

Contents at a Glance

Auditing & Assurance

1	Auditor & Auditors - I	1 - 4
2	Auditor & Auditors - II	5 - 8
3	Cost Audit	9 - 10
4	Audit of Financial Statement - I	11 - 23
5	Audit of Financial Statement - II	24 - 29
6	Audit of Various Entities	30 - 40
7	Government Audit	41 - 46
8	Audit of Co-operative Societies	47 - 50
9	Auditors Report	51 - 59
10	CARO, 2020	60 - 64
11	Nature, Objective & Scope of Audit	65 - 72
12	Preparation for an Audit	73 - 77
13	Internal Control	78 - 92
14	Standard on Auditing (SA-240)	93 - 100
15	Standard on Auditing 520	101 - 105
16	Standard on Auditing 530	106 - 113
17	Audit in Automated Environment	114 - 117
18	Audit of Banks	118 - 129
19	Standards on Auditing	130 - 162

Chapter 1

AUDIT & AUDITORS-I

APPOINTMENT OF AUDITOR [SEC 139(1)]

- ✚ **Appointment at AGM:-**Every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor of the company.
- ✚ **Tenure of Auditor:-**The auditor shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.
- ✚ **In case of non-appointment or re-appointment [Sec 139(10)]:-**Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.
- ✚ **Written consent of Auditor:-**Before any appointment is made, the written consent of the auditor shall be obtained from the auditor.
- ✚ **Certificate by Auditor:-** The auditor appointed shall submit a certificate that:
 - (a) the individual or the firm is eligible for appointment and is not disqualified for appointment.
 - (b) the proposed appointment is as per the term provided under the Act;
 - (c) the proposed appointment is within the limits laid down under the Act;
 - (d) the list of proceedings against the auditor or audit firm or any partner w.r.t. professional matters of conduct.
- ✚ **Intimation to Auditor by the Company:-**The Company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment in Form ADT – 1, with the Registrar within fifteen days of the meeting in which the auditor is appointed.



ROTATION OF AUDITOR [SEC 139 (2) (3) (4)]

- ✚ **Applicability:-**
 - Listed Company
 - All unlisted public companies having paid up share capital of rupees 10 crores or more

- All private limited companies having paid up share capital of rupees 50 crores or more
- Remaining Companies having public borrowings from Bank/FI or public deposits of rupees 50 crores or more.

✚ **Maximum Terms:-**

- An Individual auditor can serve maximum one term.
- A Firm which is an auditor can serve maximum two consecutive terms.

✚ **Cooling period:-**After expiration of the above mentioned terms, the auditor will be disqualified to be appointed as auditor of the same company for a period of five years.

✚ **Firms operating in Same network:-** Also, no audit firm operating within the same network with the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

“same network” includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control (i.e. common partners)

✚ **Appointment of new auditor:-**Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself make its recommendation for appointment of the next auditor by the members in annual general meeting.

APPOINTMENT OF FIRST AUDITOR OF NON-GOVERNMENT COMPANIES [SEC 139 (6)]

✚ **Appointment by BOD:-**The first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within thirty days from the date of registration of the company.

✚ **Appointment by Members:-**In case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

APPOINTMENT OF FIRST AUDITOR OF GOVERNMENT COMPANIES [SEC 139 (7)]

✚ **Appointment by CAG:-**The first auditor shall be appointed by Comptroller and Auditor General of India within sixty days from the date of registration.

✚ **If CAG fails to appoint:-**in case C&AG does not appoint such auditor, then BOD shall appoint such auditor within the next thirty days; and in the case of failure of the Board, it shall inform the members of the company who shall appoint such auditor within the sixty days at an EGM, who shall hold office till the conclusion of the 1ST AGM.

APPOINTMENT OF SUBSEQUENT AUDITOR OF GOVERNMENT COMPANIES [SEC 139 (5)]

✚ **Appointment:-**The Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act.

✚ **Time limit:-**CAG will appoint the auditor within a period of one hundred and eighty days from the commencement of the financial year.

✚ **Tenure:-**Auditor shall hold office till the conclusion of the annual general meeting.

FILLING OF CASUAL VACANCY [SEC 139 (8)]

✚ **In case of Government Company:-** shall be filled by Comptroller and Auditor General of India within thirty days, and in case Comptroller and Auditor General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next thirty days.

✚ **In case of Non-government company:-** shall be filled by the Board of Directors within thirty days.
If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

RE-APPOINTMENT OF AUDITOR [SEC 139 (9)]

A retiring auditor may be re-appointed at an annual general meeting, if:

- he is not disqualified for re-appointment;
- he has not given a notice in writing of his unwillingness to be re-appointed; and
- a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

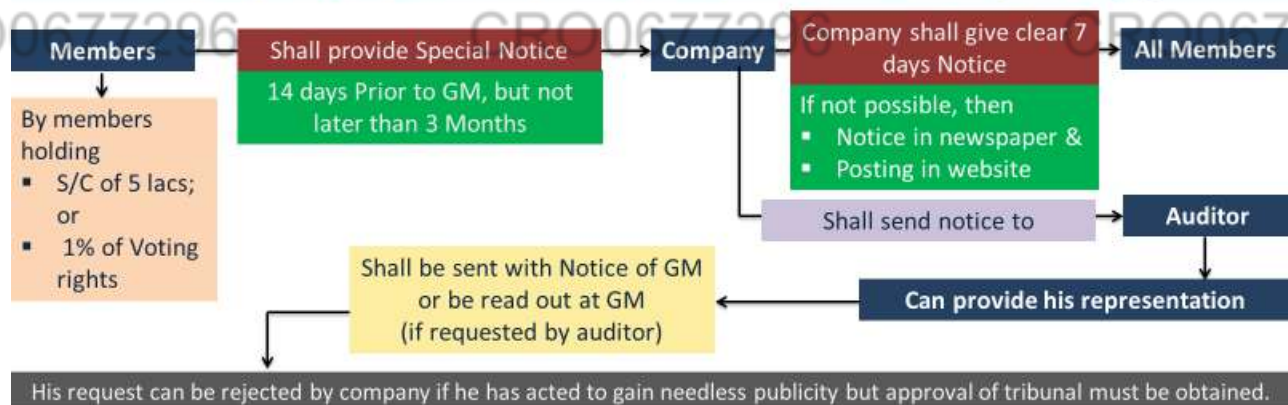
REMOVAL OF AUDITOR [SEC 140 (1) (5)]

REMOVAL [SEC 140(1)]	REMOVAL ON ORDER OF TRIBUNAL [SEC 140(5)]
<ul style="list-style-type: none"> + Approvals:- <ul style="list-style-type: none"> ▪ Board resolution in BM ▪ Application shall be made to CG (in form No. ADT-2) within 30 days of BM ▪ Special Resolution must be passed within 60 days of approval of CG + Opportunity of being heard:- Shall be provided before removal of the Auditor 	<ul style="list-style-type: none"> + Order by Tribunal:- If it is of the opinion that Auditor has acted fraudulently or involved in Fraud (D/I) + Discretion:- Order can be passed by Tribunal either suo motu or on application by CG or any other person. + Ban on Auditor:- The auditor so removed will be disqualified to be appointed as auditor of any company for the period of 5 years + Penalty:- The auditor so removed will be liable for fraud u/s 447

RESIGNATION [SEC 140 (2) (3)]

- + **Filing of Resignation [Sec 140(2)]:-** The auditor who has resigned shall file within 30 days from the date of resignation, a statement in Form ADT-3 with the company, ROC and C&AG (in case of govt. company)
- + **Penalty:-** fifty thousand rupees or remuneration of the auditor, whichever is less, and 500/day, subject to a maximum of two lakh rupees.

APPOINTMENT OF AUDITOR OTHER THAN THE RETIRING ONE [SEC 140(4)]



QUALIFICATION OF AUDITOR [Section 141(1)]

- + **Qualification:-** A person shall be eligible for appointment as an auditor of a company only if he is a Chartered Accountant.
As per Section 2(17) Chartered Accountant means a Chartered Accountant as per CA Act, 1949 and who is holding Certificate of Practice
- + **Appointment of firm:-** A firm whereof majority of partners practicing in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

ELIGIBILITY OF PARTENRS OF AUDIT FIRM [Section 141(2)]

Where a firm including LLP is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

DISQUALIFICATIONS OF AUDITOR [Section 141(3)]

B—Body Corporate (other than Indian LLP)

- I**— Indebtedness of more than 5 lacs from CASH to Person/Partner/Relative (PPR)
- G**— Guarantee of more than 1 lac to CASH by Person/Partner/Relative (PPR)
- F**— Full time employment elsewhere
- A**— An employee or partner/employee of employee of the company
- B**— Business relationship (except where activities are in OCB at ALP and Professional services)
- R**— Relative holding security more than 1 lac
- I**— If holding more than 20 Company Audits (except audit of OPC, Small CO. Dormant Co., Private co with capital less than 100 crores)
- C**— Convicted of an offence involving fraud and 10 years have not elapsed
- R**— Relative is a director or KMP in the company
- O**— Officer/Employee of the Company
- P**— Person/Partner holding Security/Interest in the Company, Associate, Subsidiary and Holding Co.
- E**— Engaged in providing prohibited services to Company, Subsidiary or Holding Co.

BIG-FABRIC-ROPE

CASUAL VACANCY [Section 141(3)]

Where a person appointed as an auditor of a company incurs any of the disqualifications after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

REMUNERATION OF AUDITOR (SEC 142)

- ✚ The remuneration of the auditor of a company shall be fixed in its general meeting or in Board Meeting.
- ✚ The remuneration shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him.

Chapter 2

AUDIT & AUDITORS-II

POWERS OF AUDITOR (SEC 143)

- ✦ **Right of access:**-Every auditor shall have a right of access at all times to books of account and vouchers of the company, whether kept at the registered office or at any other place.
- ✦ **Right to obtain information and explanation:**-Shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as the auditor.

Judicial Decision:- **Newton v Birmingham Small Arms Company**

It was held by the Court that any resolution even passed by entire body of shareholders which preclude the auditors from availing themselves of all the information for which they are entitled to under the company law are inconsistent with the Act and therefore, null and void.

- ✦ **Right of auditor of Holding company:**-The auditor of a holding company shall also have the right of access to the records of all its subsidiaries and associate companies in so far as it relates to the consolidation of its financial statements with that of its subsidiaries.

DUTIES OF AUDITOR (SEC 143)

INQUIRE INTO PROPERTY MATTERS [SEC 143(1)]

Amongst other matters, auditor is required into the following matters, namely:-

- a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms are prejudicial to the interests of the company or its members;
- b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
- c) where the company (except investment / banking company) - whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
- d) whether loans and advances made by the company have been shown as deposits;
- e) whether personal expenses have been charged to revenue account;
- f) where books show that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received

REPORTING OVER ACCOUNTS AND FINANCIAL STATEMENTS [SEC 143(2)]

- ✦ **Preparation of Auditor's Report:**-The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting.
- ✦ **True and Fair view:**-The report shall give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year.

OTHER ELEMENTS IN AUDITOR'S REPORT [SEC 143(3)]

The auditor's report shall also state:

- ✦ whether, in his opinion, the financial statements comply with the **A**ccounting standards;
- ✦ whether proper **B**ooks of account have been kept by the company;
- ✦ whether the report on the accounts of any **B**ranch office audited by a person other than the company's auditor has been sent to him;
- ✦ whether the company has **C**onsistent and adequate internal financial controls with reference to financial statements" in place and the operating effectiveness of such controls;
- ✦ whether any **D**irector is disqualified under section 164(2);

- + whether he has sought and obtained all Explanations and information which to the best of his knowledge and belief were necessary;
- + the observations or comments on Financial transactions having adverse effect on the Functioning of the company;
- + whether the company's balance sheet and profit and loss account (F/S) dealt with in the report are in agreement with the books of account and returns.

A—B—C—D—E—F**REASONS FOR RESERVATIONS [SEC 143(4)]**

Where any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons for it.

AUDIT OF GOVERNMENT COMPANY [SEC 143(5-7)]

- + **Appointment of Auditor [Sec 143(5)]**:-In case of Government company, the C&AG will appoint the auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited.
- + **Furnish of Auditor's Report [Sec 143(5)]**:-The auditor shall submit a copy of the audit report to CAG which shall include the directions issued by CAG, the action taken thereon and its impact on the accounts and financial statement of the company.
- + **Rights of C&AG [Sec 143(6)]**:- The CAG shall within 60 days from receipt of report have a right to
 - conduct a supplementary audit and may require additional information to be furnished to any authorized person and
 - comment upon or supplement such audit report.
- + **Comment of C&AG [Sec 143(7)]**:-Any comments given by the CAG upon, or supplement to, the audit report shall be sent by the Company to every person entitled to copies of audited financial statement u/s 136(1) and shall also be placed before the AGM of the company at the same time and in the same manner as the audit report.

BRANCH AUDIT [SEC 143(8)]

- + **Qualification of Branch Auditor**:-
 - **If Branch is located in India**:-Company Auditor/Qualified person in India
 - **If Branch is located outside India**:-Company Auditor/Qualified person in the Country
- + **Duty of Branch Auditor**:-The branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company.

COMPLIANCE OF AUDITING STANDARDS [SEC 143(9) (10)]

- + **Framing of Auditing Standards [Sec 143(9)]**:-The Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.
- + **Applicability of old Standards [Sec 143(10)]**:-Until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards

PENALTY [SEC 143 (14) (15)]

- + **Penalty**:- If any auditor, cost accountant, or company secretary in practice does not comply with the provisions of sub-section (12), he shall:-
 - (a) in case of a listed company, be liable to a penalty of five lakh rupees; and
 - (b) in case of any other company, be liable to a penalty of one lakh rupees."
- + **Applicability to Cost Auditor or Company Secretary**:-The provisions of this section shall as much as possible to Cost Auditor conducting cost audit under section 148; or CS in practice conducting secretarial audit under section 204.

AUDITING & ASSURANCE-SUMMARY BOOK (CA-INTER)

REPORTING OF FRAUD BY THE AUDITOR [Sec 143(12)]



AUDITORS NOT TO RENDER PROHIBITED SERVICES (SEC 144)

Prohibited on Services:- Auditor appointed cannot render any of the following services, whether such services are rendered directly or indirectly to

- the company or
- its holding company or
- subsidiary company

MEANING OF "INDIRECTLY"

INDIVIDUAL	FIRM
<ul style="list-style-type: none"> Through his relative Through any other person connected or associated with such individual Through any entity, in which such individual has significant influence or control, or Through any entity whose name or trade mark or brand is used by such individual 	<ul style="list-style-type: none"> Through any of its partners Through its parent, subsidiary or associate entity Through any other entity, in which the firm or any partner of the firm has significant influence or control Through any entity whose name or trade mark or brand is used by the firm or any of its partners.

- List of Prohibited Services:-**
- A**-Accounting and book keeping services
 - C**-carry out outsourced financial services
 - A**-actuarial services
 - D**-design and implementation of any financial information system
 - E**-Engaged in investment advisory /investment banking services
 - M**-Management services
 - I**-Internal audit
 - C**-Carry out any kind of services as may be prescribed

ACADEMIC

SIGNING OF AUDIT REPORTS (SEC 145)

Signing of Report:-The auditor shall sign the auditor's report or sign or certify any other document of the

company

- + **Reading at the GM:**-The qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting.
- + **Inspection of Report:**-shall be open to inspection by any member of the company.

AUDITOR TO ATTEND MEETINGS (SEC 146)

- + **Duty of Company:**-All notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and
- + **Duty of Auditor:**-The auditor shall (unless exempted by the company), attend either by himself or through his authorized representative, who shall also be qualified to be an auditor, any general meeting and
- + **Right of Auditor:**-shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

PENALTY (SEC 147)

COMPANY & OFFICER IN DEFAULT	AUDITOR
<p>Penalty [Sec 147(1)]:-In case of contravention of Section 139 to 146,</p> <ul style="list-style-type: none"> ▪ the company shall be punishable with fine (25K to 5 lac) ▪ Every officer in default shall be punishable fine (10K-1 lac) 	<ul style="list-style-type: none"> + Penalty [Sec 147(2)]:-If an auditor contravenes any of the provisions of section 139, 143, 144, 145, then where he has acted <ul style="list-style-type: none"> ▪ Without an intention to defraud:-the auditor shall be punishable with fine 25K to 5 lacs or 4x(remuneration of the auditor), whichever is lower. ▪ With an intention to defraud:-he shall be punishable with imprisonment upto 1 year and with fine 50K to 25 lacs or 8 x(remuneration of the auditor), whichever is lower. + Where an auditor has been convicted [Sec 147(3)]:-:he shall be liable to: <ul style="list-style-type: none"> ▪ refund the remuneration received by him to the company; and ▪ pay for damages to the company, statutory bodies or authorities or any other persons or members or creditors of the company for loss caused.
<p>Penalty of Partners [Sec 147(5)]:-In case of Audit Firm,</p> <ul style="list-style-type: none"> ▪ In case of criminal liability (other than fine):- the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable." ▪ Otherwise:-the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force shall be of the partner(s) of the audit firm concerned and of the firm jointly and severally. 	

Chapter 3

COST AUDIT

RULE 3 OF COMPANIES (COST RECORDS AND AUDIT) RULES, 2014

- ✦ **Applicability:-**The class of companies, including foreign companies, engaged in the production of the goods or providing services, having an overall turnover from all its products and services of rupees thirty five crore or more during the immediately preceding financial year, shall include cost records for such products or services in their books of accounts.
- ✦ **Exemption:-**A Company which is classified as a micro enterprise or a small enterprise under the Micro, Small and Medium Enterprise Development Act, 2006 are exempted from the compliance of these provisions

RULE 5 OF COMPANIES (COST RECORDS AND AUDIT) RULES, 2014

- ✦ **Maintenance of cost records:-**Every company covered under Rule 3 including all units and branches thereof, shall, in respect of each of its financial year commencing on or after the 1st day of April, 2014, maintain cost records in form CRA-1.
- ✦ **Utilisation of cost records:-**The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.
- ✦ **Purpose of maintaining records:-**The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, control over the various operations and costs to achieve optimum economies in utilisation of resources and these records shall also provide necessary data.

RULE 4 OF COMPANIES (COST RECORDS AND AUDIT) RULES, 2014

- ✦ **Companies covered under item A:-**Every company specified in item (A) of rule 3 shall get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees 50 crore or more and the aggregate turnover of the individual product or products or service or services is rupees 25 crore or more.
- ✦ **Companies covered under item B:-**Every company specified in item (A) of rule 3 shall get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees 100 crore or more and the aggregate turnover of the individual product or products or service or services is rupees 35 crore or more.
- ✦ **Non-Applicability:-**The requirement for cost audit under these rules shall not apply to a company which is covered in rule 3, and:-
 - whose revenue from exports, in foreign exchange, exceed, seventy five per cent of its total revenue; or
 - which is operating from a special economic zone.

RULE 6 OF COMPANIES (COST RECORDS AND AUDIT) RULES, 2014

- ✦ **Appointment of Cost Auditor:-**Company shall appoint Cost Auditor within 180 days from commencement of the Financial year, in its Board Meeting.
- ✦ **Intimation:-** Every company referred above shall
 - inform the cost auditor concerned of his or its appointment
 - file a notice of such appointment with the Central Government within
 - ✓ a period of thirty days of the Board meeting in which such appointment is made; or
 - ✓ within a period of 180 days of the commencement of the financial year, whichever is earlier through e-mode, in Form CRA-2
- ✦ **Filling of casual vacancy:-**Any casual vacancy in the office of a cost auditor, whether due to resignation, death or

removal, shall be filled by the Board within thirty days of occurrence of such vacancy.

- + **Qualification of Cost Auditor:**-Only Cost Accountant can conduct Cost Audit.
- + **Tenure of Cost Auditor:**-Every cost auditor appointed as such shall continue in such capacity till
 - the expiry of 180 days from end of financial year or
 - he submits the cost audit report, for the financial year for which he has been appointed.
- + **Submission of cost audit report:**-Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in Form CRA-3.
- + **Time period for submission of report:**-Every cost auditor shall forward his report to the Board of the company within 180 days of end of the financial year to which the report relates
- + **Submission of report by company to CG:**-Every company within thirty days from the date of receipt of cost audit report, furnish the Central Government with such report alongwith full information and explanation on every reservation or qualification contained therein, in Form CRA-4.
- + **Compliance of cost accounting standards:**-The auditor conducting the cost audit shall comply with the cost auditing standards.
- + **Same Disqualifications etc.:**-The disqualifications, rights, duties and obligations applicable to statutory auditors shall, so far as may be applicable, apply to a cost auditor.
- + **Provide assistance:**- it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.
- + **Penalty:**-If any default is made in complying with the provisions of this section then:-
 - the company and every officer of the company who is in default shall be punishable ias per Section 147;
 - the cost auditor of the company who is in default shall also be punishable as provided in the same section.

Chapter 4

AUDIT OF FINANCIAL STATEMENT-I

PART-A		PART-B	
Assets	Liabilities	Receipts	Payments
<ul style="list-style-type: none"> + Fixed Assets (PPE) (tangible) + Investments + Trade Receivables + Inventories + Intangible Assets + Cash in hand + Cash at Bank 	<ul style="list-style-type: none"> + Reserve & Surplus + Share Capital + Borrowings + Trade Payables + Provisions + Contingent Liab + Other Liabilities (eg. o/s exp.) 	<ul style="list-style-type: none"> + Sale of Products + Sale of Assets + Income from Investments + Other Incomes (eg. Rent received) 	<ul style="list-style-type: none"> + Purchase of item + Employee benefits expense + Depreciation & Amortisation + Other expenses (misc.) (power, fuel etc.)

ASSERTIONS

MEANING (SA-315):- Representations by Management explicit or otherwise that are embodied in the f/s as used by the Auditor to consider the different types of possible mis-statements that may occur

TYPES OF ASSERTIONS

INCOME STATEMENT	BALANCE SHEET
<ul style="list-style-type: none"> + Occurrence:- Transactions have occurred and related to the entity. + Completeness :- <ul style="list-style-type: none"> ▪ All transactions are recorded ▪ Transactions is recorded in correct accounting period + Measurement:- <ul style="list-style-type: none"> ▪ Transactions have been classified and presented fairly in f/s. ▪ Transactions have been recorded appropriately at their proper amount 	<ul style="list-style-type: none"> + Existence:- That A & L exist at the year end + Completeness:- All balances have been recorded + Valuation:- A & L have been properly valued + Rights & obligations:- <ul style="list-style-type: none"> ▪ Entity has right to ownership & user over asset ▪ Entity have obligations related to liabilities + Presentation & Disclosure:- That balances have been properly disclosure

QUESTION

+ Cash in hand	₹10,000
+ Investments	₹1,00,000
+ Secured loans	₹10,00,000
+ Machinery	
Opening cost	13,00,000
(-) Depreciation	
Current Dep.	1,30,000
	₹11,70,000

SOLUTION

CASH IN HAND	INVESTEMENTS	SECURED LOANS	MACHINERY
+ That entity is having a balance of ₹10,000 at year end re	+ That co. is having Investment of ₹1 lac at the year end	+ That co. has borrowed the money (existence)	+ That co. is having a certain Plant & Machinery in existence

<ul style="list-style-type: none"> + That entity is having ₹10,000 as currency notes & coins + This balance includes all forms of cash i.e. petty cash etc. + All cash transactions have been properly recoded in cash Book + That Company is having right over cash balance and it can use it freely 	<ul style="list-style-type: none"> + That all the investments have been included (i.e. FD, shares, Deb) + That value of investment is ₹1 lac. + That entity is having right over investments + That investment may be current or non-current 	<ul style="list-style-type: none"> + That all the loans have been recorded (completeness) + Borrowings are of ₹10 Lakhs (valuation) + That co. is having an obligation to pay the amount (obligations) + That loan can be short-term or long-term (presentation) + That co. has kept any Asset as security. 	<ul style="list-style-type: none"> + That co. is have Proper recording of the balances + That the value of Machinery is ₹11,70,000 + That co. is having a right over the machinery + That Dep. For the year is ₹1,30,000 + That method dep. Is 10% + That method dep. Can be WDV or SLM.
---	--	--	--

Verification of Liabilities

SHARE CAPITAL (WHAT TO STUDY)

General Aspects

Special Aspects

- + Premium (Sec 52)
- + Discount (Sec 53)
- + Sweat equity shares (Sec 54)
- + Reduction of s/capital (Sec 66)

SHARES ISSUED AT PREMIUM & DISCOUNT (Sec 52 & 53)

SHARES ISSUED AT PREMIUM (SEC 52)

SHARES ISSUED AT DISCOUNT (SEC 53)

- + **Transfer:-** a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account
- + **Application:-** the securities premium account may be applied by the company:-
 - towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
 - in writing off the preliminary expenses of the company;
 - in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
 - in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
 - for the purchase of its own shares or other securities under section 68.

- + **General Rule:-**A company shall not issue shares at a discount. Any share issued by a company at a discount shall be void.
- + **Permissible in certain situations:-**
 - To employees/directors in case of sweat equity shares
 - To its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme
- + **In case of contravention:-**
 - **Penalty:-**company and every officer who is in default shall be liable to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less,
 - **Refund of Money:-**the company shall also be liable to refund all monies received with interest at the rate of 12%. per annum from the date of issue of such shares

SWEAT EQUITY SHARES (SEC 54)

Definition:- Sweat Equity Shares means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Conditions:-

- authorised by a special resolution passed by the company.
- resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued.
- The special resolution authorising the issue of sweat equity shares shall be valid twelve months.
- In case of listed Company, Compliance of SEBI Guidelines is necessary.
- The company shall not issue sweat equity shares for more than
 - ✓ fifteen percent of the existing paid up equity share capital in a year or
 - ✓ shares of the issue value of rupees five crores, whichever is higher:

Provided that the issuance of sweat equity shares in the Company shall not exceed twenty five percent, of the paid up equity capital of the Company at any time

“Provided further that a startup company, may issue sweat equity shares not exceeding fifty per cent of its paid up capital upto five years from the date of its incorporation or registration
- The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.
- The valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer.
- the expressions “Employee” means-
 - (a) a permanent employee of the company who has been working in India or outside India; or
 - (b) a director of the company, whether a whole time director or not; or
 - (c) an employee or a director as defined in sub-clauses (a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company;

REDUCTION OF SHARE CAPITAL

Auditor will check the following =

- ✚ Whether the articles has authorized the reduction of share capital.
- ✚ Whether special resolution has been passed by the members.
- ✚ Whether notice has been served by the company to ROC, creditors CG and SEBI
- ✚ Whether approval has been obtained from the National Company Law tribunal (NCLT)
- ✚ Whether the interest of the creditors has been secured
- ✚ Whether the order of NCLT has been published as per the manner directed by the NCLT
- ✚ Whether the copy of SR along with approval of NCLT has been filed with the ROC.
- ✚ Whether ROC has provided the certificate of Registration to the company.
- ✚ There should be no default existing w.r.t. repayment of deposits or payment of interest thereon.
- ✚ In case of listed company, check compliance of SEBI guidelines.
- ✚ Check proper accounting treatment as per the relevant accounting standard

AUDIT PROCEDURES W.R.T SHARE CAPITAL (GENERAL ASPECTS)

- ✚ Compare the yearend balance with previous year balance.
- ✚ If there is any change in the share capital, obtained certified copies of resolutions.
- ✚ Obtain a copy of SH 7 w.r.t. increase of share capital.
- ✚ Obtain copy of PAS 3 w.r.t. allotment of securities.
- ✚ Check whether paid – up capital is within the limits of authorized capital
- ✚ If there is no change, obtain written representation from management.

RESERVES AND SURPLUS

MEANING OF RESERVE & SURPLUS:- These are amounts appropriated out of profits which are not intended to meet any liability or contingency

MEANING OF PROVISIONS:- These are amounts charged against profit or revenue to provide for depreciation, diminution in value asset taxation etc.

TYPES OF RESERVES

REVENUE RESERVES	CAPITAL RESERVES
<ul style="list-style-type: none"> ▪ Profits that are available for distribution to shareholders as dividend ▪ Revenue reserves are created out of profits earned in the ordinary course of business 	<ul style="list-style-type: none"> ✚ It represents surplus on profits earned in respect of certain type of transactions Eg:- 1)sale of fixed assets at a price in excess of cost 2)Profits in issue of forfeited share ✚ Capital Reserves <ul style="list-style-type: none"> ▪ Includes – 1)Share premium 2)CRR ▪ Not includes-1)Surplus in P&L A/c

ASSERTIONS (W.R.T. RESERVES & SURPLUS)

1. **Existence-** The balance of R&S existed in the year end
2. **Completeness-** That all the balances of R&S have been included
3. **Valuation-** That R&S have been valued at its appropriate amount
4. **Obligation-** It is the obligation of the company
5. **Presentation & Disclosure-** That the R&S balance have been properly presented & disclosed

RESERVES	PROVISIONS
Appropriation out of profits	Charge against profits
They are not intended to meet any liability or contingency	Provisions are made to meet liability or contingency or demunition in value of assets
Reserves cannot be created in absence of profits	They must be created whether or not there are profits
Generally, reserves are optional for the companies. But in some cases, reserves are mandatory Eg:- CRR, DRR etc	Provisions are mandatory in nature and have to be made as per generally accepted accounting principles

BORROWINGS

AUDIT PROCEDURES

- ✚ Obtain and study MOA of the company and check whether company is entitled to obtain loan/ borrowings
- ✚ In case amount of loan exceeds the limit mentioned u/s 180 of CA,2013 check whether special resolution has been passed by the means of postal ballot
- ✚ Obtain and study the loan agreement between lender and entity and ensure the principle & interest amount as well as due dates
- ✚ Ensure whether company is regularly paying principle & interest and (in case of O/S dues, Auditor shall make disclosure in Auditors Report as per CARO,2016)
- ✚ In case of secured loan, check whether charge has been register with the ROC u/s 77 of companies Act, 2013
- ✚ Make direct confirmation from the bank or financial institutions from which client has obtained the loan (external confirmation)
- ✚ In case of special purpose loan, check whether loan has been utilized in the special purpose or not

TRADE PAYABLES

COMPLIANCE PROCEDURS

- ✚ check proper system for preparation of schedules of trade payables
- ✚ check authorization for commission paid on purchase
- ✚ In case of high value items, check authorization
- ✚ check whether payment is as per the policies
- ✚ statement of A/cs should be reviewed at periodic intervals
- ✚ check the aging schedule of creditors

SUBSTANTIVE PROCEDURS (EXAMINATION OF RECORDS)

- ✚ check correspondence with the creditor
- ✚ check agreement (if any) with the creditor
- ✚ check creditor's ledger
- ✚ check cash/ pass book in order to form reliability over ledger
- ✚ check unusual payment at year end

SUBSTANTIVE PROECUDURES (DIRECT CONFIRMATION FROM CREDITOR)

- ✚ Select the creditor to whom request will be made
- ✚ design the request a) Positive b) Negative
- ✚ send the request to third parties
- ✚ in case of non-reply, send reminders to third parties
- ✚ compare the reply with that of requests
- ✚ if mgmt., refuses to send the request, inquire reasons
- ✚ in case of exception, inquire management

SUBSTANTIVE PROCEDURES (ANALYTICAL REVIEW PROCEDURES (ARP))

- ✚ Compare current year figure with that of previous year figure.
- ✚ Compare Actual fig. with that of Budgetary figure
- ✚ Compare client's ratio with that of industry Average Ratio.
- ✚ Compare client's with the ratio of similar firms.
- ✚ Compare current year aging schedule with previous year aging schedule

CONTINGENT LIABILITY

GENERAL PROCEDURE (FOR LITIGATION AND CLAIM & OTHER CONTINGENT LIABILITIES)

- ✚ Obtain the list of all the contingent liabilities
- ✚ Review minutes of board meeting
- ✚ Obtain written representation from management w.r.t completeness
- ✚ Ensure accounting treatment as per AS-29
- ✚ Ensure disclosures as per schedule III
- ✚ Review legal expense A/c
- ✚ Seek direct confirmation from the lawyers

SPECIAL PROCEDURE (FOR LITIGATION AND CLAIMS)

- a) Direct communication with entity's external legal council – (through letter of inquiry)**
- 1) In case of risk of material management regarding litigations & claims or
 - 2) Audit procedures indicate that other material litigation exist (heavy legal expenditure)

b) Meet the entity's external legal council

- 1) The auditor determines that the matter is significant risk
- 2) The matter is complex
- 3) There is disagreement (exception between management and entity's external legal council ordinary, such meeting require mgmt. permission and are held with a representative of mgmt. in attendance

Verification of Assets

Trade Receivables

AUDIT PROCEDURE TO VERIFY INTERNAL CONTROL SYSTEM W.R.T. TRADE RECEIVABLES

- + Check that all sales have been recorded.
- + Ensure that credit sales are only to approved customers
- + Check that Debts are collected promptly
- + Check proper again schedule made by client
- + Once recorded sales cannot be terminated unless
 - Cash is received
 - Approval by Authorized person

DIRECT CONFIRMATION FROM DEBTOR

- + Select the Debtor to whom request should be made
- + Design the request
 - Positive
 - Negative
- + Send the request to third parties
- + In case of non-reply, send reminders to third parties
- + Compare the reply with that of requests
- + If management refuses to send request, inquire reasons
- + In case of exception, inquire management.

ANALYTICAL REVIEW PROCEDURES (ARP)

- + Compare current year figure with that of previous year figure.
- + Compare Actual fig. with that of Budgetary figure
- + Compare client's ratio with that of industry Average Ratio.
- + Compare client's with the ratio of similar firms.
- + Compare current year aging schedule with previous year aging schedule

ASSERTIONS

EXISTENCE	COMPLETENESS	VALUATION	RIGHTS	PRESENTATION & DISCLOSURE
<ul style="list-style-type: none"> + Examine the debtor's ledger + Calculate the receivable 	<ul style="list-style-type: none"> + Ensure whether all balances have been recorded + Examine copies of sales invoice + Ensure whether 	<ul style="list-style-type: none"> + Identify doubtful debts + Ensure that provision for doubtful debt is made 	Company have right to recover amount from debtors	<ul style="list-style-type: none"> + split a) less than 6 months b) 6 months or more

<ul style="list-style-type: none"> report + Check aging report + Obtain confirmation from debtor 	<p>discount is properly deducted</p> <ul style="list-style-type: none"> + Discount As per rules & regulations Authorization Cash discount check whether cash is received + Implement cut off procedure:- (i.e. to confirm that transactions are in the correct accounting period) 	<ul style="list-style-type: none"> + Ensure that rate of provision is reasonable + In case of no provision, obtain written representation + If bad debts written off + Check authorization 	<ul style="list-style-type: none"> + classification a) secured, consider good b) unsecured, consider good c) doubtful + Disclosure Amt due from a) Director b) officer c) Pvt co.- D-Director/ manager d) Firm- D-Partner
---	---	--	---

INVENTORIES

EXAMINATION OF RECORDS

- ❖ Auditor shall check the records maintained by the management w.r.t inventories for instance , stock ledger, store register, bin card etc
- ❖ If management has not prepared complete records w.r.t inventory, then auditor shall extend his procedures and should perform additional procedures in order to form reliability over inventory
Eg:- Auditor should check purchase invoice, external confirmation

CONSIDERATION WHILE PLANNING PHYSICAL VERIFICATION OF INVENTORIES

- ❖ Nature of inventory.
- ❖ Stages of completion of work in progress.
- ❖ The risks of material misstatement related to inventory.
- ❖ The nature of the internal control related to inventory.
- ❖ Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- ❖ The timing of physical inventory counting.
- ❖ Whether the entity maintains a perpetual inventory system.
- ❖ The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate
- ❖ Whether the assistance of an auditor's expert is needed.

