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Nature, Objective and Scope of Audit

1.1 – Meaning, Nature, Objective and Scope of Auditing

Meaning of Audit

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.

Points to be ensured that F.S. not misled anybody

- Accounts have been drawn up with reference to entries in books of a/c;
- Entries in books of a/c are supported by sufficient & appropriate evidence;
- None of entries in books of account has been omitted in compilation;
- Information contained in F.S. is clear & unambiguous.
- Amounts shown in F.S. are properly classified, described & disclosures made in conformity with applicable ASs.
- F.S. reflect true and fair view of financial results & financial position.

Inter-Disciplinary Nature of Auditing

Auditing is interdisciplinary in nature.

- Auditing & Accounting:** Since audit of F.S. is concerned with financial information, a sound knowledge of accounting principles is a fundamental requirement for an auditor of F.S. to conduct audit & express an opinion.
- Auditing & Law:** Good knowledge of business & various taxation laws helps auditor to understand F.S. in a better way in accordance with applicable laws.
- Auditing & Behavioral Sciences:** During course of audit, auditor has to interact with lot of persons for seeking information and making inquiries. This can be done only if one has knowledge of human behaviour.
- Auditing & Statistics:** Auditors use statistical methods to draw samples in a scientific manner.
- Auditing & Economics:** Knowledge of economics helps auditor to be familiar with overall economic environment in which specific business is operating.
- Auditing & Financial Mngt.:** Financial Mngt. deals with issues like funds flow, WC Mngt., ratio analysis etc. & auditor is expected to have knowledge about these for applying audit procedures & carrying out audit effectively.

Objectives of Audit

As per SA 200 “Overall Objectives of Independent Auditor & Conduct of Audit in accordance with SAs”, in conducting an audit of F.S., overall objectives of auditor are:

- To obtain **reasonable assurance** about whether F. S. as a whole are free from material misstatement, whether due to fraud or error, thereby enabling auditor to express an opinion on whether F.S. are prepared, in all material respects, in accordance with an applicable FRF; &
- To report on F.S. & communicate as required by SAs, in accordance with auditor’s findings.

Reasonable Assurance vs Absolute Assurance

Absolute assurance is a complete assurance or a guarantee that F.S. are free from material misstatements. Reasonable assurance is not a complete guarantee; it is a high-level of assurance but it is not complete assurance.

Scope of Audit

Elements included in Scope of Audit

- Coverage of all aspects of entity:** Audit of F.S. should adequately cover all aspects of entity relevant to F.S.
- Reliability & sufficiency of financial information:** Be satisfied that information contained in A/cing records & other data (like bills, vouchers, documents etc.) is reliable and provide sufficient basis for preparation of F.S. For this purpose, study & assess A/cing Systems and ICs.
- Proper disclosure of financial information:** Decide whether relevant info. is properly disclosed in F.S. in compliance with statutory requirements.
Ensure that F.S. properly summarize transactions & events recorded therein & considering judgments made by mngt. in prepⁿ of F.S.
Evaluate whether A/cing policies selected by mngt. are proper & whether chosen policy has been applied consistently.

Elements not included in Scope of Audit

- Auditor is not expected to perform duties which fall outside domain of his competence.
- Auditor is not an expert in authentication of documents; hence cannot authenticate genuineness of documents.

1.1 – Meaning, Nature, Objective and Scope of Auditing

Audit vs. Investigation

- Audit is not official investigation into alleged wrong doing.
- Auditor does not have any specific powers of search or recording statements of witness on oath which may be necessary for carrying out official investigation.
- Investigation is critical examination of accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.
- Scope of audit is general and broad whereas scope of investigation is specific and narrow.

Benefits of Audit

- Audited accounts provide **high quality information**; gives confidence to users that information on which they are relying is qualitative & outcome of an exercise carried out by following Auditing Standards recognized globally.
- In case of companies, shareholders may or may not be involved in daily affairs of the company; they need an independent mechanism so that financial information is qualitative and reliable. Hence, their **interest is safeguarded** by an audit.
- Audit acts as **moral check on employees** from committing frauds for fear of being discovered by audit.
- Audited F.S. are **helpful to government authorities** for determining tax liabilities.
- Audited F.S. can be **relied upon by lenders, bankers** for making their credit decisions i.e., whether to lend or not to lend to a particular entity.
- Audit may also **detect fraud or error** or both.
- Audit **reviews existence & operations of various controls** operating in any entity. Hence, it is useful at pointing out deficiencies.

Mandatory Audit vs. Voluntary Audit

- Entities like companies are compulsorily required to get their accounts audited under law. Non-corporate entities may be compulsorily requiring audit of their accounts under tax laws, if turnover crosses certain threshold limit.
- Entities like schools may be required to get accounts audited for purpose of obtaining grant or assistance from Govt.
- Many entities may get their accounts audited voluntarily because of benefits from audit.

Who Appoints Auditor

- In case of companies, by members (shareholders) in AGM.
- In case of Govt. companies, by C&AG of India.
- In case of firm, by partners of firm.

To whom Audit Report is submitted

- To person making the appointment.
- In case of companies, these are shareholders; in case of firm, to partners who have engaged him.

1.2 - Inherent Limitations of Audit

As per SA 200, auditor is not expected to, & cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the F.S. are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit which arises due to following factors:

(1) Nature of Financial Reporting	(3) Not in Nature of Investigation
• Preparation of F.S. involves making many judgments by mngt. These judgments may involve subjective decisions or degree of uncertainty. Auditor may not be able to obtain absolute assurance that F.S. are free from material misstatements due to frauds or errors. • One of premises for conducting an audit is that mngt. acknowledges its responsibility of preparation of F.S. in accordance with applicable FRF and for devising suitable ICs. However, such controls may not have operated to produce reliable financial information due to their own limitations.	Audit is not an official investigation. Hence, auditor cannot obtain absolute assurance that F.S. are free from material misstatements due to frauds or errors.
	(4) Timeliness of Financial Reporting & decrease in relevance of information over time
	Relevance of information decreases over time & auditor cannot verify each & every matter. Therefore, a balance has to be struck between reliability of information and cost of obtaining it.
(2) Nature of Audit Procedures	(5) Future Events
There are practical & legal limitations on auditor's ability to obtain audit evidence. For example: • Auditor does not test all transactions & balances. He forms his opinion only by testing samples. (Practical limitation). • Mngt. may not provide complete info. as requested by auditor. There is no way by which auditor can force mngt. to provide complete info. In case he is not provided with required information, he can only report. (Legal limitation)	Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business. 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.

1.3 - Meaning, Nature and Types of Engagements (Assurance Engagements)

Engagement

A formal agreement between auditor and client under which auditor agrees to provide auditing services. It takes the shape of engagement letter.

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.

Elements of Assurance Engagement

- (a) **Three Party relationship:** Assurance engagement involves 3 parties:
 - **Practitioner:** Person who provides assurance. Practitioner is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.
 - **Responsible party:** Party responsible for preparation of subject matter.
 - **Intended users:** Persons for whom assurance report is prepared. These persons may use report in making decisions.
- (b) **Subject matter:** Information to be examined by practitioner. For example: Financial info. contained in F.S. while conducting audit of F.S.
- (c) **Suitable Criteria:** Benchmarks used to evaluate the subject matter like standards, guidance, laws, rules and regulations.
- (d) **Sufficient appropriate evidence:** Practitioner performs assurance engagement to obtain sufficient appropriate evidence. Conclusions are arrived & opinion is formed on basis of evidences. "Sufficiency" relates to quantity of evidence obtained; whereas "Appropriateness" relates to quality of evidence obtained.
- (e) **Written assurance report:** Outcome of assurance engagement and contains conclusion that conveys assurance about subject matter.

Elements of Assurance Engagement

	Reasonable Assurance Engagement	Limited Assurance Engagement
Level of Assurance	High, but not absolute	Lower than reasonable
Nature of Procedures to obtain evidences	Elaborate and extensive procedures	Limited procedures (Inquiry & Analytical Procedures)
Conclusion Obtained	Reasonable conclusions.	Limited conclusions.
Example	Audit engagement.	• Review engagement; • Examination of PFI & ICs.

Examples of Assurance Engagement

- **Audit of F.S.** - Reasonable assurance engagement
- **Review of F.S.** - Limited assurance engagement
- **Examination of PFI** - Provides assurance regarding reasonability of assumptions forming basis of projections & related matters.
- **Report on controls operating at an organization** - Provides assurance regarding design and operation of controls.

Audit Vs. Review	Prospective Financial Information (PFI)
• Both "audit" & "review" are related to F.S. prepared on basis of historical financial information. • Audit is reasonable assurance engagement; review is limited assurance engagement. • Review involves fewer procedures & gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up.	• Financial info. based on assumptions about events that may occur in future and possible actions by an entity. It can be in form of a forecast or projection or combination of both. • In assurance reports involving PFI, practitioner obtains sufficient appropriate evidence to the effect that: (a) Management's assumptions on which PFI is based are not unreasonable; (b) PFI is properly prepared on basis of assumptions; and (c) PFI is properly presented & all material assumptions are adequately disclosed. • As PFI is related to future events; evidences are available to support assumptions on which PFI is based, such evidences are also future- oriented. Practitioner is, therefore, not in a position to express an opinion as to whether the results shown in PFI will be achieved. • Such type of assurance engagement provides only a "moderate" level of assurance.

"Historical Financial Information (HFI)" & "Prospective Financial Information (PFI)"

HFI: Info. expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods.

PFI: Financial info. based on assumptions about occurrence of future events and possible actions by an entity.

HFI is rooted in past events which have already occurred whereas PFI is related to future events.

1.4 - Qualities of Auditor

- All personal qualities that go to make a good businessman contribute to making of a good auditor. Qualities required are:
 - (a) tact, caution, firmness, good temper, integrity, discretion, industry knowledge, judgement, patience, clear headedness and reliability.
 - (b) highest degree of integrity backed by adequate independence.
- Auditor must have basic human qualities apart from technical requirement of professional training and education. His knowledge needs to be that of an expert.
- Exhaustive knowledge of accounting in all its branches is *sine qua non* of the practice of auditing.

1.5 - Quality Control and Engagement Standards

Need for Standards	Standards on Quality Control (SQC)s	Engagement Standards
• Stds. ensure carrying out of audit against established benchmarks. • Stds. improve quality of financial reporting. • Stds. promote uniformity. • Stds. equip accountants with professional knowledge and skill. • Stds. ensure audit quality.	• Establish standards & provide guidance regarding firm's responsibilities for its system of QC for conduct of audit and review of HFI and for other assurance and related service engagements. • SQC 1 issued & requires practitioners to establish system of QC so that: (a) firm & its personnel comply with professional standards and regulatory & legal requirements and (b) reports issued are appropriate. • SQC 1 applied for all services covered by Engagement Standards.	• Standards on Auditing (SAs): to be applied in audit of HFI. • Standards on Review Engagements (SREs): to be applied in review of HFI. • Standards on Assurance Engagements (SAEs): to be applied in assurance engagements, engagements dealing with subject matter other than HFI. • Standards on Related Services (SRSs): to be applied to engagements involving application of agreed upon procedures and other related services such as compilation engagements.

Standards on Auditing (SAs)	Standards on Review Engagements (SRE)	Standards on Assurance Engagements (SAE)
• SAs apply in context of audit of F.S. by independent auditor. • SAs establish high quality benchmarks & are followed by auditors in conducting audit of HFI contained in F.S. • Examples of SAs are: (a) SA 200: Overall Objectives of Independent Auditor and Conduct of Audit in accordance with SAs. (b) SA 230: Audit Documentation. (c) SA 315: Identifying & Assessing RoMM through Understanding the Entity and its Environment. (d) SA 500: Audit Evidence.	• SRE apply in context of review of F.S. • Review is limited assurance engagement & provides assurance lower than assurance provided by audit. • Examples of SREs are: (a) SRE 2400: Engagements to Review Historical F.S. (b) SRE 2410: Review of Interim Financial Info. performed by Independent Auditor of Entity.	• SAEs deal with subject matters other than HFI. • In such type of assurance engagements, examination is not of HFI or engagement may relate to providing assurance regarding non-financial matters like design and operation of ICs in an entity. • Examples of SAEs are: (a) SAE 3400: Examination of PFI. (b) SAE 3402: Assurance Reports on Controls at a Service Organisation. (c) SAE 3420: Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus.

Standards on Related Services (SRS)	Duties in relation to EQCS
• SRSs apply in case of Non-Assurance Engagements. Examples of such related services include engagements to perform agreed-upon procedures and Compilation Engagement. • Engagement to perform agreed-upon procedures require auditor to perform certain procedures concerning individual items of financial data, say, accounts payable, accounts receivable, purchases from related parties etc. or a financial statement, say, a balance sheet or even a complete set of financial statements. • In Compilation engagement, practitioner is required to assist mngt. with preparation & presentation of HFI without obtaining assurance. In such engagements, practitioner issues a report clearly stating that it is not an assurance engagement & no opinion is being expressed. • Examples of Standards on related services are: (a) SRS 4400: Engagements to perform agreed-upon procedures regarding financial information. (b) SRS 4410: Compilation engagements.	• It is duty of professional accountants to see that Standards are followed in engagements undertaken by them. • A situation may arise when a specific procedure as required in Standards would be ineffective in particular engagement. In such case, professional accountant is required to ensure the following: (a) Document how alternative procedures performed to achieve purpose of required procedure; (b) Reason for departure also to be documented; (c) Report should draw attention to such departures.

2

Audit Strategy, Planning and Programme

2.1 – Auditor’s Responsibility to Plan an Audit of F.S.

Meaning of Audit Planning

- Developing an overall plan for the expected scope & conduct of audit and
- Developing an audit programme showing NTE of Audit procedures

Importance of planning

1. To devote attention to important areas of Audit.
2. To identify & resolve potential problems.
3. Organized and Managed audit.
4. Selection of suitable ET Members.
5. Coordination of work done by auditors of Components and Experts.
6. Direction & supervision of ET and Review of their work.

Planning – a Continuous Process

Planning is not discrete phase of audit but rather a continuous process; begins shortly after completion of previous audit & continues until completion of current audit engagement.

It includes consideration of timing of certain activities & procedures that need to be completed prior to performance of FAP, e.g., planning includes need to consider, prior to identification & assessment of RoMM, matters such as:

1. **Analytical procedures to be applied as RAP.**
2. **Obtaining general understanding of legal and regulatory framework.**
3. **Determination of materiality.**
4. **Involvement of experts.**
5. **Performance of other RAP.**

Discussion of elements of Planning with Management

- To facilitate conduct and management of audit engagement.
- Care is required in order not to compromise effectiveness of audit.

Elements of Planning

A. Preliminary Engagement Activities

- (a) Performing Procedures regarding continuance of Client relationship.
- (b) Evaluate compliance with Ethical Requirements.
- (c) Establishing understanding of terms of Engagement.

Performing procedures regarding continuance of client relationship

- Ensure that procedures regarding acceptance & continuance of client relationships followed & conclusions reached are appropriate.
- Obtain necessary information before
 - (a) accepting engagement with new client,
 - (b) deciding whether to continue an existing engagement, and
 - (c) considering acceptance of new engagement from existing client.
- Consider following matters:
 - (a) Integrity of principal owners and key Mngt.;
 - (b) Competence of ET to perform audit engagement
 - (c) Implications of matters arisen during current & previous audit engagement.

