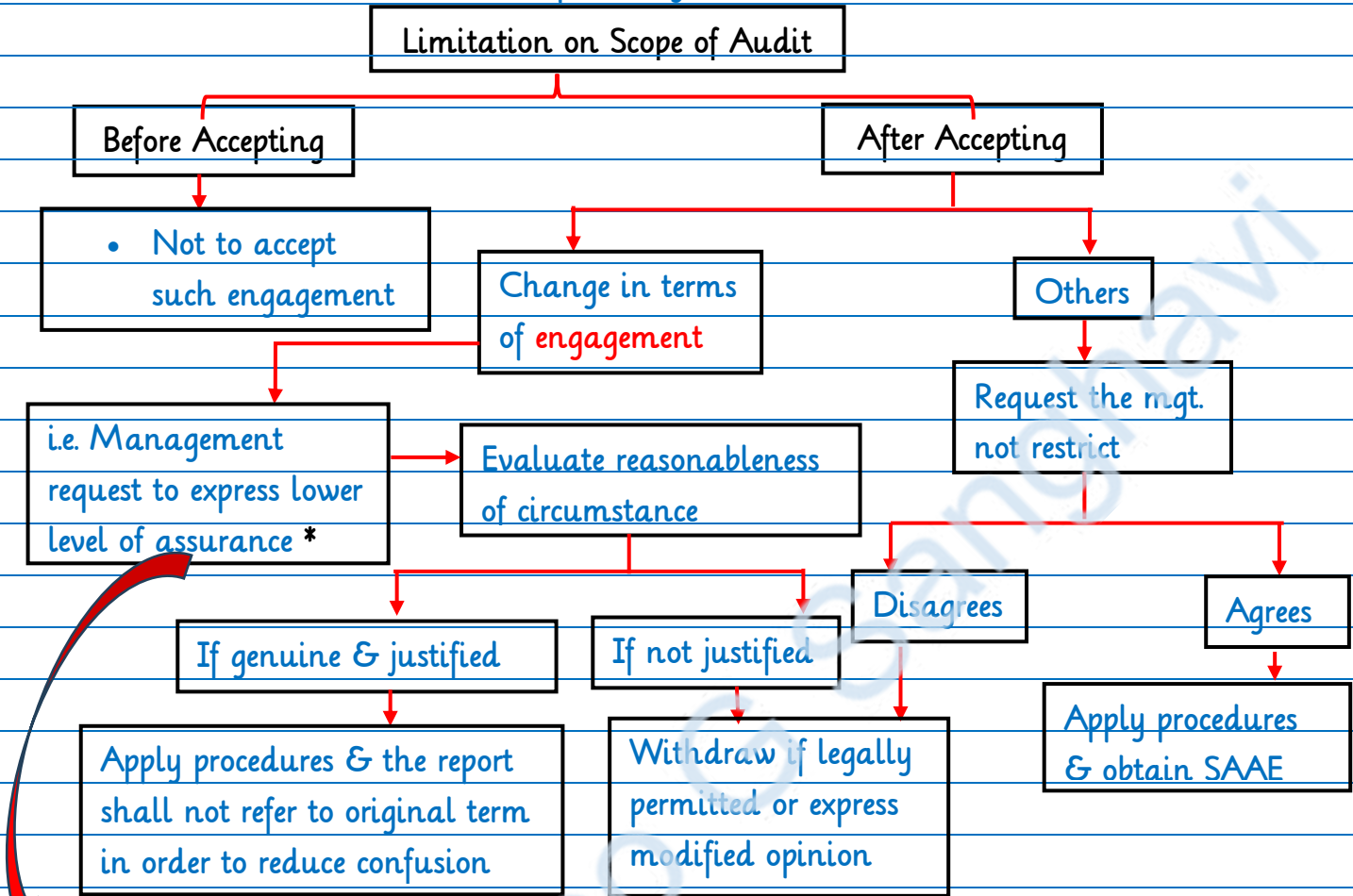
However, in following circumstances auditor may decide to reissue EL

1. Any indication that the entity that **misunderstood** the objective and scope of the Audit.
2. Any revised or special terms of audit engagement
3. A recent change of senior management.
4. A significant change in ownership.
5. A change in legal or regulatory requirements.
6. A change in the **financial reporting framework** adopted in the preparation of the FS.
7. A change in other reporting requirements.