PHYSICAL VERIFICATION OF INVENTORIES

- + **Counting other than date of F/S:-** Perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements.
- + **Unable to attend PV due to Unforeseen Circumstances:-**The auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions.
- + **If attending PV becomes Impracticable**

- The Auditor shall perform Alternative Procedures to obtain S&A evidence w.r.t. Inventory
- If not possible, then he shall disclaim the report under SA 705 on the basis of limitation of Scope

✚ **If Inventory is in the possession of T.P.:-**Then, Auditor shall perform one or both of the following procedures:-

- Request Confirmation from Third Party as to quantities and condition of inventory
- Perform Audit Procedures

CONFIRMATION OF STOCK HELD BY THIRD PARTIES

Auditor shall perform one or both of the following procedure

- a) Request confirmation from third party (w.r.t quantities and conditions of inventory)
- b) Perform inspection or Audit procedures

ANALYTICAL REVIEW PROCEDURES

- 1) Comparison of CY closing stock with that of PY closing stock
- 2) Comparison of GPR of CY with that of gross profit ratio of PY
- 3) Comparison of actual fig with that of budgetary fig
- 4) Comparison of client's ratio with that of industry average ratios
- 5) Comparison of client's ratio with that of ratio of similar firms
- 6) Comparison of CY relationship of profit with sales with that of PY

ASSERTIONS

1. Existence
 - (a) Perform invest count
 - (b) Participate the Mgmt's check verification
 - (c) Confiscation form third party w.r.t. stock held by them.
2. Completeness
 - (a) Check inventory Register
 - (b) ARP
 - (c) + Stock held by third party - Stock held by held client of third party
 - (d) Check arithmetical accuracy.
3. Valuation
 - (a) Ensure valuation as per AS-2
 - (b) Examine method of valuation
 - FIFO
 - LIFO
 - Weighted Avg.
4. Rights
 - (a) Examine purchase invoice
 - (b) Check that goods have been kept as pledge
 - (c) Obtain confirmation from third party
5. Presentation & Disclosure
 - (a) Examine proper disclosure as per schedule III of CA. 2013

VERIFICATION OF WIP

- + Examine the cost records (cost sheets)
- + ascertain that cost sheets are attested by the works manager
- + test the corrections of cost by verification of Qty and cost of RM
- + compare with the unit cost with estimated cost
- + compare CY cost with that of PY
- + ensure proper disclosure as per schedule III in the B/S

GOODS SENT ON CONSIGNMENT

- 1) check the agreement formed between consignor and consignment to ensure rate of commission etc
- 2) check the performa invoice to examine the qualities and rate of goods
- 3) check whether insold goods are disclosed as closing stock
- 4) examine freight evidences (eg:- bill, challan etc)
- 5) confirmation from consignee
- 6) examination of accounting treatment by verifying journal entry

AUDIT OF PPEs

1. Existence
 - (a) Review clients plan for performing physical verification
 - (b) Attend PV conducted by management
 - (c) Obtain PPE verification Report
 - (d) Compare verification report with fixed asset Register
 - (e) Verify the discrepancies noted and manner of dealing
2. Completeness
 - (a) Ensure that all additions have been include
 - (b) Check that Assets sold have been excluded
 - (c) + asset of client held by T.P. held by client
 - (d) Ensure whether capital expenses have been included
 - (e) Check Arithmetical accuracy
3. Valuation
 - (a) Ensure proper valuation as per accounting principles
 - (b) Verify that entity has charged depreciation
 - (c) Method of Depreciation WDV/SLM
 - (d) Ensure that method & rate is consistent
 - (e) Check whether client has been impairment Assessment of PPE
4. Rights
 - (a) Movable Property check invoice
 - (b) Immovable Property check Tettle deed
 - (c) Verify Register of charges
 - (d) In case of pledge, communicate with T.P

5. Presentation & Disclosures

(a) Check Proper disclosure as per Schedule III of CA, 2013

BASIS	REVENUE	CAPITAL
MEANING	It is a routine expenditure incurred in the normal course of business	It is incurred in acquiring or improving permanent assets which are not meant for re-sale
PURPOSE	To maintain the earning capacity	To improve the earning capacity
NATURE	It is usually a recurring item	It is not a recurring item
PERIOD	It is consumed within an accounting year	It produces benefits for several years
TREATMENT IN INCOME STATEMENT	Entire amount is charged to income statement	Only a small part is charged as depreciation
EXAMPLE	a) salary b) cost of RM	a) purchase of land, building etc b) of revenue nature but done for higher productivity c) interest paid as per AS-16 before asset is constructed (borrowings cost) d) wages on installation of P&M e) wages/material on cost of building f) legal expense in purchase of L&B g) freight on P&M h) major repair

Audit of Intangible Assets

ASSERTIONS

EXISTENCE	COMPLETENESS	VALUATION	RIGHTS	PRESENTATION & DISCLOSURE
<p>✚ Since an intangible asset is an identifiable non-monetary asset, without physical substance, for establishing the existence of such assets, the auditor should verify whether such intangible asset is in active use in the production or supply of goods or services, for rental to others or for administrative</p>	<p>✚ Ensure that all additions have been include</p> <p>✚ Check that Assets sold have been excluded</p> <p>✚ Check Arithmetical accuracy</p> <p>✚ Ensure that no cost related to research (or from the research phase of an internal project) gets</p>	<p>✚ Verify that the entity has charged amortization on all intangible assets;</p> <p>✚ Verify that the amortization method used reflects the pattern in which the asset's future economic benefits are expected to</p>	<p>the auditor should also verify that all expense invoices/ purchase contracts are in the name of the entity that entitles legal title of ownership to the entity.</p>	<p>Whether all items of intangible assets have been classified as:</p> <p>e) Goodwill f) Brands/trademarks g) Computer software h) Mastheads and publishing titles i) Mining rights j) Copyrights, and patents and other intellectual property rights, services and operating rights</p>

<p>purposes. <i>Example- for verifying the existence of software, the auditor should verify whether such software is in active use by the entity and for the purpose, the auditor should verify the sale of related services/ goods during the period under audit, in which such software has been used.</i></p> <p><i>Example- For verifying the existence of design/ drawings, the auditor should verify the production data to establish if such products for which the design/ drawings were purchased, are being produced and sold by the entity.</i></p> <p>✚ In case any <u>intangible asset is not in active use, deletion should have been recorded</u> in the books of account post approvals by the entity's management and amortization charge should have ceased beyond the date of deletion.</p>	<p>recognized as intangible asset</p> <p>✚ Verify whether the additions (acquisitions) <u>have been approved by appropriate entity's personnel.</u></p>	<p>be consumed by the entity.</p> <p>✚ The auditor should also verify whether the <u>management has done an impairment assessment</u> to determine whether an intangible asset is impaired</p>	<p>k) Recipes, formulae, models, designs and prototypes</p> <p>l) Licenses and franchise</p> <p>m) Others (specify nature).</p>
---	--	---	---

AUDIT OF CASH & ITS EQUIVALENTS

1. Existence

- ✚ The cash should be **checked not only on the last day of the year, but also checked again sometime after the close of the year** without giving notice of the auditor's visit either to the entity or to his staff. (Surprise check)
- ✚ If there are more than one cash balances, e.g., when there is a cashier, a petty cashier, a branch cashier and, in addition, there are imprest balances with employees, **all of them should be checked simultaneously, as far as practicable** so that the shortage in one balance is not made good by transfer of amount from the others.
- ✚ It is desirable for the **cashier to be present while cash is being counted and he should be made to sign the statement prepared containing details of the cash balance** counted along with denomination of cash.. If he is absent at the time the cash is being verified, he may hold the auditor responsible for the shortage, if any, in cash.

2. Completeness

- ✚ If there is any rough Cash Book or details of daily balance are separately kept, the auditor should **test entries from the rough Cash Book with those in the Cash Book** to prove that entries in the Cash Book are correct.
- ✚ The auditor should also perform a **cash sensitivity analysis** by compiling a summary of total cash receipts and payments each month and analyzing the trends to see if there have been variations in any specific month and request brief descriptions from the management.
- ✚ The auditor needs to **obtain bank reconciliation statements (BRS)** for all bank accounts maintained by the entity as at the reporting period and additionally need to understand the client's process and periodicity of making the BRS.

3. Valuation

- ✚ In addition to the procedures performed above, the auditor should ensure that all bank accounts holding foreign currency have been restated at the closing exchange rates as per applicable Financial Reporting Framework.

4. Disclosure:-

- ✚ Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:

Cash and cash equivalents

(i) Cash and cash equivalents shall be classified as:

- a) Balances with banks;
- b) Cheques, drafts on hand;
- c) Cash on hand;
- d) Others (specify nature)

(ii) Earmarked balances with banks (for example, for unpaid dividend) shall **be separately stated.**

- (iii) Balances with banks to the extent **held as margin money or security against the borrowings**, guarantees, other commitments shall be disclosed separately.
- (iv) **Repatriation restrictions**, if any, in respect of cash and bank balances shall be separately stated.
- (v) Bank deposits with **more than 12 months' maturity** shall be disclosed separately.

DIRECT CONFIRMATION FROM BANK

- + A significant and important audit activity is to **contact banks/ financial institutions directly** and ask them to confirm the amounts held in current accounts, deposit accounts, cash credit accounts, restrictive use accounts like dividend, as of the end of the reporting period under audit. This should necessarily be done for all account balances as at the period- end.
- + The **Company should be asked to investigate and reconcile the discrepancies**, if any, including seeking written explanations/ clarifications from the banks/ financial institutions on any unresolved queries.
- + The auditor should emphasize for confirmation of 100% of bank account balances. In remote situations, **where no reply is received**, the auditor should perform additional testing regarding the balances. This testing could include:
 - ✓ **Agreeing the balance to bank statement** received by the Company or **internet/ online login to account** in auditor's personal presence;
 - ✓ **Sending the audit team member to the bank branch** along with the entity's personal to obtain balance confirmation from the bank directly.

Chapter 5

AUDIT OF FINANCIAL STATEMENT-II

AUDIT OF TRSANSACTIONS	
RECEIPTS	PAYMENTS
(a) Sales <ul style="list-style-type: none"> • Sales • Consignment sales • Sales on approval basis (b) Other Income <ul style="list-style-type: none"> • Rent received • Int. on FD • Dividend • Sale of Investments 	(a) Purchases (b) Other expenses <ul style="list-style-type: none"> ▪ Rent ▪ Employee Benefit expenses (salary, Gratuity , PF ▪ Power and fuel exp. ▪ Stationery & Printing exp. ▪ Adv. Expenses ▪ Legal & Prof. fees ▪ Travelling expenses ▪ Dep. & Amortisation exp

Vouching of Receipts

SALES

- ✚ Check the internal control system over sale of items (for eg:- proper recording, proper authorization)
- ✚ Ensure revenue is not overstated by performing following audit procedures:
 - Check whether a single sales invoice is recorded twice or a cancelled sales invoice could also be recorded.
 - Whether any fictitious customers and sales have been recorded.
 - Whether unearned revenue recorded as earned.
- ✚ In case of sale with related party, check compliance of Sec 188 of CA,2013 I.e., Board Resolution and ordinary resolution is passed
- ✚ Review sequence of sales invoices
- ✚ Review journal entries for unusual transactions
- ✚ Calculate the ratio of sales return to sales and compare it with previous year and enquire for the reasons for increase/ decrease (ARP)
- ✚ Perform cut-off procedures to ensure that revenues are recognised in the current accounting period and sales were not tampered towards the period end
- ✚ Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:
 - Whether disclosure of sales in respect of each class of goods has been made.
 - Whether revenue from operations is disclosed separately in the notes as revenue arising from:
 - ✓ Sale of products (including excise duty)
 - ✓ Sale of services
 - ✓ Other operating revenues.

GOODS SENT OUT ON SALE OR RETURN BASIS

- ✚ Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
- ✚ Verify that price of such goods is unloaded from the sales account and the trade receivables record. Check the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.
- ✚ Ensure that the goods in respect of which the period of approval has expired at the end of the year, have either been received back or customers' accounts have been debited.
- ✚ Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the end of the year lying with the party, has been included in the closing inventory.

RECEIPT OF CAPITAL SUBSIDY

- ✚ Check the application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.
- ✚ Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.
- ✚ Ensure that the conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.
- ✚ Check relevant entries for receipt of subsidy.
- ✚ Check compliance with requirements of AS 12 on "Accounting for Government Grants" i.e. whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements.

OTHER INCOME (INTEREST ON FD, DIVIDEND, SALE OF INVESTEMENTS)

- ✚ Any form of income earned by an entity which is not linked to the entity's core business operations is generally classified as other income. Examples – interest on excess funds parked in fixed deposits with banks (the entity not being a bank or financial institution), interest on loans given to third parties/ within the group, return on mutual fund investment etc.
- ✚ **Interest income on fixed deposits** is recognized on a time proportion basis taking into account the amount outstanding and the applicable interest rate
- ✚ **Dividends** are recognised in the statement of profit and loss only when:
 - ✓ the entity's right to receive payment of the dividend is established;
 - ✓ it is probable that the economic benefits associated with the dividend will flow to the entity; and
 - ✓ the amount of the dividend can be measured reliably.
- ✚ **Gain/(loss) on sale of investment in mutual funds** is recorded as other income on transfer of title from the entity and is determined as the difference between the redemption price and carrying value of the investments

INTEREST ON FIXED DEPOSITS

- ✚ Obtain a listing of fixed deposits opened during the period under audit along with the applicable interest rate and the number of days for which the deposit was outstanding during the period.
- ✚ Verify the arithmetical accuracy of the interest calculation made by the entity by recomputing i.e. multiplying the deposit amount with the applicable rate and number of days during the period under audit.
- ✚ For deposits still outstanding as at the period- end, trace the same to the direct confirmations obtained from

the respective bank/ financial institution.

- ✚ Obtain a confirmation of interest income from the bank and verify that the interest income as per bank reconciles to the calculation shared by the entity.
- ✚ Also, obtain a copy of Form 26AS (TDS withholding by the bank/financial institution) and reconcile the interest reflected therein with calculation of client

SALE OF SCRAP

- ✚ Review the internal control as regards generation, storage and disposal of scrap.
- ✚ Check whether the organization is maintaining reasonable record for generation of scrap.
- ✚ Analyze the raw material used, production and generation pattern of scrap and compare the same with figures of earlier year.
- ✚ Check the rates at which scrap has been sold and compare the rate with previous year.
- ✚ Vouch sales, with invoices raised, advertisement for tender, rate contract with scrap dealers.
- ✚ Ensure that there exists a proper control procedure to identify scrap and good units and they are not mixed up and sold as scrap
- ✚ Make an overall assessment of the value of realization from scrap as to its reasonableness.

Vouching of Payments

PURCHASES

- ✚ An auditor needs to identify the control points over purchases e.g. whether segregation of duties exist, whether competitive quotes are invited, whether a purchase committee exists who authorises purchase price, issues and authorizes purchase orders.
- ✚ An auditor tests the controls the entity has set up for the purchase cycle to determine whether they are effective or not. If the controls are effective, the auditor can reduce the extent of substantive testing.
- ✚ Purchase invoice should be in the name of entity. However, in case of different branches, it should be addressed to the appropriate branch.
- ✚ In case of purchases made from related parties or allied and associated concerns, the auditor needs to verify if requisite approval from Board of Directors (appropriate authority) has been obtained
- ✚ The auditor should review whether purchases should be capitalized or expensed off in Statement of Profit and loss according to his professional judgement.
- ✚ Review journal entries for unusual transactions.
- ✚ Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:
 - Whether purchases of stock-in-trade have been specifically disclosed
 - Whether changes in inventories of finished goods, stock-in-trade and work- in-progress have been specifically disclosed.
 - Whether the transactions with related parties are appropriately disclosed in notes to accounts.

EMPLOYEE BENEFIT EXPENSES

- ✚ Obtain an understanding of entity's process of capturing employee attendance
- ✚ Further, the auditor may choose to select a sample of employees and ask the payroll department to share their bank details/ identity proofs of the employees

- + Obtain a list of employees as at the period- end
- + For a sample (selected randomly) of new hires, obtain the appointment letter and verify whether the salary for first month and subsequent months was processed as per the agreed terms.
- + For a sample (selected randomly) of resigned employees, obtain their full and final computation and verify whether all their dues including post-retirement benefits like gratuity, leave encashment have been paid and whether the respective employee's acknowledgement on final computation has been obtained
- + Obtain the monthly salary registers for all 12 months. Compile a monthly payroll reasonability by calculating the average salary per employee per month and compare with the previous year and preceding month and analyse the reasons for variance
- + Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made: Whether employee benefit expense has been classified as:
 - Salaries and wages.
 - Contributions to provident and other funds.
 - Staff welfare expenses.

DEPRECIATION AND AMORTISATION EXPENSES

- + Obtain an understanding of the accounting Policies of the client.
- + Ensure that the Company policies for charging depreciation is as per the Companies Act/Accounting Standards.
- + Check whether depreciation and amortization charges are valid.
- + Check that depreciation and amortization charges are properly calculated and recorded.
- + Check whether depreciation and amortization charges are recorded in the proper period
- + Ensure that components of property, P&E that are to be depreciated separately have been identified.
- + Check whether the most appropriate method of depreciation has been used for each component.

COMMON ATTRIBUTES FOR MISC. EXPENSES

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

INSURANCE

- + Obtain and study Insurance Policy to examine the terms of insurance
- + Check Proper computation of premium as Provided in the Policy
- + Examine Proper communication between client and Insurance company
- + In case of expiry of Insurance Policy, check whether it is renewed or not
- + Check entry in the Pass Book
- + Check entry in Nominal A/c

COMMON ATTRIBUTES FOR MISC. EXPENSES

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

LEGAL AND PROFESSIONAL FEES

- ✚ Obtain a month-wise and consultant-wise summary.
- ✚ In case of monthly retainerhip agreements, verify whether 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

RENT PAID EXPENSES

- ✚ Obtain a month wise expense schedule along with the rent agreements.
- ✚ Verify if expense has been recorded for all 12 months and whether the rent amount is as per the underlying agreement.
- ✚ Specific consideration should be given to escalation clause in the agreement to verify if the rent was required to be recorded on a straight- line basis during the period under audit.
- ✚ Also, verify if the agreement is in the name of the entity and whether the expense pertains to premises used for running business operations of the entity.

TRAVELLING, REPAIR & MAINTENANCE, PRINTING & STATIONARY EXPENSES

- ✚ The auditor should select a sample and vouch for the attributes discussed above. Wherever possible, the auditor should try to prepare a summary of expenditure on monthly basis and then analytically compare the trends.
- ✚ Perform analytical procedures to obtain audit evidence as to overall reasonableness of other expense which may include **expenditure per unit of production analysis**.
- ✚ Auditor should analyse expense per unit produced and compare the same with previous years and prevent industry trends and ask for the reasons from the management, if any significant variations are found.

FOREIGN TRAVEL EXPENSES

- ✚ Examine Travelling Allowance bills submitted by the employees stating the details of tour, details of expenses, etc.
- ✚ Verify that the tour programme was properly authorised by the competent authority.
- ✚ Check the T.A. bills along with accompanying supporting documents such as air tickets, travel agents bill and hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.
- ✚ See that the tour report accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the purpose of the tour as shown by the tour report conforms to the authorisation for the tour.
- ✚ Check Reserve Bank of India's permission, if necessary, for withdrawing the foreign exchange. For a company the amount of foreign exchange spent is to be disclosed separately in the accounts as per requirement of Schedule III to the Companies Act, 2013 and Accounting Standard 11 "The Effects of Changes in Foreign Exchange Rates".

ADVERTISEMENT EXPENSES

- + See that the advertisement relates to client's business.
- + Inspect the receipt issued by the agency.
- + Ascertain the nature of expenditure – revenue or capital expenditure and see that it has been recorded properly.
- + Ascertain the period for which payment is made and see that prepaid amount, if any, is carried to the balance sheet.
- + See that all outstanding advertisement bills have been provided for.

Chapter

6

AUDIT OF VARIOUS ENTITIES

AUDIT OF LOCAL BODIES

Objective of Audit of Local Bodies

The important objectives of audit are:

- (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.

Audit Procedure

- a. 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.**
- b. 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; whether value is being fully received on money spent. His objective should be to detect errors and fraud and misuse of resources.
- c. 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.
- d. He should ensure that **all types of sanctions,** either special or general, accorded by the competent authority.
- e. 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.
- f. 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.**

Types of Grants

Local bodies may receive different types of grants from the state administration as well. Broadly, the revenue grants are of three categories:

(a) General purpose grants: These are primarily intended to substantially bridge the gap between the needs and resources of the local bodies.

(b) Specific purpose grants: These grants which are tied to the provision of certain services or performance of certain tasks.

(c) Statutory and compensatory grants: These grants, under various enactments, are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state government from local government.

AUDIT OF NGO

✚ **While planning the audit,** the auditor may concentrate on the following:

1. Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operate.
2. Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 1976, Societies Registration Act, 1860, Income Tax Act 1961 etc. and the Rules related to the statutes.
3. Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.
4. Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
5. Examination of minutes of the Board/Managing Committee/Governing Body/ Management and Committees thereof to ascertain the impact of any decisions on the financial records.
6. Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
7. Setting of materiality levels for audit purposes.
8. The nature and timing of reports or other communications.
9. The involvement of experts and their reports.
10. Review the previous year's Audit Report.

✚ The receipt of income of NGO may be checked on the following lines:

1. **Contributions and Grants for projects and programmes:** Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976.
2. **Receipts from fund raising programmes:** Verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.
3. **Membership Fees:** Check fees received with Membership Register. Ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.
4. **Subscriptions:** Check with subscription register and receipts issued. Reconcile subscription received

with printing and dispatch of corresponding magazine / circulars / periodicals. Check the receipts with subscription rate schedule.

5. **Interest and Dividends:** Check the interest and dividends received and receivable with investments held during the year.

AUDIT OF LLP

✚ **Appointment of Auditor:** The auditor may be appointed by the designated partners of the LLP –

- At any time for the first financial year but before the end of first financial year,
- At least thirty days prior to the end of each financial year (other than the first financial year),
- To fill the causal vacancy in the office of auditor,
- To fill the casual vacancy caused by removal of auditor.

The partners may appoint the auditors if the designated partners have failed to appoint them

✚ **Audit of the Accounts of an LLP :-** LLP, whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty five lakh rupees, is not required to get its accounts audited.

However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rule.

✚ **Books of Accounts by LLP:-** LLP's are required to maintain books of accounts which shall contain-

1. Particulars of all sums of money received and expended by the LLP and the matters in respect of which the receipt and expenditure takes place,
2. A record of the assets and liabilities of the LLP,
3. Statements of costs of goods purchased, inventories, work-in-progress, finished goods and costs of goods sold,
4. Any other particulars which the partners may decide.

❖ **Returns to be maintained and filed by an LLP :-**

- Every LLP would be required to file annual return in Form 11 with ROC within 60 days of closer of financial year. The annual return will be available for public inspection on payment of prescribed fees to Registrar.
- Every LLP is also required to submit Statement of Account and Solvency in Form 8 which shall be filed within a period of thirty days from the end of six months the financial year to which the Statement of Account and Solvency relates.

❖ **Auditor's Duty:-**Regarding Audit of LLP

1. The auditor should get **definite instructions in writing** as to the work to be performed by him.

2. The auditor **should mention**

- (a) Whether the records of the firm appear to be correct & reliable.
- (b) Whether he was able to obtain all information & explanation necessary for his work.
- (c) Whether any restriction was imposed upon him.

3. The auditor should **read the LLP agreement** & note the following provisions

- (a) Nature of the business of the LLP.

- (b) Amount of capital contributed by each partner.
- (c) Interest – in respect of additional capital contributed.
- (d) Duration of partnership.
- (e) Drawings allowed to the partners.
- (f) Salaries, commission etc payable to partners.
- (g) Borrowing powers of the LLP.
- (h) Rights & duties of partners.
- (i) Method of settlement of accounts between partners at the time of admission, retirement, admission etc.
- (j) Any loans advanced by the partners.
- (k) Profit sharing ratio

4. If partners maintain **minute book he shall refer it for any resolution passed** regarding the accounts

AUDIT OF FIRM

✚ **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:

- ❖ The name and style under which the business shall be conducted.
- ❖ The duration of the partnership, if any, that has been agreed upon.
- ❖ The amount of capital that shall be contributed by each partner—whether it will be fixed or could be varied from year to year.
- ❖ Borrowing capacity of the partnership (when it is not implied as in the case of non-trading firms).
- ❖ The rate at which interest will be allowed on the capitals and loans provided by partners and the rate at which it will be charged on their drawings and current accounts.
- ❖ Whether any salaries are payable to the partners or withdrawals are permitted against shares of profits and, if so, to what extent?
- ❖ Duties of the partners as regards the management of business of the firm; also, the partners who shall act as managing partners.
- ❖ Who shall operate the bank account of the firm? How will the surplus funds of the partnership be invested?

✚ **Matters which should be specially considered in the audit of accounts of a partnership:**

1. Confirming that the **letter of appointment, signed by a partner, duly authorised**, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.
2. **Studying the minute book, if any, maintained** to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans; purchase of assets, extraordinary contracts entered into and other such matters as are not of a routine nature.
3. Verifying that the **business in which the partnership is engaged is authorised by the partnership agreement**; or by any extension or modification thereof agreed to subsequently.
4. Examining whether **books of account appear to be reasonable** and are considered adequate in relation to the nature of the business of the partnership.
5. Verifying generally that the interest of **no partner has suffered** prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any

violation of a provision in the partnership agreements.

6. Confirming that a **provision for the firm's tax payable** by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners.
7. Verifying that the **profits and losses have been divided** among the partners in their agreed profit-sharing ratio.

AUDIT OF LEASING COMPANIES

In respect of leasing transaction entered into by the leasing company, the following procedures may be adopted by the auditor:

- (1) **The object clause of leasing company** to see that the goods like capital goods, consumer durables etc. in respect of which the company can undertake such activities. Further, to ensure that whether company can undertake financing activities or not.
- (2) Whether there exists a **procedure to ascertain the credit analysis of lessee** like lessee's ability to meet the commitment under lease, past credit record, capital strength, availability of collateral security, etc.
- (3) **The lease agreement should be examined** and the following points may be noted:
 - (i) the description of the lessor, the lessee, the equipment and the location where the equipment is to be installed. (The stipulation that the equipment shall not be removed from the described location except for repairs. For the sake of identification, the lessor may also require plates or markings to be attached to the equipment).
 - (ii) the amount of tenure of lease, dates of payment, late charges, deposits or advances etc. should be noted.
 - (iii) whether the equipment shall be returned to the lessor on termination of the agreement and the cost shall be borne by the lessee.
 - (iv) whether the agreement prohibits the lessee from assigning the subletting the equipment and authorises the lessor to do so.
- (4) Examine the **lease proposal form submitted by the lessee** requesting the lessor to provide him the equipment on lease.
- (5) Ensure that **the invoice is retained safely** as the lease is a long-term contract.
- (6) Examine the **acceptance letter obtained from the lessee** indicating that the equipment has been received in order and is acceptable to the lessee.
- (7) See the **Board resolution authorising a particular director to execute the lease agreement** has been passed by the lessee.
- (8) See that the **copies of the insurance policies** have been obtained by the lessor for his records.

AUDIT OF HIRE-PURCHASE COMPANIES

While checking the hire- purchase transaction, the auditor may examine the following:

1. Hire purchase agreement is in writing and is signed by all parties.
2. Hire purchase agreement specifies clearly-

- a) The hire-purchase price of the goods to which the agreement relates;
 - b) The cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash;
 - c) The date on which the agreement shall be deemed to have commenced;
 - d) The number of instalments by which the hire- purchase price is to be paid, the amount of each of those instalments, and the date, or the mode of determining the date, upon which it is payable, and the person to whom and the place where it is payable; and
 - e) The goods to which the agreement relates, in a manner sufficient to identify them.
3. Ensure that instalment payments are being received regularly as per the agreement.

AUDIT OF EDUCATIONAL INSTITUTION

1. **Examine the Trust Deed or Regulations**, in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulation framed thereunder
2. **Read through the minutes of the meetings** of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
3. **Check names entered in the Students Fee Register** for each month or term, with the respective Class Registers, showing names of students on rolls and test amount of fees charged;
4. **Check fees received by comparing counterfoils of receipts** granted with entries in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
5. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in **advance have been carried forward and that the arrears that are irrecoverable have been written off** under the sanction of an appropriate authority.
6. **Check admission fees with admission slips signed by the head of the institution** and confirm that the amount has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
7. See that **free studentship and concessions have been granted by a person authorised to do so**, having regard to the Rules prepared by the Managing Committee.
8. Confirm that **finances for late payment or absence, etc. have been either collected** or remitted under proper authority.
9. Confirm that hostel dues were recovered before student's accounts were closed and their **deposits of caution money refunded**.
10. **Verify rental income** from landed property with the rent rolls, etc.
11. **Vouch income from interest and dividends** from investment; also inspect the securities in respect of

investments held.

12. Verify any **Government or local authority grant with the memo of grant**. If any expense has been disallowed for purposes of grant, ascertain the reasons thereof.
13. **Report any old heavy arrears** on account of fees, dormitory rents, etc. to the Managing Committee.
14. Confirm that **caution money and other deposits paid by students on admission, have been shown as liability in the balance sheet** not transferred to revenue, unless they are not refundable.
15. Vouch donations, if any with the list published with the annual report. If **some donations were meant for any specific purpose, see that the money was utilised for the purpose**.

AUDIT OF HOSPITAL

1. **Register of Patients:** Vouch the **Register of patients with copies of bills** issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared.
2. **Collection of Cash:** **Check cash collections as entered in the Cash Book with the receipts, counterfoils** and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
3. **Income from Investments, Rent etc:** See by reference to the property **and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities** have been collected.
4. **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose **have been applied in the manner** agreed upon.
5. **Authorisation and Sanctions:** Vouch all purchases and expenses and verify that the **capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee** and that appointments and increments to staff have been duly authorised.
6. **Grants:-** Verify that grants, if any, received from Government or local authority has been **duly accounted for**.
7. **Budgets:** **Compare the totals of various items of expenditure and income with the amount budgeted for them** and report to the Trustees or the Managing Committee, significant variations which have taken place.
8. **Depreciation:** See that depreciation has been **written off against all the assets at the appropriate rates**.
9. **Registers:** **Inspect the bonds, share scrips, title deeds of properties** and compare their particulars with those entered in the property and Investment Registers.
10. **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and **check a percentage of the items physically; also compare their total values** with respective ledger balances.

AUDIT OF CINEMA HALL

The special steps involved in its audit are stated below-

(1) Verify the internal control mechanism-

- i. that entrance to the cinema-hall during show is only through printed tickets;
- ii. that they are serially numbered and bound into books;
- iii. that the number of tickets issued for each show and class, are different though the numbers of the same class for the show on the same day, each week, run serially;
- iv. that for advance booking a separate series of tickets is issued; and
- v. that the inventory of tickets is kept in the custody of a responsible
- vi. official.

(2) Confirm that at the end of show, a **statement of tickets sold is prepared** and cash collected is agreed with it.

(3) Verify that a **record is kept of the 'free passes' and that these are issued under proper authority.**

(4) **Reconcile the amount of Entertainment Tax collected** with the total number of tickets issued for each class and vouch and verify the entertainment tax returns filed each month.

(5) **Vouch the entries in the Cash Book in respect of cash collected on sale of tickets** for different shows on a reference to Daily Statements which have been test checked as aforementioned with record of tickets issued for the different shows held.

(6) **Verify the charges collected for advertisement slides and shorts** by reference to the Register of Slides and Shorts Exhibited kept at the cinema **as well with the agreements, entered into with advertisers** in this regard.

(7) Vouch the expenditure incurred on advertisement, repairs and maintenance. **No part of such expenditure should be capitalized.**

(8) Confirm that **depreciation on machinery and furniture has been charged** at an appropriate rate.

(9) Vouch payments on account of **film hire with bills of distributors and in the process, the agreements** concerned should be referred to.

(10) Examine **unadjusted balance out of advance paid to the distributors against film hire contracts to see that they are good and recoverable.** If any film in respect of which an advance was paid has already run, it should be enquired as to why the advance has not been adjusted. The management should be asked to make a provision in respect of advances that are considered irrecoverable.

AUDIT OF CLUB

1. Vouch the **receipt on account of entrance fees with members' applications, counterfoils issued** to them, as well as on a reference to minutes of the Managing Committee.
2. Vouch **members' subscriptions with the counterfoils of receipt issued to them,** trace receipts for a selected period to the Register of Members; also reconcile the amount of total subscriptions due with the amount collected and that outstanding.

3. Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
4. **Check totals** of various columns of the Register of members and tally them across.
5. **See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery**; the amount considered irrecoverable should be mentioned in the Audit Report.
6. **Vouch purchase of sports items, furniture, crockery, etc.** and trace their entries into the respective inventory registers.
7. **Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale price so as to confirm that the normal rates of gross profit have been earned on their sales**. The inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.
8. **Check the inventory of furniture, sports material and other assets physically** with the respective inventory registers or inventories prepared at the end of the year.

AUDIT OF HOTEL

The special considerations in a hotel audit can be summarised as follows:

(1) Internal Controls -

- a) It is the **responsibility of management** to introduce controls which will minimise the leakage as far as possible.
- b) Evidence of their success is provided by the **preparation of regular perhaps weekly, trading accounts for each sales point** and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being investigated.
- c) The **auditor should obtain these regular trading accounts for the period under review**, examine them and obtain explanations for any apparent deviations.
- d) If the **internal control in a hotel is weak or perhaps breaks down, then a very serious problem exists for the auditor**. As a result of the transient nature of many of his clients' records, the auditor must rely to a very large extent on the gross margin shown by the accounts. As a result, the scope of his audit tests will necessarily be increased and, in the event of a material margin discrepancy being unexplained, he will have to consider qualifying his audit report.

(2) Room Sales:-

- a) The source of these entries is invariably **the guest register** and audit tests should be carried out to ensure that the correct numbers of guests are charged for the correct period.
- b) Any **difference between the charged rates used on the guests' bills and the standard room rate** should be investigated to ensure that they have been properly authorised.
- c) In many hotels, the **housekeeper prepares a daily report of the rooms which were occupied** the previous night and the number of beds kept in each room. This report tends not to be permanently retained and the auditor should ensure that a sufficient number of reports are available for him to test both with the guest register and with the individual guest's bill.

(3) Inventories:-

- a) The inventories in any hotel are both readily portable and saleable particularly **the food and beverage inventories.**
- b) It is therefore extremely important that **all movements and transfers of such inventories should be properly documented** to enable control to be exercised over each individual stores areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed.
- c) **Areas where large quantities of inventory are held should be kept locked, the key being retained by the departmental manager.** The key should be released only to trusted personnel and unauthorised persons should not be permitted in the stores areas except under constant supervision.
- d) Many hotels use specialised professional valuers to take and value the inventories on a continuous basis throughout the year. Such a valuation is then almost invariably used as the basis of the balance sheet inventory figure at the year end. Although such valuers are independent of the audit client, it is important that the **auditor satisfies himself that the amounts included for such inventories are reasonable.**
- e) In order to satisfy himself of this, the **auditor should consider attending the physical inventory** taking and carrying out certain pricing and calculation tests. The extent of such tests could well be limited since the figures will have been prepared independently of the hotel.

(5) Casual Labour:-

- a) The hotel trade operates to very large extent on casual labour. The records maintained of such wage payments are frequently inadequate.
- b) The auditor should ensure that defalcation on this account does not take place by suggesting proper controls to the management.

(6) Other points -

- a) For ledgers coming through travel agents or other booking agencies the bills are usually made on the travel agents or booking agencies. The auditor should ensure that **money are recovered from the travel agents or booking agencies as per the terms of credit allowed.**
- b) **Commission, if any, paid to travel agents or booking agents should be checked by reference to the agreement** on that behalf.
- c) The auditor should ensure that **proper records re-maintained for booking of halls** and other premises for special parties and recovered on the basis of the tariff.
- d) The auditor should see that costs of repairs and minor renovation and redecoration are treated as revenue expenditure, where as **costs of major alterations and additions to the hotel building and facilities capitalised.**
- e) The auditor should satisfy himself that all **taxes collected from occupants on food and occupation have been paid over to the proper authorities.**

AUDIT OF CHARITABLE ORGANISATION**General**

1. Studying the constitution under which the charitable institution has been set up.
2. Verifying whether the institution is being managed in the manner contemplated by the law under which it has been set up.
3. Examining the system of internal check, especially as regards accounting of amounts collected.
4. Verifying in detail the income and confirming that the amounts received have been deposited in the

bank regularly and promptly.

5. Examine the Trust Deed or the Regulations as laid down.

Subscriptions

1. Ascertaining, if any, the changes made in amount of annual or life membership subscription during the year.
2. Whether official receipts are issued;
 - a) confirming that adequate control is imposed over unused receipt books;
 - b) obtaining all receipt books covering the period under review;
 - c) test checking the counterfoils with the cash book; any cancelled receipts being specially looked into;
 - d) obtaining the printed list of subscriptions and donations and agreeing them with the total collections shown in the accounts;
 - e) examining the system of internal check regarding moneys received from box collections, flag days, etc. and checking the amount received from representatives, with the correspondence and the official receipts issued; paying special attention to the system of control exercised over collections and the steps taken to ensure that all collections made have been accounted for; and
 - f) verifying the total subscriptions and donations received with any figures published in reports, etc. issued by the charity.

Expenditure

1. Vouching payment of grants, also verifying that the grants have been paid only for a charitable purpose or purposes falling within the purview of the objects for which the charitable institution has been set up and that no trustee, director or member of the Managing Committee has benefited there from either directly or indirectly.
2. Verifying the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test- basis.
3. Verifying the cash and bank payments.
4. Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.

Chapter
7GOVERNMENT
AUDIT

Government Audit

Meaning (as per UN Handbook on Government Audit)

The President of India shall appoint CAG

Objectives

- + He can be removed from the office only on the ground of proven misbehavior or incapacity.
- + Moreover, he can be removed from office only when each house of parliament decides to do so by a majority of at least two third of members present and voting.
- + He can resign any time through a resignation letter addressed to the President of India.

C&AG

Appointment

The President of India shall appoint CAG

Removal or Resignation

- + He can be removed from the office only on the ground of proven misbehavior or incapacity.
- + Moreover, he can be removed from office only when each house of parliament decides to do so by a majority of at least two third of members present and voting.
- + He can resign any time through a resignation letter addressed to the President of India.

Remuneration

- + He shall be paid a salary equivalent to that of a Judge of the Supreme Court.
- + The parliament is competent to make laws to determine salary and other conditions of service.

Term

- ✚ He shall hold office for six years or up to age of 65 years, whichever is earlier.

Duties of Comptroller and Auditor General of India

- ✚ **Compile and submit accounts:**-He shall compile the accounts of the Union / State / Union Territory and submit those accounts to the President / Governor / Administrator respectively

- ✚ **To audit receipts and expenditure:**-He shall audit all receipts and expenditure of any body, which has been substantially financed from the Consolidated Fund of India/State/Union Territory.