Evaluating compliance with ethical requirements, including independence

- (i) Obtain relevant information from firm to identify circumstances & relationships that create threats to independence.
- (ii) Evaluate information on identified breaches to determine whether they create a threat to independence.
- (iii) Take appropriate action to eliminate such threats or reduce them to acceptable level by applying safeguards, or to withdraw from engagement.
- (iv) Promptly report to firm any inability to resolve matter for appropriate action.

B. Planning Activities

- (a) Establishing overall Audit Strategy; &
- (b) Developing Audit Plan.

2.2 – Audit Strategy

Meaning of Audit Strategy

Designing Optimised Audit Approaches to achieve necessary audit assurance at lowest cost.

Benefits of Audit Strategy:

1. Employment of Qualitative Resources.
2. Allocation of appropriate quantity of resources.
3. Determining the timing of deployment of resources.
4. Better management of resources in terms of direction, supervision, timing of team meetings etc.

Establishment of Audit Strategy

As per SA 300, auditor shall establish audit strategy that sets scope, timing & direction of audit and guides development of Audit plan.

Factors to be considered

- Characteristics of Engagement that define its scope.
- Reporting Objectives to plan timings of Audit and Nature of Communications required.
- Significant factors to direct ET efforts.
- Result of Preliminary Engagement Activities.
- NTE of Resources necessary to perform engagement.

Considerations of Characteristics of Engagement	Considerations of Reporting Objectives	Consideration of factors significant in directing ET efforts
Characteristics of engagement that defines its scope, include following: (a) FRF applicable to the entity. (b) Nature of business segments to be audited including need for specialized knowledge. (c) Industry specific reporting requirements required by industry regulators. (d) Expected use of audit evidence obtained in previous audits.	Instances to be considered are: (a) Entity's timetable for reporting, such as at interim and final stages. (b) Organization of meetings with Mngt. & TCWG to discuss NTE of the work. (c) Discussion with Mngt. regarding expected type & timing of reports to be issued. (d) Expected nature & timing of communications among ET members, including nature and timing of team meetings & timing of review of work performed.	Instances to be considered are: • Volume of transactions to determine whether it is more efficient for auditor to rely on internal control. • Significant industry developments such as changes in industry regulations & new reporting requirements. • Significant changes in FRF, such as changes in ASs. • Other significant relevant developments, such as changes in legal environment affecting entity.

2.3 – Audit Planning

Development of Audit Plan

- Once audit strategy is established, audit plan can be developed to address various matters identified in overall audit strategy.
- As per SA 300, auditor shall develop audit plan that shall include description of:
 - (i) NTE of planned RAPs;
 - (ii) NTE of planned FAPs; and
 - (iii) Other planned audit procedures required to be carried out.

Relationship between Audit Strategy & Audit Plan

- Audit strategy sets overall approach to audit; audit plan addresses various matters identified in overall audit strategy.
- Audit plan is more detailed than overall audit strategy.
- Audit strategy & plan are not necessarily sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.

Planning the Direction & Supervision of ET

- As per SA 300, auditor shall plan NTE of direction & supervision of ET members and review of their work.
- NTE of direction & supervision of ET members & review of their work vary depending on many factors, including:
 - (i) Size & complexity of entity.
 - (ii) Area of audit.
 - (iii) Assessed RoMM.
 - (iv) Capabilities & competence of team members performing audit work.

Documentation of Audit Plan

Auditor shall document:

- (a) Overall audit strategy;
- (b) Audit plan; and
- (c) Significant changes made to overall audit strategy or audit plan, and reasons for such changes.

Documentation of audit strategy is record of key decisions considered necessary to properly plan audit and to communicate significant matters to ET.

Documentation of audit plan is record of planned NTE of RAPs & FAPs in response to assessed risks.

Record of significant changes to strategy & plan, explains why significant changes were made, and overall strategy and audit plan finally adopted for audit.

Changes to Planning Decisions

- Auditor shall update & change overall audit strategy and audit plan as necessary during the course of the audit.
- Audit Strategy and Audit Plan may need to be modified as a result of
 - (a) Unexpected events,
 - (b) Changes in conditions, or
 - (c) Audit evidence obtained from the results of audit procedures.
- Based on revised consideration of assessed risks, auditor need to modify NTE of FAPs. This may be the case when information comes to auditor's attention that differs significantly from information available when auditor planned audit procedures.

2.4 – Audit Programme

Detailed plan of applying audit procedures in given circumstances with instructions for appropriate techniques to be adopted for accomplishing audit objectives.



Evolving Audit Programme for different audits

Evolving one audit programme applicable to all business under all circumstances is not practicable due to:

- (a) Variation in nature, size & composition of Businesses;
- (b) Work which is suitable to one business may not be suitable to others;
- (c) Variation in efficiency & operation of IC & exact nature of service to be rendered by auditor.

Assistant to keep an open mind

- To start with, a programme to be framed, which aim at providing for minimum essential work based on:
 - (a) nature, size & composition of business;
 - (b) dependability of internal control; &
 - (c) scope of work.

Such Programme is termed as standard programme.

- As experience is gained, programme may be altered to take care of situations which were left out originally, but are found relevant.
- If any work originally provided for proves beyond doubt to be unnecessary, it may be dropped.
- Assistants should be encouraged to keep open mind beyond programme given to him. They should be instructed to note & report significant matters coming to their notice, to seniors or partners of firm.

Periodic Review of Audit Programme

- Auditor should periodically review audit programme to assess whether it continues to be adequate for obtaining requisite knowledge & evidence about transactions.
- Utility of audit programme can be retained only by keeping programme under periodic review so that inadequacies may be removed.
- If this is not done, audit work may be carried on, on basis of obsolete programme and, for this negligence, whole audit may be held as negligently conducted and auditor may have to face legal consequences.



Points to be considered in constructing Audit Programme

- (1) Stay within scope & limitation of assignment.
- (2) Prepare a written audit programme setting forth procedures needed.
- (3) Determine evidences available & identify best evidence for deriving necessary satisfaction.
- (4) Apply steps and procedures which are useful in accomplishing verification purpose in specific situation.
- (5) Include audit objectives for each area and sufficient details which serve as a set of instructions for assistants.
- (6) Consider all possibilities of error.
- (7) Coordinate procedures to be applied to related items.

Audit Programme - Designed to provide Audit Evidence

- Evidence is very basis for formulation of opinion and audit programme is designed to provide for that by prescribing procedures and techniques.
- Evidences may be collected through:
 - Documentary examination
 - Physical examination
 - Statements & explanation of mngr., officials and employees
 - Statements of third parties
 - Arithmetical calculations
 - State of internal controls
 - Inter-relationship of A/cing data.
 - Subsidiary/Memorandum records
 - Minutes of Meetings

2.4 – Audit Programme

Advantages of Audit Programme	Disadvantages of Audit Programme
(a) Provides total and clear set of instructions of the work to be done. (b) Provide a total perspective of work to be performed. (c) Selection of assistants for jobs on basis of capability becomes easier. (d) Without a written programme, work is to be carried out on basis of some 'mental' plan. In that case, there remains a risk of ignoring or overlooking certain books and records. (e) Assistants, by putting their signature on programme, accept responsibility for work carried out by them and, if necessary, the work done may be traced back to them. (f) Progress of various audits in hand may be controlled by examination of programmes. (g) Serves as a guide for audits to be carried out in the succeeding year. (h) Serves as evidence in event of any charge of negligence being brought against auditor.	(a) Work may become mechanical and may be carried out without understanding of object. (b) Programme often tends to become rigid and inflexible; business may change in its operation, but the old programme may still be carried on. (c) Inefficient assistants may take shelter behind the programme. (d) Hard & fast audit programme may kill initiative of efficient and enterprising assistants. Disadvantages of an Audit programme may be eliminated by: Imaginative supervision of work carried on by assistants; Receptive attitude of auditor as regards assistants; Encouraging assistants to observe matters objectively and bring significant matters to the notice of supervisor/principal.



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3

Risk Assessment and Internal Control

3.1 – Audit Risk (SA 315)

Meaning and Components of Audit Risk

- Risk that auditor gives inappropriate audit opinion when F.S. are materially misstated (i.e. expressing unmodified opinion in case F.S. are materially misstated).
- Plan & perform audit to reduce audit risk to acceptable low level.
- Audit risk is a function of RoMM & detection risk.

What is not included

- Auditor's business risks such as loss from litigation, adverse publicity etc.
- Risk that auditor might express an opinion that F.S. are materially misstated when they are not.

Risk of Material Misstatements (RoMM)

- Risk that F.S. are materially misstated prior to audit, i.e., there is a probability of frauds or errors in F.S. before audit.
- RoMM may exist at two levels:
 - (a) Overall F.S. level: RoMM that relate pervasively to F.S. as a whole & potentially affect many assertions.
 - (b) Assertion level for classes of transactions, a/c balances & disclosures:
- RoMM at assertion level are assessed to determine NTE of FAPs necessary to obtain SAAE. RoMM at assertion level consist of two components:
 - (a) Inherent risk (IR); and (b) Control risk (CR).
- Both IR & CR are entity's risks & exist independently of audit of F.S; influenced by client; not by auditor.

IR	• Susceptibility of an assertion about a class of transaction, a/c balance or disclosure to a misstatement that could be material, assuming that there were no related ICs. • IR is higher for some assertions & related classes of transactions, account balances, & disclosures than for others. For example, it may be higher for complex calculations.	(a) AS providing guidance on complex issue which might not be understood by mngt; (b) Due to business failures in an industry, assertions in F.S. of entity operating in such industry carry IR of being misstated.
CR	• Risk that a misstatement that could occur in an assertion about a class of transaction, a/c balance or disclosure and that could be material will not be prevented, or detected & corrected, on timely basis by entity's IC. • There exists an inverse relation between CR & efficiency of IC. When efficiency of IC is high, CR is low and when efficiency of IC is low, CR is high.	(a) Controls are devised that cash & cheque books be kept in locked safe & access is granted to authorized personnel only. There is risk that control is not followed. (b) Controls are devised relating to petty cash that items of expenditure of only less than ₹ 10,000 should be routed through imprest system. There is a risk that control is not being followed.

Detection Risk (DR)

- Risk that procedures performed by auditor fails to detect MM.
- DR would always be present even if auditor was to examine 100% of account balances or class of transactions.
- DR comprises sampling and non-sampling risk.

Sampling risk: Risk that auditor's conclusion based on a sample may be different from conclusion if entire population were subjected to same audit procedure.

Non-sampling risk: Risk that auditor reaches erroneous conclusion for any reason not related to sampling risk. **For example:** Using inappropriate audit procedure.

- Reduce DR to keep audit risk at low level, by increasing area of checking, testing larger samples & including competent persons in ET.
- **Examples of DR:**
 - (a) Auditor does not attend inventory count inspite of Considerable Size of inventory.
 - (b) Samples selected is not representative of population.

3.1 – Audit Risk (SA 315)

Assessment of Risks

- Assessment of risks is matter of professional judgment, rather than a matter capable of precise measurement.
- Audit risk is a function of ROMM & detection risk.
- SAs do not ordinarily refer to IR & CR separately, but rather to combined assessment of “ROMM”.
- Assessment of RoMM may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms.
- Audit risk = RoMM × DR
- Audit risk = IR × CR × DR

Identifying & Assessing RoMM

Objective of auditor as stated in SA 315 is to identify & assess RoMM. Auditor shall identify & assess RoMM at:

- (a) F.S. level; and
 - (b) Assertion level for classes of transactions, account balances & disclosures
- to provide a basis for designing and performing FAPs.

Risk Assessment Process

For the purpose of Identifying & assessing ROMM, auditor shall:

- (a) Identify risks throughout the process of obtaining understanding of entity and its environment, including relevant controls;
- (b) Assess identified risks & evaluate whether they relate more pervasively to F.S. as a whole & potentially affect many assertions;
- (c) Relate identified risks to what can go wrong at assertion level, taking account of relevant controls; &
- (d) Consider likelihood of misstatement & whether potential misstatement is of a magnitude that could result in a MM.

Misstatement – Meaning and Examples

Difference between amount, classification, presentation or disclosure of a reported F.S. item & amount, classification, presentation or disclosure that is required for the item to be in accordance with the applicable FRF.

Examples:

- (a) Charging of an item of capital expenditure to revenue or vice-versa.
- (b) Difference in disclosure of a F.S. item vis-à-vis its requirement in applicable FRF.
- (c) Selection or application of inappropriate accounting policies.
- (d) Difference in accounting estimate vis-à-vis its appropriateness in applicable FRF.
- (e) Intentional booking of fake expenses in statement of profit and loss.
- (f) Overstating of receivables by not writing off irrecoverable debts.
- (g) Overstating or understating inventories

Risk Assessment Procedure (RAP)

- Audit procedures performed to obtain understanding of entity & its environment, including IC, to identify & assess RoMM, whether due to fraud or error, at F.S. & assertion levels.
- RAPs by themselves, however, do not provide SAAE on which to base the audit opinion.

Components of RAP

- (a) Inquiries of mngt. & of others within the entity.
- (b) Analytical procedures.
- (c) Observation and inspection.

1 Inquiries of management and of others within the entity

- (1) **Inquiries directed toward internal audit personnel:** provide information about internal audit procedures relating to design & effectiveness of IC.
- (2) **Inquiries of employees involved in initiating, processing or recording unusual transactions:** may help auditor to evaluate appropriateness of selection & application of accounting policies.
- (3) **Inquiries directed toward in-house legal counsel:** provide information as to litigation, compliance with laws & regulations, knowledge of fraud etc.
- (4) **Inquiries directed towards marketing or sales personnel:** provide information about changes in marketing strategies, sales trends etc.
- (5) **Inquiries directed to risk management function:** provide information about operational and regulatory risks that may affect financial reporting.
- (6) **Inquiries directed to IS personnel:** may provide information about system changes, system or control failures, or other information system-related risks.

2 Analytical procedures (AP)

- AP may identify aspects of entity of which auditor was unaware & may assist in assessing RoMM in order to provide a basis for designing & implementing responses to the assessed risks.
- AP may include both financial & non-financial info.
- AP may help identify existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications.
- Unusual or unexpected relationships that are identified may assist auditor in identifying ROMM, especially ROMM due to fraud.

3 Observation and inspection

Observation & inspection may support inquiries of management and others, and may also provide information about the entity and its environment.

Examples: Observation or inspection of the following:

- Entity's operations.
- Documents (business plans & strategies), records and IC manuals.
- Reports prepared by mngt. (Quarterly Management Reports & Interim F.S.) & TCWG (Minutes of Meetings).
- Entity's premises and plant facilities.

3.2 - SA 320 "Materiality in Planning and Performing an Audit"

Concept of Materiality

- Misstatements, including omissions are considered to be material if they individually or in aggregate, could reasonably be expected to influence economic decisions of users taken on the basis of the F.S.
- Materiality is not always a matter of relative size; a small amount lost by fraudulent practices of certain employees indicate serious flaw in IC requiring immediate attention to avoid greater losses in future.

Materiality in Planning and performing an audit

- (a) Concept of materiality is applied by auditor both in planning & performing audit, & in evaluating effect of identified misstatements on audit & of uncorrected misstatements, if any, on F. S. and in forming the opinion in AR.
- (b) Discussion present in FRF provides a reference to auditor in determining materiality for audit. Though FRF may discuss materiality in different terms, they generally explain that:
 - Misstatements, including omissions, are considered to be material if they, individually or in aggregate, could reasonably be expected to influence economic decisions of users of F.S.;
 - Judgments about materiality are made in light of surrounding circumstances & are affected by size or nature of misstatement; and
 - Judgments about matters that are material to users of F.S. are based on a consideration of common financial information needs of users as a group.
- (c) In planning audit, auditor makes judgments about size of misstatements that will be considered material. These judgments provide a basis for:
 - Determining NTE of RAP;
 - Identifying & assessing RoMM; and
 - Determining NTE of FAPs.
- (d) If there is any statutory requirement of disclosure, it is to be considered material irrespective of value of amount. For example, as per Division I of Schedule III of Companies Act, 2013:
 - any item of income or expenditure which exceeds 1% of revenue from operations or ₹ 1,00,000, whichever is higher, need separate disclosure.
 - Separate disclosure in notes to accounts of shares held by each shareholder holding > 5% shares specifying number of shares held.

