arivupro

AUDITING & ETHICS

PAPER 5



7 Years ANNIVERSARY OF ARIVUPRO ACADEMY

Chartered Accountant

STUDY NOTES

CA Karthik Shenoy

CA INTERMEDIATE

arivupro

AUDITING & ETHICS

For CA Inter

A Guide to Enhance Comprehension of Auditing Principles.

MAY 2025 ONWARDS



Compiled by
CA KARTHIK G SHENOY

KARTHIK SHENOY

AUDITING & ETHICS INDEX

#	CHAPTER NAME	PAGE NO
0	BASICS OF AUDIT	A TO E
1	NATURE, OBJECTIVE & SCOPE	1 - 18
2	AUDIT STRATEGY, PLANNING & PROGRAMME	19 - 36
3	RISK ASSESSMENT & INTERNAL CONTROL	37 - 75
4	AUDIT EVIDENCE	76 - 129
5	AUDIT OF ITEMS OF FS	130 - 177
6	AUDIT DOCUMENTATION	178 - 185
7	COMPLETION & REVIEW	186 - 212
8	AUDIT REPORT	213 - 264
9	AUDIT OF DIFFERENT ENTITIES	265 - 317
10	BANK AUDIT	318 - 349
11	ETHICS & TERMS OF ENGAGEMENT	350 - 370
	EXEMPTIONISTS	

TARGET: _____

"Focus on the Process not on the Result"

BASICS OF AUDIT | TERMINOLOGIES

SL NO	TERM	MEANING
1.	Audit	An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.
2.	Assurance	Refers to the auditor's satisfaction as to the reliability of an assertion being made by one party for use by another party. To provide such assurance, the auditor assesses the evidence collected as a result of procedures conducted and expresses a conclusion.
3.	Engagement	Engagement means an arrangement to do something. In the context of auditing, it means a formal agreement between auditor and client under which auditor agrees to provide auditing services.
4.	Assurance engagement	An engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.
5.	Those Charged with Governance (TCWG)	The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.
6.	Management	The person(s) with executive responsibility for conduct of the entity's operations. For some entities, management includes some or all of TCWG.
7.	Risk Assessment Procedure	The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control,

		to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion level are defined as risk assessment procedures.
8.	Further Audit Procedure	Audit procedures designed to get more evidence based on Risk Assessment Procedure.
9.	Internal Control Systems	The process designed, implemented and maintained by • TCWG • Management and • Other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to ▪ Reliability of financial reporting, ▪ Effectiveness and efficiency of operations, ▪ Safeguarding of assets, and ▪ Compliance with applicable laws and regulations.
10.	Audit Risk	Audit risk means the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated.
11.	Misstatement	Misstatement refers to a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.
12.	Error	An error in audit refers to an unintentional mistake in financial statements or records due to clerical, mathematical, or judgmental mistakes. It differs from fraud, which is intentional. Common errors include • Arithmetic Errors – Mistakes in calculations. • Omissions – Missing transactions or balances. • Incorrect Accounting Treatment – Misapplication of accounting principles.

<table>
<tr><td></td><td></td><td>

- Clerical Errors – Data entry or transcription mistakes.

From the point of view of audit these errors are two types namely – Self revealing errors (Apparent on record and easily identifiable) and non-self-revealing errors (Not apparent and require additional efforts to detect them). Auditors must detect and evaluate errors to ensure financial statements present a true and fair view.
</td></tr>
<tr><td>13.</td><td>Risk of material misstatement</td><td>There is a probability of frauds or errors in financial statements before audit.</td></tr>
<tr><td>14.</td><td>Materiality</td><td>Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.</td></tr>
<tr><td>15.</td><td>Performance Materiality</td><td>Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole.</td></tr>
<tr><td>16.</td><td>Engagement Standards</td><td>
<table>
<tr><th colspan="2">Nature of services</th><th>Level of assurance provided</th><th>Report Provided</th></tr>
<tr><td colspan="2">Audit</td><td>High but not absolute</td><td>Positive assurance on assertions</td></tr>
<tr><td colspan="2">Review</td><td>Moderate Assurance</td><td>Negative assurance on assertions</td></tr>
<tr><td rowspan="2">Related Services</td><td>Agreed Upon Procedures</td><td>NO Assurance</td><td>Factual findings or procedures</td></tr>
<tr><td>Compilations</td><td>NO Assurance</td><td>Identification of information compiled</td></tr>
<tr><td colspan="2">1-99</td><td colspan="2">SQCs</td></tr>
<tr><td colspan="2">100-899</td><td colspan="2">SAs</td></tr>
</table>
</td></tr>
</table>

		2000-2699 SREs 3000-3699 SAEs 4000-4699 SRSs
17.	Financial Statements	a) **Definition as per SA 200**: A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with applicable financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. b) Definition as per Companies Act: Financial statements includes the following: ▪ Profit and Loss account or Income and Expenditure account ▪ Balance Sheet ▪ Cash flow Statement ▪ Statement of change in equity, if applicable ▪ Any explanatory notes annexed to or forming part of financial statements.
18.	Applicable Financial Reporting Framework (AFRF)	In view of the nature of the entity and the objective of the financial statements, the framework adopted by management for preparation and presentation of the financial statements is known as AFRF. In other words, a FRF is nothing but, set of rules and regulations that are to be followed for preparation and presentation of financial statements.

Various Matters issued by ICAI

Matters	Purpose	Adherence	Authority
Standards	For securing compliance	Mandatory	Council
General clarifications	For clarifying any issues from standards	Mandatory	Council
Guidance notes	To assist in implementation of standards	Not Mandatory	Council
Technical guides	Giving broad knowledge about an aspect	Not Mandatory	AASB
Practice Manuals	Provides additional guidance in performing assignments	Not Mandatory	AASB
Studies & Other papers	Promoting discussion or debate or creating awareness	Not Mandatory	AASB

CHAPTER 1 – NATURE, OBJECTIVE & SCOPE OF AUDIT

DEFINITION & DECODING OF THE DEFINITION

Define Audit.

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

1. Audit is an independent examination of financial information
2. of any entity – that entity may be profit oriented or not and irrespective of its size or legal form. For example – Profit oriented – Audit of Listed company engaged in business. On the other hand, Audit of NGO – not profit oriented.
3. The objective of the audit is to express an opinion on the financial statements

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

The purpose of external audit engagements is to enhance the degree of confidence of intended users of financial statements. Such engagements are also reasonable assurance engagements.

What are the points to be considered to ensure the financial statements are not misleading?

1. The accounts have been drawn up with reference to entries in the books of account;
2. The entries in the books of account are adequately supported by sufficient and appropriate evidence;
3. None of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
4. The information conveyed by the statements is clear and unambiguous;
5. The financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and
6. The statement of accounts presents a true and fair picture of the operational results and of the assets and liabilities.

OBJECTIVES AND SCOPE

OBJECTIVES

1. To **obtain reasonable assurance** about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. Absolute assurance cannot be given. However, reasonable assurance is not a guarantee but it is a high level of assurance.
2. To **report on the financial statements**, and communicate as required by the SAs, in accordance with the auditor's findings.

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. The auditor evaluates the reliability and sufficiency of the information contained in the underlying accounting records and other source data by:
    a. making a study and evaluation of accounting systems and internal controls and
    b. carrying out such other tests, enquiries and other verification procedures of accounting transactions and account balances as he considers appropriate in the particular circumstances.
4. 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.

    Management is responsible for
        a. preparation of financial information,
        b. selection & application of accounting policies
        c. FS prepared on historical information
5. The auditor determines whether the relevant information is properly disclosed in the financial statements by:
    a. comparing the financial statements with the underlying accounting records and other source data to see whether they properly summarize the transactions and events recorded therein; and

b. considering the judgments that management has made in preparing the financial statements accordingly, the auditor assesses the selection and consistent application of accounting policies, the manner in which the information has been classified, and the adequacy of disclosure.

6. The auditor is not expected to perform duties which fall outside the scope of his competence.
7. 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.

TEST YOUR UNDERSTANDING 1

Lalji Bhai has purchased shares of a company listed on NSE. The audited financial statements of the company provide picture of healthy financial performance having robust turnover, low debt and good profits. On above basis, he is absolutely satisfied that money invested by him is safe and there is no chance of losing his money. Do audited results and audit reports of companies provide such assurance to investors like Lalji Bhai? Is thinking of Lalji Bhai correct?

Hint Ans: An audit does not provide assurance to investor in shares regarding safety of his money

TEST YOUR UNDERSTANDING 2

Good deeds Limited is engaged in business of recycling of wastes from dumping grounds of municipal corporation of Indore to usable manure. It is, in this way, also, helping to make the city clean. During course of audit by Zoha & Zoha, a firm of auditors, it is observed by auditors that company has received a notice from Central Bench of National Green Tribunal for not following certain environmental regulations involving imposition of hefty monetary penalty on the company. The company is yet to reply to the notice. The auditors point out that same is not stated in notes to accounts in financial statements. The company points out that auditors are going beyond scope of their work. Does such a matter fall within scope of audit?

Hint Ans: Proper disclosure of financial information is well within scope of audit.

TEST YOUR UNDERSTANDING 3

A huge fire broke out in NOIDA plant of KT Limited. Plant assets comprising building, machinery and inventories were insured from branch of a public sector insurance company. Apart from an insurance surveyor who was deputed for assessing loss, the regional office of insurance PSU also appointed a CA for verification of books of accounts/ financial records of the company and circumstances surrounding the loss. He was also requested to submit an early report. Would the report by CA in nature of audit report?

Hint Ans: It is an investigation and not in nature of audit report.

ASPECTS TO BE COVERED IN AUDIT

1. **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.
2. **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.
3. Checking of the **arithmetical accuracy** of the books of account.
4. **Verification of the authenticity and validity** - of transactions entered into by making an examination of the entries in the books of accounts with the relevant supporting documents.
5. Ascertaining that a proper **distinction 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.
6. **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.
7. **Verification** of the title, existence and value of the assets appearing in the balance sheet.
8. **Verification** of the liabilities stated in the balance sheet.
9. **Checking the result** shown by the profit and loss and to see whether the results shown are true and fair.
10. Where audit is of a corporate body, confirming that the **statutory requirements** have been complied with.
11. **Reporting** to the appropriate person/body whether the statements of account examined do reveal a true and fair view of the state of affairs and of the profit and loss of the organisation.

ADVANTAGES OF AUDIT OF FINANCIAL STATEMENTS – MS^{3}D will BRinG Future

1. It acts as a moral check on the employees from committing defalcations or embezzlement.
2. Audited financial statements are helpful in settling liability for taxes, negotiating loans and for determining the purchase consideration for a business.
3. These are also useful for settling trade disputes for higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.
4. Audited accounts are of great help in the settlement of accounts at the time of admission or death of partner

5. An audit can also help in the detection of wastages and losses to show the different ways by which these might be checked, especially those that occur due to the absence or inadequacy of internal checks or internal control measures.
6. Audit ascertains whether the necessary books of account and allied records have been properly kept and helps the client in making good deficiencies or inadequacies in this respect.
7. As an appraisal function, audit reviews the existence and operations of various controls in the organisations and reports weaknesses, inadequacies, etc., in them.
8. Government may require audited and certified financial statements before it gives assistance or issues a license for a particular trade.
9. It safeguards the financial interest of persons who are not associated with the management of the entity, whether they are partners or shareholders, bankers, Financial Institutions, public at large etc.

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. Many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.
2. **The Nature of Audit Procedures**: There are practical and legal limitations on the auditor's ability to obtain audit evidence like –
   a. There is the possibility that management or others may not provide, the complete information that is relevant, intentionally or unintentionally.
   b. Fraud may involve sophisticated and carefully organised schemes designed to conceal it.
3. **Not an official investigation**: 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.
4. **Timeliness of Financial Reporting and decrease in relevance of information**: Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. The relevance of information & its value, tends to diminish over time.
5. **Future Events**: Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business. The business may cease to exist in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.

IS AUDIT MANDATORY OR VOLUNTARY?

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

WHO APPOINTS AN AUDITOR?

1. Generally, an auditor is appointed by **owners** or in some cases by **constitutional or government authorities** in accordance with applicable laws and regulations. For example, in case of companies, auditor is appointed by members (shareholders) in Annual General Meeting (AGM). Shareholders are owners of a company and auditor is appointed by them in AGM.
2. However, in case of **government companies** in India, auditor is appointed by **Comptroller and Auditor General of India (CAG)**, an independent constitutional authority.
3. Take case of a **firm** who engages an auditor to audit its accounts. In such a case, auditor is appointed by **partners of firm**.
4. There may be a situation in which auditor may be appointed by a **government authority** in accordance with some law or regulation. For example, an auditor may be appointed under tax laws by a government authority.

TO WHOM REPORT IS SUBMITTED BY AN AUDITOR?

1. The report is submitted **to person making the appointment**.
    a. In case of **companies** – these are **shareholders**
    b. In case of a **firm** – to **partners** who have engaged him.

CASE STUDY – I

Rohit, Gurpreet, Ali and Goreti are friends since their school days based in Mumbai. They have cleared CA foundation exams in the same attempt and now plan to appear for CA Intermediate exams. All of them are avid news listeners and regularly keep track of business news even on social media. They are trying to understand new subjects including auditing. Rohit, Gurpreet and Ali have also started attending Live Coaching Classes (LCC) being conducted by Board of studies of ICAI. Goreti has not been able to join Live Coaching Classes yet as she was away on a holiday with her parents. However, she plans to catch it up with her friends very soon. Ali had also joined the classes but he had skipped some lectures.

During one informal get together, their discussions centred around new subject of auditing. They discussed many things regarding its nature, scope, benefits and other general practical issues. Goreti was regular in keeping track of audited results of companies being published in leading newspapers. Her view was that audited financial statements of companies give 100% guarantee to different stake holders. It is the main reason behind so much reliance upon auditing. But she could not understand why wrong doings in financial matters are being discovered after many years have gone by.

Ali also concurred with her view and added that when financial statements are audited, each and every transaction appearing in books of accounts is verified. However, he could not give clarity to Goreti. Gurpreet was of the opinion that audit was conducted on the basis of sample checking. He was also of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of the companies. Not to be left behind, Rohit also jumped in the fray. He supported Gurpreet and also added something of his own.

Based on above, answer the following questions: -

1. Gurpreet was of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of companies. What kind of assurance does audit of financial statements provide?
   a. It provides reasonable assurance meaning a moderate level of assurance.
   b. It provides reasonable assurance meaning a low level of assurance.
   c. **It provides reasonable assurance meaning a high level of assurance**.
   d. It provides reasonable assurance meaning an absolute level of assurance
2. Rohit added that auditor can force an employee of the company to provide him required information and documents. Can he do so?
   a. Yes, he can do so. It is necessary to obtain audit evidence.
   b. Yes, he can do so. There are express rights given to him in this respect.

c. **No, he cannot do so. He can only request for providing him with necessary information and documents. But it cannot be forced by him**.

d. No, he cannot do so. He has no right of seeking information and documents. Therefore, question of forcing does not arise.

3. Ali had listened in one of the classes that audit covers all aspects of an entity and concluded that each and every transaction of entity is verified by auditor. Goreti also seemed to be in agreement with him but she was of the view that besides this, it also meant that audit should be so organized to cover all areas of an entity. Which of following statements is appropriate in this regard?

   a. Only view of Ali is correct.

   b. Only view of Goreti is correct.

   c. Views of both Ali and Goreti are correct.

   d. **Views of both Ali and Goreti are incorrect**.

4. All of them also discussed about benefits of auditing. Which of the following is not a likely benefit of auditing?

   a. **Since auditing is connected to future events, audited information can be easily relied upon by users**.

   b. Errors or frauds may be discovered during audit.

   c. Government authorities can make use of audited accounts for different purposes.

   d. It can help in bringing out deficiencies in maintenance of financial records.

5. Goreti told her friends that she had read a news report about how a company had misled its auditors by producing some fabricated documents. Which of following statements seems to be appropriate in this regard?

   a. It was wrong on the part of auditor to rely upon fabricated documents. He must have discovered it as the same falls within the scope of his duties.

   b. Although it was wrong on the part of auditor to rely upon fabricated documents, he cannot do anything in the matter. He has to report on the basis of documents provided to him. He has no duty in this regard.

   c. Auditor has to conduct audit by exercising professional skill. But he is not an expert in discovering genuineness of documents. Hence, management consisting of dishonest persons may have led him to rely upon fabricated documents deliberately

   d. Management cannot mislead auditor due to high level of knowledge and expertise possessed by him. The above is an outlier case-one of the rare odd cases.

TEST YOUR UNDERSTANDING 4

Zeeba Products is a partnership firm engaged in trading of designer dresses. The firm has appointed JJ & Co, Chartered accountants to audit their accounts for a year. The auditors were satisfied with control systems of firm, carried out required procedures and necessary verifications. In particular, they carried out sample checking of purchases, traced purchase bills to GST portal and also made confirmations from suppliers. They were satisfied with audit evidence obtained by them as part of audit exercise. An audit report was submitted to the firm giving an opinion that financial statements reflected true and fair view of state of affairs of the firm. However, later on, it was discovered that purchase manager responsible for procuring dresses from one location was also booking fake purchases of small values by colluding with unethical dealers. Payments to these dealers were also made in connivance with accountant through banking channel. The partners of firm blame auditors for futile audit exercise. Are partners of firm correct in their view point? Imagine any probable reason for such a situation.

Hint Ans: This is an inherent limitation of audit.

ASSURANCE ENGAGEMENT

MEANING

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

ELEMENTS OF AN ASSURANCE ENGAGEMENT

1. A three-party relationship involving a practitioner, a responsible party, and intended users.
2. An appropriate subject matter
3. Suitable criteria
4. Sufficient appropriate evidence
5. A written assurance report in appropriate form

Meaning of Review & Audit Vs. Review

1. Audit is a reasonable assurance engagement. It provides reasonable assurance.
2. Review is a limited assurance engagement. It provides lower level of assurance than audit.

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

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

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

- Besides reasonable assurance engagements and limited assurance engagements, there is another kind of assurance which is related to matters other than historical financial information
- "Prospective financial information" means financial information based on assumptions about events that may occur in the future and possible actions by an entity.
- Such an assurance may relate to prospective financial information and not to historical financial information.
- It can be in the form of a forecast or projection or combination of both. In such type of assurance engagements, examination is not of historical financial information.
- Therefore, historical financial information is rooted in past events which have already occurred whereas prospective financial information is related to future events.
- Therefore, in Prospective assurance engagements, practitioner provides a report assuring that nothing has come to practitioner's attention to suggest that the assumptions taken do not provide a reasonable basis for the projection.
- While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future- oriented. Therefore, not in a position to express an opinion w.r.t the results shown in the prospective financial information will be achieved.
- It provides only a "moderate" level of assurance.

TEST YOUR UNDERSTANDING 5

The management of Exotic Tours and Travels Limited requests its auditor Raja & Co.to provide an assurance report on the financial information for first quarter of a year by skipping required detailed procedures.

Can Raja & Co. provide such a report? What would be nature of such a report? Would it be necessary for them to obtain sufficient appropriate evidence in such a case?

Hint Ans: Such report would be in nature of "review". However, auditors would have to obtain sufficient appropriate evidence.

QUALITIES OF AUDITOR

1. Tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability are some of qualities which an auditor should have.
2. He must have the highest degree of integrity backed by adequate independence.
3. The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education.
4. An exhaustive knowledge of accounting in all its branches is the essential condition of the practice of auditing. He must know thoroughly all accounting principles and techniques

ENGAGEMENT AND QUALITY CONTROL STANDARDS

1. The following Standards issued under authority of ICAI Council are collectively known as Engagement Standards: -

AREA OF APPLICATION	APPLICABLE STANDARDS
Audit of historical financial information	Standards on auditing (SAs)
Review of historical financial information.	Standards on review engagements (SREs)
Assurance engagements other than audits and review of historical financial information. [Ex: Examination of prospective Fin. Info]	Standards on Assurance engagements (SAEs)
Agreed upon procedures to information, compilation engagements and other related service engagements.	Standards on Related Services (SRSs)

Establish standards and provide guidance regarding a firm's responsibilities for its system of quality control	Standards on Quality Control (SQCs)

2. Why are Standards needed? [MCQ SEP 24]
    a. Standards ensure carrying out of audit against established benchmarks at par with global practices.
    b. Standards improve quality of financial reporting thereby helping users to make diligent decisions.
    c. Standards promote uniformity as audit of financial statements is carried out following these Standards.
    d. Standards equip professional accountants with professional knowledge and skill.
    e. Standards ensure audit quality.

DUTIES IN RELATION TO ENGAGEMENT AND QUALITY CONTROL STANDARDS

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

TEST YOUR UNDERSTANDING 6

CA. P Ramu is conducting audit of financial statements of Quick Buy Private Limited. He was not able to obtain external confirmations from certain debtors due to practical difficulties and peculiar circumstances. However, such a procedure is mandated under one of Standards on Auditing. Unable to obtain external confirmations from these debtors, he relied upon sale details to these parties, e-invoices, e-way bills and also traced payments from these parties in bank accounts of the company. He was reasonably satisfied with audit evidence obtained. Is there any other reporting duty cast upon him relating to not following a mandated procedure in one of Standards on Auditing?

Hint Ans: His report should draw attention to such departure.

CASE STUDY 2

Me and You Private Limited has been newly incorporated. The plant of the company has recently started production with the help of funds provided by a bank for purchase and installation of machinery. Further, the company is also utilizing working capital credit facilities from the same bank for meeting its day to day working capital requirements like for purchase of raw materials, labour payment etc. However, just within six months of its operations, the management feels that working capital funds are inadequate and situation is creating liquidity issues in the company.

The management of the company has approached its bankers and requested for enhancement in working capital credit facilities. The bank manager is insisting upon financial statements of the company for half year along with report providing assurance in this respect duly signed by Chartered Accountant as audit is far away. It also requires projected financial statements for coming years along with a report from CA providing assurance regarding these projections to consider request of management.

The management approaches CA P, who has qualified recently and started practising. Reports providing assurance for half yearly results and projected financial statements are sought from CA P. The Management provides necessary information and records to him in this regard. Assume, in above case, the company only provides trial balance, financial statements in draft/preliminary form along with accompanying records for the relevant half year to CA P and requests him to provide duly signed financial statements with a report for mutually agreed professional fees.

Based on above, answer the following questions

1. The management of company has engaged CA P to issue a duly signed report for half year. Which of the following standards, if any, issued by ICAI are relevant for CA P?
    a. Standards on Review Engagements
    b. Standards on Auditing
    c. Standards on Related Services
    d. There are no standards for issuing report in such situation.
2. Which of the following statements is MOST APRROPRIATE in given case situation?
    a. CA P can assist management in preparation of financial statements of the company. However, issue of a report in such a case is outside the scope of work.
    b. CA P can assist management in preparation of financial statements of the company and he can issue an audit report.
    c. **CA P can assist management in preparation of financial statements of the company and he can issue a compilation report in this respect**.

d. The responsibility of preparation of financial statement is of company's management. CA P cannot assist management in preparation of financial statements of the company. However, he can issue a review report

3. In the above said scenario for issuance of signed financial statements for half year by CA P, as discussed in last para of Case Study, identify the MOST APPROPRIATE statement:
   a. Standard on Quality control (SQC 1) is not applicable as CA P cannot issue audit report.
   b. Standard on Quality Control (SQC 1) is not applicable as CA P cannot issue review report.
   c. **Standard on Quality Control (SQC 1) is applicable in such type of engagement**.
   d. Standard on Quality Control (SQC 1) is not applicable as CA P is barred from issuing any report in such type of engagement.
4. The banker of company has also requested for projected financial statements for coming years along with a report from CA regarding these projections to consider request of management. Which of the following standards issued by ICAI are relevant for CA P in such a situation, if any?
   a. Standards on Review Engagements
   b. There are no standards for issuing such type of reports.
   c. Standards on Related Services
   d. Standards on Assurance Engagements
5. Suppose CA P also accepts work of issuing projected financial statements with a report to be signed by him. The management has projected turnover of ₹100 core for the next year, ₹150 crore & ₹ 200 crore for following years respectively as compared to present turnover of ₹ 25 crore in current half year. Identify the MOST APPROPRIATE statement in this situation:
   a. CA P has to satisfy himself regarding arithmetical accuracy of projected data.
   b. CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover and its consistency with actuals.
   c. CA P has to satisfy himself regarding arithmetical accuracy of data along with its proper presentation to banker.
   d. **CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover, its consistency with actuals, disclosure and presentation**.

STUDY MATERIAL QUESTIONS

1. "Choosing of appropriate accounting policies in relation to accounting issues is responsibility of management". Do you agree? Discuss duty of auditor, if any, in relation to accounting policies.
   Hint Ans: Refer to scope of audit- what it includes.

2. Assurance engagements are not restricted to audit of financial statements alone. Discuss.
   Hint Ans: Refer to examples on assurance engagements

3. An assurance engagement involves a three-party relationship. Discuss meaning of three parties in such an engagement.
   Hint Ans: Refer to elements of assurance engagement.

4. A Chartered Accountant is specifically asked to check accounts whether fraud exists. State with reasons whether it is an example of reasonable assurance engagement.
   Hint Ans: It is not a reasonable assurance engagement. It is in nature of investigation.

5. An audit does not provide absolute assurance. Discuss how nature of audit procedures itself is one of the reasons due to which audit cannot provide absolute assurance.
   Hint Ans: Refer to second point of inherent limitations of audit.

EXAMINATION QUESTIONS UNDER PREVIOUS NEW SYLLABUS

1. "An audit is 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." Explain stating clearly how the person conducting this task should take care to ensure that financial statements would not mislead anybody. [MTP-Oct. 19]
2. The person conducting audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing. [RTP-May 20]
3. The objective of an audit of financial statements, prepared within a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements.
4. State the objectives of Audit according to SA 200. [RTP-May 20]
5. List the points that merit consideration in regard to scope of audit.
6. State briefly six important aspects to be considered by an auditor while conducting an audit.

7. State the matters which the statutory auditor should look into before framing an opinion on accounts on finalisation of audit of accounts. Discuss overall audit approach.
8. State the principal aspects to be covered in an audit concerning financial statement of account. [Nov 15-5 Marks]
9. GST & Co., a firm of Chartered Accountants has been appointed to audit the accounts of XYZ Ltd. The partner wanted to cover principal aspects while conducting its audit of financial statements. Advise those principal aspects. [RTP-May 18]
10. SWM is proprietorship firm engaged in the manufacturing of different kind of yarns. It sells its finished products both in the domestic as well as in the international market. The company is making total turnover of Rs. 30 crores. It has also availed cash credit limit of ₹3 crores from Dena Bank. In the year 2018-19. Proprietor of the firm is worried about the financial position of the company and is under the impression that since he is out of India, therefore firm might not run well. He approaches an Internal Auditor about as to what would be covered in Audit. Advise regarding principal aspects (any four) to be covered in getting accounts audited. [MTP-March 19]
11. The duties of the auditor are limited to verification of the arithmetical accuracy of the books of the accounts. Comment.
12. Discuss the types of audits required under law. [Nov 11-5 Marks]
13. What is the importance of having the accounts audited by independent professional auditors? [May 01-8 Marks]
14. What are the advantages of independent audit. [May 12-8 Marks]
15. Discuss the following: Advantages of Independent Auditor. [May 15-5 Marks]
16. RAG is proprietorship firm engaged in the manufacturing of textile and handloom products. It sells its finished products both in the domestic as well as in the international market. The company is making total turnover of Rs. 30 crores. It has also availed cash credit limit of Rs. 5 crores from Canara Bank. In the year 2018-19, proprietor of the firm is worried about the financial position of the company and is under the impression that since he is out of India, therefore firm might run into losses. He approaches a CA about advantages of getting his accounts audited throughout the year so that he may not suffer due to accounting weaknesses. Advise regarding advantages of getting accounts audited. [MTP-March 18, Oct.18]
17. The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory. Explain. [RTP-Nov. 18]

18. Discuss Limitations of audit. [May 11-8 Marks]
19. "The process of auditing is such that it suffers from certain limitations". Discuss.
20. ABC Ltd. Requested the auditor to provide for absolute assurance in respect of its ten branches scattered in Mumbai and confirm that financial statements are free from material misstatements due to fraud or error. Advise.
21. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. Explain. [RTP-Nov. 18]
22. There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain with examples. [RTP-May 20]
23. In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters. [RTP-May 20]
24. The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Explain. [RTP-May 18]
25. Discuss the following: The discipline of behavioural science is closely linked with the subject of auditing. [Nov 13-5 Marks]
26. What are the objectives and functions of Auditing and Assurance Standard Board (AASB)? Explain. [May 15-6 Marks]
27. Discuss the following: Standards collectively known as the Engagement Standards issued by AASB under the authority of Council of ICAI. [May 12-5 Marks]
28. State the Standards issued by AASB which are collectively known as engagement standards. [Nov 15-4 Marks]
29. PD & Co., Chartered Accountants, were appointed as the statutory Auditors of MR Ltd for the financial year. 2023-24. MR Ltd in the appointment letter to the auditors:

    "The auditor Shall be responsible for detecting the fraud that may happen in the company during the financial year 2023-24".

    They audit our objective to inclusion of such a clause in the appointment letter. **[Sep 24 – 3 Marks]**
30. RST Ltd., a retail company, has set up internal controls requiring all invoices to be stamped and signed by an authorised person in "Goods Receiving Section" of the company stating the date and time of receiving goods in premises to ensure that only those purchase bills are produced for payment for which goods have been actually received.

During the audit, the auditor finds that two employees – a purchasing manager and an accounts clerk – have worked together to bypass this control, submitting fake invoices that resulted in payments for goods that were never received. You are required to state the objectives of an audit, as per SA 200, when it comes to ensuring the reliability of financial statements? Also explain, why auditor can provide only reasonable, rather than absolute, assurance that the financial statements are free from material misstatement due to fraud or error in the context of the given situation? **[RTP Jan 25]**

31. XYZ Ltd, a manufacturing company engaged in the production of various types of yarn, is planning to expand its operations into a new geographical market and also add new products. The company has prepared prospective financial information to be presented to potential investors and financial institutions to secure funding for the expansion. XYZ Ltd engages a firm of auditors to conduct an assurance engagement on this prospective financial information. During the engagement, the auditors reviewed the assumptions made by XYZ Ltd.'s management and issued a report. Explain the key differences between prospective financial information and historical financial information. How does this distinction impact the level of assurance provided in an assurance engagement on prospective financial information? **[Jan 25 – 5 Marks]**
32. RST Ltd., a mid-sized trading company, recently faced challenges in securing a bank loan due to doubts about the reliability of its financial statements. The management realised the importance of having audited accounts to build confidence among lenders and other stakeholders. Elucidate the benefits and need of an audit **[MTP – Jan 25]**

CHAPTER 2 – AUDIT STRATEGY, AUDIT PLANNING AND PROGRAMME

AUDIT PLANNING

A. Benefits of Audit Planning:

1. Devote appropriate attention on important areas
2. Identify and resolve potential problems on a timely basis.
3. Helps in systematic organizing and managing the audit.
4. Helps in selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and assigning work to them.
5. Directing, supervising and reviewing team member's work.
6. Helps in coordination of work done.

CAQ 1: Write short note on: Usefulness of careful and adequate audit planning.

CAQ 2: Surya and Chand Ltd is a manufacturing company engaged in the production of miscellaneous electrical goods. Trilochan and Co. has been appointed as the auditors to carry out its audit. Auditor thinks that planning an audit would involve establishing the overall audit strategy for the engagement and developing an audit plan. Also, Adequate planning benefits the audit of financial statements in several ways. **Analyse and advise explaining the benefits of adequate planning**. **[RTP-May 18]**

CAQ 3: "An adequate planning benefits the audit of financial statements." **Discuss**. **[Nov. 18 – 5 Marks]**

CAQ 5: Explain the benefits of planning in the audit of financial statements. **[RTP-May 19]**

CAQ 6: Engagement partner of Audit Firm MKC AND COMPANY thinks that planning an audit would involve establishing the overall audit strategy for the engagement and developing an audit plan. Also, Adequate planning would benefit the audit of financial statements in several ways. **Analyse explaining the benefits of adequate planning**. **[RTP-Nov. 19]**

CAQ 7: Adequate planning benefits the audit of financial statements in several ways. Explain **[RTP-May 23]**

B. Is Audit Planning a continuous process?

1. It is not a describe phase but a continual and iterative process.
2. It begins after completion of previous audit and continues till the end of audit.
3. Planning includes the need to consider identification and assessment of ROMM (Risk of material misstatement such as

a. Analytical procedures as RAP
b. Understanding applicable frame work and how it is complied.
c. Determining materiality.
d. Experts' involvement.
e. Performing other RAP.

4. The engagement partner and other key members of the engagement team shall be involved in planning the audit including planning and participating in the discussion among engagement team members.
5. The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement.

CAQ 8: "Planning is not a discrete phase of an audit, but rather a continual and iterative process". Discuss.

[Nov. 18-5 Marks]

CAQ 9: Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after the completion of the previous audit and continues until the completion of the current audit engagement. Analyse and explain. **[RTP-Nov. 19]**

PLANNING PROCESS - ELEMENTS OF PLANNING

The elements of planning can be categorized as under: -

I. Preliminary engagement activities
II. Planning activities

I. **PRELIMINARY ENGAGEMENT ACTIVITIES**: The auditor considers whether relationship with client should be continued and whether ethical requirements including independence continue to be complied with. It includes: -

a. **Performing procedures regarding the continuance of the client relationship** –

(i) Ensure that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed and that conclusions reached in this regard are appropriate.

(ii) The firm should obtain information considered necessary in the circumstances before accepting an engagement with a new client.

(iii) Matters such as

a. Integrity of principal owners and key management,
b. Competence of engagement team to perform the audit engagement and

c. Implications of matters that have arisen during current and previous audit engagement may need to be considered Evaluating compliance with ethical requirements, including independence.

(iv) In case of initial engagements, communication with predecessor auditor should be made, where there has been a change of auditors.

b. **Evaluating compliance with ethical requirements, including independence**: -

(i) The auditor shall continuously evaluate compliance with ethical requirements including independence

(ii) The engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team.

(iii) If matters come to the engagement partner's attention that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, shall determine the appropriate action.

(iv) Form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall: -

a. Obtain relevant information from the firm to identify and evaluate circumstances and relationships that create threats to independence.

b. Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement and

c. Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

c. **Establishing an understanding of terms of engagement**: - It is in the interests of both the entity and the auditor that the auditor sends an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the audit. It ensures that there is no confusion with the client regarding terms of the engagement.

II. **PLANNING ACTIVITIES**: Planning activities involve: -

Establishing the overall audit strategy

a. The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

b. The process of establishing the overall audit strategy assists the auditor to determine such matters as:

(i) The **resources** to deploy for specific audit areas

a. High risk areas – Deploys experienced members

b. Complex matters – Deploys experts

(ii) Amount of resources to allocate to specific audit areas such as

a. Number of team members assigned to observe the inventory count at material locations

b. Extent of review of other auditors' work

c. The audit budget in hours to allocate to high risk areas

(iii) When these resources are to be deployed such as whether at an interim audit stage or at key cut-off dates

(iv) How these resources to be managed, directed and supervised such as meetings, reviews etc.

CAQ 10: The process of establishing the overall audit strategy assists the auditor to determine certain matters with respect of team resource. Explain those matters.

CAQ 11: Auditor of ABC Ltd. is worried as to management of key resources to be employed to conduct audit. How the audit strategy would be helpful to the auditor?

CAQ 12: The engagement partner of AST AND ASSOCIATES, firm of Chartered Accountants appointed as auditor of Fabric India Ltd is considering as to management of key resources to be employed to conduct audit. Discuss how overall audit strategy would assist the auditor. **[MTP-March 18]**

CAQ 13: Describe how the process of establishing the overall audit strategy assists the auditor in marshalling his human resources. **[May 19 – 4 Marks]**

CAQ 14: Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan. The process of establishing the overall audit strategy assists the auditor to determine such matters as for example - the resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high-risk areas or the involvement of experts on complex matters. Explain the other three such matters. **[RTP-May 20]**

CAQ 15: The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. Discuss stating the process of establishing the overall audit strategy that would assist the auditor to determine key matters. **[RTP-Nov. 18]**

c. Factors for establishing for overall strategy: In establishing the overall audit strategy, the auditor shall, among other considerations, ascertain the nature, timing and extent of resources necessary to perform the engagement:

(i) Identify characteristic and define scope. There are many characteristics of engagement defining its scope. Some of characteristics are as under:

- Applicable financial reporting framework applicable to the entity
- Nature of business segments to be audited including the need for specialized knowledge
- Industry specific reporting requirements required by industry regulators
- Expected use of audit evidence obtained in previous audits

(ii) Ascertain reporting objectives to plan. This helps in the

- Timing of Audit
- Nature of communication.

Some of the instances are as follows:

- The entity's timetable for reporting
- Organization of meetings to discuss of nature, timing and extent of audit work with management
- Discussion with management regarding the expected type and timing of reports to be issued including the auditor's report
- Discussion with management regarding the expected communications on the status of audit work throughout the engagement.
- Expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed

CAQ 16: In establishing overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. Elucidate those cases by which auditor can ascertain the reporting objectives of the engagement. **[Nov. 19 – 4 Marks]**

(iii) Factors that are significant in auditors' judgement should be considered which will contribute in teams' effort like volume of transactions, Significant industry developments, Significant changes in the financial reporting framework, changes in the legal environment affecting the entity.

CAQ 17: Lotus Ltd., a rapidly growing manufacturing company, appointed Ridhi & Co., as statutory auditor. The engagement team of Ridhi & Co. identified key areas requiring scrutiny, such as revenue recognition, inventory valuation, and related party transactions. Based on his professional judgment, CA Ravi, the engagement partner directed the engagement team, to focus on these critical areas, emphasising to ensure accuracy and compliance.

Give some examples of the factors need to be considered by CA Ravi for establishing the audit strategy.

[MTP Jan 25 – 4 Marks]

(iv) Consider the result of preliminary engagement activities or other similar activities.

(v) Ascertain nature timing and extent (NTE) of resources necessary

CAQ 18: Comment on the following in relation to SAs: Auditor shall establish an overall strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan". **[May 11 – 5 Marks]**

CAQ 19: Discuss the factors the auditor will consider while establishing the overall strategy.

CAQ 20: "In establishing the overall audit strategy, the auditor shall, among other considerations, ascertain the nature, timing and extent of resources necessary to perform the engagement". Explain those considerations in detail.

[MTP Jan 25 – 4 Marks]

Development of Audit plan

1. An audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.
2. The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members.
3. Understanding client's business is one of the important principles in developing an audit plan.
4. SA-300 states that auditor shall develop an audit plan that shall include description of –
    (i) The nature, timing and extent of planned risk assessment procedures
    (ii) The nature, timing and extent of planned further audit procedures at assertion level
    (iii) Other planned audit procedures

Relationship between audit strategy and audit plan

1. Audit strategy sets the broad overall approach to the audit whereas audit plan addresses the various matters identified in the overall audit strategy.
2. Audit strategy determines scope, timing and direction of audit. Audit plan describes how strategy is going to be implemented.
3. The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members.
4. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.

CAQ 21: Discuss the relationship between overall audit strategy and audit plan.

CAQ 22: "Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy". Discuss.

CAQ 23: The establishment of the overall audit strategy and the detailed audit plan are closely inter-related. Explain. **[MTP-Mar 19]**

CAQ 24: Once the overall audit has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy. The establishment of the overall audit strategy and the detailed audit plan are closely inter-related. **[RTP-MAY 22]**

CAQ 25: The engagement partner of a firm of auditors, is explaining to his audit team, undergoing practical training, the inter relationship between audit strategy & audit plan. Discuss the points which the engagement partner will explain to his team in this regard. **[SEP 24 – 3 marks]**

Overall audit strategy – The auditors responsibility.

1. When discussing matters in audit strategy and audit plan, sufficient strategy is required so that effectiveness of the audit is not compromised.
2. The involvement of partners and other key members draws on their experience and insights there by enhancing the effectiveness and efficiency of the planning process.

Changes to plan

1. The auditor shall update and change the strategy and the plan as required during the course of audit.
2. As a result of unexpected events, changes in conditions, evidence obtained from results of procedures performed, the auditor may need to modify the strategy and plan.
3. This may be the case when the information comes to the auditor's attention that differs significantly from the information available the audit procedures were planned.

CAQ 26: The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. Explain. **[RTP-Nov 18]**

CAQ 27: As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan. Explain. **[RTP-Nov 19]**

CAQ 28: Plans should be further developed and revised as necessary during the course of the audit. Explain. **[RTP-May 20]**

CAQ 29: Once the audit plan has been drafted and communicated, it is obligatory on the auditor to follow the same. **[MAY 22 – 2 marks]**

Planning of Supervision and Review of team member's work

1. Auditor shall plan the nature, timing and extent.
2. While planning the above the following factors has to be considered.
    a. Size & complexity of the entity.

b. Area of the audit.
c. Assessed risks of material misstatement.
d. Capabilities and competence of the members performing a work.

CAQ 30: "The Nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors." Explain.

CAQ 31: The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors. Explain giving examples. **[RTP NOV 20]**

1. The auditor shall document.
    a. Overall audit strategy – Key decisions
    b. Audit Plan – planned RAP & FAP
    c. Significant changes made during the engagement to the plan or strategy with reasons.
2. The documentation of the strategy is the record of any key decision considered.
3. Documentation of audit plan is a record of Plan NTE and Risk Assessment Procedures and Further Audit Procedures.
4. The record of significant changes to strategy and plan explains why the changes were made and also the final strategy and plan.
5. Examples of Audit Documentation:
    a. Summary of discussions with entities key decision makers.
    b. Documentation of audit committees' approval of services.
    c. Access letters,
    d. Other communications or agreements with management, TCWG regarding scope and changes in scope.
    e. Auditors report.
    f. Other reports mentioned in the engagement agreement.

CAQ 32: The auditor shall document the overall audit strategy, the audit plan, and any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes. Explain. **[MTP-Aug. 18, RTP-Nov. 18]**

CAQ 33: The auditor shall document the overall audit strategy, the audit plan and any significant changes made to the overall audit strategy or the audit plan. Explain in detail giving examples. **[RTP-Nov 20]**

CAQ 34: Documentation of audit plan serves as a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. What all activities in the planning phase should form part of auditor's documentation? State with examples. **[MAY 21 – 4 marks]**

AUDIT PROGRAMME

Meaning

It is a list of examination and verification and steps to be applied and set out in such a way that the inter relationship of one step to another is clearly shown and designed.

Definition

"It consists of series of verification procedures to be applied on the FS and its items and accounts of a given company for the purpose of obtaining sufficient evidence to unable the auditor to express an informed opinion on such statements."

In other words, audit programme is a detailed plan of applying the procedures in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the objectives.

CAQ 35: Write short note on: Audit Programme. **[Nov. 06 – 4 marks]**

CAQ 36: "An audit programme is a detailed plan of applying the audit procedure in the given circumstance for accomplishing the audit objectives". Discuss.

Some Important points on AP

(i) **<u>One programme not practicable</u>**:

a. Evolving one audit programme applicable to all business under all circumstances is not practicable.

b. The factors that vary are –

- vary in nature, size and composition;
- work which is suitable to one business may not be suitable to others;
- efficiency and operation of internal controls and
- the exact nature of the service to be rendered by the auditor.

CAQ 37: Evolving one audit programme applicable to all audit engagements under all circumstances is not practicable. Explain **[RTP-May 18]**

CAQ 38: Evolving one audit programme applicable to all business under all circumstances is not practicable. Explain clearly stating in detail the meaning of audit programme. **[RTP-May 18]**

(ii) **<u>Keep an open mind</u>**:

- As experience is gained by actually carrying out the work, the programme may be altered to take care of situations which were left out originally, but are found relevant for the particular concern.
- Similarly, if any work originally provided for proves beyond doubt to be unnecessary or irrelevant, it may be dropped
- The assistant engaged in the job should be encouraged to keep an open mind beyond the programme given to him. He should be instructed to note and report significant matters coming to his notice, to his seniors or to the partners or proprietor of the firm engaged for doing the audit.

CAQ 39: M/s TP & Co., a firm of Chartered Accountants, is auditor of KSR Ltd. for many years. KSR Ltd. has diversified their business into newer areas during the last year. The senior member of the audit team handed over the standard audit programme of earlier years to the audit assistants and instructed them to follow the same. The assistants are conducting the audit accordingly. Whether the attitude of the audit assistants is justified or they are required to keep an open mind? Guide them. **[NOV – 4 marks]**

(iii) **Periodic Review**:

- 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.
- 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.
- This is done so that inadequacies or redundancies of the programme may be removed.
- Many persons believe that this brings an element of rigidity in the audit programme. This is not true provided the periodic review is undertaken to keep the programme as up-to date as possible and by encouraging the assistants on the job to observe all salient features of the various accounting functions of the client.

CAQ 40: "The utility of the audit programme can be retained and enhanced only by keeping the programme and also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed". Explain. **[RTP-May 19]**

CONSTRUCTING AN AUDIT PROGRAMME

The following points shall be considered while constructing the programme

1. Stay within the limits - Stay with the scope and limitation of the engagement.
2. Prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.
3. Get enough proof - Determine the evidences are reasonably available and identify the best evidence for deriving a satisfaction.
4. Relevance - Apply only those steps and procedures which are useful in the specific situations.
5. Include the audit objectives for each area and sufficient details which serve as a set of instructions for the assistants involved in audit and help in controlling the proper execution of the work
6. Error - Consider all possibilities of error.
7. Co-ordination - Coordinate the procedures to be applied to related items.

CAQ 41: Arpana Hospitals Ltd having Gross Professional Charges of ₹50 crores is engaged in providing healthcare services. STP & Co., a firm of auditors is appointed as its auditors. Advise what special points to be kept in mind for the purpose of construction of an Audit programme. Explain. **[RTP-May 18]**

CAQ 42: Explain the significant points auditor would consider while developing an audit programme. **[RTP-May 19]**

CAQ 43: List out the points that should be kept in mind by the auditor for the purpose of constructing an audit programme**.** **[May 19 – 3 Marks]**

CAQ 44: Discuss the points to be considered by auditor for the purpose of constructing an audit programme. **[Nov 19 – 4 Marks]**

It is designed to provide audit evidence

1. It means the information used by the auditor in arriving at the conclusion on which the opinion is based.
2. What is the best evidence for testing the accuracy is a matter of expert's knowledge and experience.
3. It is true that in all cases one procedure may not bring the highest satisfaction and it may be dangerous for the auditor to ignore any evidence that is available
4. The auditor, however, has to place appropriate weight on each piece of evidence and accordingly should prescribe the priority of verification.
5. The audit evidence is generally classified into
    a. Documentary
    b. Physical examination
    c. Statements and explanations of management.
    d. Statements and explanation of third party.

e. Arithmetical calculation by the auditor.
f. State of internal control and internal check.
g. Inter relationship of various accounting data.
h. minutes book.
i. subsequent action by client and by others.

CAQ 45: Evidence is the very basis for formulation of opinion and an audit programme is designed to provide for that by prescribing procedures and techniques. Analyse and explain with the help of example of evidence in respect of Sales. **[RTP-May 20]**

CAQ 46: In most of the assertions much of the evidence be drawn and each one should be considered and weighed to ascertain its weight to prove or disprove the assertion. An auditor picks up evidence from a variety of fields. Analyse and explain with the help of examples. **[RTP-Nov 20]**

DEVELOPING THE AUDIT PROGRAMME AND ADVANTAGES, DISADVANTAGES

1. Audit planning – Generally begins at the conclusion of previous year audit along with related programme. Sometimes it should be reconsidered for modification based on auditor's review of:
    a. Internal control
    b. Preliminary evaluation
    c. Compliance procedures
    d. Substantive procedures
2. Written audit programme – The auditor should prepare AP in writing setting forth the procedures that are needed.
3. Audit objective and instructions to assistants – AP may also have the objective for each area and set of instructions with details which will serve as means to control and proper execution of work.
4. Reliance on internal control – The auditor should have an understanding of accounting system and related ICS on which rely in determining NTE of audit procedures.
    a. May conclude on relying on ICS is an effective and efficient way to conduct his audit
    b. May decide not to rely on ICS when there are other efficient ways of obtaining SAAE. Also consider:
        a. Timing of procedures.
        b. Co-ordination of assistance from the client.
        c. Availability of assistants.
        d. Involvement of other auditors or experts

5. Timing of performance of audit procedures – Auditor has flexibility in deciding when to perform the procedures. In some cases, auditor will have no discretion as to timing.

ADVANTAGES OF AUDIT PROGRAMME

1. Can carry out the audit with clear set off instructions.
2. Provides a total perspective of work to be performed.
3. Selection of assistance becomes easier on the basis of their capability when the work is planned, defined and segregated.
4. Reduces danger of ignoring or overlooking certain books and records.
5. Accountability – The assistants will have the responsibility for the work carried on by them individually. It may be raised back to the assistant.
6. The auditor can have the control over the progress of various audits.
7. This serves as a guide in succeeding year.
8. Serves as the evidence in case of any charges brought against the auditor.

CAQ 47: Discuss the following: Despite of several disadvantages, audit programme is required to start an audit. **[Nov 13 – 5 Marks]**

CAQ 48: How does an audit programme help to plan and perform the audit?

CAQ 49: Audit programme is a list of examination and verification steps to be applied and set out in such a way that the inter-relationship of one step to another is clearly shown and designed, keeping in view the assertions apparent in the statements of account produced for audit or based on an appraisal of the accounting records of the client. For example, while auditing a company's inventory, the program may include steps to verify physical stock counts, ownership rights, and valuation. What are the advantages of an audit programme?

DISADVANTAGES OF AUDIT PROGRAMME

1. It may become mechanical and the work may be carried out without any understanding of the object in the entire audit scheme.
2. Becomes too rigid and inflexible in case of changes in the business operations, staff and internal control.
3. Inefficient assistants may take shelter behind the programme.
4. A hard and fast programme may kill the initiative of efficient assistants.

CAQ 50: What are the disadvantages of the use of an Audit Programme. **[May 07 – 4 Marks]**

CAQ 51: Write short note on: Disadvantages of the use of an Audit Programme. **[May 12 – 4 Marks]**

Extract of Sample audit programme pertaining to sales of an entity

Name of the concern	Fine Industries
Financial Year	2022-23
Prepared by	Priya (with date)
Reviewed by	Raj (with date)
Approved by	Suresh (with date)

Serial Number	Nature of Procedure	Extent of Check	Basis of Sample	Done by
(a)	Vouch few sales invoices from copies available in record of the concern.			
(b)	Trace these invoices into the account books of the concern			
(c)	Verify few invoices with e-way bills generated on the e-way bill portal			
(d)	Trace few sales invoices into the stock records to ensure that sold quantities have been reduced from stocks			
(e)	Trace also few sales invoices into accounts of buyers			

STUDY MATERIAL QUESTIONS

1. **Discuss how performing preliminary engagement activities as part of planning an audit assists auditor**.

   Hint Ans: It assists in identifying and evaluating events or circumstances that may affect auditor's ability to plan and perform audit engagement.

2. **Discuss how an engagement partner ensures that firm complies with relevant ethical requirements including independence in relation to client**.

   Hint Ans: Refer to point on evaluating compliance with ethical requirements including independence.

3. **"Purported disadvantages of an audit programme can be overcome". Do you agree?**

   Hint Ans: Purported disadvantages of audit programme may be eliminated by imaginative supervision of the work carried on by the assistants; the auditor must have a receptive attitude as regards the assistants; the assistants should be encouraged to observe matters objectively and bring significant matters to the notice of supervisor/principal.

4. **An auditor of a company fails to document audit strategy and audit plan. Briefly outline consequences of such failure**.

   Hint Ans: Refer to point on documentation

5. **SA 300 states that auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. Discuss few factors affecting such supervision and review of work of engagement team members**.

   Hint Ans: Refer to point on Planning supervision and review of work of engagement team members

EXAMINATION QUESTIONS UNDER PREVIOUS NEW SYLLABUS

1. "The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business" Discuss stating clearly the broad points you would be covering in framing plan to conduct audit in an efficient and effective manner. **[MTP-Mar 18, Mar 19]**
2. Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Discuss stating clearly the broad points you would be covering in framing plan to conduct audit in an efficient and effective manner. **[MTP-Oct. 18]**
3. The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business. Explain. **[RTP-Nov. 18]**
4. Plans should be made to cover acquiring knowledge of the client's accounting systems, policies and internal control procedures. Explain. **[RTP-Nov. 19]**
5. SA 300 states that auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. What matters should be covered in such Plan by the auditor? **[RTP-May 23]**

Points to be covered in framing audit plan

1. Planning in auditing encompasses developing an overall plan for the expected scope and conduct of the audit and developing an audit programme showing the nature, timing and extent (NTE) of audit procedures.
2. The audit planning is necessary to conduct an effective audit in an efficient and timely manner.
3. SA 300 "Planning an Audit of Financial Statements" deals with the auditor's responsibility to plan an audit of financial statements.
4. Plans should be made to cover, among other things:
   (a) Acquiring knowledge of the client's accounting systems, policies and internal control procedures;
   (b) Establishing the expected degree of reliance to be placed on internal control;
   (c) Determining and programming the nature, timing, and extent of the audit procedures to be performed; &
   (d) Coordinating the work to be performed.

6. In performing an audit of financial statements, the auditor shall have or obtain knowledge of the business. Explain in the light of SA 315. **[May 04 – 8 Marks]**
7. State the matters to be considered for acquiring knowledge of the business of the client by the auditor. **[May 05 – 6 Marks]**
8. Write short note on: Knowledge of Client's Business. **[May 09 – 5 Marks]**
9. 'Knowledge of Client business' is one of the important principles in developing an overall audit plan. Explain. **[Nov 17 – 6 Marks]**

Knowledge of Client's Business

Knowledge of client's business is one of the important principles in developing an overall audit plan. In fact, without adequate knowledge of client's business, a proper audit is not possible.

As per SA 315 "Identifying and Assessing the Risk of Material Misstatements through understanding the entity and its environment" auditor is required to obtain an understating of following as a part of risk assessment procedures:

(a) Industry, regulatory, and other external factors including applicable financial reporting framework.
(b) The nature of the entity, including:
- its operations;
- its ownership and governance structures;
- the types of investments that the entity is making and plan to make &
- the way that the entity is structured and how it is financed;

(c) The entity's selection and application of accounting policies, including the reasons for changes thereto.
(d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.
(e) The measurement and review of the entity's financial performance.

10. Knowledge of the Client's business is one of the important principles in developing an overall audit plan. In fact, without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework. Substantiate with the help of examples. **[RTP-May 20]**

Examples of industry, regulatory and other external factors including the applicable FRF

1. The competitive environment, including demand, capacity, product and price competition as well as cyclical or seasonal activity.

2. Supplier and customer relationships, such as types of suppliers and customers (e.g., related parties, unified buying groups) and the related contracts with those entities.

3. Technological developments, such as those related to the entity's products, energy supply and cost.

4. The effect of regulation on entity operations.

CORRECT / INCORRECT QUESTIONS

1. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely interrelated since changes in one may result in consequential changes to the other.

   Ans: Correct.

2. Establishing an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan is prerogative (exclusive right) of the management.

   Ans: Incorrect. It is the part of the audit planning activities.

3. Planning is a discrete phase of an audit. **[RTP-Nov 19]**

   Ans: Incorrect. It is a continual & iterative process.

4. There is no relation between Audit Plans and knowledge of the client's business. **[RTP-May 19]**

   Ans: Incorrect. Plans should be based on knowledge of the client's business.

5. Planning is not a discrete phase of an audit, but rather a continual and iterative process. **[RTP-May 19]**

   Ans: Correct

6. A well designed and drafted audit plan and audit strategy which takes care of all the uncertainties and conditions, need not be changed during the course of audit. **[Nov 18-2 Marks]**

   Ans: Incorrect. update and change the overall audit strategy and the audit plan as necessary during the course of the audit.

7. The auditor need not discuss elements of planning with the entity's management in any case.

   Ans: Incorrect. auditor may decide to discuss elements of planning with the entity's management

   [RTP-Nov 19]

8. Under a properly framed audit programme by the auditor, the danger is significantly less and audit can proceed systematically. **[Nov 19-2 Marks]**

   Ans: Correct. A written and pre-determined programme will ensure danger is reduced.

9. In the planning stage, analytical procedures would not in any way assist the auditor. **[RTP-May 20]**

   Ans: Incorrect. Analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk.

MORE EXAM QUESTIONS

1. AP & Co., Chartered Accountants, are appointed as statutory auditor of Heavy Industries Limited, a listed company engaged in manufacturing of electric vehicles, for the FY 2023-24. As per the recent guideline issued by the regulatory authority, every listed company is required to maintain the digital database of all those personnel who could access the books of the company to avoid insider training. In case of non-

compliance, hefty fines may be imposed on the company. CA P is the engagement partner from auditor firm for the audit of Heavy Industries Limited. During planning, CA P planned that he would inquire from in-house IT Head of the company about the maintenance of the digital database to identify and assess the risk of non-compliance with regulatory guidelines. In the light of above facts, Explain:

a. Whether CA P is required to consider about the maintenance of digital database while framing audit strategy? **[Jan 25 – 3 marks]**

b. Whether the procedures planned by CA P are in line with SA 300? **[Jan 25 – 2 marks]**

2. Z ltd., engaged ABC & Co., Chartered Accountants, to conduct its statutory audit for the F.Y 2023-24. The audit team developed an overall audit strategy and plan to address the risk. During the audit several significant changes occurred including the discovery of a material misstatement in inventory valuation and changes in the scope of audit procedures due to an unexpected acquisition by Z Ltd. The audit documentation for Z Ltd. should reflect these changes but the auditor of a company failed to document the audit strategy and the audit plan. As a senior auditor of the firm briefly outline what should be included in the documentation of audit strategy and audit plan and how should the audit documentation address significant changes have made during the audit engagement. **[Jan 25 – 5 marks]**

CHAPTER 3 – RISK ASSESSMENT AND INTERNAL CONTROL

AUDIT RISK

(a) Audit risk means the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. It means that an auditor expresses an unmodified opinion when financial statements are materially misstated.

(b) Thus, it is the risk that the auditor may fail to express an appropriate opinion in an audit assignment.

(c) During the audit of a company if the financial statements of that company are misstated and those misstatements are material in nature, then there will be a risk that audit opinion given by the auditor regarding audit of that company would be incorrect. Then that risk will be known as Audit Risk.

(d) **Example**: Strength limited purchased a Plant and Machinery for ₹ 2 Crores in the financial year 2020-2021. The accountant of strength limited debited ₹ 2 crores in the Repair and Maintenance account in the statement of Profit and loss instead of taking it to the balance sheet as PPE and claim depreciation on it. While auditing the accounts of this company the auditor did not notice this and consequently did not report anything regarding the plant and machinery. Therefore, opinion given by the auditor would be inappropriate resulting in audit risk.

(e) Therefore, Audit Risk = **Risk of Material Misstatement x Detection Risk**

(f) Misstatement refers to a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

(g) The risks of material misstatement may exist at two levels:

i. The overall financial statement level

ii. The assertion level for classes of transactions, account balances, and disclosures.

(h) Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components

i. **Inherent risk**—The susceptibility (weakness) 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 or a disclosure have a chance of being misstated and such misstatement can be material. This risk is known as Inherent Risk.

ii. **Control risk**—

(1) The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

(2) 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.

(3) 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.

(i) Detection Risk –

i. 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.

ii. Detection risk comprises sampling and non-sampling risk.

(j) Relationship

i. CR ↑ - controls ↓ - IR ↑ - errors & frauds ↑ - checking ↑ - DR ↓ - Audit risk ↓

ii. CR ↓ - controls ↑ - IR ↓ - errors & frauds ↓ - checking ↓ - DR ↑ - Audit risk ↓



(k) The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

(l) What is not included in Audit Risk?

i. The risk that the auditor might express an opinion that the financial statements are materially misstated when they are not.

ii. Business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

RISKS OF MATERIAL MISSTATEMENT

1. **The risks of material misstatement may exist at two levels**: 
   a) **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. Example: Integrity of mgt, Nature of industry, pressure on mgt, quality of accounting systems etc.
   b) **The assertion level for classes of transactions, account balances, and disclosures**- To determine the NTE of further audit procedures necessary to obtain SAAE. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

   Example: Related party transactions, year-end transactions, estimations etc.
2. **Components of Risk of Material Misstatement**:
   a. **Inherent risk** – Inherent risk factors are considered while designing tests of controls and substantive procedures. It is important to consider the reason for each identified inherent risk even if the risk is lower, when auditor designs tests of controls and substantive procedures. Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others.
   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 misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control. However, internal control can only reduce but not eliminate risks of material misstatement in the financial statements. This is because of the inherent limitations of internal control like human mistakes, collusion etc.
3. **Auditor assesses control risk as "Rely" or "Not rely" on Controls**: The auditor shall consider the following while making control risk assessments
   a. The control environment's influence over internal control.
   b. Evaluations of the related IT processes that support application and IT-dependent manual controls.
   c. Our testing approach over SCOTs and disclosure processes. Test the operating effectiveness of controls over significant class of transactions (SCOTs) when we plan to take a controls reliance strategy.
   d. The expectation of the operating effectiveness of controls based on the understanding of entity's processes.

4. Control risk assessment when control deficiencies are identified:
    a. He determines the assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements.
    b. Auditor identifies and tests more than one control for each relevant assertion, he evaluates control risk considering all of the controls he has tested.
    c. When a deficiency relates to an ineffective control that is the only control identified for an assertion, he revises risk assessment to 'not rely on controls' for associated assertions, as no other controls have been identified that mitigate the risk related to the assertion.
5. ROMM= Inherent Risk x Control Risk. Therefore, Audit Risk = Inherent Risk x Control Risk x Detection Risk.

SA 315 – IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT

1. **Objective**: to identify and assess the ROMM, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.
2. Identify and assess the ROMM at the financial statement level & the assertion level to provide a basis for designing and performing further audit procedures.
3. Assertions used by auditor with respect to account balances at the period end are:
    a. Existence – assets and liabilities shown in the balance sheet exists.
    b. Rights and obligations – rights of the entity have been shown as assets and the obligations have been shown as liabilities.
    c. Completeness – assets and liabilities have been recorded completely.
    d. Valuation and allocation – assets and liabilities are included in the financial statements at appropriate amounts and any allocation adjustments are appropriately recorded
4. For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall:
    a. Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
    b. Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;

c. Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and

d. Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

Risk Assessment Procedures

1. **Definition**: The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
2. **Audit Evidence**: Information obtained by performing risk assessment procedures and related activities may be used by the auditor as audit evidence to support assessments of the risks of material misstatement.
3. **Concurrent procedures**: The auditor also may choose to perform substantive procedures or tests of controls concurrently with risk assessment procedures because it is efficient to do so.
4. The risks to be assessed include both those due to error and those due to fraud. However, the significance of fraud is such that further requirements and guidance are included in SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", in relation to risk assessment procedures and related activities to obtain information that is used to identify the risks of material misstatement due to fraud.
5. What is included in Risk Assessment Procedures?

   a. **Inquiries of management** and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error like: -

      i. Inquiries directed toward internal audit personnel may provide information about internal audit procedures performed during the year relating to the design and effectiveness of the entity's internal control and whether management has satisfactorily responded to findings from those procedures.

      ii. Inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.

      iii. Inquiries directed toward in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud

affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contract

iv. Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.

v. Inquiries directed to the risk management function (or those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.

vi. Inquiries directed to information systems personnel may provide information about system changes, system or control failures, or other information system- related risks.

b. **Analytical Procedures: Analytical procedures performed as risk assessment procedures may** identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. The results of these analytical procedures only provide a broad initial indication about whether a material misstatement may exist.

Example: relationship between sales and square footage of selling space or volume of goods sold.

c. **Observation and Inspection**: Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment.

MATERIALITY | SA 320 Materiality in Planning and Performing an Audit

1. **Meaning**: misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.
2. Materiality is not always a matter of relative size.
3. The concept of materiality is applied by the auditor both in
    a. Planning and performing the audit, and
    b. Evaluating the effect of identified misstatements on the audit and of uncorrected misstatements
4. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:
    a. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;

b. Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and

c. Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

5. In planning the audit, the auditor makes judgments about the size of misstatements that will be considered material. These judgments provide a basis for:
   a. Determining the nature, timing and extent of risk assessment procedures;
   b. Identifying and assessing the risks of material misstatement; and
   c. Determining the nature, timing and extent of further audit procedures.
6. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality.
7. The auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements.
8. The auditor has to apply his professional judgement in determining materiality, choosing appropriate benchmark and determining level of benchmark.
9. If there is any statutory requirement of disclosure, it is to be considered material irrespective of the value of amount.