Note: A body or authority shall be treated as substantially financed if the amount of grant or loan in one year is greater than;

- Rs. 25 lakhs, and
- 75% of the total expenditure of that body or authority

- ✚ **To audit grants and loans:**-He shall audit specific purpose loan or grant given to any body other than a foreign state or international organization, out of true Consolidated Fund of India/ State/Union Territory.

- ✚ **To audit receipts of union or states:**-He shall audit all receipts payable in to the Consolidated Fund of India/ State/Union Territory.

- ✚ **To audit accounts of stores and stock:**-He shall audit the accounts of stores and stock kept in any or office department of the union or state.

- ✚ **To audit accounts of Government Companies and Corporations:**-CAG shall exercise powers and observe duties as per the provisions of the Companies Act, 1956 in relation to the Government Companies or Corporations.

- ✚ **To audit and report:**-CAG shall audit and report:
 - All expenditure from Consolidated Fund of India/ State/ Union Territory.
 - All transactions of Union State relating to the 'Contingency' Funds and Public accounts.
 - All Trading, Manufacturing, Profit and Loss account and Balance Sheet and other subsidiary accounts kept in any department of Union / State.

Powers of Comptroller and Auditor General of India

- ✚ He can inspect any office of accounts under the control of the Union or State Government.
- ✚ He may require that any accounts, books, papers and other documents, which are relevant to the

transactions under audit, be sent to specified places.

+ He can put such questions, as he may consider necessary, to the person in charge.

+ He can call for such information as he may require for the preparation of any account or report.

+ **Supplementary Audit**

- CAG may comment upon or supplement the report submitted by the professional auditor.
- CAG may issue directives to the auditors in regard to the performance of their function.
- He can also authorise any person for conducting supplementary audit of the CO.
- Person so authorized may well be the auditor of the company.
- The form and content of supplementary audit report may be specified by CAG.
- Supplementary Auditor may concentrate more on efficiency aspects.
- The person so authorized is having same powers as auditor.
- However, the directors are not required to comment on any adverse remark contained in the supplementary audit report.

+ **Submission of Accounts:-** He shall submit his report relating to the accounts of the Union or States to the President / Governor who will subsequently lay them before the Parliament / State Legislature.

EXPENDITURE AUDIT

The auditor examines the fulfilment of conditions for incurring government expenditure. It involves examination of following:

+ **Audit of rules and orders:-** Its objective is to ensure whether the expenditure is in accordance with:

- relevant provisions of the Constitution and of the laws and rules.
- the rules, regulations issued by CAG.
- the orders of, or rules made by, any higher authority.

+ **Audit of sanctions:-** Its objective is to ensure whether the expenditure is:

- Properly covered by a sanction, either general or special.
- Sanctioned by authority, which is authorized to do so.

+ **Audit against provision of funds:-** Its objective is to ensure whether the expenditure:

- Is made for the purpose to which the grant and appropriation has been provided.
- Does not exceed the appropriation made.

+ **Propriety audit:-** According to propriety audit, the auditor examines the cases of improper or wasteful expenditure even though the expenditure has been incurred as per the existing rules and regulations.

+ **Performance audit:-** Here, auditor tries to ensure that government programmes have achieved the desired objectives at the lowest cost and given the intended benefits.

PROPRIETY AUDIT

+ According to propriety audit, the auditor examines the cases of improper or wasteful expenditure

even though the expenditure has been incurred as per the existing rules and regulations.

- ✚ A transaction may satisfy all the requirements of regular audit, but may still be highly wasteful. *For e.g. a building may be constructed for running a school but may not be used for the same purpose, resulting in wasteful expenditure.*
- ✚ Auditor should try to examine public financial morality by looking in to the wisdom, faithfulness and economy of transactions.
- ✚ No hard and fast rules can be laid down regarding the standards of financial propriety.
- ✚ Here, the auditor should examine that:
 - The authorities have made the expenditure with same degree of vigilance, as a person of ordinary prudence would exercise in respect of his own money.
 - The expenditure is not prima facie more than the occasion demands.
 - No authority exercises its power of sanctioning expenditure to pass an order, which will directly or indirectly accrue to its own advantage.
 - Public money is not utilised for the benefit of a particular person / section of the community.

PERFORMANCE AUDIT

- ✚ Here, auditor tries to ensure that government programmes have achieved the desired objectives at the lowest cost and given the intended benefits.
- ✚ Performance audit includes efficiency, economy and effectiveness audit.
- ✚ Performance audit is an objective examination of the financial and operational performance. It seeks to identify opportunities for greater economy and effectiveness.
- ✚ **Efficiency audit:**-It examines whether:
 - The various schemes/projects are executed, and
 - Their operations are carried out in efficient manner, and
 - They are yielding the expected results.
- ✚ **Economy audit:**-It examines whether:
 - The government has acquired the financial, human and physical resources in an economical manner, and
 - The sanctioning and spending authority have observed economy.
- ✚ **Effectiveness audit:**-It examines whether:

- Programmes and projects are performing well.
- Overall targeted objectives are being achieved.

AUDIT OF STORES AND STOCK

- + Auditor should ascertain whether the internal controls over purchase, receipt, and issue of stores are well designed and properly carried out during the year.
- + He should bring to the notice of the government any deficiencies in the system of control
- + The audit of purchase of stores is conducted in the same manner as audit of expenditure.
- + The auditor has to ensure that the prices paid are reasonable.
- + Cases of uneconomical purchase of stores and losses due to defective or inferior quality of stores are specifically examined.
- + The certificates of quality and quantity given by expert should be examined.
- + Accounts of receipts, issues and balances are checked regarding accuracy, correctness and reasonableness of balances in stocks.
- + Any excess or idle stocks should be specifically mentioned in the report.
- + Auditor should ensure their existence by attending physical verification of stock.
- + The valuation of the stocks is also examined properly

AUDIT OF RECEIPTS

- + The government audit also covers receipts payable in to the Consolidated Fund of India and of each State / Union Territory. The auditor examines whether :-
 - Internal checks are imposed for prompt detection and investigation of irregularities.
 - Internal procedures adequately ensure proper accounting of demands collection.
 - There is effective check on assessment, collection and proper allocation of revenue.
 - Such regulations and procedures are actually being carried out.
 - All revenues have been correctly assessed, realized and credited to the government account.
 - There is no leakage of revenue.

AUDIT OF COMMERCIAL ACCOUNTS

Public enterprises are required to maintain commercial accounts and are generally classified under three categories—

- + **departmental enterprises** engaged in commercial and trading operations, which are subject to the same laws, financial and other regulations as other government departments and agencies;
- + **statutory bodies, corporations**, created by specific statutes mostly financed by government in the form of loans, grants, etc.; and
- + **government companies** set up under the Companies Act, 2013.

The audit of :-

- + **departmental concerns** is undertaken in the same manner as any department of government where commercial accounts are kept.
- + **statutory bodies or corporations** depends on the nature and type of the statute governing the bodies or corporations. Both financial and accounts audit are conducted by the C&AG, and where compilation

of accounts is vested with the C&AG, functions, norms and standards of works usually followed by the professional auditors are adopted mutatis mutandis.

✚ **Government companies** is conducted by their own auditors under the statute appointed by C&AG. In addition, the C&AG conducts a supplementary test audit of the accounts, as well as periodical financial audit and appraisal of performance. The C&AG also issues direction to the company auditors for reporting on specific aspects of their audit work. These are reviewed, and condensed in the audit reports to the government/legislatures. C&AG has adopted the mechanism of an Audit Board- comprising of representatives of the audit and nominees of government including functional specialists to process reviews or appraisals on performance.

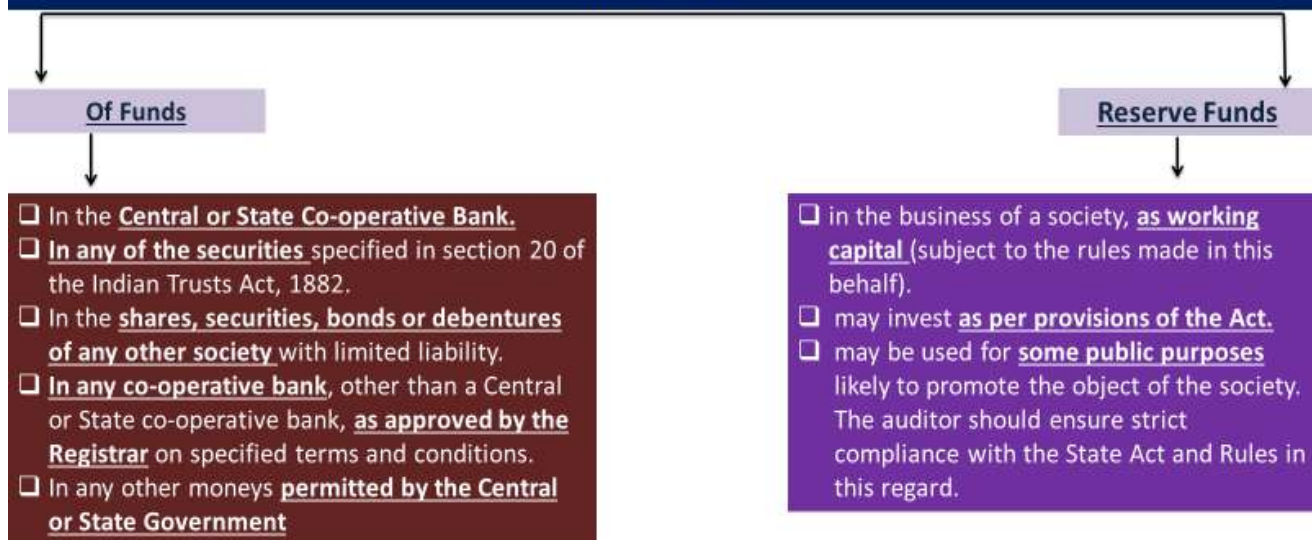
Chapter 8

AUDIT OF CO-OPERATIVE SOCIETIES

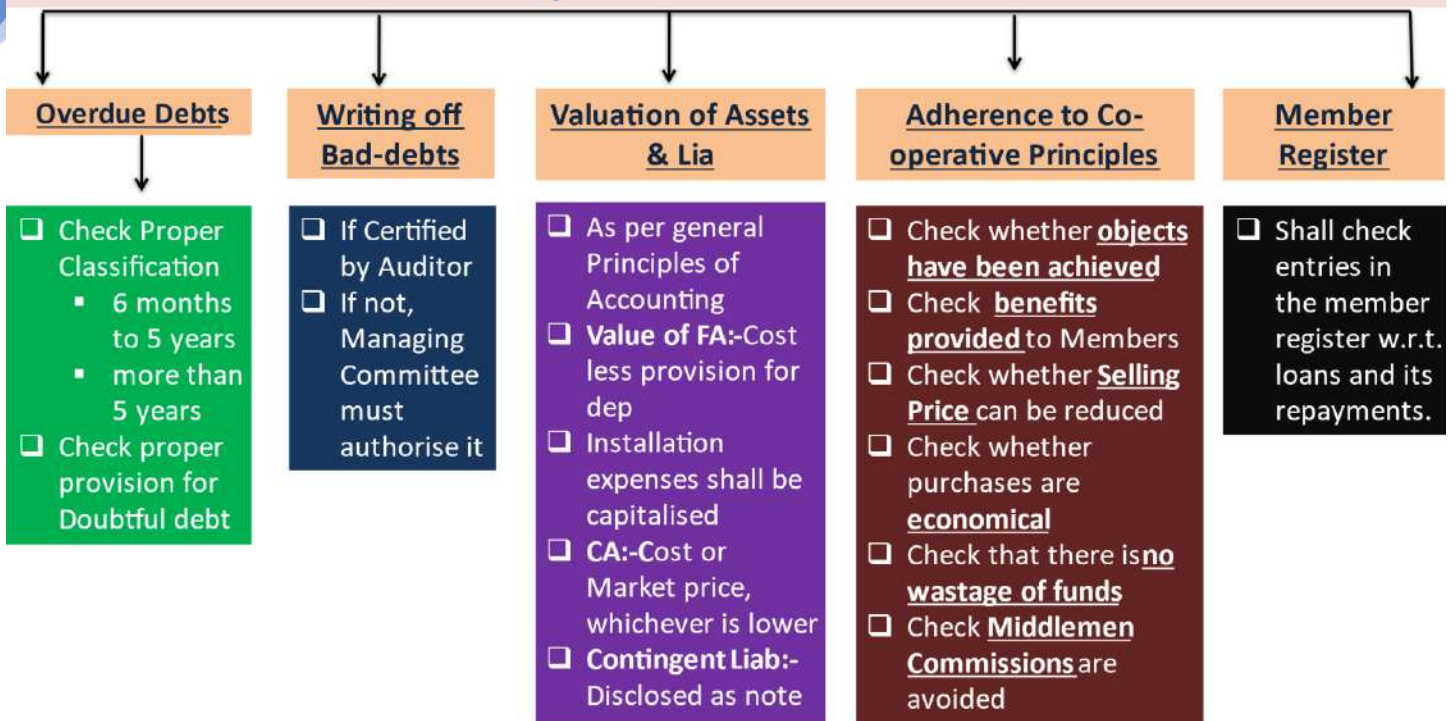
Audit as Per Section 17



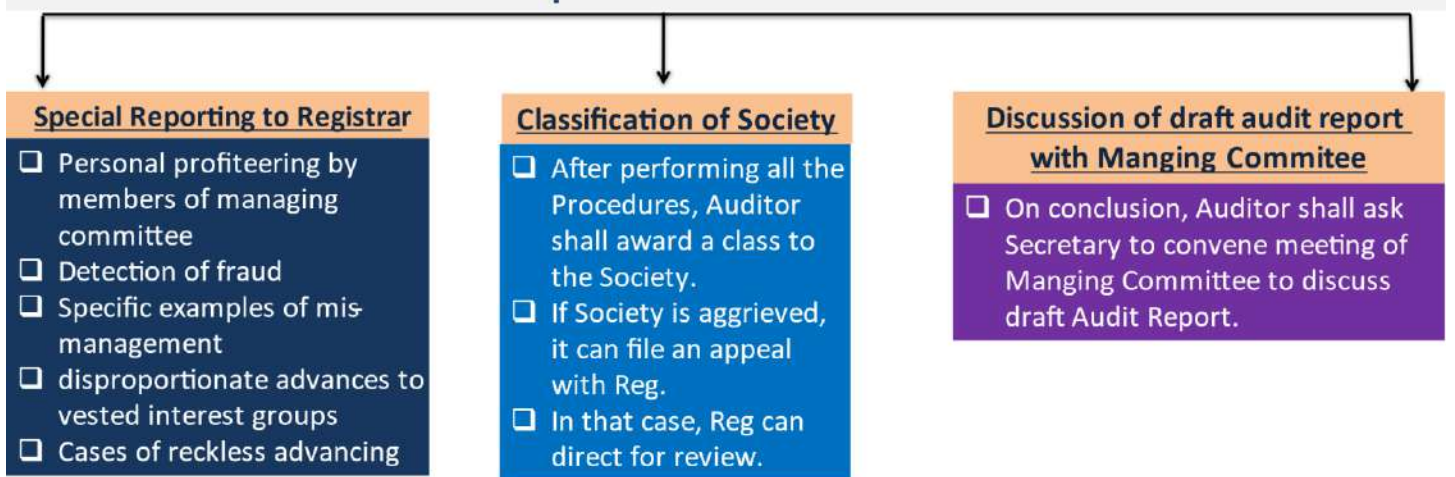
Investment



Special Features of Audit



Special Features of Audit



Content of Audit Report

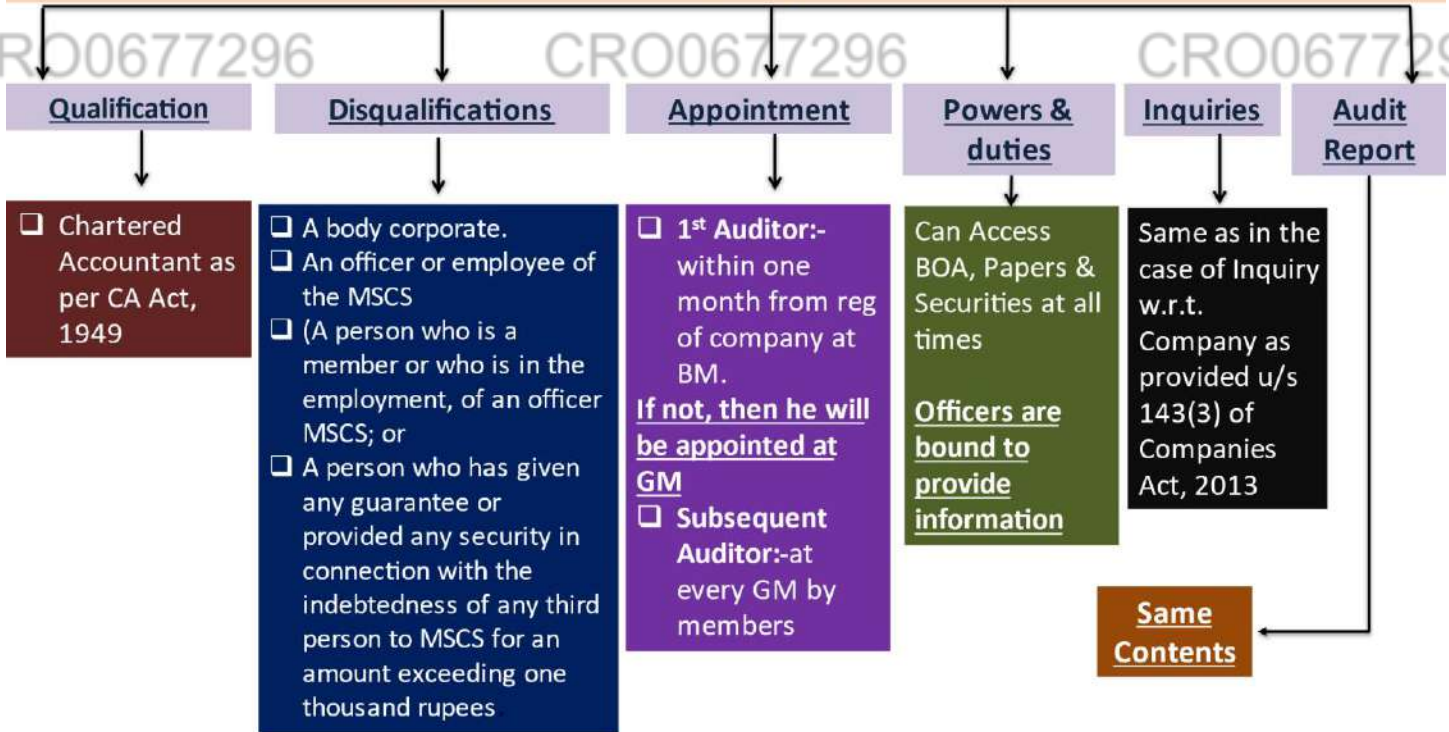
Content in Report

Content in Schedule to Report

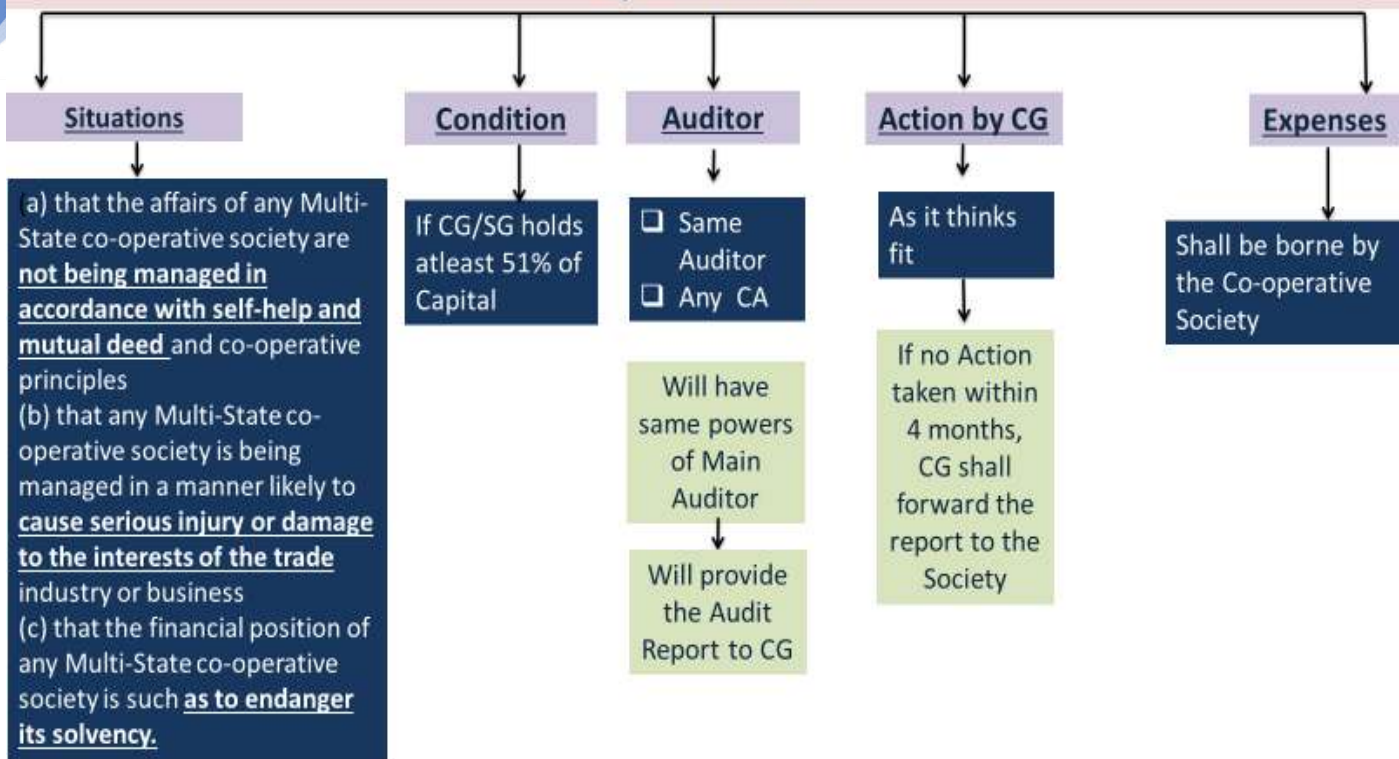
- (a) Whether he has obtained all the necessary **information and explanations** which were necessary for the purpose of audit.
- (b) Whether in his opinion, the said account **give all the information** required by the Act.
- (c) Whether the Profit and Loss Account of the society **gives a true and fair view** of the Profit and Loss made by the society.
- (d) Whether the Balance Sheet drawn up as at the end of the year gives a **true and fair view** of the state of affairs.
- (e) Whether in his opinion, **proper books of account** have been properly maintained.
- (f) Whether the Balance Sheet and the Profit and Loss Account examined by him are **in agreement with the books of account**.

- (1) All transactions which **appear to be contrary** to the provisions of the Act, the rules and bylaws of the society.
 - (2) All sums, which ought to have been **but have not been brought into account** by the society.
 - (3) Any material, or property belonging to society which appears to the auditor to be **bad or doubtful of recovery**.
 - (4) Any **material irregularity or impropriety** in expenditure or in the realisation or monies due to society.
 - (5) Any **other matters specified by the Registrar** in this behalf.
- In the case of Nil report in any of the above matters, the auditor will **have to give a Nil report**.

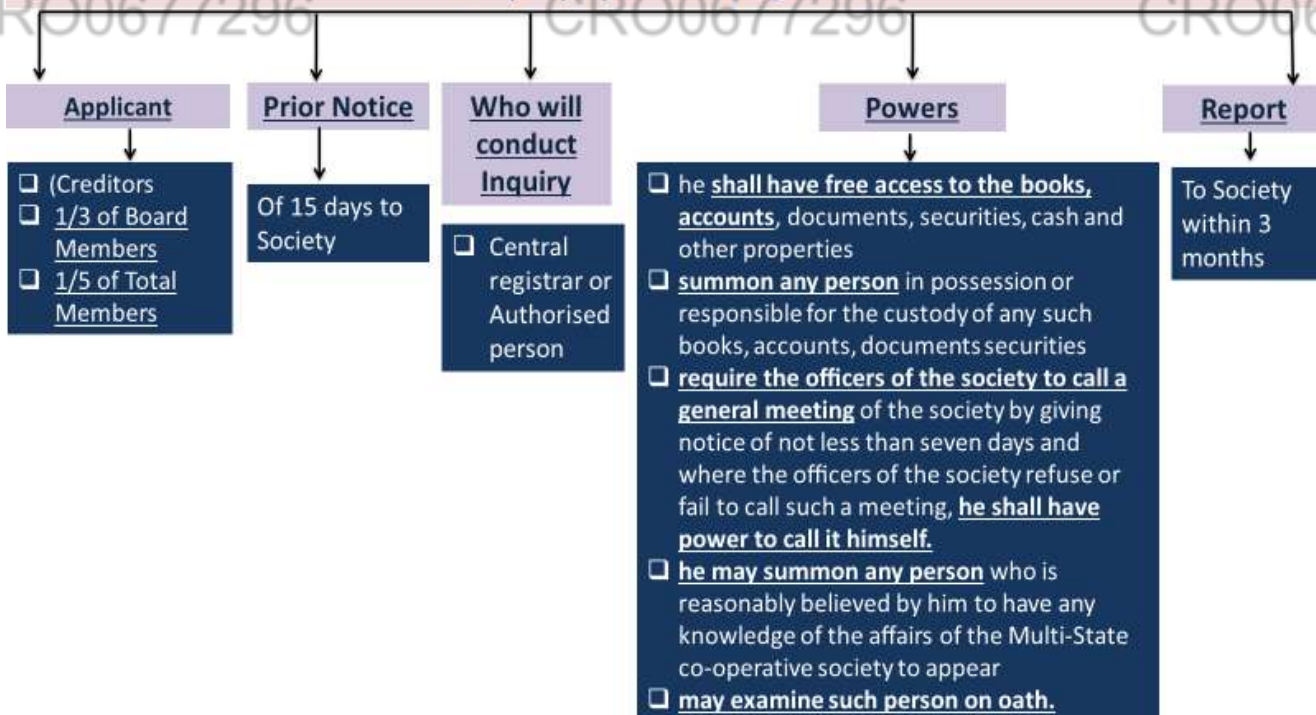
Audit of Multi-State Co-operative Societies



Special Audit



Inquiry by Central Registrar



Chapter 9

AUDITOR'S REPORT

SA 700

Forming an opinion and Reporting on the financial statements

1. To form an opinion on **Financial statements**

General purpose financial statement + related notes

Financial state. prepared in accordance with the general purpose framework

- 1. Summary of significant Accounting policies
- 2. Any explain info which is required under law

Financial reporting framework designed to meet financial info needs of wide range of users

Fair presentation Framework

Compliance Framework

FRF that requires compliance of the Framework and

FRF that requires compliance of the Framework

Acknowledge Explicit/ Implicit

Acknowledge Explicit

That to achieve fair presentation of the F/S

That to achieve fair presentation of the F/S

Mgmt to provide disclosures specifically required by Framework

Mgmt to depart from a requirement

Evaluations by Auditor

Qualitative Aspect of Financial Statements

1. while preparing the f/s mgmt will form judgment
2. SA-260 provides that Ar shall discussion with mgmt on Qualitative aspects
3. While considering Qualitative aspects, Auditor will check that there is a biasness in the management Judgement

When there is "Lack of Neutrality"

Indicators:-

1. Selective correction of mis-statement reported by the Auditor
2. possible mgmt biasness in Accounting Estimates

Specific Evaluations

1. proper disclosure of significant Accounting policies
2. Accounting policies are consistent
3. Accounting information is relevant and reliable
4. Terminologies used including the title of F/S are appropriate
5. Accounting estimates are Reasonable
6. Details of material transactions or event have been disclosed

2. Forms of Opinionclean opinion

When financial statements are prepared in accordance with FRF

f/s - free from Material Mis-statements

indicates true & fair view

Modified opinion

When f/s are not free from Material Mis-statement

Auditor has concluded it

If Auditor is unable to conclude that

Whether f/s are free from material mis-statements

S.No.	Heading	Description
1.	Title	clearly stating that it is "Independent Auditor's Report" so that it can be distinguished from other report
2.	Addressee	<p>* As per circumstances * To members/ those charged with governance (TCWG)</p> <pre> graph TD A[Company] -.-> B[Board] A -.-> C[Partners] D[Firm] -.-> B D -.-> C </pre>
3.	Opinion	<p>* It shall state (a) Name of entity (b) Components of f/s (c) Date and period of f/s (d) fact that f/s have been audited</p> <p>* Further, Auditor shall provide his opinion on f/s eg- In best of my knowlege, the f/s of infosys ltd presents true & fair view of state of Affairs of co.</p> <pre> graph TD A[clean] -.-> B[presents true & fair view] C[modified] -.-> B </pre>
4.	Basis for Opinion	<ol style="list-style-type: none"> 1) Audit has been conducted in accordance with SAs 2) Auditor has obtained Reasonable Assurance that f/s are free from Material mis-statements 3) Auditor has complied with Ethical Requirements prescribed by ICAI 4) Auditor has obtained sufficient & appropriate Audit Evidence
5.	Going concern	That Report is in accordance with SA 570
6.	Key Audit Matters	That Report is in accordance with SA 701
7.	Management's Responsibility	<p>This para shall state</p> <ol style="list-style-type: none"> (a) It is the responsibility of the Mgmt. to prepare f/s in accordance with FRF (b) To design and implement internal control which is free from mis-statement (c) To prevent and detect frauds and errors (d) To safegaurds assets of the entity (e) To assess the going concern status
8.	Auditor's Responsibility	<ol style="list-style-type: none"> a) state the objectives of Auditor <ol style="list-style-type: none"> i) To obtain reasonable assurance ii) To issue an Auditor's Report b) States that Reasonable assurance is a high level of assurance but not a guarantee that Auditor will detect a material mis-statement c) State the responsibilities <ol style="list-style-type: none"> i) Professional judgement ii) Professional Skepticism iii) Compliance of SAs iv) Compliance of ethical requirements v) To check appropriateness of accounting policies

		vi) To identify risk of Material mis-statement vii) To ensure compliance of FRF viii) To examine the effectiveness of ICC
9.	Other Reporting Responsibilities	Heading- Report on other legal and Regulatory Requirements Eg:- * Sec 143(3) of CA, 2013 * CARO, 2016
10.	Signature of Auditor	<p>The diagram shows a central point with two dashed arrows pointing to 'If Individual' and 'Firm'. Below 'If Individual', a dashed arrow points to a list of requirements: '* Name of Auditor' and '* Membership No.'. Below 'Firm', a dashed arrow points to a list of requirements: '* Name & Reg. No of firm', '* Name of Partner', and '* Membership no. of Partner'.</p>
11.	Place of Audit Report	Auditor should mention the place at which Auditor's Report has been signed
12.	Date of Audit Report	Auditor shall mention the date on which Auditor's Report has been signed, not any earlier date

SA 701 (Applicable on listed Entities)**Communicating & Determining "Key Audit Matters" in the Independent Auditor's Report****1. Meaning of Key Audit Matters-**

Those matters that in Auditor's Judgement were of most significant in Audit of Financial statement

2. Purpose of communicating 'KAM'-

- i) To improve the communicate value of Auditor's Report
- ii) To provide additional information to the users of financial statement to assist them in understanding same
- iii) To assist users in understanding the entity and judgement of Management

3. Factors determining 'KAM'-

- i) Areas of High assessed, high risk of mis statement

or
Significant risk



315

(the risk that require significant attention of Auditor)
(eg:- RPT, Risk of fraud)

- ii) Area which involves significant management judgement

eg:- Accounting estimates identified as having high estimation uncertainty



(Management estimate about tax liabilities or liabilities in a dispute)

4. Communicating 'KAM'

- i) Auditor need not to communicate those matters due to which he modified the opinion
- ii) Separate opinion on Individual matters (along with reasons)

+

Response of the Auditor

- iii) Disclosure is not permissible

- a) Prohibited by law
- b) Affect public interest

- iv) Key Audit matter is not a substitute

- a) Management Responsibilities of disclosure in the Financial statement
- b) in respect of matters covered under SA 705 (modified opinion)
- c) in respect of matters covered under SA 570

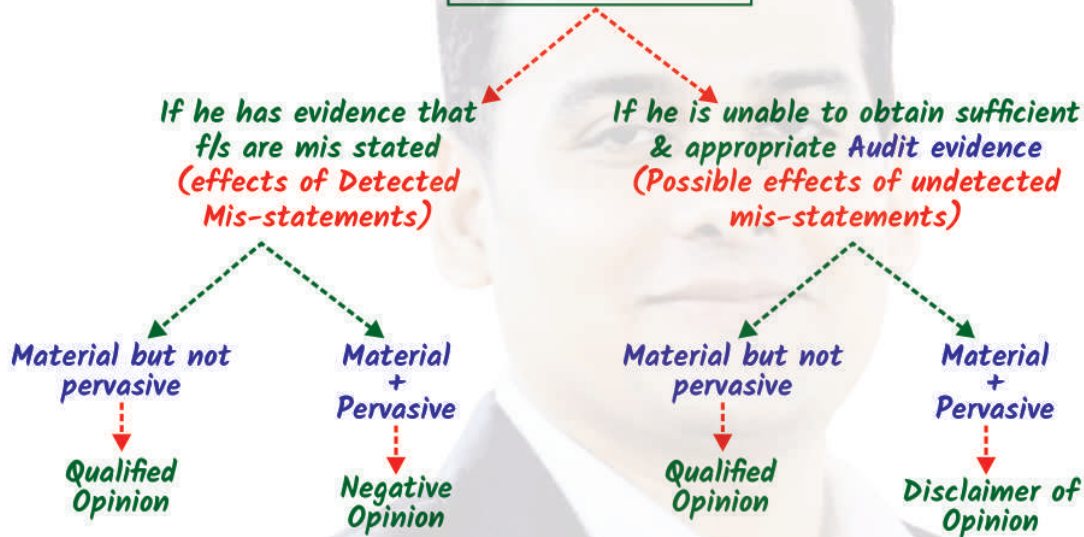
(when he has having uncertainty over going concern status) eg:- shortage of suppliers, labour unrest

5. Communicating TCWG

- i) Key Audit Matters specified in Report
- ii) If auditor considers that there is no KAM, then determination by him in the report

Ques: When does an auditor issue unqualified opinion and what does it indicate

Ques: ABC & Co., a chartered Accountant firm situated in Mumbai audited the financial statement of XYZ Ltd & signed the audit report in Delhi. The partner of the firm has mentioned Mumbai as the place of auditor's report. State, whether the action of partner is appropriate

SA 705**Modification to opinion in Independent Auditor's Report****Types of Modification****Types of Report****I. Modified Report**

When Auditor is of opinion that financial statements have not been prepared in accordance with FRF

Reasons behind providing modified opinion

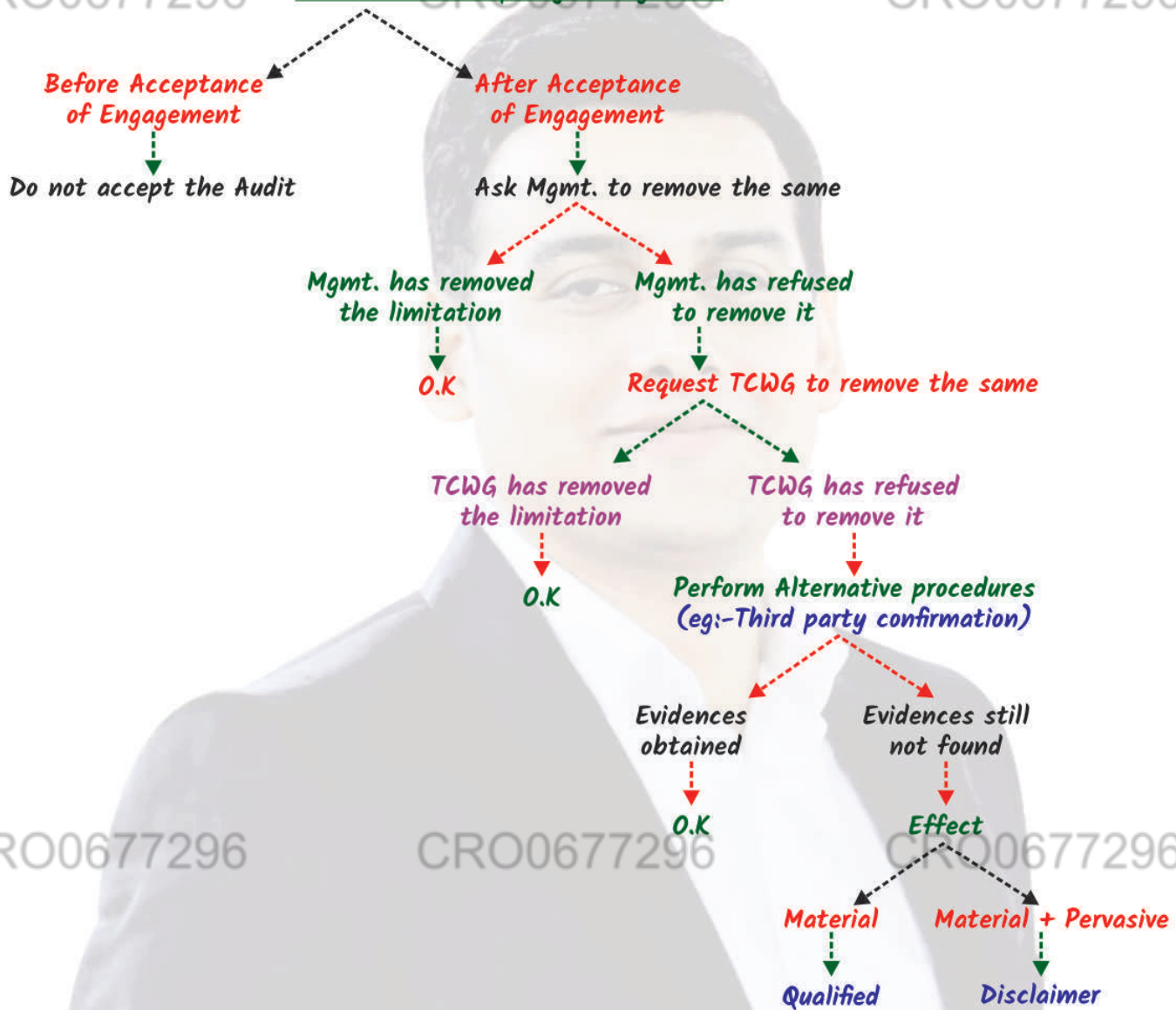
- a) Detected Mis-statement
- b) When auditor is unable to obtain S&A Audit evidence due to which he is not in a position to conclude whether there is a mis-statement or not