Performance Materiality

- Amount or amounts set by auditor at,
- less than materiality for F.S. as a whole,
- to reduce to an appropriately low level,
- probability that aggregate of uncorrected & undetected misstatements,
- exceeds materiality for the F.S. as a whole.

Determination of materiality - Matter of Professional Judgment

Determination of materiality is a matter of professional judgment & is affected by auditor's perception of financial info. needs of users of F.S. In this context, it is reasonable for auditor to assume that users:

- (i) Have reasonable knowledge of business & economic activities & accounting & a willingness to study information in F.S. with reasonable diligence;
- (ii) Understand that F.S. are prepared, presented & audited to levels of materiality;
- (iii) Recognize uncertainties inherent in measurement of amounts based on use of estimates, judgment & consideration of future events; and
- (iv) Make reasonable economic decisions on basis of info. in F.S.

Determining Materiality & Performance Materiality

- When establishing overall audit strategy, auditor shall determine materiality for the F.S. as a whole.
- In specific circumstances, also determine materiality levels to be applied to particular classes of transactions, account balances or disclosures, for which misstatements of lesser amounts, than materiality for F.S. a whole could reasonably be expected to influence economic decisions of users.

Use of Benchmark in determining Materiality

A percentage is often applied to a chosen benchmark as a starting point in determining materiality for F.S. as a whole. Factors that may affect identification of appropriate benchmark include the following:

- (1) Elements of F.S. (E.g.: Assets, liabilities, equity, revenue, expenses);
- (2) Whether there are items on which attention of users of particular entity's F.S. tends to be focused (E.g.: For purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- (3) Nature of entity, where entity is at in its life cycle & industry & economic environment in which entity operates;
- (4) Entity's ownership structure & way it is financed (For example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets & claims on them, than on the entity's earnings); and
- (5) Relative volatility of the benchmark.

Examples of benchmarks	Use of Professional Judgment
• Profit before tax (PBT), • Total revenue, • GP and total expenses, • Total equity or net asset value. PBT from continuing operations is often used for profit-oriented entities. When PBT from continuing operations is volatile, other benchmarks may be more appropriate, such as GP or total revenues.	• Determining %age to be applied to a chosen benchmark involves exercise of professional judgment. • There is a relationship between %age & chosen benchmark, such that a %age applied to PBT from continuing operations will normally be higher than a %age applied to total revenue. • E.g. Auditor may consider 5% of PBT from continuing operations to be appropriate for profit-oriented entity, while 1% of total revenue or total expenses to be appropriate for a not-for-profit entity.

3.2 - SA 320 “Materiality in Planning and Performing an Audit”

Misc. Topics

1	Factors that may indicate existence of particular classes of transactions, a/c balances or disclosures for which misstatements of lesser amounts than materiality for F.S. as a whole could reasonably be expected to influence economic decisions of users - Whether law, regulations or applicable FRF affect users expectations regarding measurement or disclosure of certain items like in case of RP transactions and remuneration of management and TCWG. - Key disclosures in relation to industry in which entity operates. For example, research & development costs for a pharmaceutical company. - Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in F.S. like in case of newly acquired business.	3	Documentation (a) Materiality for F.S. as a whole; (b) Materiality level or levels for particular classes of transactions, a/c balances or disclosures; (c) Performance materiality; & (d) Any revision of (a) to (c) as audit progressed.
2	Revision as the Audit Progresses - Materiality may need to be revised as a result of: (a) change in circumstances that occurred during audit (e.g., decision to dispose of major part of business), (b) new information, or (c) change in auditor's understanding of entity & its operations. - If auditor concludes that lower materiality than that initially determined is appropriate, he shall determine whether it is necessary to revise performance materiality & whether NTE of FAPs remain appropriate.	4	Materiality and Audit Risk Audit risk is a function of RoMM & DR. Materiality and audit risk are considered throughout the audit, in particular, when: (a) Identifying & assessing RoMM; (b) Determining NTE of FAPs; & (c) Evaluating effect of uncorrected misstatements, if any, on F.S. and in forming opinion in auditor's report.

3.3 - Understanding the Entity and its Environment

Matters of which Understanding is required

As per SA 315, auditor should an understanding of the following:

- (a) Relevant industry, regulatory & other external factors including applicable FRF.
- (b) Nature of the entity, including:
 - its operations;
 - its ownership and governance structures;
 - types of investments that the entity is making and plan to make; &
 - way that the entity is structured and how it is financed;
- (c) Selection & application of accounting policies with reasons for changes.
- (d) Entity's Objectives & Strategies, & business risks that may result in RoMM.
- (e) Measurement & review of entity's financial performance.

Relevant industry, regulatory & other external factors

- Relevant industry factors:** include industry conditions such as competitive environment, supplier & customer relationships & technological developments. Examples of matters auditor may consider include market & competition, whether entity is engaged in seasonal activities, product technology relating to entity's products.
- Relevant regulatory factors:** include regulatory environment, applicable FRF and legal and political environment. Examples of matters auditor may consider include accounting principles, industry specific practices, regulatory framework for regulated industry, legislation & regulation that significantly affect entity's operations, taxation, govt. policies, environment requirements affecting industry & entity's business.
- Other external factors:** include general economic conditions, interest rates and availability of financing, inflation etc.

Understanding of the Entity - a continuous process

Obtaining understanding is a continuous, dynamic process of gathering, updating & analysing information throughout audit.

It establishes frame of reference within which auditor plans audit & exercises professional judgment throughout audit, for example, when:

- Assessing ROMM of F.S.;
- Determining materiality as per SA 320;
- Considering appropriateness of selection & application of accounting policies;
- Identifying areas where special audit consideration may be necessary, e.g.: RP transactions, appropriateness of management's use of G.C. assumption, or considering business purpose of transactions;
- Developing expectations for use when performing APs;
- Evaluating sufficiency & appropriateness of audit evidence obtained.

3.4 – Internal Control

Meaning, Objectives, Limitations of I.C.

Meaning and Purpose of Internal Control

SA 315 defines IC as “process designed, implemented & maintained by TCWG, mngt. & other personnel to provide reasonable assurance about achievement of entity’s objectives with regard to:

- (a) reliability of financial reporting,
- (b) effectiveness and efficiency of operations,
- (c) safeguarding of assets, and
- (d) compliance with applicable laws & regulations.

Objectives of Internal Control

- (i) Transactions are executed in accordance with mngt. authorization;
- (ii) All transactions are promptly recorded in correct amount in appropriate accounts & in accounting period in which executed;
- (iii) Assets are safeguarded from unauthorised access, use or disposition; and
- (iv) Recorded assets are compared with existing assets at reasonable intervals & appropriate action is taken with regard to any differences.

Benefits of Understanding of Internal Control

Understanding of IC assists auditor in:

- (i) Identifying types of potential misstatements;
- (ii) Identifying factors that affect the ROMM; and
- (iii) Designing NTE of further audit procedures.

Limitations of Internal Control

- (a) **IC can provide only reasonable assurance:** IC, no matter how effective, can provide an entity with only reasonable assurance about achieving entity’s FR objectives.
- (b) **Human judgment in decision-making:** Realities that human judgment in decision-making can be faulty & that breakdowns in IC can occur because of human error.
- (c) **Lack of understanding the purpose:** Operation of a control may not be effective, if info. produced for purposes of IC is not effectively used.
- (d) **Collusion among People:** Controls can be circumvented by collusion of two or more people or inappropriate mngt. override of IC.
- (e) **Judgments by Management:** In designing & implementing controls, mngt. may make judgments on nature & extent of controls it chooses to implement, and nature and extent of the risks it chooses to assume.
- (f) **Limitations in case of Small Entities:** Smaller entities often have fewer employees due to which segregation of duties is not practicable. However, in a small owner-managed entity, owner-manager may be more able to override controls because system of IC is less structured.

Misc. Controls

Controls Relevant to Audit

There is a direct relationship between entity’s objectives and controls it implements to provide reasonable assurance about their achievement. Entity’s objectives & controls relate to FR, operations & compliance; however, not all of these objectives & controls are relevant to auditor’s risk assessment.

Factors relevant to auditor’s judgment about whether a control is relevant to audit may include following matters:

- (a) Materiality.
- (b) Significance of the related risk.
- (c) Size of the entity.
- (d) Nature of entity’s business, including its organisation & ownership.
- (e) Diversity & complexity of entity’s operations.
- (f) Applicable legal and regulatory requirements.
- (g) Circumstances and applicable component of IC.
- (h) Nature and complexity of systems that are part of entity’s IC, including the use of service organisations.
- (i) Whether & how, a specific control, prevents or detects and corrects, material misstatement.

Control over safeguarding of assets

- IC over safeguarding of assets against unauthorised acquisition, use or disposition may include controls relating to both FR & operations objectives.
- Auditor’s consideration of such controls is generally limited to those relevant to reliability of FR e.g., use of access controls, such as passwords, that limit access to data & programs that process cash disbursements may be relevant to F.S. audit.
- Safeguarding controls relating to operations objectives, such as controls to prevent excessive use of materials in production, generally are not relevant to F.S. audit.

Controls relating to objectives that are not relevant to an audit

An entity generally has controls relating to objectives that are not relevant to an audit & therefore need not be considered.

For Ex.: An entity may rely on sophisticated system of automated controls to provide efficient & effective operations, but these controls ordinarily would not be relevant to the audit.

Nature and Extent of the Understanding of Relevant Controls

- Evaluating design of a control involves considering whether control, is capable of effectively preventing, or detecting & correcting, MM.
- Implementation of a control means that control exists & that the entity is using it. There is little point in assessing implementation of a control that is not effective, and so design of a control is considered first. An improperly designed control may represent a material weakness in the entity’s IC.
- RAP to obtain audit evidence about the design and implementation of relevant controls may include:
 - (a) Inquiring of entity personnel.
 - (b) Observing the application of specific controls.
 - (c) Inspecting documents and reports.
 - (d) Tracing transactions through the info. system relevant FR.

3.4 - Internal Control

5 Components of I.C.

1 Control Environment - Obtain understanding of control environment & evaluate whether: (i) Mngt. has created & maintained a culture of honesty & ethical behaviour; and (ii) Strengths in control environment elements collectively provide appropriate foundation for other components of I.C. - Control environment includes: (a) governance & management functions; and (b) attitudes, awareness & actions of TCWG & Mngt. Control environment sets the tone of an organization, influencing control consciousness of its people. - Control environment includes following elements: Communication & enforcement of integrity & ethical values. Commitment to competence. Participation by TCWG. Management's philosophy and operating style. Organisational structure. Assignment of authority and responsibility. HR policies and practices. Impact of satisfactory control environment - Existence of a satisfactory control environment work as positive factor when auditor assesses ROMM. - But at the same time, it is to be kept in mind that a satisfactory control environment is not an absolute deterrent to fraud. Deficiencies in control environment may undermine effectiveness of controls, in particular in relation to fraud. - Control environment in itself does not prevent, or detect and correct, a MM. It may, however, influence auditor's evaluation of effectiveness of other controls (for example, monitoring of controls and operation of specific control activities) & thereby, auditor's assessment of ROMM. 2 Entity Risk Assessment Process (RAP) - Obtain an understanding of whether the entity has a process for: - Identifying business risks relevant to FR objectives; - Estimating significance of the risks; - Assessing likelihood of their occurrence; & - Deciding about actions to address those risks. - Entity's RAP forms the basis for how mngt. determines risks to be managed. If that process is appropriate, it assists auditor in identifying RoMM. - Risks can arise or change due to factor such as new technology, new business models, products or activities, changes in operating environment etc.	3 Information System (IS) including related business processes, relevant to FR and communication Obtain an understanding of IS, including related business processes, relevant to FR, including: - Classes of transactions in entity's operations that are significant to F.S.; - Procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to GL & reported in F.S.; - Related accounting records, supporting info. and specific accounts in F.S. that are used to initiate, record, process and report transactions; - How IS captures Significant events & conditions; - FR process used to prepare the entity's F.S.; and - Controls surrounding journal entries. 4 Control Activities relevant to Audit - Obtain understanding of control activities relevant to audit, which are necessary to assess ROMM. - Control activities are policies and procedures that help ensure that mngt. directives are carried out. - Control activities, whether within IT or manual systems, have various objectives & are applied at various organisational and functional levels. - Examples of specific control activities include: - Authorisation - Segregation of Duties - Physical Controls - Performance Review - Information processing 5 Monitoring of Controls Obtain an understanding of major activities that the entity uses to monitor ICoFR. - Monitoring of controls is process to assess effectiveness of IC control performance. - It involves assessing effectiveness of controls on timely basis & taking corrective actions. - Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of two. - Management's monitoring activities may also include using information from communications from external parties such as customer complaints and regulator comments.
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3.5 - Risks that Require Special Audit Consideration

Risks that Require Special Audit Consideration	Identifying Significant Risks	RoMM - Greater for Significant Non-Routine Transactions	RoMM - Greater for Significant Judgmental Matters
In exercising judgment as to which risks are significant, consider the following: (a) Whether risk is a risk of fraud; (b) Whether risk is related to recent significant economic, accounting, or other developments; (c) Complexity of transactions; (d) Whether risk involves significant transactions with RPs; (e) Degree of subjectivity in measurement of financial info.; and (f) Whether risk involves significant unusual transactions.	- 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 development of accounting estimates for which there is significant measurement uncertainty. Examples of significant risks: RoMM due to fraud, Significant transactions with RPs that are outside normal course of business for entity.	RoMM may be greater for significant non-routine transactions arising from matters such as: (a) Greater mngt. intervention to specify accounting treatment. (b) Greater manual intervention for data collection & processing. (c) Complex calculations or accounting principles. (d) Nature of non-routine transactions, which may make it difficult for entity to implement effective controls over the risks.	RoMM may be greater for significant judgmental matters that require development of a/cing estimates, arising from matters such as: (a) A/cing principles for accounting estimates or revenue recognition may be subject to differing interpretation. (b) Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

3.6 - Evaluation and Testing of Internal Control System

Benefits of Evaluation of IC to Auditor	Formulating Audit Programme	Testing of IC System					
Review of IC will enable auditor to know: (1) whether errors & frauds are likely to be located in ordinary course of operations of business; (2) whether adequate IC system is in use & operating as planned by mnegt.; (3) whether an effective internal auditing department is operating; (4) whether any administrative control has a bearing on his work; (5) whether controls adequately safeguard the assets; (6) extent & depth of examination that he needs to carry out in the *different areas of accounting; (7) what would be appropriate audit technique & audit procedure in given circumstances; and (8) what are the areas where control is weak and where it is excessive.	• Auditor can formulate audit programme only after satisfactory understanding of IC systems & their actual operation, otherwise, it is likely that programme may become unnecessarily heavy & object of audit may be altogether lost. • Extent & nature of audit programme is influenced by IC system in operation. Proper understanding of IC enables auditor to decide upon audit procedure to be applied in different areas to be covered in the audit programme. • In a situation where IC are considered weak in some areas, auditor might choose procedure that otherwise might not be required; he might extend certain tests to cover a large number of transactions than he otherwise would examine & at times he may perform additional tests to bring him necessary satisfaction.	Testing of IC is done on a selective basis: testing can be planned in such a manner that all important areas are covered in a period of, say, 3 years. <table><tr><th>Elements of ToCs</th></tr><tr><td>(a) Inspection of documents supporting transactions to gain audit evidence that ICs have operated properly, e.g., verifying that a transaction has been authorised.</td></tr><tr><td>(b) Inquiries & observation of ICs which leave no audit trail, e.g., determining who actually performs each function and not merely who is supposed to perform it.</td></tr><tr><td>(c) Re-performance of procedures or controls that were originally performed as part of entity's IC, e.g., reconciliation of bank accounts, to ensure they were correctly performed by the entity.</td></tr><tr><td>(d) Testing of IC operating on specific computerised applications or over the overall IT function, for example, access or program change controls.</td></tr></table>	Elements of ToCs	(a) Inspection of documents supporting transactions to gain audit evidence that ICs have operated properly, e.g., verifying that a transaction has been authorised.	(b) Inquiries & observation of ICs which leave no audit trail, e.g., determining who actually performs each function and not merely who is supposed to perform it.	(c) Re-performance of procedures or controls that were originally performed as part of entity's IC, e.g., reconciliation of bank accounts, to ensure they were correctly performed by the entity.	(d) Testing of IC operating on specific computerised applications or over the overall IT function, for example, access or program change controls.
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(d) Testing of IC operating on specific computerised applications or over the overall IT function, for example, access or program change controls.							