**Students Note**

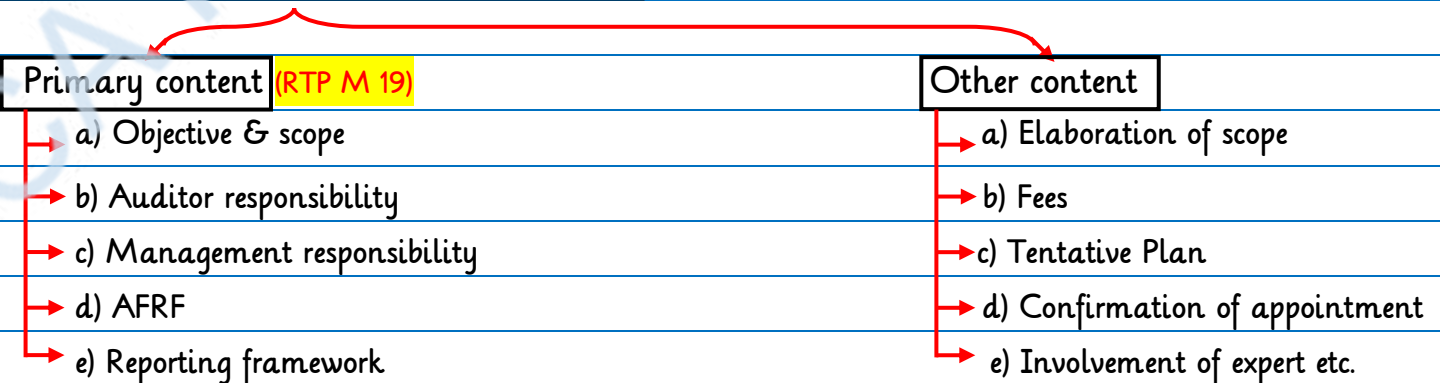
#### IV] LIMITATION ON SCOPE

- Valid to an extent which is acceptable by an auditor and which does not override law



- \* A request from the client for the auditor to change the engagement may result from –
- A change in circumstances affecting the need for the service,
  - A misunderstanding as to the nature of an audit or related service originally requested.
  - A restriction on the scope of the engagement, whether imposed by management or caused by circumstances.

#### V] CONTENT OF ENGAGEMENT LETTER



## VI] REPORTING REQUIREMENTS PRESCRIBED BY LAW

If law or regulation prescribes the layout or wording of the auditors report that are significantly different from SA then auditor shall evaluate

Whether users might misunderstand the assurance obtained from the audit of the financial statements and, if so,

Whether additional explanation in the auditor's report can mitigate possible misunderstanding

## D] SA 220 QUALITY CONTROL FOR AN AUDIT OF FS

→ As the auditor is member of ICAI its duty is to observe QC's.

SA - 220 seeks to establish standards of Quality Controls on:

- 1) Audit Firm: Implementation of policies and procedures at the audit firm level.
- 2) On Individual Audit: Implementation of policies and procedures to the work delegated at the audit level.

## I] OBJECTIVE

Auditor complies with professional standard & other legal & regulatory requirement