Types

- a) Qualified Opinion
 - i) Effect of detected mis-statement- Material but not pervasive
 - ii) possible effect of undetected M-S- Material but not pervasive
- b) Negative Opinion

effect of detected mis-statement- Material + Pervasive
- c) Disclaimer of Opinion

Possible effect of undetected M-S- Material + Pervasive



1) Qualified Opinion

a) Qualified opinion is one where an Auditor gives an opinion on truth and fairness of financial statements **subject to certain qualifications**

The overall impact of qualification is not pervasive enough to vitiate the overall true and fair view of f/s, but it is **import** that such matters should be disclosed in Auditor's Report

b) Auditor will issue a Qualified opinion when

* Clean opinion will not be appropriate

* Detect M-s are not so pervasive that issuing negative opinion will be appropriate

Possible effects of undetected M-s are not so pervasive that issuing disclaimer will be appropriate

2) Negative Opinion

a) The effect of detected mis-statements is material and so pervasive that qualified opinion will not be enough, then Auditors will issue negative opinion

b) In this case, f/s do not provide true and fair views of the state of affairs of co.

c) It is also known as Adverse opinion

d) In this case, Auditor shall provide reasons for issuing negative opinion

3) Disclaimer of opinion

1) Disclaimer will be issued by the Auditor when possible effects of undetected mis-statements is so material and pervasive, that qualified opinion would not be enough

- 2) In this case, Auditor is not in a position to comment whether there is truth & fairness in the financial statements or not
- 3) reasons for lack of evidences
 - a) Limitations imposed by Mgmt
 - b) Natural calamity
 - c) Seizure by Govt departments

SA 706

“Emphasis of matter” Paragraph and other matter Paragraph in Independent Auditor’s Report

EOM

1. Meaning

These are the matters which are properly disclosed in F/S and in the Auditor’s Judgement Relevant to user’s understanding of F/S

2. Presentation

In sign separate section in Auditor’s report titled “Emphasis of Matters”

3. Disclosure

1. Emphasize the matter and indicate to provide add. info about F/S
2. Indicate that emphasizing will not amount to modification in Auditor’s report

4. EOM is not a substitute of

- a) Management Responsibilities of disclosure in the Financial statement
- b) in respect of matters covered under SA 705 (modified opinion)
- c) in respect of matters covered under SA 570 (When there is a material uncertainty)

Examples

1. A Subsequent Event occurred after date of F/s but before the Date of A/R
2. A major catastrophe which is having significant effect on Financial position of co.
3. Application of any new accounting standard
4. The outcomes of any pending litigation /claim

OM

1. Meaning

It refers to those matters other than disclosed or presented in F/S But in the Ar’s understanding relevant to user’s understanding

2. Presentation

- * There will be a separate section in Ar’s report
- * Titled “other Matters”
- * After EOM para (if any)

Examples

1. Change in operating technology used by entity
2. Violation of any law which does not affect F/S

Difference

Qualified Report	Negative Report
1) Detected M/s is only Material	1) Material + Pervasive
2) True & fair view—certain limitations	2) No true and fair view
3) It can be issued if Auditor fails to obtain sufficient & appropriate audit evidence	3) Auditor has concluded that there is a mis-statement
4) When clean Report is not enough and issuing negative will not be appropriate	4) When qualified report would not be enough as M/s are material as well as well as pervasive

SUPER SUMMARY
SA 700, 701, 705, 706

SA 700

Clean Report

- If f/s are prepared
 - a)in accordance with FRF
 - b)it presents true and fair view
- Auditor has obtained S&A Audit Evidence

True and fair view

SA 701

"Key Audit Matter" para

- 1)Significant Risk
- 2)Material uncertainty over significant judgement of Management

The report will not be modify

SA 705

SA 706

Qualified

Negative

Disclaimer

EOM

OM

* Effect of Detected mis-statement possible effects of undetected mis-statements

Material

true and fair view subject to certain qualifications

* effects of Detected mis-statements

Material + Pervasive

No true and fair view

* Possible effects of undetected mis-statements

Material + Pervasive

Not in a position to state whether true & fair view

Matters which are part of f/s

Matters which are not part of f/s

Chapter 10

CARO, 2020

1) Companies Auditor's Report Order, 2020

Applicability

✓
1. Every company

2. Foreign Company (as defined u/s 2(42) of CA, 2013)

A company formed outside india having a place of Business in India

(electronic/ physical)

3. Electricity Co.

4. Dormant Co.

X
1. Banking Co.

2. Insurance Co.

3. Section & Co.

4. OPC

5. Small company -Sec 2(85)

Max s/cap - 2 Cr

Max T/O - 20 Cr

6. Private Co.

a) not be a subsidiary/Holding of a public company

b) paid-up cap + Res & plus should not exceed 1cr as the B/s date

c) Total Borrowings should not exceed 1 cr of any point of time

d) total revenue (inc. revenue from dist. operations) does not exceed 10 cr

2) Explanatory notes

1. Paid-up capital includes both guilty and preference share capital

2. Reserve and surplus includes

a) Revenue reserve

b) Capital reserve

c) Revaluation reserve

d) Credit Bal. in P&C a/c

2B. Capital and R&S shall not exceed the limit as the B/S date

3. Borrowings will include

a) short term Borr

b) long term loan

c) Demand loan

d) C/C limit

e) Discounting of Bills

4. Only those loan will be considered which are obtained from Bank/F

5. For computing amount of loan, only o/s balance will be considered

6. The amount of loan shall not exceed the limit at any point of time during financial year

7. Total revenue includes

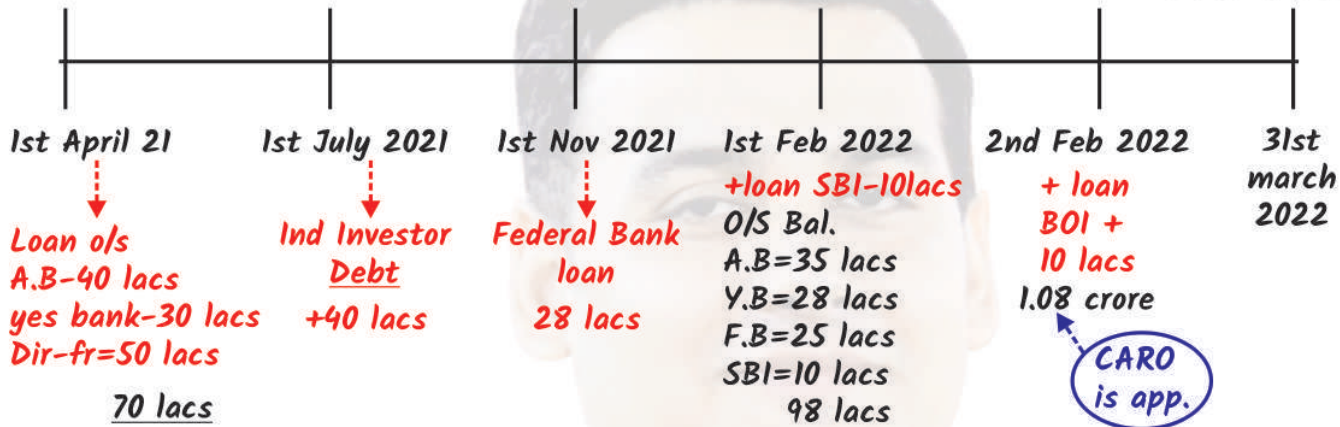
a) Turnover

b) Income from investment

c) Non-operating income

Total o/s = 95 lacs

30th March



Sub-para	Title	Details
1	PPE	1. Ensure proper records - PPE 2. - Intangible Assets 3. PV at R/intervals by mgmt discrepancies dealt by mgmt in Books 4. Title deed/lease agreement - Name of entity? Otherwise - disclosure Table 5. Revaluation - difference of 10% or more specifically disc by Ar - by reg. valuer 9 6. Benami property - proceeding initiate/pending ?
2	Inventory	1. Pv - mgmt - RI ? discrepancy - 10% or more - specific class of Asset - dealt? 2. If the limit is > 5 cr at any point time Quarterly Ret/statement submitted tally with books - <u>it not</u> disclosure by Ar

Inventory	Co.	PV	Difference
1. Books	- 40 lacs	35.80 lacs	10.5 %
2. PD.	- 8 lacs	1.80 lacs	
3. Pen	- 2 lacs	2 lacs	
	<u>50 lacs</u>	<u>45.60</u>	

4.4 = 8.8%

Sub-para	Title	Details
<p>3</p> <p>AO Ltd</p> <p>ASH.</p> <p>pub co. D-M/D</p>	<p>Loan, Guarantee, securities</p> <p>Dir</p> <p>KMP firm</p> <p>D-partner</p> <p>pvt co. D-M/D</p>	<p>1. Indicate the loan given by co. a) to joint vent/Ass/Sub (JAS) b) others</p> <p>2. The terms of loan are not prejudicial to mt. of co.</p> <p>3. Whether-schedule-stipulated? Receipts-regular?</p> <p>4. If O/S - 90 days, Reason steps for recovery of P&I</p> <p>5. Indicate the existing loan maturing in the year but renewed, extended granted fresh loan in lieu of that</p> <p>6. Indicate a) proportion of ex. loan R/E/F - total loan b) proportion of demand loan - total loan c) proportion of loan to R.P/promoter - total loan</p>
<p>4</p>	<p>Loan, Guarantee, securities</p>	<p>check compliance of section 185 and 186</p> <p>Co. cannot give loan to Director/Rel.</p> <p>Limit a. 60% X QP + FR + SP b. 100% X (FR + SP)</p> <p>Inexcers SR</p> <p>Higher</p>
<p>5</p>	<p>Deposits</p>	<p>Ensure compliance of a) Section 74-76 of Companies Act, 2013 b) RBI directions c) order of court, tribunal, NCLT, RBI, LLB</p> <p>If not, contravention must be stated</p>
<p>6</p>	<p>Cost records</p>	<p>Ensure that company which is required to prepare the cost records - have prepared it? (Turnover - (PFY - 35 Cr or more))</p>
<p>7</p>	<p>Statutory Dues.</p>	<p>In case of dispute</p> <p>In case of no dispute</p> <p>1. Amt. of dispute pending 2. Name of NrGM</p> <p>1. Whether regularly deposited 2. If not, and O/S 7 6 months or B/S date, it must be indicated by Auditor</p>
<p>8</p>	<p>Unrecorded Transaction</p>	<p>If any transaction which was not recorded earlier is disclosed? -If yes, ensure the entry in Books</p>

9	Loans obtained	<p>a. whether there is any default in repayment of loan/Debt securites? If yes, then disclose - Table</p> <p>b. If obtained for any purpose, utilized in that purpose? If not then report</p> <p>c. Whether declared as willfull defaulter by Bank/FI</p> <p>d. Whether loan for short term per utilized for longterm?</p> <p>e. whether loan taken for JAS? If yes, must be reported</p> <p>f. Whether loan obtained by keeping S/holding in 3AS as pledge if any default in repayment, Disclose</p>
10	private placement	<p>1. whether fund raised from IPO/FPO utilized towards SP purpose</p> <p>2. (Shares/Deb) private placement (shares/conv.deb)</p> <p>3. Ensure compliance of Sec 42/62 of CA, 2013?</p>
11	Fraud	<p>1. Fraud $\begin{cases} \rightarrow \text{By co.} \\ \rightarrow \text{On co.} \end{cases}$ $\begin{cases} \rightarrow \text{Noticed} \\ \rightarrow \text{reported} \end{cases}$ $\begin{cases} \rightarrow \text{state} \\ \rightarrow \text{Nature of fraud} \\ \rightarrow \text{Amt of fraud} \end{cases}$</p> <p>2. Whether Asset 4 has been pledge to CG?</p> <p>3. Whether whistle blower complaints ace consicured?</p>
12	Nidhi Companies	<p>1. Ratio of <u>Net owned</u> = $\frac{1}{20}$ <u>Deposit</u></p> <p>2. Unincumbered deposit - atleast 10% of total deposit</p> <p>3. Default in repayment of deposit/interest</p>
13	RPT	<p>Whether compliance of Sec 177 & 188? - If not, provide details ensure doc as per App. AS?</p>
14	Internal Audit	<p>1. As per the Nature & size of entity</p> <p>2. Internal A/R considered by stat Ar</p>
15	Non cash Transactions	<p>1. Ensure compliance of section 192 of CA, 2013</p>
16	Reg with RBI	<p>1. Whether NBFC/Housing finance co are registered with RBI?</p> <p>2. Ensure whether any unregistered co is carrying NBFC/HF activity</p> <p>3. Whether the company is a CIC and fullfill its eligibility criteria (T.A - 90% in form of Inv)</p> <p>4. Whether CIC is exempted (Assesst file is less than 1 as Cr)</p> <p>5. If there are >1 CIC in group, indicate the numbers</p>
17	Cash losses	<p>Whether there are cash losses in M & M lpfy ? If yes - Indicate</p>
18	Resignation by st Auditor	<p>Whether ojections, raises, concerns of outgoing ars are considered?</p>

19 Board & mgmt plans
 a.Examine ageing, Fin ratios, realisation of FA
 b.Examine B&M plans
 c.Ensure that there is no material uncertainty
 d.Co. is capable to meet is liability in next 1 year

20 CSR
 1.Unspent CSR has been lifted to fund in next 6 months?
 SchVil
 2.Unspent CSR has been titled to unspent CSR A/C?

21 Adverse remarks
 1.whether Ar of Sub/Associate has provided any qualification WRT
 CARO requirement in their report
 If yes - Indicate along with Para No.

Chapter 11 NATURE, OBJECTIVE & SCOPE OF AUDIT

DEFINITION OF AUDIT (SA 200)

"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".

SCOPE OF AUDIT

1. The audit should be organized to **cover adequately all aspects of the enterprise relevant to the financial statements** being audited.
2. To form an opinion on the financial statements, the auditor should be reasonably satisfied as to whether the information contained in the underlying **accounting records and other source data is reliable and sufficient** as the basis for the preparation of the financial statements.
3. In forming his opinion, the auditor should also decide whether the **relevant information is properly disclosed in the financial statements** subject to statutory requirements, where applicable.
4. The auditor is **not expected to perform duties which fall outside the scope of his competence**. For example, the professional skill required of an auditor does not include that of a technical expert for determining physical condition of certain assets.
5. **Constraints on the scope of the audit of financial statements that impair the auditor's ability to express an unqualified opinion** on such financial statement should be set out in his report, and a qualified opinion or disclaimer of opinion should be expressed as appropriate.

ASPECTS TO BE COVERED IN AUDIT

- (i) An **examination of the system of accounting and internal control** to ascertain whether it is appropriate for the business and helps in properly recording all transactions.
- (ii) Reviewing the system and procedures to find out whether they are adequate and comprehensive and incidentally **whether material inadequacies and weaknesses exist to allow frauds and errors** going unnoticed.
- (iii) Checking of the **arithmetical accuracy of the books of account** by the verification of postings, balances, etc.
- (iv) Verification of the authenticity and validity of transaction entered into by **making an examination of the entries in the books of accounts with the relevant supporting documents**.

(v) Ascertaining that a **proper distinction has been made between items of capital and of revenue nature** and that the amounts of various items of income and expenditure adjusted in the accounts corresponding to the accounting period.

(vi) Comparison of the **balance sheet and profit and loss account or other statements with the underlying record** in order to see that they are in accordance therewith.

(vii) **Verification of the title, existence and value of the assets** appearing in the balance sheet.

(viii) **Verification of the liabilities** stated in the balance sheet.

INDEPENDENT AUDIT

Meaning

Independence implies that the judgement of a person is not subordinate to wishes or directions of another person who might have engaged him or his own self – Interest. Independence is a condition of mind and personal character.

Requirement

Standards on Auditing
Companies Act, 2013

The Chartered Accountants Act, 1949

Advantages of Independent Audit

✚ For Management.

- Ensure reliability
- Ensure performance.
- Judge reasons for any deficiency.

✚ Employees.

- Moral check
- Reasonableness of payment.

✚ Lenders.

- Reliance on audited F/S
- Judge credit worthiness.

✚ For Government.

- Taxation.

✚ For owner.

- Real picture of P&L
- Can expect dividends.

✚ **Prospective Investor.**

- Can decide whether to invest or not.

QUALITIES OF AUDITOR

- ✚ **Sound Knowledge of Law:-** He must have a thorough knowledge of the general principles of law which govern matters with which he is likely to be in intimate contact. **The Companies Act** need special mention but mercantile law, specially the law relating to contracts, is no less important. Needless to say, where undertakings are governed by a special statute, its knowledge will be imperative.
- ✚ **Theoretical knowledge of various Subjects:-** He must pursue an intensive programme of theoretical education in subjects like financial and management accounting, general management, business and corporate laws, computers and information systems, taxation, economics, etc. Both practical training and theoretical education are equally necessary for the development of professional competence of an auditor for undertaking any kind of audit assignment
- ✚ **Accounting Knowledge:-** An exhaustive knowledge of accounting in all its branches is the sine qua non of the practice of auditing. He must know thoroughly all accounting principles and techniques.
- ✚ **Ethical Requirements:-** He must have the highest degree of integrity backed by adequate independence. In fact, Code of ethics mentions integrity, objectivity and independence as one of the fundamental principles of professional ethics.
- ✚ **Basic Human Qualities:-** The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education.
- ✚ **According to Experts:-**
 - ✓ **According to Dicksee:-**The qualities required, according to Dicksee, are tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability.
 - ✓ **According to Lord Justice Lindley:-**Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. He said, "an auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true".

THREATS TO INDEPENDENCE OF AUDITOR

The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. These are:

- ✚ **Self Interest Threat:-**This threat occurs when a professional is shown any personal benefit which can be financial or non financial.
E.g.:-To an auditor a huge audit fees or to an employee goods incentives or personal use of the entity assets.
- ✚ **Self Review Threat:-**This threat occurs when a professional who have formed a judgement himself

has to review his judgement.

E.g.:-In case of auditor if he himself has prepared the financial statements in case of employee who has prepared the FS has to perform the auditing functions as well.

✚ **Advocacy Threat:-**This threat occurs when a professional promotes a position or opinion that his own objectivity may be compromised.

E.g.:-In case of an auditor promoting the shares of in a company whose audit is done by him or an employee promoting the company whose going concern is in doubt.

✚ **Familiarity threat:-**This threat occurs when a professional has a familiar relationship with a person who have appointed him or with the work environment.

E.g.:-In case of an auditor if the mgt. / director or in case of an employee if the mgt./ director is in the family relation of the employee.

✚ **Intimidation Threat:-**This threat occurs when a professional is being threatened. In other words when a threat is being given actual or being threaten to be sued or litigation.

SAFEGUARDS TO INDEPENDENCE OF AUDITOR

The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

The following are the guiding principles in this regard: -

1. For the public to have confidence in the quality of audit, it is essential that auditors should always be and appears to be independent of the entities that they are auditing.
2. In the case of audit, the key fundamental principles are integrity, objectivity and professional skepticism, which necessarily require the auditor to be independent.
3. Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.
4. When such threats exist, the auditor should either desist from the task or put in place safeguards that eliminate them.
5. If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

THE CONCEPT OF TRUE AND FAIR VIEW

The concept of True and Fair view is a matter of an auditor's judgement and to ensure it he has to see that:

- ✚ The assets are neither undervalued nor overvalued
- ✚ No material assets is omitted
- ✚ Charge, if any, on assets is disclosed;
- ✚ Material liabilities should not be omitted;
- ✚ The profit and Loss Account and the Balance Sheet discloses all the matters required to be disclosed by Sch. III of the Companies Act, 2013.

- + Accounting Policies have been followed consistently
- + Unusual and exceptional or non-recurring items have been disclosed separately
- + There should not be any material misstatements in the financial statements.

BASIC PRINCIPLES GOVERNING AN AUDIT

+ Integrity, objectivity and Independence:-

- Integrity:-Honest and Sincere
- Objectivity:-Free, not biased
- Independence:- Independence implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.

Types of Independence

There are two interlinked perspectives of independence of auditors, one, independence of mind; and two, independence in appearance. The Code of Ethics for Professional Accountants issued by International Federation of Accountants (IFAC) defines the term 'Independence' as follows:

"Independence is: ;-

(a) Independence of mind the state of mind that permits the provision of an opinion without being affected by influences allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and

(b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a third party would reasonably conclude an auditor's integrity, objectivity or professional skepticism had been compromised."

Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons.

+ Confidentiality:-Auditor should not disclose information of client unless

- Permitted by client
- Legally Bounded.

Eg:- Income Tax Act, 1961.

+ Skill & Competence:-Auditor should have proper

- Training
- Experience
- Education and qualification

+ Work performed by others:-Auditor can delegate work to the assistant, But he will be responsible for same. Auditor should rely in work if he:-

- Exercises his skill; and

- There is nothing to doubt.

✚ **Documentation:-**He should document the matters relating to audit i.e. Maintain Working paper.

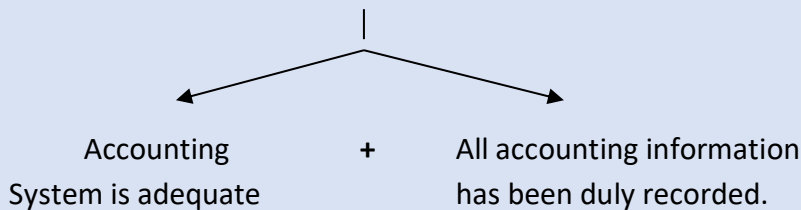
✚ **Planning:-**Auditor should plan his work to conduct audit in effective and timely manner. Plans should be:-

- Based on Business.
- further developed and revised, if circumstance require so.

✚ **Audit evidence:-**Auditor should obtain sufficient and appropriate audit evidence by performing.

- Compliance Procedure:- To check designing and Effectiveness of Internal control
- Substantive Procedure:- To check completeness accuracy and validity of transactions & Balances.

✚ **Accounting system and internal control:-**Internal control shows that



✚ **Audit Conclusion & Reporting:-**Auditor should access and review the Conclusion drawn from audit evidence. The audit report should contain clear written

- Expression of opinion of the financial statement i.e.
- Financial statement does represent a true & fair view or not.

OBJECTIVES OF AUDIT

Primary Objective:-Reporting i.e. Expression of opinion

The primary objective of auditing is reporting as to whether the financial statements present a "true and fair view" of the financial position (Balance sheet) and the financial performance (Profit and Loss Account) during the period.

SA -200, "Objective and scope of the audit of financial statements" states that, the objective of an audit of financial statements, prepared within a framework of recognized accounting policies and practices and relevant statutory requirements, is "to enable an auditor to express an opinion on such financial statements".

Secondary Objective:- Detection and prevention of frauds and errors

✚ The incidental and secondary audit objective is to detect errors and frauds and to make recommendations to the appointing authority, so as to prevent their recurrence.

- ✚ Basically, it is the responsibility of the management
 - to safeguard the assets and
 - to prevent frauds and defalcations, by designing and implementing a suitable system of internal controls.

Judicial Decision

Kingston Cotton Mills

During his audit, the auditor should bear in mind the possibility of the existence of fraud or other irregularities in the accounts. Audit cannot be believed upon to ensure the discovery of all frauds or errors. But where the auditor has any suspicion that some fraud or error may exist, which could result in material misstatements, he should extend his audit procedures to confirm his suspicion.

The auditor is only a watchdog, not a bloodhound.

INHERENT LIMITATIONS OF AUDIT

1. **The Nature of Financial Reporting:**-The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty.
2. **The Nature of Audit Procedures:**-There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:
 - ✓ There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.
 - ✓ Fraud may involve sophisticated and carefully organised schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
 - ✓ An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.
3. **Timeliness of Financial Reporting and the Balance between Benefit and Cost:**-The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.

Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over

time, and there is a balance to be struck between the reliability of information and its cost.

4. **Other Matters that Affect the Limitations of an Audit:** In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- ✓ Fraud, particularly fraud involving senior management or collusion.
- ✓ The existence and completeness of related party relationships and transactions.
- ✓ The occurrence of non-compliance with laws and regulations.
- ✓ Future events or conditions that may cause an entity to cease to continue as a going concern.



Chapter 12 PREPARATION FOR AN AUDIT

AUDIT PROCESS

PLANNING

Formulating overall plan based on client's Business.

PERFORMING

- ✚ Examine Internal Control by performing Compliance procedures
- ✚ Perform substantive Procedures
 - Conduct vouching
 - Perform verification
- ✚ Ensure appropriate disclosure of information
- ✚ Analyse ratio and trends (ARP)

CONCLUDING AND REPORTING

- ✚ Forming conclusions on basis of evidence
- ✚ Provide report on truth and fairness
- ✚ Communicate report to appropriate authority

MATTERS TO BE CONSIDERED IN DEVELOPING THE OVERALL AUDIT PLAN

- ✚ Terms of his engagement and any statutory responsibilities
- ✚ Applicable legal or statutory requirements.
- ✚ Accounting policies adopted by the client and changes in those policies.
- ✚ Effect of new accounting or auditing pronouncements on the audit.
- ✚ Identification of significant audit areas.
- ✚ Setting of materiality levels for audit purposes.
- ✚ Nature and extent of audit evidence to be obtained.
- ✚ Work of internal auditors and the extent of their involvement, if any, in the audit.
- ✚ Involvement of other auditors in the audit of subsidiaries or branches of the client.
- ✚ Involvement of experts.
- ✚ Allocation of work to be undertaken between joint auditors and the procedures for its control and review.
- ✚ Establishing and Co-ordinating staffing requirements.

BENEFITS OF PLANNING IN THE AUDIT OF FINANCIAL STATEMENTS

Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate 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 auditors of components and experts**

AUDIT PROGRAMME

MEANING

An audit programme is a detailed plan of applying the audit procedure in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.

IMPORTANT MATTERS TO BE CONSIDERED WHILE FORMULATING AN AUDIT PROGRAMME

- + Nature of business in which the organization is engaged
- + Overall plan prepared for the audit
- + System of internal control and accounting procedures
- + Size of the organization and structure of its management.
- + Information regarding the organization of the business
- + Accounting policies followed by the client.

CONSTRUCTING OVERALL AUDIT PROGRAMME

For the purpose of programme construction, the following points should be kept in mind:

- (1) Stay within the scope and limitation of the assignment.
- (2) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
- (3) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
- (4) Consider all possibilities of error.
- (5) Co-ordinate the procedures to be applied to related items

DEVELOPING AUDIT PROGRAMME

- 1. Written Audit Programme :** The auditor should prepare a written audit programme
- 2. Audit Objective and Instruction to Assistants :** The programme may also contain the audit objectives for each area and should have sufficient details to serve as a set of instructions to the assistants.
- 3. Reliance on Internal Controls :** In preparing the audit programme, the auditor may wish to rely on certain internal controls in determining the nature, timing and extent of required auditing procedures. *However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence.*
- 4. Timings of Performance of Audit Procedures :** The auditor normally has flexibility in deciding when to perform audit procedures. However, in some cases, the auditor may have no discretion as to timing, for example, when observing the taking of inventories by client personnel or verifying the securities

and cash balances at the year-end.

5. Audit Planning : The audit planning ideally commences at the conclusion of the previous year's audit, and along with the related programme, it should be reconsidered for modification as the audit progresses. Such consideration is based on the auditor's review of the internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures.

OBTAINING EVIDENCE FROM VARIETY OF FIELDS

An auditor picks up evidence from a variety of fields and it is generally of the following broad types:

- (a) Documentary examination,
- (b) Physical examination
- (c) Statements and explanation of management, officials and employees,
- (d) Statements and explanations of third parties,
- (e) Arithmetical calculations by the auditor,
- (f) State of internal controls and internal checks,
- (g) Inter-relationship of the various accounting data,
- (h) Subsidiary and memorandum records,
- (i) Minutes,
- (j) Subsequent action by the client and by **others**.

BEST EVIDENCES

- ✚ For cash in hand, the best evidence is 'count'
- ✚ For investment pledged with a bank, the banker's certificate.
- ✚ For verifying assertions about book debts, the client's ledger invoices, debit notes, credit notes, monthly accounts statement sent to the customers are all evidence: some of these are corroborative, other being complementary. In addition, balance confirmation procedure is often resorted to, to obtain greater satisfaction about the reliability of the assertion.

PERIODIC REVIEW OF AUDIT PROGRAM

There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions.

Unless this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an obsolete programme and, for this negligence, the whole audit may be held as negligently conducted and the auditor may have to face legal consequences.

Judicial Decision

Pacific Acceptance Corporation Ltd. V Forsyth and Others

If the audit programme for the audit of a branch of a financing house, drawn up a number of years ago, fails to take into consideration that the previous policy of financing of a vehicle has been changed to financing of real estate acquisition, the whole audit conducted thereunder would be entirely misdirected and may even result into nothing more than a farce.

ADVANTGES OF AUDIT PROGRAM

- + **Selection of Assistants:**-Program helps selecting assistants as per their capabilities.
- + **Instructions for staff:**-It contains Instructions ad to work to be done.
- + **No Ignorance:**-Due to properly written program, there is no chance of for getting some important matter.
- + **Responsibility:**-Program clearly. Set ous as fixation to who is required to do a particular work.
- + **Progress of work:**-The progress of work can be determined on the basis of entries on the program.
- + **Supervision:**-Work by assistants can be easily supervised by referring the program.
- + **Timely completion.**

LIMITATIONS OF AUDIT PROGRAM

- + **Mechanical Approach:**-Assistant ma carry out work Mechanically without understanding the whole concept.
- + **Inflexibility:**-The program often becomes rigid as assistants are not able to change it as per requirement of specific case.
- + **Lack of Initiative:** -Hard and fast program hurts initiative and judgemental skills of hard working assistants.
- + **Monotonous:**-Talented & efficient staff becomes frustrated due to anonymity in progress.
- + **Shelter for inefficient persons:**-Some Assistants don't even Inefficient assistants think of any unusual matter, which is not listed in program even its presence can change audit approach.

THE CONCEPT OF TRUE AND FAIR VIEW

The concept of True and Fair view is a matter of an auditor's judgement and to ensure it he has to see that:

- + The assets are neither undervalued nor overvalued
- + No material assets is omitted
- + Charge, if any, on assets is disclosed;
- + Material liabilities should not be omitted;
- + The profit and Loss Account and the Balance Sheet discloses all the matters required to be disclosed by Sch. III of the Companies Act, 2013.
- + Accounting Policies have been followed consistently
- + Unusual and exceptional or non-recurring items have been disclosed separately
- + There should not be any material misstatements in the financial statements.



CRO0677296

CRO0677296

CRO0677296

Chapter 13 INTERNAL CONTROL

AUDIT RISK

✚ **Meaning:**-It is the risk the auditor may give an inappropriate opinion when the financial statements are materially Mis-stated.

✚ **Components:**-(i) Inherent risk.; (ii) Control risk.; (iii) Detection risk.

Inherent Risk	Control Risk	Detection Risk
(a) Risk that material mis-statement may occur	(a) Risk that I.C fail to operate as desired.	Risk that auditor's substantive procedures will not detect a material mis-statement.
Arises at level of Mgmt.	Arises at level of Mgmt.	Arises at Auditors level.
Auditor only can assess this risk.	Auditor can only assess this risk.	Auditor can frame this risk.
Risk of system of Mgmt.	Risk of I.C.S of Mgmt.	Risk of substantive procedure adopted by Auditor.
This is generally high.	This is evaluated in stages.	DR should be inversely proportionate to combined assessment of IR & CR. $DR \times \frac{1}{IR+CR}$ If IR & CR are high DR should be kept at low level.

Relationship between Detection Risk and combined level of Inherent Risk and Control Risk

There is an inverse relationship between detection risks and the combined level of inherent and control risks. For example, when inherent and control risks are high, acceptable detection risk needs to be low to reduce audit risk to an acceptably low level. On the other hand, when inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risk to an acceptably low level

AUDIT RISK

MEANING AND TYPES

✚ **Meaning:**-It is the risk the auditor may give an inappropriate opinion when the financial statements are materially Mis-stated.

✚ **Components:**-(i) Inherent risk.; (ii) Control risk.; (iii) Detection risk.

(a) Inherent risk:-The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls. There is always a risk that before considering any existence of internal control in an entity, a particular transaction, balance of an account or a disclosure required to be made in the financial statements of an entity have a chance of being misstated and such misstatement can be material. This risk is known as Inherent Risk.

(b) Control risk:-The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other basis by the entity's internal control. Control Risk is a risk that internal control existing and operating in an entity would not be efficient enough to stop from happening, or find and then rectify in an appropriate time, any material misstatement relating to a transaction, balance of an account or disclosure required to be made in the financial statements of that entity. So in a way it can be said that there exists an inverse relation between Control Risk and Efficiency of Internal Control of an Entity. When efficiency of internal control of an entity is high the control risk is low and when efficiency of internal control of that entity is low the control risk is high.

WHEN MAKING CONTROL RISK ASSESSMENTS, CONSIDER:

- ✚ The control environment's influence over internal control. A control environment that supports the prevention, and detection and correction, of material misstatements allows greater confidence in the reliability of internal control and audit evidence generated within the entity. However it does not guarantee the effectiveness of specific controls. We therefore, test the operating effectiveness of controls over significant class of transactions (SCOTs) when we plan to take a controls reliance strategy. Conversely, the control environment may undermine the effectiveness of specific controls and is a key factor in our control risk assessments.
- ✚ Evaluations of the related IT processes that support application and IT- dependent manual controls.
- ✚ Our testing approach over SCOTs and disclosure processes (i.e., controls reliance or substantive only strategy).
- ✚ The expectation of the operating effectiveness of controls based on the understanding of entity's processes.

Examples

Identify a control that a shipping report is prepared only for goods that have been shipped. To determine that only sales that have occurred are recorded, identify a further control that sales cannot be recorded unless a shipping report is produced. In this example, several controls operate collectively in order to address the occurrence assertion for sales.

In another example, a regular reconciliation of quantities shipped to quantities billed is a specific control

that may be effective enough by itself to address the WCGW (What Could Go Wrong) regarding the completeness assertion in a sales process.

(c) Detection risk:-The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

Suppose auditor of a company uses certain audit procedures for the purpose of obtaining audit evidence and reducing audit risk, but still there will remain a risk that audit procedures used by the auditor may not be able to detect a misstatement which by nature is material, then that risk is known as Detection Risk.

Example

While auditing the books of accounts of ABC Limited for the financial year 2020- 21, the auditor of the above mentioned company used various audit procedures, for example-observation, inspection, reperformance, recalculation etc for obtaining audit evidence regarding stock, Debtors, sales, purchases etc., and consequently reducing the audit risk. However, there will always remain a risk that various audit procedures as used by auditor of ABC Limited will not be able to detect misstatements which are material in nature. This risk is known as Detection Risk

SUMMARISED RISKS

Inherent Risk	Control Risk	Detection Risk
(a) Risk that material mis-statement may occur	(a) Risk that I.C fail to operate as desired.	Risk that auditor's substantive procedures will not detect a material mis-statement.
Arises at level of Mgmt.	Arises at level of Mgmt.	Arises at Auditors level.
Auditor only can assess this risk.	Auditor can only assess this risk.	Auditor can frame this risk.
Risk of system of Mgmt.	Risk of I.C.S of Mgmt.	Risk of substantive procedure adopted by Auditor.
This is generally high.	This is evaluated in stages.	DR should be inversely proportionate to combined assessment of IR & CR. $DR \times \frac{1}{IR + CR}$ If IR & CR are high DR should be kept at low level.