3.6 - Evaluation and Testing of Internal Control System

Methods of Evaluation of Internal Control

Narrative record

A complete & exhaustive description of system as found in operation by auditor. Actual testing & observation are necessary before developing such record.

It is recommended where no formal control system in operation and more suited to small business. Disadvantages of narrative records are:

- (i) To comprehend 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

Series of instructions and/or questions which a member of auditing staff must follow and/or answer. This is an on job requirement & instructions are framed considering desirable elements of control.

A few examples of check list instructions are:

- Are tenders invited before placing orders?
- Is the purchase order from standardized?
- Are purchase orders forms pre-numbered?
- Are inventory control accounts maintained by appropriate persons?

Internal Control Questionnaire (ICQ)

- It comprises of comprehensive series of questions concerning IC. Most widely used form for collecting information about existence, operation and efficiency of IC.
- With a proper ICQ, all IC evaluation can be completed at one time or in sections.
- Questions are so framed that 'Yes' answer denotes satisfactory position & 'No' answer suggests weakness. Provision is made for an explanation of 'No' answers. In respect of questions not relevant to business, 'Not Applicable' reply is given.
- ICQ is usually issued to client with a request to get it filled by concerned executives & employees. If on perusal of answers, inconsistencies noticed, matter is further discussed with client.

Flow-chart

- Graphic presentation of each part of IC and is considered to be most concise way of recording of review of system.
- It minimises narrative explanations & thereby achieves a presentation not possible in any other form.
- Gives bird's eye view of system & flow of transactions and integration.
- *It is necessary for auditor to study significant features of business carried on by the concern, nature of its activities & various channels of goods and materials as well as cash, both inward and outward and also a comprehensive study of entire process of manufacturing, trading & administration. This will help him to understand & evaluate ICs in correct perspective.

Sample ICQ for F.S. Items

Purchases

- (1) Are purchases centralised in Purchase Department?
- (2) Are purchases made only from approved suppliers?
- (3) Are purchase orders based on valid purchase requisitions?
- (4) Are purchases based on competitive quotations from ≥ 2 suppliers?
- (5) Are purchase orders pre-numbered?
- (6) Are purchase orders signed only by employees authorized in this behalf?

Creditors

- (1) Are suppliers' invoices routed direct to Accounts Department?
- (2) Does system ensure that all invoices are duly processed?
- (3) Does Accounts Department match invoices of supplies with GRN and purchase orders?
- (4) Are all advance payments duly authorized by competent persons?
- (5) Are all supplier's statements compared with ledger accounts?
- (6) Is list of unpaid creditors prepared and reconciled periodically

Inventories

- (1) Are stocks stored in assigned areas?
- (2) Are stocks insured comprehensively against different risks?
- (3) Is a record maintained for the insurance policies?
- (4) Is there an official who decides on value for which stocks are to be insured?
- (5) Are perpetual stock records kept for raw materials, WIP, finished goods and stores?
- (6) Are stock records periodically reconciled with accounting records?

Fixed Assets

- (1) Are budgets for capital expenditure approved?
- (2) Is the authority to incur capital expenditure restricted to specified officials?
- (3) Is there proper check to see that amounts expended do not exceed the amount authorized?
- (4) Are fixed assets verified periodically?
- (5) Is there a written procedure for such verification?
- (6) Are discrepancies disclosed by verification reports investigated?

3.7 - Automated Environment

Meaning	Key Features	Understanding & Documenting	Risk arising from use of IT System
- Business environment where processes, operations, accounting & decisions are being carried out by using computer systems – also known as IS or IT systems. - Fundamental principle - to carry out business with less manual intervention & more system driven. - Complexity depends on level of automation i.e., if business environment is more automated, it is likely to be more complex. If a company uses integrated ERP viz., SAP, Oracle etc., then it is considered more complex to audit. If company is using off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.	- Faster Business Operations. - Accuracy in data processing & computation. - Ability to process large volume of data. - Integration between business operations. - Better security & controls. - Less prone to human errors. - Provides latest information. - Connectivity & networking capability.	Obtaining understanding of: - ISs being used (one or more application systems & what they are). - Purpose (financial and non-financial). - Location of IT systems - local vs global. - Architecture (desktop based, client-server, web application, cloud based). - Version (functions & risks could vary in different versions of same application). - Interfaces within systems (in case multiple systems exist). - In-house vs Packaged. - Outsourced activities (IT maintenance & support). - Key persons (CIO, CISO, Administrators). Auditor is required to document understanding of automated environment.	- Inaccurate processing of data, processing inaccurate data, or both. - Unauthorized access to data. - Direct data changes (backend changes). - Excessive access/Privileged access (super users). - Lack of adequate segregation of duties. - Unauthorized changes to systems or programs. - Failure to make necessary changes to systems or programs. - Loss of data

Impact of IT Related Risks

1	On Substantive Audit - Inability to address IT related risks may lead to non-reliance of data obtained from systems. - All information, data, and reports would have to be tested thoroughly for their completeness and accuracy. - Could lead to increased substantive checking i.e., detailed checking.
2	On Controls - It can lead to non-reliance on automated controls, system calculations & accounting procedures built into applications. - May result in additional audit work.
3	On Reporting Due to regulatory requirements in respect of IFC in case of companies, it may lead to modification of auditor's report in some instances.

Types of Controls in an Automated Environment

General IT Controls	Application Controls	IT Dependent Controls
Policies & procedures that relate to many applications & support effective functioning of application controls. General IT Controls that maintain integrity of information & security of data commonly include controls over: - Data center & network operations. - Program change. - Access security. - Application system acquisition, development, and maintenance.	- Manual or automated procedures that typically operate at business process level. - Such controls are embedded into IT applications viz., ERPs & help in ensuring completeness, accuracy and integrity of data. - Examples: (1) Edit checks & Validation of input data. (2) Sequence Number checks. (3) User Limit Checks. (4) Reasonable Checks. (5) Mandatory Data Fields.	- Manual controls that make use of some form of data or information or report produced from IT systems & applications. - Though control is performed manually, design and effectiveness of such controls depend on reliability of source data. - Due to inherent dependency on IT, effectiveness and reliability of application & IT dependent controls require General IT controls to be effective.
General IT Controls vs. Application Controls - These two categories of control over IT systems are interrelated. - Relationship between application controls and General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems.		

3.7 - Automated Environment

Objectives and Activities of Various General IT Controls

Data Center & Network operations	Program Change	Access Security	App. System acquisition, dev. & maintenance
Objective: To ensure that production systems are processed to meet FR objectives. Activities: (1) Overall Management of Computer Operations Activities; (2) Batch jobs – preparing, scheduling and executing; (3) Backups – monitoring, storage & retention; (4) Performance Monitoring – operating system, database and networks; and (5) Recovery from Failures – BCP, DRP.	Objective: To ensure that modified systems continue to meet FR objectives. Activities: (1) Change Management Process; (2) Change Requests – record, manage, track; and (3) Making and testing changes.	Objective: To ensure that access to programs and data is authenticated and authorized to meet FR objectives. Activities: (1) Security Organization & Management; (2) Security Policies & Procedures; (3) Application Security; (4) Data Security; (5) OS Security; (6) Network Security; and (7) Physical Security.	Objective: To ensure that systems are developed, configured & implemented to meet FR objectives. Activities: (1) Overall Management of Development Activities; (2) Project Initiation; (3) Analysis & Design; (4) Construction; and (5) Testing & Quality Assurance.

Testing Methods

Four types of audit tests:

- Inquiry
- Inspection
- Observation
- Reperformance

Consideration while selecting testing method

- Inquiry is most efficient audit test but gives least audit evidence; should be used in combination with other audit testing methods.
- Reperformance is most effective audit test & gives best audit evidence; but time consuming & least efficient.
- Applying inquiry in combination with inspection gives most effective & efficient audit evidence.
- Document nature of test (or combination of tests) applied along with judgments in audit file.

Commonly used methods

- Obtain understanding of how an automated transaction is processed by doing a walkthrough of one end-to-end transaction using a combination of inquiry, observation & inspection.
- Observe how a user processes transaction under different scenarios.
- Inspect configuration defined in an application.

Manual and Automated Elements in Internal Control

Manual and IT Elements	Circumstances in which Manual Elements are suitable	Circumstances in which Manual Elements are less suitable
Entity's system of IC contains manual & automated elements. Their Characteristics are relevant to risk assessment & FAPs based thereon. Use of manual or automated elements in IC also affects manner in which transactions are initiated, recorded, processed and reported: • Controls in manual system may include procedures like approvals of transactions, reconciliations & follow-up of reconciling items. • Controls in IT systems consist of a combination of automated controls (for example, controls embedded in computer programs) & manual controls. • Entity's mix of manual & automated elements in IC varies with nature & complexity of entity's use of IT.	Manual elements are more suitable where judgment & discretion are required such as for: • Large, unusual or non-recurring transactions. • Circumstances where errors are difficult to define or predict. • In circumstances that require control response outside scope of existing automated control. • In monitoring effectiveness of automated controls.	• High volume or recurring transactions • Situations where errors that can be anticipated or predicted can be prevented, or detected and corrected, by control parameters that are automated. • Control activities where specific ways to perform control can be adequately designed & automated.

Audit Approach in an Automated Environment

Risk Assessment	Understand and evaluate	Test for Operating Effectiveness	Reporting
• Identify Significant A/c & Disclosures; • Relevant F.S. Assertions • Identify Likely sources of Misstatements; and • Consider Risk arising from use of IT Systems.	• Understand design of controls by performing walkthroughs of end-to-end process. • Prepare Risk and Control Matrices (RCM).	• Assess NTE of controls testing; • Assess reliability of source data and completeness of population; • Testing of Key reports; & • Sample testing.	• Evaluate Control Deficiencies; • Significant deficiencies; • ICs Memo of Management letter; and • Auditor's Report

3.8 – Misc. Topics

Data Analytics

- Data analytics is combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information.
- Auditors can make use of data analytical tools in audit process and obtain good results. Data analytics methods used in audit are known as CAATs.
- Data analytics can be used in testing of electronic records & data residing in IT systems using spreadsheets & specialised audit tools viz., IDEA and ACL.

Application of Data Analytics

- Check completeness of data & population that is used in either TOCs or substantive audit tests.
- Selection of audit samples – random sampling, systematic sampling.
- Re-computation of balances – reconstruction of trial balance from transaction data.
- Reperformance of mathematical calculations – depreciation, bank interest calculation.
- Analysis of journal entries.
- Fraud investigation.
- Evaluating impact of control deficiencies.

Digital Audit

Placing assurance on effectiveness of IT systems implemented in an organization.

Use of Digital Technology

- Entities are embracing digitization as part of their operations to keep pace with changing times. New technologies are helping companies revamp their operations and rethink the way business is conducted. Companies are restructuring their business models driven by technology. Automation is key to digitization.
- In such a business environment, use of digital technology is being made by auditors right from planning to expression of final opinion.
- Auditors are making use of AI, data analytics & other latest technologies to help understand business processes in a better way. By using such tools, auditors can conduct audit in a better way and devote more attention to areas requiring greater focus.
- Digital audit is helping auditors to better identify risks making use of technology.

Internal Financial Controls (IFC)

Meaning of IFC

Policies and procedures adopted by the company for ensuring:

- Reliability of financial reporting;
- Effectiveness and efficiency of operations;
- Compliance with applicable laws and regulations;
- Safeguarding of assets; and
- Prevention and detection of frauds

Reporting Requirements

Sec. 134(5)(e)	In case of listed companies, DRS. shall state that directors have laid down IFC to be followed by Co. & such controls are adequate & operating effectively.
Sec. 143(3)(i)	Auditor is required to report whether Co. has adequate IFC w.r.t. F.S. in place & operating effectiveness of such controls. Reporting not be applicable to a private company which: (i) is a OPC; or Small company; or (ii) has turnover < ₹ 50 crore as per latest audited F.S. & having agg. borrowings from banks or F.I. or any body corporate at any point of time during FY < ₹ 25 crore.
Sec. 177(4)(vii)	Audit Committee shall act in accordance with terms of reference specified in writing by Board which shall, inter alia, include - evaluation of IFC and risk management systems.
Sec. 149(8)	• Company & IDs shall abide by provisions specified in Sch. IV which lays down the Code for IDs. • As per this code, role & functions of IDs include that they shall satisfy themselves on integrity of financial information & that financial controls and systems of risk management are robust and defensible.

Directors & mngt. have primary responsibility of implementing and maintaining an effective IC framework & auditors are expected to evaluate, validate & report on design & operating effectiveness of IFCs.

Documenting Risks (Matters to be documented)

- Discussion among ET & significant decisions reached;
- Key elements of understanding obtained regarding entity & its environment and of each of IC components, sources of information from which understanding was obtained and the RAP performed;
- Identified and assessed RoMM at F.S. level & at assertion level; and
- Risks identified & related controls about which auditor has obtained an understanding.

Assess and Report Audit Findings

Consideration while assessing findings	Assessment of findings
• Weaknesses identified in IT controls. • Impact of weaknesses on overall audit. • Reporting of deficiencies to mngt. through Management Letter. • Communicate in writing significant deficiencies to TCWG as per requirement of SA 260.	• Auditor needs to assess each finding or exception to determine impact on audit and evaluate if the exception results in a deficiency in IC. • As per SA 265, deficiency in IC exist if control is designed, implemented or operated in a way that it is unable to prevent, or detect & correct, misstatements in F.S. on timely basis; or control is missing. • Evaluation & assessment of audit findings & control deficiencies involves applying professional judgment that include considerations for quantitative and qualitative measures.

3.9 - The Auditor's Responses to Assessed Risks (SA 330)

- Auditor shall design & implement overall responses to address assessed RoMM at F.S. level.
- Auditor shall design and perform FAPs whose NTE are based on and are responsive to assessed RoMM at assertion level.