Determination of materiality- a matter of professional judgment

The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:

(a) Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;

(b) Understand that financial statements are prepared, presented and audited to levels of materiality;

(c) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and

(d) Make reasonable economic decisions on the basis of the information in the financial statements.

Performance Materiality

1. Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the

aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.

2. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.
3. Performance materiality is set at a value lower than overall materiality. It lowers the risk that auditor will not be able to identify misstatements that are material when added together.

Determining Materiality and Performance Materiality when Planning the Audit

1. When establishing the overall audit strategy, determine materiality for the FS as a whole.
2. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

Use of Benchmarks in Determining Materiality for the Financial Statements as a Whole

3. Determining materiality involves the exercise of professional judgment.
4. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.
5. Factors that may affect the identification of an appropriate benchmark include the following:
    a. The elements of the financial statements like assets, liabilities, equity, revenue, expenses
    b. Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused. For example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets.
    c. The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates, the entity's ownership structure and the way it is financed. For example, If an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings;
    d. The relative volatility of the benchmark.
6. In relation to the chosen benchmark, relevant financial data ordinarily includes: -
    a. Prior periods' financial results and financial positions,
    b. The period to-date financial results and financial position, and
    c. Budgets or forecasts for the current period,

d. Adjusted for significant changes in the circumstances of the entity (for example, a significant business acquisition) and
e. Relevant changes of conditions in the industry or economic environment in which the entity operates.

7. Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment.
8. Factors that may indicate the existence of one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements include the following:
   a. Whether law, regulations or the AFRF affect users' expectations regarding the measurement or disclosure of certain items like in case of related party transactions, and the remuneration of management and TCWG.
   b. The key disclosures in relation to the industry in which the entity operates. For example, research and development costs for a pharmaceutical company.
   c. Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements like in case of newly acquired business.

REVISION IN MATERIALITY LEVEL AS THE AUDIT PROGRESSES

1. Materiality for the financial statements as a whole OR for particular classes of transactions, account balances or disclosures may need to be revised as a result of
   a. A change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business)
   b. New information, or
   c. A change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.
2. Materiality shall be revised if during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole.
3. If the auditor concludes that a lower materiality for the financial statements as a whole or ABCD than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the NTE of the further audit procedures remain appropriate.

DOCUMENTING THE MATERIALITY

The audit documentation shall include the following amounts and the factors considered in their determination:

a. Materiality for the financial statements as a whole
b. If applicable, the materiality level or levels for particular ABCD
c. Performance materiality and
d. Any revision of (a)-(c) as the audit progressed

MATERIALITY AND AUDIT RISK

1. The concept of materiality is applied by the auditor both in
   a. Planning and performing the audit, and
   b. In evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.
2. Materiality and Audit Risk are considered throughout the audit, in particular, when:
   a. Identifying and assessing the risks of material misstatement;
   b. Determining the nature, timing and extent of further audit procedures; and
   c. Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

UNDERSTANDING OF THE ENTITY- A CONTINUOUS PROCESS

1. Is a continuous, dynamic process of gathering, updating and analysing information throughout the audit.
2. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, when:
   a. Assessing risks of material misstatement of the financial statements;
   b. Determining materiality in accordance with SA 320;
   c. Considering the appropriateness of the selection and application of accounting policies;
   d. Identifying areas where special audit consideration may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions;
   e. Developing expectations for use when performing analytical procedures;
   f. Evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and of management's oral and written representations.

3. **What is the understanding that is required?** – obtain an understanding of the following:

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

b. The nature of the entity, including

   i. its operations;

   ii. its ownership and governance structures;

   iii. the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and

   iv. the way that the entity is structured and how it is financed;

   to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements

c. The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the AFRF and accounting policies used in the relevant industry.

d. The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

e. The measurement and review of the entity's financial performance.

INTERNAL CONTROL

Meaning

"The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control."

Objectives of Internal Control

(i) Transactions are executed in accordance with managements general or specific authorization;

(ii) All transactions are promptly recorded

   a. in the correct amount

   b. in the appropriate accounts and

   c. in the accounting period

in which executed so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;

(iii) Assets are safeguarded from unauthorised access, use or disposition; and the recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences.

Benefits of Understanding of Internal Control

1. Identifying types of potential misstatements
2. Identifying factors that affect the risks of material misstatement, and
3. Designing the nature, timing, and extent of further audit procedures.

VARIOUS ASPECTS OF INTERNAL CONTROL

General Nature and Characteristics of Internal Control

1. **Purpose of Internal Control**: Internal control is designed, implemented and maintained to address identified business risks that threaten the achievement of any of the entity's objectives that concern:
    a. The reliability of the entity's financial reporting;
    b. The effectiveness and efficiency of its operations;
    c. Its compliance with applicable laws and regulations; and
    d. Safeguarding of assets.
2. **Limitations of Internal Control**:
    a. Internal control can provide only reasonable assurance
    b. Human judgment in decision-making
    c. Lack of understanding the purpose
    d. Collusion among People
    e. Judgements by Management
    f. Limitations in case of Small Entities

Controls Relevant to the Audit

There is a direct relationship between an entity's objectives and the controls it implements to provide reasonable assurance about their achievement

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

a. Materiality.
b. The significance of the related risk.
c. The size of the entity.
d. The nature of the entity's business, including its organisation and ownership characteristics.
e. The diversity and complexity of the entity's operations.
f. Applicable legal and regulatory requirements.
g. The circumstances and the applicable component of internal control.
h. The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
i. Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.
j. Controls over the completeness and accuracy of information produced by the entity.
k. Internal control over safeguarding of assets.

Example:

a. Use of access controls, such as passwords, that limit access to the data and programs that process cash disbursements may be relevant to a financial statement audit.
b. Conversely, safeguarding controls relating to operations objectives, such as controls to prevent the excessive use of materials in production, generally are not relevant to a financial statement audit.

l. Controls relating to objectives that are not relevant to an audit, need not be considered.
m. The statute & regulation governing the entity may require the auditor to report on compliance with certain internal controls.

Nature and Extent of the Understanding of Relevant Controls

1. Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements.
2. Implementation of a control means that the control exists and that the entity is using it. There is little point in assessing the implementation of a control that is not effective, and so the design of a control is considered first
3. An improperly designed control may represent a significant deficiency in internal control.

4. Risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls may include-
    - Inquiring of entity personnel.
    - Observing the application of specific controls.
    - Inspecting documents and reports.
    - Tracing transactions through the information system relevant to financial reporting.

   Inquiry alone, however, is not sufficient for such purposes.
5. Obtaining an understanding of an entity's controls is not sufficient to test their operating effectiveness, unless there is some automation that provides for the consistent operation of the controls.

Components of Internal Control

Control Environment

1. As part of obtaining this understanding, the auditor shall evaluate whether:
    - Management has created and maintained a **culture of honesty and ethical behaviour**.
    - The **strengths in the control environment elements** collectively provide an appropriate foundation for the other components of internal control.
2. What is included in Control Environment?
    - The governance and management functions and
    - The attitudes, awareness, and actions of TCWG and management.
    - The control environment sets the tone of an organization, influencing the control consciousness of its people.
3. **Elements of the Control Environment**
    a) **Communication and enforcement** of integrity and ethical values
    b) **Commitment to competence** - management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.
    c) **Participation by those charged with governance**. Their attributes are as follows
        a. Their **independence** from management.
        b. Their **experience** and stature.
        c. The extent of their **involvement** and the **information** they receive, and the scrutiny of activities.

d. The **appropriateness** of their actions, including the degree to which difficult questions are raised and pursued with management, and their interaction with internal and external auditors.

d) Management's philosophy and operating style: Characteristics such as management's
   a. Approach to taking and managing business risks.
   b. Attitudes and actions toward financial reporting.
   c. Attitudes toward **information processing and accounting functions** and personnel.

e) Organisational structure

f) Assignment of authority and responsibility

g) Human resource policies and practices

The Entity's Risk Assessment Process

1. The auditor shall obtain an understanding of whether the entity has a process for
   (a) Identifying business risks relevant to financial reporting objectives;
   (b) Estimating the significance of the risks;
   (c) Assessing the likelihood of their occurrence; and
   (d) Deciding about actions to address those risks
2. The entity's risk assessment process forms the basis for the risks to be managed.
3. If that process is appropriate, it would assist the auditor in identifying risks of material misstatement.
4. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment.

The information system

1. The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following are:
   (a) The **classes of transactions** in the entity's operations that are significant to the financial statements;
   (b) The **procedures** by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
   (c) The related accounting records, supporting **information** and specific accounts in the financial statements that are used to initiate, record, process and report transactions;
   (d) How the information system **captures events and conditions** that are significant to the financial statements;

(e) The financial reporting **process used to prepare** the entity's financial statements;

(f) **Controls** surrounding journal entries.

2. The auditor shall obtain an understanding of how the entity communicates financial reporting roles and responsibilities
   (a) between management and those charged with governance;
   (b) External communications, such as those with regulatory authorities
3. The following points need consideration in regards to communication:
   (a) **Understanding of Roles and Responsibilities**: involves providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting.
   (b) **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.
   (c) Policy Manuals and Financial Reporting Manuals
   (d) Open Communication Channels
   (e) Less structured and easier for Small Entities

Control Activities

1. An audit requires an understanding of only those control activities related to significant class of transactions, account balance, and disclosure in the financial statements and the assertions which the auditor finds relevant in his risk assessment process.
2. Control activities are the policies and procedures that help ensure that management directives are carried out.
3. Control activities that are relevant to the audit are:
   (a) Activities that relate to significant risks and those that relate to risks for which substantive procedures alone do not provide SAAE.
   (b) Those that are considered to be relevant in the judgment of the auditor.
   (c) Determine whether any of the risks identified are, in the auditor's judgment, a significant risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

(i) Whether the risk is a risk of fraud;

(ii) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;

(iii) The complexity of transactions;

(iv) Whether the risk involves significant transactions with related parties;

(v) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and

(vi) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

Identifying Significant Risks: Significant risks often relate to significant non- routine transactions or judgmental matters.

- Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently.
- Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty.

The following are always significant risks:

- Risks of material misstatement due to fraud.
- Significant transactions with related parties that are outside the normal course of business for the entity.

SL NO	Risks may be greater for significant non-routine transactions arising from matters such as the following	Risks may be greater for Judgmental Matters arising from matters such as the following
1.	Greater management intervention to **specify the accounting treatment**	Accounting **principles for accounting estimates** or revenue recognition may be subject to differing interpretation
2.	Greater **manual intervention** for data collection and processing	Required judgment may be **subjective or complex**, or require assumptions about the effects of future events, for example, judgment about fair value.
3.	**Complex calculations** or accounting principles	
4.	The **nature of non-routine transactions**, which may make it difficult for the entity to implement effective controls over the risks	

Monitoring of Controls

1. Generally, the auditor shall obtain an understanding of the following:
   a. **Meaning**: Monitoring of controls is a process to assess the effectiveness of internal control performance over time.
   b. It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.
   c. 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.
   d. 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.
   e. 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.
2. **If the entity has an internal audit function**: Auditor shall obtain an understanding of
   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.
   c. The following points merit consideration in this regard:
      i. Internal Audit Function relevant to the Audit
      ii. Size and Structure of the Entity
      iii. Internal audit function may include other activities like monitoring of ICS
      iv. External auditor's activities- on the basis of Internal Audit activities
3. Satisfactory Control Environment – not an absolute deterrent (discouragement) to fraud:
   a. Satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement.
   b. However, although it may help reduce the risk of fraud, a satisfactory control environment is not an absolute prevention to commit fraud.

c. The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls.

EVALUATION OF INTERNAL CONTROL BY THE AUDITOR

1. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded.
2. **Benefits of Evaluation of Internal Control to the Auditor:**
   (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; and
   (xi) whether some worthwhile suggestions can be given to improve the control system.
3. Formulate Audit Program after understanding Internal Control
   a. 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.
   b. It is important for him to know whether the system is actually in operation.
   c. It would be better if the auditor can undertake the review of the internal control system of client.
   d. 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.

e. It can be concluded that the extent and the nature of the audit programme is substantially influenced by the internal control system in operation. In deciding upon a plan of test checking, the existence and operation of internal control system is of great significance.

f. A proper understanding of the internal control system enables an auditor to decide upon the appropriate audit procedure to be applied in different areas in the audit.

4. Methods of evaluation of Internal Control: The auditor can use one of the following to help him to know and integrate the system and evaluate the same:

The Narrative Record

a. This is a complete and exhaustive description of the system as found in operation by the auditor.

b. Actual testing and observation are necessary before such a record can be developed.

c. May be recommended in cases where no formal control system is in operation and would be more suited to small business.

d. The basic disadvantages of narrative records are:

   i. To understand the system in operation is quite difficult.

   ii. To identify weaknesses or gaps in the system.

   iii. To incorporate changes arising on account of reshuffling of manpower, etc.

Check List

1. This is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer.
2. When he completes instruction, he initials the space against the instruction.
3. Answers to the check list instructions are usually Yes, No or Not Applicable.
4. The complete check list is studied by the Principal/Manager/Senior to ascertain existence of internal control and evaluate its implementation and efficiency.

Internal Control Questionnaire

1. This is a comprehensive series of questions concerning internal control.
2. An important advantage of the questionnaire approach is that oversight or omission of significant internal control review procedures is less likely to occur with this method.
3. With a proper questionnaire, all internal control evaluation can be completed at one time or in sections.

4. It is the general practice to review the internal control system annually and record the review in detail.
5. Generally, questions are so framed that a 'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness. Provision is made for an explanation or further details of 'No' answers. In respect of questions not relevant to the business, 'Not Applicable' reply is given.
6. The questionnaire is usually issued to the client and the client is requested to get it filled by the concerned executives and employees.
7. If on a perusal of the answers, inconsistencies or apparent incongruities are noticed, the matter is further discussed by auditor's staff with the client's employees for a clear picture.
8. The concerned auditor then prepares a report of deficiencies and recommendations for improvement.

Flow Chart

1. It is a graphic presentation of each part of the company's system of internal control.
2. Most concise way of recording the auditor's review of the system.
3. Minimises the amount of narrative explanation and thereby achieves a consideration or presentation not possible in any other form.
4. 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.
5. It is also necessary for the auditor to study the significant features of the business carried on by the concern; the nature of its activities and various channels.

TESTING OF INTERNAL CONTROL

1. Test of controls are performed to obtain audit evidence about the effectiveness of the:
    a. Designing of accounting & internal control systems – Whether suitably designed?
    b. Operation of internal controls throughout the period – Continuous operation?
2. Test of controls include tests of elements of the control environment where strengths in the control environment are used by auditors to reduce control risk.
3. When the auditor concludes that procedures performed to obtain the understanding of control systems provide audit evidence about the suitability of design and operating effectiveness of policies and procedures relevant to a particular financial statement assertion, the auditor may use that audit evidence, provided it is sufficient to support a control risk assessment at less than a high level.
4. Test of controls may include:
    i. Inspection of documents

ii. Inquiries and observation
iii. Re-performance
iv. Testing of internal control operating on specific computerised applications

5. While obtaining audit evidence about the effective operation of internal controls, the auditor considers
   i. how they were applied,
   ii. the consistency with which they were applied during the period and
   iii. by whom they were applied.
6. Deviations from prescribed controls may be caused by such factors as
   i. changes in key personnel,
   ii. significant seasonal fluctuations in volume of transactions and
   iii. human error.
7. Based on the results of the tests of control, the auditor should evaluate whether the internal controls are designed and operating as contemplated in the preliminary assessment of control risk.
8. Where the auditor concludes that the assessed level of control risk needs to be revised, he would modify the NTE of his planned substantive procedures.
9. It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth.
10. Procedural tests simply mean testing of the compliance with the procedures laid down by the management in respect of initiation, authorisation, recording and documentation of transaction at each stage through which it flows.

AUDIT IN AN AUTOMATED ENVIRONMENT

MEANING

Refers to a business environment where the processes, operations, accounting and even decisions are carried out by using computer systems – also known as Information Systems (IS) or Information Technology (IT) systems

KEY FEATURES

1. Enables faster business operations
2. Accuracy in data processing & Computation
3. Ability to process large volumes of transactions

4. Integration between business operations
5. Better security and controls
6. Less prone to human errors
7. Connectivity and networking capability
8. Provides latest information

Understanding and documenting automated environment

Auditor should consider the following to obtain an understanding of the company's automated environment:

a. Information systems being used.
b. Their purpose.
c. Location of IT systems - local vs global.
d. Architecture (desktop based, client-server, web application, cloud based).
e. Version
f. Interfaces within systems (in case multiple systems exist).
g. In-house vs Packaged.
h. Outsourced activities (IT maintenance and support).
i. Key persons (CIO, CISO, Administrators).

Risks arising from use of IT Systems

1. Inaccurate processing of data, processing inaccurate data, or both.
2. Unauthorized access to data.
3. Direct data changes (backend changes).
4. Excessive access / Privileged access (super users).
5. Lack of adequate segregation of duties.
6. Unauthorized changes to systems or programs.
7. Failure to make necessary changes to systems or programs.
8. Loss of data.

Impact of IT related risks

IMPACT ON SUBSTANTIVE AUDIT

1. Auditor may not be able to rely on the data obtained from systems where such risks exist.

2. This means, all forms of data, information or reports that we obtain from systems for the purpose of audit has to be thoroughly tested
3. More audit evidence is needed for completeness and accuracy

IMPACT ON CONTROLS

1. Auditor will not be able to rely on automated controls, calculations, accounting procedures that are built into the applications.
2. Cannot rely on IT dependent manual controls
3. This means, all forms of data, information or reports that we obtain from systems for the purpose of audit has to be thoroughly tested.
4. Additional audit work may be required in this case.

IMPACT ON REPORTING

1. Auditor has to communicate to those charged with governance.
2. Due to the regulatory requirement of auditors to report on internal financial controls of a company, the audit report also may have to be modified in some instances.

Types of Controls in an Automated Environment

GENERAL CONTROLS

Are policies and procedures that relate to many applications and support the effective functioning of application controls. General IT-controls that maintain the integrity of information and security of data commonly include controls over the following: -

1. **Data centre and network operations** – The objective – To ensure that production systems are processed to meet financial reporting objectives. Their activities are
    a. Overall Management of Computer Operations Activities
    b. Batch jobs - preparing, scheduling and executing
    c. Backups - monitoring, storage & retention
    d. Performance Monitoring - operating system, database and networks
    e. Recovery from Failures - BCP, DRP
    f. Help Desk Functions - recording, monitoring & tracking
    g. Service Level Agreements - monitoring & compliance
    h. Documentation - operations manuals, service reports

2. Program Change – The objective – To ensure that modified systems continue to meet financial reporting objectives. Their activities are:

a. Change Management Process - definition, roles & responsibilities
b. Change Requests - record, manage, track
c. Making Changes - analyze, design, develop
d. Test Changes - test plan, test cases, UAT
e. Apply Changes in Production
f. Emergency & Minor Changes
g. Documentation - user/technical manuals
h. User training

3. Access Security - The objective - To ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives. Their activities are:
    a. Security Organization & Management
    b. Security Policies & Procedures
    c. Application Security
    d. Data Security
    e. Operating System Security
    f. Network Security - internal network, perimeter network
    g. Physical Security - access controls, environment controls
    h. System Administration & Privileged Accounts - Sys admins, DBAs, Super users.

4. Application system acquisition, development, and maintenance - The objective – To ensure that systems are developed, configured and implemented to meet financial reporting objectives. Their activities:
    a. Overall Mgmt. of Development Activities
    b. Project Initiation
    c. Analysis & Design
    d. Construction
    e. Testing & Quality Assurance
    f. Data Conversion
    g. Go-Live Decision
    h. Documentation & Training

APPLICATION CONTROLS

Application controls include both automated and manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems.

IT DEPENDENT CONTROLS

1. IT dependent controls are basically manual controls that make use of some form of data or information or report produced from IT systems and applications.
2. Even though the control is performed manually, the design and effectiveness of such controls depends on the reliability of source data.
3. Due to the inherent dependency on IT, the effectiveness and reliability of automated application controls and IT dependent controls require the General IT Controls to be effective

TESTING METHODS

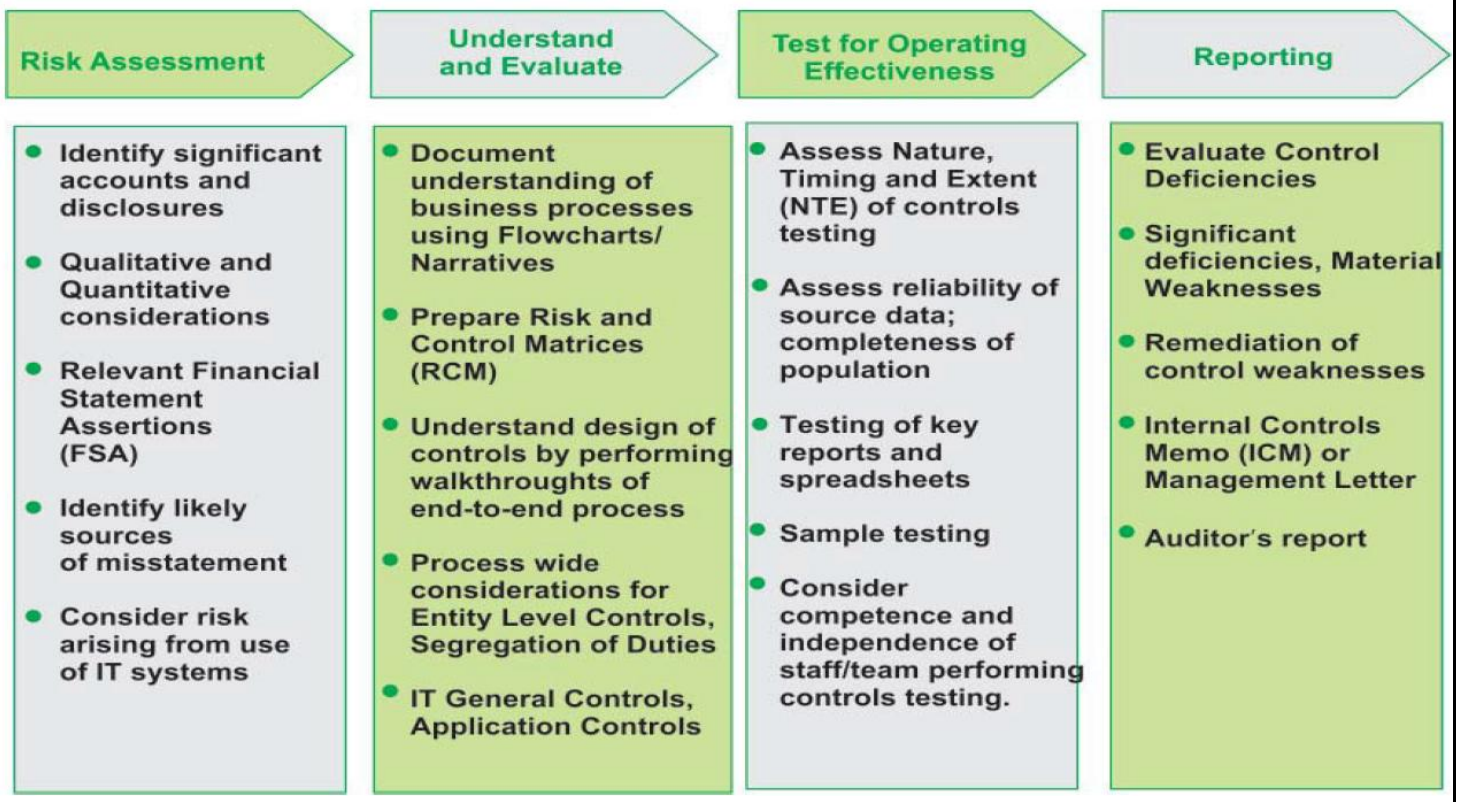
1. There are 4 methods – Inquiry, Inspection, Observation & Reperformance.
2. Inquiry is the most efficient audit test but it also gives the least audit evidence.
3. Reperformance is most effective as an audit test and gives the best audit evidence.
4. However, which audit test to use, when and in what combination is a matter of professional judgement and will vary depending on several factors including risk assessment, control environment, desired level of evidence required, history of errors/misstatements, complexity of business, assertions being addressed etc.
5. The auditor should document the nature of test (or combination of tests) applied along with the judgements in the audit file.
6. When testing in an automated environment, some of the more common methods are as follows:
    a. 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.
    b. Observe how a user processes transactions under different scenarios.
    c. Inspect the configuration defined in an application.
7. The auditor should assess the impact of IT risks and complexity of the automated environment in which the business operations take place and plan alternative audit procedures in order to rely on the system-based information.

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

1. The characteristics of manual or automated elements are relevant to the auditor's risk assessment and further audit procedures based thereon. The use of manual or automated elements in internal control also affects the manner in which transactions are initiated, recorded, processed, and reported:
   a. Controls in a manual system may include such procedures as approvals and reviews of transactions, and reconciliations and follow-up of reconciling items. Alternatively, an entity may use automated procedures to initiate, record, process, and report transactions, in which case records in electronic format replace paper documents.
   b. Controls in IT systems consist of a combination of automated controls (for example, controls embedded in computer programs) and manual controls. Further, manual controls may be independent of IT, may use information produced by IT, or may be limited to monitoring the effective functioning of IT and of automated controls, and to handling exceptions.

Manual elements may be more suitable in the following circumstances	Manual elements may not be more suitable in the following circumstances
1. Large, unusual or non-recurring transactions. 2. Circumstances where errors are difficult to define, anticipate or predict. 3. In changing circumstances that require a control response outside the scope of an existing automated control. 4. In monitoring the effectiveness of automated controls.	1. High volume or recurring transactions, or in situations where errors that can be anticipated or predicted can be prevented, or detected and corrected, by control parameters that are automated. 2. Control activities where the specific ways to perform the control can be adequately designed and automated.

AUDIT APPROACH IN AN AUTOMATED ENVIRONMENT



DATA ANALYTICS FOR AUDIT

Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialized audit tools to perform the following:

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

DIGITAL AUDIT

1. In such a business environment, use of digital technology is being made by auditors right from planning to expression of final opinion.
2. Auditors are making use of artificial intelligence, data analytics and other latest technologies to help understand business processes in a better way.
3. By using such tools, auditors can conduct audit in a better way and devote more attention to areas requiring greater focus.
4. Digital audit is helping auditors to better identify risks making use of technology.

INTERNAL FINANCIAL CONTROLS AS PER REGULATORY REQUIREMENTS

The term Internal Financial Controls (IFC) basically refers to the policies and procedures put in place by companies for ensuring:

1. Reliability of financial reporting
2. Effectiveness and efficiency of operations
3. Compliance with applicable laws and regulations
4. Safeguarding of assets
5. Prevention and detection of frauds

DOCUMENTING THE RISKS

1. The discussion among the engagement team and the significant decisions reached.
2. Key elements of the understanding obtained regarding each of the aspects of the entity and its environment and of each of the internal control components, the sources of information from which the understanding was obtained; and the risk assessment procedures performed.
3. The identified and assessed risks of material misstatement at the financial statement level and at the assertion level and
4. The risks identified, and related controls about which the auditor has obtained an understanding.

ASSESS AND REPORT AUDIT FINDINGS

1. At the conclusion of each audit, it is possible that there will be certain findings or exceptions in IT environment and IT controls of the company that need to be assessed and reported to relevant stakeholders. Some of the points to be considered are as follows: -
    a. Are there any weaknesses in IT controls?

b. What is the impact of these weaknesses on overall audit?
c. Report deficiencies to management – Internal Controls Memo or Management Letter
d. Communicate in writing any significant deficiencies to Those Charged with Governance.

2. The auditor needs to assess each finding or exception to determine impact on the audit and evaluate if the exception results in a deficiency in internal control.
3. A deficiency in internal control exists if a control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or the control is missing.
4. Each finding should be looked at individually and in the aggregate by combining with other findings/deficiencies.

SA 330 | THE AUDITOR'S RESPONSES TO ASSESSED RISKS

OBJECTIVE

1. The auditor shall design and implement overall responses to address the assessed ROMM at the financial statement level.
2. The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed ROMM at the assertion level.

1 While designing the further audit procedures to be performed, the auditor shall consider the following factors:

(a) Consider the reasons for the assessment given to the ROMM at the assertion level for each ABCD, including:
   i. The likelihood of material misstatement due to the particular characteristics of the relevant ABCD (i.e., the inherent risk); and
   ii. Whether the risk assessment takes into account the relevant controls, thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures).

(b) Obtain more persuasive (convincing) audit evidence the higher the auditor's assessment of risk.

The auditor shall design and perform TOC to obtain SAAE as to the operating effectiveness of relevant controls when:

(a) The auditor's assessment of ROMM at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the NTE of substantive procedures); or

(b) Substantive procedures alone cannot provide SAAE at the assertion level.

Substantive procedures are audit procedures designed to detect material misstatements at the assertion level. Substantive procedures comprise: (i) Tests of details (of classes of transactions, account balances, and disclosures), and (ii) Substantive analytical procedures

NATURE AND EXTENT OF TEST OF CONTROLS

In designing and performing test of controls, the auditor shall:

(a) Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:

2

i. How the controls were applied at relevant times during the period under audit.

ii. The consistency with which they were applied.

iii. By whom or by what means they were applied.

(b) Determine whether the controls to be tested depend upon other controls (indirect controls), and if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls.

EXTENT OF CONTROLS

1. Inquiry alone is not sufficient to test the operating effectiveness of controls.
2. Inquiry combined with inspection or reperformance may provide more assurance than inquiry and observation, since an observation is pertinent only at the point in time at which it is made
3. When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of TOC as well as the degree of reliance on controls.
4. Matters the auditor may consider in determining the extent of TOC include the following:
    1. The frequency of the performance of the control by the entity during the period.
    2. The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
    3. The expected rate of deviation from a control.

4. The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
5. The extent to which audit evidence is obtained from tests of other controls related to the assertion.

TIMING OF TEST OF CONTROLS

1. The auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls in order to provide an appropriate basis for the auditor's intended reliance.
2. Audit evidence pertaining only to a point in time may be sufficient for the auditor's purpose, for example, when testing controls over the entity's physical inventory counting at the period end.
3. If, on the other hand, the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate. Such tests may include tests of the entity's monitoring of controls.

USING AUDIT EVIDENCE OBTAINED IN PREVIOUS AUDITS

In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits the auditor shall consider the following:

1. The effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process
2. The risks arising from the characteristics of the control, including whether it is manual or automated
3. The effectiveness of general IT-controls
4. The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control
5. Whether the lack of a change in a particular control poses a risk due to changing circumstances and
6. The risks of material misstatement and the extent of reliance on the control.

NOTE: If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor shall establish the continuing relevance of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to the previous audit.

EVALUATING THE OPERATING EFFECTIVENESS OF CONTROLS

1. The auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively.
2. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective.
3. A material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control.

SPECIFIC INQUIRIES BY AUDITOR WHEN DEVIATIONS FROM CONTROLS ARE DETECTED

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

(a) The test of controls that have been performed provide an appropriate basis for reliance on the controls

(b) Additional test of controls are necessary or

(c) The potential risks of misstatement need to be addressed using substantive procedures

TESTS OF DETAILS

1. Tests of details are further classified into tests of transactions i.e., vouching and tests of balances i.e., verification.
2. Tests of balances consist of verification of assets as well as liabilities.
3. This may be obtained by reviewing entity's plan for performing physical verification of fixed assets and obtaining evidence for performance of physical verification of fixed assets by management.

SUBSTANTIVE ANALYTICAL PROCEDURES

1. Substantive analytical procedures refer to analytical procedures used as substantive procedures by auditor.
2. The term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.
3. The use of widely recognised ratios can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

4. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.
5. Nature and extent of Substantive procedures –
    a. The auditor may determine that:
        i. Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level.
        ii. Only TOD are appropriate.
        iii. A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks
    b. The assessment of the ROMM takes account of internal control, the extent of substantive procedures may need to be increased when the results from TOC are unsatisfactory.
    c. In designing TOD, the extent of testing is ordinarily thought of in terms of the sample size.

EXAMINATION QUESTIONS

Q1. The assessment of risks is a matter of professional judgment. Explain stating clearly what is not included in Audit Risk? **[MTP-Aug. 18]**

Q2. "Risk of material misstatement consists of two components" Explain clearly defining risk of material misstatement.

Q3. "The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". Explain. **[RTP-Oct. 19]**

Q4. When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements. Explain.

[RTP-May 20]

Q5. Discuss in brief the types of audit risk and inter relationship of components of audit risk.

[Nov. 14 (4 Marks)]

Q6. Explain the inherent risk with reference to the relevant standard on auditing. Or

Q7. Write short note on: Inherent Risk. **[Nov. 12 (4 Marks)]**

Q8. Doing a statutory audit is full of risk. Narrate the factors which causes the risk.

Q9. "Risk of material misstatement at the assertion level for classes of transactions, account balances and disclosures need to be considered". Explain stating the different categories of assertions used by the auditor.

Q10. Write short note on: Assertion about balance at the end of the reporting period. **[May 13 (4 marks)]**

Q11. Discuss the following: The assertions used by auditor to consider potential misstatements about account balances at the period end. **[Nov. 15 (5 Marks)]**

Q12. In the context of SA 315, state the assertions used by auditor to consider the different types of potential mis-statements that may occur w.r.t. classes of transactions and events for period under audit. **[Nov. 17 (4 Marks)]**

Q13. In the context of SA 315, state the assertions used by auditor to consider the different types of potential mis-statements that may occur w.r.t. classes of transactions and events for period under audit. **[Nov. 17 (4 Marks)]**

Q14. Write short note on: Assertions used by auditor to consider potential misstatements about presentation and disclosure at the period end.

Q15. The auditor shall identify and assess the risks of material misstatement at both levels to provide a basis for designing and performing further audit procedures. For the purpose of Identifying and assessing the risks of material misstatement the auditor shall Identify risks, assess the identified risks, relate the identified risks and consider the likelihood of misstatement. Explain the above in detail. **[MTP-Oct. 18]**

Q16. Discuss what is included in risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls. **[RTP-May 18]**

Q17. Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. Analyse and explain giving examples. **[RTP-May 20]**

Q18. The auditor may exercise his judgement to identify which risks are significant risks. Explain the above in the context of SA 315. **[May 15 (6 Marks)]**

Q19. 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. In exercising judgment as to which risks are significant risks, state the factors which shall be considered by the auditor. Explain the above in context of SA-315. **[RTP-May 18]**

Q20. Name the assertions for the following audit procedures:

a. Year-end inventory verification.
b. Depreciation has been properly charged on all assets.
c. The title deeds of the lands disclosed in the balance sheet are held in the name of the company.
d. All liabilities are properly recorded in the financial statements.

e. Related party transactions are shown properly. **[May 18 (5 Marks)]**

Q21. Explain the concept of Internal Control. Also state the objectives of Internal Control.

Q22. Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. Explain stating clearly the objectives of Internal Control. **[RTP-May 20]**

Q23. Explain inherent limitations of Internal control system. **[Nov. 13 (8 Marks), May 15 (5 Marks)]**

Q24. Internal Control System can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. Briefly explain the inherent limitations that the system suffers.

Q25. Briefly discuss the limitations of internal control. **[May 18 (6 Marks), MTP-April 19]**

Q26. What is Internal Control? Explain various components of Internal Control.

Q27. "The auditor shall obtain an understanding of the control environment" Explain stating what is included in control environment. Or

Q28. The auditor of XYZ Ltd, engaged in FMCG (Fast Moving Consumable Goods) obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether:

a. Management has created and maintained a culture of honesty and ethical behaviour; and

b. The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control. Advise what is included in control environment. Also explain the elements of control environment.

[MTP-March 18, RTP-May 18, MTP-Aug.18, March 19, RTP-Nov. 19]

Q29. "The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting" Explain.

Q30. Write a short note on: Narrative record. **[Nov. 17 (4 Marks)]**

Q31. What is check list? Give few examples of check list instruction.

Q32. Explain briefly technique of "Internal Control Questionnaire" to facilitate the accumulation of information necessary for proper evaluation of internal control. **[Nov. 10 (4 Marks)]**

Q33. Write short note on: Internal Control Questionnaire. **[May 13 (4 Marks)]**

Q34. Write short note on: Use of Flow Charts in evaluation of internal Control. **[Nov. 13, May 16 (4 Marks)]**

Q35. A Flow Chart is a graphic presentation of each part of the company's system of internal control. Explain elaborating each and every aspect about flow chart. **[RTP-Nov. 18]**

Q36. Why tests of controls are performed? Also explain what does they include. **[Nov. 15 (4 Marks)]**

Q37. It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Explain with the help of example in respect of the procedure for sales. **[RTP-May 20]**

Q38. "A satisfactory control environment may help reduce the risk of fraud but is not an absolute deterrent for fraud". Explain. **[May 17 (5 Marks), RTP-May 18]**

Q39. The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. Analyse and explain. **[RTP-May 19]**

Q40. So far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal control normally contributes to such assurance. Explain stating clearly the benefits of evaluation of internal control to the auditor. **[RTP-May 19]**

Q41. While obtaining audit evidence about the effective operation of internal controls, the auditor considers how they were applied, the consistency with which they were applied during the period and by whom they were applied. The concept of effective operation recognises that some deviations may have occurred. Analyse and Explain. **[RTP-Nov. 18]**

Q42. Based on the results of the tests of control, the auditor should evaluate whether the internal controls are designed and operating as contemplated in the preliminary assessment of control risk. Analyse and Explain. **[RTP-Nov. 19]**

Q43. 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. Analyse and explain. **[RTP-Nov. 18]**

Q44. The extent and the nature of the audit programme is substantially influenced by the internal control system in operation. Analyse and explain. **[RTP-Nov. 19]**

Q45. What are the specific risks related to internal controls in an IT Environment? **[May 16 (5 Marks)]**

Q46. The auditor should understand and consider the risks that may arise from the use of information technology (IT) Systems. **[May 18 (4 Marks)]**

Q47. IT poses specific risks to an entity's internal control. Explain. **[RTP-May 19]**

Q48. Which are specific risks to the company's internal control having IT environment? **[May 19 (4 Marks)]**

Q49. When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall determine the suitability of particular substantive analytical procedures for given assertions, taking account of

the assessed risks of material misstatement and tests of details, if any, for these assertions. Explain the other relevant points in this context. **[CA FINAL] [RTP-May 20]**

Q50. In the course of audit of Z Ltd., its auditor wants to rely on audit evidence obtained in previous audit in respect of effectiveness of internal controls instead of re-testing the same during the current audit. As an advisor to auditor kindly caution him about the factors that may warrant a re-test of controls. **[CA FINAL] [RTP-Nov 18, May 22, MTP-Oct.19]**

Q51. While formulating the audit plan and responding to the risks of material misstatement identified and assessed in related party transaction and relationships, Ms. K the engagement manager of the audit team of ABC Limited, decided to rely upon the internal controls placed for identification and disclosure of related party relationships and transactions in accordance with the applicable financial reporting framework. You are requested to guide Ms. K regarding the necessity to test the controls to obtain sufficient and appropriate audit evidence. Also guide, whether Ms. K can use the audit evidence obtained, regarding operative effectiveness of control on identification and disclosure of related party relationships and transactions, in the interim period. **[CA FINAL – RTP Nov 21]**

Q52. Mr Agarwal, in the course of audit of PQ Limited, wants to perform external confirmation procedures to obtain audit evidence. Guide Mr. Agarwal. listing out the factors that may assist him in determining whether external confirmation procedures are to performed as substantive audit procedures. **[CA FINAL] [DEC 21 – (5 Marks)]**

Q53. Spare Parts Limited received an input from internal auditors that internal controls implemented by the company appear to be reasonable but not so strong that any fraudulent activity can be prevented or timely detected by such controls. Accordingly, a qualified person should head the internal controls department. CA Raj has been appointed as an Internal Control Head of the company. His scope of work includes development of internal controls in various departments/areas of the company. On his joining, he studied the various verticals and, after identifying the important areas (prone to fraud), implemented strong controls in those areas. In his meeting with senior management and statutory auditors, he assured that satisfactory control environment exists and fraud cannot happen. Whether existence of a satisfactory control environment can be considered as an absolute deterrent to fraud? **[Jan 25 – 4 marks]**

Q54. In an automated environment. there are generally four types of audit tests available. As a senior auditor, it's crucial to guide your team in selecting the appropriate audit tests based on the situation. Explain the types of audit tests commonly used in an automated setting and provide insights on how to determine when and which tests to apply, emphasizing the role of professional judgment in making these decisions. **[Jan 25 – 4 marks]**

Q55. The auditor of EFG Ltd., a company engaged in the Tours & Travel business, needs to obtain an understanding of the company's control environment. To do this, the auditor evaluates whether:

a. Management has created and maintained a culture of honesty and ethical behaviour; and
b. The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

What is included in control environment? Also explain the elements of control environment.

[RTP Jan 25]

Q56. Companies are increasingly using data analytics for managing their operations. Auditors can also obtain good results by using data analytics. What are the tools and techniques used by auditors in applying the principles of Data Analytics and in which areas data analytics can be used by auditors?

[RTP Sep 24]

Q57. Satranga Foods Private Limited is engaged in manufacturing of pickles. The auditors of the company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that misstatements in revenue recognition are not identified by planned audit procedures. Identify and explain that particular risk in detail. **[RTP May 24]**

Q58. IT related risks can have an impact on audit. In what different ways, such risks can have an impact on audit of financial statements? **[RTP May 24]**

CHAPTER 4 –AUDIT EVIDENCE

ASPECTS TO BE COVERED	
1. SA 500 – Audit evidence	2. SA 501 – Audit evidence – special considerations
3. SA 505 – External Confirmation	4. SA 510 – Initial Audit Engagement
5. SA 520 – Analytical Procedures	6. SA 530 – Audit Sampling
7. SA 550 – Related Parties	8. SA 610 – Using the work of internal Auditors

SA 500 – AUDIT EVIDENCE

Aspects to be covered

1. Introduction & Meaning
2. Information to be used as audit evidence
3. Sufficient Appropriate Audit Evidence [SAAE]
4. Sources of Audit Evidence
5. Procedures to obtain Audit Evidence
6. Types of Audit Evidence
7. Relevance and reliability

INTRODUCTION AND MEANING

Auditing is a logical process. He is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively.

It may be defined as the information used by the auditor in arriving at the conclusion on which the auditor's opinion is based. It includes both information contained in the accounting records underlying the financial statements and other information.

SUFFICIENT AND APPROPRIATE EVIDENCE

1. Reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.
2. Audit evidence is necessary to support the auditor's opinion and report.

3. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit.
4. It may, also, include information obtained from other sources such as previous audits.
5. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence.
6. Information that may be used as audit evidence may have been prepared using the work of a management's expert.
7. Audit evidence comprises both information that supports and corroborates (supports) management's assertions, and any information that contradicts such assertions.
8. In some cases, the absence of information is also used as audit evidence.

SUFFICIENCY	APPROPRIATENESS
1. It is a measure of quantity of evidence 2. when ROMM is high, evidence should be more. If ROMM is low, evidence should be less. 3. Risk & evidence is directly proportionate.	1. It is the measure of quality of evidence 2. The reliability is influenced by its source and nature. 3. It also depends on the individual circumstances under which it is obtained. 4. In order to obtain reliable audit evidence, information produced by the entity that is used for performing audit procedures needs to be sufficiently complete and accurate

Note: - However, obtaining more evidence may not compensate for poor quality.

Factors affecting sufficiency of audit evidence

1. **MATERIALITY** – it may be defined as significance of AB, C,D to the users of financial statements. If assertions are less material, lesser evidence would be required. If assertions are more material, higher evidence would be required.
2. **RISK OF MATERIAL MISSTATEMENT** – defined as the risk that the financial statements are materially misstated prior to the audit. This consist of two components –
3. **SIZE & CHARACTERISTICS OF POPULATION** – refers to the number of items included in the population. Less evidence would be required in case of a smaller, more homogeneous population. More evidence would be required in case of larger, more heterogeneous population.

INFORMATION TO BE USED AS AUDIT EVIDENCE

INFORMATION TO BE USED – **PREPARED BY THE MANAGEMENT'S EXPERT**	INFORMATION TO BE USED – **PRODUCED BY THE ENTITY**
1. When information is to be used as audit evidence, he shall: a. Evaluate the competence, capabilities and objectivity of that expert. b. Obtain an understanding of the work of that expert c. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. 2. The nature, timing & extent of audit procedures may be affected by: CRAN^{2}ES a. The nature and complexity of the matter to which the management's expert relates. b. The ROMM in the matter. c. The availability of alternative sources of audit evidence. d. The nature, scope and objectives of the management's expert's work. e. Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services. f. The extent to which management can exercise control or influence over the work of the management's expert. g. Whether the management's expert is subject to technical performance standards or other professional or industry requirements.	1. Obtain audit evidence about the accuracy and completeness of the information 2. Evaluating whether the information is sufficiently precise and detailed for the auditor's purpose

h. The nature and extent of any controls within the entity over the management's expert's work. i. The auditor's knowledge and experience of the management's expert's field of expertise. j. The auditor's previous experience of the work of that expert.	

SOURCES OF AUDIT EVIDENCE

1. It is obtained by performing audit procedures to test the accounting records.
2. It is also obtained through analysis and review, re-performing procedures and reconciling related types and application of same information.
3. More assurance is ordinarily obtained from consistent audit evidence obtained from different sources, a different nature than considered individually.

AUDIT PROCEDURES TO OBTAIN AUDIT EVIDENCE

A. RISK ASSESSMENT PROCEDURES

Refers to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and asses the risks of material misstatement, whether due to fraud or error, at the FS and assertions level.

B. FURTHER AUDIT PROCEDURES

1. Test of controls: Test of controls may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.
2. Substantive Procedures: designed to detect material misstatements at the assertion level.
    a. Test of details
    b. Analytical Procedures

Audit Procedures

1. **Inspection** – Involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

2. **Recalculation** – consists of checking the mathematical accuracy of documents or records. This may be performed manually or electronically.
3. **Re performance** – involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.
4. **Analytical procedures** – consist of evaluations of financial information made by a study of plausible relationships among both financial and non – financial data. This also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.
5. **Observation** – consists of looking at a process or procedure being performed by others. It provides evidence about the performance but is limited to the point in time at which the observation takes place.
6. **External confirmation** – represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party, in paper form, or by electronic or other medium.
7. **Inquiry**:
    a. Seeking information of knowledgeable performs, about both financial and non-financial data, within or outside the entity.
    b. It may range from formal written quires to informal oral queries.
    c. Evaluating responses is an integral part of enquiry process.
    d. Responses may provide the information which was not previously available.
    e. Responses may also provide information that differs significantly from other information that the auditor has obtained.
    f. Sometimes the evidence obtained through enquiry may, limit to support managerial intent. In this case, understanding the past history and choosing a particular course of action and their ability to perceive the course of action.
    g. In some matters, it is necessary to obtain written representations from management or TCWG.

Nature and Extent

In designing and performing controls, the auditor shall –

1. Perform other procedures in combination with enquiry to obtain AE about effectiveness of control, including
    - Procedure - How the controls were applied
    - Frequency - consistency with which they were applied

- Responsible person – by whom or what means they were applied

2. Determine whether the controls depend upon other controls (indirect controls)

Question: What are the matters that can be considered in determining the extent of TOC.

1. Frequency of performance of control.
2. Length of time during the audit period that the auditor is relying on effectives of control.
3. Expected rate of deviation.
4. Relevance & reliability of audit evidence to be obtained regarding the operating effectiveness of ICS at assertion level.
5. Extent to which AE is obtained from test of other controls.

Substantive Procedures - defined as an audit procedure designed to detect material misstatements at the assertion level.

Irrespective of the assessed ROMM, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

1. This requirement reflects the facts that:
    i. The auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and
    ii. There are inherent limitations to internal control, including management override.
2. Depending on the circumstances, the auditor may determine that
    i. Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level.
    ii. Only tests of details are appropriate.
    iii. A combination.
3. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.
4. The nature of the risk and assertion is relevant to the design of tests of details.
5. The extent of substantive procedures may need to be increased when the results from test of controls are unsatisfactory.

ASSERTION - Refers to representation that are included in the F.S. and used by the auditor to consider the potential misstatement that may occur. Negative assertions are also encountered in the financial statements and the same may be expressed or implied

Assertion

Account Balances	Classes of Transaction	Presentation & disclosure
1. Existence	1. Occurrence	1. Occurrence & rights & obligations.
2. Rights & obligation	2. Completeness	2. Completeness
3. Completeness	3. Accuracy	3. Classification and understandability
4. Valuation & allocation	4. Cutoff	4. Accuracy & Valuation
	5. Classification	

Types of Audit evidence

1. Depending on the nature:
    a. Visual
    b. Oral
    c. Documentary
2. Depending on the source
    a. Internal
    b. External

Relevance & Reliability

Relevance	Reliability
It deals with logical connection with the audit procedure were appropriate A given set of procedures may provide the evidence. The relevance of information to be used as audit evidence may be affected by the direction of testing. A given set of audit procedures may provide audit evidence that is relevant to certain assertions, but not others	It is influenced by the source and its nature and the circumstances under which it is obtained. Question only for reliability.

Obtaining audit evidence regarding a particular assertion, is not a substitute for obtaining audit evidence regarding another assertion	

Q1. While considering reliability of AE what are the points to be kept in mind.

Q2. In case of reliability of AE, what are the considerations that has to be taken into account.

Q3. How do you evaluate the reliability of AE obtained.

1. The reliability is increased when it is obtained from independent sources.
2. The evidence that is generated internally the reliability with increase when the controls including its preparation and maintenance are effective.
3. The evidence obtained directly by the auditor is more reliable than obtain indirectly.
4. Evidence in documentary form is more reliable from evidence obtained orally.
5. AE provided by original done is more evident than evidence provided by photocopier or digitized or transformed into electronic form. The reliability may depend on controls our preparation and maintenance.

AUDIT TRAIL

1. Is a documented flow of a transaction.
2. It is used to investigate how a source document was translated into an account entry and from there it was inserted into financial statement of an entity.
3. Audit trails help in maintaining record of system and user activity.
4. It is a step-by-step record by which accounting, trade details, or other financial data can be traced to their source. Audit trails are used to verify and track many types of transactions including accounting and financial transactions.
5. Audit trails (or audit logs) act as record-keepers that document evidence of certain events, procedures or operations, because their purpose is to reduce fraud, material errors, and unauthorized use.
6. Audit trails help to enhance internal controls and data security.
7. Audit trails can help in fixing responsibility, rebuilding events and in thorough analysis of problem areas.
8. Use of automated tools can be made to analyse large volume of data thrown up by audit trails.
9. It aids in verification whether a transaction was indeed performed by a person authorised to do it.

Selecting Items for Testing to Obtain Audit Evidence

The means available to the auditor for selecting items for testing are:

(a) **Selecting all items (100% examination)**:

i. The auditor may decide that it will be most appropriate to examine the entire population of items that make up a class of transactions or account balance.

ii. 100% examination is unlikely in the case of tests of controls; however, it is more common for tests of details.

iii. 100% examination may be appropriate when:

- The population constitutes a small number of large value items;
- There is a significant risk and other means do not provide SAAE; or
- The repetitive nature of a calculation or other process performed automatically by an information system makes a 100% examination cost effective.

(b) **Selecting specific items**:

i. The auditor may decide to select specific items from a population

ii. Factors that may be relevant include the auditor's understanding of the entity, the assessed ROMM, and the characteristics of the population being tested.

iii. Specific items selected may include:

- High value or key items
- All items over a certain amount
- Items to obtain information like the nature of the entity or the nature of transactions.

(c) **Audit sampling**: Audit sampling is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from it. Audit sampling is discussed in subsequent paragraphs.

Evaluation of Audit Evidence

1. The auditor has to conclude whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment

SA 501 – AUDIT EVIDENCE – Specific considerations for selected items

Aspects to be covered

1. Objective
2. Inventory
    a. Inventory count conducted other than at the date of FS
    b. Unable to attend inventory counting due to unforeseen circumstances.
    c. Attending inventory counting is impracticable.
3. Litigation and claims.
4. Presentation and disclosure of segment reporting (reference AS 17)

OBJECTIVE

1. To obtain SAAE regarding existence and condition of Inventory.
2. Completeness of litigation and claims.
3. Presentation and disclosure about segment reporting.

INVENTORY

When inventory is material to the financial statements the auditor shall obtain SAAE regarding the existence and conditions of Inventory by

A. Attending physical inventory counting unless impracticable to
    1. Evaluate managements instructions and procedures for recording and controlling the results.
    2. Observe the performance of management count procedure.
    3. Inspect the inventory.
    4. Perform test count.
B. Performing audit procedures over the entities final inventory records to determine whether they accurately reflect actual inventory results.

Q. What are the relevant matters that has to be considered in planning attendance at physical inventory counting.

1. Nature of inventory
2. Stages of completion of WIP inventory
3. ROMM related to inventory.
4. Nature of ICS related to inventory.

5. Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
6. Timing of physical inventory counting.
7. Whether the entity maintains a perpetual inventory system.
8. The location at which inventory is held including the materiality and ROMM at different locations to decide.
9. Whether the assistance of auditor's expert is needed.

Situations

Counting is conducted other than Balance sheet date	**Unable to attend due to unforeseen circumstances**	**Attendance is impracticable**	**It is in the custody and control of 3rd party**
• In addition to the above procedures, • perform procedures to obtain evidence about whether the changes between the count date and the F.S. date are properly recorded. ✓ Whether the perpetual inventory records are properly adjusted. ✓ Reliability of the entity's inventory records. ✓ Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records	• Make or observe physical counts on an alternative date. • Perform audit procedures on intervening transactions.	• Perform alternate audit procedure to obtain SAAE with respect to existence and conditions. • If not possible, modify the opinion in accordance with SA 705 • In some situations, it may be due to factors like nature & location that may pose threats to auditors' safety. • Alternative audit procedures should be adopted such as inspection.	• Obtain SAAE regarding existence and conditions by performing one or both of the following. 1. Request confirmation from third parties with respect to quantities and conditions. 2. Perform inspection or other audit procedures.

LITIGATIONS AND CLAIMS

1. Audit procedures on litigations and claims which may be to ROMM including.
    a. Enquiry of management and in house legal counsel.
    b. Reviewing minutes of meeting with TCWG and correspondence b/w the entity and external legal counsel.
    c. Review legal expense account.
    d. Obtain direct communication with external counsel through a letter of enquiry requesting them to communicate directly. A letter of specific inquiry includes
        i. A list of litigation and claims
        ii. Where available, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including costs involved; and
        iii. A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered by the entity's external legal counsel to be incomplete or incorrect
    e. If law or regulation prohibits the external counsel from communicating, the auditor shall perform alternate audit procedure.
    f. In certain situations, auditor may need to discuss the likely outcome of litigation and claims by meeting them. The situations are:
        i. The auditor determines that the matter is a significant risk.
        ii. The matter is complex
        iii. There is disagreement between management and the entity's external legal counsel. Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.
    g. In the following situations, auditor shall modify the opinion in the auditor's report in accordance with SA 705.:
        i. Management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and
        ii. The auditor is unable to obtain SAAE by performing alternative audit procedures.

SEGMENT INFORMATION

1. The auditor shall obtain SAAE regarding the presentation and disclosure of segment information in accordance with the AFRF by:
    a. Obtaining an understanding of the methods used by management in determining segment information, and
        i. Evaluating whether such methods are likely to result in disclosure in accordance with the AFRF; and
        ii. Testing the application of such methods; and
    b. Performing analytical procedures or other audit procedures appropriate in the circumstances.
2. The auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a standalone basis.
3. Understanding of the Methods Used by Management: Example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:
    a. Sales, transfers and charges between segments, and elimination of intersegment amounts.
    b. Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
    c. The allocation of assets and costs among segments.
    d. Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

SA 505 – EXTERNAL CONFIRMATION (EC)

Aspects

1. Definition
2. EC procedures
3. Whether information has to be covered or requested
4. Designing confirmation requests.
5. Managements refusal to allow the auditor to send confirmation requests.

DEFINITION OF IMPORTANT TERMS (TYPES OF EC OR TYPES OF RESPONSES)

Definition of EC – External confirmation may be defined as audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.

1. **Positive confirmation request**

   A request that the party responds directly to the auditor indicating whether the party agrees or disagree with the information.

2. **Negative confirmation request**

   a. A request that the confirming party requests directly to the auditor only if the party disagrees with the information provided in the request.

   b. Provide less persuasive audit evidence than positive confirmations.

   c. Shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

      i. The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls.

      ii. The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions.

      iii. A very low exception rate is expected.

      iv. The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

3. **Non response**

   The failure of the party to respond or fully respond to a positive confirmation or a confirmation request returns undelivered.

4. **Exception**

   Response that indicates a difference between information requested to be confirmed and information provided by the party.

EXTERNAL CONFIRMATION PROCEDURES

While using EC procedures the auditor has to maintain control over the requests. What are those controls.

1. **Determining the information to be confirmed or requested** – External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements.
2. **Selecting the appropriate confirming party** – requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed
3. **Designing confirmation requests** including determining that requests are properly addressed and it contains written for responses to be sent directly to the auditor.

   This may affect the response rate and reliability and nature of audit evidence obtained.

   Question – What are the factors that has to be considered while designing confirmation requests?

   a. Specific identified ROMM including fraud risk.
   b. Layout and presentation.
   c. Prior experience of similar engagement.
   d. Assertions being addressed
   e. Method of communication.
   f. Managements authorization or engagement
   g. Ability of the intended confirming party.
4. Sending the request including **follow up requests** when applicable – send an additional confirmation request when a reply to a previous request has not been received within a reasonable time.
5. Management refusal to allow the auditor to send a confirmation request.
   a. Inquire the reasons for refusal & seek evidence for their appropriateness: The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error. [Ex: dispute or negotiations going on with confirming party]
   b. Evaluate the implications (consequences) on assessment of ROMM NTE of other audit procedures: The auditor may conclude that it would be appropriate to revise the assessment of the ROMM at the assertion level and modify planned audit procedures.
   c. Perform alternative audit procedures & obtain audit evidence.
      i. If the auditor concludes that the refusal is unreasonable or is unable to obtain AE from alternative audit procedure, then communicate with TCWG in accordance with SA 260.
      ii. Also evaluate the implications on the opinion in accordance with SA 705.

Evaluating the Evidence Obtained

1. The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether performing further audit procedures is necessary.
2. When evaluating the results of individual external confirmation requests, the auditor may categorise such results as follows:
    a. Response by the appropriate confirming party indicating agreement with the information provided in the confirmation request, or providing requested information without exception;
    b. A response deemed unreliable;
    c. A non-response; or
    d. A response indicating an exception.

SA 510 – INITIAL AUDIT ENGAGEMENT

OBJECTIVES OF AUDITOR

Definitions:

1. Initial audit engagement refers to an engagement in which either:
    a. The financial statements for the prior period were not audited; or
    b. The financial statements for the prior period were audited by a predecessor auditor.
2. Predecessor auditor – The auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor.
3. Opening balances:
    a. Means those account balances that exist at the beginning of the period.
    b. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period.
    c. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments

OBJECTIVES & PROCEDURES

1. Obtain SAAE about, whether
    a. Opening balance contains any misstatement that might materially affect current period FS.
    b. Accounting policies are reflected in opening balances and have consistently applied in current period of FS.

2. This is done by
    a. Whether closing balance have been currently brought forward and any adjustment have been disclosed as prior period items in current Year P & L

       If there are any changes it should be

       a) Accounted
       b) Presented
       c) Disclosed

        In accordance with AFRF

    b. Whether the opening balance reflects application of accounting policies.
    c. Performing one or more of the following
        i. If prior period FS are audited – Study carefully, copies of audited FS and other relevant documents.
        ii. Evaluate if audit procedure provides evidence relevant to opening balances.
        iii. Perform specific audit procedures to obtain evidence relevant to opening balances. [For current assets & liabilities, For non-current assets & liabilities]

Ensure effect has been [Op bal has misstatements & it is affecting CPFS & the effect has been]

1. Accounted
2. Presented
3. Disclosed

and if not

a. Qualified opinion
b. Adverse opinion

Note: If the auditor does not obtain the evidence about the opening balances, then give

i. Qualified opinion
ii. Disclaimer of opinion

Consistency of accounting policies - If the auditor concludes that there is no consistency or changes are not disclosed – Qualified or Adverse opinion.

NOTE: If the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's opinion that remains relevant and material to the current period's financial statements, the auditor shall modify the auditor's opinion on the current period's financial statements.

REPORTING PROCEDURES

A) **Relating to OPENING BALANCES**: If auditor concludes that
   a. Unable to obtain SAAE on opening balance: Express Qualified or Disclaimer of opinion.
   b. If opening balances includes material misstatements affecting CPFS & such misstatement is not Accounted, Presented & Disclosed: Qualified or Adverse opinion.

B) **Relating to consistency of ACCOUNTING POLICIES**: If auditor concludes that
   a. Accounting policies not consistently applied as per AFRF: Qualified or Adverse
   b. Change in accounting policies not adequately Accounted, Presented & Disclosed: Qualified or Adverse.

SA 550 – RELATED PARTIES

Aspects to be covered

1. Meaning
2. Responsibilities
3. Nature
4. Concept of true and fair view.

Meaning

A related party is a party as defined in applicable financial reporting framework (AS18, Section 188 of companies Act 2013) where AFRF establishes minimal or no related party requirements then

a. A person or other entity that has control or significant influence through one or more intermediaries our reporting entity.
b. Another entity our which the reporting entity has control or significant influence through one or more intermediaries.
c. Another entity that is in common control with another entity through having
   i. Common controlling ownership.
   ii. Owner who are close family members.
   iii. Common key management.
d. Many financial reporting frameworks discuss the concepts of control and significant influence. They generally explain that:
   i. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities; and

ii. Significant influence is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies.

e. The existence of the following relationships may indicate the presence of control or significant influence:
   i. Direct or indirect equity holdings or other financial interests in the entity.
   ii. The entity's holdings of direct or indirect equity or other financial interests in other entities.
   iii. Being part of those charged with governance or key management (i.e., those members of management who have the authority and responsibility for planning, directing and controlling the activities of the entity).
   iv. Being a close family member of any person referred to in subparagraph
   v. Having a significant business relationship with any person referred to in subparagraph (iii).

f. Meaning of Related Parties with Dominant Influence: by virtue of their ability to exert control or significant influence, may be in a position to exert dominant influence over the entity or its management.

g. Meaning of Special-Purpose Entities as Related Parties: a special-purpose entity may be a related party of the entity because the entity may in substance control it, even if the entity owns little or none of the special- purpose entity's equity.

Understanding the Entity's Related Party Relationships & Transactions

1. The auditor shall inquire of management regarding
   a. The identity of the entity's related parties, including changes from the prior period;
   b. The nature of the relationships between the entity and these related parties; and
   c. Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.
2. Inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to:
   a. Identify, account for, and disclose related party relationships and transactions in accordance with the AFRF;
   b. Authorise and approve significant transactions and arrangements with related parties; and
   c. Authorise and approve significant transactions and arrangements outside the normal course of business.
3. Considerations specific to smaller entities by the auditor:

a. TCWG may not include an outside member, and the role of governance may be undertaken directly by the owner-manager where no other owner exists.
b. Control activities in smaller entities are likely to be less formal and smaller entities may have no documented processes for dealing with related party relationships and transactions.
c. Obtain an understanding through inquiry of management combined with other procedures, such as observation of management's oversight and review activities, and inspection of available relevant documentation

Nature of RPT

1. RPT's are in the nature of normal course of business and un such cases there is no risk of material misstatement.
2. However, in certain situations it will give rise to higher ROMM.
    a. Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
    b. Information systems may be ineffective at identifying or summarising transactions and outstanding balances between an entity and its related parties.
    c. Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.

Verify the existence

1. Likely to be readily available to management because the entity's information systems will need to record, process and summarize related party relationships and transactions to enable the entity to meet the accounting and disclosure requirements of the framework.
2. Management is therefore likely to have a comprehensive list of related parties and changes from the prior period.
3. Where the framework does not establish related party requirements, the entity may not have such information systems in place.
4. Under such circumstances, it is possible that management may not be aware of the existence of all related parties
5. The inquiries specified above still applies because management may be aware of parties that meet the related party definition set out in this SA.

6. In case of common control relationships – auditor's inquiries should be focused on whether parties with which the entity engages in significant transactions, or shares resources to a significant degree, are related parties.