RELATIONSHIP BETWEEN DETECTION RISK AND COMBINED LEVEL OF INHERENT RISK AND CONTROL RISK

There is an inverse relationship between detection risks and the combined level of inherent and control risks. For example, when inherent and control risks are high, acceptable detection risk needs to be low to

reduce audit risk to an acceptably low level. On the other hand, when inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risk to an acceptably low level

WHAT IS NOT INCLUDED IN AUDIT RISK

- (i) Audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant.
- (ii) Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

ILLUSTRATIONS

ILLUSTRATION NO.1

Question:-XYZ Ltd is engaged in the business and running several stores dealing in variety of items such as ready made garments for all seasons, shoes, gift items, watches etc. There are security tags on each and every item. Moreover, inventory records are physically verified on monthly basis. Discuss the types of inherent, control and detection risks as perceived by the Auditor

Answer:-

- + **Inherent Risk:** Because items may have been misappropriated by employees, therefore, risk to the auditor is that inventory records would be inaccurate.
- + **Control Risk:** There is a security tag on each item displayed. Moreover, inventory records are physically verified on monthly basis. Despite various controls being implemented at the stores, still collusion among employees may be there and risk to auditor would again be that inventory records would be inaccurate.
- + **Detection Risk:** Auditor checks the efficiency and effectiveness of various control systems in place. He would do that by making observation, inspection, enquiry, etc. In addition to these, the auditor would also employ sampling techniques to check few sales transactions from beginning to end. However, despite all these procedures, the auditor may not detect the items which have been stolen or misappropriated.

ILLUSTRATION NO.2

Question:- A Partnership Firm of Chartered Accountants HT and Associates was appointed to audit the books of accounts of Wind and Ice Limited for the financial year 2020-21. There was a risk that HT and Associates would give an inappropriate audit opinion if the financial statements of Wind and Ice Limited are materially misstated. State the Risk mentioned in the question

Answer:- The risk mentioned in the question is known as Audit Risk, because risk that auditor of a company will give an inappropriate audit opinion if the financial statements of that company are materially misstated is known as Audit Risk.

RISK OF MIS-STATEMENT AT TWO LEVELS

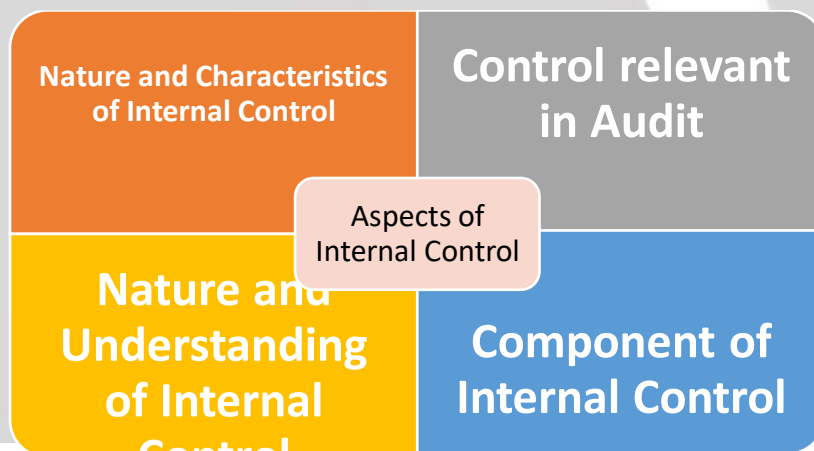
- ✚ **The overall financial statement level-** Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
- ✚ **The assertion level for classes of transactions, account balances, and disclosures-**Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

GREATER RISK OF MIS-STATEMENT**RISKS OF MATERIAL MISSTATEMENT---GREATER FOR SIGNIFICANT NON-ROUTINE TRANSACTIONS**

- ✚ 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.

RISKS OF MATERIAL MISSTATEMENT-- GREATER FOR SIGNIFICANT JUDGMENTAL MATTERS

- ✚ Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:
 - ✓ Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
 - ✓ Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.



NATURE	CONTROLS RELEVANT TO AUDIT	RISK ASS. PROCEDURE	COMPONENTS
<p>NATURE</p> <ul style="list-style-type: none"> + Proper organization Structure:-A good internal control system should involve segregation of duties + Scheme of Authorisation:- Every transaction is duly authorized by the competent official + Internal Check:- Accounting procedures should be that no single person is authorized to carry out all the operations + Suitable personnel:- Competent and honest persons should be employed in the organization + Internal Audit system:-The management may establish an internal audit department 	<p>CONTROLS OVER THE COMPLETENESS AND ACCURACY OF INFORMATION</p> <p>For example, in auditing revenue by applying standard prices to records of sales volume, the auditor considers the accuracy of the price information and the completeness and accuracy of the sales volume data.</p> <p>INTERNAL CONTROL OVER SAFEGUARDING OF ASSETS</p> <p>Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives.</p> <p>CONTROLS RELATING TO OBJECTIVES THAT ARE NOT RELEVANT TO AN AUDIT</p> <p>An entity generally has controls relating to objectives that are not relevant to an audit and therefore need not be considered. For example, an entity may rely on a sophisticated system of automated controls to provide efficient and effective operations (such as an airline's system of automated controls to maintain flight schedules),</p>	<p>Risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls may include-</p> <ul style="list-style-type: none"> ✓ Inquiring of entity personnel. ✓ Observing the application of specific controls. ✓ Inspecting documents and reports. ✓ Tracing transactions through the information system relevant to financial reporting. 	<ul style="list-style-type: none"> + The control environment; + The entity's risk assessment process + The information system, including the related business processes, relevant to financial reporting, and communication + Control activities + Monitoring of controls

LIMITATIONS OF INTERNAL CONTROL

- + **Role of Human Judgement:-**The realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error.
- + **Cost effectiveness:-**Cost of implementation of control may be more than Benefits. controls.
- + **Human error:-**Human error which may occur while carrying internal control system.
- + **Abuse of Authority:-**The person responsible for exercising control can himself over ride it.
- + **Manipulation by Management:-**Manipulation by Top level Mgmt may not be detected by control system.

✚ **Unusual transaction:**-Any unusual transaction cannot be controlled because control procedures are generally made for usual transactions.

Change in conditions:-Establish control procedure may become inadequate in a fast changing environment

Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:

- ✚ Materiality.
- ✚ The significance of the related risk.
- ✚ The size of the entity.
- ✚ The nature of the entity's business, including its organisation and ownership characteristics.
- ✚ The diversity and complexity of the entity's operations.
- ✚ Applicable legal and regulatory requirements.
- ✚ The circumstances and the applicable component of internal control.
- ✚ The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.

COMPONENTS OF INTERNAL CONTROL

CONTROL ENVIRONMENT

ELEMENTS OF THE CONTROL ENVIRONMENT

- ✚ **Communication and enforcement of integrity and ethical values:**-These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.
- ✚ **Commitment to competence:**-Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge
- ✚ **Participation by those charged with governance:**-Attributes of those charged with governance such as:
 - ✓ Their independence from management.
 - ✓ Their experience and stature.
 - ✓ The extent of their involvement and the information they receive, and the scrutiny of activities.
 - ✓ The appropriateness of their actions, including the degree to which difficult questions are raised and pursued with management, and their interaction with internal and external auditors.
- ✚ **Management's philosophy and operating style:**-Characteristics such as management's:
 - ✓ Approach to taking and managing business risks.
 - ✓ Attitudes and actions toward financial reporting.
 - ✓ Attitudes toward information processing and accounting functions and personnel.
- ✚ **Organisational structure:**-The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed.
- ✚ **Assignment of authority and responsibility:**-Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are

established.

- ✚ **Human resource policies and practices:-** Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.

ENTITY'S RISK ASSESSMENT PROCESS

The auditor shall obtain an understanding of whether the entity has a process for:

- ✚ Identifying business risks relevant to financial reporting objectives;
- ✚ Estimating the significance of the risks;
- ✚ Assessing the likelihood of their occurrence; and
- ✚ Deciding about actions to address those risks.

BUSINESS PROCESS/INFORMATION SYSTEM RELEVANT TO FINANCIAL REPORTING

COMMUNICATING FINANCIAL RESPONSIBILITIES

The auditor shall obtain an understanding of how the entity communicates financial reporting roles and responsibilities by considering the following points:-

(i) Understanding of Roles and Responsibilities: Communication by the entity of the financial reporting roles and responsibilities would involve providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting.

(ii) Understanding regarding Relation of Activities: It includes understanding by employees as to how their activities relate to the work of others and the means of reporting exceptions to higher level within the entity.

(iii) Policy Manuals and Financial Reporting Manuals: Communication may take such forms as policy manuals and financial reporting manuals.

(iv) Open Communication Channels: Open communication channels help ensure that exceptions are reported and acted on.

(v) Less structured and easier for Small Entities: Communication may be less structured and easier to achieve in a small entity than in a larger entity due to fewer levels of responsibility and management's greater visibility and availability.

CONTROL ACTIVITIES

- ✚ Control activities that are relevant to the audit are:
 - ✓ Control activities that relate to significant risks and those that relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; or
 - ✓ Those that are considered to be relevant in the judgment of the auditor;
 - ✓ As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk.

MONITORING OF CONTROL

The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting.

- ✚ **Monitoring of controls Defined:-** Monitoring of controls is a process to assess the effectiveness of internal control performance over time.

- ✦ **Helps in assessing the effectiveness of controls on a timely basis:** It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.
- ✦ **Management accomplishes through ongoing activities, separate evaluations etc.:** Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.
- ✦ **Management's monitoring activities include:** Management's monitoring activities may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.
- ✦ **In case of Small Entities:** Management's monitoring of control is often accomplished by management's or the owner-manager's close involvement in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to remedial action to the control.

MONITORING OF CONTROLS IF THE ENTITY HAS AN INTERNAL AUDIT FUNCTION

If the entity has an internal audit function, the auditor shall obtain an understanding of the following :

- (a) The internal audit function's responsibilities and how the internal audit function fits in the entity's organisational structure; and
- (b) The activities performed, or to be performed, by the internal audit function

The following points shall be considered in this regard:

- ✦ **Internal Audit Function relevant to the Audit:** The entity's internal audit function is likely to be relevant to the audit if its activities are related to the entity's financial reporting. Also if the auditor expects to use the work of the internal auditors to modify the audit procedures to be performed. When the auditor determines that the internal audit function is likely to be relevant to the audit, SA 610 applies.
- ✦ **Size and Structure of the Entity:** The objectives of an internal audit function vary widely depending on the size and structure of the entity and the requirements of management.
- ✦ **Internal audit function may include:** The responsibilities of an internal audit function may include, for example, monitoring of internal control, risk management, and review of compliance with laws and regulations.
- ✦ On the other hand, the responsibilities of the internal audit function may be limited to the review of the economy, efficiency and effectiveness of operations, for example, and accordingly, may not relate to the entity's financial reporting.
- ✦ **External auditor's activities-** on the basis of Internal Audit activities: If the internal audit function's responsibilities are related to the entity's financial reporting, the external auditor's consideration of

the activities performed may include review of the internal audit function's audit plan for the period.

TOOLS TO REVIEW/EVALUATE INTERNAL CONTROL SYSTEM

NARRATIVE RECORD

Meaning:- Complete & exhaustive detail of system as found in operation by Auditor.

Advantages:-

- Suitable for small business.
- When properly formed IC is not found
- Complete description is needed.

Limitations:-

- Time consuming.
- Detailed observation is needed.
- Not suitable for Big enterprises.

CHECK LIST

Meaning:- It contains series of questions to be asked by audit staff.

Advantages:-

- Easy location of Weakness
- Supervision by senior audit staff, thus weakness can't be overlooked.

Limitations:-

- Requires intelligence to prepare proper check list.
- Client can Manipulate when responding to questions raised by audit staff.

Examples of Check-list are as follows:-

1. Are tenders called before placing orders?
2. Are the purchases made on the basis of a written order?
3. Is the purchase order form standardised?
4. Are purchase order forms pre-numbered?
5. Are the inventory control accounts maintained by persons who have nothing to do with custody of work, receipt of inventory, inspection of inventory and purchase of inventory?

I.C. QUESTIONAIRE

Meaning:- Comprehensive series on question on each aspect of Internal control prepared by auditor and filled by the client employees

+ Advantages:-

- Detailed questionnaire thus no important aspect is overlooked.
- Weaknesses are easily located.
- Evaluating Internal control system becomes systematic and easy.

+ Limitations:-

- Time consuming to prepare questionnaire.
- Client can manipulate the answers.

FLOW CHART

+ Meaning:-

- It is a graphic presentation of each part of the company's system of internal control.
- A flow chart is considered to be the most concise way of recording the auditor's review of the system.
- It minimises the amount of narrative explanation and thereby achieves a consideration or presentation not possible in any other form.
- It gives bird's eye view of the system and the flow of transactions and integration and in documentation, can be easily spotted and improvements can be suggested.

+ Advantages:-

- Concept presentation
- Easily understandable

+ Limitations:-

- Time consuming to prepare flow chart
- Weakness can't be readily located.

BENEFITS

The review of internal controls will enable the auditor to know:

- (i) whether errors and frauds are likely to be located in the ordinary course of operations of the business;
- (ii) whether an adequate internal control system is in use and operating as planned by the management;
- (iii) whether an effective internal auditing department is operating;
- (iv) whether any administrative control has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);
- (v) whether the controls adequately safeguard the assets;
- (vi) how far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned;
- (vii) how reliable the reports, records and the certificates to the management can be;
- (viii) the extent and the depth of the examination that he needs to carry out in the different areas of accounting;
- (ix) what would be appropriate audit technique and the audit procedure in the given circumstances;
- (x) what are the areas where control is weak and where it is excessive

FORMULATE AUDIT PROGRAMME AFTER UNDERSTANDING INTERNAL CONTROL

- ✦ The auditor can formulate his entire audit programme only after he has had a **satisfactory understanding of the internal control systems and their actual operation**. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy and the object of the audit may be altogether lost in the mass of entries and vouchers.
- ✦ It is also important for him to **know whether the system is actually in operation**.
- ✦ It would be better if the auditor can undertake the review of the internal control system of client. This will give him enough time to assimilate the controls and implications and will enable him to be more objective in the framing of the audit programme. He will also be in a position **to bring to the notice of the management the weaknesses of the system and to suggest measures for improvement**.
- ✦ A proper understanding of the internal control system in its content and working also enables an auditor **to decide upon the appropriate audit procedure** to be applied in different areas to be covered in the audit programme.
- ✦ In a situation where the internal controls are considered weak in some areas, **the auditor might choose an auditing procedure or test that otherwise might not be required; he might extend certain tests to cover a large number of transactions** or other items than he otherwise would examine and at times he may perform additional tests to bring him the necessary satisfaction.

MANUAL AND AUTOMATED CONTROLS

CHARACTERISTICS OF MANUAL AND AUTOMATED ELEMENTS OF INTERNAL CONTROL RELEVANT TO THE AUDITOR'S RISK ASSESSMENT

- ✦ **Use of IT**:-An entity's mix of manual and automated elements in internal control varies with the nature and complexity of the entity's use of IT.
- ✦ **Suitability**:-Manual elements in internal control may be more suitable where judgment and discretion are required.
- ✦ **Reliability**:-Manual elements in internal control may be less reliable than automated elements because they can be more easily bypassed, ignored, or overridden and they are also more prone to simple errors and mistakes. Consistency of application of a manual control element cannot therefore be assumed.
- ✦ **Nature of Entity's Information System**:-The extent and nature of the risks to internal control vary depending on the nature and characteristics of the entity's information system. The entity responds to the risks arising from the use of IT or from use of manual elements in internal control by establishing effective controls in light of the characteristics of the entity's information system.

BENEFITS OF AUTOMATED CONTROLS

- ✦ Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;

- ✦ Enhance the timeliness, availability, and accuracy of information; Facilitate the additional analysis of information;
- ✦ Enhance the ability to monitor the performance of the entity's activities and its policies and procedures;
- ✦ Reduce the risk that controls will be circumvented; and
- ✦ Enhance the ability to achieve effective segregation of duties by implementing security controls in applications, databases, and operating systems.

RISK INCURRED BY IT IN INTERNAL CONTROL OF AN ENTITY

- ✦ Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- ✦ Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
- ✦ The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- ✦ Unauthorised changes to data in master files. Unauthorised changes to systems or programs.
- ✦ Failure to make necessary changes to systems or programs. Inappropriate manual intervention.
- ✦ Potential loss of data or inability to access data as required.

TESTING OF CONTROLS

TEST OF CONTROLS MAY 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.

INTERNAL AUDIT

MEANING

An independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto.

NEED/OBJECTIVE

- ✦ **Activities Relating to Governance:** The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness

of communication among those charged with governance, external and internal auditors, and management.

- ✚ **Activities Relating to Risk Management:** The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process). The internal audit function may perform procedures to assist the entity in the detection of fraud.
- ✚ **Activities Relating to Internal Control:**
 - (i) **Evaluation of internal control:** The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto.
 - (ii) **Examination of financial and operating information:** The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
 - (iii) **Review of operating activities:** The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including nonfinancial activities of an entity.
 - (vi) **Review of compliance with laws and regulations:** The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements

PROVISIONS W.R.T. INTERNAL AUDIT (SECTION 138)

- ✚ **Applicability:-**The following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely:
 - Every Listed Company.
 - Every unlisted company, having during the preceding financial year:
 - ✓ paid up share capital of Rs 50 crore or more; or
 - ✓ turnover of Rs 200 crore or more; or
 - ✓ outstanding loans or borrowings from banks or public financial institutions exceeding Rs 100 crore or more at any point of time; or
 - ✓ outstanding deposits of Rs 25 crore or more at any point of time; and
 - Every private company, having during the preceding financial year:
 - ✓ turnover of Rs 200 crore or more; or
 - ✓ outstanding loans or borrowings from banks or public financial institutions exceeding Rs 100 crore or more at any point of time.
- ✚ **Qualification of Cost Auditor:-** A Chartered accountant (practicing or not) or a cost accountant, or such other professional as may be decided by the Board.
- ✚ *The internal auditor may or may not be an employee of the company.*



CRO0677296

CRO0677296

CRO0677296

Chapter 14 | STANDARD ON AUDITING (SA)-240

SA 240

RESPONSIBILITY FOR DETECTION OF FRAUD

- ✚ **Responsibility of Management:-**The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.
- ✚ **Responsibility of Auditor:-**
 - An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.
 - When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit

ISSUES IN DETECTION OF FRAUD

- ✚ The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error.
- ✚ The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud.

TYPES OF FRAUD

- ✚ **Types of Fraud:-**The auditor is concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor –
 - Misstatements resulting from fraudulent financial reporting.
 - Misstatements resulting from misappropriation of assets.
- ✚ **Fraudulent financial reporting:-**Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:
 - Recording fictitious journal entries,
 - Inappropriately adjusting assumptions
 - Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
 - Concealing, or not disclosing, facts that could affect the amounts recorded
 - Engaging in complex transactions
 - Altering records and terms related to significant and unusual transactions.

- + Misappropriation of assets can be accomplished in a variety of ways including:
 - Embezzling receipts.
 - Stealing physical assets or intellectual property.
 - Causing an entity to pay for goods and services not received.
 - Using an entity's assets for personal use.

DEFALCATION OF CASH

INFLATING CASH PAYMENTS	SUPPRESSING CASH RECEIPTS	WRONG TOTALS IN CASH BOOK
<ul style="list-style-type: none"> + Making payments against <u>fictitious vouchers.</u> + Making payments against vouchers, the <u>amounts whereof have been inflated.</u> + <u>Manipulating totals of wage rolls</u> either by including therein names of dummy workers or by inflating them in any other manner. + <u>Casting a larger totals for petty cash expenditure</u> and adjusting the excess in the totals of the detailed columns so that cross totals show agreement 	<ul style="list-style-type: none"> + <u>Teeming and Lading:</u> Amount received from a customer being misappropriated; also to prevent its detection the money received from another customer subsequently being credited to the account of the customer who has paid earlier. + <u>Adjusting unauthorised or fictitious rebates,</u> allowances, discounts, etc. to customer' accounts and misappropriating amount paid by them. + <u>Writing off as debts</u> in respect of such balances against which cash has already been received but has been misappropriated. + <u>Not accounting for cash sales fully.</u> + <u>Not accounting for miscellaneous receipts,</u> e.g., sale of scrap, quarters allotted to the employees, etc. + <u>Writing down asset values</u> in entirety, selling them subsequently and misappropriating the proceeds. 	

THE FOLLOWING MUST BE DONE TO PREVENTION MISAPPROPRIATION OF GOODS:-

- + record keeping about the physical quantities and their periodic checks,
- + there must be rules and procedures for allowing persons inside the area where goods are kept.
- + In addition there should be external security arrangements to see that no goods are taken out without proper authority.
- + Auditors can detect this by undertaking a thorough and strenuous checking of records followed by physical verification process. Also, by resorting to intelligent ratio analysis, auditors may be able to form an idea whether such fraud exists.

FRAUD RISK FACTORS

+ FRAUDULENT FINANCIAL REPORTING

INCENTIVE/PRESSURES	OPPORTUNITIES	ATTITUDES/RATIONALIZATION
<p>+ High degree of <u>competition</u> or market saturation, accompanied by declining margins.</p> <p>+ High vulnerability to <u>rapid changes, such as changes in technology,</u> product obsolescence, or interest rates.</p> <p>+ Significant declines in <u>customer demand</u> and increasing business failures in either the industry or overall economy.</p> <p>+ Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.</p> <p>+ Recurring negative cash flows from <u>operations</u> or an inability to generate cash flows from operations while reporting earnings and earnings growth.</p> <p>+ New accounting, <u>statutory,</u> or <u>regulatory requirements.</u></p>	<p>+ Significant related-party <u>transactions not in the ordinary course of business</u> or with related entities not audited or audited by another firm.</p> <p>+ A strong financial presence or ability to <u>dominate a certain industry sector</u> that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions.</p> <p>+ Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.</p> <p>+ Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions</p> <p>+ Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification</p>	<ol style="list-style-type: none"> 1. Known history of violations of <u>securities laws</u> or other laws and regulations 2. Excessive interest by management in maintaining or increasing the entity's inventory price or earnings trend. 3. Management failing to remedy known significant deficiencies in internal control on a timely basis. 4. An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons. 5. The owner-manager makes no distinction between personal and business transactions. 6. The relationship between management and the current or predecessor auditor is strained, as exhibited by the following <ul style="list-style-type: none"> ✓ Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters. ✓ Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit ✓ Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with TCWG ✓ Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of

the auditor's work

MISAPPROPRIATION OF ASSETS

INCENTIVE/PRESSURES	OPPORTUNITIES	ATTITUDES/RATIONALIZATION
<ul style="list-style-type: none"> ✚ Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets. ✚ Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following: <ul style="list-style-type: none"> ✚ Known or anticipated future employee layoffs. ✚ Recent or anticipated changes to employee compensation or benefit plans. ✚ Promotions, compensation, or other rewards inconsistent with expectations. 	<ul style="list-style-type: none"> ✚ Large amounts of cash on hand or processed. ✚ Inventory items that are small in size, of high value, or in high demand. ✚ Easily convertible assets, such as bearer bonds, diamonds, or computer chips. ✚ Fixed assets which are small in size, marketable, or lacking observable identification of ownership. ✚ Weak Internal Control System <ul style="list-style-type: none"> ✓ Inadequate segregation of duties or independent checks. ✓ Inadequate oversight of senior management expenditures, such as travel and other reimbursements. ✓ Inadequate record keeping with respect to assets. ✓ Inadequate system of authorization and approval of transactions (for example, in purchasing). ✓ Inadequate physical safeguards over cash, investments, inventory, or fixed assets. 	<ul style="list-style-type: none"> ✚ Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control. ✚ Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee. ✚ Changes in behavior or lifestyle that may indicate assets have been misappropriated ✚ Tolerance of petty theft.

CIRCUMSTANCES RELATING TO POSSIBILITY OF FRAUD

(A) Discrepancies in the accounting records, including:

- ✚ Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy.
- ✚ Unsupported or unauthorized balances or transactions.
- ✚ Last-minute adjustments that significantly affect financial results.

- ✚ Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties.
- ✚ Tips or complaints to the auditor about alleged fraud.

(B) Conflicting or missing evidence, including:

- ✚ Missing documents.
- ✚ Documents that appear to have been altered.
- ✚ Missing or non-existent cancelled cheques
- ✚ Missing inventory or physical assets of significant magnitude.
- ✚ Unavailable or missing electronic evidence,

(C) Problematic or unusual relationships between the auditor and management, including:

- ✚ Denial of access to records,.
- ✚ Undue time pressures imposed by management to resolve complex or contentious issues.
- ✚ Unusual delays by the entity in providing requested information.
- ✚ Unwillingness to facilitate auditor access to key electronic files for testing
- ✚ Denial of access to key IT operations staff and facilities,

(D) Other

- ✚ Unwillingness by management to permit the auditor to meet privately with those charged with governance.
- ✚ Accounting policies that appear to be at variance with industry norms.
- ✚ Frequent changes in accounting estimates that do not appear to result from changed circumstances.
- ✚ Tolerance of violations of the entity's Code of Conduct.

REPORTING ON FRAUD

REPORTING U/S 143(12)

REPORTING OF FRAUD BY THE AUDITOR [Sec 143(12)]



MANNER OF REPORTING [SEC 143(12)]

- ✚ The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;
- ✚ The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
- ✚ The report shall be in the form of a statement as specified in Form ADT-4.

REPORTING UNDER CARO, 2016

- ✚ The auditor is also required to report under clause (xi) of paragraph 3 of Companies (Auditor's Report) Order, 2020, 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.
- ✚ The auditor is also required to report whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government; and whether the auditor has considered whistle-blower complaints, if any, received during the year by the company
- ✚ The scope of auditor's inquiry under this clause is restricted to following:
 - ✓ frauds 'noticed or reported' during the year;
 - ✓ reporting on filing of any report in Form ADT-4 during the year; and
 - ✓ whistle-blower complaints, if any, received during the year
- ✚ For reporting under this clause, the auditor may consider the following:

- ✓ This clause requires all frauds noticed or reported during the year shall be reported indicating the nature and amount involved. As specified the fraud by the company or on the company by its officers or employees are only covered.
- ✓ Of the frauds covered under section 143(12) of the Act, only noticed frauds shall be included here and not the suspected frauds.
- ✓ While reporting under this clause with regard to the nature and the amount involved of the frauds noticed or reported, the auditor may also consider the principles of materiality outlined in Standards on Auditing

SECTION 143(12) OF COMPANIES ACT, 2013 (OTHER THAN TO CG)

Sub-section (12) of section 143 of the Companies Act, 2013 furthermore prescribes that the companies, whose auditors have reported frauds under this sub-section (12) to the audit committee or the Board, but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

In this regard, sub-rule (4) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that the auditor is also required to disclose in the Board's Report the following details of each of the fraud reported to the Audit Committee or the Board under sub- rule (3) during the year:

- a. Nature of Fraud with description;
- b. Approximate Amount involved;
- c. Parties involved, if remedial action not taken; and
- d. Remedial actions taken.

OBTAINING WRITTEN REPRESENTATION FROM MANAGEMENT

The auditor should obtain written representations from management that:

- ✚ it acknowledges its responsibility for the implementation and operation of accounting and internal control systems that are designed to prevent and detect fraud and error;
- ✚ it believes the effects of those uncorrected misstatements in financial statements, aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such items should be included in or attached to the written representation;
- ✚ it has
 - ✓ disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity; and
 - ✓ it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

AUDITOR UNABLE TO CONTINUE

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- ✚ Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

- + Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and
- + If the auditor withdraws:
 - ✓ Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
 - ✓ Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.



Chapter 15 STANDARDS ON AUDITING-520

SA 520

DEFINITIONS

- ✚ **Analytical Procedures:-** Analytical Procedures refers to the evaluation of financial information through analysis of plausible relationships among both financial and non-financial data such investigation as is necessary of identified fluctuations or relationships that are inconsistent.
 - ❖ Analytical procedures include the consideration of comparisons of the entity's financial information, for example:
 - Comparable information for prior periods.
 - Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
 - Similar industry information, such as comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparative size in the same industry.

PURPOSE OF ANALYTICAL PROCEDURES

- ✚ Analytical procedures use comparisons and relationships to assess whether account balances or other data **appear reasonable**.
- ✚ Similarly, it would also be **possible to compare the balances on the Statement of Profit and Loss with that of the previous period**, it would be possible to find out the reasons for increase or decrease in the amount of profits of those years.
- ✚ By setting up certain expenses ratios on the basis of balances included in the Statement of Profit and Loss, for the year under audit, comparing them with the same ratios for the previous year, it is possible **to ascertain the extent of increase or decrease in various items of expenditure** in relation to sales and that of trading profit in relation to sales.
- ✚ If differences are found to be material, the auditor would ascertain the reasons thereof and assess **whether the accounts have been manipulated** to inflate or suppress profits.
- ✚ **An abnormal fall in the cost of manufacture or that in the administrative cost**, apart from economy in expenses, there could be no provision or less provision for expenses incurred in the year.
- ✚ Similarly, the amount of **any income or expenses which has a direct relationship with the amount of profits or that of sales can be verified independently**, e.g., commission paid to a manager calculated on the basis of net profits, commission paid to a selling agent as percentage of sales, etc. Such calculation of ratios, trends and comparisons is also termed as analytical review.

TIMING OF ANALYTICAL PROCEDURES

- Experienced auditors use analytical procedures in all stages of the audit. Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase

ANALYTICAL PROCEDURES AT PLANNING STAGE

In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware.

This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information

FACTORS TO BE CONSIDERED FOR SUBSTANTIVE ANALYTICAL PROCEDURES

- Availability of Data:**-The availability of reliable and relevant data will facilitate effective analytical procedures.
- Disaggregation:**-The degree of disaggregation in available data can directly affect the degree of its usefulness in detecting misstatements.
- Account Type:**-Substantive analytical procedures are more useful for certain types of accounts than for others. Income statement accounts tend to be more predictable because they reflect accumulated transactions over a period, whereas balance sheet accounts represent the net effect of transactions at a point in time or are subject to greater management judgment.
- Source:**-Some classes of transactions tend to be more predictable because they consist of numerous, similar transactions, (e.g., through routine processes). Whereas the transactions recorded by non-routine and estimation SCOTs (Significant Classes of Transactions) are often subject to management judgment and therefore more difficult to predict.
- Predictability:**-Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable (e.g., between sales and cost of sales or between trade receivables and cash receipts). A predictable relationship is one that may reasonably be expected to exist and continue over time.
- Nature of Assertion:**-Substantive analytical procedures may be more effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations). Predictive analytical procedures using data analytics can be used to address completeness, valuation/measurement and occurrence.
- Inherent Risk or "What Can Go Wrong":**-When we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement in

order to determine if a substantive analytical procedure can be used to obtain audit evidence. When inherent risk is higher, we may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient.

TECHNIQUES OF SUBSTANTIVE ANALYTICAL PROCEDURES

✚ **Trend analysis**:-Trend analysis is a commonly used technique. It is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. The auditor evaluates whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.

In other words, trend analysis implies analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years.

✚ **Ratio analysis**:-Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry.

✚ **Reasonableness tests**:-Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts. In other words these tests are made by reviewing the relationship of certain account balances to other balances for reasonableness of amounts.

EXAMPLES

- ✚ Raw Material Consumption to Production (quantity)
- ✚ Wastage & Scrap % against production & raw material consumption (quantity)
- ✚ Work-in-Progress based on issued of materials & Sales (quantity)
- ✚ Sales discounts and commissions against sales volume
- ✚ Rental revenues based on occupancy of premises

✚ **Structural modelling**:-A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression).

ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS

✚ When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures, the auditor shall:

- Determine the **suitability** of particular substantive analytical procedures for given assertions.
- Evaluate the **reliability** of the data.

- **Develop an expectation** of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.
- **Determine the amount of any difference** of recorded amounts from expected values that is acceptable without further investigation.

SUITABILITY OF SUBSTANTIVE ANALYTICAL PROCEDURES

- ✚ 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** and 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 misstatements, may cause the financial statements to be materially misstated.
In some cases, even an unsophisticated predictive model may be effective as an analytical procedure.
- ✚ **Different types of analytical procedures provide different levels of assurance.** Analytical procedures involving, for example, the prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified.
- ✚ The determination of the suitability of particular substantive analytical procedure **is influenced by the nature of the assertion** and the auditor's assessment of the risk of material misstatement.
For example, if controls over sales order processing are weak, the auditor may place more reliance on tests of details rather than on substantive analytical procedures for assertions related to receivables

RELIABILITY OF SUBSTANTIVE ANALYTICAL PROCEDURES

- ✚ Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity;
- ✚ Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products;
- ✚ Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved; and
- ✚ Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

EVALUATION WHETHER THE INFORMATION IS SUFFICIENTLY PRECISE

- ✚ The accuracy with which the expected results of substantive analytical procedures can be predicted.
For example, the auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.

✚ The degree to which information can be disaggregated.
For example, substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole.

✚ The availability of the information, both financial and non-financial.
For example, the auditor may consider whether financial information, such as budgets or forecasts, and non-financial information, such as the number of units produced or sold, is available to design substantive analytical procedures. If the information is available, the auditor may also consider the reliability of the information.

INVESTIGATING RESULTS OF SUBSTANTIVE ANALYTICAL PROCEDURES

If analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

- ✚ Inquiring of management and obtaining appropriate audit evidence relevant to management's responses.
- ✚ Performing other audit procedures as necessary in the circumstances.

ANALYTICAL PROCEDURES THAT ASSIST WHEN FORMING AN OVERALL CONCLUSION

The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

The results of analytical procedures are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements. This assists the auditor to draw reasonable conclusions on which to base the auditor's opinion.

Chapter 16 STANDARDS ON AUDITING-530

SA 530

DEFINITIONS

- ✚ **Audit Sampling** – The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.
- ✚ **Population** – The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

CHARACTERISTICS OF POPULATION

The Characteristics of Population are as follows

1. **Appropriateness:** The auditor will need to determine that the population from which the sample is drawn is appropriate for the specific audit objective
It is important for the auditor to ensure that the population is appropriate to the objective of the audit procedure, which will include consideration of the direction of testing
2. **Completeness:** The population also needs to be complete, which means that if the auditor intends to use the sample to draw conclusions about whether a control activity is operated effectively during the financial reporting period, the population needs to include all relevant items i.e all the activities that form part of that relevant internal control, throughout the entire period
3. **Reliable:** Auditor should obtain evidence about the reliability of population. If population is not reliable with respect to accuracy and source, the sample drawn will definitely not be relevant for the specific audit objective.

- ✚ **Sampling Risk** – The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:
 - ✓ In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
 - ✓ In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

- ✚ **Non – Sampling Risk** – The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. Examples of non-sampling risk include use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognise a misstatement or deviation.
- ✚ **Anomaly** – A misstatement or deviation that is demonstrably not representative of misstatements or deviations in a population.
- ✚ **Sampling Unit** – The individual items constituting a population. The sampling units might be physical items (for example, cheques listed on deposit slips, credit entries on bank statements, sales invoices or debtors' balances) or monetary units.
- ✚ **Statistical Sampling** – An approach to sampling that has the following characteristics:
 - ✓ Random selection of the sample items.
 - ✓ The use of probability theory to evaluate sample results, including measurement of sampling risk.
- ✚ **Stratification** – The process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).
- ✚ **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 may be the same amount or an amount lower than performance materiality.
- ✚ **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.

APPROACHES TO SAMPLING

STATISTICAL SAMPLING

- ✚ **Meaning:-** Statistical sampling is an approach to sampling that has the random selection of the sample units; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.
- ✚ **Characteristics:-**
 1. Audit testing done through this approach is **more scientific than testing based entirely on the auditor's own judgment** because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.
 2. Statistical sampling has reasonably wide application **where a population to be tested consists of a large number of similar items**
 3. **There is no personal bias of the auditor** in case of statistical sampling. Since it is scientific, the results of sample can be evaluated and projected on the whole population in a more reliable manner.

4. **In larger organisations, with huge transactions, statistical sampling is always recommended** as it is unbiased and the samples selected are not prejudged.

Advantages:-

1. The amount of testing (**sample size**) **does not increase** in proportion to the increase in the size of the area (universe) tested.
2. The **sample selection is more objective** and thereby more defensible.
3. The method provides a means of **estimating the minimum sample size** associated with a specified risk and precision.
4. It provides a means for deriving a "**calculated risk**" and corresponding precision (sampling error)
5. It may provide **a better description of a large mass of data** than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large
6. It is **widely accepted way of sampling as it is more scientific**, without personal bias and the result of sample can be evaluated and projected in more reliable way.

Disadvantages:-

1. It is complex to operate
2. It requires trained staff members
3. It will not be cost effective on the part of Auditor

JUDGEMENTAL SAMPLING

- Meaning:-** Under this approach, the sample size and its composition are determined on the basis of the personal experience and knowledge of the auditor.