Tests of Controls

- Procedure designed to evaluate operating effectiveness of controls in preventing, or detecting & correcting, MM at assertion level.
- Auditor shall design & perform ToC to obtain SAAE as to operating effectiveness of relevant controls when:
 - (a) he expects that ICs are operating effectively; or
 - (b) substantive procedures alone cannot provide SAAE at the assertion level.
- In designing & performing ToC, auditor shall:
 - (a) Perform other audit procedures in combination with inquiry to obtain audit evidence about operating effectiveness of controls, including:
 - How controls were applied at relevant times during the audit.
 - Consistency with which they are applied.
 - By whom or by what means they were applied.
 - (b) Determine whether controls to be tested depend upon other controls (indirect controls).
 - (c) Inquiry alone is not sufficient to test operating effectiveness of controls; 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.

Substantive Procedures

- Substantive procedures comprise: (a) Tests of details (TODs), and (b) Substantive Analytical Procedures. (SAP)
- Irrespective of assessed RoMM, auditor shall design & perform Sub. procedures for each material class of transactions, account balance, and disclosure.
- Depending on circumstances, auditor may determine that:
 - (a) Performing only SAPs will be sufficient to reduce audit risk to acceptably low level.
 - (b) Only TODs are appropriate.
 - (c) Combination of SAPs & TODs are most responsive to assessed risks.
- Extent of substantive procedures may need to be increased when results from TOCs are unsatisfactory.
- In designing TODs, extent of testing is ordinarily thought of in terms of the sample size.

Substantive Analytical Procedures (SAPs)

- APs used as substantive procedures by auditor.
- AP means evaluations of financial info. through analysis of plausible relationships among financial & non-financial data.
- It also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant info. or that differ from expected values by a significant amount.
- SAPs are generally more applicable to large volumes of transactions that tend to be predictable over time.



Matters to be considered in determining extent of TOCs	Using audit evidence obtained in previous audits	Specific inquiries by auditor when deviations from controls are detected
(1) Frequency of performance of control by entity during the period. (2) Length of time during audit period that auditor is relying on operating effectiveness of control. (3) Expected rate of deviation from a control. (4) Relevance & reliability of audit evidence to be obtained regarding operating effectiveness of control at assertion level. (5) Extent to which audit evidence is obtained from tests of other controls related to assertion.	Consider the following: (a) Effectiveness of other elements of IC, including control environment, entity's monitoring of controls, and entity's RAP; (b) Risks arising from characteristics of the control, including whether it is manual or automated; (c) Effectiveness of general IT-controls; (d) Effectiveness of control, including nature & extent of deviations in application of control noted in previous audits; (e) Whether lack of a change in a particular control poses a risk due to changing circumstances; and (f) RoMM & extent of reliance on control. If auditor plans to use audit evidence from a previous audit about operating effectiveness of specific controls, he shall establish continuing relevance of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to previous audit.	When deviations from controls upon which auditor intends to rely are detected, auditor shall make specific inquiries to understand these matters & their potential consequences, and shall determine whether: (a) TOCs that have been performed provide an appropriate basis for reliance on controls; (b) Additional TOCs is necessary; or (c) Potential risks of misstatement need to be addressed using substantive procedures.

6

Audit Documentation

Meaning, Objectives, Nature & Purposes

Meaning	SA 230 "Audit Documentation" defines term audit documentation as to record of: • audit procedures performed, • relevant audit evidence obtained, & • conclusions the auditor reached.
Objective of Auditor	Auditor is required to prepare documentation that provides: (a) sufficient & appropriate record of basis for auditor's report; & (b) evidence that audit was planned & performed in accordance with SAs & other regulatory requirements.
Nature	Audit documentation provides: • evidence of auditor's basis for a conclusion about achievement of overall objectives of auditor; & • evidence that audit was planned & performed in accordance with SAs & applicable L&R requirements.
Purposes of Audit Documentation	(1) Assisting ET to plan & perform the audit. (2) Assisting members of ET to direct & supervise audit, & to discharge review responsibilities. (3) Enabling ET to be accountable for its work. (4) Retaining a record of matters of continuing significance to future audits. (5) Enabling conduct of QC Reviews & inspections in accordance with SQC 1. (6) Enabling conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Form, Content & Extent of Audit Documentation

- Audit documentation shall be sufficient to enable experienced auditor to understand:
 - (a) NTE of audit procedures;
 - (b) Results of audit procedures performed & evidence obtained; &
 - (c) Significant matters arising during audit & conclusions reached thereon.
- In documenting NTE of audit procedures performed, record:
 - (a) Identifying characteristics of specific items or matters tested;
 - (b) Who performed audit work and date such work was completed; &
 - (c) Who reviewed audit work and date & extent of such review.
- Document discussions of significant matters with mngrt, TCWG & others, including nature of significant matters discussed & when & with whom discussions took place.
- If auditor identified info. that is inconsistent with his final conclusion regarding a significant matter, document how it is addressed.

Factors effecting Form, content & extent of audit documentation

- (1) Size & complexity of the entity.
- (2) Nature of audit procedures to be performed.
- (3) Identified RoMM.
- (4) Significance of audit evidence obtained.
- (5) Nature & extent of exceptions identified.
- (6) Need to document a conclusion or basis for a conclusion not readily determinable from documentation of work performed or audit evidence obtained.
- (7) Audit methodology & tools used.

Examples of Audit Documentation

- Audit documentation may be recorded on paper or on electronic or other media. Examples of audit documentation include:

(a) Audit programmes.	(b) Analyses.
(c) Issues memoranda.	(d) Checklists.
(e) Letters of confirmation & representation.	(f) Summaries of significant matters.
(g) Correspondence concerning significant matters.	
- Auditor may include copies of entity's records (for example, significant & specific contracts & agreements) as part of audit documentation. Audit documentation is not a substitute for entity's accounting records.
- Auditor need not include in audit documentation:
 - (a) superseded drafts of working papers and F.S.,
 - (b) notes that reflect incomplete or preliminary thinking,
 - (c) previous copies of documents corrected for typographical errors, &
 - (d) duplicates of documents.

Timely Preparation of Audit Documentation

- Prepare audit documentation on a timely basis; it helps to enhance quality of audit & facilitates effective review & evaluation of audit evidence obtained & conclusions reached before auditor's report is finalised.
- Documentation prepared after audit work has been performed is likely to be less accurate than documentation prepared at time such work is performed.

Audit File

One or more folders or other storage media, in physical or electronic form, containing records that comprise audit documentation for a specific engagement.

Assembly of Final Audit File

- Assemble audit documentation in an audit file & complete administrative process of assembling final audit file on timely basis after date of auditor's report.
- SQC 1 requires firms to establish policies & procedures for timely completion of assembly of audit files. Appropriate time limit within which to complete assembly of final audit file is not more than 60 days after date of auditor's report.
- Completion of assembly of final audit file after date of auditor's report is administrative process that does not involve performance of new audit procedures or drawing of new conclusions.
- Changes may, however, be made to audit documentation during final assembly process if they are administrative in nature. Examples of such changes include:
 - (1) Deleting or discarding superseded documentation.
 - (2) Sorting, collating & cross referencing working papers.
 - (3) Signing off on completion checklists relating to file assembly process.
 - (4) Documenting audit evidence that auditor has obtained, discussed & agreed with relevant members of ET before date of auditor's report.
- After assembly, auditor shall not delete audit documentation before end of its retention period.

Retention Period

- SQC 1 requires firms to establish policies & procedures for retention of engagement documentation.
- Retention period for audit engagements is no shorter than 7 years from date of auditor's report.

Ownership of Audit Documentation

- (a) SQC 1 provides that unless otherwise specified by law or regulation, audit documentation is property of auditor.
- (b) Auditor may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided:
- Such disclosure does not undermine validity of work performed, or
 - In case of assurance engagements, does not undermine independence of auditor or of his personnel.

Documentation of Significant Matters & Related Significant Professional Judgments

Judging significance of a matter requires objective analysis of facts & circumstances. Examples of significant matters:

- Matters that give rise to significant risks.
- Results of audit procedures indicating (a) that F.S. could be materially misstated, or (b) need to revise auditor's previous assessment of RoMM & auditor's responses.
- Circumstances that cause auditor significant difficulty in applying necessary audit procedures.
- Findings that could result in modification to audit opinion or inclusion of an EOM paragraph in auditor's report.

Examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment

- Rationale for auditor's conclusion when a requirement provides that auditor 'shall consider' certain information or factors, and that consideration is significant in context of the particular engagement.
- Basis for auditor's conclusion on reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates).
- Basis for auditor's conclusions about authenticity of a document when further investigation (such as making appropriate use of expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused auditor to believe that document may not be authentic.

Completion Memorandum (Audit Documentation Summary)

- Auditor may consider it helpful to prepare & retain as part of audit documentation a summary (known as a completion memorandum) that describes:
 - (a) significant matters identified during the audit and
 - (b) how they were addressed.
- Such summary facilitates effective & efficient reviews and inspections of audit documentation, particularly for large and complex audits.
- Preparation of such a summary assist auditor's consideration of significant matters.
- It also help auditor to consider whether, in light of audit procedures performed & conclusions reached, there is any individual relevant SA objective that auditor has not met or is unable to meet that would prevent auditor from achieving overall objective.

8.1 - SA 700 "Forming an Opinion and Reporting on F.S."

Forming an Opinion on the F.S.

Auditor shall form an opinion on whether F.S. are prepared in all material respects in accordance with applicable FRF. To form opinion, auditor needs to conclude as to whether he has obtained **reasonable assurance** that FS as a whole are free of material misstatements, whether due to fraud or error. The conclusion shall take into account:

- (a) Whether SAAE has been obtained;
- (b) Whether uncorrected misstatements are material, individually or in aggregate; and
- (c) Evaluations mentioned below:
 1. Whether F.S. are prepared, in all material respects, in accordance with requirements of applicable FRF.
Evaluation shall include consideration of Qualitative Aspects of Entity's Accounting Practices, including indicators of possible bias in management judgements.
 2. Whether, in view of requirements of applicable FRF:
 - F.S. adequately disclose significant accounting policies selected and applied;
 - Accounting policies selected & applied are consistent with applicable FRF & are appropriate;
 - Accounting estimates are reasonable;
 - Information presented in F.S. is relevant, reliable, comparable & understandable;
 - F.S. provide adequate disclosures to understand effect of material transactions and events on information conveyed in F.S., and
 - Terminology used in F.S., including title of each F.S., is appropriate.

Qualitative Aspects of Entity's Accounting Practices	Indicators of Lack of Neutrality
(1) Mngt. makes a number of judgements about amounts & disclosures in F.S. (2) SA 260 contains discussion of qualitative aspects of accounting practices. (3) In considering qualitative aspects of entity's accounting practices, auditor may become aware of possible bias in management's judgements. Auditor may conclude that cumulative effect of lack of neutrality, together with effect of uncorrected misstatements, causes the F.S. as a whole to be materially misstated. (4) SA 540 addresses possible mngt. bias in making accounting estimates. Indicators of possible mngt. bias do not constitute misstatements for purposes of drawing conclusions on reasonableness of individual accounting estimates.	(i) Selective correction of misstatements brought to management's attention during the audit. For Example: Correcting Misstatements with effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings. (ii) Possible management bias in making of accounting estimates.

Elements of an Unmodified Audit Report

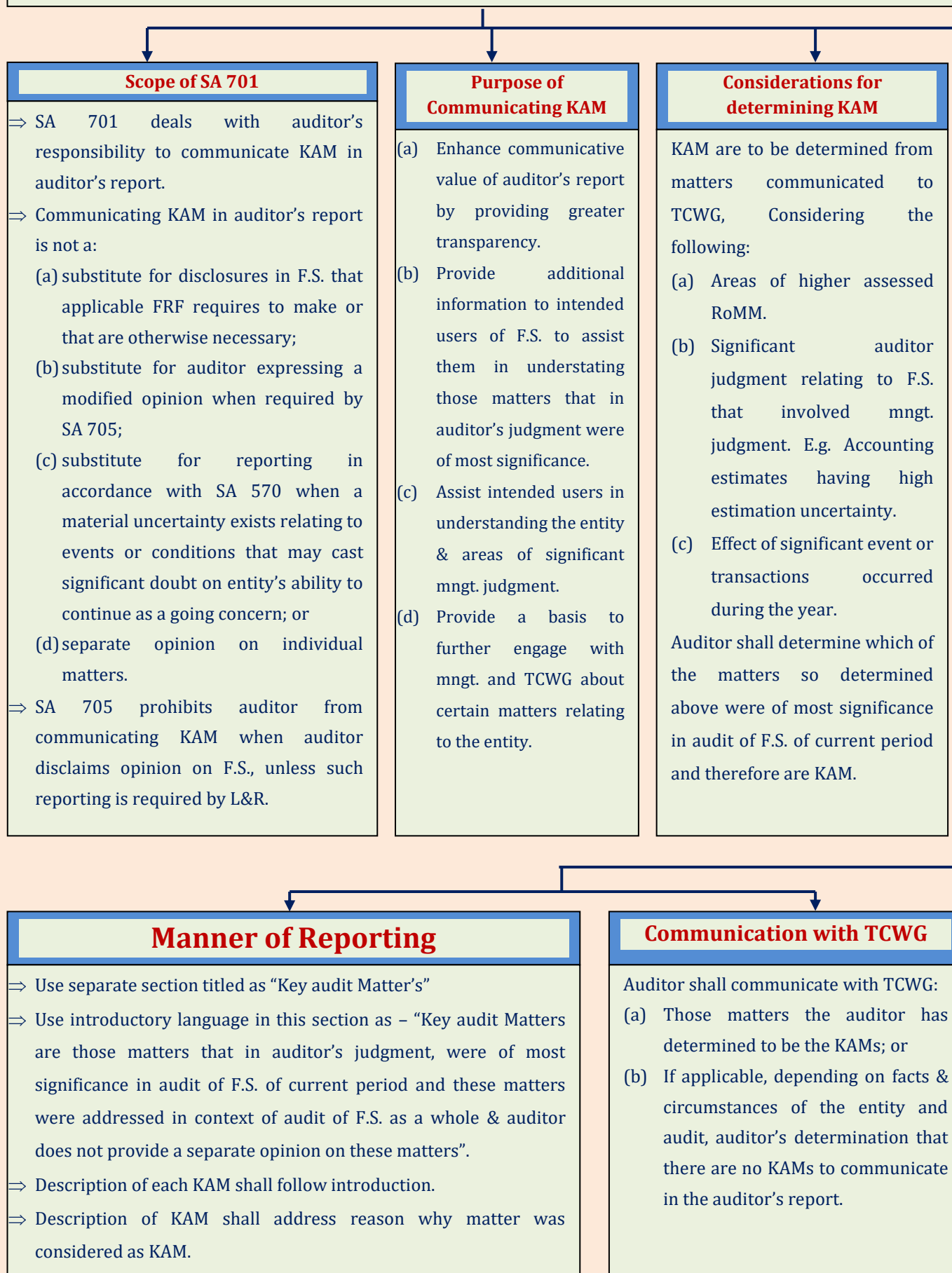
1	Title	"Independent Auditor's Report" – so as to distinguish from reports issued by others.	
2	Addressee	Auditor's Report shall be addressed as appropriate.	
3	Opinion Section	Fair Presentation Framework	In our opinion, the F.S. present fairly in all material respects in accordance with [applicable FRF]; Or In our opinion, the F.S. gives a true and fair view of _____ in accordance with [applicable FRF]
		Compliance Framework	In our opinion, the F.S. present, in all material respect in accordance with [applicable FRF]

Elements of an Unmodified Audit Report

3	Opinion Section	Opinion Para shall also cover the following: - Identify Entity. - Identify title of each financial statement. - Specify period/date covered by each F.S. - State that F.S. have been audited.
4	Basis for Opinion	- States that audit was conducted in accordance with SAs. - Refer to Section of Auditor's report that describes auditor's responsibilities. - Compliance of Ethical requirements including independence. - Auditor's believing that they had obtained SAAE to provide a basis for opinion.
5	Going Concern	Where applicable, auditor shall report in accordance with SA 570.
6	KAM	In case of Listed Entity, auditor shall communicate KAM in accordance with SA 701.
7	Management Responsibilities for the F.S.	- To prepare F.S. in accordance with applicable FRF. - Maintenance of adequate records for safeguarding of assets and prevention and detection of fraud. - Making reasonable & prudent judgments and estimates. - Design, Implementation & maintenance of IC. - Assessing appropriateness of Going Concern basis of accounting. - Overseeing financial reporting process.
8	Auditor's responsibilities for the Audit of F.S.	- State objective of auditor to obtain reasonable assurance that F.S. as a whole are free from material misstatements & issue auditor's report that includes an auditor's opinion. - Explanation w.r.t. reasonable assurance & application of concept of materiality. - Statement that auditor exercises professional judgment & maintain professional skepticism throughout audit. - State auditor's responsibilities w.r.t.: - Identifying & assessing the RoMM. - Design & perform audit procedures responsive to assessed risks. - Obtain SAAE. - Understanding of Internal Control. - Expressing opinion on adequacy and operating effectiveness of IFC. - Evaluation of appropriateness of accounting policies & reasonableness of accounting estimates. - Conclude on appropriateness of management use of G.C. basis of accounting. - Evaluate overall presentation, structure & content of F.S. - State Auditor's responsibilities w.r.t.: - Matters communicated to TCWG. - Providing statement to TCWG on compliance of Ethical requirements. - Determining KAM out of matters communicated to TCWG.
9	Other Reporting responsibilities	- Heading: "Reporting on Other Legal and Regulatory Requirements". - Will include reporting of CARO, 2020, reporting u/s 143(3) of Companies Act, 2013, Rule 11 of CAAR, 2014.
10	Signature	In personal name & name of firm, along with membership number and FRN.
11	Place	City where audit report is signed.
12	Date	Should not be earlier than date on which audit evidences are collected.
13	UDIN	Mention the UDIN w.r.t. each Audit Report along with M. No.