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

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and those charged with governance.
5. Records of the entity's investments and those of its pension plans.
6. Contracts and agreements with key management or those charged with governance.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Specific invoices and correspondence from the entity's professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.
11. Internal auditors' reports.
12. Documents associated with the entity's filings with a securities regulator e.g, prospectus.

SA 520 – ANALYTICAL PROCEDURES

MEANING

It means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.

SCOPE OF SA 520

Deals with the auditor's use of analytical procedures as substantive procedures and as procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements.

OBJECTIVES OF SA 520

1. To obtain relevant and reliable audit evidence when using substantive analytical procedures.
2. To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion

PURPOSE AND TIMING OF ANALYTICAL PROCEDURES

PURPOSE

1. Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable.
2. The overall tests can be extended for making inter-firm and intra-firm comparison of trading results.
3. 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.
4. By setting up certain expenses ratios on the basis of balances 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.
5. 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.
6. Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications.

TIMING

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 in planning the audit use both financial data and non-financial information. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures.

SUBSTANTIVE ANALYTICAL PROCEDURES

1. The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both.
2. The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment.
3. The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both.
4. The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment.

FACTORS **PANI-DAS**

1. **Availability of Data** – The availability of reliable and relevant data will facilitate effective analytical procedures.
2. **Disaggregation** – The degree of disaggregation in available data can directly affect the degree of its usefulness in detecting misstatements.
3. **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.
4. **Source** – Some classes of transactions tend to be more predictable because they consist of numerous, similar transactions. 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.
5. **Predictability** – Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable. A predictable relationship is one that may reasonably be expected to exist and continue over time.
6. **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).
7. **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.

TECHNIQUES

1. **Trend analysis** –
   a. Trend analysis is a commonly used technique.
   b. It is the comparison of current data with the prior period balance or with a trend in two or more prior period balances.
   c. 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.

1. **Ratio analysis** –
   a. Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts.

b. 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).

c. 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.

2. **Reasonableness tests –**

   a. 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.

      1. These tests are made by reviewing the relationship of certain account balances to other balances for reasonableness of amounts.

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

Let us understand by an example: An auditor is conducting an audit of a retail company's financial statements. The company reports its sales revenue as ₹200 crore for the current year. The auditor uses structural modeling with historical data to validate this reported figure.

Step 1	**Understand the Historical Data** The auditor collects financial and nonfinancial data from prior accounting periods, including: Sales Revenue, Units Sold, Marketing Spend, and Foot Traffic.
Step 2	**Build the Statistical Model** Using linear regression, the auditor develops a predictive equation based on historical data: Sales Revenue=$\beta 0+\beta 1$(Units Sold) +$\beta 2$(Marketing Spend) +$\beta 3$(Foot Traffic) +ϵ **Assumed Coefficients derived from regression analysis**: $\beta 0$ = 20 (baseline sales revenue in ₹ crore). $\beta 1$=4 (impact of 1 lakh units sold on sales revenue). $\beta 2$=1.5β2 (impact of ₹1 crore in marketing spend on sales revenue). $\beta 3$=2 (impact of 1 lakh visitors on sales revenue).
Step 3	**Apply the Model to Current Data**: The company provides the following current nonfinancial data for the year: • Units Sold = 40 lakh • Marketing Spend = ₹35 crore

	• Foot Traffic = 70 lakh visitors Substitute these values into the regression equation: Predicted Sales Revenue=20+(4×40) +(1.5×35) +(2×70) **Step-by-step calculation:** • Baseline Revenue: 20 • Effect of Units Sold: 4×40=160 • Effect of Marketing Spend: 1.5×35=52.5 • Effect of Foot Traffic: 2×70=140 **Add these together**: Predicted Sales Revenue=20+160+52.5+140**=₹372.5 crore**.
Step 4	**Compare Predicted and Reported Figures:** • Reported Sales Revenue: ₹200 crore • Predicted Sales Revenue: ₹372.5 crore • Variance: 372.5−200=₹172.5 crore
Step 5	**Interpret the Variance:** The predicted sales revenue of ₹372.5 crore is significantly higher than the reported figure of ₹200 crore. This large variance (₹172.5 crore) is well beyond any materiality threshold and indicates potential issues, such as: • **Understatement of Sales Revenue**: Possible intentional or unintentional error. • **Unrecorded Transactions**: Some sales may not have been recorded. • **Incorrect Nonfinancial Data**: Input variables (e.g., units sold) may have errors. • **Model Limitations**: The regression model may not account for all relevant factors.
Step 6	**The auditor investigates further:** • Examining the accuracy of non-financial data inputs. • Reviewing sales transactions, invoices, and reconciliations. • Discussing discrepancies with management.

Using analytical procedures as substantive tests

1. Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions.

2. Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation.
3. Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.
4. Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

THE RELIABILITY OF DATA

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

EVALUATION OF THE EXPECTATION

Matters relevant to the auditor's evaluation of whether the expectation can be developed precisely to identify a misstatement, include –

2. The accuracy with which the expected results of substantive analytical procedures can be predicted.
3. The degree to which information can be disaggregated.
4. The availability of the information, both financial and non-financial.

INVESTIGATING RESULTS OF ANALYTICAL PROCEDURES

If analytical procedures performed identify fluctuations or relationships that are inconsistent with other relevant information, the auditor shall investigate such differences by:

1. **Inquiring of management and obtaining appropriate audit evidence relevant to management's responses**: Audit evidence relevant to management's responses may be obtained by evaluating those responses.

2. **Performing other audit procedures as necessary in the circumstances**: The need to perform other audit procedures may arise when, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

SA 530 – AUDIT SAMPLING

MEANING

Refers to the application of audit procedures to less than 100% of items within a population relevant under the audit, such that all sampling units (i.e., all the items in the population) have an equal chance of selection.

SCOPE OF SA 530

1. It becomes applicable when the auditor has decided to use audit sampling in performing audit procedures
2. Deals with the auditor's use of statistical & non-statistical sampling when
    a. Designing & selecting the audit sample
    b. performing TOC & TOD and
    c. evaluating test results

POPULATION – Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions. The auditor should select sample items in such a way that the sample can be expected to be representative of the population. This requires that all items in the population have an opportunity of being selected.

SAMPLING UNIT – The individual items that make up the population are known as sampling units. The population can be divided into sampling units in a variety of ways. It is a selection from the population that is used as an extrapolation of the population.

It must be closely similar to the whole population although not necessarily exactly the same. Sampling process is performed on

a. **Test of Controls** – to identify deviations from expected internal controls
b. **Test of details** – to identify misstatements of account balances & class of transactions.

CHARACTERISTICS OF POPULATION

1. **Appropriateness** – determine that the population from which the sample is drawn is appropriate for the specific audit objective. Appropriate means population from which the samples are drawn shall be relevant for the specific objective.
2. **Completeness** – 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** – the auditor performs audit procedures to ensure that the information upon which the audit sampling is performed is sufficiently complete and accurate. Auditor should obtain evidence about the reliability of population.

APPROACHES TO SAMPLING

Audit sampling can be applied using either non-statistical or statistical sampling approaches.

1. **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.
    a. This approach is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability.
    b. Has reasonably wide application where a population to be tested consists of a large number of similar items.
    c. There is no personal bias of the auditor in case of statistical sampling. Since it is scientific
    d. In larger organizations, with huge transactions, statistical sampling is always recommended as it is unbiased and the samples selected are not prejudged.
    e. Advantages of statistical approach is as follows –
        1. The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (population) 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 i.e., the probable difference in result due to the use of a sample in instead of examining all the records in the group.

5. It may provide a better description of a large mass of data than a complete examination of all the data.
6. It is widely accepted way of sampling as it is more scientific, without personal bias.

2. **Non-Statistical sampling** is an approach where sample is chosen by applying certain mathematical and statistical methods. A sampling approach that does not have the above features considered as non-statistical sampling.
    a. Under this approach, the sample size and its composition are determined on the basis of the personal experience and knowledge of the auditor.
    b. This approach has been in common application for many years because of its simplicity in operation.
    c. The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific.
    d. 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.
    e. 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.

The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgement. However, sample size is not a valid criterion to distinguish between statistical and non- statistical approaches. The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:

a. Size of the organization under audit.
b. State of the internal control.
c. Adequacy and reliability of books and records.
d. Tolerable error range.
e. Degree of the desired confidence.

SAMPLE DESIGN, SIZE AND SELECTION OF ITEMS FOR TESTING

SAMPLE DESIGN

1. When designing an audit sample, the auditor should include the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose.
2. Consideration of the nature of the audit evidence sought and possible deviation or misstatement relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling.

3. In considering the characteristics of a population,
    a. For tests of controls – the auditor makes an **assessment of the expected rate of deviation** based on the auditor's understanding of the relevant controls or on the examination of a small number of items from the population.
    b. For tests of details – the auditor makes an **assessment of the expected misstatement** in the population. If the expected misstatement is high, 100% examination or use of a large sample size may be appropriate when performing tests of details.
4. In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection is appropriate

a. Stratification

1. Dividing population into discrete sub-populations which have an identifying characteristic. Each Sub population is called as Stratum and units under those sub population are referred to as Strata
2. 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.
3. When performing tests of details, the population is often stratified by monetary value.
4. A population may be stratified according to a particular characteristic that indicates a higher risk of misstatement. Eg: - Debtors age wise classification.

b. Value-Weighted Selection

1. Identify the sampling unit as the individual monetary units that make up the population.
2. One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items.
3. In value weighted selection, the sample size, its selection and evaluation will result in a conclusion in monetary amounts

SAMPLE SIZE

1. The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.
2. The level of sampling risk that the auditor is willing to accept affects the sample size required.
3. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.
4. The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment.
5. Factors influencing sample size for test of controls & test of details are as follows.

FOR TEST OF CONTROLS	FOR TEST OF DETAILS
1. **Extent of reliance on ICS** – The more assurance the auditor intends to obtain from the operating effectiveness of controls, the lower the auditor's assessment of the risk of material misstatement will be, and the larger the sample size will need to be.	1. **Assessment of Risk of material misstatement** – The higher the auditor's assessment of the risk of material misstatement, the larger the sample size needs to be.
2. **Tolerable error** – Tolerable error is the maximum error in the population that auditor is ready to accept in a given sample size. Smaller the tolerable error, larger will be the sample size.	2. **Reliance on other substantive procedures** – The more the auditor is relying on other substantive procedures, the less assurance the auditor will require from sampling and, therefore, the smaller the sample size can be.
3. **Expected rate of deviation** – When there is an increase in the expected rate of deviation of the population to be tested then sample size will increase, as higher the expected rate of deviation, larger the sample size needs to be so that the auditor is in a position to make a reasonable estimate of the actual rate of deviation. Question – What are the relevant factors to be considered during expecting the deviation? a. Auditor's understanding of the business b. Changes in personnel or in internal control c. The results of audit procedures applied in prior periods. d. The results of other audit procedures.	3. **Tolerable misstatement** – An increase in tolerable misstatement will decrease the sample size as lower the tolerable misstatement, the larger the sample size needs to be. 4. **Misstatement** – The greater the amount of misstatement the auditor expects to find in the population, the larger the sample size needs to be in order to make a reasonable estimate of the actual amount of misstatement in the population.
4. **Desired level of assurance** – An increase in the auditor's desired level of assurance that the tolerable rate of deviation is not exceeded	5. **Desired level of assurance** – An increase in the auditor's desired level of assurance that the tolerable rate of deviation is not exceeded by

by the actual rate of deviation in the population will increase the sample size.	the actual rate of deviation in the population will increase the sample size.

SAMPLE SIZE

1. **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:
    a. **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.
    b. **Stratified Sampling**: This method involves dividing the whole population to be tested in a few separate groups called stratum and taking a sample from each of them (strata). Each stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratums.

    Note – Stratification means dividing heterogeneous (Diversified) population into Homogeneous (having similar characteristics) sub population, where samples are drawn from each sub population.
2. **Interval Sampling or Systematic Sampling**: Systematic selection is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval. Ensure the interval does not correspond with a particular pattern in the population.
3. **Monetary Unit Sampling**: It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

    Imagine you are an auditor checking a company's sales invoices to ensure they are accurate.

    Example: -

    Total sales = ₹1,00,000

    You want to test 5 invoices using Monetary Unit Sampling.

    Let us try to perform the procedure:

    STEP 1: Determine Sampling Interval

    The sampling interval is calculated by dividing the total sales by the number of samples:

    Sampling Interval = Total Sales/Number of Samples = ₹ 1,00,000/5 = ₹ 20,000

    This means you will test invoices based on every ₹20,000 in sales.

STEP 2: Identify the Sample Invoices

Add the sampling interval (₹20,000) to the random start to identify which monetary amounts to select: Choose a random starting point between ₹ 1 to ₹ 20,000. **Let us say, Random start = ₹ 12,000 & then keep adding ₹20,000 to that.**

- ₹ 12,000 is in the Invoice 1 whose value is ₹15,000
- ₹ 32,000 (₹12,000+₹20,000) is in Invoice 3 whose individual value is ₹20,000 & cumulative value is ₹35,000 (₹15,000 + ₹20,000)
- ₹ 52,000 (₹32,000+₹20,000) is in Invoice 6 whose individual value is ₹30,000 & cumulative value is ₹65,000 (₹35,000 + ₹30,000)
- ₹ 72,000 (₹52,000+ ₹20,000) is in Invoice 9 whose individual value is ₹25,000 & cumulative value is ₹90,000 (₹65,000 + ₹25,000)
- ₹ 92,000 (₹72,000 + ₹20,000) is in Invoice 10 whose individual value is ₹10,000 & cumulative value is ₹100,000 (₹90,000 + ₹10,000)

STEP 3: Review Selected Invoices: Check the invoices for errors, such as wrong amounts or missing support.

Invoice 1 (₹15,000): No errors.

Invoice 3 (₹20,000): Overstated by ₹2,000.

Invoice 6 (₹30,000): No errors.

Invoice 9 (₹25,000): Overstated by ₹1,000.

Invoice 10 (₹10,000): No errors.

STEP 4: If there are errors, project them to the total sales:

Invoice 3: Error = ₹2,000 on ₹20,000. Error rate = 2,000/20,000 = 10%

Projected error for interval (₹20,000) = 10% × ₹20,000 = ₹2,000.

Invoice 9: Error = ₹1,000 on ₹25,000. Error rate =1,000/25,000 = 4%

Projected error for interval (₹20,000) = 4% × ₹20,000 = ₹800.

Total projected error = ₹2,000 + ₹800 = ₹2,800.

STEP 5: Compare to Tolerable Misstatement:

If your tolerable misstatement is ₹5,000, and the total projected error is ₹2,800, then the account is fairly stated.

If the error exceeded ₹5,000, you would need to investigate further or recommend adjustments.

4. **Haphazard sampling**: Haphazard selection, in which the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid

any conscious bias or predictability. Thus, attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.

5. **Block Sampling**: This method involves selection of a block(s) of contiguous (adjoining / connecting) items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population.

SAMPLING & NON-SAMPLING RISK

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**. If the acceptable sampling risk is low, larger sample size is needed.

NON-SAMPLING RISK – The risk that the auditor **reaches an erroneous conclusion for any reason not related to sampling risk.** Non sampling risk can never be mathematically measured. Examples – Human Mistakes, Misinterpreting the sample results, relying on erroneous information, Applying audit procedures not appropriate to the objectives of audit.

Sampling risk can lead to two types of erroneous conclusions which are as follows –

TYPE	TEST OF CONTROLS	TEST OF DETAILS	EFFECTS
I	**Conclusion** – ICS is More effective than they actually are	Conclusion – Material misstatement does not exist when in fact, it does.	Affects audit effectiveness. Therefore, it leads to inappropriate opinion.
II	**Conclusion** – Less effective than they actually are	**Conclusion** – Material misstatement exists when in fact, it does not.	Affects audit efficiency. Therefore, it leads to additional work to prove previous conclusions are correct.

PERFORMING AUDIT PROCEDURES

1. The auditor shall perform audit procedures, appropriate to the purpose, on each item selected.
2. If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item.

3. If 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. A deviation from the prescribed control, in the case of tests of controls, or
    b. A misstatement, in the case of tests of details.

PROJECTING MISSTATEMENTS

1. The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded.

   Example: Projection of Misstatements to Understand the Scale

   - **Sample Testing**: The auditor selects 500 invoices out of a total population of 5,000 invoices.
   - **Finding**: 20 invoices in the sample contain errors, resulting in total misstatements of ₹10,000.
   - **Projection**:
     - Sample size: 500 invoices
     - Population size: 5,000 invoices
     - Misstatement rate in sample: 20÷500 = 4%
     - Projected misstatement for the population = 5,000 x 4% = 200 invoices

       Total projected monetary misstatement: ₹10,000 ÷ 50 x 5,000 = ₹10 lakhs
   - **Conclusion**: The auditor estimates ₹10,00,000 as the potential total misstatement in accounts receivable. This projection gives a broad view but may not be the exact amount requiring adjustment

2. When a misstatement has been established as an anomaly, it may be **excluded when projecting misstatements to the population**. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.

   Example: 1 of the 2 errors in the sample is investigated further and found to be a clerical mistake caused by an unusual situation (e.g., system outage during entry). The error is considered an anomaly because it is non-recurring. This anomaly is excluded from the projection of misstatements. However, the specific misstatement amount (e.g., ₹6,000 from the anomalous error) is still considered separately in the audit report if it remains uncorrected.

3. For tests of details, the auditor shall project misstatements found in the sample to the population whereas 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.

   Example:

   1. **Tests of Details**:

- The auditor tests the monetary accuracy of invoices (details).
- Errors in the sample are projected to the entire population, as calculated in Point 1.

2. **Tests of Controls**:
   - The auditor tests whether controls over invoicing (e.g., approval workflow) are working effectively.
   - **Sample Testing**: Out of 50 invoices, the approval process failed for 3 invoices.
   - **Conclusion**:
     - Sample deviation rate: 3 ÷ 50 = 6%
     - Population deviation rate is directly assumed to be 6% (no further projection needed).
     - This means 6% of the invoicing process is potentially affected by control failures, which the auditor considers when concluding on the effectiveness of controls.

NATURE AND CAUSE OF DEVIATIONS AND MISSTATEMENTS

1. In analysing the deviations and misstatements identified, the auditor may observe that many have a common feature.
2. The auditor may decide to identify all items in the population that possess the common feature, and extend audit procedures to those items.
3. In addition, such deviations or misstatements may be intentional, and may indicate the possibility of fraud.
4. 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.
5. **Anomaly (Irregularity, glitch)** – In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly.
6. The auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population.
7. The above is done by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.

EVALUATING RESULTS OF AUDIT SAMPLING

1. The auditor shall evaluate –
   a. The results of the sample, and
   b. Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

2. **For test of controls** – an unexpectedly high sample deviation rate may lead to an increase in the assessed risk of material misstatement.
3. **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.
4. **In the case of tests of details**, the projected misstatement + anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population.
5. When the projected misstatement + uncorrected anomalous misstatement > tolerable misstatement = the sample does not provide a reasonable basis for conclusions about the population that has been tested.
6. Also, if the projected misstatement is greater than the auditor's expectations of misstatement used to determine the sample size, the auditor may conclude that **there is an unacceptable sampling risk** that the actual misstatement in the population exceeds the tolerable misstatement.
7. In case 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 –
    a. To investigate misstatements that have been identified and the potential for further misstatements and;
    b. To make any necessary adjustments; or modify the nature, timing and extent of those further audit procedures to achieve the required assurance.

NOTE – 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.

SA 610 – USING THE WORK OF INTERNAL AUDITORS

Introduction

1. The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement.
2. Although they may perform audit procedures similar to those performed by the external auditor, neither the internal audit function nor the internal auditors are independent of the entity as is required of the external auditor in an audit of financial statements in accordance with SA 200.
3. This SA, therefore, defines the conditions that are necessary for the external auditor to be able to use the work of internal auditors.

4. It also defines the necessary work effort to obtain SAAE that the work of the internal audit function, or internal auditors providing direct assistance, is adequate for the purposes of the audit.
5. The requirements are designed to provide a framework for the external auditor's judgments regarding the use of the work of internal auditors to prevent over or undue use of such work.

Definition of Internal Audit Function

A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.

objectives and scope of internal audit functions

1. 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
2. Activities Relating to Risk Management:
    a. The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process).
    b. The internal audit function may perform procedures to assist the entity in the detection of fraud.
3. Activities Relating to Internal Control:
    c. Evaluation of internal control: The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation, and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control.
    d. 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.
    e. Review of operating activities: The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non- financial activities of an entity.

f. 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.

USAGE OF THE FUNCTION BY EXTERNAL AUDITOR

The external auditor may make use of the function for purposes of the audit in one or more of the following ways:

a. To obtain information that is relevant to the external auditor's assessments of the ROMM due to error or fraud.
b. Unless prohibited, or restricted to some extent, by law or regulation, the external auditor, after appropriate evaluation, may decide to use work that has been performed by the internal audit function during the period in partial substitution for audit evidence to be obtained directly by the external auditor.
c. Unless prohibited, or restricted to some extent, by law or regulation, the external auditor may use internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

SCOPE OF SA 610

Deals with the external auditor's responsibilities if using the work of internal auditors. This includes:

a. Using the work of the internal audit function in obtaining audit evidence and
b. Using internal auditors to provide direct assistance under the direction, supervision and review of the external auditor.

OBJECTIVES OF THE EXTERNAL AUDITOR

To determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent; and having made that determination:

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

EVALUATING THE INTERNAL AUDIT FUNCTION

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

1. The objectivity (impartial, unbiased, independent) of the internal auditors.
    a. Objectivity refers to the ability to perform those tasks without allowing bias, conflict of interest or undue influence of others to override professional judgments.
    b. Factors to be considered while evaluating objectivity of IAF: C^2O^2
        i. Whether the organizational status of the internal audit function, including the function's authority and accountability, supports the ability of the function to be free from bias, conflict of interest or undue influence of others to override professional judgments.
        ii. Whether TCWG oversee (supervises) employment decisions related to the function.
        iii. Whether there are any constraints or restrictions placed on the function by management or TCWG.
        iv. Whether the internal audit function is free of any conflicting responsibilities.
2. The level of competence (skill, ability, capability) of the function:
    a. Refers to the attainment and maintenance of knowledge and skills of the function as a whole at the level required to enable assigned tasks to be performed diligently and in accordance with applicable professional standards.
    b. Factors to be considered while evaluating competence:
        i. Whether the function is adequately and appropriately resourced relative to the size of the entity and the nature of its operations.
        ii. Whether there are established policies for hiring, training and assigning internal auditors to internal audit engagements.
        iii. Whether the internal auditors have adequate technical training and proficiency in auditing.
        iv. Whether the internal auditors possess the required knowledge relating to the entity's FR and the AFRF.

NOTE: Objectivity and competence may be viewed as a continuum (continuity, sequence).

3. Systematic and disciplined approach, including quality control: Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:
    a. The existence, adequacy and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting, the nature and extent of which is commensurate (proportionate) with the size and circumstances of an entity.

b. Whether the function has appropriate quality control policies and procedures.

CIRCUMSTANCES WHEN WORK OF THE INTERNAL AUDIT FUNCTION CANNOT BE USED

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

DETERMINING THE NATURE AND EXTENT OF WORK OF THE INTERNAL AUDIT FUNCTION THAT CAN BE USED

1. Once the external auditor has determined that the work of the internal audit function can be used for purposes of the audit, a first consideration is whether the planned nature and scope of the work of the internal audit function
    a. that has been performed, or
    b. is planned to be performed,

    is relevant to the overall audit strategy and audit plan that the external auditor has established.
2. Examples of work of the internal audit function that can be used by the external auditor include the following:
    a. Testing of the operating effectiveness of controls.
    b. Substantive procedures involving limited judgment.
    c. Observations of inventory counts.
    d. Tracing transactions through the information system relevant to financial reporting.
    e. Testing of compliance with regulatory requirements

CIRCUMSTANCES IN WHICH THE EXTERNAL AUDITOR SHALL PLAN TO USE LESS OF THE WORK OF THE INTERNAL AUDIT FUNCTION AND PERFORM MORE OF THE WORK DIRECTLY

1. The external auditor shall make all significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function.
2. He shall plan to use less of the work of the function and perform more of the work directly if:
    a. The more judgment is involved in:

i. Planning and performing relevant audit procedures; and
ii. Evaluating the audit evidence gathered;

b. The higher the assessed ROMM at the assertion level, with special consideration given to risks identified as significant;
c. The less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and
d. The lower the level of competence of the internal audit function.

USING THE WORK OF THE INTERNAL AUDIT FUNCTION

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

1. Discuss the planned use of its work with the function as a basis for coordinating their respective activities. Discussion may be useful to address the following:
    a. The timing of such work.
    b. The nature of the work performed.
    c. The extent of audit coverage.
    d. Materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures), and performance materiality.
    e. Proposed methods of item selection and sample sizes.
    f. Documentation of the work performed.
    g. Review and reporting procedures

Coordination between the auditor & function is effective when:

a) Discussions take place at appropriate intervals throughout the period.
b) The external auditor informs the function of significant matters that may affect the function.
c) The external auditor is advised of and has access to relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement.

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

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

DETERMINING WHETHER, IN WHICH AREAS, AND TO WHAT EXTENT INTERNAL AUDITORS CAN BE USED TO PROVIDE DIRECT ASSISTANCE

1. Direct assistance refers to the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.
2. The external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors.
3. If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the existence and significance of threats to objectivity (independence) and the level of competence of the internal auditors who will be providing such assistance.
4. Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:
    a. Obtain written agreement from an authorized representative of the entity that
        i. The internal auditors will be allowed to follow the external auditor's instructions, and
        ii. The entity will not intervene in the work the internal auditor performs for the external auditor; and
    b. Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.
5. The external auditor shall not use an internal auditor to provide direct assistance if:
    a. There are significant threats to the objectivity of the internal auditor; or
    b. The internal auditor lacks sufficient competence to perform the proposed work
6. The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:
    a. Involve making significant judgments in the audit;
    b. Relate to higher assessed ROMM where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
    c. Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or TCWG by the internal audit function; or

d. Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

BASICS OF INTERNAL FINANCIAL CONTROL AND REPORTING REQUIREMENTS

Distinction between Internal Financial Control and Internal Control over financial reporting

1. The term Internal Financial Controls (IFC) refers to the policies and procedures put in place by companies for ensuring: PE-CSR
    a. Prevention and detection of frauds.
    b. Effectiveness and efficiency of operations,
    c. Compliance with applicable laws and regulations,
    d. Safeguarding of assets and
    e. Reliability of FR.
2. On the other hand, Internal controls over financial reporting is required where AUDITORS ARE REQUIRED TO EXPRESS AN OPINION on the effectiveness of an entity's internal controls over financial reporting, such opinion is in addition to and distinct from the opinion expressed by the auditor on the financial statements.

STUDY MATERIAL QUESTIONS

1. Many related party transactions are in the normal course of business. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Give few examples of such areas.
2. An auditor is appointed for the first time for audit of accounts of an entity. The accounts of previous year were unaudited. He is unable to obtain sufficient appropriate audit evidence regarding the opening balances. What is his responsibility in this regard?
3. Discuss some of circumstances when work of the internal auditor cannot be used by external auditor.
4. Discuss what is understood by "appropriateness" of audit evidence.
5. Maintaining accounts using accounting software having a feature of recording audit trail can be useful for an auditor. Discuss some of the advantages for such a feature in accounting software for auditors.
6. Explain how a statutory auditor of a company can apply analytical procedures at the planning phase of audit.

7. Discuss the objective of Auditor with respect to Opening balances in conducting an initial audit engagement.
8. M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore, he is not required to verify them. Is CA Pankaj correct in his approach?
9. While applying the Substantive Analytical Procedures what techniques can be used by the statutory auditor of a company to obtain sufficient and appropriate audit evidence?
10. The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Explain with the help of at least three examples.
11. When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including sending the requests, including follow-up requests when applicable, to the confirming party. Explain the other points as to when using external confirmation procedures, the auditor would be required to maintain control over external confirmation requests.
12. Explain clearly the examples of matters relevant in planning attendance at physical inventory counting.
13. The statutory auditor of MNO Ltd., CA Kishore identifies certain inconsistencies while applying analytical procedures to the financial and non-financial data of
14. MNO Ltd. What should CA Kishore do in this case with reference to SA 520 on "Analytical Procedures"?
15. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain
16. What are the factors that determine the extent of reliance that the auditor places on results of analytical procedures? Explain with reference to SA-520 on "Analytical procedures".
17. Define Analytical Procedures.
18. M/s PQR and associates are the statutory auditors of TUV Ltd. for the FY 2022-23-. They have been appointed as statutory auditors of TUV Ltd. for the first time. What is the objective of the engagement partner in terms of SA 510?
19. What is meant by sufficiency of Audit Evidence? Explain the factors affecting the auditor's judgement as to the sufficiency of audit evidence.
20. What is the meaning of Sampling? Also discuss the methods of Sampling.
21. Explain in the light of SA 530 "Audit Sampling".

22. With reference to Standard on Auditing 530, state the requirements relating to audit sampling, sample design, sample size and selection of items for testing.
23. While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind?
24. Write short notes on the following:
    a. Advantages of Statistical sampling in Auditing.
    b. Stratified sampling
25. What precautions should be taken by the auditor while applying test check techniques?
26. Explain the factors to be considered while determining the extent of checking on a sampling plan.

EXAMINATION QUESTIONS UNDER PREVIOUS NEW SYLLABUS

1. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. Discuss. **[RTP-May 18]**
2. Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. He needs evidence to obtain information for arriving at his judgment. Discuss explaining clearly the detailed meaning of audit evidence. **[RTP-Nov. 19]**
3. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain. **[RTP-Nov. 18]**
4. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain. **[RTP-Nov. 19]**
5. What do you mean by sufficient appropriate audit evidence? State various factors that help the auditor to ascertain as to what is sufficient appropriate audit evidence. **[Nov. 10 (6 Marks)]**
6. State various factors that help the auditor to ascertain as to what is sufficient and appropriate audit evidence. **[Nov. 17 (4 Marks)]**
7. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement. Auditor's judgment as to sufficiency may be affected by few factors. Explain. **[RTP-May 18]**
8. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also

by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. Analyse and explain stating clearly the factors affecting the auditor's judgement as to sufficiency of audit evidence. **[RTP-May 19]**

9. What are the audit procedures to obtain audit evidence? Mention the same in brief.
10. Explain the tests of controls and substantive procedures as audit procedures of obtaining sufficient appropriate audit evidence for forming an audit opinion.
11. Write short note on: Substantive Procedures. **[May 10 (5 Marks), Nov. 14 (4 Marks)]**
12. "The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time". Explain.
13. Explain various methods to obtain audit evidence. **[May 11 (8 Marks)]**
14. Write short note on: Methods to obtain audit evidence. **[May 15 (4 Marks)]**
15. Mr. A was appointed statutory auditor of P Ltd. but he was not able to gather the sufficient audit evidences. Discuss how he should proceed to gather more audit evidences. **[Nov. 15 (6 Marks)]**
16. Discuss the following: Inquiry is one of the audit procedure to obtain audit evidence. **[May 13 (5 Marks)]**
17. Evaluating responses to inquiries is an integral part of the inquiry process. Explain. **[RTP-May 18]**
18. Distinguish between: Internal Evidence and External Evidence. **[Nov. 08 (6 Marks)]**
19. Discuss the principles which are useful in assessing the reliability of audit evidence.
20. Write short note on following: Reliability of audit Evidence. **[Nov. 11 (4 Marks)]**
21. Discuss the following: The reliability of audit evidence is influenced by its source, sample size and selection of items for testing. **[Nov. 13 (5 Marks)]**
22. With reference to SA 500, "Audit Evidence", discuss the different sources and their reliability, of audit evidence. **[May 17 (6 Marks)]**
23. "Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability". Explain. Also state clearly generalisations about the reliability of audit evidence. **[RTP-May 18]**
24. Explain the procedures to be performed by auditor to obtain sufficient and appropriate audit evidence regarding the existence and condition of inventory.
25. How would an auditor proceed to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory? Also, state reporting requirements in this respect.
26. ABC Ltd is engaged in manufacturing of different type of yarns. Ongoing through its financial statements for the past years, it is observed that inventory is material to the financial statements. You as an auditor

of the company wanted to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory as appearing in the financial statements. Discuss, how would you proceed as an auditor. **[MTP-March 18]**

27. Explain clearly the examples of matters relevant in planning attendance at physical inventory counting. **[RTP-May 20]**
28. Explain the auditor's procedures w.r.t. determination of existence and condition of inventory under the following circumstances:
    a. Inventory count conducted at a date other than balance sheet.
    b. To attend the inventory is impracticable.
29. "P India" Ltd. is a manufacturer of various sports products. The company is having several cases of litigation pending in courts. The auditor wanted to identify litigation and claims, which may give rise to risk of material misstatements. Suggest the audit procedures in the given case. **[May 19 (4 Marks)]**
30. Define the following:
    a. Positive confirmation request
    b. Negative confirmation request
    c. Non-response
    d. Exception **[RTP-May 20]**
31. What is meant by external confirmation? Mention four situations where external confirmation may be useful for auditors.
32. Explain the process of External Confirmation. Give some examples where external confirmation may be used as audit evidence**. [Nov. 11 (8 Marks)]**
33. When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including sending the requests, including follow-up requests when applicable, to the confirming party. Explain the other points as to when using external confirmation procedures, the auditor would be required to maintain control over external confirmation requests. **[RTP-May 20]**
34. What are the factors to be considered while designing a confirmation request. **[Nov. 12 (8 Marks)]**
35. The auditor of H Ltd. wanted to obtain confirmation from its creditors. But the management made a request to the auditor not to seek confirmation from certain creditors citing disputes. Can the auditor of H Ltd. Accede to this request?
36. Write short note on: Reliability of external confirmations. **[Nov. 10 (4 Marks)]**
37. Write short note on: Initial audit Engagement. **[May 12 (4 Marks)]**
38. Discuss the objective of Auditor with respect to Opening balances – in conducting an initial audit engagement.

39. What are the audit procedures to be followed by a statutory auditor in the audit of opening balances if the financial statements for the preceding year were audited by another auditor.
40. Discuss with reference to SA '510' Initial Audit Engagements – Opening Balances", the procedures the auditor should undertake in respect of opening balances for a new audit engagement. **[May 17 (5 Marks)]**
41. M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore he is not required to verify them. Is CA Pankaj correct in his approach? **[Nov. 18 (5 Marks)]**
42. Auditors of M/s Tender India (P) Ltd. were changed for the accounting year 2019-20. The closing inventory of the company as on 31.3.2019 amounting to Rs. 100 lacs continued as it is and became closing inventory as on 31.3.2020. The auditors of the company propose to exclude from their audit programme the audit of closing inventory of Rs. 100 lacs on the understanding that it pertains to the preceding year which was audited by another auditor. **[MTP-Oct. 19]**
43. The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Explain with the help of at least three examples. **[RTP-May 20]**
44. Explain the responsibilities of auditor in relation to related parties.
45. There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements. Analyse and explain stating the responsibility of auditor in this regard. **[RTP-May 19]**
46. Write short note on: Identification of significant related party transaction outside business. **[Nov. 13 (4 Marks)]**
47. Discuss the following: With reference to SA 550 "Identification of significant related party transaction outside the entity's normal course of business. **[May 16 (5 Marks)]**
48. What is the meaning and purposes of sampling. Explain in the light of SA 530 "Audit Sampling". **[Nov. 06 (8 Marks)]**
49. Write short note on: Statistical and Non-Statistical Sampling. Or Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. Discuss explaining Statistical and Non-Statistical sampling approaches. **[RTP-May 18]**
50. Write short note on: Advantages of Statistical Sampling. **[Nov. 11, May 14 (4 Marks)]**

51. "The auditor is faced with sampling risk in both tests of control and substantive procedures". Comment on this statement with reference to SA 530 on Audit Sampling. **[Nov. 10 (8 Marks)]**

Or

52. While planning the audit of S Ltd, you want to apply sampling techniques. What are the risk factors you should keep in mind. **[RTP-Nov. 18, MTP-April 19]**

Or

53. "Sampling risk can lead to erroneous conclusion". Justify. **[May 19 (4 Marks)]**
54. Discuss the following: As per SA 530, meaning of audit sampling, sample design, sample size and selection of items for testing. **[Nov. 13 (5 Marks)]**

Or

55. Discuss the following: With reference to SA 530, meaning of audit sampling and requirements relating to sample design, sample size and selection of items for testing. **[May 16 (5 Marks)]**
56. Write short note on: Stratified sampling**. [May 11 (5 Marks)]**
57. XYZ Ltd is engaged in trading of electronic goods and having huge accounts receivables. For analysing the whole accounts receivables, auditor wanted to use sampling technique. In considering the characteristics of the population from which the sample will be drawn, the auditor determines that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques. Advise the auditor in accordance with SA 530. **[RTP-May 18, MTP-Oct. 19]**
58. Discuss the following: 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. Explain Stating the examples of factors that the auditor may consider when determining the sample size for tests of controls. **[MTP-March 18]**

Or

59. The sample size can be determined by the application of a statistically based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen. Explain Stating the examples of factors that the auditor may consider when determining the sample size for tests of controls. **[MTP-Oct. 18]**
60. Discuss the following: Factors that should be considered for deciding upon the extent of checking on a sampling plan. **[Nov. 18 (5 Marks)]**

Or

61. Discuss the factors that should be considered for deciding upon the extent of checking on a sampling plan. **[RTP-May 19]**
62. Write short note on: Random Sampling. **[May 12, May 15 (4 Marks), May 17 (6 Marks)]**
63. Write short note on: Haphazard sampling. **[Nov. 17 (4 Marks)]**
64. The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement. Explain. **[RTP-May 19]**

Or

65. 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. Explain. **[RTP-May 20]**
66. Define Analytical Procedures.

Or

67. Explain what do you mean by Analytical procedures. How such procedures are helpful in auditing. Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis. Analyse and Explain stating clearly the meaning of analytical procedures. **[RTP-Nov. 19]**
68. Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Explain stating the purpose of analytical procedures. **[RTP-May 18]**
69. Use of substantive Analytical Procedures requires consideration of many factors. Explain those factors.
70. When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions. Explain the other relevant points in this context. **[RTP-May 20]**
71. What are the factors that determine the extent of reliance that the auditor places on results of analytical procedures? Explain with reference to SA-520 on "Analytical procedures".

or

72. What are the considerations to be kept in mind while performing analytical procedures on data prepared by the client?

or

73. The reliability of data in influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, what are the relevant criteria which determine whether the data is reliable for the purposes of designing substantive analytical procedures?

or

74. CA A, auditor of ABC Ltd. wants to design substantive analytical procedure and for that he wants to check whether the data is reliable or not. Mention the relevant points which he has to consider whether data is reliable for purpose of designing the substantive analytical procedures. [Nov. 19 (3 Marks)]
75. Explain the techniques available while applying SAP. [RTP-May 19]

or

76. 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). Explain stating the techniques available as substantive analytical procedures. [RTP-May 18, MTP-Oct. 19]

or

77. Discuss the techniques available as substantive analytical procedures. [May 18 (5 Marks)]

or

78. The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Explain clearly stating the techniques available as substantive analytical procedures. [MTP-Aug. 18]
79. If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, explain how would the auditor investigate such differences. [RTP-May 19]
80. Fashion Garments Limited (FGL) is a company engaged in the manufacturing and sale of ready-made garments. The products manufactured by FGL cater to clothing requirements of men, women and kids section. Pearl & Associated, Chartered Accountants, is the statutory auditor of FGL. Partner CA Pearl asked her audit assistant to go through the segment information disclosed and presented in the financial statements, Assistant is new to the audit engagements and seeks her guidance on what is the key responsibility of the auditor in relation to segment information,
    a. what should CA Pearl guide the assistant on the said matter? **[Jan 25 – 2 marks]**
    b. What audit procedures should CA Pearl perform to ensure that methods used by the management to present segment information are in accordance with the applicable (financial reporting framework)? **[Jan 25 – 3 marks]**
81. FRP & Associates are the statutory auditors of Paint Private Limited. Company is into the business of trading and has operations across India. CA M, partner in charge of the audit, is carrying out the audit procedures with his audit team. He entrusted CA Ravi, one of the team members, the task of obtaining various audit evidences connected with the audit and submit the same to the engagement partner for

finalizing the audit report. How can CA M ensure that the evidences collected by CA Ravi during the audit will be sufficient for the purpose of audit or not? **[Jan 25 – 4 marks]**

82. POR & Co., Chartered Accountants, has been appointed as statutory auditor of MGM Ltd. The financial statements of the company have material amount outstanding as debtors. Ageing of debtors is being done by the internal auditors and is given by them in their monthly report. This issue was also discussed with the management. The engagement partner from PQR & Co. decided to give the age wise debtors as per the report of internal auditor due shortage of time. After the audit report was released, the engagement partner realized that the disclosure of the debtors is misleading and the ageing was not done by the. internal auditor on correct principles due to which the provision made against old debtors was wrong. The engagement partner held the internal auditor responsible for this. Is he correct in making statement that the internal auditor is responsible for false provisioning? What considerations PQR & Co. should have undertaken before relying on the work of internal auditor? **[Jan 25 – 5 marks]**
83. Explain the various factors affecting the auditor's judgments as to the sufficiency of the audit evidence.
84. What is the objective of the auditor with respect to the opening balances when conducting an initial audit engagement as per the relevant SA? **[RTP May 23]**
85. CA Kanika audited books of accounts of Engineering Ltd. for the financial year 2022-2023. The auditor used an audit procedure according to which all the documents and records maintained by the company were checked in detail to obtain audit evidence. Explain the audit procedure used by the auditor. Comment on reliability of audit evidence obtained by performing such an audit procedure in some situations. **[RTP May 24]**
86. CA J is conducting statutory audit of Gemini Ltd engaged in manufacturing of pharma products. The company is fairly large one and has a well-functioning internal audit department. While considering sending out external confirmation requests to trade receivables outstanding as on date of financial statements, CA J has delegated the process of choosing trade receivables, designing requests and receiving responses from customers to internal audit department. The responses are also received on the mail id of internal audit department. Is the approach of CA J proper? **[RTP May 24]**
87. The newly appointed auditor of BTN Limited wants to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements. What audit procedures should he perform for this purpose? **[RTP May 24]**
88. SPR Ltd has been into the media business since 2001. During the F.Y 2022-2023, many notices were received by the company for hurting public sentiments and financial claims were filed against the company. As an auditor of the company, you requested the management for arranging the meeting

with company's external legal counsel. Management is of the view that such meetings are necessary in certain circumstances only. Can you list down such circumstances? **[RTP May 24]**

89. Quality Products Limited is engaged in manufacturing of bicycles. As part of manufacturing activities, it sends raw material to some business entities and procures finished components from them. As on 31st March 2024 inventories lying with such business entities are material. Being statutory auditor of Quality Products Limited, how you will obtain sufficient appropriate audit evidence regarding existence and condition of inventories lying with such business entities? **[RTP Sep 24]**

90. CA Mukul is the external auditor of Beige Ltd., a large company, engaged in the manufacturing of fast-moving consumer (FMCG) goods. After assessing the internal audit function of the company, CA Mukul decided to use the internal auditor of the company to provide direct assistance. In this context, what is meant by direct assistance under relevant Standard on Auditing? Also comment whether prior to using internal auditor for direct assistance for the purpose of audit, CA Mukul is required to obtain any written agreements or not. Give examples of procedures in which CA Mukul shall not use an internal auditor to provide direct assistance. **[RTP Jan 25]**

SPACE FOR ADDITIONAL NOTES

CHAPTER 5 – AUDIT OF ITEMS OF FINANCIAL STATEMENTS

DEFINITION OF ASSERTION

It refers to the representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.

CLASSIFICATION OF ASSERTIONS

INCOME STATEMENT CAPTIONS

1. **Occurrence** – transactions and events that have been recorded have occurred and pertain to the entity.
2. **Completeness** – all transactions and events that should have been recorded have been recorded.
3. **Accuracy** – amounts and other data relating to recorded transactions and events have been recorded
4. appropriately.
5. **Cut-off**– transactions and events have been recorded in the correct accounting period.
6. **Classification** – transactions and events have been recorded in the proper accounts.
7. **Presentation & Disclosure** - events, transactions, and other matters have occurred and pertain to the entity, complete, understandable, valued properly

BALANCE SHEET CAPTIONS

1. **Existence** – assets, liabilities, and equity interests exist.
2. **Rights and obligations** – the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
3. **Cut off & Completeness** – all assets, liabilities and equity interests that should have been recorded have been recorded and recorded in the correct period.
4. **Valuation and allocation** – assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.
5. **Presentation & disclosure** – Whether particular items in the financial statements are properly classified, described & disclosed.

The above assertions can be achieved by performing the below mentioned procedures –

1. Inquiry
2. Inspection
3. Observation
4. Recalculation – checking the mathematical accuracy of documents or records
5. Reperformance – auditor's independent execution of procedures or controls
6. External Confirmation
7. Analytical procedure

I^2OR^2EA

SHARE CAPITAL

General Audit procedures

1. Tally the **period-end share capital balance** authorised, issued and paid up to the previous year audited financial statements.
2. In case there is no change during the year, **obtain a written confirmation/ representation** from the Company Secretary that there were no changes to the entity's capital structure during the year.
3. In case there is any change, verify whether the paid up **capital** as at the period-end is **within the limits of authorised capital**. Authorised capital should be verified by examining MOA.
4. Obtain the certified copies of **relevant resolutions** passed at the meetings of board of directors, shareholders authorising the increase/ decrease in authorised share capital, if required, or paid up share capital.
5. In case of **Fresh issue made** in the current year, check with compliance of Companies Act 2013 with regard to
    - Return of Allotment,
    - Minimum Subscription,
    - Minimum application money to be collected,
    - Maintenance of separate Bank account,
    - Payment of underwriting commission as per Sec 40 etc.
    - No shares have been issued at Discount (Sec. 53 of Companies Act)
    - Check if Shares are issued for cash or for Consideration other than cash . (Eg: To promoters for their services, underwriters for commission payable to them etc.)
    - Compliance with SEBI regulations and Guidelines.
    - Also, obtain and verify copies of forms filed with Ministry of Corporate Affairs (MCA)

6. In case there was an increase in share capital, verify whether the Company has accurately calculated the **required fee and stamp duty payable** to MCA.

Shares Issued at Premium

1. Compliance of **section 52** of The Companies Act, 2013.
2. whether the premium received on shares, if any, has been **transferred to a "securities premium account"** and
3. whether the **application of any amount** out of the said "securities premium account" is only for the purposes mentioned above.

Past Examination Questions

The securities premium account may only 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. Comment. **(SA, May 2019, 3 Marks)**

"Sec. 52 of the Companies Act states that Security Premium Account can be applied by the Company for one of the purposes mentioned below. Which of the following is a CORRECT option?

(a) To adjust loss on revaluation of Assets
(b) To pay dividend to equity shareholders
(c) Providing for the premium payable on redemption of Preference shares
(d) To use it as working capital for its business." **(MTP1, Nov 2021, 2 marks)**

Shares Issued at Discount

1. Compliance of **section 53** of The Companies Act, 2013.
2. Auditor needs to check:
   a. The **movement in share capital** during the year and wherever there is any issue,
   b. They should verify that the Company has not issued any of its shares at a discount **by reading the minutes of meeting** of its directors and shareholders authorising issue of share capital and the issue price.
   c. Further, auditor should also verify that whether the company has **issued shares at a discount to its creditors** when its debt is converted into shares in pursuance of any **statutory resolution plan or debt restructuring scheme** in accordance with any guidelines or

directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

Past Examination Questions

Any share issued by a company at a discounted price shall be void. Explain also the audit procedure in this regard. **(MTP1, May 2019, 3 Marks)**

OR

Validity and consequence of issue of shares at discount, check with respect to the provisions of the Companies Act, 2013. **(SA, Nov 2019, 4 Marks)**

OR

While conducting audit of Air Space Ltd, the auditor observes that it has issued shares at discount to its creditors when its debt is converted into shares in pursuance of debt restructuring scheme in accordance with any guidelines specified by the Reserve Bank of India. Discuss clearly the provisions relating to discount on issue of shares and its verification by the auditor. **(RTP, May 2022, NA)**

According to Section 53 of the Companies Act, 2013, a company can issue shares at a discount. **(RTP, Nov 2019, NA)**

Issue of Sweat Equity Shares

1. Compliance of **sec 54** of The Companies Act, 2013.
2. Whether the fresh issue of shares was a **rights issue or a preferential issue**.
3. Whether the **relevant requirements** for issue of share capital as per provisions of Companies Act, 2013 have been complied with.

What audit points are to be borne in mind in case of issue of "Sweat Equity Shares" by a limited company? **(MTP1, Nov 2019, 3 marks)**

Reduction of Capital

The auditor shall undertake the following audit procedures:

1. Verify that the meeting of the shareholders held to pass the **special resolution** was properly convened and that the proposal was circularised in advance to all the shareholders;
2. Verify that the **Articles of Association** authorises reduction of capital;

3. Examine that there has been **no default w.r.t repayment of deposits accepted** by company or payment of interest on such deposits. Reduction of capital shall not be affected if such default exists.
4. Examine the **order of the Tribunal confirming the reduction** and verify that a copy of the order and the minutes have been registered and filed with the Registrar of Companies;
5. Check the **Registrar's Certificate** as regards to reduction of capital;
6. Vouch the **accounting entries recorded to reduce the capital** and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also check whether the requirements of Schedule III, Part I, have been complied with in relation to presentation;
7. Confirm whether the **revaluation of assets has been properly disclosed** in the Balance Sheet;
8. The company may reduce the capital by reduction in unpaid capital or cancellation of lost capital or paying off excess paid up capital**. Verify the adjustment made in the members' accounts in the Register of Members** and confirm that either the paid-up amount shown on the old share certificates has been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled;
9. Confirm that the **words "and reduced",** if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.
10. Check if the company has **complied with all the terms and conditions** imposed by the tribunal while confirming reduction of share capital.
11. Verify that the **Memorandum of Association** of the company has been suitably amended.

BNP Ltd has reduced its Share Capital to a greater extent in the year for which you are conducting the audit. State how will you proceed for verifying the reduction of Capital. **(MTP1, Nov 2020, 6 Marks)**

Disclosure requirements of Schedule III

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

a. The **number and amount** of shares authorised;
b. The **number of shares issued**, subscribed and fully paid, and subscribed but not fully paid;
c. **Par value** per share;
d. A **reconciliation** of the number of shares outstanding at the beginning and at the end of the reporting period;
e. The **rights, preferences and restrictions** attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;

f. Shares in respect of each class in the company **held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates** of the holding company or the ultimate holding company in aggregate;

g. Shares in the company held by each **shareholder holding more than 5 per cent shares** specifying the number of shares held;

h. **Shares reserved for issue under options and contracts**/commitments for the sale of shares/disinvestment, including the terms and amounts;

i. For the period of five years immediately preceding the date as at which the Balance Sheet is prepared:
   i. Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.
   ii. Aggregate number and class of shares allotted as fully paid up by way of bonus shares.
   iii. Aggregate number and class of shares bought back.

j. **Terms of any securities convertible** into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date.

k. **Calls unpaid** (showing aggregate value of calls unpaid by directors and officers)

l. **Forfeited shares** (amount originally paid up)

m. A company shall disclose **Shareholding of Promoters** as below:
   a. S.no
   b. Promoter Name
   c. No. of Shares
   d. % of Total Shares
   e. Change during the year

Explain the disclosure requirements of IND AS compliant Schedule III to Companies Act, 2013 for each component of "Other Equity." **(SA, Nov 2019, 3 Marks)**

Amount Loaned or Received For Indirect Investment etc.

a. Where a company has given funds indirectly,
   i. **Date and amount** of fund advanced or loaned or invested in Intermediaries with complete **details of each Intermediary**.
   ii. **Date and amount** of fund further advanced or loaned or invested by such Intermediaries to other intermediaries or Ultimate Beneficiaries along with complete **details of the ultimate beneficiaries**.

iii. **Date and amount** of guarantee, security or the like provided to or on **behalf of the Ultimate Beneficiaries**

iv. Declaration that relevant **provisions of the Foreign Exchange Management Act**, 1999 (42 of 1999) **and Companies Act has been complied** with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002 (15 of 2003).;

b. Where a **company has received funds**,

i. Date and amount of fund **received from Funding parties** with complete details of each Funding party.

ii. **Date and amount** of fund further advanced or loaned or **invested by other intermediaries or Ultimate**

iii. **Beneficiaries** along with complete details of the other intermediaries or ultimate beneficiaries.

iv. Date and amount of **guarantee**, security or the like provided to or on behalf of the Ultimate Beneficiaries

v. Declaration that relevant provisions of the Foreign Exchange Management Act, 1999 (42 of 1999) and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002 (15 of 2003).

RESERVES AND SURPLUS

1. The reserves can be segregated as revenue or capital reserves.
2. **Revenue reserves** represent profits that are available for distribution to shareholders or below purposes such as:
   a. To supplement divisible profits in lean years,
   b. To finance an extension of business,
   c. To expand the working capital of the business or
   d. To generally strengthen the company's financial position.
3. **Capital Reserve** represents a reserve which does not include any amount regarded as free for distribution. They can be utilised only for certain limited purposes.
4. Capital Reserve is **created from capital profits** earned through sale of capital assets such as sale of fixed assets, profit on sale of shares.
5. A capital reserve, generally, can be **utilised for writing down fictitious assets or losses** or (subject to provisions in the Articles) for issuing bonus shares if it is realised.
6. But the amount of securities premium or capital redemption reserve account can be utilised only for the purposes specified in **Sections 52 and 55** of the Companies Act, 2013, respectively.
7. **Assertions to be Examined**

a. Existence
b. Completeness
c. Valuation
d. Presentation and disclosure

8. **Audit Procedures**:
   a. **Trace and tally the opening balance** of reserves and surplus to the previous year audited financial statements.
   b. For **addition/utilisation** in current year, in case of:
      i. **Profit and Loss balance** –
         - Trace the movement to surplus/ deficit as per the Statement of profit and loss for the year under audit.
         - The movement should be traced in the Statement of Changes in Equity.
         - Verify the resolution passed by the board of directors regarding the recommendation of dividend, resolution passed by shareholders declaring the dividend.
      ii. **Securities Premium** - It needs to be confirmed that the company has issued shares in excess of the nominal value of the shares and for the same, the auditor should obtain and verify the resolution passed by the board of directors. Auditor needs to ensure the usage of securities premium amount is as per Section 52 of Companies Act 2013)
9. **Disclosure requirements of Schedule III**:
   a. **Classification** of reserves
   b. A reserve specifically represented by **earmarked investments** shall be termed as a "fund".
   c. **Debit balance** of statement of **profit and loss** shall be shown as a **negative figure** under the head "Surplus".
   d. Similarly, the balance of "Reserves and Surplus", after adjusting the negative balance of surplus, if any, shall be shown under the head "Reserves and Surplus" even if the resulting figure is in the negative.

BORROWINGS

1. Audit Procedures to be followed are as follows:
   a. Review **board minutes for approval of new lending agreements**. During review, make sure that any new loan agreements or bond issuances are authorized.
   b. Ensure that significant **debt commitments** should be **approved by the board** of directors.
   c. Agree **details of loans recorded** such as interest rate, nature and repayment terms to the loan agreement. (NOTE - Checking completeness)

d. Verify that the loans obtained are **within the borrowing limits** of the entity.

e. Roll out and obtain **independent balance confirmations** (SA 505) in respect of all the borrowings from the lender (banks/ financial institutions etc.).

f. Agree **details of leases and hire purchase** creditors recorded to underlying contracts/agreements.

g. In case of Debentures, **examine trust deeds for terms** and dates of redemption borrowing restrictions and compliance with covenants.

h. When debt is **retired**, ensure that a **discharge is received on assets** securing the debt.

i. Obtain **Written Representation** that all the liabilities which have been recorded represent a valid claim by the lenders.

2. **Direct confirmation procedures**:

a. Ascertain that the confirmation asks for all **information likely to be relevant** to the tests of debt and related interest balances (e.g., applicable interest rates, due dates, collateral and security interests).

b. Send **reminders** for non-replies.

c. **Compare** the balances are per the confirmations obtained to the books of the accounts. Ask for reconciliations, if there are any differences and test the supporting documents for the reconciling items on a test check basis.

3. **Disclosure as per Schedule III**:

a. Ensure borrowings have been presented, classified and DISCLOSED in the financial statements in accordance with the requirements of applicable financial reporting framework i.e. Companies Act, 2013 and applicable Indian GAAP.

b. Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 are made for each amount disclosed under each of the following headings: Long- Term Borrowings & Short-Term Borrowings.

4. Disclosures related to borrowings in special cases:

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

i. whether quarterly returns or statements of current assets filed by the Company with banks or financial institutions are in agreement with the books of accounts.

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

b. **Wilful Defaulter**: Where a company is a declared wilful defaulter by any bank or financial institution or other lender, following details shall be given:
   i. Date of declaration as wilful defaulter
   ii. Details of defaults (amount and nature of defaults),

c. **Registration of charges or satisfaction with Registrar of Companies**: Where any charges or satisfaction yet to be registered with Registrar of Companies beyond the statutory period, details and reasons thereof shall be disclosed.

d. **Amount Loaned or Received for Indirect Investment etc**.: Disclose the following
   i. If Company has advanced / given / paid:
      - **date and amount** of fund advanced or loaned or invested in Intermediaries **with complete details of each Intermediary**.
      - **date and amount** of fund further advanced or loaned or invested by such Intermediaries to other intermediaries or Ultimate Beneficiaries along with **complete details of the ultimate beneficiaries**.
      - **date and amount of guarantee**, security or the like provided to or on behalf of the Ultimate Beneficiaries.
      - **declaration** that relevant **provisions** of the Foreign Exchange Management Act, 1999 and Companies Act **has been complied with** for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002.

Past Examination Question - (MTP1, May 2018, 5 Marks) (MTP2, Nov 2018, 5 Marks)

On going through the financial statements of PQR Ltd, its auditors Kamal Gagan and Associates observed that the company has taken Loans from banks and financial institutions. Further, the audit team discusses the following about Liabilities:

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

Verification of liabilities is as important as that of assets, for, if any liability is omitted (or understated) or over stated, the Balance Sheet would not show a true and fair view of the state of affairs of the company."

Advise stating clearly the audit procedures generally required to be undertaken for verification of existence of Borrowings.

TRADE RECEIVABLES

A. **It is important to carry out compliance procedures in the sales audit as part of the debtors' audit procedure. In summary, check to ensure that the system for receivables has the following features**:

1. Only **bona fide sales** lead to receivables
2. Sales are **made to approved customers**.
3. All such sales are **duly recorded** in the books
4. Once recorded, the **debts can only be eliminated by receipt of cash or on the authority of a responsible official**
5. Debts are **collected promptly**
6. Balances are **regularly reviewed and aged**, a proper system of follow up exists and if necessary **adequate provision** for bad debt exists
7. Clear **segregation of duties** relating to identification of debt, receipt of income, reconciliations and write off of debts.

B. For **VERIFICATION** of **EXISTENCE** of Trade Receivables, the auditor should check the following:

a. Check whether there are controls in place to ensure that
   i. invoices **cannot be recorded more than once** and
   ii. receivable **balances are automatically recorded** in the general ledger from the original invoice.
   iii. Ask for a **period-end accounts receivable ageing report** and trace the balance as per the report to the general ledger.

b. Check whether realization is recorded invoice-wise or not.
   i. If not, check that **money received from debtors** is **adjusted chronologically** invoice-wise and on FIFO basis i.e., previous bill is adjusted first.

c. If any **large balance is due for a long time**, auditor should ask for reasons and justification for the same.

d. A **list of trade receivables** selected for confirmation should be **given to the entity** for preparing request letters for confirmation which should be properly addressed.

e. The auditor should **maintain strict control** to ensure the **correctness** and proper **despatch** of request letters. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client.

f. Any **discrepancies revealed** by the confirmations received or by the additional tests carried out by the auditor **may have a bearing on other accounts** not included in the original sample.

g. Where no reply is received, the auditor should **perform alternative procedures** regarding the balances. This could include:

h. Agreeing the **balance to cash received subsequently**;

i. Preparing a **detailed analysis** of the balance, ensuring it consists of identifiable transaction and confirming that these revenue transactions actually occurred. (examination in depth for those balances)

j. If there are any **related party receivables**, review them for collectability as well as whether they were **properly authorized** and the value of such transactions were reasonable and at arm's length.

k. Check that receivables for other than sales or services are not included in the list.

l. Review a trend line of sales and accounts receivable, or a comparison of the two over time, to check if there are any unusual trends i.e., perform Analytical procedures. Make inquiries about reasons for changes in trends with the management and document the same in audit work papers.

C. All Trade receivable balances that were supposed to be recorded have been recognized in the financial statements. (COMPLETENESS)

a. The auditor needs to satisfy himself of the **cut-offs**. Without a cut-off, sales could be understated or overstated.

b. Test **invoices listed** in the receivable report.

c. Sales are being **recorded** in the **correct accounting period**.

d. Examine **supporting documentation** to determine whether a sale has actually taken place or not.

e. Check if the Company has **recorded an inordinately large amount of customer returns** after the audit period.

f. Review the **process of giving discounts**/ incentives and check whether the same were given as per the Company's policy/ general industry trends.

g. Review **credit memos**, on a sample basis, issued during the audit period to see if they were properly authorized.

D. Trade receivable balances have been VALUED appropriately

a. Review the **process** followed by the Company **to derive an allowance** for doubtful accounts.

b. Check if provisions are made at appropriate rates.

c. Obtain the **ageing report of accounts receivable** ,

d. Obtain the list of debtors under litigation and compare with previous year.

e. Identify those debtors which appear doubtful & discuss with the mgt.

f. Check that write-offs of the receivable balances have been approved by an appropriate authority.

E. **Required DISCLOSURE for trade receivables have been appropriately made.**

a. Check that the **restatement of foreign currency trade receivables** has been done properly in accordance with AS 11.

b. Proper disclosure of **Related Party Transactions**. regarding receivables have been made as per AS 18 or IND AS 24.

c. Ensure that the transactions with parties covered under Section 189 of the Companies Act, 2013 are **reported properly in Companies Auditors' Report Order (CARO),2020.**

d. Ensure whether the **following disclosures** as required under Schedule III (Part 1) to Companies Act, 2013 are made for each amount disclosed under the heading "Trade Receivables".

i. Trade Receivables ageing schedule

ii. Sub classification of trade receivables

iii. Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

iv. Debts due by directors / other officers / firms / private companies in which director is a partner or a director.

Particulars	Outstanding for following periods from due date of payment				
	Less than 6 Months	6 Months to 1 year	1-2 years	More than 3 years	Total
Undisputed Trade receivables considered good					
Undisputed Trade Receivables considered doubtful					
Disputed Trade Receivables considered good					
Disputed Trade Receivables considered doubtful					

A. **To establish the EXISTENCE of cash and cash equivalent balances as at the period- end**:

a. **Check by Surprise** – 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.

b. If there are **more than one cash balances** all of them should be checked simultaneously.

c. 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.

B. **COMPLETENESS – Cash and cash equivalent balances that were supposed to be recorded have been recorded in the financial statements**.

a. Test entries from the **rough Cash Book** with those in the Cash Book to prove that entries in the Cash Book are correct.

b. If the auditor finds **any slip, chit or I.O.U.s** (I owe you) in respect of temporary advances paid to the employees included as part of the cash balance, he should check whether those are approved by an authorized official and recorded in the appropriate accounts.

c. The auditor should also perform a **cash sensitivity analysis.**

d. Obtain **bank reconciliation statements** (BRS) for all bank accounts.

e. Ensure that BRS is **signed by the authorized personnel** so that he is able to assign responsibility in case of any errors.

C. **Direct confirmation procedure**:

a. **Contact** banks/ financial institutions **directly** and ask them to **confirm the amounts** held in current accounts, deposit accounts, etc as of the end of the reporting period under audit.

b. **Investigate and reconcile the discrepancies**, if any, including seeking written explanations/ clarifications from the banks/ financial institutions on any unresolved queries.

c. The auditor should **emphasize for confirmation of 100%** of bank account balances.

d. In **remote situations**, where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include

i. Agreeing the balance to bank statement received by the Company or internet/ **online login** to account in auditor's personal presence;

ii. **Sending** the audit **team member to the bank branch** along with the entity's personal to obtain balance confirmation from the bank directly.

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, EEFC account, cash credit accounts, etc. as at the end of the reporting period under audit. Explain the audit procedure in this context.