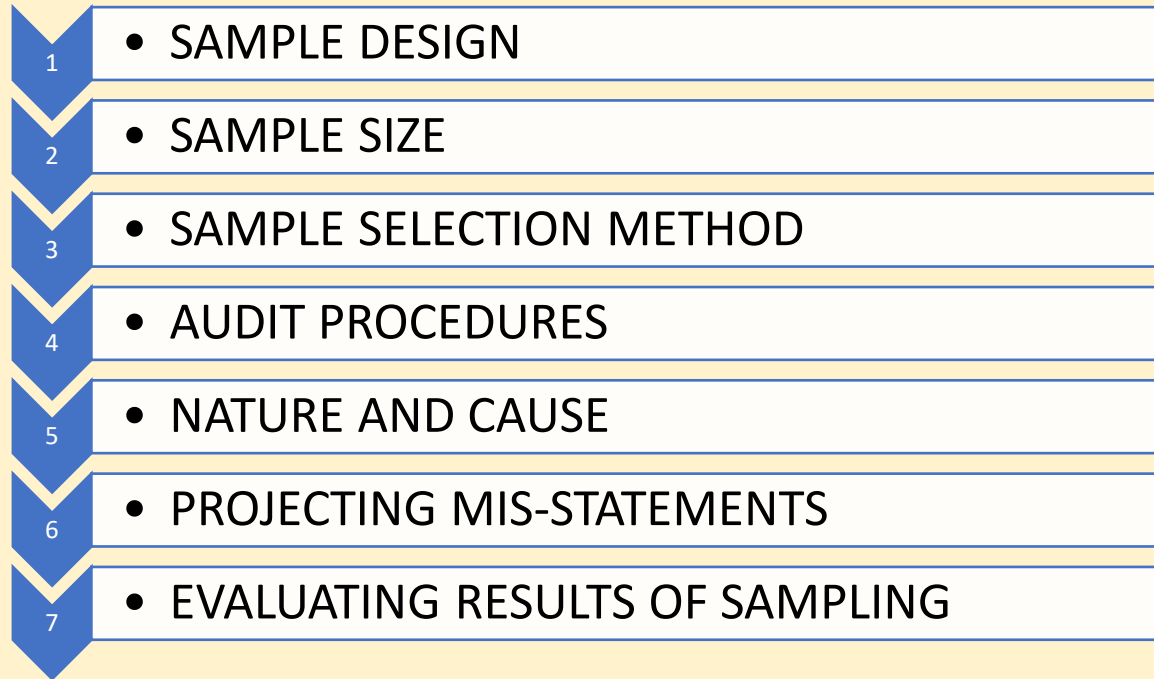
Advantages:-

- 1) It is **simple to operate**
- 2) **No requirement of trained staff** members
- 3) However, it may be stated that the auditor with his experience and knowledge of the client's business can evaluate accurately enough the sample findings to make audit decision and the **mathematical proof of accuracy in some cases may be a luxury which the auditor cannot afford.**

Disadvantages:-

1. The non-statistical sampling is criticized on the grounds that it **is neither objective nor scientific.**
2. The expected degree of objectivity cannot be assured in non- statistical sampling because the risk of **personal bias** in selection of sample items cannot be eliminated.
3. **The closeness of the qualities** projected by the sample results with that of the whole population **cannot be measured** because the sample has not been selected in accordance with the mathematically based statistical techniques.
4. This method is simple to operate but sometimes **the sample may not be a true representative of the total population** because of personal bias and no scientific method of selection.

SAMPLING PROCESS



1. SAMPLE DESIGN

✚ In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection is appropriate.

- ❖ **Stratification** – Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub – populations which have an identifying characteristic. The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk. The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum. To draw a conclusion on the entire population, the auditor will need to consider the risk of material misstatement in relation to whatever other strata make up the entire population.
- ❖ **Value – Weighted Selection** – One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection, and can result in smaller sample sizes. This approach may be used in conjunction with the systematic method of sample selection and is most efficient when selecting items using random selection.

The decision whether to use a statistical or non – statistical sampling approach is a matter for the auditor’s judgment.

2. SAMPLE SIZE

- ✚ The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.
- ✚ The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower

the risk the auditor is willing to accept, the greater the sample size will need to be.

- The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment.

FACTOR	EFFECT ON SAMPLE SIZE FOR TEST OF CONTROL
An increase in the extent to which the auditor's risk assessment takes into account relevant controls.	Increase
An increase in the tolerable rate of deviation.	Decrease
An increase in the expected rate of deviation of the population to be tested.	Increase
An increase in the auditor's desired level of assurance that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population.	Increase
An increase in the number of sampling units in the population.	Negligible effect

FACTOR	EFFECT ON SAMPLE SIZE FOR TEST OF DETAILS
Higher the auditor's assessment of the risk of material misstatement	Increase
The more the auditor is relying on other substantive procedures	Decrease
The greater the amount of misstatement the auditor expects to find in the population	Increase
An increase in the auditor's desired level of assurance that the tolerable misstatement is not exceeded by actual misstatement in the population.	Increase
An increase in the number of sampling units in the population.	Negligible effect
An increase in tolerable misstatement	Decrease
When stratification of the population is appropriate	Decrease

3. SAMPLE SELECTION METHOD

METHODS TO COLLECT SAMPLE

RANDOM SAMPLING

Random selection ensures that all items in the population or within each stratum have a known chance of selection. It may involve use of random number tables. Random sampling includes two very popular methods which are discussed below—

1. Simple Random Sampling:-

- + Under this method each unit of the whole population e.g. purchase or sales invoice **has an equal chance of being selected.**
- + It is considered that random number tables are simple and easy to use and also **provide assurance that the auditors' bias does not affect the selection.**
- + Each item in a population is selected **by use of random number table** either with a help of computer or picking up a number in a random way (may be randomly from a drum). Today random numbers are also generated using various applications on the cellphones like the random number generator.

This method is considered appropriate provided the **population to be sampled consists of reasonably similar units** and fall within a reasonable range i.e it is suitable for a homogeneous population having a similar range.

2. Stratified Sampling:

- + This method involves dividing the whole population to be tested in a **few separate groups called strata and taking a sample** from each of them.
- + Each stratum is treated as if it was a separate population and if **proportionate of items are selected from each of these stratum.**
- + The number of groups into which the whole population has to be divided is determined **on the basis of auditor judgment.**

The reasoning behind the stratified sampling is that for a **highly diversified population, weights should be allocated to reflect these differences.** It can be seen that the stratified sampling is simply an extension of simple random sampling

SYSTEMATIC SAMPLING

Systematic selection, in which the number of sampling units in the population is divided by the sample size to give a sampling interval. When using systematic selection, the auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval corresponds with a particular pattern in the population.

MONETARY UNIT SAMPLING

Monetary Unit Sampling is a type of value-weighted selection in which sample size, selection and valuation results in a conclusion in monetary amounts.

BLOCK SAMPLING

Block selection involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

HAPHAZARD SAMPLING

Haphazard selection, in which the auditor selects the sample without following a structured technique. Haphazard selection is not appropriate when using statistical sampling.

4. PERFORMING AUDIT PROCEDURES

- ✚ The auditor shall perform audit procedures, appropriate to the purpose, on each item selected.
- ✚ If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item.
- ✚ If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor shall treat that item as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details.

5. NATURE AND CAUSE OF DEVIATION OF MIS-STATEMENTS

- ✚ The auditor shall investigate the nature and causes of any deviations or misstatements identified, and **evaluate their possible effect on the purpose of the audit procedure** and on other areas of the audit.
- ✚ In the extremely rare circumstances when the **auditor considers a misstatement or deviation discovered in a sample to be an anomaly**, the auditor shall obtain **a high degree of certainty** that such misstatement or deviation is not representative of the population.
- ✚ The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.

6. PROJECTING MIS-STATEMENTS

- ✚ The auditor **is required to project misstatements for the population** to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded.
- ✚ When a misstatement has been established as an anomaly, **it may be excluded when projecting misstatements to the population.**
- ✚ For tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.

7. EVALUATING RESULTS OF AUDIT SAMPLING

- ✚ The auditor shall evaluate
 - The results of the sample.
 - Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

- ✚ For tests of controls, an unexpectedly high sample deviation rate may lead to an increase in the assessed risk of material misstatement.
- ✚ For tests of details, an unexpectedly high misstatement amount in a sample may cause the auditor to believe that a class of transactions or account balance is materially misstated.
- ✚ In the case of tests of details, When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested.
- ✚ Also, if the projected misstatement is greater than the auditor's expectations of misstatement used to determine the sample size, the auditor may conclude that there is an unacceptable sampling risk that

the actual misstatement in the population exceeds the tolerable misstatement.

- ✚ If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:
- ✓ Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments.
 - ✓ Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance



Chapter 17

AUDIT IN AUTOMATED ENVIRONMENT

AUTOMATED ENVIRONMENT

Meaning

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.

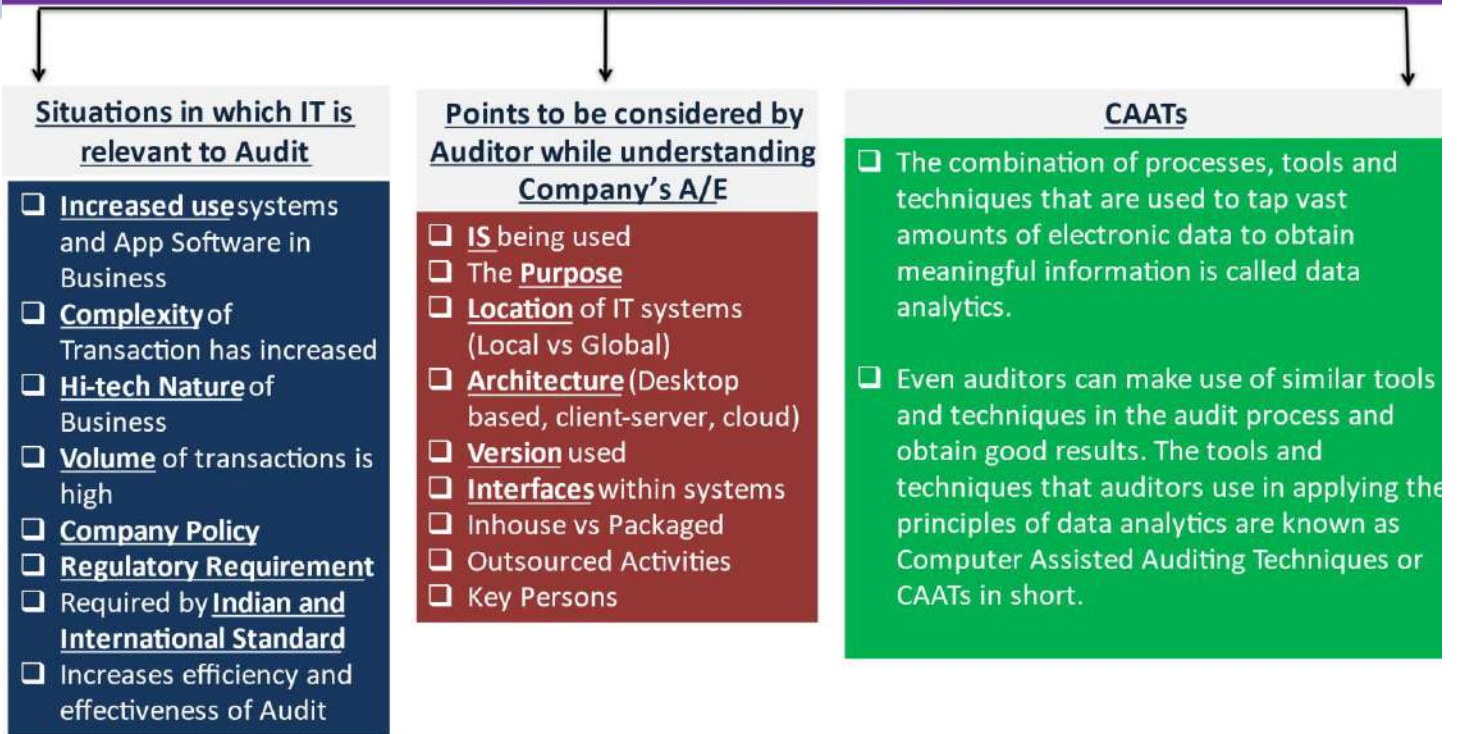
Key Features

- Enables **faster** business operations
- Accuracy** in data processing
- Ability to process **large volume of transactions**
- Integration** between business operations
- Less errors**
- Better **Security**
- Provide latest information
- Connectivity

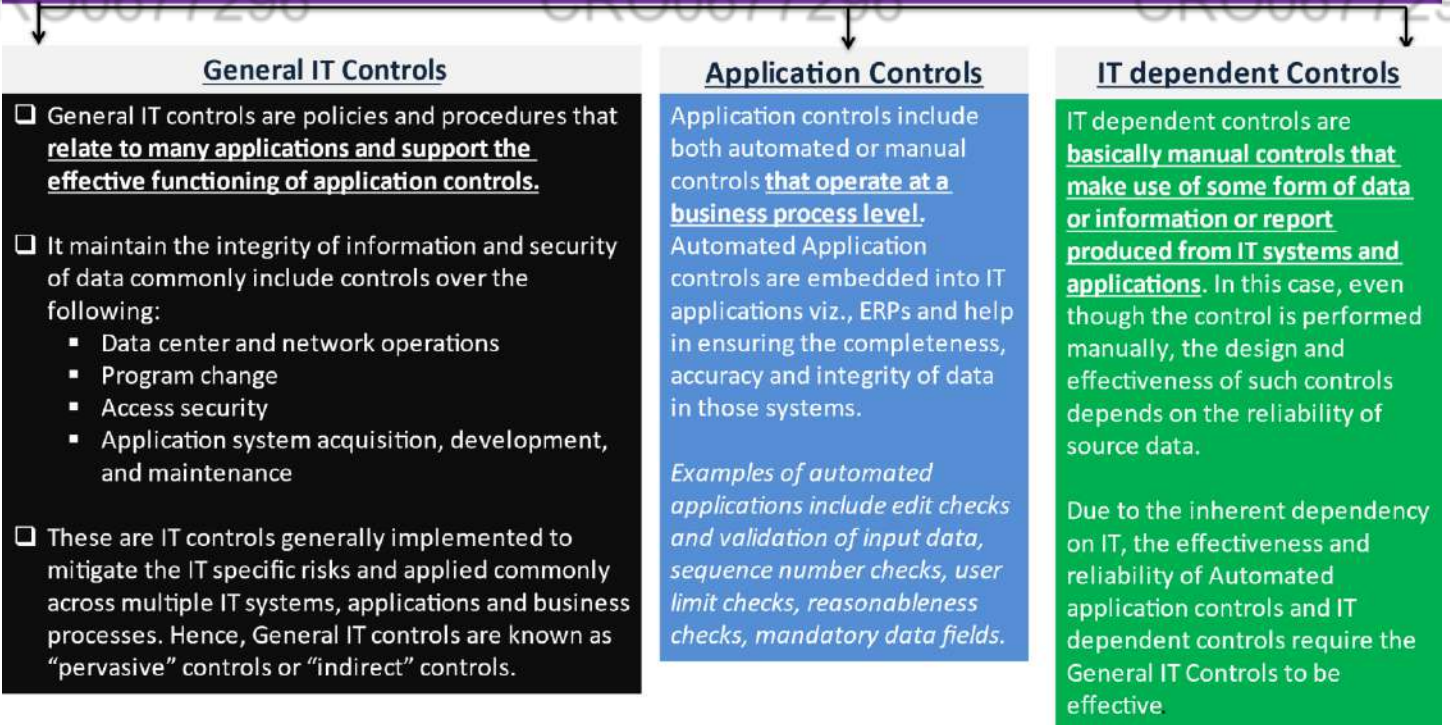
Aspects involved in Automated Environment

- Computation and Calculations are automatically** carried out (for example, bank interest computation and inventory valuation).
- Accounting entries are posted automatically** (for example, sub-ledger to GL postings are automatic).
- Business policies and procedures, including internal controls**, are applied automatically (for example, delegation of authority for journal approvals, customer credit limit checks are performed automatically).
- Reports used in business are produced from systems** (for example, debtors ageing report).
- User access and security** are controlled by assigning system roles to users (for example, segregation of duties can be enforced effectively).

AUTOMATED ENVIRONMENT



Types of Controls



Risks in Automated Environment

Kinds of Risks

- Inaccurate processing of data
- 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.

Impact of Risks

- On Substantive Procedures**
 - Cannot rely on the data obtained from systems
 - There must be In-depth Examination
 - More Audit Evidence is needed
- On Controls**
 - Cannot rely on automated controls, system calculations etc.
 - Cannot rely on IT dependent manual controls
 - Systems data & reports must be thoroughly checked
- On Reporting**
 - Communicate to TCWG
 - Modified Audit Report

Testing in Automated Environment

Testing of Automated Controls

- 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 and inspection.
- Observe** how a user processes transactions under different scenarios.
- Inspect** the configuration defined in an application
- 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.
- Conduct reperformance** using raw source data and independently applying formulae, business rules or validations on the source data using CAATs

Testing of Data (Data Analytics)

- 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.**

Auditing in Automated Environment

Types of Testing

When auditing in an automated environment, the following testing methods are used:

- (a) Inquiry
- (b) Observation
- (c) Inspection
- (d) Reperformance

Which method is appropriate?

- 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
- A combination of inquiry and inspection** is generally the most effective and efficient testing method.
- Reperformance is **most effective as an audit test and gives the best audit evidence**. However, testing by reperformance could be very time consuming and **least efficient** most of the time.
- However, determining the most effective and efficient testing method is a **matter of professional judgement and depends on the several factors** including risk assessment, control environment, desired level of evidence required, history of errors/misstatements, complexity of business, assertions being addressed

Does finding result in Control Deficiency?

YES

Communicate

- Management:-All deficiencies
- TCWG:-Significant Deficiencies

Check whether

- Compensating Controls are there
- Other Risk mitigating factors are there

YES

Unmodified Report

NO

Modified Report

NO

Auditor shall document the findings

Unmodified Report

Chapter 18 | AUDIT OF BANKS

Q-1 Name the laws which are applicable on a Banking Company.

Ans:- The laws applicable on Banking Company are as follows:

- ❖ Banking Regulation Act, 1948
- ❖ Companies Act, 2013
- ❖ State Bank of India Act, 1955
- ❖ State Bank of India (Subsidiary Banks) Act, 1959
- ❖ Regional Rural Banks Act, 1976
- ❖ IT Act, 2000
- ❖ Prevention of Money Laundering Act, 2002
- ❖ Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

Q-2 Explain types of Banks/Banking Institutions prevailing in India.

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.

Examples are :- State Bank of India, Axis Bank, HDFC Bank, etc.

2. 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 etc.

3. 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.

4. 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 & Mobilebanking.

Examples are :- Airtel Payments Bank , India Post Payments Bank, Paytm Payments Bank , etc.

5. 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.

6. 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:- Equitas Small Finance Bank, AU Small Finance Bank, etc.

Q-3 What is the responsibility of Reserve Bank of India (RBI)?

Ans:- RBI is responsible for :-

1. development and supervision of the constituents of the Indian financial system (which comprises banks and non-banking financial institutions)
2. determining, in conjunction with the Central Government, the monetary and credit policies keeping in with the need of the hour.
3. regulating the activities of commercial and other banks

Q-4 What are the important functions of Reserve Bank of India (RBI)?

Ans:- The Important Functions of RBI are as follows

1. issuance of currency;
2. regulation of currency issue
3. acting as banker to the central and state governments; and
4. acting as banker to commercial and other types of banks including term- lending institutions. Besides, RBI has also been entrusted with the responsibility of regulating the activities of commercial and other banks.
5. No bank can commence the business of banking or open new branches without obtaining license from RBI. The RBI also has the power to inspect any bank.

Q-5 What are the peculiarities involved in Bank?

Ans:- The peculiarities involved in Bank are as follows:

1. Huge volumes and complexity of transactions;
2. Wide geographical spread of banks' network;
3. Large range of products and services offered;
4. Extensive use of technology;
5. Strict vigilance by the banking regulator etc.

Q-6 On the basis of Computerization, State the types of Banks involved.

Answer: Banks may be divided into three broad categories based on the level of computerisation:

1. **Non-computerised banks** :- Transactions can be done only at bank branches during working hours using paper and pen.
2. **Partially computerised banks** :- Some transactions are computerised while major are non-computerised.
3. **Fully computerised banks**:- Core banking allows inter-connectivity between branches of the same bank and with CBS , customers can operate their accounts as well as avail banking services from any branch of the bank over the network

Q-7 What is the difference between Computerized and Non-Computerized Banks?

Computerized Banks	Non-Computerized Banks
All Banking activities are done through Computer system	Banking System done manually
Transaction-anywhere, anytime	Transaction during business hours only
Will take less time for Banking Process	Will consume a lot of time in Banking process
More Productive	Less productive

Q-8 Explain Bank Audit Approach in detail

1. Drawing an Audit Plan:- An audit plan should be drawn up based on :-

- (a) the nature and level of operations,
- (b) nature of adverse features,
- (c) level of compliance based on previous reports and
- (d) audit risks based on inadequacy in or breach of internal controls and the familiarization exercise carried out,

2. Questions on Internal Control

- (a) Who performs the Control?
- (b) What evidence is generated that Internal control is Performed?
- (c) When and with what frequency is the control performed?
- (d) Where is the evidence that proves Control is Performed?
- (e) Why is the control being Performed?
- (f) How is the Control Performed?

3. Engagement Team Discussions

❖ **Nature of Discussions**

- (a) Error that may occur

- (b) Errors that have been occurred in Past Years
- (c) Method by which can be conducted by Bank personnel
- (d) Audit response to identified risk
- (e) Need to maintain Professional Skepticism

❖ **Benefits of Discussions**

- (a) An opportunity for experienced team members to share their viewpoints
- (b) An understanding among team members to exchange information about Banking risks.

Q-9 Explain provisions w.r.t. Auditor (Qualifications, Disqualifications & Appointment) of a Banking Company.

Answer:-

- + **Qualification:-** Same as provided under Section 141(1) (2) of Companies Act, 2013
- + **Disqualifications:-** Same as provided under Section 141(3) of Companies Act, 2013
- + **Powers:-** Same as of Company's Auditor
- + **Remuneration:-** As provided under Section 142 of Companies Act, 2013.
- + **Appointment:-**
 - **Nationalised Banks:-** Board of Directors in consultation with RBI
 - **Other Banks:-** Members in consultation with RBI
 - **SBI:-** C&AG in consultation with CG
 - **Subsidiary of SBI:-** State Bank of India
 - **Regional Rural Bank:-** Board of Directors in consultation with CG

Q-10 Explain provisions w.r.t. Auditor's Report of a Banking Company.

Answer:-

Legal Requirements:-

1. **Standards of Auditing:-** SA 700, 705, 706
2. **Companies Act, 2013:-** Section 143(3)
3. **Long Form Audit Report:-** Prescribed by RBI
4. **Circular:-** issued by RBI

CARO, 2020 is not applicable on Banking Company

Report to CG (Nationalised Bank):- Contents:-

1. That Balance Sheet present True and fair view of Banking Affairs
2. That transactions are within the powers of the Board.
3. That returns submitted by Branch is adequate
4. That P&L presents actual situation of profit or loss
5. Any other matter which is necessary

LFAR

1. The terms of appointment of auditors of public sector banks, private sector banks and foreign banks (as well as their branches), require the auditors to also furnish a long form audit report (LFAR).
2. The matters which the banks require their auditors to deal with in the long form audit report have been

specified by the Reserve Bank of India.

3. The LFAR is to be submitted before 30th June every year.
4. To ensure timely submission of LFAR, proper planning for completion of the LFAR is required.
5. While the format of LFAR does not require an executive summary to be given, members may consider providing the same to bring out the key observations from the whole document.

Reporting of Fraud:-Same as provided u/s 143(12) of Companies Act, 2013

Circular by RBI:-Circular states that if an Accounting Professional whether in the course of internal or external audit finds anything susceptible to be

- Fraud
- Fraudulent Activity
- Act of excess of Power
- Smell any foul play in any transaction

He should refer the matter to the regulator (RBI). Any deliberate failure on the part of the Auditor should render himself for action.

As per the above requirement, the member shall be required to report the kind of matters stated in the circular to RBI.

1. Auditor should also consider the provisions of SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements". The said Standard explains that the duty of confidentiality is over-ridden by statute, law or courts.
2. SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" states that an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.
3. It must be noted that auditor is not expected to look into each and every transaction but to evaluate the system as a whole. Therefore, if the auditor while performing his normal duties comes across any instance, he should report the matter to the RBI in addition to Chairman/Managing Director/Chief Executive of the concerned bank.

Q-11 Explain the stages involved in Bank Audit.

Answer:-The stages are as follows:-

STAGE 1:-Initial consideration by the Statutory Auditor

- (a) Obtain Status of Indebtness from Bank.
- (b) Statutory Auditor should not be involved in Internal Assignments of Bank
- (c) Develop an Audit Plan:-In compliance of SA 300
- (d) Communication with the Previous Auditor
- (e) Fix the terms of Engagement:-In Compliance of SA 210
- (f) Perform Audit Procedures in Initial Audit Engagement:-In compliance of SA 510
- (g) Assessment of Engagement Risk

(h) Establish the Engagement Team

STAGE 2:-Identify and assess the risk of Material Mis-statement

STAGE 3:-Understand the Bank and its environment including Internal Control

STAGE 4:-Understand Bank's Accounting Process

STAGE 5:-Understand Risk Management Process performed by Bank

- (a) Oversight and involvement in control process by TCWG
- (b) Identification, measurement of risks
- (c) **Control Activities:-**A Bank should have proper control to overcome IR and CR
- (d) **Monitoring Activities:-**The Control system should be regularly monitored

STAGE 6:-Engagement Team Discussion

STAGE 7:-Establish overall audit strategy

STAGE 8:-Establish Audit Plan

STAGE 9:-Determine Audit Materiality

STAGE 10:-Consider going concern

Q-12 Explain the types of Loans.

TYPES OF LOANS

- 1. Funded loans** are those loans where there is an actual transfer of funds from the bank to the borrower. Examples of funded loans are Term loans, Cash credits, Overdrafts, Demand Loans, Bills Discounted and Purchased, Participation on Risk Sharing basis, Interest-bearing Staff Loans
- 2. Non-funded facilities** are those which do not involve such transfer. Examples of non-funded loans are Letters of credit, Bank guarantees, etc.

Q-13 Explain the types of Advances

CLASSIFICATION OF ADVANCES

SECTOR WISE

RBI issues common guidelines for lending to Priority Sector which banks are required to follow. These guidelines cover rate of interest; service charges, receipt, sanction, rejection, disbursement Register; issue of Loan Application Acknowledgement. RBI also issues targets for banks for lending to Priority Sector.

Examples of Priority Sectors are Agriculture , MSME , Education , Housing , etc.

SECURITY WISE

Banks ask Security or Collateral while lending to assure that the Borrower will return the money to bank in prescribed time else the Banks have legal authority to sell the collateral to recover its money.

AS PER PRUDENTIAL NORMS

STANDARD LOANS	NPA LOANS
<p>(a) Standard Regular</p> <p>(b) Special Mention Accounts</p> <p>(I) SMA 0 (Accounts Showing Stress Signals)</p> <p>(II) SMA 1 (Overdue between 31 to 60 days)</p> <p>(III) SMA 2 (Overdue between 61 to 90 days)</p>	<p>(a) Sub-Standard</p> <p>(b) Doubtful (D1/D2/D3)</p> <p>(c) Loss</p>

Q-14 Explain the nature of Security in case of advance provided by Bank

Answer:-There are two types of security provided by the borrower:-

- ❖ **Primary Security**:-It refers to the security offered by the Borrower for Bank Finance or the one against which credit has been extended by the Bank
- ❖ **Collateral Security**:-It is an additional security which is kept the borrower in addition to the primary security.

Q-15 Explain modes of creation of Security.

Answer:-

- ✚ **Mortgage**:-Usually on an Immovable Property. Its types are as follows:-
 - ✚ **Registered Mortgage**:-Mortgage Deed is prepared between Lender and Borrower.
 - ✚ **Equitable Mortgage**:-Mere delivery of title deeds to create Security
- ✚ **Pledge**:-
 - It is a kind of Bailment
 - Movable goods are kept as Security
 - Ownership remains with the pawnor while pawnee will have interest on it
- ✚ **Hypothecation**:-
 - ✚ Here, proper agreement is created between both the parties.
 - ✚ Physical possession of the security is with the borrower.
 - ✚ Currently, Bank has neither the ownership nor the possession of the Security.
 - ✚ In case of default, Bank can seize the Security

✚ **Assignment:**-It means transfer of rights by borrower to Bank. Only Actionable Claims such as Books debts and Insurance Policies are transferred.

✚ **Set-Off:-**

- In this case, Borrower will have two accounts i.e. Deposit account and Loan account.
- Bank can adjust the amount of loan from Balance credited in deposit account.

Q-16 Explain Prudential norms on Income Recognition.

Answer:-

✚ **Non-Performing Asset:**-An asset becomes NPA when it ceases to generate income for the Bank.

Where any loan/Advance

- A) Interest and/or instalment overdue for a period of 90 days in term loan
- B) The account remains 'out of order' in respect of OD/CC Limit
- C) The Bill remains overdue for a period of more than 90 days.

✚ **Out of Order:**-An account shall be treated as 'out of order' if:-

- Outstanding Balance is in excess of the limits
- Balance is within the limit but there are no credits since 90 days

✚ **Overdue:**-An account due to the bank which is not paid on due date will be termed overdue.

Q-17 Explain categories of NPA along with Provision required.

CATEGORIES	PROVISION	
1) SUB-STANDARD ASSETS (Remained NPA for 12 months or less)	15%	
2) DOUBTFUL ASSETS	Secured	Insecured
Doubtful upto one year (D1)	25%	100%
Doubtful 1 to 3 years (D2)	40%	100%
Doubtful more than 3 years (D3)	100%	100%
3) LOSS ASSETS Would be one, where loss has been identified by the Bank/Internal Auditor/External Auditor/RBI	100%	

Q-18 Explain Government Guaranteed Advances.

Answer:-Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets, but regarded as NPA for Income Recognition purpose.

The situation would be different if the advance is guaranteed by State Government, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

Q-19 Explain Advances under Consortium.

Answer:-

1. Consortium advances mean advancing loans to a **borrower by two or more Banks jointly by forming a Consortium.** Joint appraisal, control and monitoring will facilitate for exchange of valuable information among the Banks. Usually, a Bank with a higher share will lead the consortium.
2. Consortium advances should be **based on the record of recovery of the respective individual member** banks and other aspects having a bearing on the recoverability of the advances.
3. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, **the account should be treated as not serviced in the books of the other member banks and therefore, an NPA.**
4. The banks participating in the consortium, therefore, **need to arrange to get their share of recovery transferred from the lead bank** or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

Q-20 Explain the Accounts in which there is erosion in value of Security.

Answer:-

Value of Security reduces to less than 50% of its value:-**DOUBTFUL ASSET**

Value of Security reduces to less than 10% of O/S Loan:-**LOSS ASSET**

Q-21 Explain Agricultural Advances

Answer:-

LONG DURATION CROPS	SHORT DURATION CROPS
MEANING: The "long duration" crops would be crops with crop season longer than one year	MEANING: crops, which are not "long duration" crops would be treated as "short duration" crops.
The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each State.	
NPA: will be treated as NPA if instalment/interest remains overdue for one crop season.	NPA: will be treated as NPA if instalment/interest remains overdue for two crop seasons.

Q-22 Explain Reversal of Income

Master Circular issued by the RBI deals elaborately with the classification and income recognition issues due to impairment caused by natural calamities. Banks may decide on their own relief measures, viz., conversion of the short term production loan into a term loan or re-scheduling of the repayment period and the sanctioning of fresh short term loan, subject to the guidelines contained in RBI's latest Master Circular on Prudential Norms on Income Recognition, Asset Classification and provisioning pertaining to Advances. In such cases, the NPA classification would be governed by such rescheduled terms.

Q-23 Explain Advances to Staff

1. Interest-bearing staff advances as a banker should be included as part of advances portfolio of the bank. In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards.
2. Such loans/advances should be classified as NPA only when there is a default in repayment of installment of principal or payment of interest on the respective due dates.
3. The staff advances by a bank as an employer and not as a banker are required to be included under the sub-head 'Others' under the schedule of Other Assets.

Q-24 Explain Reversal of Income

1. If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the **entire interest accrued and credited to income account in the past periods, should be reversed** or provided for if the same is not realised. This will apply to Government guaranteed accounts also.
2. In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.
3. Further, in case of banks which have **wrongly recognised income in the past should reverse the interest** if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s).
4. Furthermore, the auditor should enquire if there are any large debits in the Interest Income account that have not been explained. It should be enquired whether there are **any communications from borrowers pointing out differences in interest charge** and whether appropriate action has been taken in this regard.

Q-25 Explain partial Recoveries of NPA

1. In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e., towards principal or interest due), **banks are required to adopt an accounting policy** and exercise the right of appropriation of recoveries in a uniform and consistent manner.

2. The appropriate policy to be followed is **to recognise income as per AS 9** when certainty attaches to realisation and accordingly amount reversed/derecognised or not recognised in the past should be accounted
3. Interest partly/fully realised in NPAs can be taken to income. However, it should be ensured that the credits towards **interest in the relevant accounts are not out of fresh/additional credit facilities** sanctioned to the borrowers concerned.

Q-26 Explain Audit Approach for Audit of Provisions and Contingencies.

1. For audit of Provisions and contingencies, the auditor should ensure that the **compliances for various regulatory requirements** for provisioning as contained in the various circulars have been fulfilled.
2. The auditor should obtain an **understanding as to how the bank computes provision** on standard assets and non-performing assets.
3. It will primarily include checking **the basis of classification** of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets. The auditor may verify the loan classification on a sample basis.
4. The auditor should obtain the **detailed break up of standard loans**, non-performing loans and agree the outstanding balances with the general ledger.
5. The auditor should obtain the **tax provision computation** from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation.
6. The other provisions for expenses should be examined vis-a-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

Q-27 Explain the points which shall be considered by Bank while computing drawing power of Borrower.

Answer:-

- ❖ Bank should ensure that Accounts shall be kept **within Sanctioned Limits**.
- ❖ Bank should ensure that drawings in working capital **are covered by Current Assets**
- ❖ **Stock Statements, Quarterly returns submitted** by borrower shall be issued
- ❖ The **Audited Annual Report provided by borrower** shall be scrutinized
- ❖ Bank shall ensure that drawing power **is within limits** provided by Board
- ❖ In case **of Construction Business**, the drawing power is to be examined carefully w.r.t. WIP

Q-28 As an Auditor, how will you verify the internal control over advances made by the Bank.

Answer:-

- ❖ The Bank should make an advance after satisfying with the **credit worthiness of the Borrower**.
- ❖ All the **necessary documents** have been prepared
- ❖ Ensure that the bank has complied **with the Sanctioned limit**.
- ❖ **Drawing Power should be updated** every month.
- ❖ All Accounts have been kept **within drawing powers**
- ❖ All the Accounts **which exceed the Sanctioning limit or drawing power** should be brought in notice.
- ❖ The operation of each Advance Account shall **be reviewed atleast once in a year**.
- ❖ **Sufficient margin** should be kept against securities so as to cover for any decline in value of Security.

Q-29 Explain Audit Approach with respect to Income of a Banking Company.

Answer:-

- ❖ the auditor is primarily concerned with obtaining reasonable assurance that **there is no unrecorded income**, and that income is recorded in proper amounts and **is allocated to the proper period**.
- ❖ RBI has advised that in respect of any income **which exceeds one percent of the total income** of the bank if the income is reckoned on a gross basis or one percent of the net profit before taxes if the income is reckoned net of costs, should **be considered on accrual as per AS-9**.
- ❖ If any item of income is not considered to be material as per the above norms, **it may be recognised when received** and the auditors need not qualify the statements in that situation.
- ❖ In the case of bills for collection, the auditor should also **examine the procedure for crediting the party** on whose behalf the bill has been collected.
- ❖ **Test check the Fees and commissions earned** by the banks made for commission on Bills for collection; Letters of credit; Bank Guarantees.

Q-30 Explain Audit Approach with respect to Expenses of a Banking Company.

- ❖ In carrying out an audit of Interest expended, the auditor is primarily concerned with **assessing the overall reasonableness** of the amount of interest expense
- ❖ The auditor should also compare the average rate of **interest paid on the relevant deposits with the corresponding figures for the previous years** and analyse any material differences.
- ❖ The auditor should, on a test check basis, verify the calculation of interest and satisfy himself that:
 - (a) Interest rates are in accordance with the **bank's internal regulations, of the RBI directives**, and agreements with the respective depositors;
 - (b) 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.
 - (c) Interest on Savings Account should be checked on a test check basis in accordance with the **rules framed by the bank** in this behalf.
 - (d) Interest on inter-branch balances has been provided at the **rates prescribed by the head office**.