8.2 - SA 701 “Communicating Key Audit Matters in Independent Auditor’s Report”

Key Audit Matters (KAM): Those matters that in the auditor’s judgment were of most significance in audit of F.S. of current period. These are selected from matters communicated with TCWG.



8.3 - SA 705 "Modifications to the Opinion in the Independent Auditor's Report"

Types of Modified Opinion

Qualified	Issued when: - F.S. are misstated having material but not pervasive effect. Or - Auditor not been able to collect SAAE for transactions that are having material but not pervasive effect.
Adverse	Issued when F.S. are misstated having material & pervasive effect.
Disclaimer	Issued when auditor not able to collect SAAE for transactions that are having material and pervasive effect.

Meaning of Pervasive Effect

Pervasive effects on F.S. are those that, in auditor's judgement:

- are not confined to specific elements, accounts or items of F.S.;
- if so confined, represent or could represent a substantial proportion of F.S.; or
- in relation to disclosures, fundamental to users understanding of the F.S.

Limitation after Auditor has accepted the Engagement

- If, after accepting engagement, mngt. imposed limitation on scope, request mngt. to remove limitation.
- If mngt. refuses, communicate to TCWG & determine whether it is possible to perform alternative procedures to obtain SAAE.
- If unable to obtain SAAE, modify opinion.
- Consider withdrawal, where practicable.
- If withdrawal is not practicable, disclaim opinion on F.S.
- If auditor withdraws, before withdrawing, communicate to TCWG matters regarding misstatements identified that would have given rise to modification of opinion.

Considerations while issuing modified Opinion

Opinion Section

Use the heading:

- Qualified Opinion
- Adverse Opinion
- Disclaimer of Opinion.

Wordings of Opinion:

Qualified	Except for effects of matters prescribed in "Basis of Qualified Opinion" section, F.S. have been prescribed fairly in all material respects in accordance with [applicable FRF]
Adverse	In auditor's opinion, because of significance of matters described in "Basis of Adverse Opinion" section, F.S. does not give a true and fair view of _____ in accordance with [applicable FRF].
Disclaimer	Because of significance of matters described in "Basis for Disclaimer of Opinion" section, auditor has not been able to obtain SAAE to provide a basis for audit opinion on F.S.

Basis for Opinion Section

Amend the heading: Basis for Qualified Opinion
Basis for Adverse Opinion
Basis for Disclaimer of Opinion.

- Include description of matter giving rise to modification.

Cause of Modification	Description
Material Misstatement in Amount	- Description of Misstatement. - Quantification of financial effect, if determinable. - If not determinable, state the fact.
Material Misstatement in Disclosure	Explanation how the disclosures are misstated.
Material Misstatement due to non-disclosure of required information	Describe nature of omitted information. And Include the omitted disclosure provided it is practicable.
Inability to obtain SAAE	State the reason for inability.

- Amend statement w.r.t. auditor believing that audit evidences are sufficient and appropriate to provide basis for "Qualified Opinion" or "Adverse Opinion".
- In case of disclaimer, auditor's report shall not include reference to section of auditor's report that describes auditor's responsibilities and statement w.r.t. auditor's believing that SAAE obtained.

Auditor's Responsibility Section

When auditor disclaims opinion, he shall amend description of auditor's responsibilities to include only the following:

- Statement that auditor's responsibility is to conduct audit in accordance with SAs & to issue Auditor's Report.
- Statement that because of significance of matters described in basis for disclaimer of opinion section, auditor was not able to obtain SAAE to provide a basis for audit opinion.
- Statement about auditor's independence & other ethical requirements.

8.4 - SA 706 “Emphasis of Matter Paragraph & Other Matter Paragraph in Independent Auditor’s Report”

Emphasis of Matter (EOM) Para

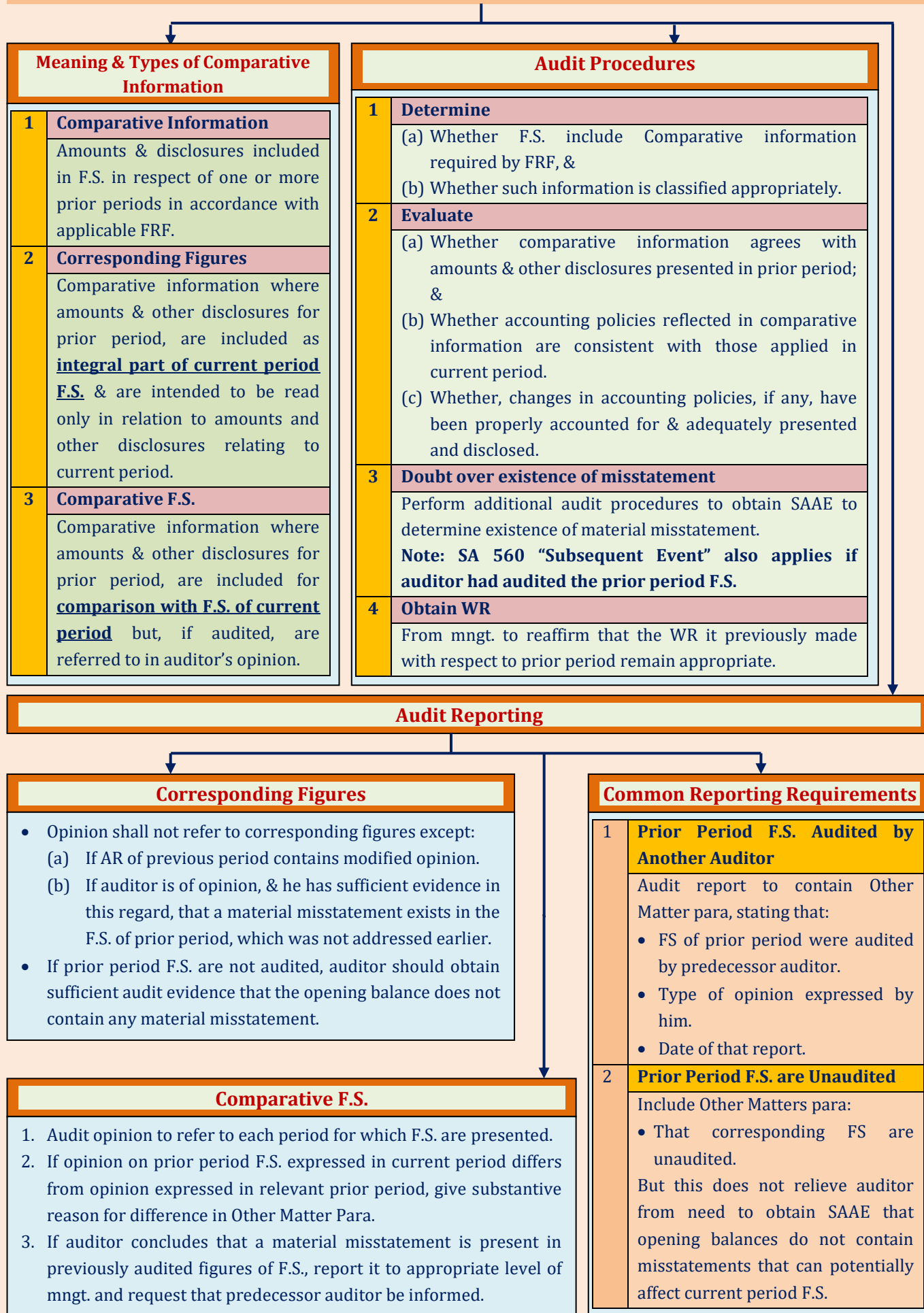
1	Meaning
	Para included in Auditor’s report that refers to a matter appropriately reflected/disclosed in F.S. that in auditor’s judgment is of such significance that it is fundamental to user’s understanding of F.S.
2	Requirements
	- Auditor shall include EOM Para in auditor’s report provided: (a) Auditor would not be required to modify opinion as per SA 705 as a result of the matter; and (b) When SA 701 applies, matter has not been determined to be a KAM. - When auditor includes EOM Para in auditor’s report, he shall: (a) Include Para within a separate section with appropriate heading that includes term “Emphasis of Matter”; (b) Include in Para a clear reference to matter being emphasized & to where relevant disclosures that fully describe matter can be found in F.S.; (c) Para shall refer only to information presented or disclosed in F.S.; and (d) Para shall indicate that auditor’s opinion is not modified in respect of matter emphasized.
3	Circumstance when EOM Para can be issued
	(a) Uncertain situation as to future outcome of an exceptional litigation. (b) Significant subsequent events. (c) Early application of new AS in advance of its effective date. (d) Occurrence of major catastrophe that may have a significant effect on entity financial position.
4	Nature of EOM Para
	EoM Para is not a substitute for: (a) Modified opinion in accordance with SA 705; (b) Disclosures in F.S. that applicable FRF requires; or (c) Reporting in accordance with SA 570 when material uncertainty exists relating to events that may cast significant doubt on an entity’s ability to continue as a going concern.

Other Matter Para

1	Meaning
	Para included in Auditors Report that refers to a matter other than presented/disclosed in F.S. that in auditor’s judgment is relevant for users understanding of audit, auditor’s responsibilities or auditor’s report.
2	Requirements
	- OM Para should be included in audit report in a separate section termed as “Other Matter”. - Auditor shall include Other Matter paragraph in auditor’s report, provided: ⇒ not prohibited by L & R; and ⇒ when SA 701 applies, matter has not been determined to be a KAM to be communicated in auditor’s report.

Note: If auditor expects to include EOM or OM Para, auditor shall communicate with TCWG regarding this expectation and the proposed wording of this paragraph.

8.5 - SA 710 "Comparative Information – Corresponding Figures & Comparative F.S."



8.6 – Branch Audit and SA 600 “Using the Work of Another Auditor”

Provisions Relating to Maintenance of Records and Branch Audit

Books of Account, etc., to be kept - Sec. 128	Persons eligible to be appointed as Auditor of Branch – Sec. 143(8)	Duties of Branch Auditor - Sec. 143(8)
- Every Co. shall prepare & keep at its Regd. office books of a/c, other relevant books & papers and F.S. for every FY which gives a true & fair view of affairs of Co. including that of its branch office, if any. - Where a Co. has branch office in India/outside India, proper books of a/c relating to transactions effected at branch office may be kept at that office.	Where company has a branch office, accounts of that office shall be audited by: - auditor appointed for the company, i.e. company auditor; or - other person qualified for appointment as auditor of company under this Act; or - where branch office is situated in country outside India, accounts of branch office shall be audited either by company's auditor or by accountant or by other person duly qualified to act as auditor of accounts of branch office in accordance with laws of that country.	Branch auditor shall prepare a report on accounts of branch examined by him & send it to auditor of company who shall deal with it in his report in such manner as he considers necessary. Rule 12 of Companies (Audit and Auditors) Rules, 2014, - Branch auditor shall submit his report to company's auditor. - Provisions regarding reporting of fraud by the auditor shall also extend to such branch auditor.

SA 600 “Using the Work of Another Auditor”

Applicability: In situation where an auditor (principal auditor - PA), reporting on the financial information of an entity, uses the work of another auditor (other auditor - OA) w.r.t. to the financial information of one/more components (Division, Branch subsidiary, J. V. etc.), included in the financial information of the entity.

Rights of Principal Auditor

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

Principal Auditor's Procedures

PA should perform procedures to obtain SAAE that work of other auditor is adequate for PA purposes, in the context of the specific assignment. When using work of AO, PA should ordinarily perform following procedures:

- Inform OA, matters such as:
 - areas requiring special consideration,
 - procedures for identification of inter component transactions; and
 - time-table for completion of audit.
- Advise OA of significant a/cing, auditing & reporting requirements & obtain representation as to compliance.
- Review written summary of OA procedures and findings through questionnaires/ checklist.
- PA may also wish to visit the other auditor.
- NTE of procedures will depend on circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor.

8.7 – Joint Audit and SA - 299 “Joint Audit of Financial Statements”

A joint audit is an audit of F.S. of an entity by two or more auditors appointed with the objective of issuing the audit report. Such auditors are described as joint auditors.

Advantages of Joint Audit	Disadvantages of Joint Audit
• Sharing of expertise. • Advantage of mutual consultation. • Lower workload. • Better quality of performance. • Improved service to client. • In respect of MNCs, work can be spread using expertise of local firms which are in a better position to deal with detailed work and local L&R. • Lower staff development costs. • Lower costs to carry out the work. • Sense of healthy competition towards a better performance.	• Fees being shared. • Psychological problem where firms of different standing are associated in joint audit. • General superiority complex of some auditors. • Problems of co-ordination of the work. • Areas of work of common concern being neglected. • Uncertainty about liability for work done.

SA 299 “Joint Audit of F.S.”

Audit Planning & Allocation of Work	
1	Development of Audit Plan In developing joint audit plan, joint auditors shall: - Identify division of audit areas & common audit areas; - Ascertain reporting objectives of engagement; - Consider & communicate among all joint auditors, factors that are significant in directing ET efforts; - Consider results of preliminary engagement activities. - Ascertain NTE of resources necessary.
2	Allocation of Work • Joint auditors should, by mutual discussion, divide audit work among themselves. Documentation • Work allocation document shall be signed by all joint auditors & same shall be communicated to TCWG.