(RTP, Nov 2020, NA)

D. Cash and cash equivalent balances have been VALUED appropriately

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.

E. **Required DISCLOSURES for cash and cash equivalents have been appropriately made**.

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

How is "Cash and cash equivalents" disclosed in the Financial Statements as required under Schedule III (part 1) to Companies Act, 2013? **(SA, Dec 2021, 3 Marks)**

INVENTORIES

A. To establish the EXISTENCE of Inventories as at the period- end.

a. Review **entity's plan** for performing inventory count.
b. Ensure that consigned **goods have been segregated**.
c. Auditor should **participate in the inventory count** with the management.
d. **Test counts** of inventory by auditor should include observation, adherence to policies, exclusion of third-party stock and damaged or obsolete stock etc.
e. When the entity uses a periodic **system for inventory count**, it should be undertaken at the end of the period. If the entity uses a perpetual system with proper and adequate records, inventory may be counted at interim dates.

f. Confirm or investigate any **inventory lying with a third party** (specifically relevant for cases where the entity gets job work done in its process of production).

B. **Rights & Obligations**:

a. Perform **analytical procedures** (comparison tests with industry averages, budgets, prior years, trend analysis, etc.).
b. Perform purchase and sales **cut-off tests**.
c. With respect to tagged inventory, perform **tests for omitted transactions** and tests for invalid transactions.
d. Verify the **clerical and arithmetical accuracy** of inventory listings.
e. **Reconcile p**hysical inventory amounts with perpetual records.
f. Reconcile physical counts with **general ledger control totals**.
g. Reconcile **inventories which belong to client but are held with third parties** like transporters, warehouses, port authorities etc.
h. Goods **received on consignment basis have been properly segregated** from other items of inventory.

C. **Inventories have been VALUED appropriately and as per generally accepted accounting policies and practices**:

a. The management may value inventory using First-in-first-out (FIFO) or weighted average basis. Consider the reasonableness of the method adopted.
b. For **Raw materials and consumables** –
    i. elements of cost
    ii. standard costs
    iii. cost prices used with purchase invoices
    iv. valuation of all damaged or obsolete inventories
c. For **Work in progress**
    i. Ascertain how the various stages of production/ value additions are measured and in case estimates are made, understand the basis for such estimates.
    ii. Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included.
d. For **Finished goods and goods for resale**:
    i. Enquire as to what costs are included

ii. Ensure AS 2 is followed
iii. Follow up for items that are obsolete, damaged, slow moving and ascertain the possible realizable value of such items
iv. Request the client to provide inventory ageing split.
v. Follow up any inventories which at time of observance of physical counting were noted as being damaged or obsolete.
vi. Calculate inventory turnover ratio.
vii. Test overhead allocation rates and ensure that only direct labor, direct material and overhead have been included.

Goods Lying with Third Party: The auditor should check that the materiality of the item under this caption is included in inventories.

i. He should **obtain confirmation** of the amount of goods lying with them.
ii. He should inquire into the **necessity** of sub-contractor retaining the inventory.
iii. The goods lying with them for a very long period would merit auditors' special **attention for making provision**.
iv. The records, voucher/slips for the **regulating the movement of inventory** into and out of entity for sub-contracting work be reviewed by vouching for few transactions for ensuring existence and working of internal control system for them.
v. The **valuation** of inventories should be correctly made for including material cost on appropriate inventory valuation formulae and also for inclusion of proportionate processing charges for the work in process with the contractors.
vi. Evaluate the **condition of goods** and see whether adequate provision has been made.
vii. Check whether subsequently the goods lying with third party were **sold or received back after the expiry** of the stipulated time period.
viii. Ensure that the goods have been **included in the closing inventory** though lying with a third party.

Management of Z Ltd. wants to include all the cost incurred by the Company in valuing the cost of its inventories. The Accountants, however, of the view that certain costs should be excluded from the cost of inventories and should be recognised as expenses for the period in which they are incurred. What are such costs that should be excluded while determining the cost of inventories?

(MTP2, Nov 2021, 4 marks)

While conducting an audit of Vee Ltd, CA Aman, auditor of the company, found that some goods were lying with third parties for a long period. Advise Aman how he will verify them.

(MTP1, Nov 2021, 4 marks)

"ABC Limited has a closing balance of work in progress of inventories aggregating Rs 850 lakhs in their balance sheet as at March 31, 2020.

As Statutory Auditor of ABC Limited, explain various audit procedures which need to be performed to confirm Work-in-progress of inventories have been valued appropriately and as per generally accepted accounting policies and practices."

(SA, Jan 2021, 3 marks)

D. **Required DISCLOSURES for inventories have been appropriately made**:

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

b. Whether inventory has been classified as:

i. Raw materials

ii. Work-in-progress

iii. Finished goods

iv. Stock-in-trade (goods acquired for trading)

v. Stores and spares

vi. Loose tools Others (specify nature).

vii. Whether goods-in-transit have been disclosed separately under each sub-head of inventories. Mode of valuation shall be stated.

LAND, BUILDING, PLANT & EQUIPMENT, FURNITURE & FIXTURES, VEHICLES, OFFICE EQUIPMENT, COMPUTERS ETC. REFERRED TO AS "PROPERTY, PLANT AND EQUIPMENT" ("PPE")

I. **To establish the EXISTENCE of PPE as at the period-end**:

a. Review entity's plan for performing physical verification of PPE.

b. Evidence of appropriate supervision of those performing physical verification of PPE should be examined.

c. Obtain PPE physical verification report backed by the working sheets & verify tagging, reconciliation & discrepancy.

d. Additions to PPE during the period under audit have been recorded in the financial statements.

i. Tally the opening balances to the previous year audited financial statements.

ii. Verify the movement in the PPE schedule compiled by the management.

iii. Check the arithmetical accuracy
iv. Obtain a listing of all additions
v. Verify expenditure meets AS 10 criteria.
vi. Entity is not recognizing costs of the day-to-day servicing in the carrying amount. Verify the same.
vii. Test the purchase invoice, installation certificate or report or other similar documentation
viii. Additions have been approved by authorized personnel
ix. Proper internal processes and procedures like inviting competitive quotations/ floating tenders etc. were followed prior to finalising the vendor.
x. In relation to deletions to PPE, understand from the management the reason and rationale for deletion & the manner of disposal.
xi. Verify the process followed for sale of discarded PPE.
xii. Verify that the management has accurately recorded the deletion, profit or loss on disposal of PPE

The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Plant and Equipment) purchase invoices are in the name of the entity he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor. **(RTP, May 2018, NA) (RTP, Nov 2019, NA) (MTP1, Nov 2019, 3 Marks)**

2. **RIGHTS AND OBLIGATIONS – The entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements**:
   a. Verify that **purchase invoices are in the name of the entity** that entitles legal title of ownership to the respective entity.
   b. For all additions to **land and building** in particular, the auditor should check the **conveyance deed/ sale deed**.
   c. In case the entity has given such **immovable property as security for any borrowings** and the original title deeds are not available with the entity, the auditor should request the entity's management for **obtaining a confirmation from the respective lenders.**
   d. The auditor should also **verify the register of charges**, available with the entity to assess that any charge has been created against the PPE.

CA R is the statutory auditor of QRS Ltd. While performing testing of additions during the year, he wanted to verify that:

i. All PPE (property, plant and equipment) are in the name of the entity he is auditing.
ii. For all additions to land and building in particular, the auditor desires to have concrete evidence about the ownership.
iii. The auditor wants to know whether the entity has valid legal ownership rights over the PPE, where it is kept as security for any borrowings.

Advise the auditor on the audit procedure to be undertaken by him to establish the Rights and Obligations of the entity over the PPE. **(SA, Dec 2021, 4 Marks)**

3. **Required DISCLOSURES for PPE have been appropriately made**: Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made under the heading "Property, Plant and Equipment"
   a. **Classification** shall be given as: Land, Buildings, Plant & equipment, Furniture & Fittings, Vehicles, Office equipment, others (specify nature)
   b. **Assets under lease** shall be **separately specified** under each class of asset.
   c. A **reconciliation** of the gross and net carrying amounts shall be disclosed separately.
   d. Where **sums have been written-off** on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, **every balance sheet** subsequent **shall show the reduced or increased figures** as applicable and shall by way of a note **also show the amount of the reduction or increase** as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.
   e. For each class of Property, Plant and Equipment
      i. Opening balance of gross carrying amount
      ii. Additions
      iii. Acquisitions through business combinations, Disposals through demergers other adjustments Borrowing costs capitalized Closing balance of gross carrying amount.
   f. For each class of property, plant and equipment, whether the entity has disclosed:
      i. Opening accumulated depreciation
      ii. Charge for the year
      iii. Deduction/ other adjustments for depreciation
      iv. Closing accumulated depreciation

Depreciation details

   g. For each class of property, plant and equipment, whether the entity has disclosed:

i. Opening accumulated impairment losses
ii. Impairment losses
iii. Impairment reversals
iv. Closing accumulated impairment losses

Impairment details

NOTE:

a. **Title deeds of Immovable Property not held in name of the Company**: The company shall provide the details of all the immovable property se title deeds are not held in the name of the company in format given below and where such immovable property is jointly held with others, details are required to be given to the extent of the company's share.

Relevant line item in the Balance sheet	Description of item of property	Gross carrying value	Title deeds held in the name of	Whether title deed holder is a promoter, director or relative of promoter / director or employee of promoter/director	Property held since which date	Reason for not being held in the name of the company (Also indicate the dispute if any)

b. **Where the Company has revalued its Property, Plant and Equipment** - the company shall disclose as to whether the revaluation is based on the valuation by a registered valuer as defined under rule 2 of the Companies (Registered Valuers and Valuation) Rules, 2017.

c. **Capital-Work-in Progress (CWIP)** –
   (i) Ageing schedule shall be given.
   (ii) Whose completion is overdue or has exceeded its cost compared to its original plan, completion schedule shall be given.

INTANGIBLE ASSETS

1. To establish the EXISTENCE of intangible fixed assets as at the period- end:

a. Verify whether such intangible asset is in **active use** in the production or supply of goods or services, for rental to others or for administrative purposes.

b. **Not in active use**, deletion should have been **recorded** in the books of account post **approvals** by the entity's management and amortization charge should have ceased beyond the date of deletion.

c. **Additions** to Intangible assets during the period:

   i. Check the **movement** in the intangible assets schedule.

   ii. Check the **arithmetical accuracy**.

   iii. Obtain a **listing** of all additions from the management.

   iv. Verify whether such expenditure **meets the criterion** for recognition of an intangible asset as per AS 26.

   v. **Cost related to research** should not get recognized as an intangible asset.

   vi. Check the **certificate or report or other similar documentation** for date of commencement.

   vii. Verify whether **proper internal processes** and procedures like inviting competitive quotations/ proper tenders etc. were followed prior to finalizing the vendor.

d. In relation to **deletions** of intangible assets:

   i. Reason and rationale for deletion and the manner of disposal.

   ii. Obtain the management approval and disposal note authoring disposal.

   iii. Verify the process followed for sale of discarded asset.

   iv. Management has accurately recorded the deletion of intangible asset.

2. VALUATION of Intangible assets:

a. value may diminish due to efflux of time, use and/ or obsolescence

b. The auditor should:

   i. Verify that the entity has charged amortization on all intangible assets;

   ii. Verify that the amortization method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

   iii. The auditor should also verify whether the management has done an impairment assessment. Verify whether the entity has applied AS 28 - Impairment of Assets.

3. **RIGHTS AND OBLIGATION – valid legal ownership rights over the Intangible Assets**:

a. verify that all expense invoices/ purchase contracts are in the name of the entity that entitles legal title of ownership to the entity.

While auditing the books of accounts of QHMP Ltd., CA. Ranker, the statutory auditor of the company, came to know that the management of the company has recognized internally generated goodwill as a fixed asset. CA. Ranker discussed with the management that according to accounting standards, internally

generated goodwill is not recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost. However, the management is quite rigid to the accounting treatment followed for internally generated goodwill and not paying attention to the auditor. Thus, through an example, CA. Ranker explained which type of goodwill may be recognized as a fixed asset for which the management got justified. State which of the following examples the auditor must have given to the management?

a. If an item meeting the definition of an intangible asset is acquired in a business combination, it forms part of the goodwill to be recognized at the date of the amalgamation.
b. Only those goodwill needs to be recognized as a fixed asset which can be touched like physical assets, for example, land and buildings.
c. Goodwill is recognised only when there is a contractual or other legal rights for a physical asset which shall not be amortized over the period.
d. All of the above. **(RTP, May 2019, NA)**

Explain with examples the audit procedure to establish the existence of intangible fixed assets as at the period- end. **(RTP, Nov 2018, NA) (MTP2, May 2019, 3 Marks) (RTP, Nov 2019, NA)**

You are an auditor of PQR Ltd. which has spent Rs 10 lakhs on Research activities of the product during period under audit. Board of Directors want to recognize it as an internally generated intangible asset. Advise and discuss the conditions necessary to be fulfilled to recognize the intangible assets in the financial statements. **(SA, May 2019, 4 Marks) (MTP1, May 2021, 4 marks)**

OR

You are an auditor of PQR Ltd. which has spent Rs 50 lakhs on Research activities of the product during period under audit, Board of Directors want to recognize it as an internally generated intangible asset. Advise and discuss the conditions necessary to be fulfilled to recognize the intangible assets in the financial statements. **(MTP1, Nov 2020, 3 Marks)**

The value of intangible assets may diminish due to efflux of time, use and/or obsolescence. The domination of the value represents cost to the entity for earning revenue during a given period. Discuss the audit procedures to be applied by the auditor to ensure that intangible assets have been valued appropriately and as per generally accepted accounting policies and practices. **(SA, July 2021, 3 Marks)**

Correct/Incorrect: Computer software which is the integral part of the related hardware should be treated as fixed asset/tangible asset **(RTP, Nov 2021, NA)**

4. **DISCLOSURES – for Intangible Assets have been appropriately made**: Disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made under the heading "Intangible Assets":
    a. **Classification** shall be given.
    b. A **reconciliation** of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period.
    c. Where **sums have been written-off** on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, **every balance sheet** subsequent to date of such write-off, or addition **shall show the reduced or increased figures** as applicable.
    d. For each class of intangible asset
        i. Opening balance of gross carrying amount
        ii. Additions
        iii. Disposals
        iv. Impairments
        v. Other adjustments.
    e. For each class of intangible assets
        i. Opening accumulated amortization
        ii. Charge for the year 0 Deduction/ other adjustments for amortization
        iii. Closing accumulated amortization
    f. Intangible assets under development:
        i. Ageing schedule shall be given
        ii. Intangible assets under development, whose completion is overdue or has exceeded its cost completion schedule shall be given.

TRADE PAYABLES AND OTHER CURRENT LIABILITIES

1. **To establish the EXISTENCE of trade payables and other current liabilities as at the period-end**:
    a. Whether there are controls in place to ensure that **any purchase/ expense invoice does not get recorded more than once**.
    b. Obtain the accounts payable **ageing report** and trace its balances to the general ledger.
    c. **Direct confirmation procedure** for all significant account payable balances –
        i. **Contact vendors** directly/independently with the consent of the entity under audit and ask them to confirm the amounts of accounts payable.

ii. Where the **management requests** the auditor not to seek confirmation, consider whether there are valid grounds for such a request.
iii. The **date** should be decided by the auditor in consultation with the Company.
iv. The **method** of selection of the trade creditors should not be revealed to the Company.
v. A **list of trade creditors** selected for confirmation should be given to the entity for preparing request letters for confirmation which should be properly addressed.
vi. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client.
vii. Where **no reply is received**, the auditor should perform additional testing regarding the balances.
    a) Testing of **subsequent payments**.
    b) Agree the **details** of the respective balance **with vendor invoices**.
    c) Detailed **analysis** of the balance and confirming that **transactions actually occurred**.

d. If there are any **related party payables**, review whether they were properly authorized and the value of such transactions were reasonable and at arm's length.

2. **COMPLETENESS – Balances that were supposed to be recorded have been recognized**:
   a. The auditor needs to perform cut off procedures.
   b. Test purchases/ expenses on a sample basis and check their supporting documents.
   c. Match purchase invoice dates to the gate entry (inward) dates to check whether the purchases are being recorded in the correct accounting period.
   d. Review all material expense vouchers recorded post the balance sheet date to see if they relate to transactions from within the audit period.
   e. Statutory dues liability –
      i. Prepare a reasonability statement with respect to sales/purchases/ employee benefit expenses.
      ii. Provident Fund liability for last month may be calculated by applying the applicable rate and in case of any variance with the liability recorded by the entity, reasons for variance should be requested from client.
      iii. obtain and verify the challans for deposits made subsequent to the period-end also analyse the reasons for any variance.

iv. prepare a complete list of all statutory dues and consider his reporting requirements under CARO, 2020.

3. **VALUATION – Balances have been valued appropriately**:
   a. Review the process followed by the Company to identify if any old creditor balance/ liability needs to be written back.
   b. Obtain the ageing of payable balances.
   c. Also, obtain the list of vendors with whom the Company has disputes and any claims from customers, under litigation and compare with previous year.
   d. Check that the restatement of foreign currency trade payables has been done properly in accordance with AS.
   e. Liability balances assessed as no longer payable have been approved by an appropriate and authorised member.
   f. Understand management's process to identify the principal amount and the interest due thereon but unpaid to suppliers.

Verification of liabilities is as important as that of assets, considering if any liability is omitted (or understated) or overstated, the Balance Sheet would not show a true and fair view of the state of affairs of the entity. Explain stating also criteria for a liability to be classified as current liability.

(RTP, Nov 2018, NA) (MTP2, May 2019, 3 Marks)

Liabilities include trade payables and other current liabilities, deferred payment credits and provisions. Verification of liabilities is as important as that of assets, considering if any liability is omitted (or understated) or overstated, the Balance Sheet would not show a true and fair view of the state of affairs of the entity.

Advise stating clearly the audit procedure to establish the existence of trade payables and other current liabilities as at the period-end. **(MTP1, Nov 2018, 10 marks)**

4. **DISCLOSURES have been appropriately made**:
   a. Disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made.
   b. Whether the Company has **classified a payable as a trade payable** if it is in respect of the **amount due on account of goods sold or services** rendered in the normal course of business.
   c. Whether the Company has disclosed details relating to micro and small enterprises in the notes.
   d. Other Current Liabilities – Whether the amount disclosed under other current liabilities are classified.

- Interest accrued but not due on borrowings
- Interest accrued and due on borrowings
- Income received in advance
- Unpaid Dividends
- Application money received for allotment of securities and due for refund and interest accrued thereon.
- Unpaid matured deposits/debentures and interest accrued thereon
- Unpaid matured debentures and interest accrued thereon
- Others (specify nature)

LOANS AND ADVANCES AND OTHER CURRENT ASSETS

1. **EXISTENCE of loans and advances and other current assets**: direct confirmation procedures should be performed, the principal amount, interest receivable, if any, as per the agreed terms between the parties, may also be included as part of the balance to be confirmed.

2. **COMPLETENESS balances that were supposed to be recorded have been recognized**:
   a. Obtain a **list of all advances** and other current assets and compare them with balances in the ledger.
   b. Verify **loan agreements and acknowledgements** of parties in respect of outstanding loans.
   c. Examine, in case of material loan or advances, **authorisation** by the Memorandum and Articles of Association in the case of Company.
   d. The auditor should confirm that the loans advanced were **within the competence** of persons who had advanced the same, directors in the case of a Company, partners in the case of a firm and trustees in the case of a trust.
   e. Inspect the **minutes of meeting** of board of directors to confirm if all material loans and advances were approved by the board of directors.
   f. Ascertain if **loans are being recovered regularly** as per agreed instalments.
   g. If there are any **related party loans and advances**, review whether they were properly authorized and the value of such transactions were reasonable and at arm's length.

3. **VALUATION has been done properly**:
   a. Assess the allowance for doubtful accounts
   b. Obtain the ageing report of loans and advances
   c. obtain the list of loans and advances under litigation and compare with previous year

d. Identify those loans and advances that appear doubtful; discuss with management about the reasons as to why these loans/ advances are not included in the provision for doubtful balances.
e. Assess bad loans/ advances write-offs
f. Check that write-offs have been approved by the authorsied and appropriate senior authority.
g. Check restatement of foreign currency loans and advances/ other current assets has been done properly in accordance with AS 11.

Write the audit procedures to be performed as an auditor for valuation (assertion) of following:

(i) Loans and Advances and other current assets.

(ii) Finished goods and goods for resale. **(SA, Nov 2018, 10 Marks) (MTP1, May 2020, 6 Marks)**

4. DISCLOSURE for loans and advances and other current assets have been appropriately made:
   a. Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:
      i. Long Term loans & Advances
      ii. Short-term loans and advances
   b. Following disclosures shall be made where Loans or Advances in the nature of loans are granted to promoters, Directors, KMPs and the related parties (as defined under Companies Act, 2013,) either severally or jointly with any other person, that are:
      i. Repayable on demand or
      ii. Without specifying any terms or period of repayment

Type of Borrower	Amount of loan or advance in the nature of loan outstanding	Percentage to the total Loans and Advances in the nature of loans
Promoters		
Directors		
KMPs		
Related Parties		

PROVISIONS AND CONTINGENT LIABILITIES

PROVISIONS

1. A provision is a liability which can be measured only by using a substantial **degree of estimation.**
2. A provision is recognised when:

- ✓ An entity has a **present obligation** (legal or constructive) as a result of a past event
- ✓ It is **probable that an outflow of resources** embodying economic benefits will be required to settle the obligation; and
- ✓ A **reliable estimate can be made** of the amount of the obligation.

If these conditions are not met, no provision should be recognized.

CONTINGENT LIABILITY

1. A contingent liability is:
   - ✓ a **possible obligation** that arises **from past events** and whose **existence will be confirmed only by the occurrence or non-occurrence** of one or more uncertain future events not wholly within the control of the entity; or
   - ✓ a **present obligation** that arises **from past events but is not recognized** because:
     i. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
     ii. The amount of the obligation cannot be measured with sufficient reliability.

AUDIT PROCEDURES

1. **EXISTENCE & COMPLETENESS**:
   a. Obtain a list of all provisions and compare them with balances in the ledger.
   b. Inspect the underlying agreements like agreement with customers to assess warranty commitments, any legal and other claims on the entity i.e. litigations.
   c. Obtain the underlying working and the basis for each of the provisions made, from the management and verify whether the same is complete and accurate.
   d. Wherever required, obtain expert's report, calculation and underlying working for the provision amount.

2. **VALUATION – Provision have been valued appropriately**:
   a. As per SA 500 – "Audit Evidence", issued by ICAI, when using the work of a management's expert, audit evidence that the auditor should obtain include:
      i. Evaluate the competence, capabilities and objectivity of that expert
      ii. Obtain an understanding of the work of that expert
      iii. Evaluate the appropriateness of his work as audit evidence for the relevant assertion
      iv. Obtain written representation from the management

The management of BOB Ltd. could not differentiate between any obligation for which either provisions need to be made or the contingent liability to be shown. The auditor of the company clarifies the management that the provisions are the amounts charged against revenue to provide for a known liability, the amount whereof cannot be determined with substantial accuracy. On the other hand, a contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability. The auditor further explains the concept with the help of examples. State which of the following examples the auditor must have provided in respect of contingent liability?

(a) Depreciation.
(b) Clean-up costs for unlawful environmental damage.
(c) Product warranties.
(d) Lawsuit against the company where it is more likely that no present obligation exists.

Explain the difference between reserves and provisions. **(MTP1, May 2019, 3 Marks)**

_____ is a possible obligation that arises from the past events and whose existence will be confirmed only by the occurrence/ non-occurrence of one or more uncertain future events not wholly within the control of the entity:-

(a) Provisions

(b) Reserves

(c) Contingent Liabilities

(d) Liability **(MTP1, Nov 2020, 2 Marks) (RTP, May 2021, NA)**

From the auditing point of view, the auditor should verify that a proper disclosure about contingent liabilities is made in financial statements as required by AS 29. What type of disclosures should be made for each class of contingent liability as at the balance sheet date?

(MTP1, May 2021, 3 marks) (MTP2, May 2021, 4 marks)

3. **DISCLOSURE for provisions have been appropriately made**:
   a. Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made
      i. Long-term provisions
      ii. Short-term provisions
   b. Contingent liabilities and commitments (to the extent not provided for)
      i. Contingent liabilities shall be classified as
         a) Claims against the company not acknowledged as debt;
         b) Guarantees;
         c) Other money for which the company is contingently liable.
      ii. Commitments shall be classified as
         a) Estimated amount of contracts remaining to be executed on capital account and not provided for;
         b) Uncalled liability on shares and
         c) Other investments partly paid.
   c. In terms of AS 29, "Provisions, Contingent Liabilities and Contingent Assets", ensure whether disclosures required have been made.

INCOME STATEMENT CAPTIONS

SALE OF PRODUCTS AND SERVICES

1. **OCCURRENCE – sales performed during the period**:
   a. Check whether a single sales **invoice is recorded twice or a cancelled** sales invoice could also be recorded.
   b. Check a few invoices with their relevant **entries in sales journal**.
   c. Obtain **confirmation from few customers** to ensure genuineness of sales transaction Whether any **fictitious customers** and sales have been recorded.
   d. Whether any **shipments were done without the consent and agreement** of the customer, especially at the year end to inflate the sales figure Whether unearned revenue recorded as earned. Whether any substantial uncertainty exists about collectability.
   e. Review **sequence** of sales invoices
   f. Review journal **entries for unusual transactions**

g. Calculate the **ratio of sales return to sales** and compare it with previous year and enquire for the reasons for increase/ decrease
h. Check the **sales return with a sales invoice**, challan, credit note, stock register, etc.

2. **COMPLETENESS – All sales made during the period were recorded and there is no understatement or overstatement**:
   a. Perform **cut-off procedures** to ensure that revenues are recognised in the current accounting period.
   b. verify the **credit not**es issued after the accounting period
   c. Trace from the **shipping documents** to the sales journal.
   d. Check whether **quantity** is appearing in sales register or not.
   e. Check **reconciliation** of total sales/goods dispatched as per stock records and financial records and statutory records like GST.
   f. **Review GST tax returns** and ensure that the same are reconciled with revenue reported in the profit and loss account.
   g. Verify the **reasonableness of GST** by applying the applicable rate to the gross sales value and compare the amount of GST as per statutory returns and analyze the reasons for variance, if any.

3. **MEASUREMENT – All sales are accurately measured as per applicable accounting standards**
   a. Trace a few transactions from **start to end**.
   b. if the client is engaged in **export sales**, then **compliance with AS 11** shall be ensured.
   c. Auditors must understand the **client's operations and related GAAP** issues.
   d. Compare the **rate of sales affected with related parties** and review them for collectability, as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.

4. **DISCLOSURE for sales have been appropriately made**:
   a. In respect of **each class of goods** has been made.
   b. **Revenue from operations** is disclosed separately in the notes as revenue arising from:
      i. Sale of products (including excise duty)
      ii. Sale of services
      iii. Other operating revenues.

c. Whether **brokerage and discount on sales** other than usual trade discount has been disclosed.

d. Whether the **transactions with related parties are appropriately disclosed** in notes to accounts.

Auditor of ABC Ltd while auditing its financial statements wants to ensure whether the disclosures regarding sales has been made as required under Schedule III (Part 1) to Companies Act, 2013. Explain such disclosure requirements. **(MTP1, May 2021, 3 marks)**

CA "X" while conducting an audit of Joyful Ltd. found a considerable increase in sales as compared to the previous year, he doubts that few fictitious sales have been recorded by the company to overstate its revenues. Discuss any four audit procedures to be undertaken by the auditor to ensure revenue from sales of goods and services performed during the period is not overstated? **(SA, July 2021, 4 Marks)**

OTHER INCOME

1. Obtain a **list 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.
2. 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.
3. **Direct confirmations** obtained from the respective bank/ financial institution.
4. 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.
5. Also, obtain a copy of **Form 26AS** (TDS withholding by the bank/ financial institution) and reconcile the interest reflected therein to the calculation shared by client.
6. For Dividends, verify that the same are recognised in the statement of profit and loss only when the entity's **right to receive payment of the dividend** is established.
7. Verify that **Gain/(loss) on sale of investment in mutual funds** is recorded as other income only on
    a. Transfer of title from the entity AND
    b. Is determined as the difference between the redemption price and carrying value of the investments.
8. For the purpose, **obtain the mutual fund statement and trace the gain / loss** as recorded in the books of account to the gain/ loss as reflected in the statement.

9. Give details of any **transaction not recorded in the books of accounts that has been surrendered or disclosed as income** during the year in the tax assessments under the Income Tax Act, 1961.
10. Disclosure:
    a. Interest income
    b. Dividend income
    c. Not gain/ loss on sale of investments
    d. Other non-operating income (net of expenses directly attributable to such income)

As statutory auditor of the company, list out audit procedures required to be undertaken for the following:

(i) Interest income from fixed deposits.

(ii) Dividend income.

(iii) Gain/(loss) on sale of investment in Mutual funds.

Also indicate disclosure requirements of above as per Companies Act, 2013.

(SA, May 2018, 10 Marks) (SA, Jan 2021, 3 marks)

Correct/Incorrect – Dividends are recognized in the statement of profit and loss only when the amount of dividend can be measured reliably. **(SA, Nov 2020, 2 Marks)**

ABC limited appointed XYZ & Company, Chartered Accountants, as a Statutory Auditor of the Company for the year 2019-20. CA X, partner of XYZ & Company, was looking after the audit of other income of the company which consists of interest income on fixed deposits. As a Statutory Auditor how would CA X verify interest income on fixed deposits for the year 2019-20? **(SA, Nov 2020, 4 Marks)**

PURCHASES

1. **OCCURRENCE CHECK**:
    a. Ensure purchases are not understated/overstated by performing following audit procedures:
        - Whether any **fictitious vendors have been booked** or purchases have been recorded by reviewing the vendor selection process followed by the entity and also performing procedures to ensure existence of the vendors.
        - Whether there exists an entry in the security gate inward register
        - Whether quality inspection of goods was done.
        - Whether a goods receipt note was prepared and signed by an appropriate client personnel.

- Whether the purchase invoice was approved as per delegation of authority and whether a 3 or 2-way match was done.
- Whether the stock record has been updated by the authorised personnel.

b. The purchase invoice received should be the "Original" copy

c. Purchase invoice should have been booked only once risk and reward incidental to ownership has been transferred to the entity.

d. Purchase invoice should be in the name of entity

e. Input tax component should have been booked in the input tax ledger

f. The auditor should obtain tax returns filed with the authorities and tally the input tax

g. In case of purchases made from related parties, the auditor needs to verify approval from Board of Directors.

h. Review journal entries for unusual transactions.

i. Perform cut-off test to ensure that purchases are recognised in the correct accounting period

j. Ensure correct accounting treatment of goods – in – transit as per the agreed terms.

k. Obtain written representation from the management.

l. Perform analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price which may include:

- **Consumption Analysis**: Auditor should scrutinize **raw material consumed as per manufacturing account** and **compare the same with previous years** with closing stock and **ask for the reasons** from the management, if any significant variations are found.
- **Stock Composition Analysis**: Auditor to **collect the reports** from management for composition of stock i.e., raw materials as a percentage of total stock and compare the same with previous year and ask for reasons from management in case of significant variations.
- **Ratios**: Auditor should **compare the creditors turnover ratios** and stock turnover ratios of the current year with previous years.
- Auditor should **review quantitative reconciliation** of closing stocks with opening stock, purchases and consumption.

Discuss the audit procedure to be considered by an auditor while performing analytical procedure to obtain audit evidence as to overall reasonableness of purchase quantity and price.

(SA, Nov 2019, 3 Marks)

2. **DISCLOSURES for purchases have been appropriately made**: Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made

a. Purchases of **stock-in-trade** have been specifically disclosed.

b. Changes in inventories of **finished goods, stock–in-trade and work- in-progress** have been specifically disclosed

c. Transactions with **related parties** are appropriately disclosed in notes to accounts.

EMPLOYEE BENEFITS EXPENSES

Meaning: Employee benefits expenses or commonly called as payroll expenses represent the aggregate sum an entity pays as a consideration to its employees for their labour/ efforts along with associated expenses such as perquisites/ benefits, postemployment benefits like gratuity, superannuation, leave encashment, provident fund contribution etc. as well as towards their hiring, their welfare and training.

Audit Procedures to be followed:

1. An auditor **tests the controls** the entity has set around the employee benefit payment process to determine how effective they are.
2. The auditor selects a **random sample of transactions and examines** the related appointment letters, appraisal letters, attendance records, HR policies, employee master etc.
3. Obtain an understanding of the entity's **process of capturing employee attendance**.
4. Obtain a **list of employees** as at the period-end along with a monthly movement split between new hires, leavers and continuing employees.
5. For a sample 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**.
6. For a sample 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.
7. Obtain the **monthly salary registers** for all 12 months.
8. Verify if **provision has been made** for all employee benefits and obligations.
9. In case provident fund (PF), employee state insurance (ESI) is applicable to the entity, compile a **reasonability** by applying the rate to the basic wages and **comparing** to the **amount recorded in books and analyse reasons for variance**, if any. Also, obtain **monthly deposit challans to verify** if the month-on-month liability was subsequently deposited with the authorities and within the defined timelines.
10. Perform **analytical procedures** to obtain audit evidence as to overall reasonableness of employee benefit expenses which may include production per employee analysis.
11. Ensure whether the following **disclosures as required under Schedule III** (Part 1) to Companies Act, 2013 have been made.

While reviewing Employee benefits expenses of a company, how you as an auditor you will evaluate its hiring, appraisal and retirement process? **(SA, May 2019, 3 Marks)**

DEPRECIATION AND AMORTISATION

- Depreciation represents systematic allocation of the depreciable value of an item of PPE over its useful life while.
- Amortisation represents systematic allocation of the depreciable amount of an intangible asset over its useful life.

Correct/ incorrect

One of the key principles of accrual basis of accounting requires that an asset's cost is proportionally expensed based on the period over which the asset is expected to be used. **(RTP, Nov 2020)**

Tangible assets are depreciated when the asset is actually put to active use.

(MTP1, Nov 2020, 2 Marks)

Auditor needs to consider the following attributes while verifying for depreciation and amortisation expenses

1. Obtain the understanding of entity's **accounting policy related to depreciation** and amortisation.
2. Ensure the **Company policy for charging depreciation and amortisation** is as per AFRF.
3. The accounting policy has been **applied consistently** year on year.
4. Any change in the accounting policy has been **adequately disclosed**.
5. Whether the depreciation has been **calculated after making adjustment of residual value** from the cost of the assets.
6. Whether depreciation and amortisation **charges are valid**.
7. Whether depreciation and amortisation charges are **accurately calculated and recorded**.
8. Whether all charges are **recorded in the appropriate period.**
9. Ensure the **parts** (components) of each item of property, plant and equipment that are to be **depreciated separately** have been properly identified.
10. Whether the most appropriate **depreciation method** for each separately depreciable component has been used.

Mention any five attributes to be considered by an auditor while verifying for a depreciation and amortisation expenses. **(SA, May 2018, 5 Marks)**

OR

Depreciation and amortisation expense generally constitute an entity's significant part of overall expenses and have direct impact on the profit/loss of the entity. What are the attributes, the Auditor needs to consider while verifying Depreciation and amortisation expense. **(SA, Jan 2021, 4 marks)**

Audit Procedures to Check

1. Obtain an understanding of entity's **process of charging** depreciation and amortization.
2. Obtain the fixed **asset register maintained** by the entity.
3. Select the **sample of assets** from the Fixed Assets Register, on materiality considerations and verify the rates of depreciation and depreciation calculations.
4. Ensure **Intangible assets** like patents, goodwill, copy rights have been **properly amortized** over the period.
5. Ensure depreciation is **charged** on the assets from the date **when it is ready to use** and not from the date of actual usage
6. Ensure **depreciation on revalued amount** has been properly accounted from revaluation reserve.
7. Depreciation computation as per **Income tax Act, 1961**- Ensure that additions are tallying with the additions as per Companies Act
8. Perform **analytical procedures** to obtain audit evidence as to overall reasonableness of depreciation and amortisation expense.
9. Check the **arithmetical accuracy** of records and perform independent calculations.
10. Depreciation and amortization have been **charged as per the useful lives** of PPE and intangible assets.
11. Ensure that **residual values have been properly verified** as that impacts the computation of depreciation.
12. Depreciation and amortization have been compu**ted prospectively whenever there is any change in useful lives** of PPE and intangible assets.
13. Required disclosures:
    a. Accounting policy for depreciation and amortization.
    b. Useful lives of assets as per Schedule II to the Companies Act, 2013.
    c. Residual value of assets.
    d. Depreciation method

Other Expenses like Power and Fuel, Rent, Repair to Building, Plant and Machinery, Insurance, Travelling, Legal and Professional, Miscellaneous

An auditor generally prefers to vouch for other expenses to verify following attributes

1. **Occurrence**: Whether the expenditure was in relation to the entity's business and not a personal expenditure.
2. **Accuracy & Completeness**: Whether the expenditure had a valid supporting documents like travel tickets, insurance policy, third party invoice etc.
3. **Cut-off**: Whether the expenditure pertained to current period under audit;
4. **Classification**: Whether the expenditure qualified as a revenue and not capital expenditure;
5. Whether the expenditure has been classified under the correct expense head;
6. **Internal Control**: Whether the expenditure was authorised as per the delegation of authority matrix.

An entity in addition to undertaking purchases and incurring employee benefit expenses also spends on other expenditure like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to running of business operations.

While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch

for other expenses to verify some important attributes Advise stating clearly those attributes and the audit procedures generally required to be undertaken while auditing other expenses

(MTP2, May 2018, 10 Marks)

"While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel but for other expenses, an auditor generally prefers to verify other attributes." Mention those attributes.

(SA, Nov 2018, 5 Marks) (MTP1, Nov 2021, 4 Marks)

Profit and Loss account of an organisation shows various types of expenses like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to running of business operations. What are the attributes that an auditor generally prefers for vouching these types of expenses? **(SA, Dec 2021, 3 Marks)**

"Explain the audit procedure to vouch/verify:

(i) Rent expenses

(ii) Power and Fuel expenses" **(RTP, May 2019, NA)**

Audit procedures for different expenses

Rent expense

1. Obtain a month wise **expense schedule** along with the rent agreements.
2. Examine whether expense has been **recorded for all 12 months** and whether the rent paid is as per the underlying agreement.
3. Examine whether the agreement contains any **escalation clause** and if yes, verify whether the rent has been increased or adjusted during the period only as per escalation clause.
4. Verify whether the **agreement is in the name of the entity** and verify whether the expense pertains to **premises used for running business operations** of the entity.

Power and fuel expense

1. Obtain a month wise **expense schedule** along with the power bills.
2. Verify whether the expenses have been **recorded for all 12 months**.
3. Also, compile a **month wise summary of power units consumed** and the applicable rate and check the **arithmetical accuracy** of the bill raised on a monthly basis.
4. **Analyse** the monthly power **units consumed by linking it to units of finished goods produced** and investigate reasons for variance in monthly trends.

Insurance expense

1. Obtain a **summary of insurance policies taken** along with their validity period.
2. Verify whether the expense has been **correctly classified between prepaid and expense for the period** based on the number of days.

Legal and professional expenses

1. Obtain a month-wise and consultant-wise **summary**.
2. In case of **monthly retainership agreements**, verify whether the expenditure for all 12 months has been recorded correctly.
3. For non- recurring expenses, **select a sample and vouch for the attributes** discussed above.
4. 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.

An entity in addition to undertaking purchases and incurring employee benefit expenses also spends on other expenditure that are essential and incidental to running of business operations. One of such

expenses is the legal and professional expenses. These are the fees paid for professional advices regarding specific deals.

Iconic Ltd. is having a retainership agreement with a lawyer, Mr. Avi, to whom the company is paying a huge sum as legal and professional expenses on monthly basis. While vouching such expenses, what should be kept in mind by the auditor?

(a) In case of monthly retainership agreements, only verify if the expenditure for all 12 months has been recorded correctly.
(b) The auditor should verify that the payments have been only through bank vouchers.
(c) 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.
(d) In case of monthly retainership agreements, only verify that all the payments have been made and there is no outstanding balance to be shown as liability in the Balance Sheet. **(Sample MCQs)**

Travel, repair and maintenance, printing and stationery, miscellaneous expenses

1. The auditor should **select a sample and vouch** for the attributes discussed above.
2. Wherever possible, the auditor should try to **prepare a summary of expenditure** on a monthly basis and then **analytically compare the trends**.
3. Perform analytical procedures to obtain audit evidence as to **overall reasonableness of other expense** which may include expenditure per unit of production analysis.
4. Auditor should **analyse expenses per unit produced and compare** with PY and present industry trends and **ask for the reasons** from the management for **variations are noticed.**

Details of Benami Property held

1. Where any proceedings have been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, the company shall disclose the following:
    a. **Details** of such property, including year of acquisition,
    b. **Amount** thereof,
    c. Details of **Beneficiaries**,
    d. If property is in the books, then **reference** to the item in the Balance Sheet,
    e. If property is not in the books, then the **fact** shall be stated with reasons,

f. Where there are **proceedings** against the company under this law as an abetter of the transaction or as the transferor then the details shall be provided,

g. **Nature** of proceedings, **status** of same and company 's **view** on same.

Details of Crypto Currency or Virtual Currency

Where the Company has traded or invested in Crypto currency or Virtual Currency during the financial year, the following shall be disclosed:

a. **Profit or loss** on transactions involving Crypto currency or Virtual Currency

b. Amount of **currency held** as at the reporting date,

c. **Deposits or advances** from any person for the purpose of trading or investing in Crypto Currency/virtual currency.

Corporate Social Responsibility (CSR)

1. Amount required to be spent by the company during the year,
2. Amount of expenditure incurred,
3. Shortfall at the end of the year,
4. Total of previous years shortfall,
5. Reason for shortfall,
6. Nature of CSR activities,
7. Details of related party transactions, e.g., contribution to a trust controlled by the company in relation to csr expenditure as per relevant accounting standard,
8. Where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately.

Rounding off of income

Total Income	Rounding off
less than one hundred crore rupees	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof.
one hundred crore rupees or more	To the nearest lakhs, millions or crores, or decimals thereof.

Once a unit of measurement is used, it should be used uniformly in the Financial Statements

OTHER QUESTIONS

Q1. Expenses which are essentially of a revenue nature if incurred for creating an asset or adding to its value for achieving higher productivity are regarded as expenses of a capital nature. Describe any five such expenses.

(SA, May 2018, 5 Marks)

Q2. Expenses which are essentially of a revenue nature if incurred for creating an asset or adding to its value for achieving higher productivity are regarded as expenses of a capital nature. Describe any six such expenses. **(MTP2, May 2021, 3 marks)**

Q3. Define the different types of lease agreements as per Accounting Standard/Ind-AS.

(SA, May 2019, 4 Marks)

Q4. Newton Ltd. has made loans and advances on the basis of following securities to various borrowers. As an' auditor what type of documents can be verified to ensure that the company holds a legally enforceable security?

(i) Shares and Debentures

(ii) Life Insurance Policy

(iii) Hypothecation of goods.

(MTP1, May 2020, 3 Marks) (RTP, May 2021, NA) (MTP2, May 2021, 3 Marks)

Q5. How will you vouch/verify the following?

(a) Trademarks and copyrights

(b) Investments income in the case of charitable institutions

(c) Contingent liabilities

(d) Leasehold rights **(RTP Nov 2020)**

Q6. Correct / Incorrect: Mr. Z, a team member of auditor of Grateful and Competent Limited was of the opinion that while conducting an audit of a company no distinction is required to be made between revenue expenditure and capital expenditure. **(MTP1 Nov 2020 – 2 Marks)**

Q7. Discuss the audit procedures generally required to be undertaken by the auditor while auditing Goods sent out on Sale or Return Basis. **(Nov 2020 – 3 Marks)**

Q8. Correct/Incorrect: If the purpose of an audit procedure is to test for understatement in the existence or valuation of accounts payable then testing the recorded accounts payable may be relevant audit procedure. **(Jan 2021 – 2 marks)**

Q9. XYZ Ltd. which is in the business of trading of automobile components is following Cash Basis of Accounting for sale of spare parts. As Statutory Auditor of XYZ Ltd. explain the reporting requirements, manner of qualification and disclosure, if any, to be made in the auditor's report in line with AS-1 'Disclosure of Accounting Policies'. **(Jan 2021 – 3 marks)**

Q10. List out the steps to be taken by auditor while vouching/ verifying the 'Refund of General Insurance premium paid'. **(RTP May 2021)**

Q11. "Which of the following is an example of revenue expenditure-

(a) Wages on installation of Machinery

(b) Regular repairs incurred on PPE

(c) Legal expenses in purchase of land and building

(d) Freight inwards on purchase of PPE" **(MTP1 May 2021 – 1 mark)**

Q12. Correct/Incorrect: As per AS 26, internally generated goodwill is not recognised as an asset. **(MTP1 – May 2021 – 2 marks)**

Q13. "Explain how you will verify the items given while conducting an audit of an entity:

(a) Recovery of Bad debts written off

(b) Receipt of Insurance claims

(c) Payment of Taxes

(d) Sale proceeds of scrap material" **(RTP – Nov 2021) (RTP – May 2022)**

Q14. APQ Ltd. deals in real estate and classifies all of its land holding under current assets as inventory. The same is, therefore valued at cost or market value whichever is less. How would you verify profit or loss arising on sale of plots of land by such a dealer? **(RTP – Nov 2021)**

Q15. "Statement I: A capital reserve cannot be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realized.

Statement II: The amount of securities premium or capital redemption reserve account can be utilised only for the purposes specified in Sections 52 and 55 of the Companies Act, 2013, respectively.

(a) only Statement I is correct

(b) only Statement II is correct

(c) both the statements are correct

(d) both the statements are incorrect. " **(MTP2 – Nov 2021 – 2 Marks)**

Q16. Identify and explain the assertions that the auditor will check by performing the following audit procedures –

(i) Employee benefit expenses do not include the cost of any unauthorized personnel

(ii) All the items of inventory pertaining to the relevant year shall be included regardless of the location

(iii) Sales are recorded correctly in the books based on the invoices. Discounts have been properly adjusted or accounted for.

(iv) The entity owns or controls the inventory recorded in the financial statements. i.e. the purchase invoices have been made in the name of the client.

(v) Inventory has been recognized at the lower of cost and net value in accordance with AS 2-Inventories. **[Jan 25 – 5 marks]**

Q17. ABC & Co., a Chartered Accountant firm, has been appointed as the statutory auditors of Pen Private Limited for the F.Y 2023-24. During audit, one of the team members. Mr. R noticed that Pen Private Limited has purchased software amounting to 2.00 crore and the said software IS not an integral part of the related hardware. Mr. R further observed that Pen Private Limited has conducted some research of an internal project work amounting to 1.00 crore. Pen Private Limited, following Indian GAAP, has presented the aforesaid details in the Balance Sheet as on 31 March, 2024 as follows:

Property, Plant, and Equipment	**₹**
Software	2.00 crore
Research	1.00 crore

Mr. R approached the engagement partner with above details and enquired about the correctness of the presentation made by Pen Private Limited in terms of Schedule III to the Companies Act, 2013. Mr. R further wanted to ensure that all additions Intangible assets during the year 2023-24 have been recorded appropriately in the financial statements of Pen Private Limited. Guide Mr. R.

[Jan 25 – 5 marks]

Q18. The financial statements of XYZ Limited show long-term borrowings from the banks, financial institutions, leasing, and hire purchase companies. Additionally, the company has issued debentures to its 1000 members to raise funds in accordance with the provisions of the Companies Act, 2013. The money raised by issuing debentures is also reflected in long-term borrowings. As the statutory auditor of XYZ Limited, CA X wants to verify that all borrowings on the balance sheet represent valid claims by banks or other third parties. Suggest a few audit procedures in this regard. **[RTP Sep 24]**

Q19. Name the assertions for the following audit procedures:

(i) Year-end inventory verification.

(ii) Depreciation has been properly charged on all assets.

(iii) The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company.

(iv) All liabilities are properly recorded in the financial statements.

(v) Related party transactions are shown properly. **[RTP Nov 22]**

Q20. PK Pvt Ltd, based in Moradabad, is engaged in export of brassware goods. The company has huge export receivables as on 31st March 2022. It is also analysed from Export Sales account of the company that large number of small shipments were almost despatched daily during month of March 2022. List out few audit procedures you would adopt as an auditor to verify completeness assertion of export trade receivables. **[RTP Nov 22]**

Q21. M/s MP & Co, Chartered Accountants, have been appointed as auditors of LMP Private Limited. The partner of the firm asked the Audit assistant to carry out the 'examination-in-depth' of the payment made to a creditor. Advise him about the documents to be verified. **[RTP Nov 23]**

Q22. (a) As an auditor, how will you verify the hire purchase transaction in the case of an entity engaged in the business of hire purchase?

(b) A junior accountant of a limited company has not separated transactions of one period from those in the ensuing period. As an Auditor, state the correct procedure to be followed and the areas in which it can be applied. **[RTP Nov 23]**

Q23. Explain how you will verify the items given while conducting an audit of an entity:

(a) Recovery of Bad debts written off

(b) Receipt of Insurance claims

(c) Payment of Taxes

(d) Sale proceeds of scrap material **[RTP May 22]**

Q24. While conducting audit of Air Space Ltd, the auditor observes that it has issued shares at discount to its creditors when its debt is converted into shares in pursuance of debt restructuring scheme in accordance with any guidelines specified by the Reserve Bank of India. Discuss explaining clearly the provisions relating to discount on issue of shares and its verification by the auditor. **[RTP May 22]**

Q25. While verifying the PPE of the client entity, the auditor also needs to consider whether the PPE has been valued appropriately and as per the generally accepted accounting principles and practices. Explain. **[RTP May 23]**

Q26. What are the required disclosures for cash & Cash equivalents to be made by the company as per Schedule III (Part I) to Companies Act, 2013? **[RTP May 23]**

Q27. CA Saurabh is the statutory auditor of UVW Ltd. for the FY 20-21. While verifying the purchases made by UVW Ltd., CA Saurabh decided to perform analytical procedures to obtain audit evidence regarding

the overall reasonableness of purchase quantity and price of purchases. What analysis should CA Saurabh perform? **[RTP May 23]**

Q28. Proceedings have been initiated against False Limited for holding benami property under law relating to prohibition of benami transactions and the rules made thereunder but such property is not recorded in books of accounts. As a consultant to the company, what will you advise the company as far as disclosure requirements are concerned in financial statements in relation to said proceedings?

[RTP May 24]

Q29. Droma Shoes Private Limited was established in year 2022-23 for manufacturing of footwear. As funds were needed to carry on its business activities - including for purchase of different raw materials, incurring of regular expenses like power and fuel and payment of wages etc., it had got sanctioned a credit facility amounting to ₹ 2 crores repayable on demand from a bank against primary security of its current assets and collateral security of residential house of one of its directors. Duly signed guarantee documents by directors in favour of bank also form part of bank's loan documentation. Account statement of above facility downloaded from bank's website shows debit balance of ₹1.85 crores as on 31st March, 2023. The operations in above credit facility are satisfactory. In this regard: -

(i) Identify nomenclature of such credit facility given by banks. How would above amount of ₹ 1.85 crores be reflected and classified in financial statements of company as on 31.3.23?

(ii) Also state specific disclosure requirements of Schedule III of Companies Act, 2013 in relation to above. **[RTP May 24]**

Q30. Following is extract of notes to accounts of financial statements of STU Private Limited listing some ratios. Discuss, whether disclosure, given in following manner meets requirements of Schedule III of the Companies Act, 2013. Ignore other ratios which are not listed in extract given below:

Name of ratio	31.3.2023	31.3.2022
Current ratio	2.50	2.30
Inventory turnover ratio	3.00	6.00
Trade receivables turnover ratio	1.75	5.00
Net profit ratio (in%)	13%	10%

[RTP May 24]

Q31. During the audit of Rapid Industries Private Limited, CA Akshat notices that inventories of raw materials & consumables and work-in- progress amounting ₹ 2.50 crores and ₹ 0.25 crores appear in the financial statements of the company as on March 31st, 2024. He wants to verify that the above-mentioned inventories have been valued appropriately and as per generally accepted accounting policies and practices. How should he proceed to verify the above? **[RTP Jan 25]**

Q32. The financial statements of XYZ Limited show long-term borrowings from the banks, financial institutions, leasing, and hire purchase companies. Additionally, the company has issued debentures to its 1000 members to raise funds in accordance with the provisions of the Companies Act, 2013. The money raised by issuing debentures is also reflected in long-term borrowings. As the statutory auditor of XYZ Limited, CA X wants to verify that all borrowings on the balance sheet represent valid claims by banks or other third parties. Suggest a few audit procedures in this regard. **[RTP Sep 24]**

CHAPTER 6 – AUDIT DOCUMENTATION | SA 230

DEFINITION OF AUDIT DOCUMENTATION

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

OBJECTIVE OF THE AUDITOR

(a) A sufficient and appropriate record of the basis for the auditor's report; and

(b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

NATURE OF AUDIT DOCUMENTATION

1. It provides evidence that the auditor had a basis for the conclusion about achieving overall objectives.
2. Evidence that audit was planned and performed in accordance with (IAW) SA's and requirements

PURPOSE OF AUDIT DOCUMENTATION

1. Assist the team to plan and perform the audit.
2. Assisting the members of the team to direct and supervise the audit and discharge review responsibilities.
3. Enabling the team members to be accountable for their work.
4. Retaining record of matters of significance to future audits.
5. Enabling the conduct of quality control reviews and inspections as per SQC 1.
6. Enabling external inspections in accordance with requirements

FORM CONTENT AND EXTENT OF AUDIT DOCUMENTATION

1. Why should an auditor prepare audit documentation?

Ans:

(a) The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

(i) The nature, timing and extent of the audit procedures performed.

(ii) The results of the audit procedures performed and the audit evidence obtained and

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

(b) Further in documenting the nature, timing and extent of audit procedures performed, the auditor shall record:

(i) The identifying characteristics of the specific items or matters tested.

(ii) Who performed the audit work and the date such work was completed; and

(iii) Who reviewed the audit work performed and the date and extent of such review.

(c) The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

(d) If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency.

II. The form, content and extent of audit documentation depend on **factors** such as:

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

PREPARATION OF AUDIT DOCUMENTATION

1. Audit documentation is not a substitute for the entity's accounting records.
2. Here are some examples of audit documentation
    a. Audit programme
    b. Analyses
    c. Summary of significant matters.
    d. Letter of confirmations and representation.
    e. Cheque lists
    f. Correspondence (including Email)
    g. Entity records
3. The auditor shall prepare audit documentation on a timely basis.
4. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

AUDIT FILE & IT'S ASSEMBLY

1. Meaning of audit file - It consists of more than one folder or other storage media in any form that comprises of audit documentation for a specific engagement.
2. Assemble the audit documentation and complete the assembling of final audit file on a timely basis.
3. SQC 1 requires the timely completion of assembling the audit file.
4. The appropriate time limit is less than or equal to 60 days from date of auditor's report.
5. The assembly does not involve performance of audit procedure or drawing conclusion.
6. Administrative changes can however be made during the final assembly stage, like –
    a. Deleting or discarding superseded documents
    b. Sorting, collating & cross-referencing working papers
    c. Signing off on completion checklists relating to assembly process
    d. Documenting audit evidence that the monitor has already obtained, discussed & agreed with the engagement team before the audit report date.
7. Changes may be made to the documentation during the final assembly.
8. After the assembly auditor shall not discard or dispose any documents before the end of retention period.
9. SQC 1 establish policies and procedures for the retention of engagement documentation. The period is 7 years from date of auditor's report.

DOCUMENTATION OF SIGNIFICANT MATTERS AND PROFESSIONAL JUDGEMENT

1. Judging the significance of a matter requires an objective analysis of the facts and circumstances.
2. An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgement exercised in performing the work and evaluating the results.
3. Documentation of the professional judgements made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgement.
4. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits, when reviewing matters of continuing significance.

Matters that give rise to significant risks

1. **Results of audit procedures** indicating
    a. That the financial statements could be materially misstated, or
    b. A need to revise the auditor's previous assessment of the ROMM and the auditor's responses to those risks.

2. **Circumstances** that cause the auditor significant difficulty in applying necessary audit procedures.
3. **Findings** that could result in a modification to the audit opinion or the inclusion of an EOM Paragraph in the auditor's report.

DOCUMENTATION OF SIGNIFICANT MATTERS AND PROFESSIONAL JUDGEMENT

Circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgement include, where the matters and judgements are significant:

1. The rationale for the auditor's conclusion when a requirement provides, the auditor considers certain information or factors and consideration is significant.
2. The basis for auditor conclusion on the reasonableness of subjective judgements.
3. The basis for auditor's conclusion about the authenticity of document in further investigation in response to conditions identified during the audit that caused him to believe the document may be not authentic.

COMPLETION MEMORANDUM OR AUDIT DOCUMENTATION

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

OWNERSHIP OF AUDIT DOCUMENTATION

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

STUDY MATERIAL QUESTIONS

1. **As per SA 230 on "Audit Documentation", the working papers are not the property of the auditor**.

   Hint Ans: Incorrect. He may at his discretion can make available working papers to his client.

2. **Mr. A is a statutory auditor of ABC Ltd. The branch of ABC Ltd. is audited by Mr. B, another Chartered Accountant. Mr. A requests for the photocopies of the audit documentation of Mr. B pertaining to the branch audit**.

   Hint Ans: Incorrect. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

3. "**The form, content and extent of audit documentation depends upon number of factors. List out any four such factors.**

   Hint Ans: Refer to heading "Form, content and extent of audit documentation".

4. **Discuss any two purposes of audit documentation.**

   Hint Ans: Refer to point on documentation.

5. **Define audit documentation. Also give some examples**.

   Hint Ans: Audit Documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. Examples of Audit Documentation.

6. **"Audit documentation summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits". Explain**.

   Hint Ans: Completion Memorandum or Audit Documentation Summary.

EXAMINATION QUESTIONS UNDER PREVIOUS NEW SYLLABUS

1. Define audit documentation. Also give some examples.
2. Write short note on: Audit Working Papers. **[May 10-5 Marks]**
3. Comment on the following in relation to SAs: "Audit Documentation Serves a number of additional purposes". **[May 11-5 Marks]**
4. Audit documentation serves a number of purposes. Explain with reference to SA 230. **[May 15-6 Marks]**
5. Audit documentation provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor and evidence that the audit was planned and performed in accordance

with SAs and applicable legal and regulatory requirements. Explain stating clearly purpose of audit documentation. **[MTP-Aug18]**

6. Audit documentation provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor. Explain clearly stating the nature and purpose of Audit Documentation. **[MTP-Oct 18]**
7. Discuss the meaning and nature of Audit Documentation. **[RTP-Nov 19]**
8. What do you mean by Audit Documentation? Also explain the nature and purpose of audit documentation. **[RTP-Nov 19]**
9. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Explain with the help of examples. **[RTP-May 19]**
10. "Audit documentation summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits". Explain.
11. "Completion Memorandum" is helpful as part of the audit documentation. Explain. **[May 19-3 Marks]**
12. Discuss with reference to SAs: Factors effecting form, contents and extent of audit documentation. **[May 13-5 Marks, MTP-Apr 19]**
13. The Form, content and extent of audit documents depends on certain factors. Explain with reference to SA 230. **[Nov 15-4 Marks]**
14. The form, content and extent of audit documentation depend on factors such as the size and complexity of the entity, the nature of the audit procedures to be performed etc. Explain in detail. **[RTP-Nov 18]**
15. R.K & Company is the auditor of PQR Company Ltd. The Managing Director of the Company demands copies of the working papers from the auditors. Are the auditors bound to oblige the Managing Director? **[Nov 10-4 Marks]**
16. The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. Discuss. **[MTP-Mar 18, Mar 19]**
17. Briefly explain the policies and procedures of assembling the final audit file on a timely basis after the date of auditor's report under SQC-1. **[Nov 19-3 Marks]**
18. A new team member of GSR & Co., the auditors of Esteem Limited, was of the view that Audit Documentation would not serve any purpose at any stage of Audit. Explain. **[RTP-May 21]**
19. While documenting the nature, timing and extent of audit procedures performed in case of audit of PQR Ltd, explain the important matters its auditor should record. **[RTP-May 21]**

20. TRS & Associates, Chartered Accountants, having completed the audit of Genuine Leathers Ltd has started the assembling of final audit file. TRS & Associates has established policies and procedures for the timely completion of the assembly of audit files. Explain the various aspects related to final audit file discussed in SA 230 giving specific reference to SQC 1, wherever required. **[RTP-May 22]**
21. M/s Samar Amar & Associates are the statutory auditors of Ganga Ltd. for FY 2020-21. CA Samar is the engagement partner for such assignment. While discussing with the engagement team, CA Samar briefed his team that "the auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation." Explain. **[RTP-May 23]**
22. SA 230, "Audit Documentation" deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements. Such audit documentation serves various purposes. Explain. **[RTP-May 23]**
23. The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor to understand significant matters arising during the audit. Explain the above statement and also give examples of significant matters. **[RTP-Nov 22]**
24. M/s PK & Company, Chartered Accountants, are the statutory auditors of JC Limited. CA Tarun partner of M/s PK and company, was entrusted to supervise and verify the inventory items as on 31.03.2024. During the process of verification, A large chunk of draft inventory sheets was accumulated, and then a final inventory sheet was prepared. The audit assistant has kept all these drafts and the final inventory sheet in the audit file. Is the approach of the audit assistant, correct? Which Papers slash documents may not be included in the audit documentation? **[QP SEP 24 – 4 Marks]**
25. Rajni, a CA student, has understood that SA 230 requires auditor to prepare audit documentation on a timely basis. While reading about SQC 1, she notices that time limit for completion of final audit file is ordinarily not more than 60 days after the date of auditor's report. She finds it to be puzzling. Unable to comprehend, she seeks your guidance. Guide her. **[RTP May 24]**
26. Discussing meaning of completion memorandum, elaborate upon its importance. **[RTP May 24]**
27. An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results. Explain stating clearly the examples of significant matters. **[RTP Sep 24]**
28. CA Ripun completed the audit of a listed company, and the audit report was issued on July 17th, 2024. However, he had not properly organized the audit working papers, including records of discussions with management, audit procedures performed, and conclusions reached. More than six months after issuing

the report, he received a letter from the regulator in connection with audit of the company requesting him to share copy of audit file. In a hurry, CA Ripun quickly assembled the audit file, adding some papers he thought were necessary, but he used the current date on these newly added documents. He then sent the audit file to the regulator. Discuss the issues involved related to "audit documentation" and assembling of the final audit file in this case. **[RTP Jan 25]**

CHAPTER 7 – COMPLETION AND REVIEW

ASPECTS TO BE COVERED	
1. SA 560 – Subsequent events	2. SA 570 – Going concern
3. SA 580 – Written representations	4. SA 450- Evaluation of misstatements identified during the audit
5. SA 260 – Concerning Communication with TCWG	6. SA 265 – Communicating Deficiencies in Internal Control to TCWG

SA 580 – WRITTEN REPRESENTATIONS (WR)

Aspects to be covered

1. WR as AE
2. Objectives of auditor
3. From whom WR is to be obtained.
4. WR about management responsibilities.

WRITTEN REPRESENTATION AS AUDIT EVIDENCE

1. Written representation is audit evidence similar to responses to enquires.
2. These are necessary information that the auditor requires in connection with audit of FS.
3. These are requested from those responsible for preparation and presentation of FS.
4. They do not provide SAAE on their own about way of the matters.

Illustration:

The auditor of a public company requests management to provide bankers certificate in support of Fixe Deposits whereas management provides only written representations. Discuss how do you deal with above situation.

1. WR provides necessary AE but they don't provide SAAE on their own.
2. The fact that management has provided WR does not affect the nature or extent of other AE that auditor obtains about fulfilment of its responsibilities or about specific assertions.
3. In the given problem the auditor would further request the management to provide banker certificate.

OBJECTIVES OF AUDITOR

1. To obtain written representation from management.
2. To support other audit evidence.
3. To respond appropriating to the representation given and if not given.

FROM WHOM THE WR IS TO BE OBTAINED

1. The auditor shall request WR from management with appropriate responsibilities for FS and knowledge of matters concerned.
2. It is generally requested from those responsible for preparation and presentation of FS and these may vary depending on governance structure and relevant laws.
3. However, management is often responsible party.
4. Therefore, WR may be requested from CEO and CFO or other equivalent officers that do not use such titles.
5. In some cases, TCWG is also responsible.
6. In certain situations, management can decide to make enquiries of others who are participating in presentation and preparation of FS. Such individuals may include.