CRO0677296

CRO0677296

CRO0677296

Standards

On

Auditing

CRO0677296

CRO0677296

CRO0677296

CRO0677296

CRO0677296

CRO0677296

IFAC**International Federation of Accountants**

Objective:- To bring Harmony & uniformity in the Accounting profession

IAASB was established under authority of IFAC
(International Auditing & Assurance standard Board)

Objective:- To formulate and review standards on

- a) Quality control (SQC)
- b) Audit of financial information (SA)
- c) Review of Historical financial information (SRE)
- d) Review of other than Historical financial information (SAE)
- e) Related services with Auditing (SRS)

To frame worldwide standards as Auditing so as to build & enhance the rest of public on Auditor profession

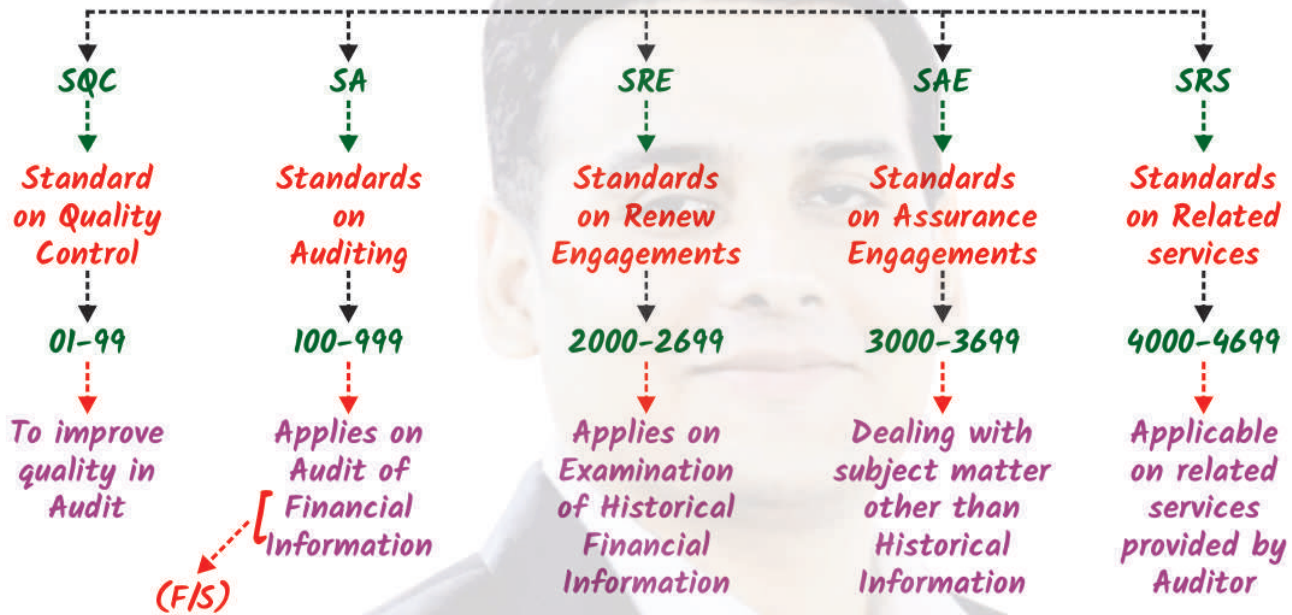
ICAI

* As ICAI is the member of IFAC. So, ICAI established AASB (Auditing and Assurance standards Board) under Authority of ICAI

AASB**Objectives and Functions of AASB**

- a) To review the existing and emerging practices worldwide and identify areas in which SAs, SQC, SAE need to be developed
- b) To formulate SAE, SA, SQC, SRE under the Authority of the ICAI
- c) To review SA, SQC, SAE, SRE, SRS to assess their relevance in changed conditions
- d) To formulate Guidance notes under the Authority of ICAI
- e) To review Guidance notes to assess their relevance in changed conditions
- f) To formulate general classifications on issues from standards
- g) To formulate technical guide, practice Manuals etc

Standards



SA

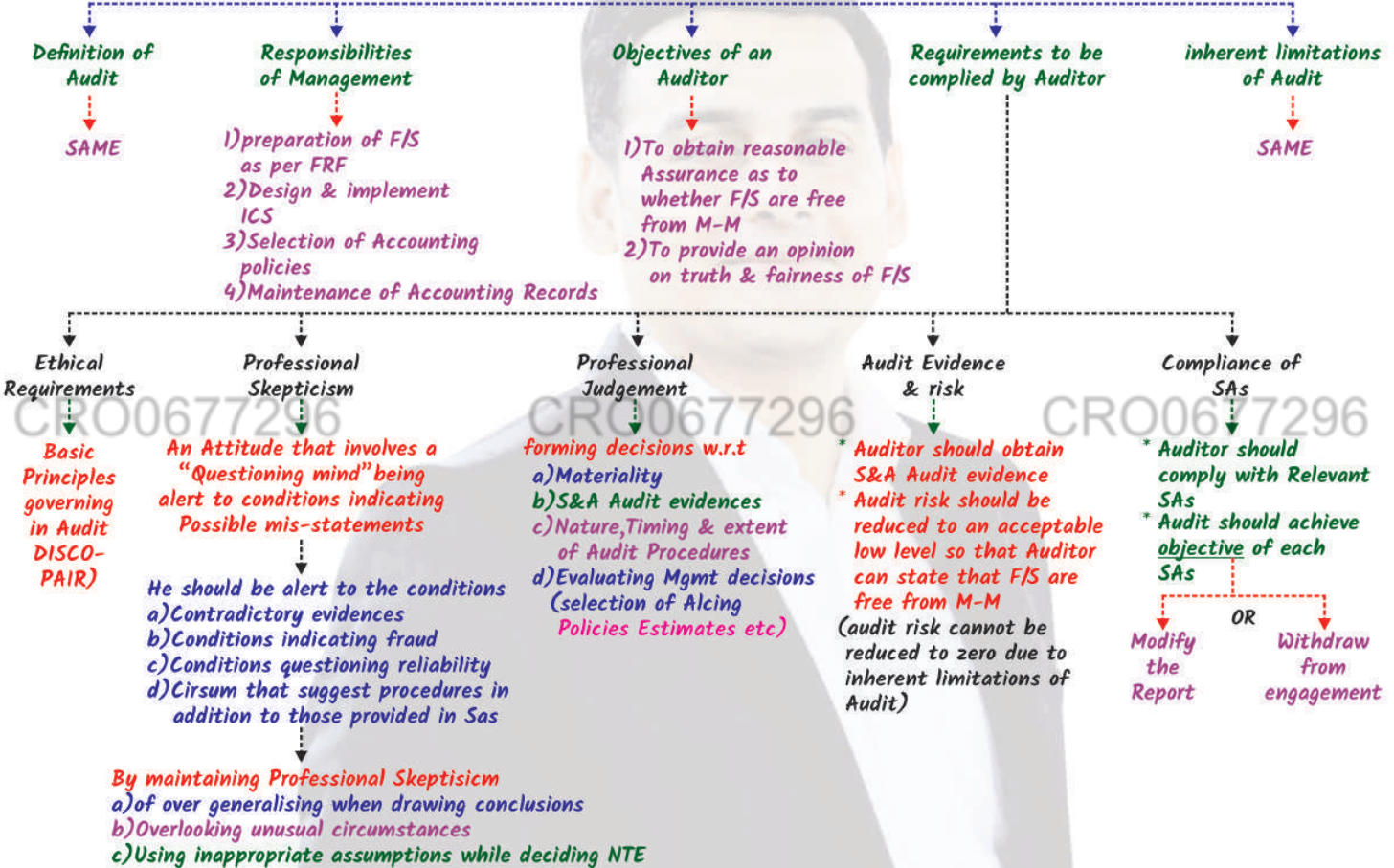
- 100-199 -----> Introductory Matters
- 200-299 -----> General Principles and Responsibilities
- 300-499 -----> Risk Assessment and Response to Assessed Risk
- 500-599 -----> Audit Evidence
- 600-699 -----> Using work of others
- 700-799 -----> Audit conclusion & Reporting
- 800-899 -----> Specialized Areas

Applicable for CA-Inter except

- * SA 260
- * SA 265
- * SA 330
- * SA 402
- * SA 450
- * SA 540
- * SA 600
- * SA 620
- * SA 720

SA 200

Overall objectives of Independent Auditor and Conduct of an Auditor in Accordance with SAs



SA 210

Agreeing the terms of Engagement

Beginning of Audit

During the course of Audit

Initial Audit engagement

Recurring Audit

Mgmt request the Auditor to change its terms of Engagement

Determine the effect

High Assurance

Lower Assurance

Accept the change

check whether Mgmt act is resonable

Non-Resonable

Resonable

Do not accept the change

accept the change

Modify the Report

Withdraw

Communicate TCWG

Determine requirement w.r.t

- a) change in Mgmt
- b) change in law
- c) change in ownership
- d) change in Business Activities
- e) change in terms of engagement
- f) change in FRF

Required

Not Required

send new engagement letter

No further duty

Engagement letter

Meaning:-it is a contract or Arrangement between Auditor & client which defines legal relationship between them

Contents-

- a) Name of client
- b) Scope of Audit
- c) objectives of Auditor
- d) Resp. of Auditor
- e) Resp. of Mgmt
- f) Identification of FRF
- g) form & contents of Audit Report
- h) Maintenance of Quality control

Management is imposing limitations

Management is not imposing any limitations

Do not accept the Audit

check existence of Pre-conditions

Pre-conditions are in existence

Pre-conditions are not in existence

Accept the Audit

Discuss matter with mgmt

Do not accept the Audit if a) Unacceptable FRF or b) management does not agree with responsibilities

- Pre-conditions-
- i) Whether Management has complied with FRF
 - ii) Acknowledgement by Mgmt of its responsibilities
 - a) Preparation of F/S as per FRF
 - b) Maintenance of ICS
 - c) Mgmt will provide an assistance to the Auditor

CONTENT OF ENGAGEMENT LETTER

Date :- 22-01-2021

To,
The Executive Director
Reliance Industries Limited, Mumbai

Sub :- Engagement letter for conducting statutory audit for the economical year 20-21

Dear Sir,
You have requested vide your letter no. _____ dated _____, that we audit the balance sheet of RIL as an 31st March 2021 & related profit & loss a/c for the year ended on the date

We are pleased to confirm our acceptance and our understanding of the engagement of this letter our audit will be conducted with the objective of our expressing an opinion on the f/s

Thanking You
yours faithfully,
for Ato & Co
Chartered Accountants

Ankit Oberoi
(partner)

SA 220

Quality control for Audit of Financial Statements

Objectives

- * To maintain Quality control by the Auditor during the perform + during the reporting
- * The fact should be mentioned in the engagement letter
- * To provide Reasonable assurance that
 - a) Auditor has complied with SAs
 - b) Audit opinion is appropriate

Definitions

- 1. **Engagement partner** partner or other person in the firm who is a member of ICAI and is in full time practice is responsible for engagement and its Performance for the report issues on behalf of firm
- To maintain quality control is his responsibility
- 2. **Engagement team** ---> All persons involved in performing an audit engagement
Eg:-Engagement partner, article, paid assistants etc

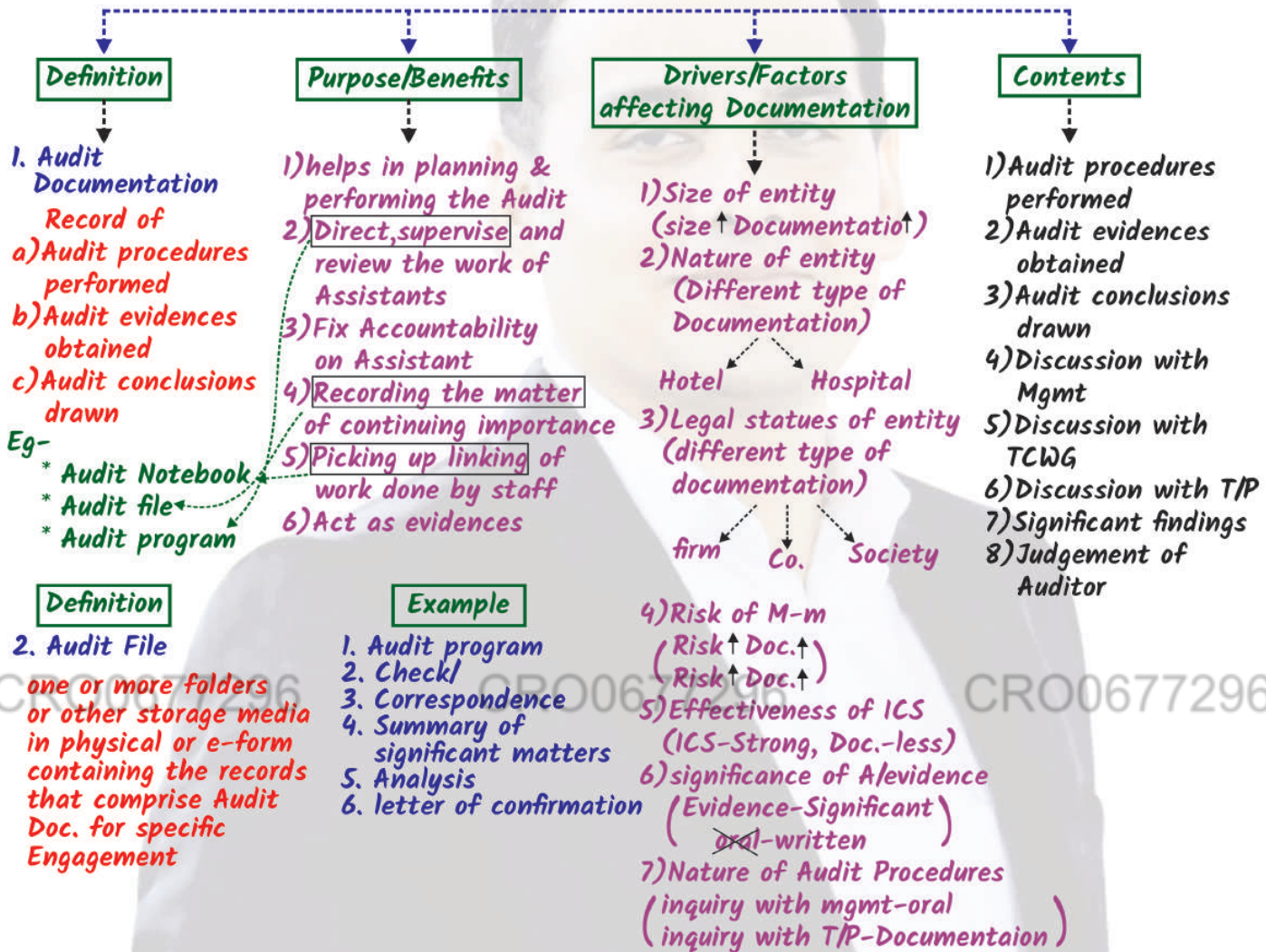
Quality control for Audit of Financial Statements

Requirements to implement quality control

Documentation

Ar shall documentation
 a) Issues wrt compliance of ethical requirements
 b) Conclusions on compliance with independence
 c) Conclusions regarding acceptance & conti of C/R
 d) Nature & scope resulting from consultations during Audit



SA 230Audit Documentation

SQC-1

1. Audit file must be assembled within 60 days from date of Auditor's report
2. Auditor shall retain the docs upto 7 years from date of Audit report
3. Audit documentation is the property of Ar (unless stated by law)
Ar is not bound to share his documentation either with the mgmt/ TCWG
Branch Ar is not bound to provide his working papers/ copies to the statutory Auditor
Although, the auditor can extract copies of Audit doc. at his discretion
4. Assembly is an administrative process, and Ar can bring change in Audit doc. like
 - a) Deleting repeated documentation
 - b) Discarding superceded documentation
 - c) Sorting working papers
 - d) Documenting Audit evidence after discussion with ET

**Completion Memorandum/
Audit Doc Summary**

Auditor will describe here
a) Significant matters identified during Audit
b) How they were addressed

will facilitate effective & eff. review & inspection of Audit doc

After Assembling but before compl. of retention period, Auditor cannot discard Audit doc

Significant professional Judgement

1. Auditor shall document SPJ
2. SPJ shall include
 - a) Auditor's conclusion on the reasonableness of judgement of mgmt
 - b) Auditor's conclusion on authenticity of document for further investigation
 - c) Rationale of Auditor's conclusion when it provides that Ar shall consider significant matter which Inv. SPJ even

SA 250

Consideration of laws and Regulations in an Audit of F/S



SA 299

Responsibilities of Joint Auditors

Meaning

Joint Audit is an Audit of f/s of an entity by two or more Auditors with the objective to an issue Audit Report

Such Auditors are termed as Joint Auditors

Division of work

- work to be based on
- a) Time period
- b) Geographical Area
- c) Component of f/s

This discussion must be documented

Planning, Risk Assessment

Before commencement of Audit, J/A shall discuss and develop an Audit Plan, Auditors

- a) should identify division of work
- b) NTE of audit pro to be nerfor
- c) form & content of A/R
- d) consider terms of engagement
- e) consider result of pre.activities

- 1) Engagement partner + Engagement team member of all J/A shall be involved in planning
- 2) J/A shall jointly establish an overall joint strategy
- 3) J/A will provide a common engagement letter
- 4) J/A will obtain common WR
- 5) After division of work,
 - a) It must be documented "work Allocation Document" & signed by all J/A
 - b) It must be intimated to TCWG

Advantages

- 1) Sharing of expertise
- 2) less workload on Ar
- 3) Better audit quality
- 4) high level of Assurance
- 5) Timely completion
- 6) conv. for MNCs as they can appoint local Auditor
- 7) all imp. areas will be covered
- 8) Healthy competition between auditor

Disdvantages

- 1) lack of co-ordination between joint Ar
- 2) Ignorance of common areas of work
- 3) Superiority complex
- 4) Psychological barriers when firms are standing at different level
- 5) Dispute due to sharing of fees
- 6) costly on the part of entity

Nobita d shizuka & co.

Nobita
statutory Ar

Gian
Gian de & co.
(statutory Ar)

Auditor

AO ltd

Joint Auditor

SA-299

Division:

- 1) G. Area
- 2) Component of f/s
- 3) Period

Miscellaneous

- 1) J/A shall intimate deficiencies/ matter which are relevant other J/A
(Before finalisation of Audit)
- 2) J/A is not bound to review the work of other joint Auditor

Auditor's report

- 1) Before finalising A/R, J/A should have a common discussion and will share their respec. opinions
- 2) Generally, J/A form a common opinion
- 3) But in case of contrad-, J/A can provide different opinions
In that case, they must provide reference to each other's opinion in EOM
- 4) The opinion of J/A will not be affected by majority of the joint Auditor

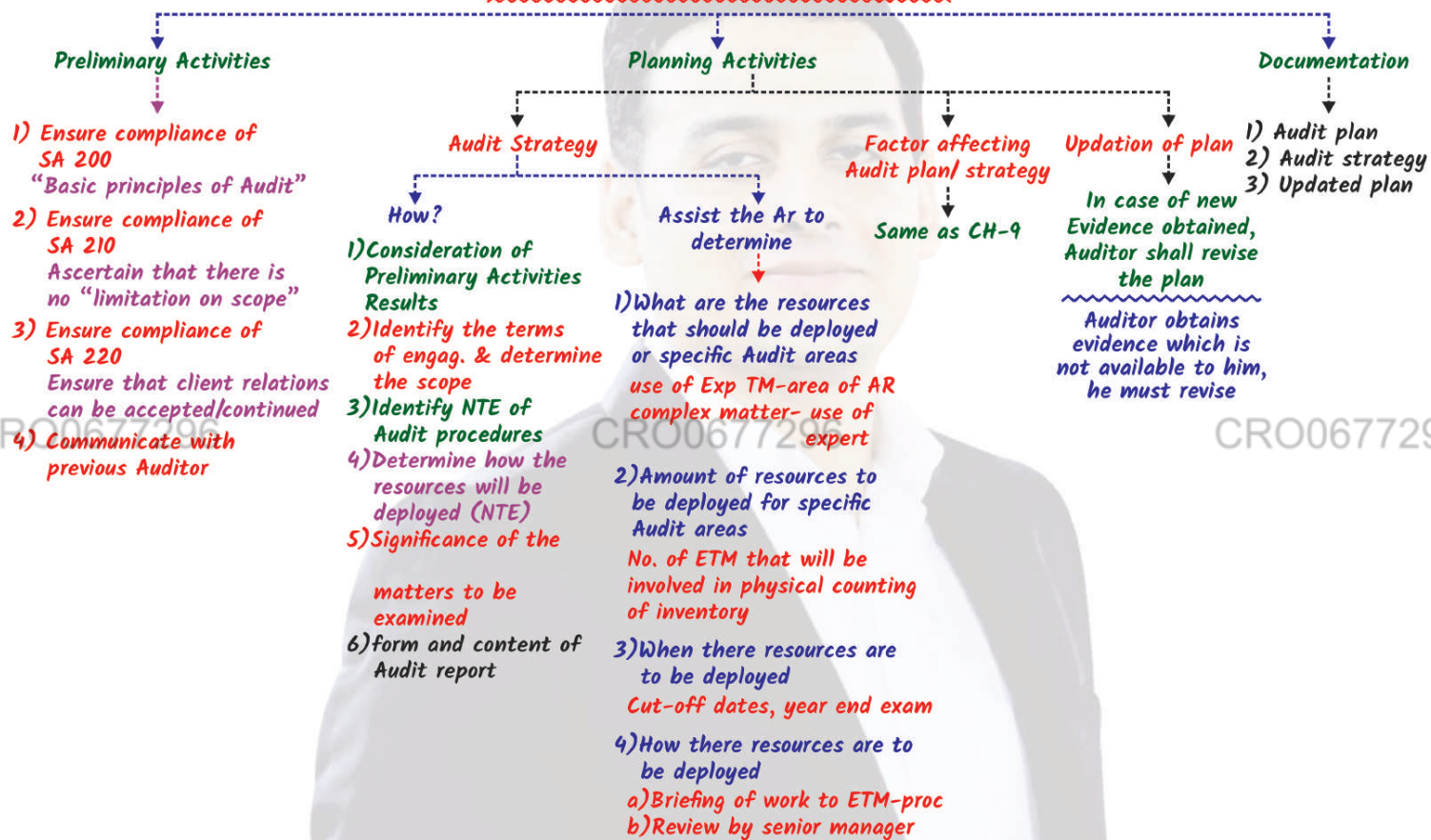
Responsibility of Joint Auditor

Joint and several

- 1) common areas of work
- 2) common opinion
- 3) common conclusion on comp. of FRF
- 4) common discussion on Audit proc.
- 5) Any matter brought to attention to all J/A and agreed to it
- 6) form & content of report
- 7) confirm. obtained jointly

Several

- 1) Specific area of work
- 2) Individual opinion
- 3) Individual conclusion on comple. of FRF
- 4) Confirmation obtained individual
- 5) Branch Audit

Planning in an audit of financial statements

SA 315

Identifying and Assessing the risk of Material mis-statement through



understanding entity, its environment & Related Internal Control

Understand the entity & environment

through understanding **Entity, its Environment**

- 1) Industry, Regulatory & external factors
- 2) Nature of Entity
 - a) its operations
 - b) ownership & gov. structure
 - c) types of Inv. that entity is making
 - d) the way entity is structured/ financed
- 3) Accounting policies (inconsistent-Risk)
application selection and consistency
- 4) Objectives and strategies of Business
(vision, mission - Risk)
- 5) Measurement and review of entity's FP
(KPI, Budget, forecast etc)

Understand the ICS

Entity, its Environment & related Internal control

- 1) Evaluate D & I of ICS
- 2) Control Environment
culture of honesty and ethical behaviour of Employees
- 3) Strength of control environment and any deficiency

Understanding RAP of Entity

- 1) Identifying Business Risk relevant to FR
- 2) Estimating the significance of risks
- 3) Assessing the likelihood of their occurrence
- 4) Actions to address such risk
 - * NO RAP:- Discussion with mgmt that is there any Business Risk
 - * No RISK:- Discussion with mgmt + obtain WR
 - * Mgmt-No Risk:- (Deficiency in Auditor-Risk ICS-Weak)

Risk in Automated Environment

- i) Undue Reliance on the software system which has been formed inadequacies
- ii) Unauthorized access to data may result in damage of data
- iii) Mis-use of powers by IT personnel
- iv) Unauthorized damages in master files
- v) Potential loss of data
- vi) Failure to make changes to systems

SA 320

Audit Evidence

General Points

- 1) An item is said to be material if it can influence the economic decision of the user
- 2) Materiality is a subjective concept which depends upon situation
- 3) Materiality is dependent upon professional Judgement of the Auditor
- 4) Materiality is applied both at the planning & Performance level

Relationship b/w Materiality & Audit risk

- 1) There is inverse relationship between Materiality & Audit Risk
- 2) ↑ Materiality level
↑ examination
↓ Risk
- 3) ↓ Materiality level
↓ examination
↑ Risk

4) If any transaction is above performance materiality but less than Mat. level as a whole then Auditor shall perform limited procedures

Materiality at planning level

While planning the Audit, Auditor shall form judgement for materiality item which provides basis for

- a) Nature
Highly Material
E.C + WR
- Timing
Highly Material
year end checking
- Extent
Highly Material
Checking ↑
of Audit Procedure
- b) Identification & Assessment of Risk

Performance Materiality

some items which are individually immaterial but when collected together becomes material

Auditor will reduce the mat. level as a whole to a lower level so as to cover the smaller items which could be material when aggregated together

Eg: Auditor has decided that only transaction amount Rs40,000 or more will be material and client has to transactions with RP amounting Rs2000/- each

In this case, Auditor reduces the material level to Rs 2000 specifically for RPTs

The performance materiality

- 1) Depend upon prof judgement
- 2) Reduce the risk of smaller items
- 3) leads to larger sample size

Benchmarks in Determining materiality

A percentage is often applied to a chosen Benchmark as a starting point in determining materiality

Factors that affect identification of Benchmark

- 1) Element of f/s (Asset, liab, exp)
- 2) the items on which users normally focuses (for purpose of evaluating proper, users tends to focus on profit/revenue)
- 3) The entity's ownership structure and way of is financed
(If entity is financed solely by debt rather than equity, then users may focus more on Assets rather than earnings)
- 4) Nature of entity, its life cycle and industrial and economic environment

Meaning

1. Audit evidence is information used by Auditor in arriving at the conclusions on which Auditor's report is based

Objectives

To obtain sufficient & Appropriate Audit Evidence

Factors affecting sufficiency and Appropriateness of Audit Evidence

- 1) Risk of M-m (Risk \uparrow - Evid \uparrow)
- 2) Result of control test (ICS \uparrow - Evid \downarrow)
- 3) Materiality of item (Material \uparrow - Evid \downarrow)
- 4) Size of population (population \uparrow - Evid \downarrow) being tested
- 5) size of sample (sample size \uparrow - Evid \downarrow)
- 6) reliability of evidence (reliability \downarrow - Evid \uparrow) obtained
- 7) Accounting policies (inconsistency \uparrow - Evid \uparrow)
- 8) knowledge & experience of Auditor

2. It includes both information contained in Accounting records underlying F/S and other information

1. record of a/cing entries
2. Invoice
3. Contract
4. General & Sub ledgers
5. Journal entries
6. Worksheet, spreadsheets supporting cost allocation, documentation

1. Minutes of the meeting
2. Written confirmation from trade Rec/Trade pay
3. Manual of internal control

Collection of Evidences

- 1) **Inspection**: - Examination of Records, Documents and Tangible Assets
- 2) **Observation**: - The process of witnessing the procedure performed by other
Eg - Attending physical verification conducted by management
- 3) **Inquiry and Confirmation**

It means Response to an obtaining information from persons within/ outside the entity Enquiry

- 4) **ARP**: - It means studying significant ratio and trends and investigating abnormal fluctuations
- 5) **Recalculation**: - Checking the Arithmetical Accuracy of figures
- 6) **Reperformance**: - Execution of procedures that were originally performed by mgmt.

Rules on Reliability

- 1) External Evidences are more reliable than internal evidences. However, internal evidences can also be reliable if internal control is strong
- 2) Evidences obtained directly by the Auditor are more reliable than obtained indirectly
- 3) Documentary evidences are more reliable than oral evid.
- 4) Evidence in original copies are more reliable than photocopies

Obtaining evidence by performing procedures

Test of control

1. It means examination of operating effectiveness of ICS in preventing, detecting or correcting M-M
2. Ar will perform TOC when
 - a. Auditor's expectation is that control are operating effectively
 - b. Substantive alone cannot provide S&A evidence
3. Nature of TOC
 - a. perform procedures in combination with inquiry to obtain evidence, it will include
 - i) How controls were applied
 - ii) Consistency of control
 - iii) By whom it was applied
 - iv) By what means it was applied
 - b. Whether controls to be tested depend upon other controls
4. Matters that affect extent of TOC
 - a. Frequency of perfor of control by Entity
 - b. Relevance & reliability of Audit Evidence
 - c. Expected rate of deviation
 - d. Extent to which A/E is obtained from TOC
5. Using Audit Evidence obtained in previous Audits
Ar shall consider
 - a. Effectiveness of other elements of ICS
 - b. Risk from control
 - c. Effect of general IT controls
 - d. RMM
 - e. Extent of reliable on control
6. Specific inquires when deviation of controls are detected
Ar shall inquire and determine whether:-
 - a. TOC performed provide an appropriate basis for reliable on the controls
 - b. Additional TOC are necessary
 - c. The Optional RMM need to be addressed using sub. proc.

Substantive procedure

- ◆ Ar shall design substantive procedures because
 - a) Assumed RMM may not be perfect as it involve judgemnt of Ar
 - b) There are investment limitations to ICS

Dependent upon circumstances, Auditor can perform

- a) TOD
- b) ARP
- c) Combination of both

If result of TOC is unsatisfactory, extent of TOD will be high

External confirmations (SA-505)

- ◆ Information be used as Audit Evidence

Evidence from work performed by mgmt's expert

- Ar shall
- a) Evaluate competence cannot objectivity of expert
 - b) Understand work of expert
 - c) Evaluate appro. of work of expert

Evidence from information provided by entity

- 1) Obtaining A/E that info is complete & accurate
- 2) Evaluating whether info is sufficiently precise

Information to be used as Audit Evidence

Evidence from work performed by mgmt's, expert, AR shall check

- a. Evaluate competence, capabilities & objectivity of that expert*
- b. Obtaining understanding of work of expert*
- c. Evaluate the appropriateness of expert's work*

Evidence from in for provided by Entity, Ar shall

- a. Obtaining A/E about accuracy & completeness of info*
- b. Evaluating whether information is sufficiently precise.*

According to source

External

Internal

According to nature

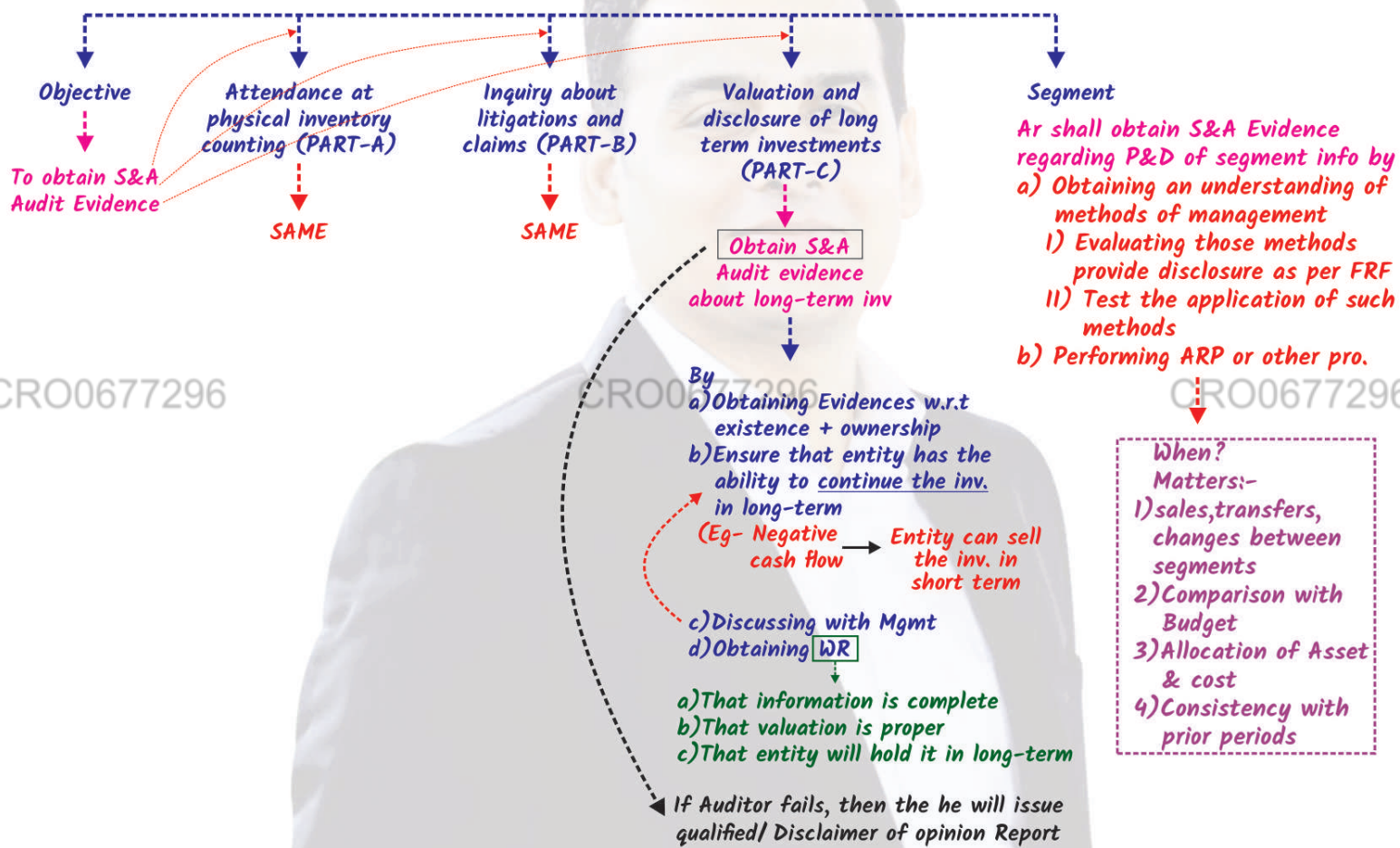
Documentary

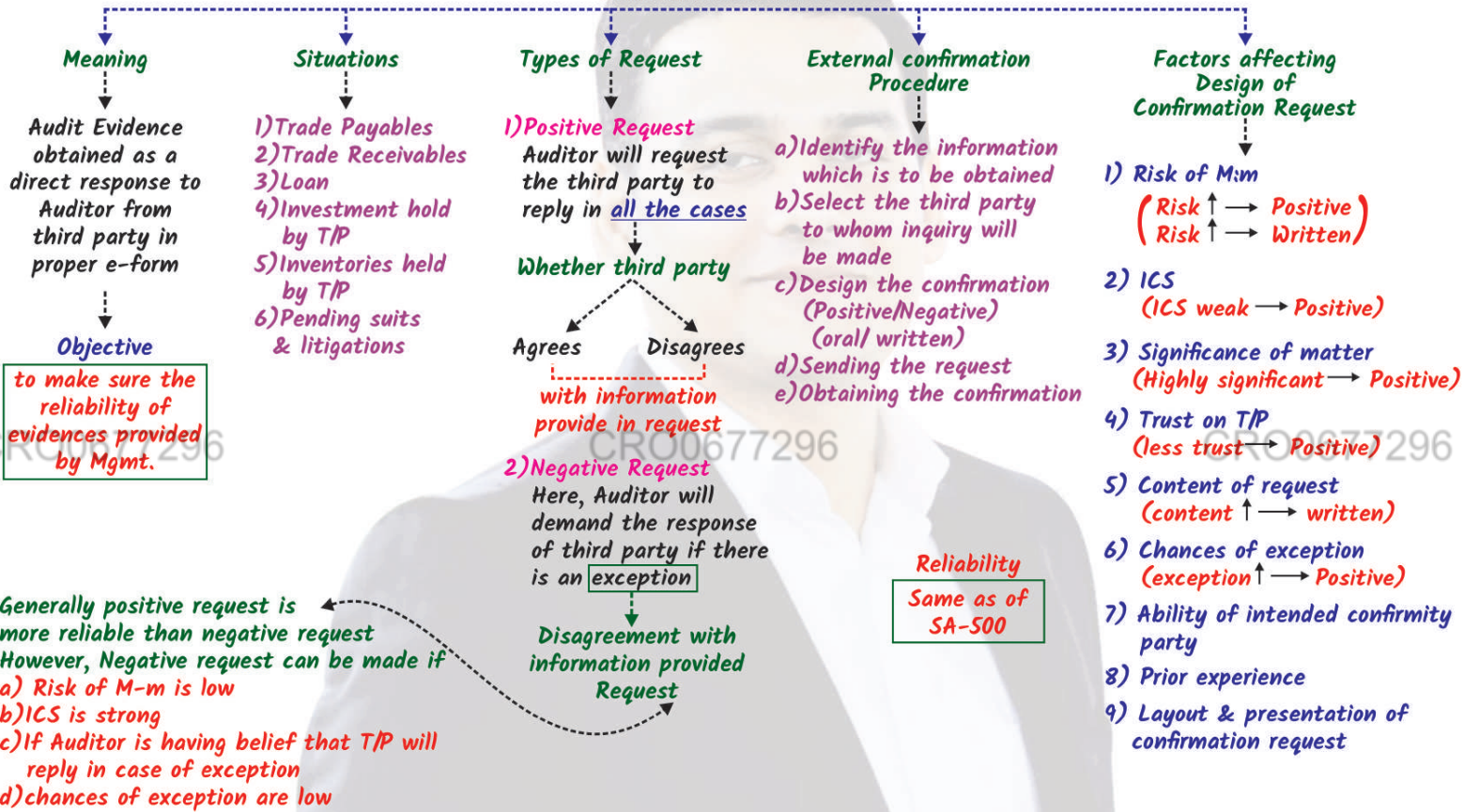
oral

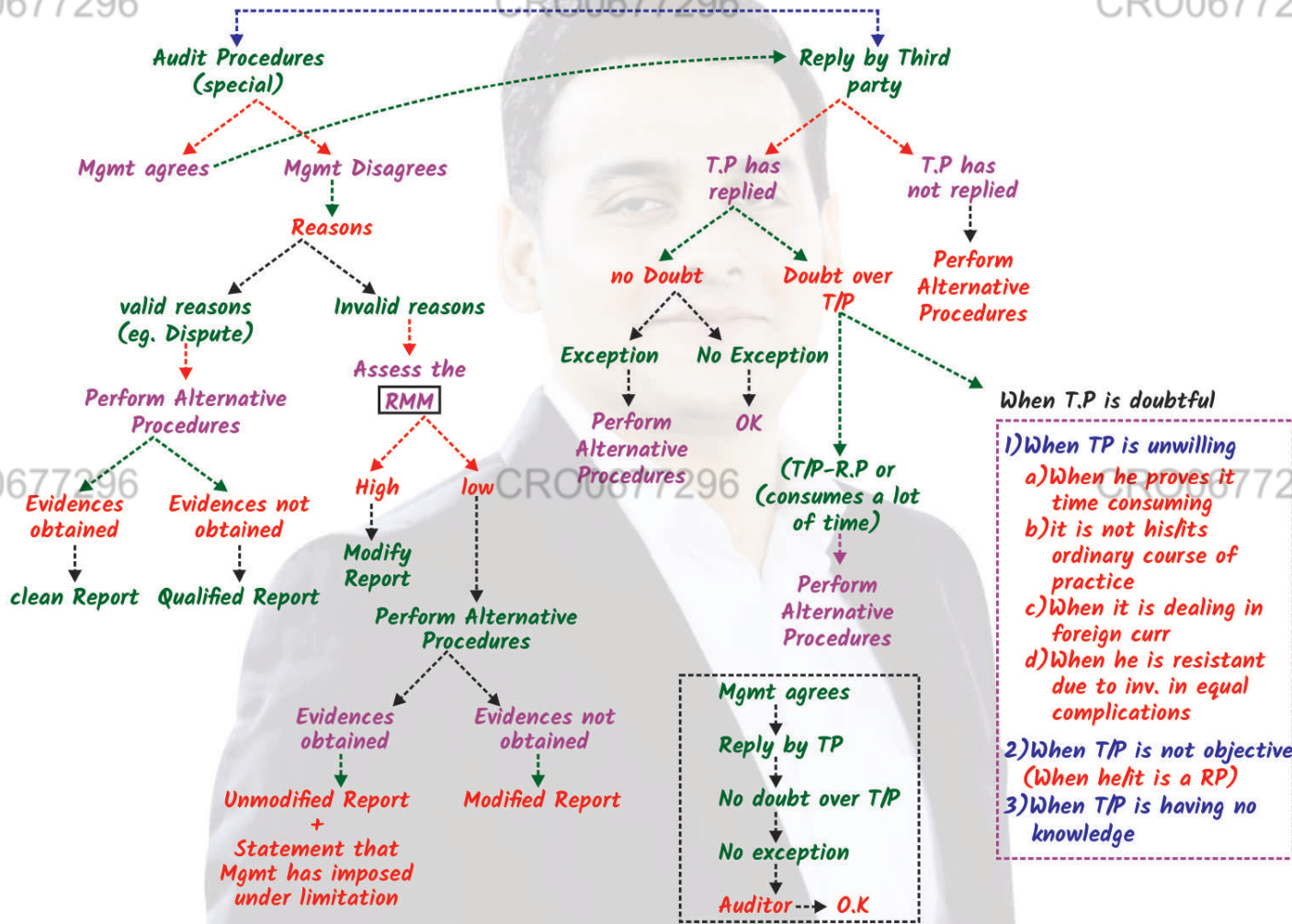
Visual

<i>External Evidences</i>	<i>Internal Evidences</i>
<i>1) External Evidences are originated from outside the entity</i>	<i>Internal Evidences are originated within the entity</i>
<i>2) Eg: purchase invoice Bank statement</i>	<i>copies of sales invoice salary sheet inventory register</i>
<i>3) External are more reliable than internal evidences</i>	<i>Internal are less reliable</i>
<i>4) Even if ICS is weak, it will not affect reliability of ext. Evidence</i>	<i>Internal Evidence is not reliable if ICS is weak</i>