Responsibility of Joint Auditors
• In respect of audit work divided among joint auditors, each joint auditor shall be responsible only for work allocated to him including execution of audit procedures. • All joint auditors shall be jointly & severally responsible for: - audit work which is not divided; - decisions taken by all joint auditors under audit planning in respect of common audit areas. - matters brought to notice of joint auditors by any one of them; - examining that F.S. comply with the requirements of relevant statutes; - presentation & disclosure of F.S. as required by applicable FRF; - ensuring that audit report complies with requirements of statutes, SAs & other relevant pronouncements.

Reporting Requirements
• Joint auditors are required to issue common audit report. • However, in case of any disagreement with regard to opinion or any matters to be covered by audit report, they shall express their opinion in a separate audit report. • In case of separate reports, audit report(s) issued by joint auditor(s) shall make a reference to separate report(s) issued by other joint auditor(s).

8.8 – Reporting Requirements under Companies Act, 2013

Inquire into Propriety Matters – Sec. 143(1)

1. Loans and advances are properly secured & terms are prejudicial.
2. Book entries are prejudicial.
3. Shares, debentures & other securities are sold at a price less than acquisition cost in case of non-banking & non-investment company.
4. Loans and advances made are shown as deposits.
5. Personal expenses charged to revenue account.
6. Cash has actually been received on shares allotted for cash, if not received, correct position shown in books and balance sheet.

Reporting on accounts – Sec. 143(2)

- Auditor shall make a report to members of company on:
 - (a) accounts examined by him; &
 - (b) on every F.S. which are required to be laid before company in GM.
- State that to best of information & knowledge, said accounts, F.S. give a true & fair view of state of affairs as at end of its FY & P & L & Cash flow for year.

Reporting of Fraud – Sec. 143(12) & Sec. 143(13)

Reporting to Central Government

If auditor has reason to believe that an offence of fraud involving amount of > ₹ 1 Cr., is committed, in company by its officers or employees, he shall report matter to C.G.

Reporting to Audit Committee or Board

In case of a fraud < 1 Cr., auditor shall report matter to audit committee or Board in prescribed manner.

Reporting u/s 143(3)

- (a) Whether auditor has obtained all necessary info. & explanations for audit.
- (b) Whether proper books of account have been maintained.
- (c) Whether branch audit report has been received & manner of dealing with it.
- (d) Whether B/S and P & L Account agree with books of account.
- (e) Whether Financial statements comply with AS.
- (f) Comments on financial transactions or matter having any adverse effect on functioning of the company.
- (g) Whether any director is disqualified u/s 164(2).
- (h) Qualification or adverse remarks w.r.t. maintenance of accounts.
- (i) Whether IFC with reference to F.S. are in place & effectively operated.

Exception: not apply to a private company:

- (i) which is a one-person company or a small company; or
- (ii) which has turnover less than ₹ 50 crores as per latest audited F.S. & which has aggregate borrowings from banks or financial institutions or any body corporate at any point of time during FY less than ₹ 25 Cr.

(j) Other matters as prescribed. (Rule 11)

Rule 11

- (a) Whether impact of pending litigations on financial position is disclosed.
- (b) Whether provisions for material Foreseeable losses on long term contracts made.
- (c) Whether there is any delay in transferring amounts to IEPF.

(d) Omitted

(e) Whether mngt. represented that no funds have been advanced/invested to or in any other entity with understanding, that it shall, lend/invest in other entities identified in any manner by or on behalf of the company or provide any guarantee, security or the like on behalf of Ultimate Beneficiaries.

Whether mngt. represented that no funds have been received from any entity with understanding that it shall lend/invest in other entities identified in any manner by or on behalf of the Funding Party or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries.

Auditor consideration that mngt. representations made under this Rule does not contain any material mis-statement.

(f) Whether dividend declared or paid during the year is in compliance with section 123 of the Companies Act, 2013.

(g) Whether company has used accounting software which has a feature of recording audit trail (edit log) facility and same has been operated throughout year for all transactions recorded in software and audit trail feature has not been tampered with and it has been preserved for record retention.

8.9 – CARO, 2020

CARO, 2020 apply to all companies including foreign companies except the following

- (a) Banking Company
- (b) Insurance Company
- (c) Company licensed to operate u/s 8
- (d) One Person Company
- (e) Small Company
- (f) Private limited Company (not being a subsidiary or holding of public co.)
 - Paid up capital + Reserves & Surplus $\leq$ 1 Cr. (as on Balance Sheet Date)
 - +
 - Total borrowings from Bank & F.I. $\leq$ 1 Cr. (at any point of time during the FY)
 - +
 - Total revenue as disclosed in Schedule III $\leq$ 10 Cr. (for the FY)

Important Notes

1. CARO not apply over audit report on Consolidated F.S. except Para 3(xxi).
2. A company if covered under the definition of small company, it will remain exempted from applicability of the Order even if it falls under any of the criteria specified for private company.
 Note: Small company means a company, other than a public company:
 - (a) paid-up share capital of which does not exceed ₹ 4 crore; and
 - (b) turnover of which as per its last profit and loss account for the immediately preceding financial year does not exceed ₹ 40 crore.

Matters to be reported under CARO 2020

Para No.	Reporting Area	Reporting Requirements
3(i)	Fixed Assets	- Whether proper records maintained. - Whether physical verification has been conducted at reasonable intervals by mngt. - Whether material discrepancies noticed and if so, whether dealt properly in books. - Title deeds of immovable properties are held in name of Co., if not provide details. Whether company has revalued its PPE or intangible assets or both during year &, if so, whether revaluation is based on valuation by a Regd. Valuer; specify amount of change, if change is $\geq 10\%$ in aggregate of net carrying value of each class of PPE or intangible assets. Whether any proceedings have been initiated or are pending against company for holding any benami property under Benami Transactions (Prohibition) Act, 1988 and its rules; if so, whether company has appropriately disclosed details in its F.S.
3(ii)	Inventories	- Whether physical verification has been conducted at reasonable intervals by mngt. Whether coverage & procedure of verification by mngt. is appropriate; whether any discrepancies of $\geq 10\%$ in aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in books of account; Whether company has been sanctioned working capital limits $>$ ₹ 5 crores, in aggregate, from banks or FI on basis of security of current assets; whether quarterly returns or statements filed by the company with such banks or FI are in agreement with the books of account of the Company, if not, give details.

Para No.	Reporting Area	Reporting Requirements
3(iii)	Investments, Guarantee/ Security, Loans or Advances	<i>Whether company made investments in, provided any guarantee or security or granted any loans or advances in nature of loans, secured or unsecured, to companies, firms, LLPs or any other parties, if so,</i> <i>(a) whether company has provided loans or provided advances in nature of loans, or stood guarantee, or provided security to any other entity, if so, indicate:</i> <i>(A) aggregate amount during year & balance o/s at balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, JVs and associates;</i> <i>(B) aggregate amount during year & balance outstanding at balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, JVs and associates;</i> <i>(b) whether investments made, guarantees provided, security given and terms and conditions of grant of all loans and advances in nature of loans and guarantees provided are not prejudicial to company's interest;</i> <i>(c) in respect of loans & advances in nature of loans, whether schedule of repayment of principal & payment of interest has been stipulated & whether repayments or receipts are regular;</i> <i>(d) if amount is overdue, state total amount overdue for > 90 days, & whether reasonable steps have been taken by company for recovery of principal & interest;</i> <i>(e) whether any loan or advance in nature of loan granted which has fallen due during year, has been renewed or extended or fresh loans granted to settle overdues of existing loans given to same parties, if so, specify aggregate amount of such dues renewed or extended or settled by fresh loans and percentage of aggregate to total loans or advances in nature of loans granted during year [not applicable to companies whose principal business is to give loans];</i> <i>(f) whether company has granted any loans or advances in nature of loans either repayable on demand or without specifying any terms or period of repayment, if so, specify aggregate amount, percentage thereof to total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in Sec. 2(76) of the Companies Act, 2013.</i>
3(iv)	Compliance of Provisions of Secs. 185 & 186	• In respect of loans, investments, guarantees, and security • If not, provide the details thereof.
3(v)	Public Deposits	• Directives by RBI and Secs. 73 to 76 complied with. If not - nature of contravention. • Order passed by CLB/RBI/Court/Tribunal-Whether complied with or not.
3(vi)	Cost Records	• Whether Specified u/s 148(1); • If yes, whether accounts and records made and maintained.
3(vii)	Statutory Dues	• Whether undisputed GST, PF, ESI, IT, ST, Custom, Excise, VAT, cess & Other – paid regularly. If not outstanding >6 months as on Balance Sheet Date. • W.r.t. disputed statutory dues – state amount involved & forum where dispute is pending.
3(viii)	Unrecorded Income	• <i>Whether any transactions not recorded in books of account have been surrendered or disclosed as income during the year in the tax assessments under the I-tax Act, 1961,</i> • <i>if so, whether previously unrecorded income has been properly recorded in books of a/c during the year.</i>
3(ix)	Repayment of Dues	<i>(a) Whether co. defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and amount of default to be reported.</i> <i>(b) Whether company is a declared wilful defaulter by any bank or F.I. or other lender;</i> <i>(c) Whether term loans were applied for 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;</i> <i>(d) Whether funds raised on short term basis have been utilised for long term purposes, if yes, nature and amount to be indicated;</i> <i>(e) Whether company has taken any funds on account of or to meet obligations of its subsidiaries, associates or JVs, if so, details thereof with nature of such transactions and amount;</i> <i>(f) whether company has raised loans during year on pledge of securities held in its subsidiaries, JVs or associate companies, if so, give details thereof and also report if company has defaulted in repayment of such loans raised.</i>

Para No.	Reporting Area	Reporting Requirements
3(x)	<i>Money raised by public issue & term loans</i>	• Whether moneys raised by way of IPO or FPO applied for purposes for which those are raised, if not, details together with delays or default & subsequent rectification, if any. • Whether Co. has made preferential allotment or private placement of shares or convertible debentures during year and if so, whether requirements of secs. 42 and 62 of Companies Act, 2013 have been complied with and funds raised have been used for purposes for which funds were raised, if not, provide details in respect of amount involved & nature of non-compliance.
3(xi)	<i>Fraud</i>	• Whether any fraud by company or any fraud on Company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated. • Whether any report u/s 143(12) of Companies Act has been filed by auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with C.G.; • Whether auditor has considered whistle-blower complaints received by company.
3(xii)	<i>Nidhi Companies</i>	• Whether Nidhi Co. has complied with Net Owned Fund to Deposits in ratio of 1:20; • Whether Nidhi Company is maintaining 10% unencumbered term deposits to meet out liability. • Whether there has been any default in payment of interest on deposits or repayment thereof and if so, the details thereof.
3(xiii)	<i>Transaction with Related Parties</i>	• Whether all transactions with RP are in compliance with Secs. 177 & 188 of Companies Act, 2013; and • details have been disclosed in the F.S. as required by the applicable ASs.
3(xiv)	<i>Internal Audit System</i>	• Whether company has internal audit system commensurate with size & nature of business; • Whether reports of Internal Auditors were considered by statutory auditor.
3(xv)	<i>Non-cash transactions with Directors</i>	• Whether co. has entered into any non-cash transactions with directors or persons connected with him; • If so, whether provisions of Section 192 of Companies Act, 2013 have been complied with.
3(xvi)	<i>Registration with RBI</i>	(a) Whether regn. is required u/s 45-IA of RBI Act, 1934 and if so, whether regn. has been obtained. (b) Whether company has conducted any Non-Banking Financial or Housing Finance activities without a valid CoR from the RBI; (c) Whether company is a Core Investment Company (CIC), if so, whether it continues to fulfil criteria of a CIC, and in case company is an exempted or unregistered CIC, whether it continues to fulfil such criteria; (d) Whether Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group;
3(xvii)	<i>Cash Losses</i>	• Whether company has incurred cash losses in the FY and in the immediately preceding FY, • If so, state the amount of cash losses;
3(xviii)	<i>Considerations of issues raised by outgoing auditor</i>	• Whether there has been any resignation of the statutory auditors during the year, • If so, whether auditor has considered issues, objections or concerns raised by the outgoing auditors.
3(xix)	<i>Existence of Material uncertainty as to company ability to meet its liabilities</i>	On basis of financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying F.S., auditor's knowledge of BOD and management plans, whether auditor is of opinion that no material uncertainty exists as on date of audit report that company is capable of meeting its liabilities existing at date of balance sheet as & when they fall due within a period of 1 year from the balance sheet date.
3(xx)	<i>Transfer of unspent CSR amount</i>	• Whether, in respect of other than ongoing projects, company has transferred unspent amount to Fund specified in Schedule VII to Companies Act within a period of 6 months of expiry of FY in compliance with 2nd proviso to Sec. 135(5) of the said Act; • Whether any amount remaining unspent u/s 135(5), pursuant to any ongoing project, has been transferred to special account in compliance with provision of Sec. 135(6) of said Act.
3(xxi)	<i>Remarks in CARO Reports of group companies</i>	• Whether there have been any qualifications or adverse remarks by respective auditors in CARO reports of companies included in consolidated F.S., • If yes, indicate details of companies and paragraph no. of CARO report containing qualifications or adverse remarks.

10.1 – Banking Operations

Types of Banks

- Commercial Banks:** Widest spread banking institutions, that provide a number of products and services to general public.
- Regional Rural Banks (RRBs):** Banks that cater basic banking & financial needs of rural communities.
- Co-operative Banks:** Banks set up on Cooperative Principles & registered under Cooperative Societies Act.
- Payment Banks:** Such banks cannot issue loans & credit cards. Customers can open Current & Savings accounts & avail facility of ATM cum Debit cards, Internet-banking & Mobile banking.
- Development Banks ('Term-Lending Institutions'):** Provide funds for infrastructural facilities important for economic growth of country.
- Small Finance Banks:** Set up by RBI to make available basic financial & banking facilities to unserved & unorganised sectors like small marginal farmers, small & micro business units.

Regulating Body

- Banking industry is regulated by Reserve Bank of India (RBI) known as the Central Bank.
- RBI is responsible for:
 - development & supervision of banks & non-banking financial institutions
 - determining monetary and credit policies.
 - to regulate activities of commercial and other banks.
- Important functions of RBI are:
 - issuance of currency;
 - regulation of currency issue;
 - acting as banker to Central & State govts., commercial & other banks including term-lending institutions.

1 Regulatory Framework

- Banking Regulation Act, 1949;
- Reserve Bank of India Act, 1934;
- State Bank of India Act, 1955;
- Regional Rural Banks Act, 1976;
- Companies Act, 2013;
- Information Technology Act, 2000;
- Prevention of Money Laundering Act, 2002;
- SARFAESI Act, 2002;
- Credit Information Companies Regulation Act, 2005; and
- Payment and Settlement systems Act, 2007

2 Peculiarities of Banking Operations

- Voluminous and complex transactions,
- Wide geographical spread of banking network,
- Diversified and large range of products and services offered,
- Extensive use of technology,
- Strict vigilance and compliance.

3 Form and Content of F.S.

- As per Sec. 29 of Banking Regulations Act, 1949, every banking company is required to prepare a B/S and a P & L A/c in the forms set out in 3rd Schedule to Banking Regulation Act, 1949.
- Form A contains form of B/S & Form B contains form of P & L A/c.
- Every banking company needs to comply with disclosure requirements under various ASs as notified u/s 133 of Companies Act, 2013, in so far as they apply to banking companies.

Auditor

1 Eligibility, qualification & Disqualifications

F.S. of banking company should be audited by person qualified to be auditor of companies.