An actuary responsible for measurements determined actuarially	Staff Engineers who is responsible and has specialized knowledge about environmental liability measurements.	Internal counsel who provides information about provision for legal claims.

WR ABOUT MANAGEMENT RESPONSIBILITIES

1. The auditor shall request WR from management stating that it has fulfilled its responsibility for preparation of FS. They shall provide a written representation that: -
    a. It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement and
    b. All transactions have been recorded and are reflected in the financial statements.
    c. The auditor may consider it necessary to request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware.
2. The audit evidence obtained during audit that management has fulfilled its responsibilities is not sufficient without obtaining confirmation from management about the same.

3. The auditor may also ask the management to reconfirm its acknowledgement and understanding of those responsibilities in WR.

   This is appropriate when:

   a. Those who signed the terms no longer have the relevant responsibilities
   b. The terms were prepared in previous year.
   c. There is indication that management misunderstands those responsibilities
   d. Changes in circumstances make it appropriate to do so.

OTHER WRITTEN REPRESENTATIONS

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

WRITTEN REPRESENTATIONS ABOUT SPECIFIC ASSERTIONS

1. When obtaining evidence about, or evaluating, judgments and intentions, the auditor may consider one or more of the following:
   a. The entity's past history in carrying out its stated intentions.
   b. The entity's reasons for choosing a particular course of action.
   c. The entity's ability to pursue a specific course of action.

d. The existence or lack of any other information that might have been obtained during the course of the audit that may be inconsistent with management's judgment or intent.

2. The auditor may consider it necessary to request management to provide WR about specific assertions in the financial statements, in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion.
3. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

Very Important Concept of DATE / PERIOD covered in WR

The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements. The written representations shall be for all financial statements and period(s) referred to in the auditor's report.

DOUBT AS TO THE RELIABILITY OF WRITTEN REPRESENTATIONS

1. If written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter.
2. If the matter remains unresolved,
   a. The auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and
   b. Shall determine the effect that this may have on the reliability of representations and audit evidence in general.
3. If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705, having regard to the requirement of disclaimer of opinion.

REQUESTED WRITTEN REPRESENTATIONS NOT PROVIDED

If management does not provide one or more of the requested written representations, the auditor shall:

(a) Discuss the matter with management;
(b) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations and audit evidence in general; and
(c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705 having regard to the requirement of disclaimer of opinion.

The auditor shall disclaim an opinion on the financial statements in accordance with SA 705 if:

(a) The auditor **concludes that there is sufficient doubt about the integrity of management** such that the WR about management fulfilling its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions are not reliable; or

(b) **Management does not provide the written representations** relating to fulfilling its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions.

SA 560 – SUBSEQUENT EVENTS

MEANING

a) It means:
   (i) Events occurring between the date of the financial statements and the date of the auditor's report and
   (ii) Facts that become known to the auditor after the date of the auditor's report are known as subsequent events.
   (iii) Facts which become known to the auditor after the financial statements have been issued

b) Meaning of events: financial reporting frameworks ordinarily identify two types of events: -
   (i) Those that provide evidence of conditions that existed at the date of the financial statements and
   (ii) Those that provide evidence of conditions that arose after the date of the financial statements.

Examples of situation (i)	Examples of situation (ii)
• Declaration of insolvency of a major debtor of the entity between the date of financial statements and the date of auditor's report providing evidence on the recoverability of the money due from debtor as on date of the financial statements. • Settling a legal claim outside the court at a reduced amount between the date of financial statements and the date of auditor's report for which provision has	• Issue of new share capital. • Planned merger of the company. • Destruction of substantial inventories due to fire between the date of the financial statements and the date of auditor's report.

already been made in financial statements. It provides evidence on adjustment in provision amount already made in financial statements, if any.	

OBJECTIVES

(d) Obtain SAAE about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements and

(e) Respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report.

AUDIT PROCEDURES

1. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.
2. The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto.
3. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following: -
    a. Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
    b. Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
    c. Read minutes - of meetings If any held after the date of F.S. of
        i. Owners
        ii. TCWG
        iii. Management

    Also enquire for matters discussed but minutes not available

    d. Read entity's latest subsequent Interim F.S.
4. Such information may also be obtained by auditor from accounting records pertaining to period after date of financial statements, reading entity's latest available budgets etc.

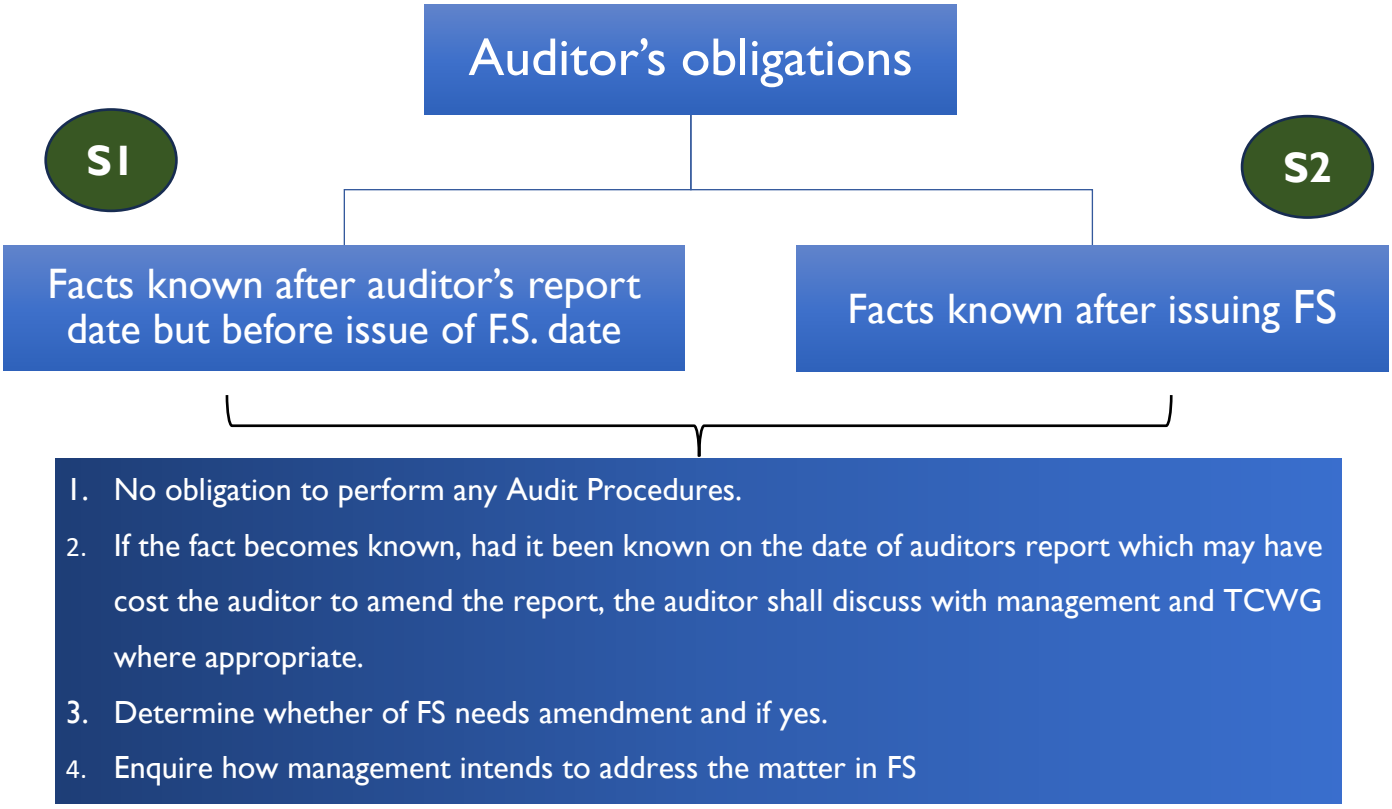
5. The auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.
6. The auditor shall request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580.

Situations to be kept in mind

1. New commitments
2. Sale or purchase of assets
3. Increase in capital
4. Asset appropriated by govt. destroyed or no
5. Developments regarding contingencies
6. Appropriate accounting adjustments

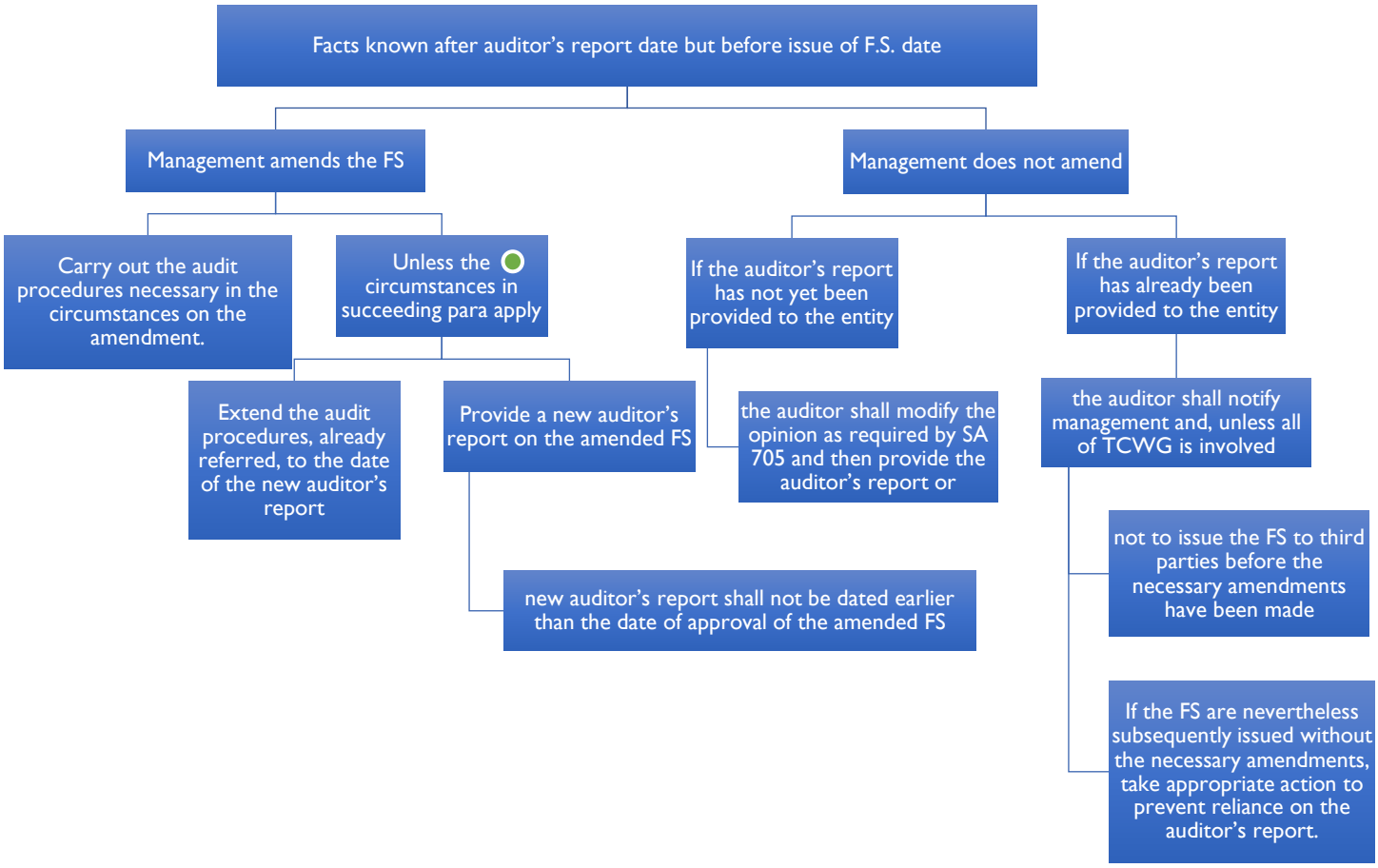
Note: Obtain written representations with respect to all events requiring adjustments or disclosures that have been adjusted or disclosed.

AUDITOR'S OBLIGATIONS: For Two (2) matters

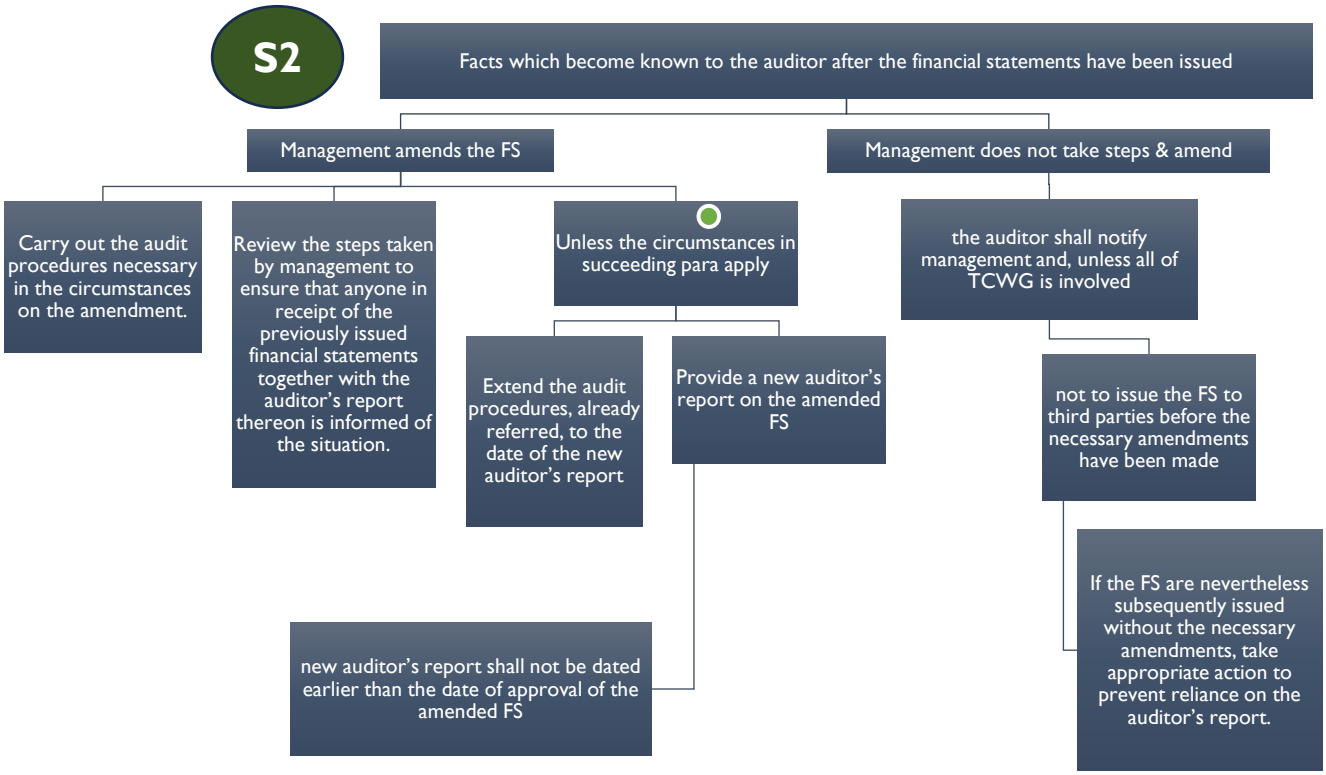


RESULTS AFTER ABOVE PROCEDURE

S1



S2



CIRCUMSTANCE:

When law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent events or events causing that amendments and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment, the auditor is permitted to restrict the audit procedures on subsequent events to that amendment

Meaning of "Date the financial statements are issued":

1. It reflects the date that the auditor's report and audited financial statements are made available to third parties.
2. The date the financial statements are issued generally depends on the regulatory environment of the entity.
3. In some circumstances, the date the financial statements are issued may be the date that they are filed with a regulatory authority.
4. Since audited financial statements cannot be issued without an auditor's report, the date that the audited financial statements are issued must not only be at or later than the date of the auditor's report, but must also be at or later than the date the auditor's report is provided to the entity.

SA 570 – GOING CONCERN

Aspects to be covered

1. Objectives
2. Responsibilities
3. Events or conditions

OBJECTIVES

1. Obtain SAAE regarding the appropriateness of managements use of going concern basis of accounting in the preparation of the financial statements.
2. Obtain SAAE to conclude whether material uncertainty exists related to events or conditions that may cast significant doubt on the about the ability to continue as going concern.
3. To report in accordance with this SA.

RESPONSIBILITIES

MANAGEMENT'S RESPONSIBILITY	AUDITOR'S RESPONSIBILITY
1. The preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so. 2. It involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions.	1. Obtain SAAE regarding and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

3. Following factors are to be considered relevant: a. The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the outcome occurs. b. The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions. c. Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.	2. These responsibilities exist even if the FRF used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment. 3. The Auditor cannot predict future events and conditions due to inherent limitations. 4. The absence of any reference to material uncertainty about the entities ability to continue as going concern in auditors report cannot be viewed as guarantee.

BASIC PROCEDURES

1. Determine whether management has already performed a preliminary assessment of going concern ability of the entity
2. If such assessment has been performed – Discuss the assessment & determine whether the events & conditions may cast a doubt on entity's ability to continue & if yes, management plans to address them.
3. Evaluating management's assessment of the entity's ability to continue as a going concern, may include
    a. An evaluation of the process management followed to make its assessment,
    b. The assumptions on which the assessment is based and
    c. Management's plans for future action and
    d. Whether management's plans are feasible in the circumstances.
4. If such an assessment has not yet been performed, discuss with management the basis for the intended use of such basis & inquire whether there are any events or conditions that may cast doubt on going concern assumption.

5. **Period of assessment**:
    a. The auditor shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation if it specifies a longer period.
    b. If management's assessment of the entity's ability to continue as a going concern covers less than 12 months from the date of the financial statements, the auditor shall request to extend its assessment period to at least 12 months from that date.
6. It is not the auditor's responsibility to rectify the lack of analysis by management.
7. Remain alert throughout the audit for audit evidence of events or conditions SA 315 requires the auditor to revise the risk assessment & modify the planned further audit procedures accordingly.

Events or conditions

Financial indicators	Operating indicators	Other indicators
1. Net liability 2. Fixed term borrowings nearing maturity without any sign of renewal or repayment. 3. Withdrawal of support from creditors 4. Negative operating cash flows. 5. Adverse key financial ratios.	1. Intention to liquidity 2. Loss of key management without replacement. 3. Loss of major market, key customers, franchise, license or principal suppliers 4. Labour difficulties (food, coffee industries) 5. Shortage of important supplies. 6. Emergence of a highly successful competitor	1. Non-compliance with requirements. 2. Pending legal proceedings, if successful results in claims that entity is unlikely to satisfy. Eg: Red bull – Wings 3. Changes in law expected to adversely effect the entity Eg: Gujarat liquor 4. Changes in law expected to adversely effect the entity Eg: Gujarat liquor

ADDITIONAL PROCEDURES

Basic Audit Procedures (Every year)	Additional audit procedures
1. If going concern assessment is not made, request the management to make it. 2. Evaluate managements plan for future actions. 3. Check whether the outcome is likely to improve the situation.	1. Reading the terms of debentures & loan agreements & determining whether they have been preached. 2. Reading minutes of the meeting of shareholders, TCWG and relevant

4. If cash flow forecast is prepared and if analysis is a significant factor, then ↓ ↓ Evaluate the reliability of data Determine support for assumptions made 5. Consider additional facts and all information that have become available since date of assessments. 6. Request WR from management with respect to plans & feasibility.	committees for reference to financing difficulties. 3. Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with **related and third parties** and assessing the financial ability of such parties to provide additional funds. 4. Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications. 5. Confirming the existence, terms and adequacy of borrowing facilities. 6. Evaluating the entities plans to deal with customer orders not fulfilled. 7. Obtaining and reviewing reports of regulatory actions. 8. Determining the adequacy of support for any land disposal of assets. 9. Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.

Implications for the Auditor's Report

(A) Use of Going Concern Basis of Accounting is Inappropriate

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

2. When the use of the going concern basis of accounting is not appropriate in the circumstances, management may be required, or may elect, to prepare the financial statements on another basis (e.g., liquidation basis)
3. The auditor may be able to perform an audit of those financial statements (prepared on liquidated basis) provided that the auditor determines that the other basis of accounting is acceptable in the circumstances.
4. The auditor may be able to **express an unmodified opinion** on those financial statements, **provided there is adequate disclosure therein about the basis of accounting** on which the financial statements are prepared, but may c**onsider it appropriate or necessary to include an Emphasis of Matter paragraph** in accordance with SA 706 (Revised) in the auditor's report to draw the user's attention to that alternative basis of accounting and the reasons for its use.

(B) Use of the Going Concern Basis of Accounting is Appropriate but a Material Uncertainty Exists

The identification of a material uncertainty is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that a material uncertainty related to going concern exists alerts users to this circumstance.

(1) Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements

(a) If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern."

(2) Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements

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

(a) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and

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

(C) Management unwilling to make or extend its assessment:

a. The auditor shall consider the implications for the auditor's report.

b. In such a situation, a qualified opinion or a disclaimer of opinion in the auditor's report may be appropriate, because it may not be possible for the auditor to obtain SAAE regarding management's use of the going concern basis of accounting in the preparation of the FS.

SA 450 – EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

MEANING

The difference between amounts, classification, presentation or disclosure of a reported financial statement item AND amount, classification, presentation or disclosure that is required to be reported in accordance of FRF.

OBJECTIVES

Evaluate: -

(a) The effect of identified misstatements on the audit and

(b) The effect of uncorrected misstatements, if any, on the financial statements.

Note:

1. The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial (unimportant / inconsequential)
2. A misstatement may arise from variety of factors viz., Factual, Judgemental, Projected.

CONSIDERATION OF IDENTIFIED MISSTATEMENTS AS THE AUDIT PROGRESSES

1. The auditor shall determine whether the overall audit strategy and audit plan need to be revised if: -
   a. The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements MAY exist (undetected misstatements) that, when aggregated with misstatements accumulated (detected) during the audit, could be material or
   b. The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with SA 320.
2. The auditor may request management to examine a class of transactions, account balance or disclosure in order for management
   a. To understand the cause of a misstatement identified by the auditor,
   b. Perform procedures to determine the amount of the actual misstatement in the class of transactions, account balance or disclosure, and
   c. To make appropriate adjustments to the financial statements. Such a request may be made, for example, based on the auditor's projection of misstatements.

3. If, at the auditor's request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain.

COMMUNICATION AND CORRECTION OF MISSTATEMENTS

1. The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation.
2. The auditor shall request management to correct those misstatements.
3. Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the items are misstatements, inform the auditor if it disagrees and take action as necessary.
4. If management refuses to correct some or all of the misstatements, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement.

EVALUATING THE EFFECT OF UNCORRECTED MISSTATEMENTS

1. The auditor shall reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results.
2. The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider: -
    a. The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence and
    b. The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

1. The auditor shall communicate with TCWG regarding uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation.
2. The auditor's communication shall identify material uncorrected misstatements individually & shall request that uncorrected misstatements be corrected.

3. Also communicate with TCWG the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

WR FROM MANAGEMENT REGARDING EFFECTS OF UNCORRECTED STATEMENTS

1. The auditor shall request a written representation from management and, where appropriate, TCWG whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole.
2. A summary of such items shall be included in or attached to the written representation.

DOCUMENTATION REGARDING MISSTATEMENTS IDENTIFIED DURING AUDIT

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

SA 260- COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

SIGNIFICANCE OF COMMUNICATION

1. An effective two-way communication is important in assisting: -
    a. The auditor and TCWG in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.
    b. The auditor in obtaining from TCWG information relevant to the audit like internal control, environment etc.
    c. TCWG in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the ROMM of the financial statements.

OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 260

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

MATTERS TO BE COMMUNICATED BY AUDITOR

1. The **auditor's responsibilities** in relation to the financial statement audit including that:
    a. The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of TCWG and
    b. The audit of the financial statements does not relieve management or TCWG of their responsibilities.
2. Planned scope and timing of the audit: The auditor shall communicate with TCWG an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor.
3. Significant **findings from the audit**: The auditor shall communicate:
    a. The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to TCWG why the auditor considers a significant accounting practice, that is acceptable under the AFRF, not to be most appropriate to the particular circumstances of the entity.
    b. Significant difficulties, if any, encountered during the audit such as:
        i. Significant delays by management, the unavailability of entity personnel, or an unwillingness by management to provide information necessary for the auditor to perform the auditor's procedures.
        ii. An unreasonably brief time within which to complete the audit.
        iii. Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
        iv. The unavailability of expected information.
        v. Restrictions imposed on the auditor by management.
        vi. Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.
    c. Unless all of TCWG are involved in managing the entity: -
        i. Significant matters arising during the audit that were discussed, or subject to correspondence, with management;
        ii. WR the auditor is requesting
    d. Circumstances that affect the form and content of the auditor's report, if any and
    e. Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process.

COMMUNICATION OF AUDITOR'S INDEPENDENCE IN CASE OF LISTED ENTITIES

1. A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence and
2. (i) All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist TCWG in assessing the effect of services on the independence of the auditor and
3. (ii) The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

THE COMMUNICATION PROCESS

1. The auditor shall communicate with those charged with governance on a timely basis.
2. The auditor shall communicate in writing with TCWG regarding significant findings from the audit if, in the auditor's professional judgment, oral communication would not be adequate.
3. Written communications need not include all matters that arose during the course of the audit.
4. The auditor shall communicate in writing with TCWG regarding auditor independence when required in case of listed entities.
5. Evaluate whether the two-way communication between the auditor and TCWG has been adequate for the purpose of the audit. If it has not, the auditor shall evaluate the effect, if any, on the auditor's assessment of the ROMM and ability to obtain SAAE, and shall take appropriate action.
6. Documentation:
    a. Where matters are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated.
    b. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation.

SA 265- COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO TCWG AND MANAGEMENT

SCOPE OF STANDARD

1. The auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the risks of material misstatement.

2. In making those risk assessments, the auditor considers internal control in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control.
3. The auditor may identify deficiencies in internal control not only during this risk assessment process but also at any other stage of the audit.
4. SA 265 specifies which identified deficiencies the auditor is required to communicate to those charged with governance and management.

OBJECTIVE OF AUDITOR

To communicate appropriately to TCWG and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

MEANING

1. Deficiency in internal control – This exists when: -
   a. Control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis or
   b. A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.
2. Significant deficiency in internal control –
   a. A deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to get the attention of TCWG.
   b. The significance of a deficiency or a combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude (extent, scale) of the misstatement. Significant deficiencies may, therefore, exist even though the auditor has not identified misstatements during the audit.

EXAMPLES OF MATTERS THAT THE AUDITOR MAY CONSIDER IN DETERMINING WHETHER A DEFICIENCY OR COMBINATION OF DEFICIENCIES IN INTERNAL CONTROL CONSTITUTES A SIGNIFICANT DEFICIENCY
1. The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
2. The susceptibility (exposure, weakness) to loss or fraud of the related asset or liability.

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

EXAMPLES OF INDICATORS OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL

1. Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
2. Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
3. Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
4. Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
5. Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
6. Evidence of management's inability to oversee the preparation of the financial statements.
7. Evidence of ineffective aspects of the control environment, such as: -
    a. Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by TCWG.

b. Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
c. Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.

COMMUNICATION OF SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE

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

STUDY MATERIAL QUESTIONS

Q1. List out some matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency".

Q2. In what ways an effective two-way communication between auditor and those charged with governance is important?

Q3. The auditor of a company is having concerns about following of going concern basis of accounting followed by management for preparation of financial statements. It asks the management to justify preparation of financial statements. However, management is not willing to make its assessment and share with auditor. What are implications for auditor's report in such a scenario?

Q4. Discuss documentation requirements for an auditor regarding misstatements identified during audit under SA 450.

Q5. Discuss meaning of "Date the financial statements are issued" under SA 560.

EXAMINATION QUESTIONS

Q1. Write short note on: Subsequent Events.

Q2. Explain the meaning of term "Subsequent Events" as used in SA 560. Should all types of subsequent events be considered by the auditor in attest functions. **[May 12 (8 Marks)]**

Q3. "The auditor should consider the effect of subsequent events on the financial statements and auditor's report according to SA 560". Comment. **[MTP-Oct. 19]**

Q4. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. Explain. **[RTP-May 19]**

Q5. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report. Explain the auditor's obligation in the above situation. **[RTP-May 20]**

Q6. Enquiry from management is helpful for auditor to evaluate subsequent events. Discuss specific enquiries in reference of SA 560, which might have effect on the financial statements. **[Nov. 14 (5 Marks)]**

Q7. In the context of SA 560 "Subsequent events", state specific enquiries on matters by an auditor which may have effect on Financial Statements. **[Nov. 17 (5 Marks)]**

Q8. On the basis of which assumption, the financial statements of a company are prepared. Explain. Also describe the objectives of the auditor regarding going concern. **[RTP-May 19]**

Q9. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the

normal course of business. Explain stating also the objective of the auditor regarding going concern. **[RTP-Nov. 19]**

Q10. Write short note on: Procedures to be performed by the auditor in expressing opinion on 'going concern' assumption. **[Nov. 10 (4 Marks)]**

Q11. Explain with reference to relevant SA: Appropriateness of going concern assumption.

Q12. Explain going concern assumption with reference to SA 570. State some financial events or conditions that may case doubt about going concern assumption. [May 12 (8 Marks)]

Q13. Discuss with reference to SAs: Operating conditions that may case doubt going concern assumption. **[May 14 (5 Marks)]**

Q14. Explain clearly meaning of Management Representation and objective of the auditor regarding written representation.

Q15. Explain clearly objective of the auditor regarding written representation. **[RTP-Nov. 19]**

Q16. Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Explain stating clearly objectives of the auditor regarding written representation. **[RTP-May 20]**

Q17. "Although written representations provide necessary audit evidence yet they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal". Discuss.

Q18. The auditor P of PAR and Co., a firm of Chartered Accountants is conducting audit of AB Industries Ltd. The auditor requests management to provide Banker's certificate in support of Fixed deposits whereas management provides only written representation on the matter. Analyse how would you deal as an auditor. **[RTP-May 18]**

Q19. Discuss with reference to SAs: What do you mean by "Written Representations"? As an auditor, how would you deal if management does not provide requested written representations? **[May 14 (5 Marks)]**

Q20. The auditor needs to assess each finding or exception to determine impact on the audit and evaluate if the exception results in a deficiency in internal control. Explain the statement.

Q21. In an audit plan for T Ltd., as the audit partner you want to highlight the sources of misstatements, arising from other than fraud, to your audit team and caution them. Identify the sources of misstatements. **[RTP Nov 18, May 22]**

Q22. CA Rashmi is the auditor of ABC Ltd. for the financial year ending 31/03/2024. The audit report for the year was signed by her on 19/04/2024. On 25/04/2024, the company received a communication

from the central government that an incentive amount of ₹ 5 crores pertaining to FY 2023-24 was approved. It was paid to the company before the end of April 2024. The financial statements of the company were not yet issued to the shareholders. The board of directors wished to include the incentive amount in the financial statements and requested the auditor to issue a fresh audit report for the year ended 31/03/2024. Analyse the issue involved and give an overview of the auditor's responsibility in such a situation. **[QP SEP 24 – 4 Marks]**

Q23. Projects India Limited (PIL) is engaged manufacturing and trading of disposable glasses and plates used in social gatherings/functions. XYZ & Co., Chartered Accountants, is the statutory auditor of PIL for the F.Y 2023-24. Analytical procedures carried out by the audit team, headed by CA Z, indicate that company's business is going downward and PIL could achieve only 50% of total revenue of F.Y 2022-23. Management has not taken any steps to increase the revenue or add new products or customers to stabilize the revenue and profitability. Also, the suppliers are demanding cash payment at the time of purchase of raw material. Before finalizing the audit report, audit in charge asked for a cash flow forecast from management for the next 12 months from the end date of financial statements. Keeping in view the above facts, answer the following:

a. What can be the likely purpose of CAZ in the above situation? **[Jan 25 – 3 Marks]**
b. State any two audit procedures in relation to the cash flow forecast likely to be performed by CA Z. **[Jan 25 – 2 Marks]**

Q24. SRP Limited appointed M/s JK & Co, as its statutory auditors. Auditors while carrying out the audit observed that company has entered into a complex transaction having material effect on the financial statements, In order to have realistic information on the said transaction (relevant to the audit), audit team decided to take assistance Irom those charged with governance. Two of the team members were discussing to who can be Those charged with governance" but could not get a fair idea of the same. Can you guide them by explaining the same? **[Jan 25 – 5 marks]**

Q25. Whilst the audit team has identified few matters, they need your advice to conclude on the same. Engagement partner have asked them to review the board minutes and other secretarial / regulatory records based on which the following additional matters were brought to the attention of the partner:

a. The long-term borrowings from the parent company has no written terms & neither the interest nor the principal has been repaid for.
b. Certain computers were received from the parent company free of cost, the value of which is ₹ 0.23 lakhs & no accounting or disclosure of the same has been made in the notes to accounts.
c. An amount of ₹ 3.25 lakhs per month is paid to M/s WE CARE Associates, a partnership firm, which is a related party in accordance with the provisions of the Companies Act, 2013 for the

marketing services rendered by them. Based on an independent assessment, the consideration paid is higher than the arm's length pricing by ₹ 0.25 lakh per month. Whilst the transaction was accounted in financial statements based on the amounts paid, no separate disclosure of this RPT has been made in the notes to accounts forming part of the FS highlighting the same as 'related party' transaction.

Audit manager has reported that she has asked certain information relating to another 'related party' transaction (amounting to approx. ₹ 47 lakhs) but the CFO refused to provide the same since the same is perceived to be confidential and cannot be shared with the auditors.

You are required to advise about items to be reported to TCWG, where applicable, based on your audit findings in the given situation. **[CA Final]**

Q26. M/s Manidhari & Associates have been appointed as an auditor of JIN Limited, a multinational company dealing in spare parts. During the course of audit, CA Manidhari is facing many problems including the problem of not getting the desired information from the management. Accordingly, he decided to communicate with TCWG about significant difficulties encountered during the audit. CA Manidhari seeks your guidance on matters which can be considered as significant difficulties as per SA 260.

[CA Final]

Q27. CA N has been appointed as an auditor of TRP Ltd. while conducting the audit he has identified some deficiencies in the internal control. He needs to determine whether a deficiency or combination of deficiencies in Internal control constitutes a "significant deficiency" and has to communicate them in writing to TCWG and management on timely basis. Guide CA N with some examples of maters to be considered while determining "significant deficiency" in internal control with reference to relevant SA. **[CA Final Nov 20 (5 marks)]**

Q28. During the course of the audit of Tirthankara Limited, CA Shreyansh Manager in the audit team identified that there is significant risk in lease transactions due to complex cross-border sale & lease back arrangements. This significant risk of material misstatement was not identified in management's risk assessment process. Upon various inquiries with management regarding their risk assessment process, it was identified and concluded by the audit team that the management's risk assessment process is not effective to identify all the significant risks.

CA Shreyansh decided that this in combination with other potential deficiencies in internal control constitutes significant deficiencies in internal control and hence, is required to be communicated to TCWG. However, the engagement partner had a different view regarding the audit of Thirthankara Limited. According to him, the only matter that is identified and poses significant deficiencies due to

their magnitude is only required to be communicated. Matters of potential misstatements that are not actual misstatements cannot be termed as significant deficiencies.

You are required to guide CA Shreyansh with respect to examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency. **[CA Final MTP Oct 22]**

Q29. Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. During the course of audit of ABD Ltd., you observed that significant deficiency exists in the internal control system and you want to ascertain the same. Elucidate the various indicators of significant deficiencies which will help you in assessing the efficiency of internal control system of the organisation.

[CA Final Jan 21 (5 marks)]

Q30. CA K is statutory auditor of DEMA Private Limited for the year 2022-23. The company has three plants in India. He is nearing completion of audit procedures relating to financial statements for the year under audit and has yet to sign audit report. Meanwhile, a huge fire had broken out in one of plants of the company located near Nashik on 25th June, 2023 damaging substantial part of machinery and work-in-process resulting in loss of about ` 5 crores. Unaware of the incident, he is in process of finalizing his report in first fortnight of July 2023. State few audit procedures to be performed by him to obtain sufficient appropriate evidence for identifying such events. Also explain auditor's responsibilities in this situation.

Q31. Kundan, a CA student, is part of an engagement team conducting audit of an entity. The audit procedures are nearing completion. He notices that engagement partner has asked for a cash flow forecast from management for next twelve months from date of financial statements. Keeping in view above, answer the following: -

a. Discuss likely purpose of engagement partner in the above situation. Elaborate upon significance of such testing being performed by engagement partner.

b. State any two audit procedures in relation to cash flow forecast likely to be performed by engagement partner. **[RTP Sep 24]**

Q32. CA Manoj is the statutory auditor of a company. He has completed the audit and issued the audit report dated June 30, 2024. Before signing the audit report, written representations dated June 29, 2024, were obtained from the management of the company. Discuss the significance of the date of written representations. Also state whether the written representations obtained on June 29, 2024 is appropriate or not. **[RTP Sep 24]**

Q33. While conducting audit of BYN Limited, CA Y notices that company has lost one of its key markets along with important customers. Additionally, several highly successful competitors have emerged, impacting business of the company. Despite the existence of material uncertainty, CA Y finds the use of going concern basis of accounting appropriate for preparation of financial statements. The company has also disclosed material uncertainty in notes to accounts adequately. How should he deal with the matter in auditor's report? **[RTP Sep 24]**

Q34. During the audit of a company, CA Kartik has noticed that company's turnover has fallen drastically as compared to last three years due to loss of its major markets and key customers. The company is in need of funds for new product development, but bankers are not willing to lend financial support. Which additional audit procedures need to be performed by CA Kartik in accordance with SA 570 when such events or conditions are identified? **[RTP Jan 25]**

Q35. Projects India Limited (PIL) is engaged manufacturing and trading of disposable glasses and plates used in social gatherings/functions. XYZ & Co., Chartered Accountants, is the statutory auditor of PIL for the F.Y 2023-24. Analytical procedures carried out by the audit team, headed by CA Z, indicate that company's business is going downward and PIL could achieve only 50% of total revenue of F.Y 2022-23. Management has not taken any steps to increase the revenue or add new products Or customers to stabilize the revenue and profitability. Also the suppliers are demanding cash payment at the time of purchase of raw material. Before finalizing the audit report, audit in charge asked for a cash flow forecast from management for the next 12 months from the end date of financial statements. Keeping in view the above facts, answer the following:

a. What can be the likely purpose of CAZ in the above situation?

b. State any two audit procedures in relation to the cash flow forecast likely to be performed by CA Z. **[Jan 25 – 5 marks]**

SPACE FOR ADDITIONAL NOTES

CHAPTER 8 – AUDIT REPORT

ASPECTS TO BE COVERED	
1. SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements."	
2. SA 705 "Modifications to The Opinion in The Independent Auditor's Report"	3. SA 701- "Communicating Key Audit Matters in The Independent Auditor's Report"
4. SA 706 – The Emphasis of Matter Paragraphs and Other Matter Paragraphs in The Independent Auditor's Report as per SA 706	5. SA 710 - "Comparative Information- Corresponding figures and Comparative financial statements"
6. Branch Audit & SA 600 – "Using the work of Another Auditor"	7. SA 299 – "Joint Audit of Financial Statements"
8. Reporting requirements under the Companies Act, 2013	9. Companies (Auditor's Report) Order, 2020

Introduction

1. Management is responsible for the preparation of the financial statements.
2. Management also accepts responsibility for necessary internal controls.
3. The purpose of an audit is to enhance the degree of confidence of intended users of the financial statements.
4. Purpose is achieved by the expression of an independent reporting by the auditor as to whether the financial statements exhibit a true and fair view of the affairs of the entity.
5. Thus, an audit report is an opinion drawn on the entity's financial statements to make sure that the records are true and fair representation of the transactions they claim to represent.

SA 700 (Revised)- "Forming an Opinion and Reporting on Financial Statements"

1. Deals with the auditor's responsibility to form an opinion on the financial statements.
2. It also deals with the form and content of the auditor's report issued as a result of an audit of financial statements.

OBJECTIVE OF THE AUDITOR

1. To **form an opinion** on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained. To obtain this, the auditor shall conclude as to whether the auditor

has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account

a. Whether sufficient appropriate audit evidence has been obtained;
b. Whether uncorrected misstatements are material, individually or in aggregate;
c. The evaluations

2. To express clearly that opinion **through a written report**.

EVALUATIONS BY THE AUDITOR

Qualitative Aspects of the Entity's Accounting Practices:

1. Management makes a number of judgements about the amounts and disclosures in the financial statements.
2. SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.
3. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgements. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:
    a. The selective correction of misstatements brought to management's attention during the audit
    b. Possible management bias in the making of accounting estimates.
4. SA 540 addresses possible management bias in making accounting estimates.

Specific Evaluations by the Auditor: An auditor shall evaluate the following –

1. The financial statements adequately disclose the significant accounting policies selected and applied;
2. The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
3. The accounting estimates made by management are reasonable;
4. The information presented in the financial statements is relevant, reliable, comparable, and understandable;
5. The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
6. The terminology used in the financial statements, including the title of each financial statement, is appropriate.

7. when the financial statements are prepared in accordance with a fair presentation framework, the evaluation shall also include an evaluation by the auditor whether the financial statements achieve fair presentation which shall include consideration of
    a. The overall presentation, structure and content of the financial statements.
    b. Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

RELEVANT DEFINITIONS

(a) **General purpose financial statements** – Financial statements prepared in accordance with a general-purpose framework.

(b) **General purpose framework** – A financial reporting framework designed to meet the common financial information needs of a wide range of users. The financial reporting framework may be a fair presentation framework or a compliance framework.

(c) **Fair presentation framework** – is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and acknowledges explicitly or implicitly that
    a. To achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework.
    b. In extremely rare circumstances, It may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements.

(d) **Compliance framework** – Is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above.

(e) **Unmodified opinion** – The opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

FORM OF OPINION

(A) **Unmodified Opinion**: The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

(B) **Modified Opinion**: If the auditor

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

The auditor shall modify the opinion in the auditor's report in accordance with SA 705

AUDITOR'S REPORT

Basic Elements of an Audit Report are given below:

1. **Title**: The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor.

2. **Addressee**:
   a. The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement.
   b. Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed.
   c. It is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.
   d. In case of a company, the report is addressed to the shareholders of the company.
3. **Auditor's Opinion**: The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion". This section shall also state –
   a. Identify the entity **whose** financial statements have been audited.
   b. State that the financial statements **have been audited**.
   c. Identify the **title of each statement** comprising the financial statements.
   d. Refer to the **notes**, including the summary of significant accounting policies.
   e. Specify the **date of, or period covered** by, each financial statement comprising the financial statements.
4. **Basis for Opinion**: The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that
   a. States that the audit was **conducted in accordance with Standards** on Auditing;
   b. **Refers to the section** of the auditor's report that describes the auditor's responsibilities under the SAs;

c. Includes a statement that the **auditor is independent of the entity** in accordance with the relevant ethical requirements relating to the audit **and has fulfilled the auditor's other ethical responsibilities** in accordance with these requirements.

d. States **whether the auditor believes that the audit evidence** the auditor has obtained is sufficient and appropriate to **provide a basis for the auditor's opinion.**

5. **Going Concern**: Where applicable, the auditor shall report in accordance

a. The financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future.

b. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

c. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

d. The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

e. Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's judgement, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

f. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgement, appropriate disclosure of the nature and implications of the uncertainty is necessary for:

i. In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or

ii. In the case of a compliance framework, the financial statements not to be misleading.

6. **Key Audit Matters**: For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701.

a. When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.

b. Law or regulation may require communication of key audit matters for audits of entities other than listed entities.

7. **Responsibilities for the Financial Statements**: This section of the auditor's report shall describe management's responsibility for
   a. Preparing the financial statements in accordance with the applicable financial reporting framework, and
   b. For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
   c. Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern.
   d. SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted.
   e. SA 210 requires the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.
8. **Auditor's Responsibilities for the Audit of the Financial Statements**: The auditor's report shall include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."
   I. **This section of the auditor's report shall state**:
      a. That the objectives of the auditor are to
         i. Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
         ii. Issue an auditor's report that includes the auditor's opinion
      b. **That reasonable assurance is a high level of assurance, but is not a guarantee** that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and
      c. That misstatements can arise from fraud or error, and either
         i. Describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements; or
         ii. Provide a definition or description of materiality in accordance with the applicable financial reporting framework.

II. **The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report shall further**:

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

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

   i. To identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error;

   ii. To design and perform audit procedures responsive to those risks; and

   iii. To obtain audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion.

   iv. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

   v. To obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances.

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

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

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

c. When SA 600 applies, further describe the auditor's responsibilities in a group audit engagement by stating – The division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components is audited by the other auditors have been included in the financial information of the entity.

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

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

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

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

9. **Location of the description of the auditor's responsibilities for the audit of the financial statements**:

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

   b. Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix.

   c. By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so.

10. **Other Reporting Responsibilities**: other reporting responsibilities that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled "Report on Other Legal and Regulatory Requirements".

11. **Signature of the Auditor**:

   a. The auditor's report shall be signed.

   b. The report is signed by the auditor (i.e. the engagement partner) in his personal name.

   c. Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm.

   d. The partner/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India.

e. They also include the registration number of the firm, wherever applicable, as allotted by ICAI, in the audit reports signed by them.

12. **Place of Signature**: The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.
13. **Date of the Auditor's Report**: The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that:
    a. All the statements that comprise the financial statements, including the related notes, have been prepared; and
    b. Those with the recognized authority have asserted that they have taken responsibility for those financial statements.
    c. An auditor is required to mention the UDIN with respect to each audit report being signed by him, along with his membership number while signing an audit report.
    d. Chartered Accountants having full-time Certificate of Practice can register on UDIN Portal and generate UDIN by registering the certificates attested/certified by them.
    e. It is required to be stated in case of audit reports and certificates. All Certificates were made mandatory with effect from 1st February, 2019 as per the Council decision taken at its 379th meeting held on 17th – 18th December, 2018.

SA 705 (Revised) – "Modifications to The Opinion In The Independent Auditor's Report"

➢ **When will modification be required?**

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

b) The auditor is **unable to obtain SAAE** to conclude that the financial statements as a whole are free from material misstatement.

Definition of Pervasive – A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence.

Pervasive effects on the financial statements are those that, in the auditor's judgement:

(i) Are not limited to specific elements, accounts or items of the financial statements;

(ii) If so limited, represent or could represent a substantial proportion of the financial statements; or

(iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.

- **Objective of the Auditor**- To Express Clearly an Appropriately modified Opinion when
  a) The auditor **concludes**, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
  b) The auditor is **unable to obtain SAAE** to conclude that the financial statements as a whole are free from material misstatement.
- **Types of Modified Opinions**:
  a) **Qualified Opinion**: express a qualified opinion when
     a) The auditor, having obtained SAAE, **concludes** that misstatements, individually or in the aggregate, are **material, but not pervasive**, to the financial statements.
     b) The auditor is **unable to obtain SAAE** on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be **material but not pervasive**.
  b) **Adverse Opinion**: shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
  c) **Disclaimer of Opinion**: The auditor shall disclaim an opinion when the auditor is **unable to obtain SAAE** on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.
- **Which type of opinion is appropriate?**
  (a) It depends on two factors, namely
     - Nature of matter which is misstated &
     - Auditor's judgement of pervasiveness or possible effects of the matter on the financial statements.

Nature of Matter Giving Rise to the Modification	Auditor's Judgement about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but not Pervasive	Material and Pervasive
Financial statements are materially misstated	QUALIFIED	ADVERSE
Inability to obtain sufficient appropriate audit evidence	QUALIFIED	DISCLAIMER OF OPINION

- **Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement**:

a) If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers is likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

b) If management refuses to remove the limitation referred above, the auditor shall communicate the matter to TCWG, unless all of TCWG are involved in managing the entity and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

c) If the auditor is unable to obtain SAAE, the auditor shall determine the implications as follows:

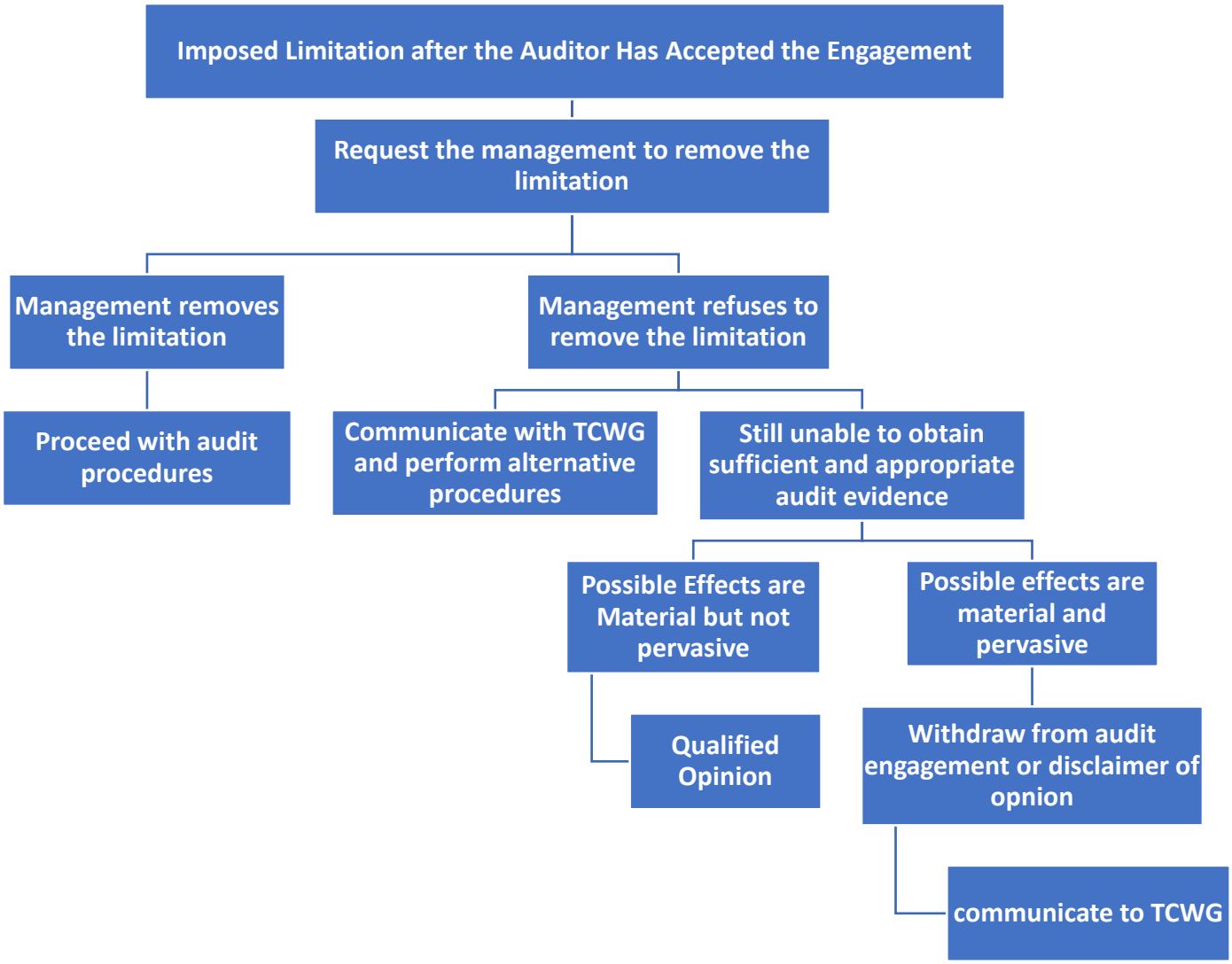
(i) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or

(ii) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity (seriousness, severity) of the situation, the auditor shall:

a) Withdraw from the audit, where practicable and possible under applicable law or regulation; If the auditor withdraws as contemplated by point (b)(i) above, before withdrawing, the auditor shall communicate to TCWG any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion

or

b) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.



➢ **Form and Content of the Auditor's Report When the Opinion is Modified**:

Qualified Opinion

When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, **except for the effects of the matter(s) described in the Basis for Qualified Opinion section**,

(a) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or

(b) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

Adverse Opinion

When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, **because of the significance of the matter(s) described in the Basis for Adverse Opinion section**,

(a) When reporting in accordance with a fair presentation framework, the accompanying financial statements **do not present fairly** (or give a true and fair view of) […] in accordance with [the applicable financial reporting framework]; or

(b) When reporting in accordance with a compliance framework, the accompanying financial statements have **not been prepared**, in all material respects, in accordance **with [the applicable financial reporting framework]**.

Disclaimer of Opinion

When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:

(a) State that the auditor **does not express an opinion** on the accompanying financial statements;

(b) State that, **because of the significance of the matter(s) described** in the Basis for Disclaimer of Opinion section, the **auditor has not been able to obtain sufficient appropriate audit evidence** to provide a basis for an audit opinion on the financial statements; and

(c) **Amend the statement** required by SA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

- **Basis for Opinion**: When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):
  a) Amend the heading "Basis for Opinion" required by SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and
  b) Within this section, include a description of the matter giving rise to the modification
  c) What to specify?
     i. If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements – description and quantification.
     ii. If it is not practicable to quantify the financial effects, the auditor shall so state in this section.
     iii. If there is a material misstatement of the financial statements that relates to narrative disclosures – explanation of how the disclosures are misstated.

iv. If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed
    - Discuss the non-disclosure with TCWG;
    - Describe in the Basis for Opinion section the nature of the omitted information.
    - Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained SAAE about the omitted information

v. If the modification results from an inability to obtain sufficient appropriate audit evidence – reasons for that inability.

vi. When the auditor expresses a qualified or adverse opinion, the auditor shall amend the statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis to include the word "qualified" or "adverse".

vii. When the auditor disclaims an opinion on the financial statements, the auditor's report shall not include the following elements
    - A reference to the section where the auditor's responsibilities are described.
    - A statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis

- **Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements:**

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

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

  (b) A statement that, however, beca**use of the matter(s) described in the Basis for Disclaimer of Opinion section**, the auditor was not able to obtain SAAE to provide a basis for an audit opinion on the financial statements; and

  (c) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised).

- When the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.

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

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

Deals with additional communication in the auditor's report when the auditor considers it necessary to draw user's attention for their own understanding.

- **Objective of the Auditor as per SA 706**: is to draw users' attention, when in the auditor's judgement it is necessary to do so, by way of clear additional communication in the auditor's report, to:
  (a) A matter, although **appropriately presented or disclosed in the financial statements**, that is of such importance that it is fundam**ental to users' understanding of the financial statements**; or
  (b) As appropriate, **any other matter** that is relevant to users' **understanding of the audit, the auditor's responsibilities or the auditor's report.**

➢ EMPHASIS OF MATTER PARAGRAPH

1. Emphasis of Matter paragraph is a paragraph included in the auditor's report
2. That refers to a matter appropriately presented or disclosed in the financial statements
3. That, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements.

- **Conditions before the auditor includes any matter in EOM Paragraph**:
  (a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter
  (b) The matter has not been determined to be a key audit matter to be communicated in the auditor's report
- **Separate section for Emphasis of Matter paragraph**:
  (a) Include the paragraph within a **separate section** of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";

(b) Include in the paragraph a **clear reference to the matter** being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and

(c) Indicate that the **auditor's opinion is not modified** in respect of the matter emphasized.

(d) **Examples** where auditor can consider it necessary to include in EOM paragraph:

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- A major catastrophe (disaster / calamity) that has had, or continues to have, a significant effect on the entity's financial position.

➢ **Should EOM Paragraph affect auditor's opinion**? – An Emphasis of Matter paragraph is not a substitute for:

(a) A **modified opinion** in accordance with SA 705 (Revised) **when required** by the circumstances of a specific audit engagement;

(b) **Disclosures** in the financial statements **that the** applicable financial reporting **framework requires** management to make, or that are otherwise necessary to achieve fair presentation.

(c) Reporting in accordance with SA 570 (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

➢ OTHER MATTER PARAGRAPH

1. Other Matter paragraph is a paragraph included in the auditor's report
2. That refers to a matter other than those presented or disclosed in the financial statements.
3. That, in the auditor's judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, PROVIDED
    a. This is not prohibited by law or regulation; and
    b. The matter has not been determined to be a key audit matter to be communicated in the auditor's report.

- **Separate section for Other Matter paragraph**:
  (a) The auditor shall include the paragraph within a separate section with the heading "Other Matter," or other appropriate heading.

Communication with Those Charged with Governance

If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the **auditor shall communicate** with those charged with governance regarding this expectation and the wording of this paragraph.

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

- **Definition** – Key Audit Matters are those matters that, in the auditor's professional judgement were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.
- **Purpose of Communicating KAM** –
  (a) Enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed.
  (b) Provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period.
  (c) May also assist intended users in understanding the entity and areas of significant management judgement in the audited financial statements.
- **Objectives of the Auditor regarding Key Audit Matters:**
  (a) To determine key audit matters and,
  (b) Having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report.
- **Determining Key Audit Matters:**
  (a) From the matters communicated with TCWG,
  (b) Those matters that required significant auditor attention in performing the audit.
  (c) In making this determination, the auditor shall take into account the following:
    - Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.

- Significant auditor judgements relating to areas in the financial statements that involved significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty.
- The effect on the audit of significant events or transactions that occurred during the period.

➢ **Communicating Key Audit Matters**:

(a) Describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters".

(b) The introductory language in this section of the auditor's report shall state that:

- Key audit matters are those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements [of the current period]; and
- These matters were **addressed in the context of the audit** of the financial statements as a whole, and in forming the auditor's opinion thereon, and the **auditor does not provide a separate opinion on these matters.**

➢ **Communicating KAM- not a substitute for disclosure in the Financial Statements etc**: Communicating key audit matters in the auditor's report is not –

(a) A substitute **for disclosures in the financial statements** that the AFRF requires management to make, or that are otherwise necessary to achieve fair presentation;

(b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705.

(c) A substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

(d) A separate opinion on individual matters.

➢ **Communication with Those Charged with Governance**: The auditor shall communicate with those charged with governance

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

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

SA 710 – "COMPARATIVE INFORMATION-CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS"

- **The Nature of the Comparative Information**: There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements:
  - ✓ The essential audit reporting differences between the approaches are:
    - **For corresponding figures –** the auditor's opinion on the financial statements refers to the current period only; whereas
    - **For comparative financial statements –** the auditor's opinion refers to each period for which financial statements are presented
- **Objectives**
  - ✓ To obtain SAAE about whether the comparative information included in the financial statements has been presented, in accordance with the requirements for comparative information in the AFRF.
  - ✓ To report in accordance with the auditor's reporting responsibilities.

COMPARATIVE INFORMATION

- **Definition of Comparative Information** – The amounts and disclosures included in the financial statements
- Audit Procedures regarding comparative information
  - The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified.
  - For this purpose, the auditor shall evaluate whether:
    - ❖ The comparative information agrees with the amounts and other disclosures presented in the prior period.
    - ❖ The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.
  - If the auditor **becomes aware of a possible material misstatement** in the comparative information while performing the current period audit, the auditor shall **perform such additional audit procedures** to determine whether a material misstatement exists.

- If the auditor had **audited the prior period's financial statements**, the auditor shall also follow the relevant requirements of SA 560.
- As required by SA 580, the auditor shall **request written representations** for all periods referred to in the auditor's opinion.
- The auditor shall also obtain a **specific written representation** regarding any prior period item that is separately disclosed in the current year's statement of profit and loss.

➢ Audit Reporting regarding Corresponding Figures:

- Comparative information where **amounts and other disclosures for the prior period** are included as an integral part of the current period financial statements.
- and are intended to be **read only in relation to the amounts and other disclosures** relating to the current period (referred to as "current period figures").
- The **level of detail** presented in the corresponding amounts and disclosures **is dictated primarily by its relevance** to the current period figures.

➢ **When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances**:

- **If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved:**
  - ❖ The auditor shall **modify the auditor's opinion** on the current period's financial statements.
  - ❖ In the **Basis for Modification paragraph** in the auditor's report, the auditor shall either:
  - ❖ **Refer to both** the current period's **figures** and the corresponding figures **giving rise to the modification** when the effects or possible effects of the matter on the current period's figures are material; or
  - ❖ In other cases, **explain that the audit opinion has been modified because of** the effects or possible **effects of the unresolved matter** on the comparability of the current period's figures and the corresponding figures.
- **If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued**:

- ❖ The auditor shall **verify whether the misstatement has been dealt with** as required under the applicable financial reporting framework and,
- ❖ If that is not the case, the auditor shall **express a qualified opinion or an adverse opinion** in the auditor's report **on the current period** financial statements, modified.

▪ **Prior Period Financial Statements Not Audited**

- ❖ If the prior period financial statements were not audited, the auditor shall **state in an Other Matter paragraph that the corresponding figures are unaudited.**
- ❖ Such a statement does not, however, relieve the auditor of the requirement to obtain SAAE that the opening balances do not contain misstatements that materially affect the current period's financial statements.

COMPARATIVE FINANCIAL STATEMENTS

- **Definition**: Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor 's opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period
- **Auditor's opinion- to refer each period**: When comparative financial statements are presented, the **auditor's opinion shall refer to each period** for which financial statements are presented and on which an audit opinion is expressed.
- **When reporting on prior period financial statements in connection with the current period's audit:** If the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall **disclose the substantive reasons for the different opinion** in an **Other Matter** paragraph in accordance with SA 706.
- **Prior Period Financial Statements Audited by a Predecessor Auditor**: If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:
  - That the financial statements of the prior period were audited by a predecessor auditor
  - The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and
  - The date of that report, unless the predecessor auditor's report on the prior period's financial statements is revised with the financial statements.
- If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the

auditor shall communicate the misstatement with the appropriate level of management and those charged with governance and request that the predecessor auditor be informed. If the prior period financial statements are amended, and the predecessor auditor agrees to issue a new auditor's report on the amended financial statements of the prior period, the auditor shall report only on the current period.

- **Prior Period Financial Statements Not Audited**:
  - If the prior period financial statements were not audited, the auditor shall state in an OM paragraph that the comparative financial statements are unaudited.
  - Such a statement does not, however, relieve the auditor of the requirement to obtain SAAE that the opening balances do not contain misstatements that materially affect the current period's financial statements.

JOINT AUDIT

Meaning - Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually.

Advantages & Disadvantages

Advantages of Joint audit is as follows –

1. Sharing of expertise.
2. Advantage of mutual consultation.
3. Lower workload.
4. Better quality of performance.
5. Improved service to the client.
6. Displacement of the auditor of the company taken over in a take - over often obviated.
7. In respect of multi-national companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.
8. Lower staff development costs.
9. Lower costs to carry out the work.
10. A sense of healthy competition towards a better performance.

Disadvantages of joint audit is as follows –

1. The fees being shared.
2. Psychological problem where firms of different standing are associated in the joint audit.
3. General superiority complexes of some auditors.
4. Problems of co-ordination of the work.
5. Areas of work of common concern being neglected.
6. Uncertainty about the liability for the work done

(SA) 299 (Revised), "Joint Audit of Financial Statements" which lays down the principles for effective conduct of joint audit to achieve the overall objectives of the auditor as laid down in SA 200 "Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with Standards on Auditing".

This Standard deals with the SPECIAL CONSIDERATIONS in carrying out audit by joint auditors. It requires that–

1. The engagement partner and other key members of the engagement team from each of the joint auditors should be involved in planning the audit.
2. The joint auditors should jointly establish an overall audit strategy which sets the scope, timing and direction of the audit, and also guides the development of the audit plan.
3. Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:
   a. Identify division of audit areas and common audit areas;
   b. Ascertain the reporting objectives of the engagement;
   c. Consider and communicate among all joint auditors the factors that are significant
   d. In directing the engagement team's efforts;
   e. Consider the results of preliminary engagement activities, or similar engagements performed earlier.
   f. Ascertain the nature, timing and extent of resources necessary to accomplish the engagement.
4. Each of the joint auditors should consider and assess the risks of material misstatement and communicate to other joint auditors.
5. The joint auditors should discuss and document the nature, timing, and the extent of the audit procedures for (I) common and (II) specific allotted areas of audit to be performed.
6. The joint auditors should obtain common engagement letter and common management representation letter.

7. The work allocation document should be signed by all the joint auditors and communicated to those charged with governance.