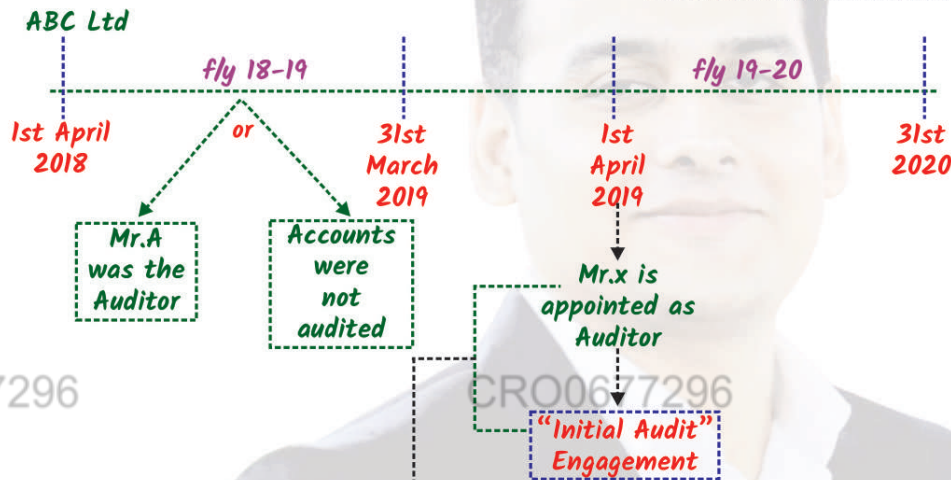
Audit Evidence :- specific considerations for selected items







Initial Audit Engagement



Meaning

In engagement in which f/ls or prior period
a) were not audited
b) were audited by Predecessor Auditor

Objective
Obtain S&A Evidence about whether

- a) Opening Balances contain mis-statements that material affect current period F/ls
- b) Appropriate along policies have been consistently applied in current period F/ls

Check

- i) proper carry forward of balances
- ii) consistency of Accounting policies (AS-1)

Audit Procedure

Opening Balances

check misstatement in PY figures

Obtain S&A Evidence that whether opening balances contain mis-statement that affect Current year statement of Profit & loss a/c, by

- a) Prior period closing Balance are properly brought forward
- b) Determine whether opening balance reflect application of Approp. A/cing policies
- c) Performing one or more of:-
 - i) Whether PY figures were audited?
 - ii) Evaluate whether Audit procedure of CY provide Evidence of Opening Balance
 - iii) performing Audit procedures (specific) to obtain Evidence of O/B

If Auditor

Obtain evidence that O/B can affect CY Balances

cannot obtain Evidence

perform necessary Audit procedures

Modified Opinion (SAIOS)

If Ar concludes that there is misstatement in CYF

Communicate TCWG + Modified report

Accounting Policies

check consistency of Accounting Policies

consistent

Non-consistent

Clean Report

Modified Report

Obtain S&A Evidence that

A/C policies are consistently applied

change is disclosed as per FRF

Unmodified Report

Modified Report

Modification in PY Auditor's Report

check modification in PY Auditor's Report

Modified

Clean

Modified Report

O.K

1) Discussion with Mgmt Predecessor Auditor

2) Check that M-m exist in CY or not

Exist

Non-Exist

Modified Report

Unmodified Report

Definition

1) Related Party

a) RP means related party as defined in the Financial Reporting Framework

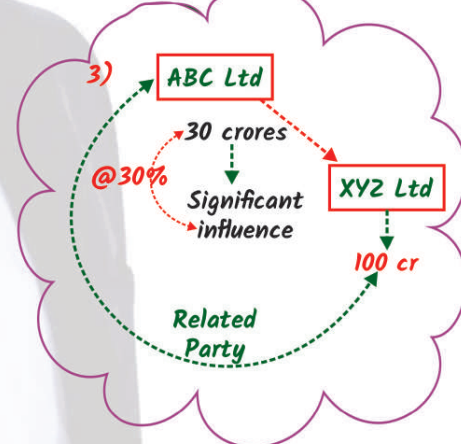
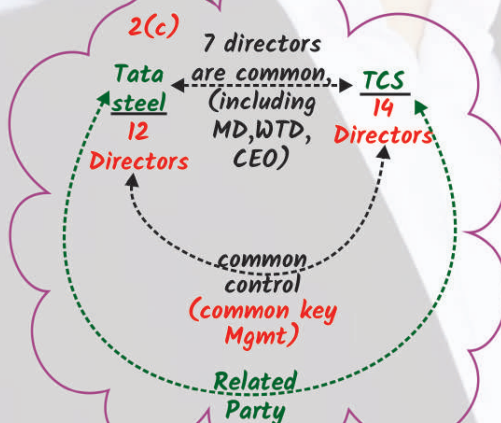
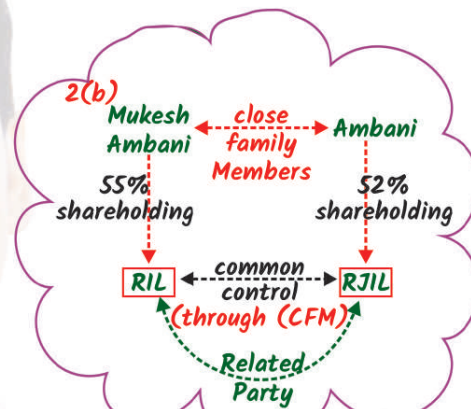
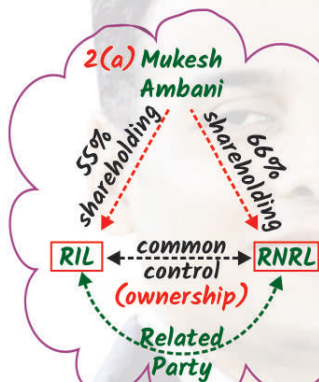
sec 2(16) of CA, 2013 AS-18

- b) Entity under common control with client
 - a) close family members
 - b) being owners
 - c) common key Mgmt

c) Entity over which client is having significant influence/control

2) Arm length price

A transaction conducted on such terms and conditions as between a willing buyer and willing seller who are unrelated and acting independently of each other and preserving their own best interests



Responsibilities of Mgmt

- 1) Identify RP
- 2) obtain proper authorization (Section 188-BR to R)
- 3) proper recording of RPT's (section 189-Register)
- 4) Compliance of As
- 5) proper disclosure of RPTs (as per sch.III)

Risk Assessment Procedures

Inquire Management

- 1) Obtain list of RPs
- 2) Obtain list of RPTs
- 3) Nature of relation with RP
- 4) Change in relation with RP
- 5) Obtain written representation

understand ICS w.r.t. RPTs

- 1) Discussion with Engagement team
- 2) Maintain Professional Skepticism
- 3) Identify significant risk
- 4) Identify undisclosed R.P

How can Auditor verify Existence of RPTs He can inspect

- 1) Entity ITR
- 2) Inform supplied by entity to Regulatory Authorities
- 3) Register of member/s/h
- 4) Records of entities investment
- 5) contract with KMP/TCWG
- 6) Internal audit reports
- 7) Life insurance policies accused by ented
- 8) Statement of conflict of interest from management/TCWG

Response to Assessed Risk

Documentation

Responsibilities of Auditor

If Auditor identifies undisclosed RP

Identified Rps (IF RPT is not in OCB)

RPTs in OCB at ACP

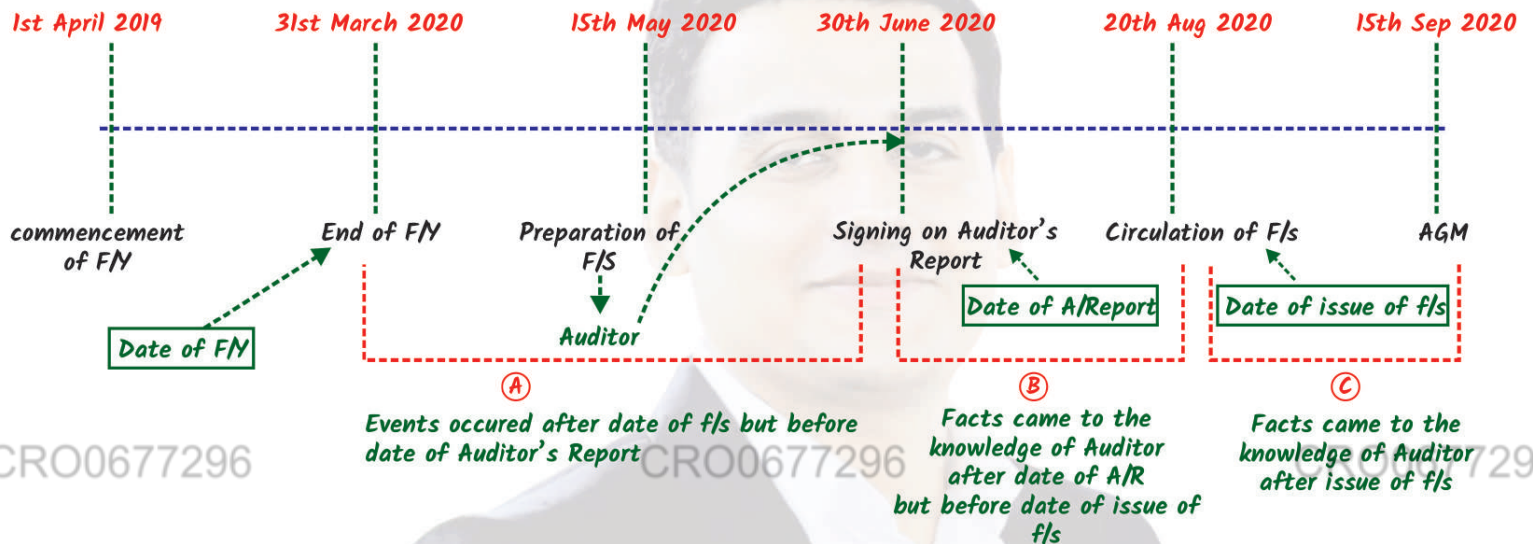
- 1) Rps
- 2) RPTs
- 3) Undisclosed RP

- 1) communication with that Related Party
- 2) Identify such other RPs
- 3) Revise the risk
- 4) Design further Audit Proc. accordingly
- 5) Discussion with engagement team
- 6) Discussion with mgmt to identify all transactions

- 1) Examine contract & under T&C
- 2) Ensure proper path & approval
- 3) Ensure proper A/c+D

- 1) obtain S&A Audit evidence
- 2) Obtain WR

- 1) The Ar should identify RMM wrt RPTs and design response for it
- 2) Ar should obtain understanding of entity RPTs to conclude that F/s presents provide fair disclosure
- 3) Ar should understand RPTs and evaluate whether fraud risk factors are present as per sec 240
- 4) In case of inherent limitations, the potential effect of not detecting m-s is higher
Therefore Ar shall plan & perform the Audit with professional Skepticism (as per SA 200)



Meaning of Subsequent events

Events occurring after date of f/s but before date of Auditor's Report and it includes the facts came to the knowledge of Auditor after the date of Auditor's Report

Specific Enquiries

- 1) Whether any new borrowing has been obtained
- 2) Whether any new guarantee has been provided
- 3) Whether any asset is acquired ?
- 4) Whether any asset is sold ?
- 5) Whether there are any development wrt contingencies ?
- 6) Whether any decision wrt pending litigation & claims has been arrive ?
- 7) Whether any doubtful asset is recovered ?
- 8) Whether any asset is destroyed by natural calamity or sealed by Govt. auth

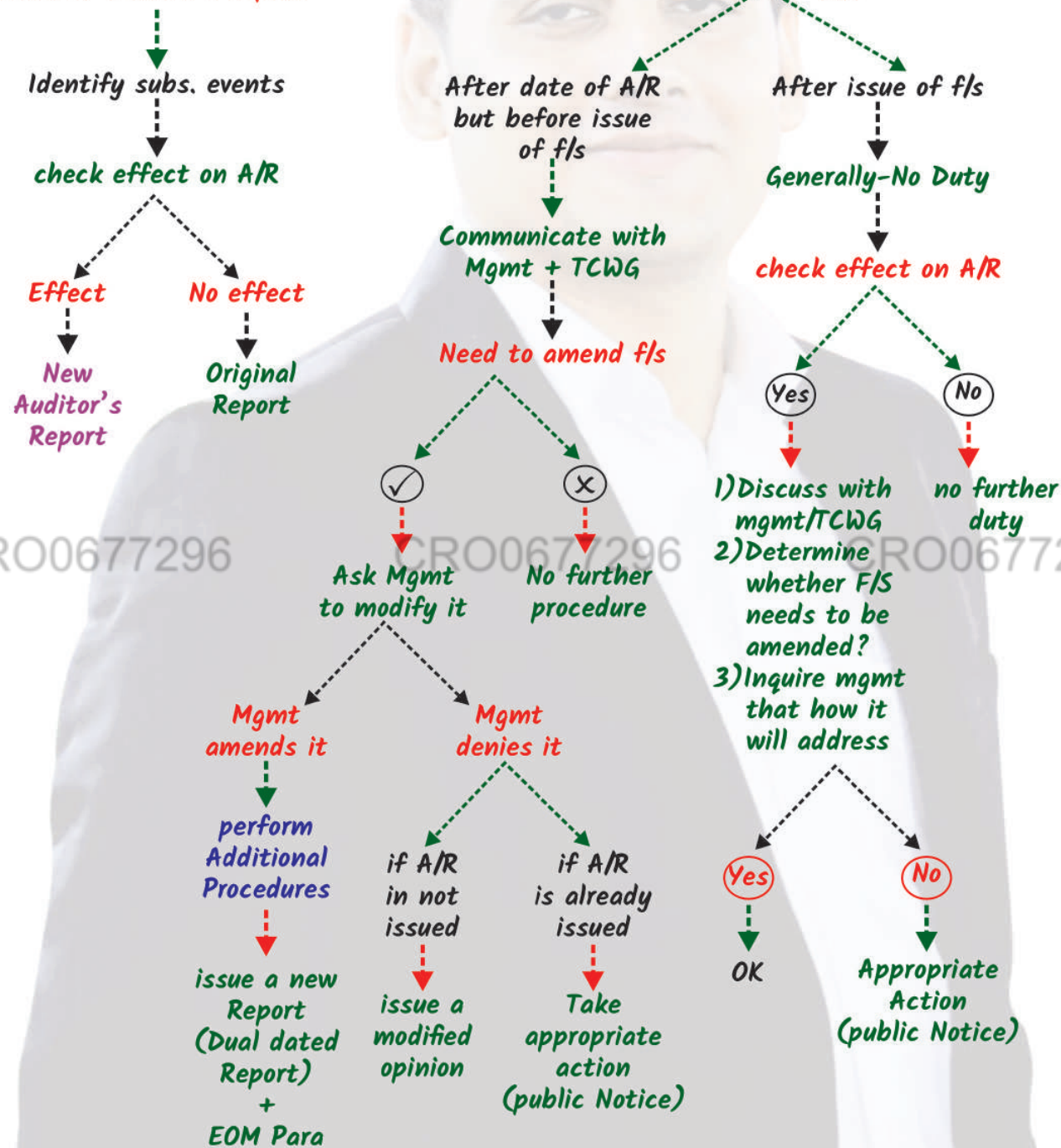
Identification of Subsequent events

- 1) inquiry with Management (TCWG)
- 2) Obtain WR (that all sub events are disclosed)
- 3) Study Minutes of BM (after date of f/s)
- 4) Review interim Reports
- 5) Reading entities interim financial statements
- 6) Understand procedure of mgmt how subsequent event are identified

Audit Produces

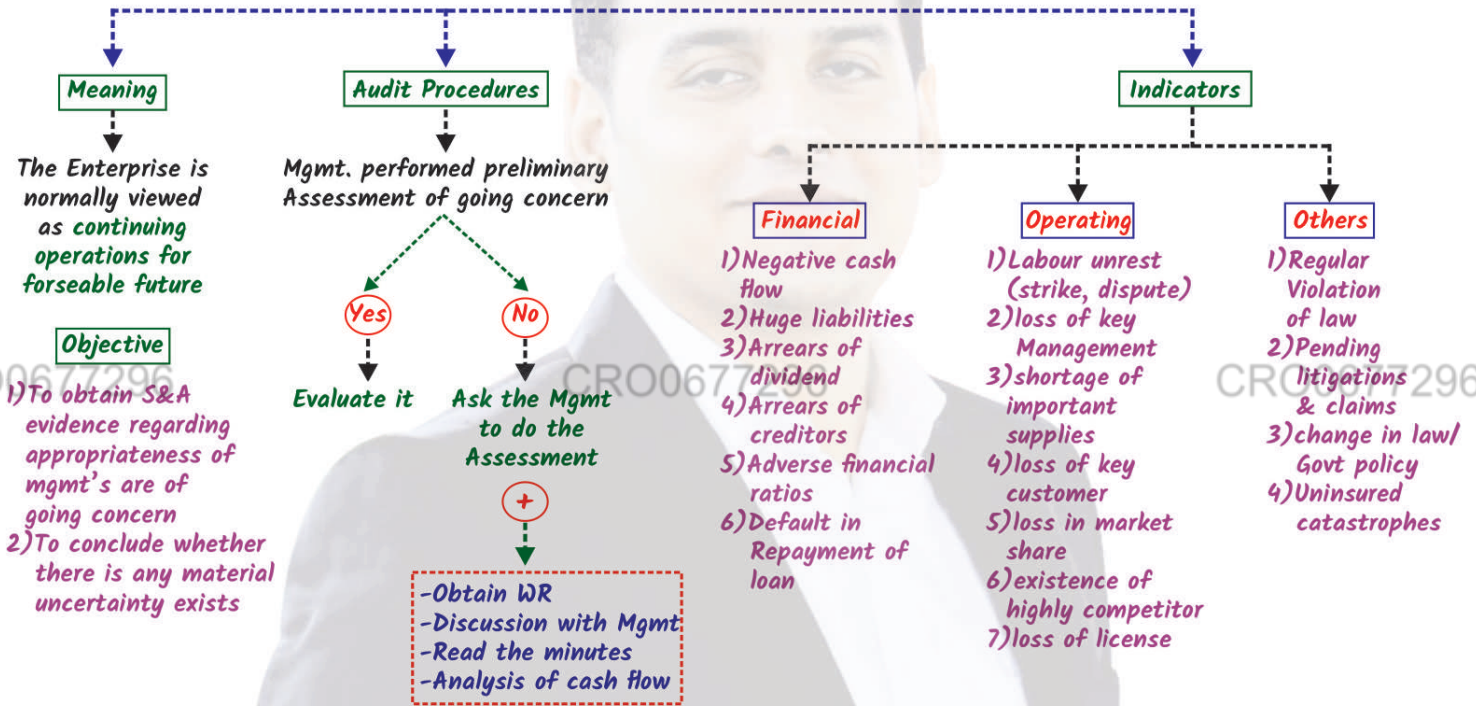
Events occurring after f/s date but before date of Auditor's Report

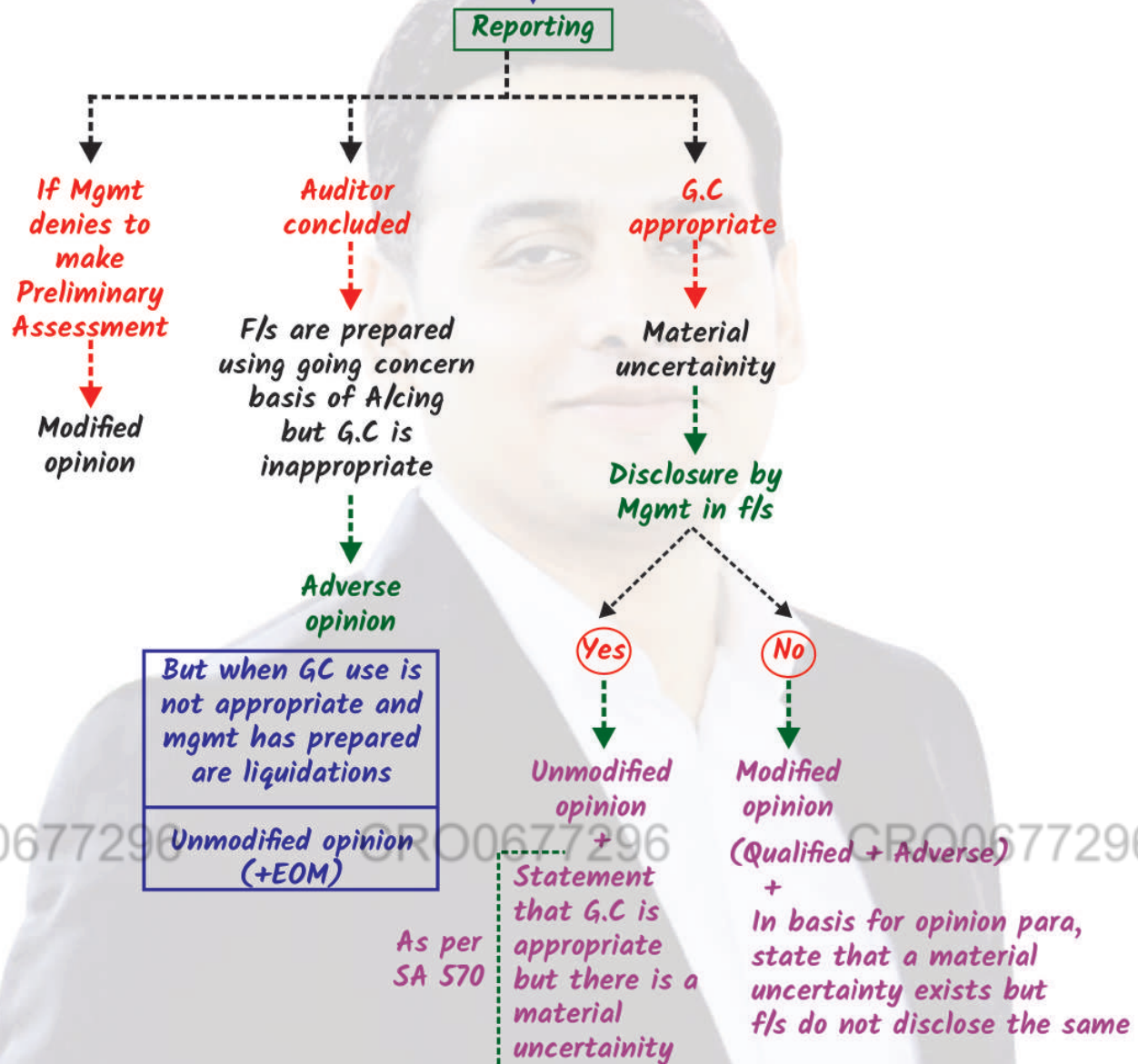
Events that came to the knowledge of Auditor after A/R



SA 570

Going concern

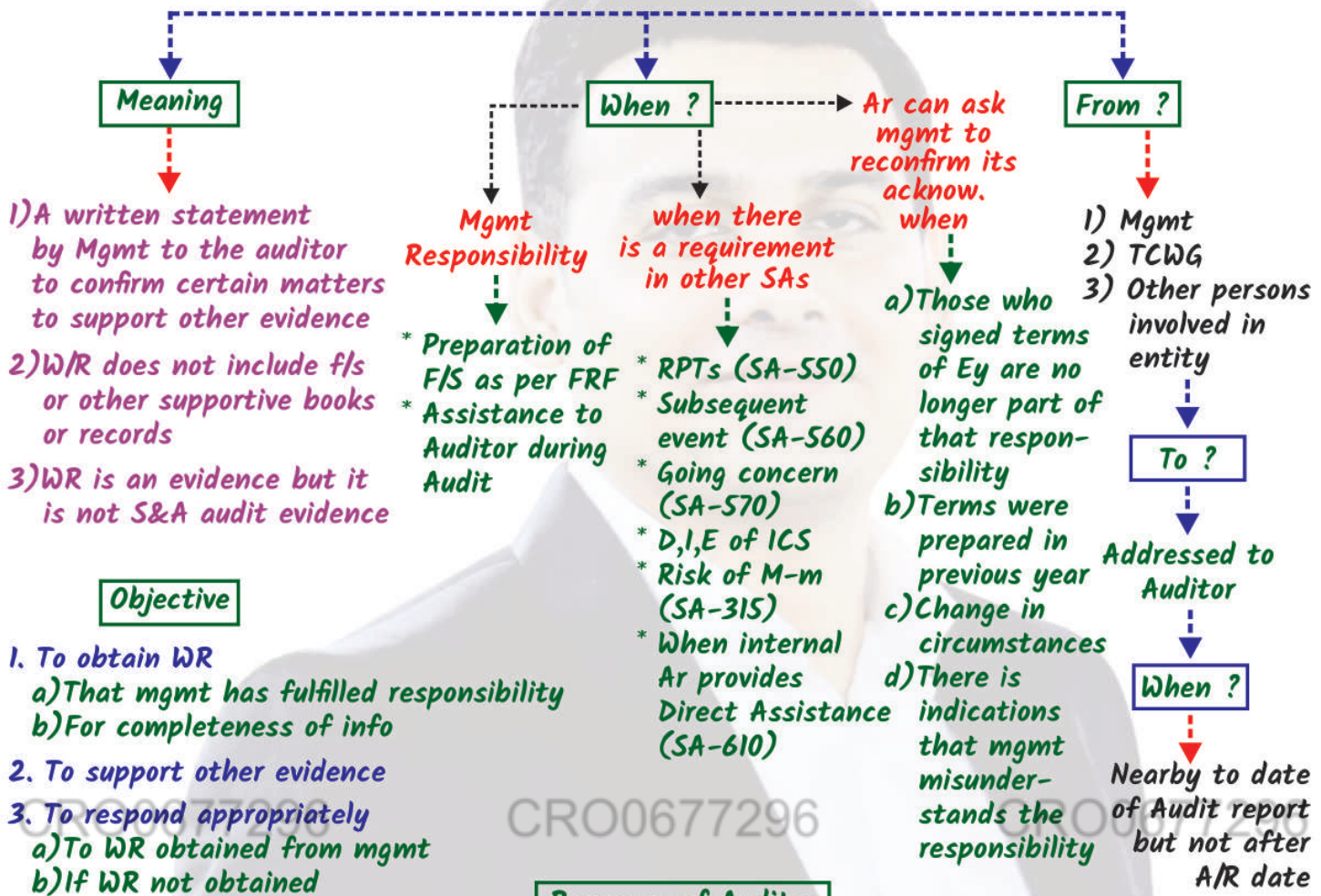




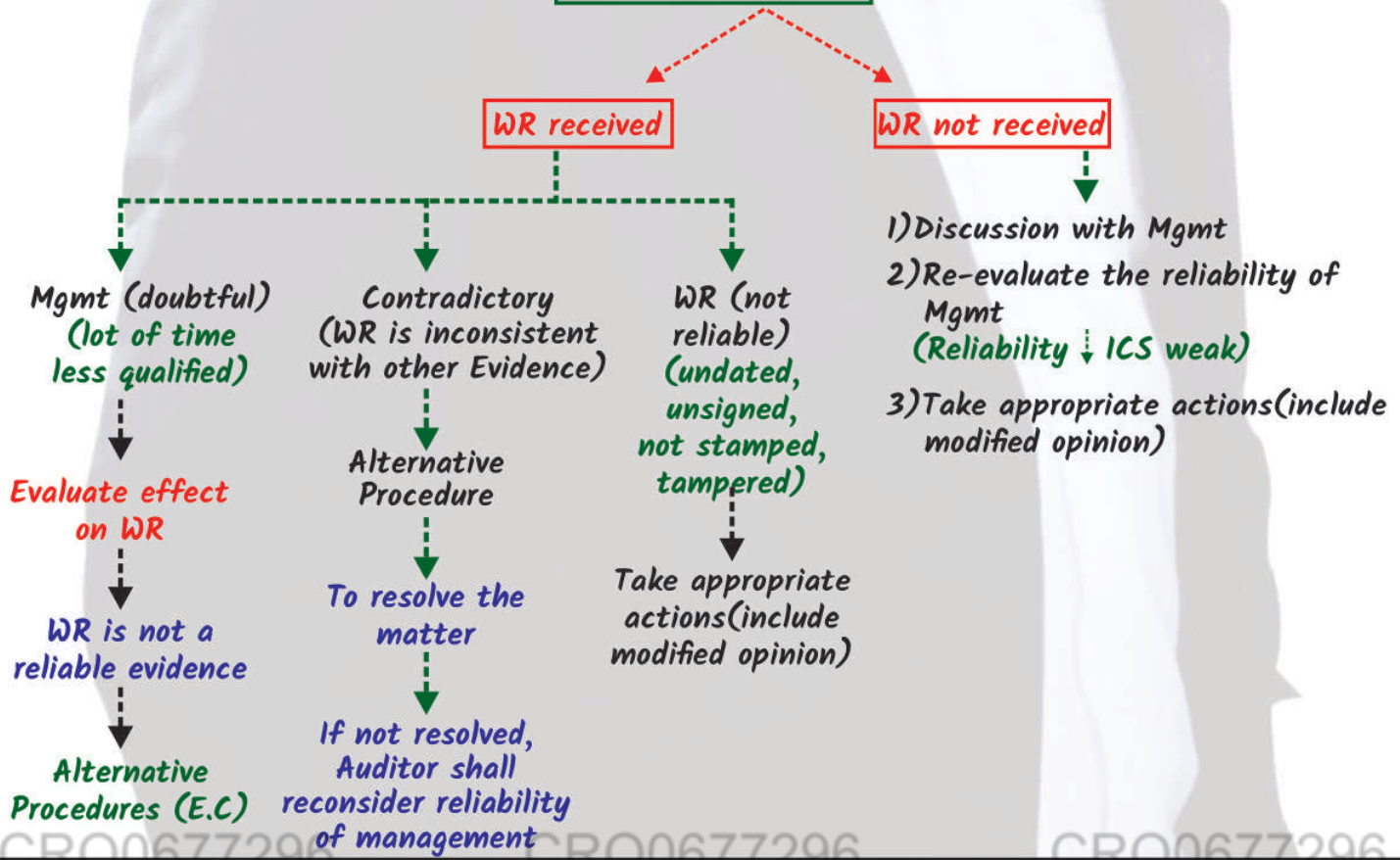
Audit procedures → To Assess going concern

1. Subsequent event after B/S → consider the impact on going concern
2. Litigation and claims → consider the impact on going concern and inquire with legal council
3. Interim financial statements → can check the quarterly F/s even of subsequent period
4. Cash Flow statement → consider the negative cash flow
5. Examine minutes of Board Meeting → It will show the status of going concern
6. Status of debt repayment → consider the terms of loan agreement and ensure its compliance

Written Representation



Response of Auditor



1) Internal Audit means

1. An independent mgmt function
2. Which involves a continuous and critical appraisal of functioning of entity
3. with a view to suggest improvements therefore
4. and add value & strengthen the
 - a) overall governance mechanism
 - b) Risk management system
 - c) Internal Control system

2) Objective - If External Ar determine internal Audit is relevant to Audit he shall determine

- a) Whether and to what extent to use work of internal Ar
- b) If so, whether such work is adequate for external audit purpose

However external Ar has such responsibility for Audit Opinion and that responsibility is not required by use of work of I/A

3) If internal Audit function is relevant, Determine

Adequacy of work of Internal Auditor

- 1) IA-objectivity
- 2) IA-Technical competence
- 3) due professional care
- 4) communication between IA & EA

Design NTE of Audit Procedures

- By considering
- 1) Nature & scope of specific work
 - 2) degree of subjectivity in evaluating work of IA
 - 3) Assesst risk of mm at assertion level

4) Using specific work of Internal Auditor

S/A shall consider

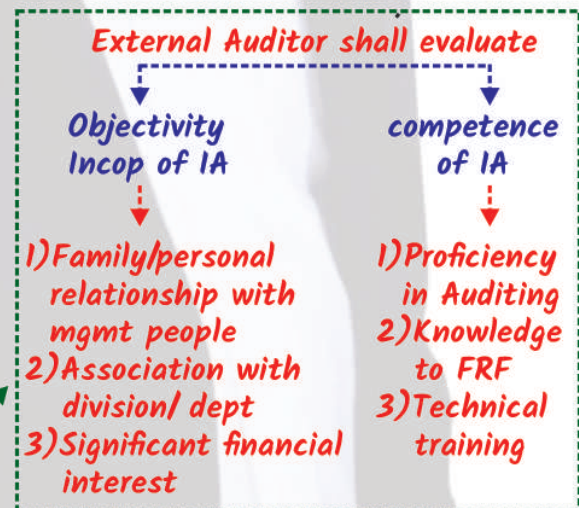
- 1) Technical training & proficiency of IA
- 2) supervision, review & Doc of IA
- 3) Adequacies of evidences
- 4) Approval of conclusions reached

5) Documentation

- a) conclusions regarding evaluation of adequacy of work of IA
- b) Audit procedures performed by EA

6) Internal Auditor to provide Direct Assistance -

- 1) Evaluate whether work of IA can be used as DA
- 2) Determine extent of work to be assigned to IA
- 3) Obtain WR from Mgmt. that it will not restrict IA
- 4) Obtain written consent from IA to keep matters confidential
- 5) Document the work performed by IA
- 6) supervise the work of IA



Comparatives

The amount and disclosures included in the F/s in respect of one or more prior previous in accordance with applicable FRF