Audit Report is appropriate in all circumstances

## II] COMPONENTS REQUIREMENTS OF QUALITY CONTROL: (Key - LEAHEM)

### 1] LEADERSHIP RESPONSIBILITIES

EP should emphasize the ET the following: -

Compliance with professional standard and legal requirements

Compliance with firm's Q.C. policies

Issuance of appropriate audit report

Ability to raise concerns without fear of reprisals

Quality is essential and indispensable performance

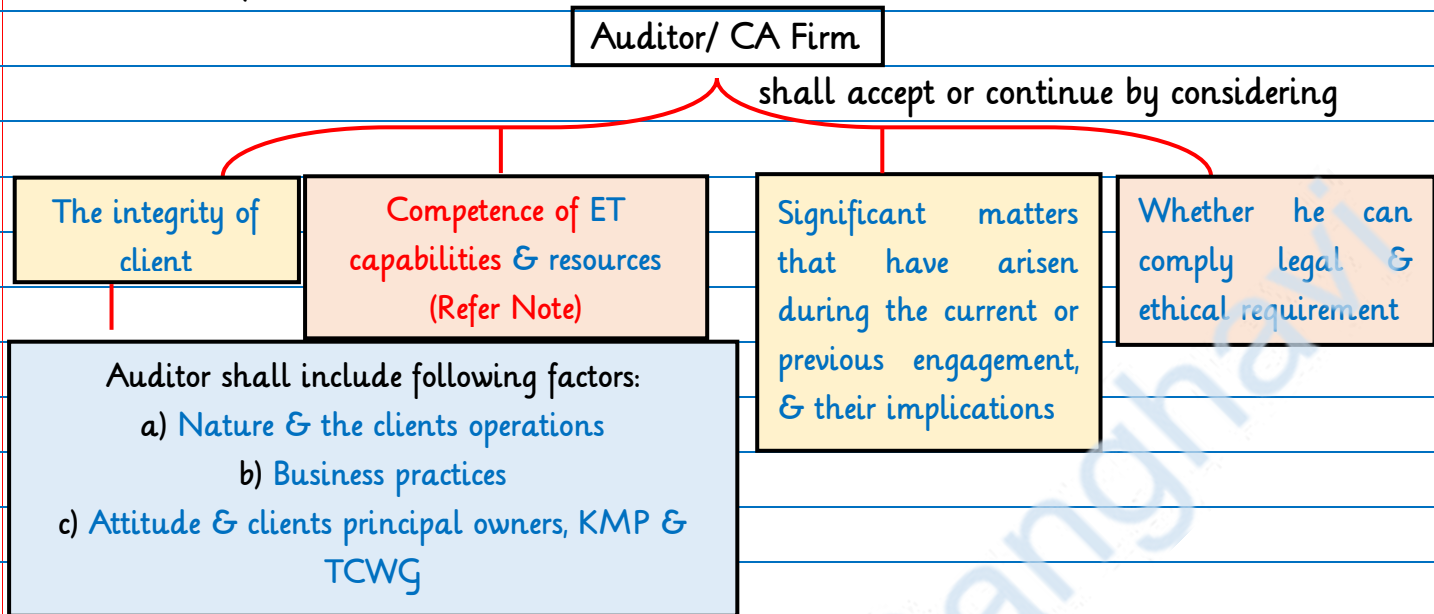
### 2] ETHICAL REQUIREMENTS (same as SA 200)

The firm should establish policies & procedures to ensure compliance with: (Key - COPPII)

- (i) C = Confidentiality
- (ii) P = Professional competence & due care
- (iii) I = Integrity and
- (iv) O = Objectivity
- (v) P = Professional behaviour

(v) **INDEPENDENCE** in mind & of appearance

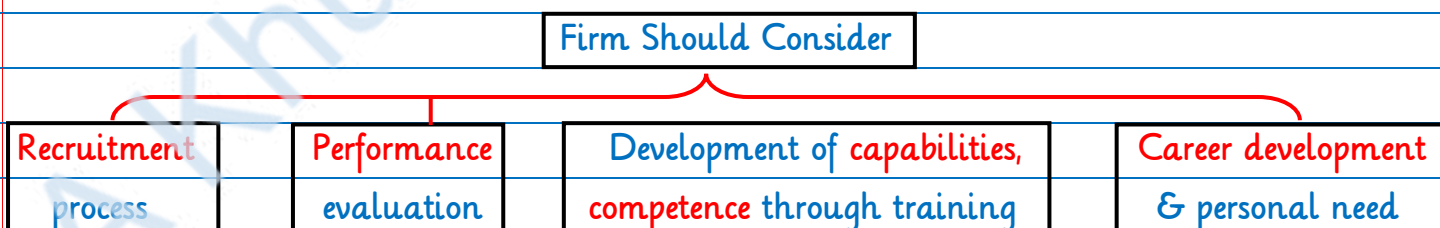
### 3] **ACCEPTANCE/CONTINUANCE OF CLIENT RELATIONSHIP**



Note: - For considering **competence & capacities** auditor may consider **(important)**:

- (i) Understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- (ii) Understanding of professional standards and regulatory and legal requirements.
- (iii) Technical expertise, including expertise with relevant information technology and specialised areas of accounting or auditing.
- (iv) Knowledge of relevant industries in which the client operates.
- (v) Ability to apply professional judgment.
- (vi) Understanding of the firm's quality control policies and procedures.

### 4] **HUMAN RESOURCES**



### 5] **ENGAGEMENT PERFORMANCE**

**C = Consultation:**

Engagement Partner shall: -

- (i) Take responsibility for the engagement undertaking appropriate consultations.
- (ii) Be satisfied that Engagement Team have undertaken appropriate consultation during the course of audit (within & outside the firm)
- (iii) Be satisfied that nature and scope of consultation are agreed with the party consulted.