LIABILITY OF JOINT AUDITORS

1. In respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures.
2. On the other hand, all the joint auditors shall be jointly and severally responsible for:
   a. The audit work which is not divided among the joint auditors and is carried out by all joint auditors.
   b. Decisions taken by all the joint auditors under audit planning in respect of common audit areas.
   c. Matters which are brought to the notice of the joint auditors by any one of them and there is an agreement among the joint auditors on such matters;
   d. Examining that the financial statements of the entity comply with the requirements of the relevant statutes;
   e. Presentation and disclosure of the financial statements as required by the applicable financial reporting framework;
   f. Ensuring that the audit report complies with the requirements of the relevant statutes, applicable Standards on Auditing and other relevant pronouncements issued by ICAI.
3. In case a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by other joint auditors, the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

Reporting of Joint Auditors

It may be noted that the joint auditors are required to issue common audit report. However, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit report(s).

BRANCH AUDIT

RELEVANT PROVISIONS OF THE COMPANIES ACT, 2013.

Section 128 of The Companies Act, 2013 –

1. Every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and
2. Explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.
3. It may be noted that all or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the company shall, within 7 days thereof, file with the Registrar a notice in writing giving the full address of that other place.
4. 128(2) provides that where a company has a branch office in India or outside India, it shall be deemed to have complied with the provisions of sub-section (1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns periodically are sent by the branch office to the company at its registered office or the other place referred in 3 above.

Section 143 of The Companies Act, 2013 –

1. Where a company has a branch office, the accounts of that office shall be audited either
   a. By the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or
   b. where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country
2. It may be noted that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

3. Further as per rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

SA 600 – USING THE WORK OF ANOTHER AUDITOR – ROLES & RESPONSIBILITIES OF BRANCH AUDITOR

1. Principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so.
2. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.
3. It requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes –
    a. Advise the other auditor of the use that is to be made of his work and report
    b. Make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit.
    c. The principal auditor would inform the other auditor of matters such as are as requiring special consideration, procedures for the identification of inter -component transactions that may require disclosure
    d. The time-table for completion of audit; and
    e. Advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.
4. The principal auditor might discuss with the other auditor
    a. The audit procedures applied or
    b. Review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list.
    c. The principal auditor may also wish to visit the other auditor.

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

REPORTING REQUIREMENTS UNDER THE COMPANIES ACT, 2013

Powers of Auditors [Section 143(1)]

1. Every auditor of a company shall have a right of access, at all times to the books of accounts and vouchers of the company, whether kept at the registered office of the company or at any other place.
2. Entitled to require from the officers of the company such information and explanations as the auditor may consider necessary for the performance of his duties as auditor.
3. Auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statements with that of its subsidiaries

Duties of Auditors

1. Matters of inquiry: The auditor shall inquire into the following matters, namely:
2. Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members
3. Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company
4. Where the company not being an investment company or a 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.
5. Whether loans and advances made by the company have been shown as deposits.
6. Whether personal expenses have been charged to revenue account.
7. Where it is stated in the books and documents of the company 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, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

Reporting over Accounts and Financial Statements [Section 143(2)]

1. The auditor shall make a report to the members of the company on the following:
2. On the accounts examined by him; and
3. On every financial statement which are required by or under this Act to be laid before the company in general meeting.
4. The auditor shall express his opinion of the accounts and financial statements examined by him. He shall express the opinion which according to him and to the best of his information and knowledge,

the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

Other elements to be covered in Audit report - [Section 143(3)]

The auditors' report shall also state-

1. whether he has **sought and obtained all the information and explanations** which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements.
2. whether, in his opinion, **proper books of account** as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
3. whether the report on the **accounts of any branch office** of the company audited under section 143(8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
4. whether the company's **balance sheet and profit and loss account** dealt with in the report **agree with the books of account** and returns.
5. whether, in his opinion, the **financial statements comply with the accounting standards**.
6. the **observations or comments of the auditors** on financial transactions or matters which have any **adverse effect** on the functioning of the company.
7. whether any **director is disqualified** from being appointed as a director under section 164(2).
8. any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.
9. whether the company has adequate **internal financial controls system in place and the operating effectiveness of such controls**. However, it may be noted that the reporting requirement on adequacy of internal financial controls (IFCs) with reference to financial statements shall not be applicable to a private company which is a-
    a. One person company; or
    b. Small company; or
    c. Company having turnover less than ₹ 50 crore as per latest audited financial statement and having aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year less than ₹ 25 crore.
10. Such other matters as may be prescribed.

Rule 11 of the Companies (Audit and Auditors) Rules, 2014 provides that the auditor's report shall also include their views and comments on the following matters, namely -

1. Whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.
2. Whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts
3. Whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.
4. Indirect Advancement of funds:
   a. Whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries.
   b. Whether the management has represented, that, to the best of it's knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and
   c. Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and (ii) contain any material mis-statement
5. Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.
6. Whether the company has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered

with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

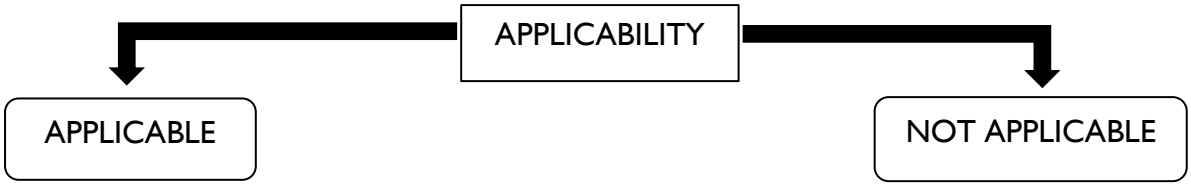
Reporting of frauds by auditors [Section 143(12)]

1. If an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving amount of ₹. 1 crore or above is being or has been committed,
2. in the company by its officers or employees,
3. the auditor shall report the matter to the Central Government within such time and in such manner prescribed in Rule 13 of the Companies (Audit and Auditors) Rules, 2014 which is as under –
4. The auditor shall report the matter to the Central Government as under:
    I. the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days.
    II. on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the CG within 15 days from the date of receipt of such reply or observations;
    III. in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the CG along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
    IV. 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.
    V. the report shall be on the letterhead 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
    VI. The report shall be in the form of a statement as specified in Form ADT-4.
5. In case of a fraud involving lesser than the amount specified the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:
        I. Nature of Fraud with description.
        II. Approximate amount involved; and

III. Parties involved.

6. The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year shall be disclosed in the Board's Report:
   I. Nature of Fraud with description.
   II. Approximate Amount involved.
   III. Parties involved, if remedial action not taken; and
   IV. Remedial actions taken.
7. The companies, whose auditors have reported frauds 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.

COMPANIES (AUDITOR'S REPORT) ORDER, 2020 – CARO, 2020



Every company including foreign company

a. A banking company.
b. An insurance company
c. A section 8 company
d. A One Person Company as defined in Section 2(62) of the Companies Act
e. A small company as defined in clause (85) of sec 2 of the Companies Act
f. a private limited company,
   a. not being a subsidiary or holding company of a public company,
   b. having a PUC + R&S ≤ Rs 1 crore as on the balance sheet date and
   c. having borrowing ≤ Rs 1 crore from any bank or financial institution at any point of time during the financial year and
   d. Having revenue (incl discontinuing operations) < 10 crores during the FY

NOTE: Order shall not apply to the auditor's report on consolidated financial statements except clause (xxi) of paragraph 3.

PARAGRAPH 3

(i) PROPERTY, PLANT & EQUIPMENT

(a) Relating to records

(a) whether the company is **maintaining proper records** showing full particulars, including quantitative details and situation **of Property, Plant and Equipment.**

(b) whether the company is **maintaining proper records** showing full particulars **of intangible assets.**

(b) **Physical Verification** –

(a) whether these PPE have been **physically verified** by the management at reasonable intervals;

(b) whether any **material discrepancies** were noticed on such verification

(c) And if so, whether the same have been **properly dealt** with in the books of account.

(c) **Immovable property** – whether the **title deeds of all the immovable properties** (other than taken on lease) disclosed in the financial statements **are held in the name of the company**, if not, provide the details thereof in the format below: -

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held – indicate range, where appropriate	Reason for not being held in name of company

(d) **Revaluation** – Whether the company has revalued its PPE (including Right of Use assets) **or intangible assets or both during the year** and, if so, whether the revaluation is based on the valuation by a Registered Valuer; **specify the amount of change, if change is 10% or more in the aggregate** of the net carrying value of each class of PPE or intangible assets.

(e) **Proceedings related to Benami property** – whether any **proceedings have been initiated** or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 and rules made thereunder, if so, whether the company has **appropriately disclosed the details** in its financial statements.

(ii) INVENTORY

(a) **Physical Verification** –

(a) whether **physical verification of inventory** has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate;

(b) whether any **discrepancies of 10% or more** in the aggregate for each class of inventory were noticed and if so, whether they **have been properly dealt** with in the books of accounts.

(b) **Working capital limits** –

(a) whether during any point of time of the year, the company has been sanctioned working capital limits **> Rs 5 crores**, in aggregate, **from banks or financial institutions** on the basis of security of current assets;

(b) whether the **quarterly returns or statements filed by the company** with such banks or financial institutions are in agreement with the books of account of the Company, **if not, give details.**

(iii) LOANS, INVESTMENTS, GUARANTEE OR SECURITY

whether during the year the company has **made investments** in, **provided any guarantee** or **security** or **granted any loans or advances** in the nature of loans, secured or unsecured, **to companies, firms, Limited Liability Partnerships or any other parties**, if so, -

(a) whether during the year the company has **provided loans or provided advances in the nature of loans, or stood guarantee, or provided security** to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-

(A) The **aggregate amount** during the year, **and balance outstanding** at the balance sheet date **to subsidiaries, joint ventures and associates**;

(B) The **aggregate amount** during the year, **and balance outstanding** at the balance sheet date **to parties other than subsidiaries, joint ventures and associates**;

(b) Whether the **investments** made, **guarantees** provided, security given and the **terms and conditions** of the grant of all loans and advances in the nature of loans and guarantees provided **are not prejudicial (damaging) to the company's interest**;

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

(d) If the **amount is overdue**, state the total amount **overdue for > 90 days**, and whether **reasonable steps** have been taken by the company **for recovery of the principal and interest.**

(e) whether any **loan or advance** in the nature of loan granted which has **fallen due during the year,** has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, if so, **specify the aggregate amount** of such dues renewed or extended or settled by fresh loans **and the percentage of the aggregate to the total loans or advances** in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];

(f) whether the company has **granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment**, if so, **specify the aggregate amount, percentage thereof to the total loans granted**, aggregate amount of loans granted to Promoters, related parties as defined in sec 2(76) of The Companies Act, 2013;

(iv) COMPLIANCE OF SECTION 185 & 186

In respect of loans, investments, guarantees, and security, whether provisions of sections 185 and 186 of the Companies Act have been complied with, if not, provide the details thereof.

(v) DEPOSITS

(a) In respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the **directives issued by the RBI** and the **provisions of sections 73 to 76** or any **other relevant provisions** of the Companies Act **and the rules** made thereunder, where applicable, **have been complied with**, **if not, the nature of such contraventions** be stated;

(b) if an **order has been passed** by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, **whether the same has been complied with or not**.

(vi) MAINTENANCE OF COST RECORDS

whether maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act and whether **such accounts and records have been so made and maintained**.

(vii) STATUTORY DUES

(a) whether the company is **regular in depositing undisputed statutory dues** to the appropriate authorities **and if not, the extent of the arrears of outstanding** statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated.

(b) where statutory dues referred to in sub-clause (a) have not been deposited on account of **any dispute**, then the **amounts involved and the forum where dispute is pending** shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute).

(viii) UNRECORDED INCOME

whether any **transactions not recorded** in the books of account **have been surrendered or disclosed as income during the year** in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income **has been properly recorded in the books of account during the year.**

(ix) REPAYMENT OF LOANS

(a) whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below:

Nature of borrowing, including debt securities	Name of lender	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any

(b) whether the company is a **declared wilful defaulter by any bank or financial institution or other lender.**

(c) whether term loans were **applied for the purpose for which the loans were obtained**; if not, the amount of loan so diverted and the purpose for which it is used may be reported;

(d) whether funds **raised on short term basis have been utilised for long term purposes**, if yes, the nature and amount to be indicated;

(e) whether the company has **taken any funds** from any entity or person on account of or **to meet the obligations of its subsidiaries, associates or joint ventures**, if so, details thereof with nature of such transactions and the amount in each case;

(f) whether the company has **raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details** thereof and also report if the company has defaulted in repayment of such loans raised;

(x) IPO / FPO / PREFERENTIAL ALLOTMENT

(a) **By way of initial public offer or further public offer** – Moneys raised during the year were **applied for the purposes for which those are raised, if not, the details** together with delays or default and subsequent rectification, if any, as may be applicable, **be reported.**

(b) **Preferential allotment or private placement** – Company **has made PA or PP** of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the **requirements of section 42 and section 62** of the Companies Act, 2013 have been complied with and the **funds raised have been used for the purposes for which the funds were raised**, if not, provide details in respect of amount involved and nature of non-compliance.

(xi) FRAUD REPORTING

(a) Whether any fraud **by the company** or any fraud **on the company** has been **noticed or reported during the year, if yes, the nature and the amount involved** is to be indicated.

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

(c) whether the auditor has **considered whistle-blower complaints**, if any, received during the year by the company.

(xii) NIDHI COMPANIES

(a) Complied with the **Net Owned Funds to Deposits in the ratio of 1:20** to meet out the liability.

(b) Maintaining **10% unencumbered term deposits** as specified in the Nidhi Rules, 2014 to meet out the liability.

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

(xiii) RELATED PARTY TRANSACTIONS

whether all transactions with the related parties are in **compliance with sections 177 and 188 of Companies Act** where applicable and the **details have been disclosed** in the financial statements, etc., as required by the applicable accounting standards.

(xiv) INTERNAL AUDIT SYSTEM

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

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

(xv) NON-CASH TRANSACTIONS

Whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the **provisions of section 192** of Companies Act have been complied with.

(xvi) REGISTRATION WITH RBI

(a) whether the **company is required to be registered under section 45-IA** of the RBI Act, 1934 (2 of 1934) and if so, **whether the registration has been obtained**;

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

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

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

(xvii)CASH LOSSES

whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses

(xviii) RESIGNATION OF STATUTORY AUDITOR

whether there has been any resignation of the statutory auditors during the year, if so, whether the **incoming auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.**

(xix) FINANCIAL ASSET & FINANCIAL LIABILITIES

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

(xx) CSR COMPLIANCE

(a) Whether, in **respect of other than ongoing projects**, the company has **transferred unspent amount to a Fund specified in Schedule VII** to the Companies Act **within a period of 6 months of the expiry of the financial year** in compliance with second proviso to section 135(5) of the said Act.

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

(xxi) NEGATIVE REMARKS IN CARO OF OTHER COMPANIES

whether there have been any **qualifications or adverse remarks by the respective auditors in the** Companies (Auditor's Report) Order (**CARO**) reports **of the companies included in the consolidated financial statements**, if yes, **indicate the details** of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.

Paragraph 4. Reasons to be stated for unfavourable or qualified answers

(1) Where, in the auditor's report, the **answer to any of the questions** referred to in paragraph 3 **is unfavourable or qualified**, the auditor's report **shall also state the basis** for such unfavourable or qualified answer, as the case may be.

Where the **auditor is unable to express any opinion on any specified matter**, his report shall **indicate such fact together with the reasons** as to why it is not possible for him to give his opinion on the same.

EXAMINATION QUESTIONS

BASED ON SA 700

Q1. In order to form the audit opinion as required by SA 700, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Explain the conclusions that the auditor shall take into account. Also explain the objective of auditor as per SA 700. **[MTP-Aug. 18]**

Q2. "An auditor is required to make specific evaluations while forming an opinion in an audit report." State them. **[Nov. 18 (5 Marks)]**

Q3. The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain. **[RTP-Nov. 18, MTP-April 19]**

Q4. When does an auditor issue unqualified opinion and what does it indicate. **[May 08 (4 Marks)]**

Q5. The Auditor is fully satisfied with the audit of an entity in respect of its systems and procedures and wants to issue a report without any hesitation. What type of opinion can be given and give reasoning. **[MTP-April 19]**

Q6. State any six elements of the Auditor's Report. **[Nov. 12 (6 Marks)]**

Q7. The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion". Explain what is included in this "Basis for Opinion" section. **[RTP-Nov. 19]**

Q8. The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion." The Opinion section of the auditor's report shall also Identify the entity whose financial statements have been audited. Apart from the above, explain the other relevant points to be included in opinion section. **[RTP-May 20]**

Q9. Singh & Associates, while carrying out statutory audit of Rubber Industries Limited, observed that debtors are not making payments invoice wise. As the debtors constitute sixty percent of the total assets, so auditors requested management to provide external confirmations of all the debtors outstanding for an amount exceeding ₹ 1.00 Lac. However, management resisted and no external confirmations were made available. Auditor firm has decided to disclaim an opinion on the financial statements and seek your guidance on amendments that should be made in the "Basis for Opinion" section and elements required by SA 700 (Revised) which need not to be included in the auditor's report. Guide them suitably. **[Jan 25 – 4 marks]**

Q10. Kiran, a CA student, was reviewing an audit report of the company when she noticed an 18-digit alphanumeric code below the auditor's signature and membership number. She wants to understand the purpose and importance of this randomly generated number as unique code. Is this code required for audit reports only?

BASED ON SA 701

Q1. Communicating Key Audit Matter is not a substitute for disclosure in the Financial Statements rather Communicating key audit matters in the auditor's report is in the context of the Auditor having formed an opinion on the financial statements as a whole. Analyse. **[RTP-May 18]**

Q2. Explain clearly the purpose of communicating key audit matters. **[RTP-Nov. 18]**

Q3. Mr. A was appointed as statutory auditor of X Ltd. While doing audit, Mr. A is required to determine the key audit matters which are required to be mentioned in the audit report. You are required to advise Mr. A about the considerations which Mr. A shall take into account while determining key audit matters.

Q4. State the circumstances in which a matter determined to be a key audit matter is not required to be communicated in the Auditor's Report.

BASED ON SA 705

Q1. What is a qualified auditor report? Under what circumstances a qualified report is issued.

[May 07 (8 Marks)]

Q2. What is clean audit report. Explain how it is different from qualified report affecting Auditor's opinion.

[Nov. 07 (8 Marks)]

Q3. Write short note on: Disclaimer of opinion. **[Nov. 08 (5 Marks)]**

Q4. State briefly the circumstances when an auditor issues a disclaimer of opinion. **[Nov. 10 (4 Marks)]**

Q5. Differentiate between `Qualified Report' and `Adverse Report'. **[May 10 (5 Marks)]**

Q6. State the circumstances which could lead to any of the following in an Auditor's Report:

a. A modification of opinion
b. Disclaimer of opinion
c. Adverse opinion
d. Qualified opinion **[May 13 (8 Marks)]**

Q7. Discuss the following: The Auditor's Report is considered to be modified under certain circumstances.

[May 15 (5 Marks)]

Q8. Write short note on: Qualified Opinion. **[Nov. 15 (4 Marks)]**

Q9. CA. S, while conducting audit of an entity is facing the following issues: -

a. He has not been provided with necessary support for attending inventory count process of entity as at year end.
b. Accounts Manager is not providing him present addresses of customers as well as suppliers for sending external confirmations. Even mail ids have not been provided on the pretext of business confidentiality.
c. He was not able to verify revenues of entity due to lack of complete details.
d. He has been asking for bills on a sample basis for the purpose of verifying expenses, but staff has been making lame excuses.

The matter was brought to knowledge of higher management, but of no avail. The auditor, CA S has come to the conclusion that the possible effects on the financial statements of undetected misstatements would be material and affecting many aspects of financial statements and in such a case, a qualification of the opinion would be inadequate to communicate the gravity of the situation.

How should the auditor proceed in such a situation?

BASED ON SA 706

Q1. What is Emphasis of matter Paragraph? State the circumstances when EOM para can be included in Auditor's report.

Q2. What is Modified Reports? Discuss disclosure pattern when the auditor includes an Emphasis of Matter Paragraph in the Auditor's Report. **[May 14 (5 Marks)]**

Q3. What is an Emphasis of Matter paragraph, when it is used and manner of its use in an audit report? **[May 17 (4 Marks)]**

Q4. Define emphasis of matter paragraph and how it should be disclosed in the independent auditor's report? **[May 18 (5 Marks)]**

Q5. Define Emphasis of Matter paragraph. When the auditor shall include an Emphasis of Matter paragraph in the auditor's report? Also explain how the auditor would include an Emphasis of Matter in the auditor's report? **[RTP-May 19]**

Q6. NHG & Co., Chartered Accountants, is statutory auditor of M/S Backlog Private Limited (BPL) for the F.Y 2023-24. BPL is engaged in providing telecom services and received a notice from telecom regulator to deposit fee for violating norms. BPL went into litigation and filed an appeal win telecom appellate authority and the matter is pending for decision as at the end of the financial year. However, the company has disclosed the same in financial statements. Audit team members have completed the audit procedures for the year 2023-24 and are in the process of drafting the audit report. Audit team leader knows that matter of norms violation and pending appeal need to be included in the audit report and seeks your guidance on how to report the matter in the auditor's report. Guide him. **[Jan 25 – 4 marks]**

Q7. Mention some examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph. **[RTP May 24]**

BASED ON SA 710

Q1. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. Explain clearly stating the essential audit reporting differences between the approaches. Also define comparative information and audit procedures regarding comparative information. **[RTP-May 19]**

Q2. What are the auditor's responsibilities in respect of corresponding figures.

Q3. The extent of audit procedures performed on corresponding figures is less compared to audit of current period figure's reporting. Justify the statement with regard to auditor's duties for reporting of comparatives under SA 710. **[May 10 (5 Marks)]**

Q4. When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in some circumstances. Explain those circumstances. **[MTP-Aug. 18]**

Q5. When corresponding figures are presented, the auditors' opinion shall not refer to the corresponding figures. Discuss the exceptions of the above statement when the prior period financial statements are audited. **[Nov. 19 (4 Marks)]**

Q6. Oval Enterprises Limited is (OEL) is under legal obligation to represent its current year's financial statements along with the previous year's financial statements (comparative financial statements). Karan & Associates, Chartered Accountants, has been appointed as the statutory auditor for the year. CA Karan noticed that the last year's financial statements contain an adverse opinion for the financial statement as a whole due to a misstatement in the evaluation and disclosure of the debtors. Guide CA Karan for his duty regarding the treatment and addressing the issue while drafting his audit report. What disclosures he is required to make in this regard? **[Jan 25 – 5 marks]**

Q7. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements.

Explain clearly the differences between the approaches stating the essential audit reporting. Also define comparative information and audit procedures regarding comparative information.

BRANCH AUDIT

Q1. Ltd. has a branch office in Malaysia. The company has appointed Mr. X, who is qualified to audit accounts as per Malaysian laws. Mr. Z, the statutory auditor objects to the same, contending that he alone can audit the branch office accounts. Discuss.

Q2. When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole. Explain. **[RTP-Nov. 18]**

Q3. Explain the audit procedure when principal auditor is using the work of another auditor.

[Nov. 14 (8 Marks)]

Q4. There should be a sufficient liaison between a principal auditor and other auditors". Discuss the above statement and state in this context the reporting consideration, when the auditor uses the professional work performed by another auditor.

Q5. ABC Ltd is a company incorporated in India. It has branches within and outside India. Explain who can be appointed as an auditor of these branches within and outside India. Also explain to whom branch auditor is required to report. **[RTP-May 20]**

JOINT AUDIT

Q1. Write short note on: Joint audit.

Q2. Explain the concept of Joint Audit. Discuss its advantages and Disadvantages. **[May 11 (8 Marks)]**

Q3. Discuss the following: Advantages and Disadvantages of Joint Audit. **[Nov. 14 (5 Marks)]**

Q4. The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Explain stating the advantages of the joint audit. **[RTP-Nov. 19]**

Q5. A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report. Justify this statement in the light of responsibilities of Joint Auditors under SA 299. **[May 10 (5 Marks)]**

Q6. Write short note on: Responsibilities of Joint Auditor.

Q7. In joint Audit, "each joint auditor is responsible only for the work allocated to him". **[May 12 (5 Marks)]**

Q8. You have been appointed as an auditor of a company along with 2 other auditors. What steps would you like to take to ensure a smooth and effective audit? To what extent do you think you will be responsible in relation to the work performed by yours co-auditors and vice versa?

Q9. Mention the points/areas in which all the joint auditors are jointly and severally responsible. **[Nov. 15 (5 Marks)]**

Q10. "Before the commencement of audit, the joint auditors should discuss and develop a joint audit plan." Discuss the points to be considered in developing the joint audit plan by the joint auditors. **[Nov. 19 (4 Marks)]**

Q11. Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should identify division of audit areas and common audit areas. Explain stating the other relevant considerations in this regard. **[RTP-May 20]**

Reporting requirements under the Companies Act, 2013

Q1. "Auditor of a company shall have a right of access to the books of account and vouchers of the company" Explain.

Q2. Explain Auditor's right and duties in relation to-

a. Report to the members of the company on the accounts examined by him

b. Obtain information and explanation from officers. **[RTP-Nov. 18]**

Q3. State the matters to be specified in Auditor's Report in terms of provisions of Section 143 (3) of the Companies Act, 2013.

Q4. While conducting the audit of a limited company for the year ended 31st March, 2019, the auditor wanted to refer to the Minute Books. The Board of Directors refused to show the Minute Books to the auditor.

Q5. During the audit of PQR Ltd. you as an auditor requested officers of the company to have access to secretarial records and correspondence which they refused to provide. Comment. **[MTP-April 19]**

Q6. The auditor of X Ltd. did not report on the matters, specified u/s 143(1) of the Companies Act, 2013, on which he inquired into, because of the reason that he was satisfied. But the management of the company wanted the auditor to report on those matters so that the members can also be aware of the true position of the company. Comment as to whether the auditor is required to report the matters, specified under the Act, he inquired into and whether the contention of the management is sustainable.

Q7. "Travelling expenses of Rs. 2.25 lakhs shown in Statement of Profit and Loss of X Ltd., including a sum of Rs. 1.10 lakhs spent by a director on his foreign travel for company's business accompanied by his mother for her medical treatment". Comment.

Q8. M/s XYZ & Co., auditors of Goodwill Education Foundation, a recognised nonprofit organisation feels that the standards on auditing need not to be applied as Goodwill Education Foundation is a non-profit making concern.

Q9. An auditor became aware of a matter regarding a company, only after he had issued his audit opinion. Had he become aware of the same prior to his issuing the audit report, he would have issued a different opinion.

Q10. Y, is the auditor of X Pvt. Ltd. In which there are four shareholders only, who are also the Directors of the company. On account of bad trade and for reducing the expenses in all directions, the directors asked Y to accept a reduced fee and for that he has been offered not to carry out such full audit as he has done in the past. Y accepted the suggestions of the directors.

Q11. At the Annual General Meeting of the Company, a resolution was passed by the entire body of shareholders restricting some of the powers of the Statutory Auditors. Whether powers of the Statutory Auditors can be restricted?

Q12. The members of C. Ltd. preferred a complaint against the auditor stating that he has failed to send the auditor's report to them.

Q13. One of the directors of Hitech Ltd. is attracted by the disqualification under Section 164(2) of the Companies Act, 2013.

Q14. Mr. X, a Director of M/s KP Private Ltd., is also a director of another company viz., M/s GP Private Ltd., which has not filed the financial statements and annual return for last three years 2016-17 to 2018-197. Mr. X is of the opinion that he is not disqualified u/s 164(2) of the Companies Act, 2013, and auditor should not mention disqualification remark in his audit report.

Q15. Explain the auditor's duties with respect to reporting over fraud under Companies Act 2013.

Q16. Mr. A is appointed as statutory auditor of a company for the financial year ended 31st March, 2019. During the course of audit, it was found that few doubtful transactions had been committed by finance manager who retired in March, 2019. The fraud was going on since last 3 years and the total amount misappropriated exceeding Rs. 100 lakhs. As a statutory auditor, what would be reporting responsibilities of Mr. A? [May 18 (5 Marks)]

Q17. Explain the manner of Reporting of fraud under Companies Act, 2013

Q18. Explain the term "Auditor's Lien". [Nov. 12 (4 Marks)] Or

Q19. Though legally auditor may exercise right of Lien in case of companies, it is mostly impracticable for legal and practicable constraints. Do you agree? [May 19 (3 Marks)]

Q20. Write short note on: Audit enquiry w.r.t. Companies Act, 2013. [Nov. 16 (4 Marks)]

Q21. The auditor is not required to report on the matters specified in subsection (1) of Section 143 unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. Explain clearly stating the matters for which the auditor has to perform his duty of inquiry under this section. [MTP-Aug. 18]

Q22. Explain the duties of Auditor to inquire under Section 143(1) of the Companies Act, 2013. [RTP-Nov. 18]

Q23. The head accountant of a company entered fake invoices of credit purchases in the books of account aggregate of ₹50 lakh and cleared all the payments to such bogus creditor. How will you deal as an auditor? [RTP-May 20]

CARO, 2020

Q1. Examine the applicability of CARO, 2016 in the below mentioned cases:

(a) Educating Child' is a limited company registered under section 8 of the Companies Act, 2013.

(b) Ashu Pvt. Ltd. having paid capital and reserves of Rs. 50 lakh.

During the year, the company had borrowed Rs. 70 lakh each from a bank and a financial institution independently. Turnover for the year was Rs. 900 lakh.

Q2. Comment on the following: XYZ (Pvt.) Ltd. Has paid up Capital and Reserves of ₹110 lacs and secured Loans of Nationalized Banks having sanctioned limit of ₹28 lacs and outstanding balance of ₹23 lacs. The turnover of the company is ₹5.10 crores for the year ended 31.3.2019. Customer returns goods worth 40 lacs on 02.04.2019, out of sales made during the year ended 31.03.2019. The management is of the opinion that CARO is not applicable to the company. [May 10 (6 Marks)]

Q3. Write short note on: Reporting requirement under CARO, 2016 w.r.t. physical verification of Fixed Assets.

Q4. The company has dispensed with the practice of taking inventory of their inventories at the year-end as in their opinion the exercise is redundant, time consuming and intrusion to normal functioning of the operations. Explain reporting requirement under CARO, 2016.

Q5. Comment: No cost accounting records are maintained though the company is required to maintain the same.

Q6. Comment on the following: ABC Ltd. Has not deposited provident fund contributions of `20 lakhs to the authorities, but accounted in the books.

Q7. On what companies the CARO, 2016 is applicable and what companies are not covered by it?

Q8. What is CARO? Explain the companies which are not covered by CARO. [Nov. 11 (8 Marks)]

Q9. Write short note on: Companies not covered under CARO, 2016 [Nov. 14 (4 Marks)]

Q10. Discuss which class of companies are specifically exempt from the applicability of CARO 2016. [Nov. 16 (6 Marks), MTP-Oct. 19]

Q11. Discuss the matters to be included in the auditor's report regarding statutory dues and repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders as per CARO, 2016. [RTP-May 18]

Q12. State the matters to be included in the auditor's report as per CARO, 2016 regarding-

(a) Default in repayment of loans or borrowing to a financial institution, bank etc.

(b) Fraud by the company or on the Company by its officers or employees. [MTP-March 18], March 19]

Q13. State the matters to be included in the auditor's report as per CARO, 2016 regarding;

(a) Private placement of preferential issue.

(b) Utilisation of IPO and further public offer. [May 18 (4 Marks), MTP-April 19]

Q14. State the matters to be included in the auditor's report as per CARO, 2016 regarding-

(c) Fixed Assets

(d) Statutory dues. [MTP-Aug. 18]

Q15. Discuss the reporting requirements regarding Fixed Assets under CARO, 2016. [MTP-Oct. 18]

Q16. Explain the Reporting requirements the auditor should ensure under CARO 2016 related to fixed assets. [May 19 (3 Marks)]

Q17. "The company has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. However, the company utilized these funds for repayment of long term loans and advances." Advise the auditor regarding requirements under CARO, 2016. [Nov. 18 (4 Marks)]

Q18. M Ltd. has given certain loans to related parties and also has accepted certain deposits. As an auditor, how you include the above items in paragraph 3 of CARO, 2016? [Nov. 19 (4 Marks)]

Q19. Explain the Reporting requirements the auditor should ensure under CARO 2016 related to fixed assets. [RTP Nov 21]

Q20. Explain the Reporting requirements the auditor should ensure under CARO 2020 related to PPE and Intangible assets. [RTP May 22]

Q21. Astha Pvt Ltd has fully paid up capital of ₹ 140 lakhs. During the year, the company had borrowed ₹ 15 lakhs, each from a bank and a financial institution independently. It has the turnover (net of GST ₹ 50 lakhs, which is credited to a separate account) of ₹ 475 lakhs during the immediate preceding financial year. Will companies' (auditors report) order 2020 be applicable to Astha Pvt Ltd.?

Q22. E Tech Pvt Ltd, which has an aggregate outstanding loan of ₹ 20 lakhs from banks and ₹ 30 lakhs from financial institutions, defaulted in repayment thereof to the Extent of 50%. The company holds that it being a private limited company, the company's auditors report order 2020 is not applicable. You are required to state the list of companies to which Caro is not applicable and state how would you deal with the given situation as an auditor?

Q23. E Private Ltd had issued fully paid up shares of ₹ 80,00,000. Had borrowed ₹ 60,00,000 each from two financial institutions and its turnover (net of excise ₹ 100 lakhs, which is credited to a separate account,) Is ₹ 950 lakhs during immediately preceding financial year. Will companies' auditors report order 2020 be applicable to a private limited?

Q24. As an auditor how would you deal with the following: L private limited, which has outstanding loan of more than ₹ 100 lakhs from financial institution defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company CARO is not applicable.

Q25. T Pvt ltd's paid up capital & reserves are less than ₹ 1 cr. and it has no outstanding loan exceeding ₹ 1,00,00,000 from any bank or financial institution. Its sale for the immediately preceding financial year was ₹ 12 crores before deducting trade discount of ₹ 20 lakhs and sales return of rupees 1.90 crores. The service is rendered by the company amounted to ₹ 20 lakhs. The company contends that reporting under CARO is not applicable. Discuss.

Q26. A Private limited company reports the following position as at end of current financial year:

Paid up capital	60 Lakhs
Revaluation Reserves	20 Lakhs
Capital Reserves	22 Lakhs
P&L A/c (dr. Balance)	4 Lakhs

The Management of the company contends that CARO 2020 is not applicable.

Q27. Under CARO 2020 how has a statutory auditor would you comment on the following? X private limited is a subsidiary of a listed company. The. Management of the company believes that since X Private Limited is a private company and satisfies all the conditions under CARO 2020 reporting under CARO is not applicable.

Q28. Private limited, (not a small company) had taken over drafts from 2 banks with a limit of ₹ 40 lakh each against the security of fixed deposit it had with those banks. And an unsecured overdraft from a financial institution of ₹ 36 lakhs. The set loans were outstanding, as at the end of current financial year. The paid up capital and reserves of the company, as at the end of financial year, was ₹ 80 lakhs. And its revenue for the immediately preceding financial year was ₹ 6 crores. The management of the company is of the opinion that CARO 2020 is not applicable to it, because turnover and paid up capital were within the limits prescribed and loans taken against the fixed deposits cannot be considered. The company further contended that loan limit is to be reckoned per bank or financial institution and not cumulatively comment.

Q29. X Ltd had closed its manufacturing operations and sold all its manufacturing fixed assets during the current financial year. However, it intends continued its operations as trading company in respect of other fixed assets. The company carried out a physical verification as at the end of the current financial year and found a material discrepancy to the tune of rupees 1 length, which was written off and is disclosed separately in the profit and loss account. Kindly incorporate the above in your audit report.

Q30. Under CARO 2020 as a statutory auditor. How would you report NSP limited as its factory building appearing as fixed assets in its financial statement in the name of one of its director, who was overlooking the manufacturing activities?

Q31. BBC Limited owns a piece of land and building situated IP Road, Mumbai, which was purchased before 30 years. The title deeds for the same are deposited with State Bank of India for obtaining credit facilities by the company. As the statutory order of the company, what are the audit procedures to be followed? And what is the reporting under CARO 2020?

Q32. The property plant and equipment of Amir Limited included ₹ 25.75 crores of earth removing machines of outdated technology, which had been retired from active use and had been kept for disposal after knockdown. These assets appeared at residual value and had been last inspected 10 years back as an auditor, what may be your reporting concern in view of CARO 2020 on matters specified above.

Q33. As the statutory auditor of B Limited to whom CARO 2020 is applicable. How would you report in the following situations? Physical verification of only 50% in value of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources.

Q34. Mr Arjun was appointed as the engagement partner on behalf of Ishu and company a chartered accountant firm for conducting statutory audit assignment of Sinwar limited, unlisted public company, Mr Brijesh, one of the senior engagement team member, was given the responsibility to audit the matters as per the requirements of CARO 2020. and in that connection, he made the following observations that may be relevant for reporting. As per the said order:

a. One of the plant and equipment taken on the lease, right of use asset by Sinmar Ltd, was revalued based on the valuation by a registered valuer and the net carrying value of plant and equipment in aggregate was changed from ₹ 4 crore to ₹ 4.45 crores.

b. During the year under consideration cash create limit of ₹ 5.5 crore was sanctioned to Sinwar Ltd by. DMC bank based on the security of current assets, which was reduced to ₹ 4.5 crore after six months. In this connection, quarterly returns have been filed by the company with the DMC bank, which are in agreement with the books of accounts.

You are required to examine the contention of Mr Brijesh regarding reporting of the above observations in accordance with CARO 2020.

Q35. Jack Private Limited was engaged in business of manufacture of cycles. CA Roy was appointed as a statutory auditor of the company for the financial year 2021-22. During the year under audit jam. Private limited obtained working capital facilities from ABC Bank limited for ₹ 10 crore. Hypothecating the stock of goods as primary security on inquiry. CA Roy was informed by management that stock statements are furnished periodically to ABC Bank Limited. And the details of submission of quarterly stock statement are as follows.

Period of quarter for the year 2021-22	Stock value as per the BOA as at the end of quarter (₹ in crore)	Stock value as per quarterly statement submitted to ABC bank limited as at the end of quarter (₹ in crore)
Q1	11.50	14.00
Q2	14.75	17.00
Q3	11.50	14.00
Q4	15.25	15.25

The management of jam private limited did not disclose the above variations in notes to accounts, forming part of financial statements of the company for the year 21-22. The management replied that there are no variations as on balance sheet date and further, they are off the view that stock statement furnished to bank is only a formality and computed arbitrary only for the purpose of securing higher drawing power, and hence statutory auditors need not be bothered. Is the contention of the management valid as the statutory auditor how CA Roy should deal and discuss the disclosure reporting requirement, if any. As per the companies at 2013 and CARO 2020.

Q36. In the course of audit of Y limited, the auditor of company you observe the following: The company has advanced a loan to a firm in which a director was interested at a rate lower than the prevailing market rate, as well as there was no agreement on terms of repayment. How the auditor will report this in CARO 2020?

Q37. H limited granted unsecured loan of ₹ 1,00,00,000 at. 15% per annum to 2 of its subsidiaries during the current financial year before the year. Before the year end, both the company's repaid the loan, the management of H Limited is of the opinion that since no balance is outstanding at the end of financial year, these loans were not required to be reported in CARO 2020 comment and draft a suitable report.

Q38. As a company auditor, you noticed that there is an intercorporate loan granted by the company. What are they reporting requirements as regards the matters concerning terms of interest on the Inter corporate loan?

Q39. CARO 2020 requires the auditor of the company to report whether maintenance of cost records has been specified by the central government under section 148 of the companies Act. 2013 and whether such accounts and records have been so made and maintained. You are required to briefly explain the audit procedure to be followed by the auditor.

Q40. During the course of audit of M/s CT Limited, it has noticed that ₹ 2 lakhs of employee contribution and ₹ 9.50 lakhs of employer contribution towards ESIC have been accounted in the books of account

in respective heads. Whereas it was found that ₹ 4 lakhs only have been deposited with ESIC department during the year. The finance manager informed that auditor that due to financial crunch, they have not deposited the amount due, but will deposit the amount overdue along with interest, as in when financial position improves. Comment, as a statutory auditor.

Q41. As a statutory auditor, how would you deal with the following: PQR Ltd. Has not deposited provident fund contribution of ₹ 10 lakhs with the authorities till the year end.

Q42. Comment the following: Is the company regular in depositing undisputed statutory dues including GST, Provident Fund, ESI, Income tax, Sales tax, Wealth tax, Customs duty, Excise duty, Value Added Tax, Cess and any other statutory dues with the appropriate authorities and if not, the extent of arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than 6 months from the date, they became payable shall be indicated by the auditor.

Q43. Big & Small ltd received a show cause notice from GST Department intending to levy a demand of ₹ 25 lakhs in December 2022. The company replied to the above notice in January 2023 contending that it is not liable for the levy. No further action was initiated by the GST department upto the finalization of the audit for the year ended on 31st March, 2023. As the auditor of the company, what is your role in this?

Q44. XYZ Pvt Ltd. Has submitted he financial statements for the current financial year for audit. The audit assistant observes and brings to your notice that the company's records show following dues:

a. Income Tax relating to Assessment Year 2017-18 ₹ 125 Lakhs – Appeal is pending before Hon'ble ITAT since 30-09-2018.
b. Customs duty ₹ 85 lakhs – Demand notice received on 15-09-2022 but no action has been taken to pay or appeal.

As an auditor, how would you bring this fact to the members?

Q45. OK Ltd. Has taken a term loan from a nationalised bank in 2017 for ₹ 200 lakhs repayable in five equal instalments of Rs 40 lakhs from 31st March, 2018 onwards. It has repaid the loans due in 2018 & 2019, but defaulted in 2020, 2021 & 2022. As the auditor of OK Ltd. What is your responsibility assuming that company has sought reschedulement of loan?

Q46. R Ltd. as at 31st March 2023 defaulted in the repayment of interest and principal due to a financial institution. The due date was 28th February 2023. However, the defaulted amount was paid on 5th April 2023. The company's management is of the opinion that since the default is set right before the audit completion these need not be reported in CARO, 2020. Comment.

Q47. Under CARO how, as a statutory auditor how would you comment on the following: A Term Loan was obtained from a bank for ₹ 75 lakhs for acquiring R&D equipment, out of which ₹ 12 lakhs were used to buy a car for use of the concerned director, who was overlooking the R&D activities.

Q48. As a statutory auditor, how would you deal with the following: LM Ltd. has obtained a term loan of ₹ 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in short term deposits.

Q49. During the financial year ended on 31st March 2023. LMP private limited had borrowed from a nationalized bank, a term loan of ₹ 120 lakhs, consisting of ₹ 100 lakhs for purchase of a machinery for. The new plant and is ₹ 20 lakhs for erection expenses as. On the date of 31st March 2023, the total of capital and free reserves of the company was ₹ 50 lakhs and turnover for the year 2022-23 was ₹ 750 lakhs. The bank paid ₹ 100 lakhs to the vendor of the company for the supply of machinery on 31st December 2022. The machinery had reached the yard of the company on 28 to 2023 company. Had drawn the balance of loan ₹ 20 lakhs to the credit of its current account maintained with the bank and utilize the full amount for renovating its administrative office building. The machinery had been kept as capital stock under construction comment as to reporting issues. If any that the altar should be concerned with for the financial year ended on 31st March 2023.

Q50. As a statutory auditor? How would you report the following under CARO? ABC Pvt limited. Is a manufacturer of jewellery A senior employee of the company informed you that the company does not properly disclose the purity of the gold used on the jewellery.

Q51. What are the reporting requirements in the audit report under the companies act, 2013 / CARO 2020 for the following situations?

a. A fraud has been committed against the company by an officer of the company.
b. A fraud has been committed against the company by a vendor of the company.
c. The company has committed a major fraud on its customer and the case is pending in the court.
d. A fraud has been reported in the cost audit report but not noticed by statutory auditors in his audit.

Q52. Discuss the reporting requirements as per CARO, 2020, regarding:

a. Statutory Dues and
b. Transactions with Related Parties **[RTP – Sep 24]**

CHAPTER 9 – AUDIT OF DIFFERENT ENTITIES

ASPECTS TO BE COVERED	
1. Educational Institutions	2. Hospitals
3. Cinemas	4. Charitable Institutions
5. Clubs	6. Hotels
7. Leasing Companies	8. Non-Government Organisations
9. Hire purchase companies	10. Local Bodies
11. Partnership Firms	12. LLP Audit
13. Co-operative societies	14. Government Audit
15. Trusts & Societies	

1. AUDIT OF EDUCATIONAL INSTITUTION/COLLEGE

O – GF – ACE

General	(a) Examine the Trust Deed or Regulations and note all the provisions affecting accounts. (b) In the case of a university, refer to the Act of Legislature and the Regulation framed thereunder. (c) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions to see that these have been duly complied with, especially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
Fee from Students	(a) 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; and (b) Verify that there operates a system of internal check which ensures that demands against the students are properly raised. (c) 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. (d) 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. (e) 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. (f) See that free studentship and concessions have been granted by a person authorised to do so, as per the Rules prepared by the Managing Committee. (g) Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority. (h) Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded.
Other Receipts/Grants & Donations	(a) Verify rental income from landed property with the rent rolls, etc. (b) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held. (c) 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.
Expenditure	(a) Verify that the Provident Fund money of the staff has been invested in appropriate securities. (b) Vouch donations, if any with the list published with the annual report. (c) If some donations were meant for any specific purpose, see that the money was utilised for the purpose. (d) Vouch, all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book. (e) Vouch, in the usual manner, all establishment expenses and enquire into any unduly heavy expenditure under any head. (f) If there was any annual budget prepared, see that any excess under any head over the budgeted amount was duly sanctioned by the Managing Committee. If not, bring it to the Committee's notice in your report. (g) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
Assets & Liabilities	(a) Report any old heavy arrears on account of fees, dormitory rents, etc. to the Managing Committee.

	(b) 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. (c) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus. (d) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment. (e) Verify the inventories of furniture, stationery, clothing, provision and all equipment etc. These should be checked by reference to Inventory Register or corresponding inventories of the previous year and values applied to various items should be test checked.
Compliances	(a) Confirm that the refund of taxes deducted from the income from investment (interest on securities etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax. (b) Finally, verify the annual statements of account and, while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of staff, etc.

2. AUDIT OF HOSPITAL

Preliminary

1. Hospitals can be run as sole proprietorship or partnership or trust and even as a company etc. Auditor should ascertain the legal status & study applicable statute, if any.
2. Examine the trust or partnership deed or MEMORANDUM, ARTICLES as per the status of hospital, (other points, same as in previous topic)

Receipts

From Patients

1. Check copies of bills issued to the patients with reference to register of patients to ensure that all patients have been billed properly.
2. Check calculation of few bills.

3. Examine whether bills are raised properly bifurcating into rent charges, services charges & payments regarding medicine.
4. Check internal control & authorisation for bills raised at concessional rates.
5. Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence
6. Check cash collected shown in cash book with duplicate copies of receipts issued to the patients.

From grants

1. Check copies of correspondence with the government or local bodies to ensure the purpose of grant.
2. Ensure whether grant or donations received for specific purpose have been properly applied.
3. Obtain WR regarding use of grants.
4. Examine accounting for grants with special attention to classification into capital & revenue.

Income from Investment

1. Examine investment register.
2. Vouch interest, dividend etc. to ensure whether same has been properly accounted for.
3. Check collection of various incomes received on investment with reference to entry' in cash book/pass book.

Others

1. Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
2. Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due.

Payments

With respect to purchases & various expenses

1. Ensure authorisation of various payments especially capital expenditure.
2. Compare various items of expenditure with those of previous year (ARP).
3. Check few calculations w.r.t staff salary to check whether these are in accordance with the pay rules.
4. Special attention should be given to purchase of high value medicines & injections. Also check whether there is strict control over their purchases and issues.
5. Obtain WR regarding abnormal item of expenses if any.

Taxation

1. Examine calculation & accounting of provision for taxation.
2. Check whether hospital is eligible for income tax exemption.

Assets & liabilities

1. Examine whether all fixed assets are properly accounted for.
2. Check ownership & existence of fixed assets by verifying records & conducting physical verification respectively.
3. Verify whether depreciation has been properly calculated on each class of fixed assets.
4. Obtain WR for existence, ownership & valuation of assets.
5. Verify corpus/ capital fund with special attention to any increase in the same as compared to that of previous year.
6. Examine adequacy of internal controls over purchase and issue of stock.
7. Examine whether any claim against the hospital has been properly accounted for.

AS PER ICAI MATERIAL – [BGM – C – DL – A I^3 R^3]

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. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
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.
Income from Investments, Rent etc	See with reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected
Legacies and Donations	Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
Reconciliation of Subscriptions	Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).

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.
Grants and TDS	Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
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.
Internal Check	Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation
Depreciation	See that depreciation has been written off against all the assets at the appropriate rates.
Registers	Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
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.
Management Representation and Certificate	Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

3. AUDIT OF CINEMA HALL

Preliminary

1. Study the provision of applicable statute as per the legal status of the cinema hall. ii.
2. Examine the trust deed or regulations.
3. Study the minutes of meetings of governing body / trustee to gain knowledge of any important decision which may affect the accounts, for e.g... Purchase of projector etc. iv.

4. Evaluate the system of internal control.
5. Obtain list of accounting records & accounting policy adopted by them.

Receipts

From shows

1. Check that tickets to be issued are serially numbered & kept in proper custody.
2. Perform compliance procedures to check whether there is strict internal control on entry to cinema hall which should be only against show of the ticket.
3. Check internal control w.r.t. issuance of free passes.
4. Check collection shown in cash book with number of tickets sold for each show.
5. Check internally generated daily report with number of tickets sold for each category (balcony, first class etc.).
6. For advance booking, ensure that different series of tickets are issued.
7. Reconcile total entertainment tax collected with total number of tickets sold for each category.

From Advertisement

1. Study agreement entered into for advertisement.
2. Ascertain whether income w.r.t slides shorts exhibited has been properly recognized & collected.
3. Check calculations of it with reference to agreement.

Restaurant Income

1. Study the agreement entered into by cinema hall with restaurant run in the premises.
2. Check collection of share in restaurant income.
3. Stall may be run by cinema hall. In this case, ensure about recognition & accounting of stall incomes, also consider control over stock of foodstuff, cold drinks, ice creams etc.

Payments

Towards Expenditure

1. Examine whether expenditure incurred has been properly classified into Capital & Revenue.
2. Vouch the payment made for repairs and maintenance of infrastructure.
3. Examine expenditure incurred on advertisements or any promotional campaign.
4. Vouch payments towards film hire with the bills given by distributors.
5. Check agreement entered into with distributors.

Advance paid to Distributors

1. Check whether all advance paid relating to films already run has been properly adjusted.
2. Obtain WR & confirmation from distributors.

Assets & liabilities

1. Examine whether all fixed assets are properly accounted for.
2. Ensure about ownership & existence of fixed assets by verifying records & conducting physical verification respectively.
3. Verify whether depreciation has been properly calculated on each class of fixed assets.
4. Obtain WR w.r.t existence, ownership & valuation of assets.
5. Verify corpus/ capital fund with special attention to any increase in the same as compared to that of previous year (ARP).

AS PER ICAI MATERIAL [FIT – SCARED²]

Free passes	Verify that a record is kept of the 'free passes' and that these are issued under proper authority.
Internal control	(a) That entrance to the cinema-hall during show is only through printed tickets (b) That they are serially numbered and bound into books (c) 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 (d) That for advance booking a separate series of tickets is issued; and That the inventory of tickets is kept in the custody of a responsible official
Taxation	Reconcile the amount of Tax collected with the total number of tickets issued for each class and vouch and verify the tax returns filed each month.
Statement of tickets sold	Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it.
Cash collection	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.
Advertisement	Verify the charges collected for advertisement slides and shorts by reference to the Register of Slides and Shorts kept at the cinema as well with the agreements entered into with advertisers in this regard.
Restaurant income	(a) The arrangement for collection of the share in the restaurant income should be enquired into either a • fixed sum or a • fixed percentage of the taking may be receivable annually. (b) In case the restaurant is run by the Cinema, its accounts should be checked. The audit should cover sale of various items of foodstuffs, purchase of foodstuffs, cold drink, etc. as in the case of club.
Expenditure	Vouch the expenditure incurred on advertisement, repairs and maintenance. No part of such expenditure should be capitalized
Depreciation	Confirm that depreciation on assets has been charged at an appropriate rate.
Distributors& Advance paid	(a) Vouch payments on account of film hire with bills of distributors and the agreements should be referred to. (b) Examine unadjusted balance out of advance paid to the distributors against film hire contracts to see that they are good and recoverable. If 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.

4. AUDIT OF CHARITABLE INSTITUTION

Preliminary work

1. Studying the constitution under which the charitable institution has been set up.
2. 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 and donations

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;
   (d) Any cancelled receipts being specially looked into;
   (e) Obtaining the printed list of subscriptions and donations and agreeing them with the total collections shown in the accounts;
   (f) 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;
   (g) 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
   (h) Verifying the total subscriptions and donations received with any figures published in reports, etc. issued by the charity.

Legacies & grants

1. Verifying the amounts received by reference to correspondence with any figures and other available information.
2. Vouching the amount received with the relevant correspondence, receipts and minute books.
3. Obtaining a certificate from a responsible official showing the amount of grants received.

Income

1. Vouching the amounts received with the dividend and interest counterfoils.
2. Checking the calculations of interest received on securities bearing fixed rates of interest.
3. Checking that the appropriate dividend has been received where any investment has been sold ex-dividend or purchased cum-dividend.

4. Comparing the amounts of dividend received with schedule of investments making special enquiries into any investments held for which no dividend has been received.
5. Examining the rent roll and inspecting tenancy agreements, noting in each case:
    a. the amounts of the rent, and
    b. the due dates.
6. Vouching the rent on to the rent roll from the counterfoils of receipt books and checking the totals of the cash book.
7. **Special function, etc.** - Vouching gross receipts and outgoings in respect of any special functions, e.g. concerts, dramatic performance, etc., held in aid of the charity with such vouchers and cash statements as are necessary. In particular, verifying that the proceeds of all tickets issued have been accounted for, after making the allowance for returns.
8. **Income Tax Refunds** - Where income-tax has been deducted at source from the Investment income, it should be seen that a refund thereof has been obtained since charitable institutions are exempt from payment of Income tax.
9. This involves:
    a. Vouching the Income-tax refund with the correspondence with the tax Department;
    b. Checking the calculation of the repayment of claims.

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.

5. AUDIT OF CLUBS

Preliminary

1. Study the provision of applicable statute as per the legal status of the club. ii.
2. Examine internal rules & regulations of club.

3. Study the minutes of meetings of governing body to gain knowledge of any important decision, which may affect the accounts. For e.g., purchase of sports equipment etc.
4. Evaluate the system of internal controls.
5. Obtain list of accounting records & accounting policy adopted by them.

SA^2M^3 E - P^2 I^3

Subscriptions	Vouch members' subscriptions with the counterfoils of receipt issued to them, trace receipts for a selected period to the Register of Members; also reconcile the amount of total subscriptions due with the amount collected and that outstanding.
Arrears of Subscriptions	Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscriptions received in advance have been correctly adjusted
Arithmetical accuracy	Check totals of various columns of the Register of members and tally them across.
Member Accounts	Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.
Margins earned	Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale price so as to confirm that the normal rates of gross profit have been earned on their sales. The inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.
Management Powers	Examine the financial powers of the secretary and, if these have been exceeded, report specific case for confirmation by the Managing Committee.
Entrance Fee	Vouch the receipt on account of entrance fees with members' applications, counterfoils issued to them, as well as on a reference to minutes of the Managing Committee.
Pricing	Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests, as well as, with the fees chargeable for the special services rendered, such as billiards, tennis, etc.

Purchases	Vouch purchase of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.
Inventories	Check the inventory of furniture, sports material and other assets physically with the respective inventory registers or inventories prepared at the end of the year.
Investments	Inspect the share scrips and bonds in respect of investments, check their current values for disclosure in final accounts; also ascertain that the arrangements for their safe custody are satisfactory
Irrecoverable Member Dues	See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery; the amount considered irrecoverable should be mentioned in the Audit Report.

6. AUDIT OF HOTEL

Preliminary

1. Study the provision of applicable statute as per the legal status of the hotel.
2. Examine the internal rules & regulation of hotel.
3. Study the minutes of meetings of governing body to gain knowledge of any important decision, which may affect the accounts. For e.g., purchase of cars etc.
4. Evaluate the system of internal controls. Obtain list of accounting records & accounting policy adopted by them.

Receipts

Room rents/ sales

1. Study daily occupancy report prepared by the management.
2. Ensure properness of billing. Also verify whether appropriate rates have been charged according to category of rooms.
3. Check whether bills have been raised to all parties listed in guest register. In case it is not so, obtain Reconciliation.
4. If receipts are in foreign currency, ensure compliance with FEMA.
5. Vouch receipts from room rents. Also ensure their correct posting in relevant accounts.
6. Special attention is given to receipts accepted through credit cards.

Restaurant Income

1. Examine a few bills issued to customers to ensure their correctness.
2. Perform compliance procedures to check internal controls in restaurant.
3. Check a few bills with order books to ensure their correctness.

Other Incomes

1. In case, hotel provides banquet hall for various functions, study tariff structure.
2. Ensure correctness of billing for letting out banquet hall.
3. In case spaces have been let out to shopkeepers or travel agencies etc., check agreement entered into with them.
4. Vouch collections from above and ensure their correct postings.

Payment

Purchase of Various items

1. Check authorisation for purchase of stock such as food, beverages, linens, crockery, etc.
2. Vouch payment w.r.t. same with copies of bills issued by vendors.

To Staff

1. Test Check a few salary payments made to permanent staff with entries in cashbook.
2. Regarding casual labour, check attendance records & wage payment registers. Also ensure adequacy of internal controls over this area to rule out possibility of dummy labour.
3. Compare payment to staff with that made in previous period (ARP).

Taxes

1. Hotels charge various taxes from customers such as luxury tax, service tax etc.
2. Ensure that same has been deposited to authorities on timely basis.

Commission

1. Normally hotels pay commission to various travel agents for bookings received through them.
2. Inspect the agreement entered into with them.
3. Check whether payments have been made as per agreement.
4. Ensure appropriateness of accounting of commission in correct account and period.

Expansion Expenses

1. Ensure whether room addition expenses / major additions to hotel buildings (construction of new health club etc.) have been properly capitalised.
2. However, redecoration & daily maintenance expenses should be charged to revenue.
3. Vouch payments with respect to it. Trace entries in relevant accounts.

Assets

Fixed Assets

As per previous topic

Stock

1. Check whether valuation methods are consistently applied.
2. Attend physical stock taking.
3. Ensure that stocks are kept under appropriate authority.

Cash and foreign currency

1. Physically check the cash.
2. Ensure application of proper conversion rate in case of foreign currency.
3. Obtain Bank reconciliation statement.

Liabilities

Loans

1. In case hotel has taken any long-term loan from bank, inspect the loan agreement.
2. Check regularity of payment of interest charges.

Other liabilities

1. Check whether all liabilities have been taken into account.
2. Ensure whether outstanding expenditures has been properly shown as liabilities.

7. AUDIT OF NON-GOVERNMENT ORGANISATIONS

Background

1. NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors.
2. They also receive donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities etc.

3. NGO would include religious organisations, voluntary health and welfare agencies, hospitals, old age homes, research foundations etc.
4. Some examples of NGOs operating in India include Child Relief and You (CRY), UNICEF, Vidya, etc









Sources of funds

1. The main sources of funds include grants and donations, fund raising programmes, advertisements, subscriptions, gifts, sale of product or publications, etc.
2. Donations and grants received in the nature of capital receipts are shown as liabilities in the Balance Sheet of NGO.
3. These may either be in the form of corpus contribution or a contribution towards revolving fund
4. A contribution made towards the capital or the corpus of an NGO is known as corpus contribution.
5. The grant towards a Revolving Fund is used to rotate the amount by giving temporary loans from the fund to other NGO or beneficiaries for their projects.
6. Donations and grants are also received for acquisition of specific fixed assets or for running some specific project. For example, it may be received for running flood relief camp in certain area

Provisions Relating to Audit

1. The auditors of an NGO registered as Societies or Trusts are normally appointed by the Management of the Society or Trust.
2. The auditors of NGO registered under section 8 of the Companies Act, 2013 are appointed by the members of the company.
3. Some of the statues such as the Companies Act, 2013, Foreign Contribution (Regulation) Act 2010, Income Tax Act 1961 required that the accounts of the NGO be audited and submitted to the prescribed authorities and failure to do so could lead to forfeiture of certain exemptions and benefits.
4. In the case of NGO/PDA's different statutes have specified certain audit reports.
5. The Foreign Contribution (Regulation) Act 2010 has prescribed the format and requires that the same be furnished to the Ministry of Home Affairs within 60 days from the close of the FY.

Audit Plan

1. Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates.
2. Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 2010, Societies Registration Act, 1860, Income Tax Act 1961 etc. and the Rules related to the statutes.
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.

Audit programme

Balance sheet items

a. **Corpus Fund**: The contributions/ grants received towards corpus should be examined with reference to the letters from the donor. The interest income should be checked with Investment Register.
b. **Reserves**: Examine board resolutions of NGO.
c. **Ear-marked Funds**: Check requirement s of donors, board resolution of NGO and rules and regulations of the schemes of the ear-marked funds.
d. **Loans**: Examine loans with loan agreements.
e. **Fixed Assets**: Vouch all acquisitions / sale or disposal of assets including depreciation in usual way.
f. **Investments**: Check Investment Register and the investments physically. Also examine that investments are in the name of the NGO.
g. **Cash in Hand**: Physically verify the cash in hand.
h. **Bank Balance**: Check the bank reconciliation statements.

i. **Stock in Hand**: Attend physical verification of stock in hand and obtain adequate WR for the quantities and valuation of the same.

Expenses

a. **Programme and Project Expenses**. Verify agreement with donor/ contributor supporting the particular programme or project. Vouch various disbursements w.r.t. same.
b. **Establishment Expenses**: Verify that provident fund, life insurance premium, employee's state insurance and other administrative charges are properly accounted for.

Receipts

a. **Contributions and Grants for projects and programmes**: Check agreements with donors and grants letters to ensure that funds received have been accounted for. Examine relevant entry in pass book.
b. **Receipts from fund raising programmes**: Verify in detail the internal control system and obtain confirmations from the persons who are responsible for collection of funds and mode of receipt.
c. **Membership Fees**: Check fees received with Membership Register. Reconcile fees received with fees to be received during the year.
d. **Subscriptions**: Examine them with subscription register and receipts issued.
e. **Interest and Dividends**: Check the interest and dividends received and receivable with investments held during the year.

8. AUDIT OF LOCAL BODIES

Background

1. A municipality can be defined as a unit of local self-government in an urban area.
2. Local self-government' ordinarily means the administration of a locality - a village, a town, a city or any other area smaller than a state.
3. It raises its revenue through local taxation and spends its income on local services.
4. These bodies generally follow the cash basis of accounting.

Financial administration

Budgetary Procedure

Budget preparation is determining the levels of taxation, rates and the ceilings on expenditure. The objectives of local bodies budgetary procedure are:

- Financial Accountability.
- Control of expenditure and
- To ensure that funds are raised and money is spent in accordance with the rules and regulations.

Expenditure Control

Matters of regular revenues and expenditures are generally delegated to the executives for example, commissioners. Thus, it should be seen whether expenditure is within limits.

Accounting System

Municipal accounting system is usually kept as per the cash system.

Objectives 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 of error, fraud and misuse of resources.

AUDIT PROCEDURE

Preliminary Understand

Auditor should obtain basic information about the constitution, functions and financial status of the local body.

Financial Administration

1. Obtain sufficient knowledge about their budget and accounting system.
2. The auditor should obtain complete knowledge about the budget as it is an important tool of financial planning and control for urban local bodies.

Vouch income and expenditure

1. The revenue items may include property tax, collection from public places, grants, etc.
2. The expenditure may include salary and wages, allowances to employees, rem, printing and stationery, repairs and maintenance, etc.
3. He should vouch income and expenditure account in the usual manner.

Verification of assets and liabilities

1. Assets may consist of land, buildings, plant and machinery, vehicles, office equipment, furniture and fittings, etc.
2. Reserves, long-term and short-term loans and unutilised grants are included in the liabilities side.
3. Verification of assets and liabilities should also be carried out in usual manner.

Audit report

Finally, he expresses opinion on financial statements. He should also communicate the comparisons of budgeted and actual figures.

9. AUDIT OF A PARTNERSHIP FIRM

Basics

1. The auditor is usually appointed by the partners either on the basis of a decision taken by them or to comply with a condition in the partnership agreement.
2. His remuneration is also fixed by the partners.
3. The letter of appointment should clearly state the nature and scope of audit.
4. The Indian Partnership Act, 1932 does not prescribe audit of a partnership firm.
5. Before starting the audit, auditor should examine the partnership agreement and note the provisions therein.

Advantages

1. Audited accounts provide a reliable means of settling accounts between the partners and thus, the possibility of occurrence of a dispute among them is mitigated.
2. On the retirement or death of a partner, audited accounts constitute a reliable evidence for computing the amounts due to the retiring partner or to the representative of the deceased partner in respect of his share of capital, profits and goodwill.
3. The audited accounts are generally accepted by the Income Tax Department as the basis for computing the assessable income of the partners.
4. Audited statements of accounts are relied upon by the banks when advancing loans.
5. Audited statements of account can be helpful in the negotiations to admit a person as a partner.
6. An audit is an effective safeguard against any undue advantage being taken by a working partner.

Audit Considerations

1. Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit.
2. Studying the minute book.
3. Verifying that the business in which the partnership is engaged is authorised by the partnership agreement.
4. Examining whether books of account appear to be reasonable.
5. Verifying generally that the interest of no partner has suffered prejudicially by an actively engaged partner.
6. Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts at proper value.
7. Verifying that the profits and losses have been divided among the partners m their agreed profit-sharing ratio

10. AUDIT OF CO-OPERATIVE SOCIETIES

Meaning

(a) A Cooperative (also known as co-operative, co-op, or coop) is "an autonomous **association of persons** united **voluntarily to meet their common** economic, social, and cultural **needs and aspirations** through a jointly-owned enterprise".

(b) The Co-operative Societies Act, 1912, a Central Act, contains the fundamental law regarding the formation and working of the co-operative societies in India and is applicable in many states with or without amendments.

(c) In many states, viz., Maharashtra, West Bengal, Orissa, the co-operative societies are governed by specific state Acts.

(d) Co-operative society is a business organisation with a special mode of doing business, by pulling together all the means of production co-operatively, elimination of middlemen and exploitation from outside forces.

Audit under section 17 of the co-operative societies act 1912:

1. The Registrar shall audit or cause to be audited by some person authorised by him by general or special order in writing in this behalf the accounts of every registered society once at least in every year.
2. The audit under sub- section (1) shall include an examination of overdue debts, if any, and a valuation of the assets and liabilities of the society.

3. The Registrar, the Collector or any person authorised by general or special order in writing in this behalf the Registrar shall at all times have access to all the books accounts, papers and securities of a society, and every officer of the society shall furnish such information in regard to the transactions and working of the society as the person making such inspection may require.

The following points should be kept in mind in connection with the audit of a co-operative society

1. **Qualifications of Auditors** –
   a. A chartered accountant within the meaning of the Chartered Accountants Act, 1949,
   b. Persons holding a government diploma in co-operative accounts or in co-operation and accountancy and
   c. A person who has served as an auditor in the co-operative department of a government to act as an auditor.
2. **Appointment of the Auditor** –
   a. An auditor of a co-operative society is appointed by the Registrar of Co-operative Societies and the auditor so appointed conducts the audit on behalf of the Registrar and submits his report to him as also to the society.
   b. The audit fees are paid by the society on the basis of statutory scale of fees prescribed by the Registrar, according to the category of the society audited.
3. **Books, Accounts and other records of Co-operative Societies** –
   a. Under section 43(h) of the Central Act, a state government can frame rules prescribing the books and accounts to be kept by a co-operative society.
   b. In order to maintain proper financial accounting records so as to disclose full financial results of working of the society, the statutory or mandatory provisions provide a directive, but they are not conclusive.
   c. Depending upon the nature and object of the society, different kinds of books and registers will be maintained, so as to disclose a proper and fair picture of financial transactions.
   d. The society is at liberty to maintain such additional records according to its convenience and which it thinks more useful for clarity and detailed explanation.
4. **Restrictions on shareholdings** – According to section 5 of the Central Act,
   a. In the case of a society where the liability of a member of the society is limited, no member of a society other than a registered society can hold such portion of the share capital of the society as

would exceed a maximum of 20% of the total number of shares or of the value of shareholding to ₹ 1,000/-.

b. One should also watch whether any provision in the bye-laws of the society is not contrary to this statutory position. The State Acts may provide limits as to the shareholding, other than that provided in the Central Act.

5. **Restrictions on loans** - Section 29 of the Central Act puts restriction on loan.
   a. It states that a registered society shall not make a loan to any person other than a member. However, with the special sanction of the Registrar, a registered society may make a loan to another registered society.
   b. The State Government may further put such restrictions as it thinks fit in the interest of the society concerned and its members.
6. **Restrictions on borrowings** - Section 30 of the Central Act further puts restriction on borrowings. According to this section, a registered society shall accept loans and deposits from persons who are not members subject to the restrictions and limits of the bye-laws of the society. The auditor will have to examine the bye-laws in this respect.
7. **Investment of funds** - According to section 32 of the Central Act, a society may invest its funds in any one or more of the following:
   a. In the Central or State Co-operative Bank.
   b. In any of the securities specified in section 20 of the Indian Trusts Act, 1882.
   c. In the shares, securities, bonds or debentures of any other society with limited liability.
   d. In any co-operative bank, other than a Central or State co-operative bank, as approved by the Registrar on specified terms and conditions.
   e. In any other moneys permitted by the Central or State Government.

   In the principal provision relating to the investments of funds of a co-operative society, the Central as well as State Acts does not mention anything about the investment of reserve fund outside the business specifically.
8. **Appropriation of profits** - According to section 33 of the Central Act, a prescribed percentage of the profits should be transferred to Reserve Fund, before distribution as dividends or bonus to members.
9. **Contributions to Charitable Purposes** - According to section 34, a registered society may, with the sanction of the Registrar, contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund for any charitable purpose as defined in section 2 of the Charitable Endowments Act, 1890.

10. **Investment of Reserve Fund outside the business or utilisation as working capital** - Some of the State Acts provide that a society may use the Reserve Fund:
    a. in the business of a society, as working capital (subject to the rules made in this behalf).
    b. may invest as per provisions of the Act.
    c. may be used for some public purposes likely to promote the object of the society. The auditor should ensure strict compliance with the State Act and Rules in this regard.
11. **Contribution to Education Fund** - Some of the State Acts provide that every society shall contribute annually towards the Education Fund of the State Federal Society, at the appropriate rate as per the class of the society. Contribution to Education Fund is a charge on profits and not an appropriation.
12. The auditor may have regard to the provisions in bye-laws and Rules and Regulations of the society regarding the appropriation of profits.
13. Appropriations of profits must be approved by the General Body of the society, which is the supreme authority in the co-operative management. Further, it may be noted that necessary accounting entries for the appropriation of profits must be passed after the date of approval by the General Body.
14. According to certain State Acts, transfers to Dividend Equalization Reserve and Share Capital Redemption Fund are stated as charges against profits. According to the generally accepted principles of accountancy these items are not charges, but appropriation of profits

SPECIAL FEATURES

Examination of overdue debts

(a) Overdue debts for a period from six months to five years and more than five years shall be classified and shall have to be reported by an auditor.
(b) The auditor will have to ascertain whether proper provisions for doubtful debts are made.
(c) It affects its working capital position.
(d) A further analysis of these overdue debts from the viewpoint of chances of recovery will have to be made, and they will have to be classified as good or bad.

Overdue Interest

(a) Overdue interest should be excluded from interest outstanding and accrued while calculating profit.
(b) Overdue interest is interest accrued in accounts of which the amount is overdue.
(c) In practice an overdue interest reserve is created and the credit of overdue interest credited to interest account is reduced.

Certification of Bad Debts

A peculiar feature regarding the writing off of the bad debts in case of co-operative societies is that bad debts can be written off only when they are certified as bad by the auditor (if law requires) or managing committee.

Verification of Assets and Liabilities

The auditor shall examine existence, ownership and valuation of assets. Fixed assets should be valued at cost less provision for depreciation. The current assets should be valued at cost or market price, whichever is lower. All the known liabilities should be brought into the account and not merely disclosed as contingent ones.

Adherence to Co-operative Principles

(a) While auditing the expenses the auditor shall ensure that they are economically incurred and there is no wastage of funds.
(b) The principles of propriety audit should be followed for the purpose.
(c) The assessment is not necessarily in terms of profits, but in terms of extending of benefits to members who have formed the society.

Observations of the Provisions of the Act and Rules

(a) Auditor shall also examine the non-compliance with the provisions of Co-operative Societies Act and Rules and bye-laws.
(b) The financial implications of such infringements should be properly assessed by the auditor and they should be reported.

Restrictions on cooperative societies

1. In case of a society having limited liability of member, no member other than a registered society can hold share capital exceeding 20% or Rs. 1,000.
2. A registered society can provide loan to its members. However, it may provide loan to another registered society only with special section of the Registrar.
3. It may accept loans & deposits from member and others subject to the conditions specified in by laws.
4. A central co-operative society may invest its funds only in the following:
    i. Shares, securities, bonds or debentures of any other society with limited liability.
    ii. Securities specified in Section 20 of the Indian Trusts Act, 1882.
    iii. Central or State Co-operative Bank.

iv. Co-operative bank, other than a Central or State co-operative bank, as approved by the Registrar.
v. Others as permitted by the Government.

Verification of Members' Register and examination of their pass books

Auditor should carry out examination of entries in members pass books regarding the loan given and its repayments. Confirmation of loan balances should also be obtained in accordance with SA 505.

Special report to the Registrar

In case auditor notices serious irregularities in the working of the society he may report these special matters to the Registrar, The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, a special report may become necessary:

(i) Personal profiteering by members of managing committee.
(ii) Detection of fraud.
(iii) Specific cases of mis-management. Decisions of management against co-operative principles.
(iv) In the case of urban co-operative banks, disproportionate advances to vested interest group. Reckless advancing without evaluating the credit worthiness of the party.

Audit classification of society

After a judgment of an overall performance of the society, the auditor shall award a class to the society. However, if the management of the society is not satisfied about the award of audit class, it can make an appeal to the Registrar, and the Registrar may direct to review the audit classification.

Discussion of draft audit report with managing committee

The audit report should be finalized only after discussion with the managing committee. Minor irregularities may be rectified.

Distribution of profit

25% of profit should be transferred to Reserve Fund before distribution to members. Registrar may reduce it but at least 10% is even then required. Society may use Reserve fund in business of a society or for some public purpose.

Schedule to this report

- Transaction contrary to Act, rules and Bye-laws
- Sums not brought into accounts.
- Material/ property appearing as doubtful/ bad.
- Material irregularity in expenses/ realization of money.
- Any other matter specified by registrar

AUDIT OF MULTI STATE CO-OPERATIVE SOCIETIES

Books of Accounts

Every multi state co-operative society shall keep books of accounts for-

- ✓ All sales and purchases of goods.
- ✓ The assets and liabilities of the society.
- ✓ All sum of money received and expended and the matters in respect of which the receipt and expenditure took place.
- ✓ In the case of Multi State Co-operative Society engaged in production, processing and manufacturing, particulars relating to utilisation of materials or labour or other term of cost as may be specified in the bye laws of such a society.

Others books to be maintained

(a) **Stock register** containing Information as regards receipts, issues and balances of stock-in-trade.

(b) **Cash book**: To record cash receipts and expenses under suitable heads capital and revenue items

(c) **Register of loan**: detailing to record particulars regarding loans sanctioned by the society, the dates of disbursement and recovery

(d) **Register of fixed deposits**: which contains details of dates of acceptance, maturity, interest, etc. in the case of a co-operative credit society, or a cooperative bank, or any other society accepting deposits.

(e) **Register of assets and investments**: Particulars regarding immovable and movable assets, types of assets, location, date of acquisition, cost, depreciation etc.

(f) **Register of sureties**: In the case of a co-operative credit society, loans are given against personal security of members as also guarantee is provid ed by two other members. It contains particulars about the borrowers in respect of which a member has stood surety

Qualification of Auditors (Sec. 72)

A chartered accountant

Disqualifications are as follows:

- Body corporate.
- Officer or Employee of MSCOS.
- Partner / Employee of Officer / Employee of MSCOS.
- Indebted I Guarantor for amount > 1,000/-

Appointment of auditors (Sec. 70)

(a) First auditor to be appointed by board within one month of registration date to hold office until conclusion of 1st AGM. If board fails to appoint first auditor then appointment shall be mad e in general meeting.

(b) Subsequent auditor shall be appointed at each AGM. He shall hold office from conclusion of that meeting until conclusion of next AGM.

Power & Duties of Auditors (Sec. 73)

Powers of auditor

i. Every auditor of a multi-State co-operative society shall have a right of access at all times to the books, accounts and vouchers of the multi-State co-operative society, whether kept at the head office of the multi-State co-operative society or elsewhere, and shall be entitled to require from the officers or other employees of the multistate co- operative society such information and explanations as the auditor may think necessary for the performance of his duties as an auditor.

Inquiry by auditor

ii. Without prejudice to provisions of sub-section (1), the auditor shall inquire: -

a. whether loans and advances made by the multi-State cooperative society on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the multi-State co-operative society or its members;

b. whether transactions of the multi-State co-operative society which are represented merely by book entries are not prejudicial to the interests of the multi-State co- operative society;

c. whether personal expenses have been charged to revenue account; and

d. Where it is stated in the books and papers of the multi-State cooperative society 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, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

Audit report

iii. The auditor shall make a report to the members of the multi-state cooperative society on the accounts examined by him and on every balance-sheet and profit and loss account and on every other document required to be part of or annexed to the balance- sheet or profit and loss account, which are laid before the multi-State co-operative society in general meeting during his tenure of office, and the report shall state whether, in his opinion and to the best of his information and according to the explanations given to him, the said accounts give the information required by this Act in the manner so required and give a true and fair view

   a. In the case of the balance-sheet, of the state of the multi-State cooperative society's affairs as at the end of its financial year; and
   b. In the case of the profit and loss account, of the profit or loss for its financial year.

iv. The auditors' report shall also state-

   a. whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit;
   b. whether in his opinion, proper books of account have been kept by the multi-State co-operative society so far as appears from his examination of those books, and proper returns adequate for the purposes of his audit have been received from branches or offices of the multi-State co-operative society not visited by him;
   c. whether the report on the accounts of any branch office audited by a person other than the multi-State co-operative society's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report;
   d. Whether the multi-State co-operative society's balance-sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns.

Special Audit of MSCOS (Sec. 77)

1. In case, Central Government or State Government either alone or both hold 51% or more of paid-up share capital in such MSCOS.
2. Central Government may direct either a C.A or MSCOS's auditor to conducts special audit & make a report to it.

3. If Central Government is of opinion that:
    - Affairs of MSCOS aren't being managed in accordance with self-help & Cooperative principles or sound business principles or:
    - MSCOS is managed in manner likely to cause serious injury I damage to interest of trade / industry or business to which it pertains or
    - The financial position of any MSCOS is such as to endanger its solvency.
4. Auditor has same powers & duties as in Sec. 73.
5. On receipt of report of special audit, Central Government may take such action as it considers necessary.

Section 78 – Inquiry by Central Registrar

1. Central Registrar may on request from
    - Federal co-operative to which MSCOS is affiliated or
    - A creditor or
    - At least 1/3 of member of board or
    - At least 1/5 of total member of MSCOS,

    Hold an Inquiry or direct some person to Inquire into constitutions, working & financial condition of MSCOS. However, before inquiry, 15 days' notice is to be given to MSCOS.
2. By general or special order in writing in this behalf inspect or direct any person authorized by him by order in writing.
3. Central Registrar or person authorised, shall have following powers:
    - Free access to books / A/c / Cash & Properties in custody of MSCOS and may summon any person in possession or responsible for the custody.
    - He may, require the officers of the society to call a general meeting of the society by giving notice of not less than seven days at such time and place at the headquarters of the society to consider such matters as may be directed to him, and where the officers of the society refuse or fail to call such a meeting, he shall have power to call it himself.
    - he may summon any person before him at any place at the headquarters of the society or any branch thereof and may examine such person on oath.
    - In event of serious irregularities discovered during inspection, take them into custody and shall have power to verify the cash balance of the society and subject to the general or

special order of the central registrar to call a meeting of the society where such general meeting is, in his opinion necessary.

- Furnish such information with regard to the working of the society as the central registrar or the person making such inspection may require.

Section 79 – Inspection by Central Registrar

1. Central Registrar may on request from
    - Federal co-operative to which MSCOS is affiliated or
    - A creditor or
    - At least 1/3 of member of board or
    - At least 1/5 of total member of MSCOS
2. By general or special order in writing in this behalf inspect or direct any person authorized by him by order in writing.
3. Central Registrar or person authorised, shall have following powers:
    - Free access to books / A/c / Cash & Properties in custody of MSCOS and may summon any person in possession or responsible for the custody.
    - In event of serious irregularities discovered during inspection, take them into custody and shall have power to verify the cash balance of the society and subject to the general or special order of the central registrar to call a meeting of the society where such general meeting is, in his opinion necessary.
    - Furnish such information with regard to the working of the society as the central registrar or the person making such inspection may require.
4. A copy of the report of inspection under this section shall be communicated to the Multi-State Co-operative society within a period of three months from the date of completion of such inspection

11. GOVERNMENT AUDIT

Government audit means the systematic and independent examination, of financial, administrative and other operations of a public entity, for evaluating and verifying them.

Its objective is to ensure the accountability of the government entity in respect of public revenue and expenditure.

Auditor presents a report containing audit findings along with recommendations for future actions.

In India, the function of government audit is performed by Comptroller and Auditor General.

COMPTROLLER & AUDITOR GENERAL - Certain Provisions

Appointment

The President of India shall appoint CAG.

Removal or Resignation

He can be removed from the office only on the ground of proven mis-behaviour 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.

DUTIES OF COMPTROLLER & AUDITOR GENERAL

1. 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.
2. 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;
   a. Rs. 25 lakhs, and
   b. 75% of the total expenditure of that body or authority.
3. To audit grants and loans – He shall audit specific purpose loan or grant given to anybody other than a foreign state or international organization, out of the Consolidated Fund of India/ State/ Union Territory.
4. To audit receipts of union or states – He shall audit all receipts payable in to the Consolidated Fund of India/ State/ Union Territory.
5. To audit accounts of stores and stock – He shall audit the accounts of stores and stock kept in any office or department of the union or state.

6. 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.
7. To audit and report – CAG shall audit and report:
    a. All expenditure from Consolidated Fund of India/ State/ Union Territory.
    b. All transactions of Union State relating to the 'Contingency Funds and Public accounts.'
    c. All Trading, Manufacturing, Profit and Loss account and Balance Sheet and other subsidiary accounts kept in any department of the Union/ State.
8. 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.

POWERS OF COMPTROLLER & AUDITOR GENERAL

General powers

1. He can inspect any office of accounts under the control of the Union or State Government.
2. He may require that any accounts, books, papers and other documents, which are relevant to the transactions under audit, be sent to specified places.
3. He can put such questions, as he may consider necessary, to the person in charge.
4. He can call for such information as he may require for the preparation of any account or report

Directions by CAG to the auditor [Sec. 143(5)] of the companies act, 2013]

1. In the case of a Government company, CAG shall direct the auditor the manner in which the accounts of the Government Company are required to be audited.
2. The auditor shall submit a copy of his audit report to CAG
3. The audit report shall, among other things, include the directions, if any, issued by CAG, the action taken thereon and its impact on the accounts and financial statement of the company.

Right of CAG to conduct

Supplementary audit or supplement the audit report

[Sec. 143(6) of The Companies Act, 2013]

CAG shall, within 60 days from the date of receipt of the audit report, have the following rights:

Supplementary audit

- CAG may order conduct of a supplementary audit of the financial statement of the company.

- Supplementary audit shall be conducted by such person(s) as CAG may authorise in this behalf.
- CAG may authorise such person(s) to obtain such information as may be required for conduct of supplementary audit.
- CAG Comments on –
  - CAG may comment upon the audit report.
  - CAG may supplement the audit report.
  - Any such comments or supplement shall be sent by the company to every person entitled to copies of audited financial statements.
  - Any such comments or supplement shall also be placed before the members in the AGM at the same time and in the same manner as the audit report.
- Test audit [Sec. 143(7) of the companies act, 2013]
  - CAG may by an order, cause test audit to be conducted of the accounts of a government company.

AUDIT OF VARIOUS ITEMS UNDER GOVERNMENT AUDIT

Expenditure audit

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

(a) Audit of rules and orders
(b) Audit of sanctions
(c) Audit against provision of funds
(d) Propriety audit
(e) Performance audit

Audit of Rules and Orders/ Audit of Regularity and Legality

1. Its objective is to ensure whether the expenditure is in accordance with:
   a. Relevant provisions of the Constitution and of the laws and rules,
   b. The rules, regulations issued by CAG.
   c. The orders of, or rules made by, any higher authority.
2. In this connection, auditor should have sound knowledge of rules and orders w.r.t. following:
   a. The powers to incur and sanction expenditure from the Consolidated Fund/ contingency fund of India / State;

b. The mode of presentation of claims against government, withdrawing moneys from the Consolidated Fund, Contingency Fund and the financial rules prescribing the procedure to be followed by government; and
c. Regulating the conditions of service, pay and allowances, and pensions of government servants.

Audit of Sanctions

1. Its objective is to ensure whether the expenditure is:
   a. Properly covered by a sanction, either general or special.
   b. Sanctioned by authority, which is authorized to do so.
2. Thus, auditor should consider following:
   a. He should have knowledge of the sanctioning powers of various authorities.
   b. He should examine whether all sanctions are adequately noted in the prescribed register.
   c. For petty expenditure, the signature of the competent authority on a bill can be regarded as a sanction.

Audit against provision of funds

Its objective is to ensure whether the expenditure:

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

Propriety Audit

1. 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.
2. A transaction may satisfy all the requirements of regular audit, but may still be highly wasteful.
3. 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.
4. Auditor should try to examine public financial morality by looking in to the wisdom, faithfulness and economy of transactions.
5. No hard and fast rules can be laid down regarding the standards of financial propriety.
6. Here, the auditor should examine that: -
   a) 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.
   b) The expenditure is not prima fade more than the occasion demands.

c) No authority exercises its power of sanctioning expenditure to pass an order, which will directly or indirectly accrue to its own advantage.

d) Public money is not utilised for the benefit of a particular person / section of the community.

Performance Audit/ Full Scope Audit

1. Here, auditor tries to ensure that government programmes have achieved the desired objectives at the lowest cost and given the intended benefits.
2. Performance audit includes efficiency, economy and effectiveness audit.
3. Performance audit is an objective examination of the financial and operational performance. It seeks to identify opportunities for greater economy and effectiveness.
4. **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.
5. **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.
6. **Effectiveness audit -** It examines whether:
    - Programmes and projects are performing well.
    - Overall targeted objectives are being achieved

Audit of stores and stocks

1. Auditor should ascertain whether the internal controls over purchase, receipt, and issue of stores are well designed and properly carried out during the year.
2. He should bring to the notice of the government any deficiencies in the system of control.
3. The audit of purchase of stores is conducted in the same manner as audit of expenditure.
4. The auditor has to ensure that the prices paid are reasonable.
5. Cases of uneconomical purchase of stores and losses due to defective or inferior quality of stores are specifically examined.
6. The certificates of quality and quantity given by expert should be examined.

7. Accounts of receipts, issues and balances are checked regarding accuracy, correctness and reasonableness of balances in stocks.
8. Any excess or idle stocks should be specifically mentioned in the report.
9. Auditor should ensure their existence by attending physical verification of stock. 10.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: -

1. Internal checks are imposed for prompt detection and investigation of irregularities.
2. Internal procedures adequately ensure proper accounting of demands collection.
3. There is effective check on assessment, collection and proper allocation of revenue.
4. Such regulations and procedures are actually being carried out.
5. All revenues have been correctly assessed, realized and credited to the government account.
6. There is no leakage of revenue.

12. TRUSTS & SOCIETIES

1. There are three basic legal forms of charitable entities under Indian law:
    a. Trusts,
    b. Societies, and
    c. Section 8 companies.
2. The applicability of legal framework governing the charitable institution will depend on the form of business organization the charitable institution takes.
    a. If the charitable institution is formed as a Public Trust,
        (i) It will be governed by the Public Trust Act applicable in the relevant State.
        (ii) However, if no Public Trust Act exists in that state, then the applicable legislation will be the Indian Trusts Act, 1882.
    b. If the charitable institution is formed as a Society, it will be governed by the Societies Registration Act, 1860.
    c. The charitable institution can also be formed as a non-profit company under section 8 of the Companies Act, 2013.
    d. Apart from the above legislations, the Income Tax Act 1961 will be applicable to charitable institutions.

e. And in the case of foreign contributions to these charitable institutions, the Foreign Contribution (Regulation) Act, 2010 will be applicable.

3. The format for preparation and presentation of financial statements is prescribed under respective state laws.
4. Auditor's responsibility:
   a. The auditor should obtain the list of the books and records maintained by the Trust.
   b. The list should be matched with the above requirement for maintaining mandatory books and records as may be applicable in each case
   c. He will have to conduct the audit by applying the generally accepted auditing procedures, which are applicable for any other audit.
   d. The auditor will also have to keep in mind the concept of materiality depending upon the circumstances of each case.
   e. He should keep detailed notes about the evidence on which he has relied upon while conducting the audit and also maintain all his working papers.
   f. Such working papers should include his notes on the following, amongst other matters:
      (i) Work done while conducting the audit and by whom;
      (ii) Explanation and information given to him during the course of the audit and by whom;
      (iii) Decision on the various points taken;
      (iv) The judicial pronouncements relied upon by him while drafting the audit report; and
      (v) Certificates issued by the client / management letters.
   g. It is important that the audit working papers prepared and/or obtained provide evidence that:
      (i) The opinion expressed by the auditor is based on the examination made by him;
      (ii) In arriving at his opinion, the auditor has given due awareness to the information and explanations given by the assesses and that his opinion is not subjective;
      (iii) The information and explanations obtained were full and complete that is, the auditor has called for all the information and explanations which were necessary to be considered before arriving at his opinion; and
      (iv) The auditor did not merely rely upon the information or explanations given by the assesses but that he subjected such information and explanations to reasonable tests to verify their accuracy and completeness.

TRUSTS

The auditor has to ascertain the following:

1. Whether accounts are maintained regularly and as per the provisions of the applicable Act and rules;
2. Whether receipts and disbursements are properly and correctly shown in the accounts and money received in the form of donations is being applied as per the objects of the trust and as per the specific direction by the donor, if any.
3. Whether the cash balance and vouchers in the custody of the manager or trustee on the date of audit were in agreement with the accounts;
4. Whether all books, deeds, accounts, vouchers or other documents or records required by the auditor were produced before him;
5. Whether a register of movable and immovable properties is maintained, the changes therein are communicated from time to time to the regional office, and the defects and inaccuracies mentioned in the previous audit report have been duly complied with and rectified.
6. Whether the manager or trustee or any other person required by the auditor to appear before him did so and furnished the necessary information required by him;
7. Whether any property or funds of the Trust were applied for any object or purpose other than the object or purpose of the Trust;
8. The amounts of outstanding for more than one year and the amounts written off, if any;
9. Whether any money of the public trust has been invested contrary to the provisions of applicable Act which have come to the notice of the Auditor
10. All cases of irregular, illegal or improper expenditure, or failure or omission to recover monies or other property belonging to the public trust or of loss or waste of money or other property thereof, and whether such expenditure, failure, omission, loss or waste was caused in consequence of breach of trust or misapplication or any other misconduct on the part of the trustees or any other person while in the management of the trust
11. Whether the maximum and minimum number of the trustees is maintained;
12. Whether the meeting are held regularly as provided in such instrument
13. Whether the minute books of the proceedings of the meeting is maintained
14. Whether any of the trustees has any interest in the investment of the trust
15. Whether any of the trustees is a debtor or creditor of the trust.
16. Whether anonymous donations received are properly accounted for and donations in cash are not received by the Trust over and above the prescribed limit of accepting cash donations.
17. Whether the irregularities pointed out by the auditors in the accounts of the previous year have been duly complied with by the trustees during the period of audit

18. Any special matter which the auditor may think fit or necessary to bring to the notice of the Deputy or Assistant Charity Commissioner.

SOCIETIES

1. The auditor should ascertain governing legislation of society i.e. Societies Registration act, 1860 or any applicable state law under which it has been registered.
2. Object of society needs to be ascertained from its memorandum of association/bye laws. Its activities may include charitable, social, cultural or educational activities.
3. Ascertain whether society has obtained registration under Foreign Contribution (Regulation) Act, 2010 in case foreign contributions are received.
4. Ascertain whether it is also registered under relevant provisions of Income Tax Act which may make it eligible for tax exemption on its income.
5. Obtain an understanding of internal control to design audit procedures with special reference to donations and various expenditures incurred in relation to achievements of objects of society.
6. Evaluate appropriateness of accounting policies with special reference to donations and grants. Also evaluate accounting policies in relation to specific grants.
7. In case some expenses incurred by society are reimbursed by donors, ascertain how these are recognized in financial statements.
8. Ascertain, if any inquiry has been held by Registrar under applicable law in the working or financial condition of society and its implications for auditor's opinion.
9. Ascertain all cases of irregular, illegal or improper expenditure or failure or omission to recover monies or other property belonging to society or of loss or waste of money or other property thereof.
10. Ascertain whether such expenditure or waste was caused in consequence of breach of trust or misapplication or any other misconduct on the part of governing body.

AUDIT OF LIMITED LIABILITY PARTNERSHIP	
Basics of Limited Liability Partnerships (LLP)	1. LLP is governed by Limited Liability Partnership Act, 2008. 2. It is a form of business organisation which enshrines in itself the advantages of both the Company and Partnership forms of Organisation. 3. Minimum of 2 Partners can form an LLP and at least 2 partners would be Designated Partners who would be required to take DPIN (Designated Partner Identification Number). 4. The Partners in an LLP and their rights and duties are governed by way of an agreement between them.

Small Limited Liability Partnership	(a) the **Contribution** of which, does not exceed ₹ 25 lakh or such higher amount, not exceeding ₹ 5 crore, as may be prescribed; **and** (b) the **Turnover** of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed ₹ 40 lakh or such higher amount, not exceeding ₹ 50 crore, as may be prescribed
Obligation to maintain Books of Account	**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
Audit of the Accounts of an LLP	**Rule 24 of LLP, Rules 2009** 1. Any LLP, whose a. **turnover does not exceed**, in any financial year, **₹ 40 lakh**, or b. **contribution does not exceed** ₹ 25 lakh, is not required to get its accounts audited. 2. 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.
Advantages / Purpose / Need of Audit	1. **Detection of Errors**: - Auditing the accounts of a LLP helps in detecting errors & frauds & verification of financial statements. 2. **Disputes**: -Disputes, if any between any partners in the matter of accounts can be settled with the help of audited accounts. 3. **Reliability**: - Banks & financial institutions lend money to the firms only on the basis of audited accounts. 4. **Better Compliance and Management**: -Periodical visits & suggestions by the auditor will be helpful in improving the management of the LLP. 5. **Reconstitution**: - For settling accounts between partners at the time of admission, death, retirement, insolvency, insanity, etc. audited accounts are accepted by those concerned who have dealings with the LLP.
Returns to be maintained and filed by an LLP	1. Every LLP would be required to file **annual return in Form 11** with ROC within **60 days of closure of financial year**. The annual return will be available for public inspection on payment of prescribed fees to Registrar. 2. Every LLP is also required to submit Statement of Account and Solvency in **Form 8** which shall be filed **within** a period of **30 days from the end of 6 months the financial year** to which the Statement of Account and Solvency relates.
Appointment of Auditor	The auditor may be appointed by the designated partners of the LLP – 1. At any time for the first financial year but before the end of first FY

	2. At least 30 days prior to the end of each FY (other than the first FY) 3. To fill the casual vacancy in the office of auditor, 4. 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.
Auditor's Duty Regarding Audit of LLP	1. **Engagement Letter**: - The auditor should get definite instructions in writing as to the work to be performed by him. 2. **Minutes Book**: - If partners maintain minute book, he shall refer it for any resolution passed regarding the accounts 3. **LLP Agreement**: - 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. **Reporting**: - The auditor should mention a. Whether the records of the firm appear to be correct & reliable. b. Whether he was able to obtain all information & explanation necessary for his work. c. Whether any restriction was imposed upon him

Relevant Questions

1. **Write a short note on: Books of Account to be maintained by a Limited Liability Partnership.**
2. **Write a short note on: Statutory provisions as to Audit of Limited Liability Partnerships.**
3. **List the benefits that arise to LLP from getting the accounts audited.**
4. **Briefly describe the auditor's duty regarding audit of LLP.**

AUDIT OF HIRE PURCHASE

Meaning of hire purchase	**A Hire-purchase agreement** means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which – (i) Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments, (ii) The property in the goods is to pass to such person on the payment of the last of such instalments, and

	(iii) Such person has a right to terminate the agreement at any time before the property so passes.
Parties Involved	1. ***Hirer*** means the person who obtains or has obtained possession of goods from an owner under a hire- purchase agreement and 2. ***Owner*** means the person who lets or has let, delivers or has delivered possession of goods to a hirer under a hire purchase agreement in order to complete the purchase of, or the acquisition of property in the goods of which the agreement relates; and includes any sum so payable by the hirer under the hire- purchase agreement by way of a deposit or other initial payment.
Audit Procedures	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 b. The cash price of the goods 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. 3. Ensure that instalment payments are being received regularly as per the agreement

AUDIT OF LEASES	
Meaning	In a **lease agreement**, a party (called '**lessee'**) acquires the right to use an asset for an agreed period of time in consideration of payment of rent to another party (called '**lessor'**).
Types of Leases	1. **Finance Lease** – the legal ownership of the asset remains with the lessor (the leasing company), but in substance, all the **risks and rewards** of ownership of the asset are **transferred to the lessee.** 2. **Operating Lease** – is a simple arrangement where, in return for rent, the lessor allows the lessee to use the asset for a certain period.
Process of Lease transaction	A normal finance lease transaction usually goes through the following modality: a. The **lessee will select the equipment**, and satisfy himself about its functional fitness and specifications, the lessor has no participation at this stage. b. Having chosen the equipment, the **lessee approaches a lessor**, either directly or through a lease-broking agency. c. The lease agreement is broadly negotiated and the rates are finalised. The **lessor places an order** on the manufacturer as chosen by the lessee. d. The **manufacturer delivers the equipment** at the site of the lessee, and the latter gives notice of acceptance to the lessor. e. The lease agreement giving detailed **terms of contract** is signed between the parties. Leases will normally be full pay-out, with term varying as per requirements. f. During the lease period, the lessee:

	i. Will pay **rentals** regularly at periods agreed-upon, which are usually each calendar month; ii. Will keep the equipment in good repair and working **condition**, etc. iii. Will be entitled to any manufacturer's **warranties or after-sales services**. g. At the end of the lease period, the equipment shall **retreat to the lessor**. The lessee may, however, be given a renewal right, or may be allowed to participate in purchase of the equipment when the lessor intends to sell it. h. **No purchase option** shall be given to the lessee in the lease agreement itself.
Audit Procedures to be followed	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: a. 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). b. The amount of tenure of lease, dates of payment, late charges, deposits or advances etc. Should be noted. c. Whether the equipment shall be returned to the lessor on termination of the agreement and the cost shall be borne by the lessee. d. 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.
Detailed meaning of Finance Lease	1. An arrangement with the following attributes qualifies as a Finance Lease: a. The lease arrangement transfers ownership of the asset to the lessee at the end of the lease term. b. The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised. c. The lease term is for the major part of the economic life of the asset even if title is not transferred.

<table>
<tr><td></td><td>d. At the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
e. the leased assets are of such a specialized nature that only the lessee can use them without major modifications.</td></tr>
<tr><td>Operating Lease</td><td>An arrangement that does not transfer substantially all the risks and rewards incidental to ownership qualifies as an Operating Lease. In other words, an operating lease is a lease arrangement “Other than finance lease”.</td></tr>
<tr><td>Difference between Operating & Finance Lease</td><td>
<table>
<tr><th></th><th>Operating Lease</th><th>Financial Lease</th></tr>
<tr><td>Ownership</td><td>Ownership of the asset remains with the lessor for the entire period of lease</td><td>Ownership transfer option at the end of the lease period is with the lessee. Title may or may not be eventually transferred</td></tr>
<tr><td>Accounting treatment</td><td>Operating lease is generally treated like a renting arrangement. That means, the lease payments are treated as operating expenses and the asset does not appear as an asset on lessee’s balance sheet</td><td>Financial lease is treated like loan arrangement. Hence, the asset ownership is considered of that of the lessee and thus appears on the balance sheet of the lessee.</td></tr>
<tr><td>Purchase Option</td><td>Under operating lease, the lessee does not have any option to buy the asset during the lease period.</td><td>Financial lease allows the lessee to have a purchase option at less than the fair market value of the asset</td></tr>
<tr><td>Lease Term</td><td>Lease term generally extends to less than 75% of the projected useful life of the leased asset.</td><td>Lease term is generally more than or equal to estimated economic life of the asset under the lease arrangement.</td></tr>
<tr><td>Operating/ running expenses</td><td>Lessee pays only the monthly lease payments. No running or administration costs are to be borne for example: registration, repairs etc. since it gives only right to use the asset</td><td>Lessee generally bears insurance, maintenance and taxes.</td></tr>
<tr><td>Tax benefit</td><td>Since operating lease is as good as renting, lease payment is considered as expense. No depreciation can be claimed by the lessee.</td><td>Lessee can claim both interest and depreciation expense as financial lease is treated like a loan.</td></tr>
</table>
</td></tr>
</table>

	Common examples	Lease of Projector, Computers, Laptops, Coffee Dispensers etc	Lease of Plant and Machinery, Land, Office Building etc.

Relevant Questions

1. **What procedure may be adopted by an auditor, while auditing leasing transactions entered into by leasing company? [Nov 13 – 8 marks]**
2. **Define the different types of lease agreements as per Accounting Standard / Ind-AS [May 19 – 4 marks]**

EXAMINATION QUESTIONS

Q1. Explain in detail the duties of Comptroller and General of India.

[May 03 (8 Marks), Nov. 12 (10 Marks), RTP-May 19, Nov. 19]

Q2. Write short note on: Audit of Expenditure in Government Audit.

[May 07 (5 Marks), May 11 (4 Marks)]

Q3. Write short note on: Basic Standards set for audit of Government Expenditure. **[Nov. 13 (4 Marks)]**

Q4. An audit of Expenditure is one of the major components of Government Audit. In the context of 'Government Expenditure Audit', write in brief, what do you understand by:

(i) Audit against Rules and Orders

(ii) Audit of Sanctions

(iii) Audit against Provision of Funds

(iv) Propriety Audit

(v) Performance Audit. **[RTP-May 18]**

Q5. Write basis standards set for Expenditure Audit of Government. **[Nov. 18 (5 Marks)]**

Q6. Audit of government expenditure is one of the major components of government audit conducted by the office of C&AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Explain those standards. **[RTP-Nov. 19]**

Q7. What are the focus points in doing propriety audits by C & AG as regards government expenditure?

[Nov. 11 (8 Marks)]

Q8. Write short note on: Propriety Audit. **[Nov. 17 (4 Marks)]**

Q9. Audit against the propriety seeks to ensure that expenditure confirms to certain principles. Explain.

[MTP-Oct. 19]

Q10. With reference to Government Audit, what do you understand by "Audit of Commercial Accounts"? **[May 05 (8 Marks)]**

Q11. What are the powers of C&AG in relation to the accounts of Government Companies audited by the statutory auditors? **[Nov 05 (8 Marks)]**

Q12. In case of government companies, CAG has a right to issue directions to auditor and do supplementary audit. Explain. **[May 07 (8 Marks)]**

Q13. Write short notes on the following: Power of CAG u/s 143(6) & 143(7) in relation to audit of Government Company. **[Nov 07 (5 Marks)]**

Q14. Write short note on: Powers of C & AG in connection with the performance of his duties. **[Nov. 09 (5 Marks), Nov. 14 (4 Marks)]**

Q15. Discuss the power of C & AG in Government audit. **[May 19 (3 Marks)]**

Q16. Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG." Discuss.

Q17. Describe the salient features of Financial Administration of Local Bodies. **[Nov. 04 (8 marks)]**

Q18. Draft an Audit programme for conducting audit of accounts of a local body. **[May 10 (5 Marks), May 16 (6 Marks)]**

Q19. State the background of "Local Bodies". Draft an audit programme for audit of local bodies. **[May 14 (8 Marks)]**

Q20. State the important objectives of local body's audit. **[May 15, May 17 (4 Marks)]**

Q21. State any five special points which you, as an auditor, would look into while examining the income and collection of fund by an NGO engaged in providing relief work for flood victims. **[Nov. 07 (5 Marks)]**

Q22. What important points should an auditor keep in mind while checking receipt of income of a Non-Governmental Organization (N.G.O)? **[Nov. 10 (4 Marks)]**

Q23. What are the points on which an auditor should concentrate while planning audit of an N.G.O.? **[May 13 (8 Marks)]**

Q24. You have been appointed as an auditor of an NGO, briefly state the points on which you would concentrate while planning the audit of such an organisation? **[RTP-Nov. 18]**

Q25. An NGO operating in Delhi had collected large scale donations for Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which

you will like to incorporate in your audit programme for audit of said receipts and remittances of donations. **[MTP-March 18, Oct. 18, March 19]**

Q26. You are approached by a partnership firm to list out the advantages that will accrue to them, if the accounts are audited. State five important advantages. **[May 07 (5 Marks)]**

Q27. What are the advantages of the audit of the accounts of partnership firm. **[May 15 (6 Marks), MTP-April 19]**

Q28. Mention important points which auditors will consider while conducting audit of accounts of a partnership firm. **[May 13 (8 Marks), May 16 (6 Marks), RTP-May 19]**

Q29. There are certain points which are required to consider specially in the audit of accounts of a partnership. Discuss any three points briefly. **[Nov. 19 (3 Marks)]**

Q30. Write a short note on: Books of Accounts to be maintained by a Limited Liability Partnership.

Q31. Write a short note on: Statutory provisions as to Audit of Limited Liability partnerships.

Q32. List the benefits that arise to LLP from getting the accounts audited.

Q33. Briefly describe the auditor's duty regarding audit of LLP.

Q34. Mention any six points to be considered for good internal control for collection of tuition fees from students of college. **[May 09 (6 Marks)]**

Q35. Mention the eight important points which an auditor will consider while conducting the audit of educational institutions. **[May 12 (8 Marks)]**

Q36. Mention any eight important points which an auditor will consider while conducting the audit of a school. **[Nov. 14 (8 Marks)]**

Q37. Mention any 8 special points which you as an auditor would look into while auditing the books of accounts of Hospital.

[May 11, Nov. 12, May 14 (8 Marks), MTP-March 18, Aug. 18, Oct. 18, March 19; RTP-Nov. 18, May 19]

Q38. You have been appointed auditor of M/s. Divine Children Hospital. Discuss any four important points that would attract your attention while audit. **[Nov. 19 (4 Marks)]**

Q39. What steps would you take into consideration in auditing the receipts from patients of a hospital? **[Nov. 17 (6 Marks)]**

Q40. In the case of audit of a charitable institution, what attentions should be paid by auditor regarding audit of expenditure items? **[Nov. 19 (4 Marks)]**

Q41. Mention any 8 special points which you as an auditor would look into while auditing the books of accounts of Cinema. **[May 11 (8 Marks)]**

Q42. Mention any eight important points which an auditor will consider while conducting audit of club?
[Nov. 13 (8 Marks)]

Q43. What procedure may be adopted by an auditor, while auditing leasing transactions entered into by the leasing company? **[Nov. 13 (8 Marks)]**

Q44. Define the different types of lease agreements as per Accounting Standard/Ind-AS. **[May 19 (4 Marks)]**

Q45. What special steps will you take into consideration in auditing the accounts of a hotel.
[May 05 (10 marks)]

Q46. What are the six important points that will attract your attention in the case of audit of a hotel.
[Nov. 09 (5 Marks)]

Q47. Write short note on: Restriction on shareholding in a Co-operative Society.

Q48. Write short note on: Restrictions on investments of funds of a central co-operative society.

Q49. Mention the duties of Auditor of Co-operative Societies in regard to the following:

(i) Over-due interest.

(ii) Compliance with provisions of Co-operative Act and Rules thereunder.

(iii) Special Report to Registrar of Co-operative Societies.

Q50. Under what circumstances, an auditor is required to submit a special report to the registrar of Co-operative Societies?

Q51. "Examination of overdue debts, audit classification of society, and reporting the infringements of provisions of the Act are the special features of audit of a co-operative society." Do you agree?

Q52. Auditor of a cooperative society has to submit his audit report in the prescribed form specified by the Registrar or as given in the related Rules. State the matters to be covered in the audit report.

Q53. An auditor of a Co-operative Society governed by Cooperative Societies Act, 1912 is required to attach schedules giving certain information. Please list the information required to be given in the schedules.

Q54. State the requirements regarding the maintenance of books of accounts with respect to a multi-state co-operative society.

Q55. Write short note on: Aspects to be covered in the books of accounts to be maintained by a multi-cooperative society.

Q56. Multi-State Co-operative Societies Act, 2002 states that a person who is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 can only be appointed as auditor of multi-State co-operative society. Explain stating also the persons who are not eligible for appointment as auditors of a multi-State co-operative society. **[MTP-Aug. 18]**

Q57. Briefly explain the provisions for qualification and appointment of Auditors under the Multi-State Co-operative Societies Act, 2002. **[Nov. 18 (5 Marks)]**

Q58. Write short notes on: Powers and duties of an auditor of a Multi-State Cooperative Society. **[RTP-May 20]**

Q59. As per Multi-state Co-operative Societies Act, 2002, the auditor shall make a report to the members of the Multi-State co-operative society on the accounts examined by him and on every balance-sheet and profit and loss account and on every other document required to be part of or annexed to the balance-sheet or profit and loss account. Explain. **[RTP-May 20]**

Q60. Under which circumstances can the Central Government appoint the special auditor of a Multi-State Cooperative Society?

Q61. Central Govt. hold 55% of the paid up share Capital in Kisan Credit Cooperative Society, which is incurring huge losses. Advise when the Central Government can direct Special Audit under Section 77 of the Multi State Co-operative Society Act. **[May 19 (3 Marks)]**

Q62. Mr. M, has served as an auditor in the Co-Operative Department of a Government, is appointed as a statutory auditor by a Co-Operative society that has receipts over Rs. 3 crores during the financial year. He is not a chartered accountant. Mr. D, chartered accountant is appointed to conduct tax audit of the society u/s 44AB of the income tax Act, 1961. Comment. **[May 18 (4 Marks)]**

Q63. Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. Analyse and Explain

Q64. The auditor of a Govt Company has to ensure that each item of expenditure is covered by a sanction, either general or special, of the competent authority. Explain **[RTP Nov 20]**

Q65. **Answer the following questions:** **[RTP Nov 21]**

(a) The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. Explain stating important objectives of audit of such bodies.

(b) While planning the audit of an NGO, the auditor may focus on Knowledge of the NGO's work, its mission and vision, Updating knowledge of relevant statutes especially with regard to recent amendments, circulars etc. Explain the other relevant points the auditor needs to focus while planning the audit of NGO.

Q66. **Answer the following questions:** **[RTP Nov 22]**

(a) You have been appointed as an auditor of ABC Hotel, a three star hotel, for Financial Year 2021-22. As an auditor what are the special points that need to be considered in verifying the Inventories in the nature of food and beverages?

(b) Cinescreen Multiplex Ltd. is operating cinemas in different locations in Mumbai and has appointed you as an internal auditor. What are the areas that need to be verified in relation to receipts from sale of Tickets?

Q67. **Answer the following questions:** **[RTP Nov 23]**

(a) "Public moneys should not be utilised for the benefit of a particular person or section of the community". List out the exceptions to this rule while conducting audit against propriety.

(b) State six important advantages of audit of accounts of a Partnership firm.

Q68. **Answer the following questions:** **[RTP May 21]**

(a) Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession. Explain stating clearly the definition of Government auditing as discussed in U.N. Handbook on Govt Auditing and Developing Countries and also state Objectives of Govt audit.

(b) Government audit is neither equipped nor intended to function as an investigating agency, to pursue every irregularity or misdemeanour to its logical end. Explain

Q69. **Answer the following questions:** **[RTP May 22]**

(a) Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. Explain.

(b) No inspection under Section 79 of Multi-State Co-operative Societies Act, 2002 shall be made unless a notice has been given to the multi-state co-operative society. Explain stating clearly when and how such inspection can be made. Also state the powers available with the Central Registrar in this regard along with provisions relating to communication of the inspection report under the said section.

Q70. **Answer the following questions:** **[RTP May 23]**

(a) The audit of Government expenditure is one of the major components of Government audit. Briefly explain the basic standards set in relation to audit of Government expenditure.

(b) State the important objectives of Local bodies Audit.

Q71. **Answer the following questions:** **[Dec 21 (6 marks)]**

(a) In case of Government entities, audit of accounts of stores and inventories has been developed as a part of expenditure audit. Discuss about the duties and responsibilities entrusted to C&AG. **(3 Marks)**

(b) CA A is appointed as the auditor of a charitable institutions. Discuss the audit procedure undertaken by him while auditing the Subscription and Donation received by the charitable institution. **(3 Marks)**

Q72. **Answer the following questions:** **[July 21 (8 marks)]**

(a) Define Government Audit and explain its objectives.

(b) You have been appointed as an auditor of VJM Schools. Discuss the points which merit your consideration as an auditor while verifying Assets and Liabilities of VJM Schools.

Q73. M/s T & Co. Chartered Accountants, a partnership firm, is appointed as an auditor of Treatment Hospital run by Smile Foundation, a charitable trust. Over and above the receipts of treatment of patients, during the year trust has received donations from various donors to treat COVID-19 patients and also incurred some capital expenditure for further development of the hospital. On some of the investment income, income tax has been deducted. What are the special points to be considered by M/s T & Co. while auditing such transactions of Treatment Hospital? **[May 22 (3 marks)]**

Q74. M/s PQ & Co., Chartered Accountants have been appointed as statutory auditor of CBD Multiplex Cinema Ltd. The audit team started the audit and verified the ledger and other books of accounts for the F.Y 2021-2022. However, one of the team members is of the view that the internal control mechanism of the company should also be verified. Can you guide the audit team about the areas that will be covered in verifying the internal control mechanism? **[Nov 22 (4 marks)]**

Q75. CA B is appointed as the auditor of a Public Charitable Trust. Guide him the focus area of attention relating to the vouching and verification of expenditure of charitable institution. **[May 23 (3 marks)]**

Q76. Helping Hands Co-operative society working for the welfare of its members since last 10 years. Governing body observed that the society had some idle funds during the F.Y 2023-24 and considering the equity markets growth, decided to invest the same in blue chip mutual funds. Decision brought fortune and society earned handsome return on the investment made. Auditor of the society however gave a qualified opinion. Management has hired you to guide where they went wrong. Give your comments considering section 32 (Investment of funds) of the Central Act? **[Jan 25 – 4 marks]**

Q77. CA P was Consulted by one of his friends. Mr. Robin, Robin informed him that he wants to enter in education sector and invest in one of the schools being operated in the city. The operations of the school will be managed by Robin only and the proposed investment will be made once CA P confirms the revenue figures given to him (Robin) by existing management of the school, CA P said that main source of revenue to school is fee from students and that will be verified.

What special steps are involved in the verification of fees collected from students? **[Jan 25 – 5 marks]**

SPACE FOR ADDITIONAL NOTES

CHAPTER 10 – BANK AUDIT

Types of Banks

1. **Commercial banks** are the widest spread banking institutions in India, that provide a number of products and services to general public and other segments of economy. Two of its main functions are: -
   (a) accepting deposits and
   (b) granting advances.
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, Andhra Pradesh Grameen Vikas 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., Chhattisgarh 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 & Mobile banking. 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.

Regulating body – Reserve Bank of India

1. **Responsibility** of RBI –
   a. Development and supervision of the constituents of the Indian financial system (which comprises banks and non-banking financial institutions)
   b. Determining, in conjunction with the Central Government, the monetary and credit policies keeping in with the need of the hour.
   c. Regulating the activities of commercial and other banks.
2. Important functions of RBI are :-
   a. Issuance of currency
   b. Regulation of currency issue
   c. Acting as banker to the central and state governments
   d. Acting as banker to commercial and other types of banks including term-lending institutions.
   e. Regulating the activities of commercial and other banks.

Regulatory Framework

- Banking Regulation Act, 1949.
- State Bank of India Act, 1955.
- Companies Act, 2013.
- State Bank of India (Subsidiary Banks) Act 1959.
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970.
- Regional Rural Banks Act, 1976.
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.
- Information Technology Act, 2000.
- Prevention of Money Laundering Act, 2002.
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
- Credit Information Companies Regulation Act, 2005.
- Payment and Settlement Systems Act, 2007.

Peculiarities Involved

1. Huge volumes and complexity of transactions;
2. Wide geographical spread of banks' network;

3. Large range of products and services offered;
4. Extensive use of technology;
5. Strict vigilance by the banking regulator etc.

Types of Bank Audit Reports to be issued (generally)

1. Report on **adequacy and operating effectiveness of Internal Controls** over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI.
2. Long Form Audit Report. (LFAR)
3. Report on **compliance with SLR** requirements.
4. Report on whether the **treasury operations of the bank have been conducted** in accordance with the instructions issued by the RBI from time to time.
5. Report on whether the **income recognition, asset classification and provisioning** have been made as per the guidelines issued by the RBI from time to time.
6. Report on whether any **serious irregularity was noticed in the working** of the bank which requires immediate attention.
7. Report on **status of the compliance** by the bank with regard to the **implementation of recommendations of the Ghosh Committee** relating to frauds and malpractices **and** of the **recommendations of Jilani Committee** on internal control and inspection/credit system.
8. Report on instances of **adverse credit-deposit ratio** in the rural areas.

BANK AUDIT APPROACH

1. **Drawing an Audit Plan**: - An audit plan should be drawn up based on :-
   - The nature and level of operations,
   - Nature of adverse features,
   - Level of compliance based on previous reports and
   - Audit risks based on inadequacy in or breach of internal controls and the familiarization exercise carried out.
2. **Control Environment at the Bank**: - A bank should have appropriate controls to mitigate its risks, including effective segregation of duties (particularly, between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of

positions and results, setting up limits, reporting and approval of exceptions, physical security and contingency planning.

The following are certain common questions /steps, which have to be kept in mind while undertaking/ performing control activities:

Nature of Questions	Questions to be considered / answered
WHO	▪ Who performs the control? ▪ Does the above person have requisite knowledge and authority to perform the control?
WHAT	▪ What evidence is available to demonstrate /prove that the control is performed?
WHEN	▪ When and with what frequency is the control performed? ▪ Is the frequency enough to prevent, detect and correct
WHERE	▪ Where is the evidence of performance of the control retained? ▪ For how long is the evidence retained? ▪ Is the evidence accessible/ available for audit?
WHY	▪ Why is the control being performed? ▪ What type of errors are prevented or detected through the performance of the control?
HOW	▪ How is the control performed? ▪ What are the control activities? ▪ Can these activities be bypassed? ▪ Can the bypass, if any, be detected? ▪ How are exceptions / deviations resolved on identification? ▪ What is the time frame for resolving the above?

3. **Engagement Team Discussions**:
   a. The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements.
   b. All these discussions should be appropriately documented for future reference.
   c. These discussions are ordinarily done at the planning stage of an audit.
   d. The **engagement team discussion** ordinarily includes a discussion of the following matters:

i. Errors that may be more likely to occur;
ii. Errors which have been identified in prior years;
iii. Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
iv. Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
v. Need to maintain professional skepticism throughout the audit engagement;
vi. Need to alert for information or other conditions that indicates that a material misstatement may have occurred (e.g., the bank's application of accounting policies in the given facts and circumstances).

e. **Advantages of such a discussion**: -
i. Specific emphasis should be provided to the susceptibility (weakness) of the bank's financial statements to material misstatement due to fraud, that enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
ii. It further enables the audit engagement partner to delegate the work to the experienced engagement team members, and to determine the procedures to be followed when fraud is identified.
iii. Further, audit engagement partner may review the need to involve specialists to address the issues relating to fraud.

APPOINTMENT OF AUDITOR

1. The auditor of a banking company is to be appointed at the AGM of the shareholders.
2. The auditor of a nationalised bank is to be appointed by the bank concerned acting through its Board of Directors.
3. The auditors of the State Bank of India are to be appointed by the Comptroller and Auditor General of India in consultation with the Central Government.
4. The auditors of the subsidiaries of the State Bank of India are to be appointed by the State Bank of India.
5. The auditors of regional rural banks are to be appointed by the bank concerned with the approval of the Central Government.

REMUNERATION OF AUDITOR

1. The remuneration of auditor of a banking company is to be fixed in accordance with the provisions of Section 142 of the Companies Act, 2013 (i.e., by the company in general meeting or in such manner as the company in general meeting may determine).
2. The remuneration of auditors of nationalised banks and State Bank of India is to be fixed by the Reserve Bank of India in consultation with the Central Government.

AUDITOR'S REPORT

1. **Content**: In the case of a nationalised bank, the auditor is required to make a report to the Central Government in which he has to state the following:
    a. whether, in his opinion, the financial statements present a true and fair view of the affairs of the bank and in case he had called for any explanation or information, whether it has been given and whether it is satisfactory;
    b. whether or not the transactions of the bank, which have come to his notice, have been within the powers of that bank;
    c. whether or not the returns received from the offices and branches of the bank have been found adequate for the purpose of his audit; and
    d. any other matter.
2. **Format of Report**:
    a. Ensure that the audit report issued by them complies with the requirements of Standards on Auditing discussed in Chapter 11 on Audit Report.
    b. The auditor of a banking company is also required to state in his report the matters covered by Section 143 of the Companies Act, 2013.
    c. CARO is not applicable for banking companies.
3. **Long Form Audit Report**:
    a. The LFAR is to be submitted before 30th June every year. To ensure timely submission of LFAR, proper planning for completion of the LFAR is required.
    b. 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.
    c. The matters which the banks require their auditor to deal with in the form of Long Form Audit Report have been specified by the RBI.
4. Auditor shall also report to RBI as per their circular.

5. Duty to report on Frauds under the Companies Act, 2013.

CONDUCTING AN AUDIT

1. Initial consideration by the statutory auditor

a. The RBI has advised that the banks, before appointing their statutory central/branch auditors obtain declaration of Indebtedness.

b. The RBI decided that the audit firms should not undertake statutory audit assignment while they are associated with internal assignments in the bank during the same year.

c. Follow SA 300 - "Planning an Audit of Financial Statements"

d. Communication with Previous Auditor: As per Clause (8) of the Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice cannot accept position as auditor previously held by another chartered accountant without first communicating with him in writing. He should get a NO Objection Certificate (NOC) from the previous auditor through this communication as to know whether he has any objections to such an appointment made, for any valid reasons.

e. The auditor should agree on the terms of the audit engagement with the bank before beginning significant portions of fieldwork.

f. The auditor needs to perform the audit procedures as mentioned in SA 510 "Initial Audit Engagements-Opening Balances".

g. The assessment of engagement risk is a critical part of the audit process and should be done prior to the acceptance.

h. Establish the Engagement Team

i. Auditor should obtain an understanding of the entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement of the financial statements.

2. Auditor to identify and assess the ROMM at the financial statement level and the assertion level for classes of transactions, account balances and disclosures to provide a basis for designing and performing further audit procedures.

3. An understanding of the bank and its environment, including its internal control, enables the auditor:
   a. to identify and assess risk;
   b. to develop an audit plan so as to determine the operating effectiveness of the controls and to address the specific risks.

4. Understanding the Bank's Accounting Process.

5. Understanding the Risk Management Process: An effective risk management system in a bank generally requires the following:
    a. **Involvement of TCWG**: Risk Management policies should be approved by TCWG. While approving the policies, TCWG should ensure that the policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it considers as acceptable.
    b. **Identification, measurement & monitoring of risks**: Risks that may significantly affect the achievement of bank's goals and objectives should be identified, measured and monitored against pre-approved limits and criteria.
    c. **Control activities**: Banks must have appropriate controls to manage its risks, including the following: • effective segregation of duties, • verification and approval of transactions, • setting of limits, and • reporting and approval of exception.
    d. **Monitoring activities**: Independent risk management unit should be set up which regularly assess the risk management models, methodologies and assumptions used to measure and manage risk.
    e. **Reliable information systems**: Banks must have a reliable information system that provide adequate financial, operational and compliance information on a timely and consistent basis to management and TCWG.
6. The engagement team should **hold discussions** to gain better understanding of banks and its environment:
    a. Engagement team should hold discussions to gain better understanding of banks and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference. The discussion should be done on the susceptibility of the bank's financial statements to material misstatements. These discussions are ordinarily done at the planning stage of an audit.
    b. Benefits of discussion:
        i. Opportunity for team members to share their insights based on their knowledge of the bank and its environment.
        ii. Opportunity for team members to exchange information about the bank's business risks.
        iii. To make an understanding amongst the team members about effect of the results of the risk assessment procedures on other aspects of the audit, including decisions about the NTE of further audit procedures.

c. Matters to be discussed:
   (a) Errors that may be more likely to occur;
   (b) Errors which have been identified in prior years;
   (c) Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
   (d) Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
   (e) Need to maintain professional skepticism throughout the audit engagement;
   (f) Need to alert for information or other conditions that indicates that a material misstatement may have occurred

7. Establish the Overall Audit Strategy prior to the commencement of an audit & involve key engagement team members and other appropriate specialists.
8. Develop the Audit Plan as per SA 300.
9. Audit Planning Memorandum:
   a. Describe the expected scope and extent of the audit procedures
   b. Highlight all significant issues and risks identified
   c. Provide evidence that they have planned the audit engagement appropriately
10. Determine Audit Materiality
11. Consider Going Concern
12. Assess the Risk of Fraud including Money Laundering
13. Assess Specific Risks
14. Risk Associated with Outsourcing of Activities:
15. Response to the Assessed Risks
16. BASEL III framework
17. Reliance on / review of other reports.

ADVANCES

Advances are amount of money or credit, given as a loan from a bank to another party with an agreement that the money will be repaid.

- Types of Advances: - Funded Loans & Non-Funded Loans
  - **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.

- **Non-funded facilities** are those which do not involve such transfer. Examples of non-funded loans are Letters of credit, Bank guarantees, etc.

➢ What do ADVANCES comprise – Advances comprise of funded amounts by way of term loans Cash credits, Overdrafts, Demand Loans, Bills Discounted and Purchased, Participation on Risk Sharing basis, Interest-bearing Staff Loans:

CLASSIFICATION OF ADVANCES

SECTOR WISE

1. RBI issues common guidelines for lending to Priority Sector which banks are required to follow.
2. These guidelines cover rate of interest; service charges, receipt, sanction, rejection, disbursement Register; issue of Loan Application Acknowledgement.
3. RBI also issues targets for banks for lending to Priority Sector.
4. Examples of Priority Sectors are Agriculture, MSME, Education, Housing, etc.

SECURITY WISE

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.