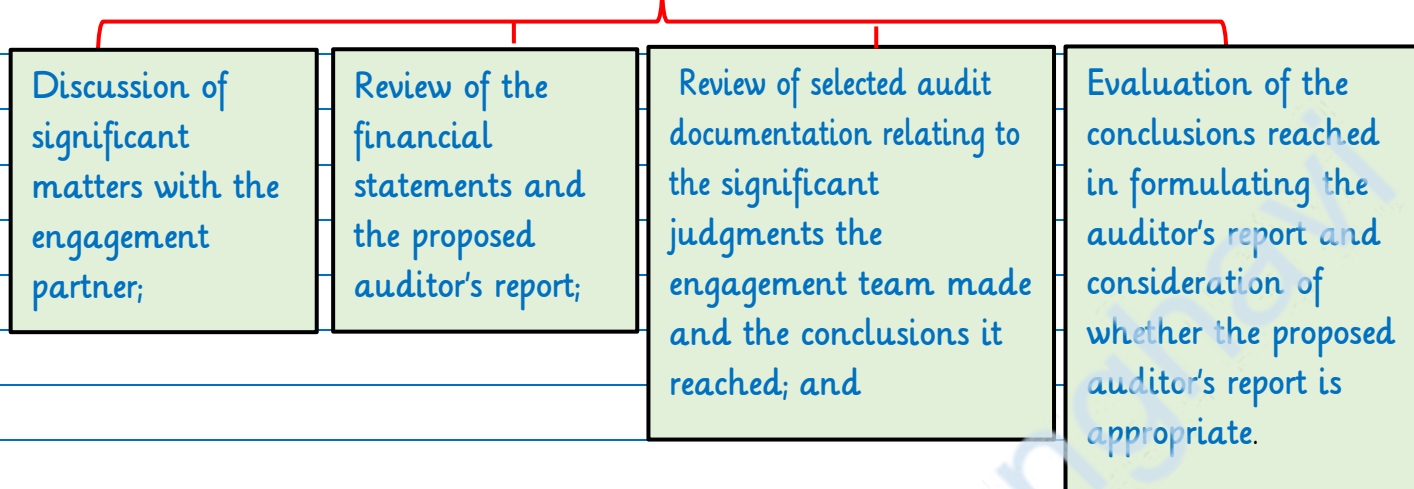


(iv) Conclusion are implemented.

**E = Engagement quality control review (EQCR): - (RTP M 19)**

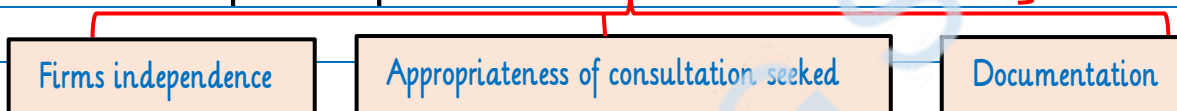
i) It is process designed to provide an objective evaluation, before the report is issued.

ii) The reviewer shall perform an objective evaluation of significant judgement, it includes



iii) EQCR is mandatory for audit of Listed Entities

iv) For review of audits of listed entities the reviewer shall consider (RTP M 19)



v) EQCR does not reduce the responsibilities of engagement partner.

Difference of opinion

Follow the firm's policies and procedures for dealing with and resolving differences of opinion.

Report shall not be issued in case of difference of opinion.

### → Important Question

Q. During the audit of RTV Ltd, a listed company, Engagement Partner (EP) completed his

reviews & also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner & not EQCR. EQCR objected to this & refused to sign off the documentation. Please advise as per SA 220. (RTP M 19)

Ans. In the given case, Engagement Partner is not right. The independence assessment documentation should also be given to EQCR for his review.

**M = MONITORING**

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. 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.

→ **Important Question**

\* Q. If Signing partner is different than engagement partner (RTP N 19)

Ans. Signing partner should exercise adequate skill & due care before signing audit report

**SQC 1 VS. SA 220 KEY DIFFERENCES IN NATURE, SCOPE AND APPLICABILITY**

SQC1	SA 220
It applies to entire firm and fixes the responsibility of firm to be assumed by CEO or managing partners.	It applies to a particular audit engagement and engagement partner takes responsibility of the same.
It is applicable to audits, reviews of historical financial information, and other assurance and related services engagements.	It is applicable to audit engagements only.
It relates to setting up of a quality control system consisting of policies and procedures for firm as a whole.	It deals with responsibilities of engagement teams to implement quality control procedures that are applicable to audit engagements.
It pertains to establishing a system of quality control designed to provide firm with a reasonable assurance that a firm and its personnel comply with professional standards and regulatory and legal requirements so that reports issued by firm or engagement partners are appropriate in circumstances.	It is premised on the basis that firm is subject to SQC 1. Therefore, SQC 1 is a sine qua non for applicability of SA 220. It is within overall context of a firm's system of quality control, engagement teams implement quality control procedures applicable to audit engagements.

**Students Note**

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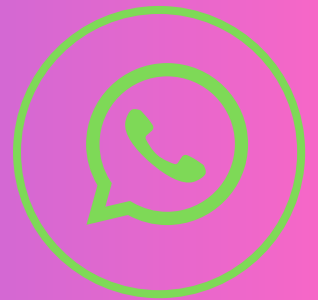
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