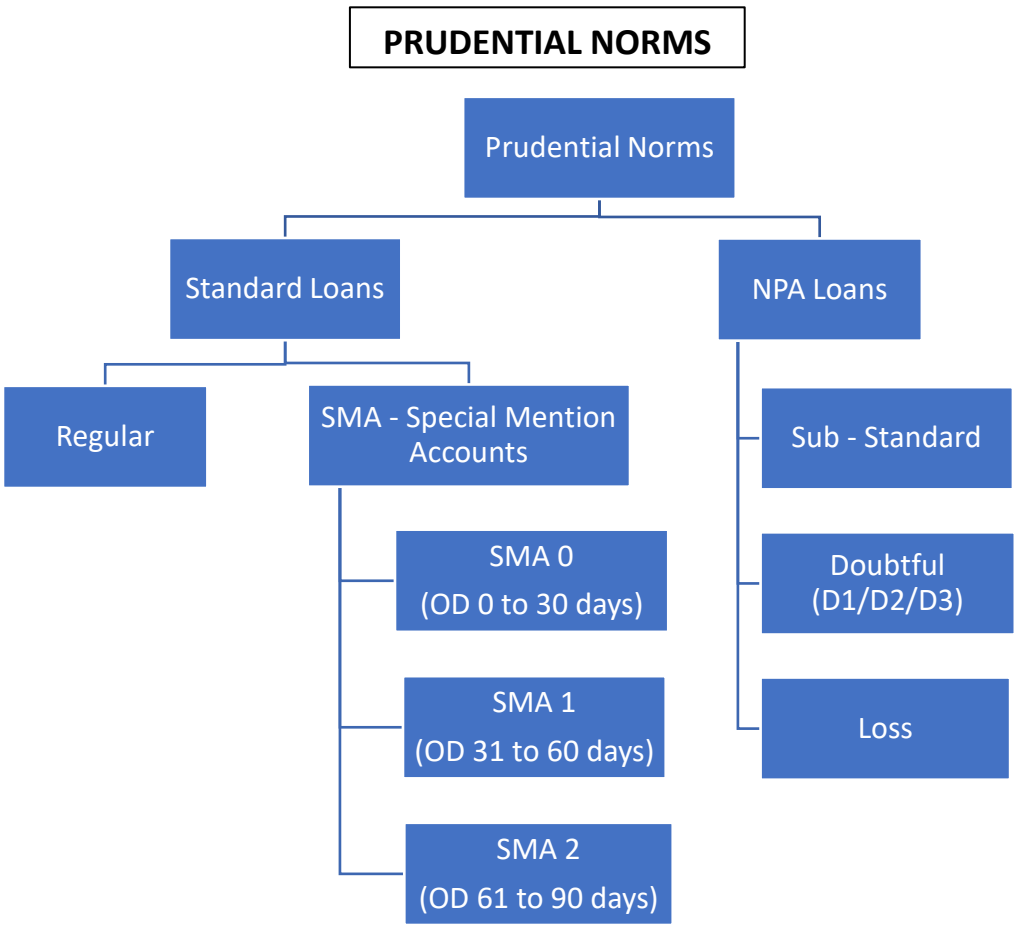
1. Type of security:
   a. **Primary security** refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the principal security for an advance.
   b. **Collateral security** is an additional security. Security can be in any form i.e. tangible or intangible asset, movable or immovable asset.
2. **Mode of Creation of Security**:
   a. **Mortgage**: Mortgage are of several kinds but the most important are the Registered Mortgage and the Equitable Mortgage.
   b. **Pledge**: A pledge thus involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance. The legal ownership of the goods remains with the pledger while the lending banker gets certain defined interests in the goods. The pledge of goods constitutes a specific (or fixed) charge.
   c. **Hypothecation**: The hypothecation is the creation of an equitable charge which is created in favour of the lending bank by execution of hypothecation agreement in respect of the moveable securities belonging to the borrower. Neither ownership nor possession is transferred to the

bank. However, the borrower holds the physical possession of the goods as an agent/trustee of the bank.

d. **Assignment**: Assignment represents a transfer of an existing or future debt, right or property belonging to a person in favor of another person. Only actionable claims such as book debts and life insurance policies are accepted by banks as security by way of assignment.

e. **Set-off**: Set-off is a statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor.

f. **Lien**: Lien is creation of a legal charge with consent of the owner, which gives lender a legal right to seize and dispose / liquidate the asset under lien.



I. **Non-performing Assets**:

a. An asset becomes NPA when it ceases to generate income for the Bank. It is a loan or an advance where -:

i. Interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan;

ii. The account remains 'out of order' in respect of an overdraft/cash credit (od/ cc);

iii. The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.

b. Classification as NPA should be based on the record of recovery.

c. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise.

d. Asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

For Example: - Mr. Raman has availed two Loan facilities - a Car Loan as well as a Housing Loan from XYZ Bank Ltd. He is regular in depositing the Housing loan EMI but has not deposited the last 4 EMI's of the Car Loan due to paucity of funds. Hence, in this case, not only the Car loan but the Housing Loan would also be treated as an NPA, although it is going well and there are no irregularities because the NPA classification is Borrower wise (Mr. Raman) and not Facility wise (Car & Housing Loan individually).

2. **Out of Order**: An account should be treated as 'out of order' if: -
   a. The outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
   b. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet; or
   c. Credits are there but are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.
3. **Overdue**: Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.
4. **Accounts regularized near the Balance Sheet Date**: The asset classification of borrower accounts where a solitary or a few credits are recorded before the balance sheet should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as NPA.
5. **Government Guaranteed advances**: -
   a. 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.
   b. State Government guaranteed Advances, The advance is guaranteed by, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

6. **Advances under Consortium**:
    a. Consortium advances mean advancing loans to a borrower by two or more Banks jointly by forming a Consortium.
    b. Joint appraisal, control and monitoring will facilitate for exchange of valuable information among the Banks.
    c. Usually, a Bank with a higher share will lead the consortium.
    d. 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.
    e. 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.
    f. 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. **Example**: Kingfisher Airlines loan – Led by the State Bank of India (SBI), a consortium of 11 banks. SBI has the highest exposure of Rs 1,600 crore out of the original loan of Rs 6,900 crore to the defunct Kingfisher Airlines. Other banks that have exposure to the airline include Punjab National Bank (Rs 800 crore) and IDBI Bank (Rs 800 crore), Bank of India (Rs 650 crore), Bank of Baroda (Rs 550 crore), Central Bank of India (Rs 410 crore).
    g. **Drawing Power Allocation in case of Consortium Cash Credit Account**: The Lead Bank would be responsible for computing the drawing power (DP) of the borrower and allocate the same to member banks. In certain special circumstances, at the request of the Borrower, the Lead Bank may allot a higher or lower share of drawing power to the member bank, as against their share of advances.
7. **Accounts where there is erosion in the value of security / frauds committed by borrowers**:
    a. Erosion means the gradual destruction or diminution of something not prudent to follow stages of asset classification
    b. It should be straight-away classified as doubtful or loss asset as appropriate as follows: -
        i. Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straight-away classified under doubtful category and provisioning should be made as applicable to doubtful assets.

ii. If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrower accounts, the existence of security should be ignored and the asset should be straight-away classified as loss asset. It may be either written off or fully provided for by the bank.

8. **Advances Against Term Deposits, NSCs, KVPs/ IVPs, etc**.: Advances against Term Deposits, NSCs eligible for surrender, KVP/IVP and life policies need not be treated as NPAs, provided adequate margin is available in the accounts.

9. **Agricultural Advances Affected by Natural Calamities**:
   a. Banks may decide on their own relief measures, viz., conversion of the short term production loan into a term loan or re-schedulement 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.
   b. In such cases, the NPA classification would be governed by such rescheduled terms.

10. **Advances to Staff**: -
   a. Interest-bearing staff advances as a banker should be included as part of advances portfolio of the bank.
   b. 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.
   c. Such loans/advances should be classified as NPA only when there is a default in repayment of instalment of principal or payment of interest on the respective due dates.
   d. 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.

11. **Agricultural Advances**: - Agricultural Advances are of two types:
   a. Agricultural Advances for "long duration" crops: The "long duration" crops would be crops with crop season longer than one year.
   b. Agricultural Advances for "short duration" crops: Crops which are not "long duration" crops would be treated as "short duration" crops.
   c. The following NPA norms would apply to agricultural advances:
      i. A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons; and
      ii. A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

NOTE: 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.

COMPUTATION OF DRAWING POWER

1. **Meaning**: - Drawing Power generally addressed as "DP" is an important concept for Cash Credit (CC) facility availed from banks and financial institutions. Drawing power is the limit up to which a firm or company can withdraw from the working capital limit sanctioned.
2. **Different from Sanctioned Limit**: - The Sanctioned limit is the total exposure that a bank can take on a particular client for facilities like cash credit, overdraft, export packing credit, non-funded exposures etc. On the other hand, Drawing Power refers to the amount calculated based on primary security less margin as on a particular date.
3. **Considerations**: - All accounts should be kept within both the drawing power and the sanctioned limit at all times. The accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be brought to the notice of the Management/Head Office regularly.
4. **Bank's Duties**: - Banks should ensure that drawings in the working capital account are covered by the adequacy of the current assets. Drawing power is required to be arrived at based on current stock statement. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months is deemed as irregular.
5. **Auditor's Concern**: - The stock statements, quarterly returns and other statements submitted by the borrower to the bank should be scrutinized in detail. The audited Annual Report submitted by the borrower should be scrutinized properly. The monthly stock statement of the month for which the audited accounts are prepared and submitted should be compared and the reasons for deviations, if any, should be ascertained.
6. **Computation of DP:** - It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors. Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power.
7. **Stock Audit**: - The stock audit should be carried out by the bank for all accounts having funded exposure of more than ₹ 5 crores. Auditors can also advise for stock audit in other cases if the situation warrants the same. Branches should obtain the stock audit reports from lead bank in the cases where the Bank is not leader of the consortium of working capital. The report submitted by the stock auditors

should be reviewed during the course of the audit and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of drawing power.

Let us understand by an example: Let us take sanctioned limit is ₹ 50 lakhs.

MONTH 1		MONTH 2	
Stocks	₹ 35 lakhs	Stocks	₹ 55 lakhs
Creditors	₹ 10 lakhs	Creditors	₹ 10 lakhs
Book Debts < 90 days	₹ 25 lakhs	Book Debts < 90 days	₹ 35 lakhs
Margin on stocks	25%	Margin on stocks	25%
Margin on book debts	40%	Margin on book debts	40%

Solution

Formula for calculating drawing power is as follows

DP = [stock (-) creditors (-) Margin] + [Book Debts (-) Margin]

MONTH 1	MONTH 2

CA Inter May 2022: Compute the drawing power for cash credit A/c of S Limited for the month of March 2022 with the following information:

PARTICULARS	AMOUNT IN ₹
Stock	50,000
Debtors (Including debtor of ₹ 5,000 for an invoice dated 17.11.2021)	45,000
Sundry Creditors	15,000
Sanctioned Limit	45,000

Margin on stock is 20% and on debtors is 50%

Note: Debtors older than 3 months are ineligible for calculation of DP

AUDIT OF ADVANCES

1. **In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following**:
   a. Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
   b. Advances represent amount due to the bank.
   c. Amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of advances.
   d. There are no unrecorded advances.
   e. The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.
   f. The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
   g. Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.
2. **The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of internal controls relating to advances, and by**:
   a. Examining the validity of the recorded amounts;
   b. Examining loan documentation;
   c. Reviewing the operation of the accounts;
   d. Examining the existence, enforceability and valuation of the security;
   e. Checking compliance with rbi norms including appropriate classification and provisioning; and
   f. Carrying out appropriate analytical procedures.

NOTE: The following shall be noted by students

a) In carrying out his substantive procedures, the auditor should examine all large advances while other advances may be examined on a sampling basis.
b) The accounts identified to be problem accounts, however, need to be examined in detail unless the amount involved is insignificant.

3. **Evaluation of Internal Controls over Advances**:

a. **Credit Worthiness**: The bank should make an advance only after satisfying itself as to the credit worthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank.
b. **Execution of docs**: All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
c. **Compliance**: The compliance with the terms of sanction and end use of funds should be ensured.
d. **Margin**: Sufficient margin as specified in the sanction letter should be kept against securities taken so as to cover for any decline in the value thereof. The availability of sufficient margin needs to be ensured at regular intervals.
e. **Control of security**: If the securities taken are in the nature of shares, debentures, etc., the ownership of the same should be transferred in the name of the bank and the effective control of such securities be retained as a part of documentation.
f. **Registration**: All securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to give title to the bank.
g. **Inspection**: In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipt. The godown should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.
h. **DP Register**: Drawing Power Register should be updated every month to record the value of securities hypothecated. These entries should be checked by an officer.
i. **Limits**: The accounts should be kept within both the drawing power and the sanctioned limit.
j. **Irregularity**: All the accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly.
k. **Review**: The operation of each advance account should be reviewed at least once a year and at more frequent intervals in the case of large advances.

AUDIT OF REVENUE ITEMS

1. **Auditor's Concern**: - In carrying out audit of income, the auditor is primarily concerned with obtaining reasonable assurance that the recorded income arose from transactions, which took place during the relevant period and pertained to the bank, there is no unrecorded income and the income is recorded at appropriate amount.
2. **RBI's Directions**: -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 Accounting Standard 9.

3. **Materiality**: - If any item of income is not considered to be material as per the above norms, it may be recognised when received and the auditors need not qualify their report in that situation.
4. **Revenue Certainty**: -Banks recognise income (such as interest, fees and commission) on accrual basis, i.e., as it is earned. It is an essential condition for accrual of income that it should not be unreasonable to expect its ultimate collection. In modern day banking, the entries for interest income on advances are automatically generated through a batch process in the CBS system.
5. **Revenue Uncertainty**: - In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require that banks should not recognize income on non-performing assets until it is actually realised. When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for. This will apply to Government guaranteed accounts also.
6. **Advances against Securities**: - Interest on advances against Term Deposits, National Savings Certificates (NSCs), Indira Vikas Patras (IVPs), Kisan Vikas Patras (KVPs) and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.
7. **Bills Purchased**: -
    a. In the case of bills purchased outstanding at the close of the year the discount received thereon should be properly apportioned between the two years. [The Unexpired discount/ rebate on bills discounted i.e., where part of receipt comprising discount charges on bills purchased relate to the period beyond the year-end, should be recorded as "Other Liabilities"].
    b. Interest (discount) component paid by Bank/Branch on rediscount of bills from other financial institutions, is not to be netted off from the discount earned on bills discounted.
8. **Bills for Collection**: - 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. The procedure is usually such that the customer's account is credited only after the bill has actually been collected from the drawee either by the bank itself or through its agents, etc. This procedure is in consonance with the nature of obligations of the bank in respect of bills for collection. The commission of the branch becomes due only when the bill has been collected.
9. **Renegotiations**: - Fees and commissions earned by the banks as a result of re-negotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the re-negotiated or rescheduled extension of credit. Test check the interest earned by

the banks for the sample selected. Test check the fees and commissions earned by the banks made for commission on bills for collection, letters of credit and bank guarantees.

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.
5. **On leased assets**: The component of finance income (as defined in AS 19 – Leases) on the leased asset which was accrued and credited to the income account before the asset became non-performing and remaining unrealised, should be reversed or provided for in the current accounting period.
6. **On Take-out finance**: Takeout financing, is long-term financing that the lender promises to provide at a particular date or when particular criteria for completion of a project are met. Takeout loans are commonly used in property development. In the case of take-out finance, if based on record of recovery, the account is classified by the lending bank as NPA, it should not recognize income unless realised from the borrower/taking-over institution (if the arrangement so provides).
7. **On Partial Recoveries in NPAs**: 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). The appropriate policy to be followed is to recognise income as per AS 9 when certainty attaches to realisation and accordingly amount reversed/derecognised or not recognised in the past should be accounted. Interest partly/fully realised in NPAs can be taken to income. However, it should be ensured that the credits towards interest in the relevant accounts are not out of fresh/additional credit facilities sanctioned to the borrowers concerned.
8. **Memorandum Account**: On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account and stop further application of interest. However, banks may continue to record such accrued interest in a Memorandum account in their

books for control purposes. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

9. **Income from Investments**:
   a. **Interest Income on Investments**: This includes all income derived from Government securities, bonds and debentures of corporates and other investments by way of interest and dividend, except income earned by way of dividends, etc., from subsidiaries and joint ventures abroad/in India. Broken period interest paid on securities purchased and amortisation of premium on SLR investments is net off from the interest income on investments.
   b. **Profit on Sale of Investments**: Investments are dealt in the course of banking activity and hence the net profit or loss on sale of investments is taken to profit and loss account.
   c. **Profit/Loss on Revaluation of Investments**: In terms of guidelines issued by the RBI, investments are to be valued at periodical intervals and depreciation or appreciation in valuation should be recognised and taken to profit and loss account.

AUDIT OF EXPENSES

1. Assess the overall reasonableness of the amount of interest expense by analysing ratios of interest paid on different types of deposits and borrowings to the average quantum of the respective liabilities during the year. In modern day banking, the entries for interest expenses are automatically generated through a batch process in the CBS system.
2. The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter. From such information, the auditor may work out a weighted average interest rate. The auditor may then compare this rate with the actual average rate of interest paid on the relevant deposits as per the annual accounts and enquire into the difference, if material.
3. The auditor should also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyse any material differences.
4. The auditor should obtain general ledger break-up for the interest expense incurred on deposits (savings and term deposits) and borrowing each month/quarter. The auditor should analyse month on month (or quarter on quarter) cost analysis and document the reasons for the variances as per the benchmark stated. He should examine whether the interest expense considered in the cost analysis agrees with the general ledger. The auditor should understand the process of computation of the average balance and re-compute the same on sample basis.
5. The auditor should, on a test check basis, verify the calculation of interest and ensure that:
   (a) Interest has been provided on all deposits up to the date of the balance sheet;

(b) Interest rates are in accordance with the bank's internal regulations, the RBI directives and agreements with the respective deposit holder;

(c) Interest on savings accounts is in accordance with the rules framed by the bank/RBI in this behalf.

(d) Interest on inter–branch balances have been provided at the rates prescribed by the head office/RBI.

6. Ascertain whether there are any changes in interest rate on saving accounts and term deposits during the period. The auditor should obtain the interest rate card for various types of deposits and analyse the interest cost for the period accordingly. The auditor should examine the completeness that interest has been accrued on the entire borrowing portfolio and the same should agree with the general ledgers. Re-compute the interest accrual i.e., by referring to the parameters like frequency of payment of interest amount, rate of interest, period elapsed till the date of balance sheet, etc. from the term sheet, deal ticket, agreements, etc. and ensure that the recomputed amount is tallying with the amount as per books of accounts without any significant difference.
7. **For audit of operating expenses**: Study and evaluate the ICS relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit respect of major items of expenses. The auditor should perform substantive analytical procedures in respect of these expenses. e.g. assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years. The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required.
8. **For audit of Provisions and contingencies**: Ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled. The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. 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.
9. Obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger. 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. 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.

NOTE: Since the format of the profit and loss accounts of banks prescribed in Form B under Third Schedule to the Banking Regulation Act, 1949 does not specifically provide for disclosure of the impact of prior period items on the current year's profit and loss, such disclosures, wherever warranted, may be given.

Categories of Non-Performing Assets	Provision required
1. **Substandard Assets**: Would be one, which has remained NPA for a period less than or equal to 12 months.	15%
2. **Doubtful Assets**: Would be one, which has remained in the substandard category for a period of 12 months. **Sub Categories**: Doubtful up to 1 Year (D1) Doubtful 1 to 3 Years (D2) Doubtful more than 3 Years (D3)	(Secured + Unsecured) 25% + 100% 40% + 100% 100% + 100%
3. Loss Assets: Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.	100%

TEST YOUR UNDERSTANDING QUESTIONS

1. Ranjana Ceramic Private Limited is sanctioned a cash credit facility of ₹100 lacs from a branch of LMO Bank. Besides, branch has also sanctioned a one-time bank guarantee of ₹10 lacs on behalf of the company in favour of a statutory authority. Discuss, what type of credit facilities have been sanctioned by branch of LMO bank to the company along with probable purpose for each of credit facility.

Hint Ans:

2. During course of audit of branch of a nationalized bank, you find that system has generated a report marking ten term loan accounts as SMA. Discuss, meaning of SMA accounts and significance of such a classification.

   Hint Ans: Special Mention Account (SMA) is an account which is exhibiting signs of incipient stress resulting in the borrower defaulting in timely servicing of debt obligations, though the account has not yet been classified as NPA as per the RBI guidelines

3. CA P is conducting stock audit of a borrower availing cash credit facility of ₹100 lacs from branch of a bank. The cash credit facility is against security of paid stocks and debtors up to 90 days. Margin stipulated is 25% for stocks and 40% for debtors. Following further information is available as on 31.12.22: -

Value of stocks	₹ 125 lacs
Value of stocks (fully damaged) included in above	₹ 5 lacs
Value of debtors	₹ 50 lacs
Value of debtors exceeding 90 days included in above	₹ 10 lacs
Value of creditors for goods	₹ 50 lacs

   Is Drawing Power computed by CA P for ₹ 82.50 lacs proper?

   Hint Ans: The drawing power calculated by CA P is not proper. Drawing Power comes to ₹ 76.50 lacs.

CORRECT OR INCORRECT QUESTIONS

1. RBI has been entrusted with the responsibility of regulating the activities of commercial banks only.
2. In the computerised environment, the auditor need not be familiar with latest applicable RBI guidelines.
3. The auditor can assume that the system generated information is correct and relied upon.
4. Collateral security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank.
5. Registered mortgage is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof
6. Any amount due to the bank under any credit facility is 'overdue' if it is not paid within 90 days of becoming due.
7. An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.
8. Banks recognize income on Non-Performing Assets on accrual basis.
9. Auditor of a Nationalised bank is to be appointed at the annual general meeting of the shareholders.

10. Reporting of fraud of INR 150 Lakhs by auditor will be done within three days of the fraud coming to the knowledge of the auditor to the Board or the Audit Committee along with remedial action taken in case of audit of ABA Bank Ltd.
11. Central Govt. guaranteed Advances, where the guarantee is not invoked/repudiated would be classified as Standard Assets.

EXAMINATION QUESTIONS

Q1. The functioning of banking industry in India is regulated by the Reserve Bank of India which acts as the Central Bank of our country. Explain.

Q2. Write short note on: Principal Enactments governing Bank Audit.

Q3. In the case of a nationalised bank, the auditor is required to make a report to the Central Government. The report of auditors of State Bank of India is also to be made to the Central Government and is almost identical to the auditor's report in the case of a nationalised bank. Explain what would the auditor state in his report. **[MTP-Oct. 18]**

Q4. Write a short note on Long Form Audit Report.

Q5. Management develops controls and uses performance indicators to aid in managing key business and financial risks. Explain in this reference the requirements of an effective risk management system in a bank.

Q6. Write short note on: Requirements of a Risk Management Process/System in a bank.

Q7. Mr. Piyush, the Bank Manager develops controls to aid in managing key business and financial risks. Discuss the various requirements for an effective risk management system in a bank.

[May 19 (4 Marks)]

Q8. "The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference". Explain.

Q9. The engagement team of FRN & Co.- Auditors of Bank of Baroda held discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. The discussion between the members of the engagement team and the audit engagement partner are being done on the susceptibility of the bank's financial statements to material misstatements. These discussions are ordinarily done at the planning stage of an audit. Analyse and advise the matters to be discussed in the engagement team discussion. **[MTP-March 18, March 19]**

Q10. You are appointed as an auditor of Banking Co., and hold discussions with engagement team. List out matters which you would discuss at planning stage of an audit to gain better understanding of the bank and its environment. **[May 19 (4 Marks)]**

Q11. The discussion between members of the engagement team members and the audit engagement partner should be done on the susceptibility of the bank's financial statements to material misstatements. Briefly discuss the points ordinarily included in discussion of the engagement team. **[Nov. 19 (3 Marks)]**

Q12. An asset becomes NPA when it ceases to generate income for the Bank. Explain the criteria for classification of advance as Non-Performing Advance.

Q13. Shy & Co. had been allotted the branch audit of a nationalized bank for the year ended 31st March, 2018. In the audit planning, the partner of Shy & Co. observed that the allotted branches are predominantly based in rural areas and major portion of the advances were for agricultural purpose. He needs your assistance in incorporating the criteria prescribed for determination of NPA norms in respect of agricultural advance, in audit plan.

Q14. "Ramjilal & Co. had been allotted the branch audit of a nationalised bank for the year ended 31st March, 2019. In the audit planning, the partner of Ramjilal & Co., observed that the allotted branches are predominantly based in rural areas and major portion of the advances were for agricultural purpose." Now he needs your assistance on the following points so as to incorporate them in the audit plan:

a. for determine of NPA norms for agricultural advances
b. for accounts where there is erosion in the value of security/frauds committed by the borrowers. **[Nov. 18 (5 Marks)]**

Q15. State the internal controls in the area of Loans and Advances of Banks.

Q16. "The Auditor should examine the efficiency of various internal controls over advances, to determine the nature, timing and extent of his substantive procedures." Discuss briefly. **[Nov. 18 (5 Marks), MTP-April 19]**

Q17. The auditor should examine the efficacy of various internal controls over advances in case of Banks to determine the nature, timing and extent of his substantive procedures. Explain what is included in the internal controls over advances. **[RTP-May 19]**

Q18. Your firm of Chartered Accountants has been appointed as the Auditor of two branches of OBC which are located in the Industrial area. Considering that the location of the branches of bank in industrial area, these would be "advances oriented branches and audit of advances would require the

major attention of the auditors. Advise how would you proceed to obtain evidence in respect of audit of advances. **[RTP-May 18, MTP-Oct. 19]**

Q19. The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of internal controls relating to advances. Explain in the context of Audit of Banks. **[RTP-Nov. 19]**

Q20. Mr. A approaches a bank for financial assistance for his upcoming project. The bank branch manager, after verifying the proposal, is agreeable to financial Mr. A, but asks for the security of be offered to the bank. Discuss the nature of securities required to be offered to the bank.

Q21. Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors. In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about, among other points, the amounts included in balance sheet in respect of advances are outstanding at the date of the balance sheet. Explain. **[RTP-Nov. 19]**

Q22. "There is no difference in provisioning of NPA as regards to categories of NPA, whether the debt is secured or unsecured." Critically evaluate the statement on the basis of provisioning norms of NPA of nationalised bank. **[Nov. 19 (4 Marks)]**

Q23. Explain income recognition norms with respect to advances in case of a banking company.

Q24. Write a short note on reversal of income under bank audit.

Q25. In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require that banks should not recognize income on non-performing assets until it is actually realised. When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for. This will apply to Government guaranteed accounts also. Analyse and explain. **[RTP-May 20]**

Q26. How would you verify the Interest Expenditure while carrying out audit of a bank.

Q27. In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense. Analyse and explain stating the audit approach and procedure in regard to interest expense. **[RTP-May 20]**

Q28. Write short note on: Audit procedures for verification of provisions and contingencies in case of bank audit.

Q29. In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense. Analyse and explain stating the audit approach and procedure in regard to interest expense. **[RTP May 20]**

Q30. In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require that banks should not recognize income on non-performing assets until it is actually realised. When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for. This will apply to Government guaranteed accounts also. Analyse and explain. **[RTP May 20]**

Q31. Your firm of auditors, SRG & Co., has been appointed as Statutory Central Auditors of Reliable Bank. Explain the reporting requirements of the Statutory Central Auditors (SCAs) in addition to their main audit report. **[RTP May 21]**

Q32. Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors. Explain the broad considerations about which the auditor is primarily concerned with obtaining evidence in carrying out audit of advances **[RTP May 21]**

Q33. There are different provisioning requirements as regards to categories of NPA such as Sub-standards assets, Doubtful assets and loss assets. Explain in detail. **[RTP May 22]**

Q34. Explain the following in the context of Bank audit:

a. For audit of operating expenses, the auditor should study and evaluate the system of internal control relating to expenses.

b. 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. **[RTP May 22]**

Q35. Explain the audit approach you would follow to check the Operating Expenses of a Bank. **[RTP May 23]**

Q36. Mr Rishikesh, the Bank Manager develops controls to assist in managing key business and financial risks. Discuss the various requirements for an effective risk management system in a bank. **[RTP May 23]**

Q37. Distinguish between Primary Security and Collateral Security with reference to audit of Banks. Also give examples of most common types of securities accepted by the Banks. **[RTP Nov 20]**

Q38. Depending on the nature of the item concerned, creation of security may take the form of a mortgage, pledge, hypothecation, assignment, set-off or lien. Explain with specific reference to Audit of Banks. **[RTP Nov 20]**

Q39. The engagement team discussion ordinarily includes a discussion of the matters such as - Errors that may be more likely to occur; Errors which have been identified in prior years; Method by which fraud

might be perpetrated by bank personnel or others within particular account balances and/or disclosures; etc. In the above context, explain the advantages of such a discussion **[RTP Nov 21]**

Q40. In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense. Analyse and explain stating the audit approach and procedure in regard to interest expense. **[RTP Nov 21]**

Q41. CA. Puranjay is appointed as statutory branch auditor of two branches of a nationalized bank for year 2021-22. During the course of audit, he came across the following: **[RTP Nov 22]**

a. While verifying advances of one semi-urban branch, he noticed substantial number of accounts categorized as SMA (Special mention accounts). In this context, explain the nature and significance of SMA.

b. While verifying interest income of a mid-corporate branch of an urban centre having advances consisting of only cash credit limits for large borrowers, it was noticed that advances of ₹ 300 crores were outstanding as on balance sheet date carrying average interest rate @8% p.a. One articled clerk in audit team makes quick back of the envelope calculations of interest income of ₹ 24 crores on advances. However, schedule of profit & loss a/c shows interest income on advances for ₹ 10 crores. Discuss any two probable reasons for such variation.

Q42. In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about amounts included in balance sheet in respect of advances which are outstanding. Explain stating clearly all the considerations in this context. **[RTP Nov 22]**

Q43. Your firm has been appointed as branch auditor of SP Bank Ltd. Discuss about the primary evidence you will look into while carrying out verification of advances. **[RTP Nov 23]**

Q44. TEP Industries Private Limited, a company engaged in obtaining rice from paddy, is enjoying a cash credit facility against hypothecation of paid stocks and book debts (eligible up to 90 days only) from LMV Bank for ₹ 4.00 crore. The letter sanctioning the above credit facility stipulates margin @ 25% on stocks and @ 40% on eligible book debts up to 90 days. While preparing stock statement as on 30.6.23, accountant of the company calculates value of stocks for ₹ 5 crore (including ₹ 1 crore of rice which was lying in a low lying godown and was completely damaged during recent floods caused by river Yamuna). Debtors outstanding as on 30.6.23 are ₹ 3 crore (including ₹ 50 lacs outstanding for last 6 months). Trade creditors outstanding as on date are ₹ 2 crore. He calculates DP as on 30.6.23 for ₹ 3.30 crore. Is he correct? Justify with your workings. What does drawing power calculated by you signify to the borrower company? **[RTP Nov 23]**

Q45. In a bank, all accounts should be kept within the drawing power and the sanctioned limit. The accounts which exceed the sanctioned limit or drawing power should be brought to the notice of the

management regularly. Analyse the following points to be considered in the computation of drawing power in case of bank audit.

(i) Bank's Duties

(ii) Auditor's concern

(iii) Computation of DP

(iv) Stock audit **[Dec 21 (4 Marks)]**

Q46. N Ltd. has been sanctioned a Cash Credit Facility by XYZ Bank Ltd. for INR 1 crore and drawing power as per the stock statements furnished for the last quarter is INR 80 Lakh. Outstanding balance in the account is INR 75 lakh. Interest charged to the account is INR 3.5 Lakh and total credit into the account for the quarter is INR 2.5 Lakh. As an auditor how will you report this account in your report. **[July 21 (4 Marks)]**

Q47. Discuss the advantages of engagement team discussion done at the planning stage of the bank audit. **[July 21 (3 Marks)]**

Q48. After becoming Chartered Accountant, you have got your first assignment as an auditor of a bank branch dealing in various types of advances. What are the areas which you will be looking for obtaining sufficient appropriate evidence (for advances) besides studying and evaluating internal controls? **[May 22 (3 Marks)]**

Q49. CARD Ltd. is into the banking business and handles large amount of loans and advances of different kinds. Non-performing assets are on the rise since last two quarters. The management is concerned with correct provisioning for the same. CA R is appointed to check whether correct provisioning of NPA's is being made by the bank or not. What are the aspects that will be verified by CA R for this purpose? **[Nov 22 (4 Marks)]**

Q50. A ltd has availed cash credit facilities against stock & book debt term Loan For machineries and bank guarantee from Big Bank Ltd. A limited furnished stock statements and age wise list of debtors to Big Bank Ltd on regular basis. Concurrent auditors of Big Bank Limited mentioned about wrong calculation of drawing power by the bank branch along with sanctioned limit and balances overdrawn due to wrong calculation of drawing power, (DP) in the monthly report. Explain the meaning of drawing power and how it differs from sanctioned limit. What is to be ensured while computing drawing power? **[May 23 (3 Marks)]**

Q51. Agrim, a CA student, is part of an engagement team conducting audit of Madurai branch of ARB Bank. CA Bhuvan, engagement partner, has asked him to verify provision made by branch as on March 31st, 2024 in respect of the following non-performing assets: -

Name of Account	NPA classification	Outstanding amount as on March 31st, 2024 (In ₹ lakhs)	Amount of provision made (In ₹ lakhs)
AK Industries	Doubtful (D1)	10.00	5.00
Jupiter Traders	Substandard asset	50.00	7.50
VT & Co.	Doubtful (D2)	30.00	30.00
ASD & Sons	Loss	1.00	1.00

The engagement partner has already verified NPA classification. Outstanding amounts as on March 31st, 2024, relating to each NPA account listed above (except ASD & Sons) are fully secured. However, only personal guarantee of proprietor (Net worth of proprietor `50 lakhs) is available in account of ASD & Sons. Comment on the correctness of the above provisions.

Agrim is in dilemma regarding classification of above accounts as NPA although these are fully secured or guaranteed. Guide him. **[RTP Jan 25]**

Q52. Compute the Drawing Power for Cash Credit A/c of Kirpa Limited for the month of March 2024 with following information:

	(Amount in ₹)
Stock	60,000
Debtors	55,000
(Including Debtor of ₹ 15,000 for an invoice dated 20.10.2023)	
Sundry creditors	10,000
Sanctioned Limit	48,000

Margin on stock is 30% and on debtors is 40%.

Note: Debtors older than 3 months are ineligible for calculation of DP.

Q53. While conducting statutory audit of branch of a nationalized bank, it is noticed by CA Z that credit facilities granted to a borrower consisting solely of term loan have been classified as "Sub-standard Asset" during the year 2022-23 due to failure of borrower to pay EMIs on time. Such EMIs were outstanding for more than 90 days and account was, therefore, classified as "Sub-Standard Asset". CA Z has also agreed to above asset classification made by branch management.

What are CA Z's responsibilities regarding verification of compliance with income recognition norms by branch in respect of above credit facilities?

Q54. While verifying provisions of advances of a branch of MCO Bank as part of statutory branch audit, CA Z notices that credit facilities consisting of term loan to KRT Enterprises have been classified under doubtful asset (D1) category. The outstanding balance in above term loan account as on

31.3.2023 is ₹ 50 lakhs. Value of security held in account is ₹ 40 lakhs. The branch has made provision of ₹ 7.50 lakhs. Is provision made by branch proper? Discuss.

CHAPTER 11 – ETHICS AND TERMS OF AUDIT ENGAGEMENTS

ETHICS – A STATE OF MIND

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

NEED FOR PROFESSIONAL ETHICS

1. A distinguishing feature of the accountancy profession is its acceptance of the responsibility to act in the public interest.
2. Professional ethics seek to protect the interests of the profession as a whole and act as a shield that enables us to command respect.
3. A Chartered Accountant, either in practice or in service, has to abide by ethical behaviours.
4. They are expected to follow the fundamental principles of professional ethics while performing their duties.
5. Service users of professionals should be able to feel secure that there exists a framework of professional ethics which governs the provision of those services.
6. Institute of Chartered Accountants of India (ICAI) requires its members to comply with the principles of ethics while performing their duties.
7. The ethics for Chartered Accountants have, therefore, been codified as ethical compliance has always been a philosophy of the profession.
8. Chartered accountants, whether in practice or in service, are required to comply with the provisions of Code of Ethics.
9. Any deviation from the ethical responsibilities brings the disciplinary mechanism into action against the Chartered Accountants which may result into fines, suspension of membership, removal from membership or other disciplinary actions.

FUNDAMENTAL PRINCIPLES OF PROFESSIONAL ETHICS



INTEGRITY

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

OBJECTIVITY

1. The principle of objectivity requires an auditor **not to compromise professional judgment** because of bias, conflict of interest or undue influence of others.
2. It requires that a professional accountant shall not undertake a professional activity if a circumstance or relationship unduly **influences the accountant's professional judgment** regarding that activity.

PROFESSIONAL COMPETENCE AND DUE CARE

1. Which requires an accountant to attain and maintain **professional knowledge and skill** at the level required **to ensure** that a client or employing **organization receives competent professional service**, based on current technical and professional standards and relevant legislation; and act diligently and in accordance with applicable technical and professional standards.
2. Diligence includes responsibility to act carefully, thoroughly and on a timely basis in accordance with requirements of an assignment.

CONFIDENTIALITY

1. Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant with the understanding that the information will not be disclosed to a third party.

2. Confidential information may be disclosed, for example, when it is required by law, when it is permitted by law and is authorised by the client or employer or there is a professional duty or right to disclose when not prohibited by law.

PROFESSIONAL BEHAVIOUR

1. It requires an accountant to **comply with relevant laws and regulations** and avoid any conduct that the accountant knows or should know might discredit the profession.
2. A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

1. Leadership Responsibilities for Quality on Audits

1. As per SA 220 "Quality Control for an Audit of Financial Statements", the **engagement partner shall take responsibility** for the overall quality on each audit engagement to which that partner is assigned.
2. The actions of the **engagement partner** on each audit engagement shall emphasise on –
    a. The importance to audit quality of:
        i. Performing work that complies with professional standards and regulatory and legal requirements;
        ii. Complying with the firm's quality control policies and procedures as applicable;
        iii. Issuing auditor's reports that are appropriate in the circumstances; and
        iv. The engagement team's ability to raise concerns without fear of reprisals; and
    b. The fact that quality is essential in performing audit engagements.

INDEPENDENCE OF AUDITORS

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.
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.

Threats to Independence – IRAFI

i. **Self-interest threats**, which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client.
   a. Direct financial interest or materially significant indirect financial interest in a client.
   b. Loan or guarantee to or from the concerned client
   c. Undue dependence on a client's fees and, hence, concerns about losing the engagement
   d. Close business relationship with an audit client,
   e. Potential employment with the client
   f. Contingent fees for the audit engagement

ii. **Self-review threats**, which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement or when a member of the audit team was previously a director or senior employee of the client.
   a. When a member of the audit team was previously a director or senior employee of the client.
   b. When an auditor having recently been a director or senior officer of the company,
   c. When auditors perform services that are themselves subject matters of audit

iii. **Advocacy threats**, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised.
   a. When an auditor deals with shares or securities of the audited company, or
   b. Becomes the client's advocate in litigation and third-party disputes.

   In such situations, auditor can be perceived as backing and championing causes of auditee client and it may lead to belief that auditor is not acting and working objectively

iv. **Familiarity threats** are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests.
   a. Close relative of the audit team working in a senior position in the client company
   b. Former partner of the audit firm being a director or senior employee of the client
   c. Long association between specific auditors and their specific client counterparts
   d. Acceptance of significant gifts or hospitality from the client company, its directors or employees.

v. **Intimidation threats**, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism.
   a. Threat of replacement over disagreements with the application of accounting principles
   b. Pressure to disproportionately reduce work in response to reduced audit fees
   c. Being threatened with litigation.

Safeguards to Independence

i. 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.
ii. In the case of audit, the key fundamental principles are integrity, objectivity and professional skepticism, which necessarily require the auditor to be independent.
iii. Before taking on any work, an auditor must thoroughly consider whether it involves threats to his independence.
iv. When such threats exist, the auditor should either desist from the task or put in place safeguards that eliminate them.
v. If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

Professional Skepticism

a. Refers to an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.
b. Professional skepticism includes being alert to the following conditions–
    i. Audit evidence that contradicts other audit evidence obtained.
    ii. Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
    iii. Conditions that may indicate possible fraud.
    iv. Circumstances that suggest the need for audit procedures in addition to those required by the SAs.
    v. Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:
    vi. Overlooking unusual circumstances.
    vii. Over generalising when drawing conclusions from audit observations.
    viii. Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.
    ix. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances

3. Acceptance and Continuance of Client Relationships and Audit Engagements

SQC 1 requires the firm to obtain information before accepting an engagement. Information such as the following assists the engagement partner in determining whether the decisions regarding the acceptance and continuance of audit engagements are appropriate:

1. The integrity of the principal owners, key management and those charged with governance of the entity;
2. Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
3. Whether the firm and the engagement team can comply with relevant ethical requirements; and
4. Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

SA 210 – Agreeing the Terms of Audit Engagements

Objective – As per SA 210 "Agreeing the Terms of Audit Engagements", the objective of an auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:

(A) Establishing whether the preconditions for an audit are present and

(B) Confirming that there is a common understanding between the auditor and management and, where appropriate, those charged with governance of the terms of the audit engagement.

A) **PRECONDITIONS FOR AN AUDIT**: In order to establish whether the **preconditions for an audit are present**, the auditor shall-

a) Determine whether the financial reporting framework is acceptable; and

b) Obtain the agreement of management that it acknowledges and understands its responsibility: -

1. For the preparation of the financial statements in accordance with the applicable financial reporting framework
2. For the internal control as management considers necessary; and
3. To provide the auditor with:
   - ✓ Access to all information such as records, documentation and other matters;
   - ✓ Additional information that the auditor may request from management for the purpose of the audit; and

- ✓ Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

B) AGREEMENT ON AUDIT ENGAGEMENT TERMS:

The audit engagement letter is sent by the auditor to his client. The ICAI has issued SA 210 "Agreeing the Terms of Audit Engagements" on the subject. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

(a) The objective and scope of the audit of the financial statements;

(b) The responsibilities of the auditor;

(c) The responsibilities of management;

(d) Identification of the applicable financial reporting framework for the preparation of the financial statements; and

(e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

WHAT HAPPENS IF PRECONDITIONS FOR AN AUDIT ARE NOT PRESENT?

1. If the preconditions for an audit are not present, the auditor shall discuss the matter with management.
2. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement: -
   a. If the auditor has determined that the FRF to be applied in the preparation of the financial statements is unacceptable or
   b. If the agreement of management is not obtained on matters relating to understanding of responsibility of management on preparation of financial statements, internal controls for preparation of financial statements, providing access to all information to auditor and unrestricted access to persons within the entity.

LIMITATION ON SCOPE PRIOR TO AUDIT ENGAGEMENT ACCEPTANCE

- If management or those charged with governance
- Impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement
- Such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements,

- The auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

ACCEPTANCE OF A CHANGE IN ENGAGEMENT

SITUATION – An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

A request from the client for the auditor to change the engagement may result from –

1. A change in circumstances affecting the need for the service,
2. A misunderstanding as to the nature of an audit or related service originally requested.
3. A restriction on the scope of the engagement, whether imposed by management or caused by circumstances.

➢ The auditor would **consider carefully the reason** given for the request, particularly the implications of a restriction on the scope of the engagement, especially any legal or contractual implications.

➢ What could be considered as reasonable basis for requesting change?

a. A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the audit engagement.

b. A change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory

AUDITOR'S DECISION TO ACCEPT OR NOT

a. If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement. **In order to avoid confusion, the report would not include reference to:**

(1) The original engagement

(2) Any procedures that may have been performed in the original engagement

b. The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.

Agreement on new terms –

a. If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

b. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:
   (1) Withdraw from the audit engagement where possible under applicable law or regulation; and
   (2) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

RECURRING AUDITS

1. On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.
2. the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms –
   a. Any indication that the entity misunderstands the objective and scope of the audit.
   b. Any revised or special terms of the audit engagement.
   c. Recent change of senior management.
   d. A significant change in ownership.
   e. A significant change in nature or size of the entity's business.
   f. A change in legal or regulatory requirements.
   g. A change in the financial reporting framework adopted in the preparation of the financial statements.
   h. A change in other reporting requirements.

AUDIT QUALITY

1. SQC 1 and SA 220 both deal with quality control.
2. Whereas SQC 1 deals with all engagements including audits, reviews and other assurance and related service engagements.
3. SA 220 applies to audit engagements only.

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

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

ELEMENTS OF A SYSTEM OF QUALITY CONTROL as per SQC 1

1. Leadership Responsibilities for Quality on Audits

1. SQC 1 requires firms to establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements.
2. Such policies and procedures should require the firm's CEO or the firm's managing partners to assume ultimate responsibility for the firm's system of quality control.
3. Further, persons assigned operational responsibilities for the firm's quality control system by the firm's CEO or managing partners should have sufficient and appropriate experience, ability and the necessary authority to assume that responsibility.

2. Ethical requirements

1. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements contained in the Code of ethics issued by ICAI. Such policies and procedures should enable the firm to: -
    a. Communicate its independence requirements to its personnel
    b. With regards to independence
        i. Identify and evaluate circumstances and relationships that create threats, and
        ii. to take appropriate action to eliminate those threats or
        iii. reduce them to an acceptable level by applying safeguards, or,
        iv. if considered appropriate, to withdraw from the engagement.
    c. All breaches of independence should be promptly notified to firm for appropriate action
2. The fundamental principles of professional ethics which include integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.
3. Observance of "Independence" in all engagements is the basic requirement.

3. Acceptance and Continuance of Client Relationships and Specific Engagements

1. A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about: -
    a. Integrity of Client – With regard to the integrity of a client, matters that the firm considers include
        - The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
        - The nature of the client's operations, including its business practices.
        - Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
        - Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
        - Indications of an inappropriate limitation in the scope of work.
        - Indications that the client might be involved in money laundering or other criminal activities.
        - The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.
    b. Competence of the team (including capabilities, time and resources) to perform engagement
    c. Compliance with ethical requirements by the firm & the team.
2. Firm should obtain such information as it considers necessary in the following circumstances
    a. Before accepting an engagement with a new client.
    b. When deciding whether to continue an existing engagement, and
    c. When considering acceptance of a new engagement with an existing client.
3. If there is any conflict of interest between the firm and client, it should be properly resolved before accepting the engagement. Where the firm obtains information that would have caused it to decline an engagement if that information had been obtainable earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of:
    a. The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and

b. The possibility of withdrawing from the engagement or from both the engagement and the client relationship

4. Human resources

1. Concept –
   - The firm should establish policies and procedures
   - Designed to provide it with reasonable assurance that
   - It has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary
   - To perform its engagements in accordance with professional standards and regulatory and legal requirements, and
   - To enable the firm or engagement partners to issue reports that are appropriate in the circumstances.
2. Such policies and procedures address the following personnel issues –
   a. Recruitment;
   b. Performance evaluation;
   c. Capabilities
   d. Competence;
   e. Career development;
   f. Promotion;
   g. Compensation; and
   h. Estimation of personnel needs

5. Engagement Performance

1. Consistency in quality of engagement performance is achieved through
   a. Briefing of engagement teams of their objectives,
   b. Processes for complying with engagement standards,
   c. Processes of engagement supervision and training,
   d. Methods of reviewing performance of work,
   e. Appropriate documentation of work performed.
2. Consultation should take place in difficult or contentious (argumentative) matters pertaining to an engagement. Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter.

3. Significant judgments made in an engagement should be reviewed by an engagement quality control reviewer for taking an objective view before the report is issued.
4. There might be difference of opinion within engagement team, with those consulted and between engagement partner and engagement quality control reviewer. The report should only be issued after resolution of such differences.
5. **Assembly of audit files**: The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized. The assembly of engagement files should be completed in not more than 60 days after date of auditor's report in case of audit engagements and in other cases within the limits appropriate to engagements.
6. Engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.
7. **In case of assurance engagements**: Engagement documentation has to be retained for a period of no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

6. Monitoring

1. The firm should ensure that policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice.
2. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.
3. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:
    a. Adherence to professional standards and regulatory and legal requirements;
    b. Whether the quality control system has been appropriately designed and effectively implemented;
    c. Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

SA 220- "QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS"

I. **Objective of the auditor**: to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that: -
   a. The audit complies with professional standards and regulatory and legal requirements and
   b. The auditor's report issued is appropriate in the circumstances.

II. SA 220 is modelled on lines of SQC 1. It describes responsibilities of engagement partner in relation to following matters:
   a. **Leadership responsibilities for quality on audits**: The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise:
      i. The importance to audit quality of: -
         a. Performing work that complies with professional standards and regulatory and legal requirements;
         b. Complying with the firm's quality control policies and procedures as applicable;
         c. Issuing auditor's reports that are appropriate in the circumstances; and
         d. The engagement team's ability to raise concerns without fear of reprisals.
      ii. The fact that quality is essential in performing audit engagements.
   b. **Relevant ethical requirements**: The responsibilities of an engagement partner in relation to ethical requirements in an audit engagement are as under: -
      i. Identifying a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level.
      ii. Reporting by engagement partner to the relevant persons within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement, where withdrawal is legally permitted.
   c. **Acceptance and Continuance of Client Relationships and audit Engagements**: The responsibility of an engagement partner in this regard in an audit engagement is on lines of SQC 1.
   d. **Assignment of engagement teams**: Should be ensured by engagement partner that the engagement team and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the engagement in accordance with professional standards and regulatory and legal requirements.

e. **Engagement Performance**:
   i. Engagement partner has the responsibility for
      a. Direction, supervision and performance of audit engagement in accordance with professional standards and regulatory and legal requirements.
      b. Auditor's report being appropriate in circumstances.
      c. Review of audit documentation before issue of audit report.
      d. Ensuring undertaking appropriate consultation on difficult or contentious matters by engagement team not only within the team but also with others at appropriate level within or outside the firm.
   ii. For **audits of financial statements of listed entities**, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:
      a. Determine that an engagement quality control reviewer has been appointed.
      b. Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer.
      c. Not date the auditor's report until the completion of the engagement quality control review.
   iii. If differences of opinion arise the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

f. **Monitoring**:
   i. An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively.
   ii. The engagement partner should document following matters pertaining to an audit engagement:
      a. Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
      b. Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.
      c. Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.

d. The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.

STUDY MATERIAL QUESTIONS

1. CA P. Suryakantam has conducted audit of accounts of an entity for a particular year. ICAI has issued a letter to him relating to certain matters concerning audit. He didn't even bother to reply to the letter despite reminders. Discuss which fundamental principle governing professional ethics is disregarded by him.

   Hint Ans: **Failure to reply to professional body smacks of lack of courtesy and professional responsibility. The principle of "Professional behaviour" is disregarded**

2. A Chartered accountant in practice issued a certificate showing original cost of plant and machinery installed in premises of a client for Rs. 9 crores to save some regulatory fees for his client. However, original cost of plant and machinery was Rs.15 crore as per records of client. Which fundamental principle governing professional ethics is violated in this case?

   Hint Ans: **a false certificate is knowingly issued showing misstated original cost of machinery. Therefore, fundamental principle of "integrity" is violated**.

3. CA Raman Gupta is offered appointment as auditor of a company. One of his distant uncles held some shares in the same company. Holding of such shares, by a distant relative, is not prohibited under provisions of law nor does it affect his independence. Before he could accept appointment, he received unfortunate news of death of his uncle who had died without any children. He came to know that he was nominee of these shares having substantial value. It landed him in a tricky situation. What should be proper course of action for him?

   Hint Ans: **When threats to independence exist, the auditor should either desist from the task or eliminate the threat or at the very least, put in place safeguards which reduce the threats to an acceptable level**.

4. A Chartered accountant receives about 40% of his total audit fees from a single client. Discuss how it could affect independence of Chartered accountant as auditor of this client. What are such types of threats referred to as?

   Hint Ans: **Undue dependence on fees of a client constitutes a threat as there is fear of losing the client. Such threats are referred to as self-interest threats**.

5. CA Murli Madhavan provides accounting and book keeping services to a leading NGO engaged in environmental protection work. He is also offered audit of the accounts of NGO. Identify and discuss

what kind of threat to independence may be involved in accepting such an engagement.

Hint Ans: **If he accepts audit, he would be involved inreviewing own work. Therefore, the same constitutes "self-review" threat**

6. The auditors of a company have only relied upon management representation letter regarding treatment of certain tax matters under appeal by the company. The auditors have not carried out any other audit procedures to justify management's treatment of the said tax matters under appeal in the financial statements. What is lacking on part of auditors in such a situation?

   Hint Ans: **No other audit procedures to verify management's treatment of such matters under appeal have been performed by auditors. It shows lack of "professional skepticism" on part of auditors.**

7. Chirag, as part of articled training, is part of an engagement team conducting audit of a company. He has read somewhere that engagement letter issued by auditor to client also includes expected form and content of the auditor's report. He was at a loss to understand how could an auditor include form and content of the report beforehand. Try to help Chirag by making things clear to him.

   Hint Ans: **Auditor needs to give a modified opinion, he shall do so**.

8. The management of an entity feels that it is not necessary for it to give in writing explicitly to the auditor that it understands its responsibilities for preparation of financial statements in accordance with applicable financial reporting framework. Discuss, whether, it is necessary for the management to do so. In case management refuses, why should an auditor not accept the proposed engagement?

   Hint Ans: **Refer "what happens if preconditions for an audit are not present" section**

9. CA PK Nair is offered appointment as auditor of a company engaged in providing tourism services. While making due diligence of the proposed client, he comes to know that there have been raids on premises of the company and residences of its directors by National Investigation Agency (NIA) on suspicion of links with terror outfits. It has been followed up with searches by Enforcement Directorate hunting for illicit money trail. There is a strong suspicion of tourism services provided by company being façade of terror funds. Should proposed offer be accepted by him?

   Hint Ans: **There have been raids of NIA on suspected links with terror outfits which is a criminal activity. Further, raids by Enforcement Directorate also point towards money laundering. Therefore, proposed offer should not be accepted**.

10. CA Arpita has joined a mid-sized CA firm recently. She finds that partners remain too busy and the firm is proposing to accept audit work in areas in which it has no experience or capabilities. The firm is proposing to accept audit of some entities engaged in emerging "fin-tech" sector. Such audits may be requiring extensive use of technology and data analytics. However, the said firm has no such capabilities

and trained personnel. Discuss, whether, firm should accept such audits with reason.

Hint Ans: **The proposed engagements involve use of technology and data analytics. The firm has no prior experience of audits in emerging "fintech" sector. The firm does not have trained personnel to carry out these audits. Hence, offer for these audits should not be accepted.**

EXAMINATION QUESTIONS

Q1. The firm's system of quality control should include policies and procedures addressing each element. Explain. **[RTP-Nov. 18, MTP-Oct. 19]**

Q2. As per SA 220, the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. While taking responsibility for the overall quality on each audit engagement, analyse and explain the emphasis of the actions of the engagement partner and appropriate messages to the other members of the engagement team. Also define engagement partner. **[MTP-Aug. 18]**

Q3. The engagement partner shall take the responsibility for the overall quality on each audit engagement to which that partner is assigned. Discuss with reference to SA 220 "Quality Control for an audit of financial statement". **[Nov. 19 (3 Marks)]**

Q4. Comment as an auditor on the following situations: Mr. X, a partner in X & Co., a firm of a Chartered Accountants, died on 31-03-2019 after completing routine audit work of XYZ Company Ltd. Mr. Y another partner of the firm of Chartered Accountants signed the financial statements of XYZ Company Ltd., without reviewing the finalization work done by the assistants. **[Nov. 10 (5 Marks)]**

Q5. Mention any four information which assists the auditor in accepting and continuing of relationship with the client as per SA 220. **[May 15 (5 Marks)]**

Q6. As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. Explain. **[RTP-May 18]**

Q7. CA Raj, an engagement partner wants to take decision, regarding acceptance and continuance of an audit engagement. Which information, he should obtain before accepting an engagement? **[May 19 (3 Marks)]**

Q8. The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic

inspection of a selection of completed engagements. Explain in the above context the purpose of monitoring compliance with quality control policies and procedures. **[RTP-Nov. 19]**

Q9. "Independence of auditors must not only exist infact, but should also appear to exist to all reasonable persons". Discuss highlighting the advantages of an independent audit.

Q10. Write short note on: Auditor's Independence. **[May 07 (4 Marks)]**

Q11. The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats." Explain.

Q12. The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded as being incompatible with integrity and objectivity. Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of assurance engagements may differ and consequently different threats may exist requiring the application of different safeguards. Explain stating clearly the five types of threats as contained in Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC). **[MTP-Oct. 18]**

Q13. Write a note on "Self-review threats". **[RTP-Nov. 19]**

Q14. Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. Explain. **[MTP-April 19]**

Q15. 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. State the guiding principles in this regard

Q16. Comment on the following: "The Auditor shall comply with relevant ethical requirements including independence". or

Q17. Discuss prerequisites and fundamental principles to be possessed by an auditor. **[May 11 (8 Marks)]**

Q18. Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants related to an audit of financial statements. Discuss with reference to those fundamental principles of professional ethics. **[RTP-May 19]**

Q19. Discuss with reference to SAs: The auditor is responsible for maintaining an attitude of professional skepticism throughout the audit. Do you agree with the statement. **[May 14 (6 Marks)]**

Q20. The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statement to be materially misstated. Discuss any four examples of professional skepticism. **[Nov. 19 (4 Marks)]**

Q21. "Independence of mind and independence in appearance are interlinked perspectives of Independence of auditors." Explain. **[May 19 (3 Marks)]**

Q22. What is an audit engagement letter? What are the principal contents of audit engagement letter. or

Q23. What is the purpose of a Letter of Engagement? What are the important contents of a Letter of Engagement? **[May 17 (6 Marks)]**

Q24. Write short note on: Preconditions of an audit.

Q25. Comment on the following: "It is not mandatory to send a new engagement letter in recurring audit, but sometimes it becomes mandatory to send new letter." Explain those situations where new engagement letter is to be sent. **[Nov. 11 (5 Marks)]**

Q26. Indicate the factors which make it appropriate for an auditor to send a new engagement letter for a recurring audit. **[Nov. 14 (5 Marks)]**

Q27. 'P' an auditor decides not to send a new engagement letter to G Ltd. every year. Whether he is right in his approach. State the circumstances where sending new engagement letter, would be appropriate. **[Nov. 15 (5 Marks)]**

Q28. X, a Chartered Accountant was engaged by PQR & Co. Ltd. for auditing their accounts. He sent his letter of engagement to the Board of Directors, which was accepted by the Company. In the course of audit of the company, the auditor was unable to obtain appropriate sufficient audit evidence regarding receivables. The client requested for a change in the terms of engagement. Offer your comments in this regard. **[Nov. 09 (5 Marks)]**

Q29. "An auditor who before the completion of the engagement is requested to change the engagement to one which provides a lower level of assurance should consider the appropriateness of doing so." Discuss.

Q30. An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so. Explain stating the factors based on which client can request the auditor to change the engagement. **[RTP-Nov. 19]**

Q31. CA H is managing partner of HK & Co, a Chartered Accountant firm, having registered office at Delhi. With the annual task of reviewing whether any threat to independence is observed in the firm, CA H noted down the following observations received from the staff and partners of the firm for the F.Y 2023-24:

a. CA J, partner of the firm, performed statutory audit as well as non-audit engagement for M/s, Take A way Private Limited.
b. CA M, partner of the firm, who has done income tax audit for M/s. Happy Associates where in CA M has material significant indirect financial interest.
c. The costs of air travel and stay accommodation of family members of audit team for audit of Chennai was borne by the client stationed at Chennai.
d. One of the clients, M/s. Chalk Limited, threatened to replace them as auditors because the audit team insisted to make provision for expected credit loss which the company was not willing to provide.
e. CA N, partner of the firm, who audited M/s. NM Private Limited became arbitrator for dispute between M/s. NM Private Limited and one of its vendors.
f. CA N accepted the assignment of Tax audit (on behalf of firm) of TRF Industries. Management agreed to pay him contingent fee for tax audit.

You are requested to help CA H in classifying the type of threats to independence in each of the above observation received from the staff and partners of the firm. **[Jan 25 – 3 Marks]**

In case such threats exist, what should the auditor do? **[Jan 25 – 2 Marks]**

Q32. Identify and explain the fundamental principles being referred to in the following cases:

a. Professional accountants should act diligently and in accordance with applicable technical and professional standards while providing professional services. **[Jan 25 – 2 Marks]**
b. A professional accountant shall not knowingly be associated with reports where he believes that the information contains a materially false or misleading statement. **[Jan 25 – 2 Marks]**

KARTHIK SHENOY

Some of my top

Achievers



Venkatesh V

86 marks - May ‘24



Sujith

72 marks
Sep ‘24



Parthasarathy

80 marks - May ‘24

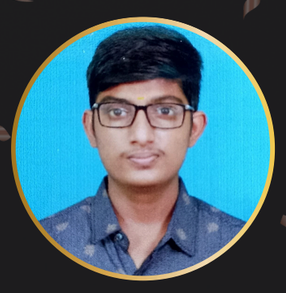


Ashvini

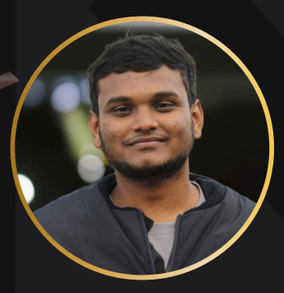
72 marks - May ‘24



David Pinto
65 - Sep ‘24



Karthikeya
64 - Sep ‘24



Yogesh Kumar
61 - Sep ‘24



Zeesha Fathima
59 - Sep ‘24



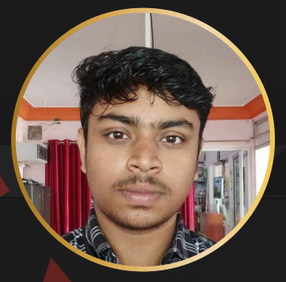
Parnika Bhat
59 - Sep ‘24



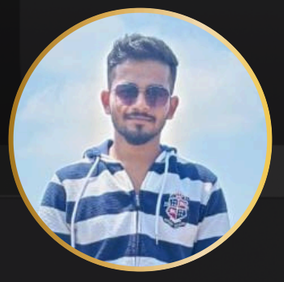
Tanisha Bhor
57 - Sep ‘24



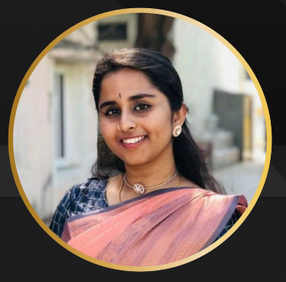
Anto Niketha
59 - Sep ‘24



John Gallwin
56 - Sep ‘24



Sushanth Y H
64 - Sep ‘24



Pavithra P K
58 - Sep ‘24



Dhanraj Huded
59 - Sep ‘24



Poornima Varier
59 - Sep ‘24

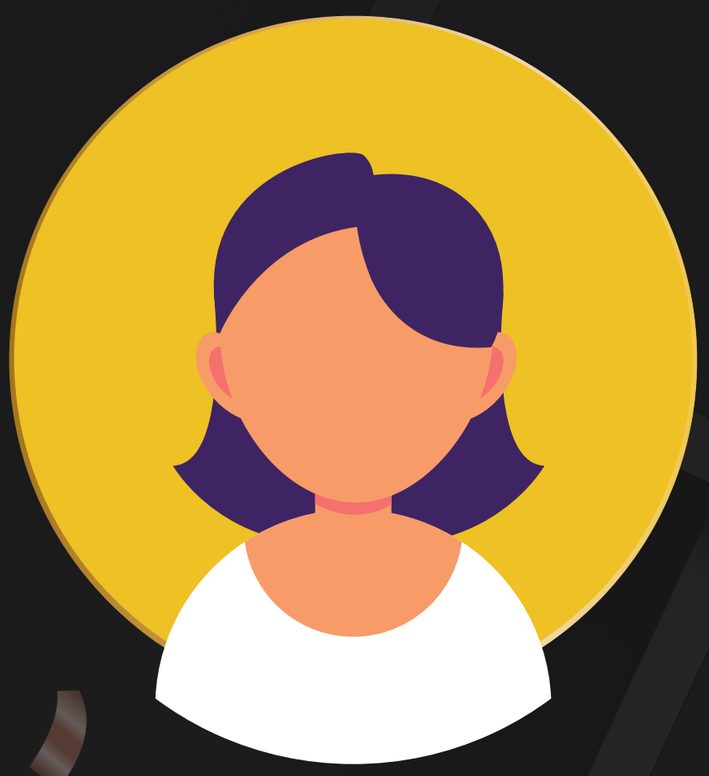
Many Congratulations,

Loosetools!

KARTHIK SHENOY

Some of my top

Achievers



Sisira

72 marks - May ‘24



Kerthi T A

75 marks

May ‘24



Avinash Bhat
54 - Sep ‘24



Adithya B N
50 - Sep ‘24



Narasimha Bhat
52 - May ‘24



Krithin
63- May ‘24



Raghav
58 - Sep ‘24



Sagar S
55 - May ‘24



Bhoomisha P H
58 - May ‘24



K Yaswanti
62 - May ‘24



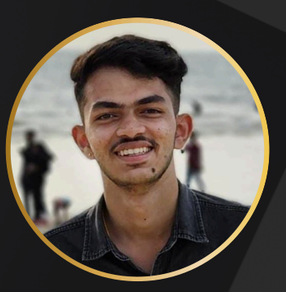
Swathi Kamath
55 - May ‘24



Vinathi V
63 - May ‘24



Apeksha
65 - May ‘24



Adithya Shenoy
52 - May ‘24



Yokeshwaran
64 - May ‘24



Sowndarya R
55 - May ‘24



YOU
could be next

Many Congratulations,

Loosetools!