2 Appointment of Auditor

- Banking company - at AGM. (With Approval of RBI)
- Nationalised bank - by bank acting through its BoD. (With Approval of RBI).
- RRBs - by bank concerned with approval of C.G.

3 Remuneration of Auditor

- of banking company is to be fixed as per Sec. 142 of Companies Act.
- of nationalised banks & SBI to be fixed by RBI in consultation with C.G.

4 Powers

Auditor has same powers as those of a company auditor in matter of access to books, A/Cs, documents & vouchers.

10.2 – Auditing Framework

Types of Reports		Bank Audit Approach	
1	Statutory Audit Report Auditor of nationalised bank, is required to make report to C.G., stating: 1. Whether, in his opinion, F.S. present a true & fair view of affairs of bank & in case he had called for any explanation or information, whether it has been given & satisfactory; 2. Whether or not transactions, are within powers of bank. 3. Whether or not returns received from offices and branches of bank have been found adequate for purpose of audit. 4. Whether P & L A/c show a true balance of profit or loss. 5. Other matter considered, to be brought to notice of C.G. Auditor of banking company is also required to state in report matters covered by Sec. 143 of Companies Act, 2013. However, CARO 2020 is not applicable to a banking company.	Control Environment at the Bank Bank should have appropriate controls to mitigate its risks, including • effective segregation of duties; • accurate measurement & reporting of positions; • verification & approval of transactions; • reconciliation of positions and results; • setting up limits; • reporting & approval of exceptions; • physical security & contingency planning.	
2	Additional reports to be issued by Statutory Auditor 1. Report on adequacy & operating effectiveness of ICoFR in case of banking companies in terms of Sec. 143(3)(i) of Companies Act, 2013. 2. Long Form Audit Report. (LFAR) 3. Report on compliance with SLR requirements. 4. Report on whether treasury operations have been conducted in accordance with RBI instructions. 5. Report on whether income recognition, asset classification & provisioning have been made as per the RBI guidelines. 6. Report on whether any serious irregularity was noticed in working of bank which requires immediate attention. 7. Report on instances of adverse credit-deposit ratio in rural areas.	Common questions while performing control activities	
3	LFAR • LFAR has to be furnished by auditor in addition to audit report as per statutory requirement. • Matters to be reported in LFAR to be specified by RBI. • LFAR is to be submitted before 30th June every year.	Who	Who performs the control?
4	Reporting of Fraud to RBI • RBI Circular regarding liability of A/cing & auditing profession, provides that "If accounting professional, in course of internal or external audit or institutional audit finds anything susceptible to be fraud or act of excess power or smell any foul play, he should refer the matter to RBI. Any deliberate failure on part of auditor should render himself liable for action". • While reporting such kind of matters, consider provisions of SA 250, "Consideration of L&R in an Audit of F.S.". • As per SA 240, " Auditor's Responsibilities Relating to Fraud in Audit of F.S." auditor conducting audit is responsible for obtaining reasonable assurance that F.S. taken as a whole are free from material misstatement, whether caused by fraud or error. • Auditor is not expected to look into each & every transaction but to evaluate system as a whole.	What	What evidence is available to demonstrate that control is performed?
		When	• When & with what frequency is control performed? • Is frequency enough to prevent, detect & correct RoMM?
		Where	• Where is evidence of performance of control retained? • For how long is evidence retained? • Is evidence accessible/ available for audit?
		Why	• Why is control being performed? • What type of errors are prevented or detected through performance of the control?
		How	• How is control performed? • What are control activities? • Can these activities be bypassed? • Can bypass, if any, be detected? • How are exceptions/ deviations resolved? • What is time frame for resolving exceptions/ deviations?

10.2 – Auditing Framework (Bank Audit Approach and Conducting an Audit)

Engagement Team Discussion

- ET should hold discussions to gain better understanding of banks and its environment, including IC, and also to assess potential for material misstatements of F.S.
- All discussions should be appropriately documented for future reference.
- Discussion should be done on susceptibility of bank's F.S. to material misstatements.
- Discussions are ordinarily done at planning stage of an audit.

Matters to be discussed

- 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;
- Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
- Need to maintain professional skepticism throughout the audit engagement;
- Need to alert for information or other conditions that indicates that a material misstatement may have occurred.

Benefits of discussion

- Specific emphasis should be provided to susceptibility of bank's F.S. to material misstatement due to fraud, that enables ET to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
- Enables EP to delegate work to experienced ET members, and to determine procedures to be followed when fraud is identified.
- EP may review the need to involve specialists to address the issues relating to fraud.

1 Understanding the Risk Management Process

1	Involvement of TCWG	Risk Management policies should be approved by TCWG having regard to bank's business objectives & strategies, capital strength, mngt. expertise, regulatory requirements & risks.
2	Identification, Measurement & Monitoring of Risks	Risks that may significantly affect the achievement of bank's goals and objectives should be identified, measured and monitored.
3	Control Activities	Banks must have controls over: - effective segregation of duties, - verification and approval of transactions, - setting of limits, - reporting and approval of exception.
4	Monitoring Activities	Risk mngt. models, methodologies and assumptions used to measure and manage risk need to be evaluated by independent risk management unit.
5	Reliable Information System	Must exist so as to provide adequate financial, operational and compliance information on a timely and consistent basis to management and TCWG.

2 Stress Testing

- Software testing activity that determines robustness of software by testing beyond limits of normal operation. It is particularly important for "mission critical" software, but is used for all types of software.
- RBI required that all commercial banks shall put in place Board approved 'Stress Testing framework' to suit their individual requirements which would integrate into their risk management systems.

3 Reliance / Review of other Reports

- Auditor should consider the adverse/qualified remarks, if any, appearing in the following:
- Previous audit reports.
 - Internal inspection reports.
 - RBI inspection reports.
 - Concurrent/Internal audit report.
 - Report on verification of security.
 - Other internal reports specially related to particular accounts.

4 Assessing Risk of Fraud (KYC Norms)

- As per SA 240 "Auditor's Responsibilities Relating to Fraud in Audit of F.S.", auditor's objective is to identify & assess RoMM in the F.S. due to fraud, to obtain SAAE on those identified misstatements and to respond appropriately.
- Attitude of professional skepticism should be maintained so as to recognise possibility of misstatements due to fraud.
- RBI has framed specific guidelines that deal with prevention of money laundering and "Know Your Customer (KYC)" norms. RBI has from time to time issued guidelines ("KYC Guidelines – Anti Money Laundering Standards"), requiring banks to establish policies, procedures & controls to deter and to recognise and report money laundering activities.

10.3 – Types and Classification of Advances

Types of Advances

- | | |
|----------|---|
| 1 | Funded Loans |
| | <ul style="list-style-type: none"> Loans where there is actual transfer of funds from bank to borrower. Examples: Term loans, CC, OD, Demand Loans, BP/BD, Interest-bearing Staff Loans, etc. |
| 2 | Non-Funded Facilities |
| | <ul style="list-style-type: none"> Facilities which do not involve transfer of funds. Examples: Letters of credit, Bank guarantees, etc. |

Creation of Security

- Primary security:** Security offered by borrower for bank finance or one against which credit has been extended by bank.
- Collateral security:** Additional security and can be in any form i.e. tangible or intangible asset, movable or immovable asset.
- Examples of Securities:**
 - Personal Security of Guarantor
 - Goods/Stocks/Debtors/Trade Receivables
 - Gold Ornaments and Bullion
 - Immovable Property
 - Life Insurance Policies
 - Stock Exchange Securities

Mode of Creation of Security

Mortgage	- Registered Mortgage: Affected by 'Mortgage Deed' signed by mortgagor. - Equitable mortgage: Affected by mere delivery of title deeds with intent to create security.
Pledge	- Physical delivery of goods by borrower to lending bank with intention of creating a charge thereon as security. - Legal ownership of goods remains with pledger.
Hypothecation	- Creation of equitable charge, in favour of lending bank by execution of hypothecation agreement in respect of movable securities belonging to borrower. - Borrower holds physical possession of goods. - Borrower periodically submits statements regarding quantity & value of hypothecated assets (like stocks, debtors, etc.) to bank on basis of which DP is fixed.
Lien	Creation of legal charge with consent of owner, which gives lender a legal right to seize and dispose/liquidate the asset under lien.
Assignment	- Transfer of existing or future debt, right or property belonging to a person in favour of another person. - Only actionable claims such as book debts and LIP are accepted by banks as security by way of assignment.
Set-Off	- Statutory right of creditor to adjust, debit balance in debtor's account against any credit balance lying in another account of debtor. - It enables a bank to combine two accounts (a deposit account & a loan account) of the same person provided both the accounts are in the same name and same right. - For this purpose, all branches of a bank are treated as one single entity. Right of set-off can be exercised in respect of time-barred debts also.

Prudential Norms

- | | |
|----------|---|
| 1 | Non-Performing Advances |
| | <p>An Advance will be classified as NPA if:</p> <ol style="list-style-type: none"> It ceases to generate income for a bank. interest and/or installment of principal remain overdue for > 90 days in respect of a term loan; account remains 'out of order' in respect of OD/ CC; bill remains overdue for > 90 days in case of bills purchased and discounted. |

Out of Order

Account should be treated as 'out of order' if:

- O/S balance remains continuously in excess of sanctioned limit/DP; or
- No credits continuously for 90 days; or credits are not enough to cover interest debited during the same period.

- | | |
|----------|--|
| 2 | Special Mention Accounts |
| | <p>Accounts, resulting signs of incipient stress leading to possibility that borrowers may default on debt obligations.</p> <p>SMA 0 – Accounts showing stress signals
 SMA 1 – Overdue between 31 to 60 days
 SMA 2 – Overdue between 61 to 90 days</p> <p>Such classification is significant as early recognition of such accounts enables banks to initiate timely remedial actions to prevent potential slippages into NPAs.</p> |

- | | |
|----------|--|
| 3 | Classification as per Prudential Norms |
| | <ul style="list-style-type: none"> Standard: Assets which does not carry more than normal risk. Sub-standard: Asset remained NPA for a period ≤ 12 months. Doubtful: Asset remained in sub-standard category for > 12 months. Loss: Asset in respect of which loss has been identified by bank or internal auditors or RBI inspection, but amount has not been written off, wholly. |

- | | |
|----------|--|
| 4 | Provisioning Requirements |
| | <ul style="list-style-type: none"> Standard assets - 0.40% Sub-standard assets - 15% Doubtful assets: <ol style="list-style-type: none"> Unsecured portion - 100% Secured portion <ul style="list-style-type: none"> ⇒ Up to one year - 25% ⇒ > 1 year but upto 3 years - 40% ⇒ > 3 years - 100% Loss assets - 100% |

10.3 – Types and Classification of Advances (Special cases w.r.t. NPA Classification)

1. Asset Classification borrower-wise - Asset classification would be borrower-wise and not facility-wise. - All facilities including investments in securities would be termed as NPA.	6 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.
2. Accounts Regularised near B/S date - Where it appears that an account has inherent weakness & few credits near B/S tries to make it regular, account should be classified as NPA. - Auditor should check for sample transactions immediately before & after closing of FY to get a knowledge of objective behind the transactions.	7 Agricultural Advances affected by Natural Calamities Where, due to natural calamities, short-term agricultural loans are converted into term loans or there is rescheduling of repayment period or fresh short-term loans are sanctioned, term loan as well as fresh short-term loan may be treated as current dues and need not be classified as NPA.
3 Govt. guaranteed Advances - Credit facilities backed by C.G. guarantee, though overdue should be treated as NPA only when govt. repudiates its guarantee when invoked. - This exemption is only asset classification & provisioning and not for recognition of income. Interest on such advances should not be taken to income account unless realized. - Credit facilities backed by S.G. guarantee should be classified as NPA in normal way.	8 Advances to Staff - Interest-bearing staff advances should be included as part of advances portfolio of bank. In case of housing loan or similar advances where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. - Such loans/advances should be classified as NPA only when there is a default in repayment of installment of principal or payment of interest on respective due dates.
4 Advances under Consortium - Consortium advances mean advancing loans by ≥ 2 Banks jointly. Usually, a Bank with a higher share will lead the consortium. - Classification of Consortium advances to be based on record of recovery of respective individual member banks. - Where remittances by borrower under consortium lending arrangements are pooled with one bank and bank receiving remittances is not parting with share of other member banks, account should be treated as not serviced in books of other member banks and therefore, an NPA.	9 Agricultural Advances Agricultural advances are classified as NPA if interest and/or Instalment of principal is overdue for (a) 2 crop seasons, if loans granted for Short Duration, (b) 1 crop season, if loans granted for Long Duration crops.
5 Erosion in Value of Securities In case there arise erosion in value of security, banks can directly classify these accounts as Doubtful or Loss Assets, irrespective of the period for which the account has remained NPA. - Erosion in value of securities by $> 50\%$ of value assessed by bank or accepted by RBI inspection team at time of last inspection, would be considered as “significant”, requiring the asset to be classified as doubtful straightaway. - If realisable value of security as assessed by bank/approved valuers/ RBI is $< 10\%$ of outstanding in borrowal accounts, existence of security should be ignored and asset should be classified as loss asset.	

10.4 – Computation of Drawing Power & 10.5 Audit of Advances

Computation of Drawing Power		Audit of Advances	
1	Meaning of DP Limit up to which a firm or company can withdraw from the working capital limit sanctioned.	1.	Audit Approach Obtain evidence about the following: • Amounts included in B/S are outstanding. • Advances represent amount due to bank. • Amounts due to bank are appropriately supported by loan documents. • There are no unrecorded advances. • Basis of valuation is appropriate and properly applied. • Advances are disclosed, classified & described in accordance with recognised accounting policies & practices & relevant statutory and regulatory requirements. • Appropriate provisions have been made as per RBI norms, ASs and GAAPs.
2	Sanctioned Limit vs. DP • Sanctioned limit: Total exposure that a bank can take on a particular client for facilities like CC, OD etc. • DP: Amount calculated based on primary security less margin as on a particular date.	2.	Obtaining Evidences SAAE can be obtained by study and evaluation of ICs relating to advances, and by: • examining validity of recorded amounts; • examining loan documentation. • reviewing operation of accounts; • examining existence, enforceability & valuation of security; • checking compliance with RBI norms including classification and provisioning; and • carrying out appropriate APs.
3	Considerations • All accounts should be kept within both DP & sanctioned limit at all times. • Accounts which exceed sanctioned limit or DP should be brought to notice of Management/Head Office regularly.	3	Evaluation of Internal Control ICs over advances should include the following: • Advances should be made only after evaluating creditworthiness of borrowers & obtaining sanction from proper authorities. • All loan documents like promissory notes, letters of hypothecation, etc. should be executed by the parties. • Compliance with terms of sanction & end use of funds should be ensured. • Sufficient margin should be kept against securities taken to cover any decline in value thereof and to comply with RBI directives. • Securities requiring registration should be registered in the name of the bank. • DP Register should be updated every month to record value of securities hypothecated. • Accounts should be kept within both DP and sanctioned limit. • Operation of each advance account should be reviewed at least once a year & at more frequent intervals in case of large advances.
4	Bank's Duties • Ensure that drawings in working capital account are covered by adequacy of current assets. • DP to be arrived on current stock statement; should not be older than 3 months. • Outstanding in account based on DP calculated from stock statements older than 3 months is deemed as irregular.		
5	Auditor's Concern • Stock statements, quarterly returns & other statements submitted by borrower to bank should be scrutinized in detail. Audited Annual Report should be scrutinized properly. • Monthly stock statement submitted should be compared with audited accounts and reasons for deviations, if any, should be ascertained.		
6	Computation of DP • Ensure that DP is calculated as per extant guidelines formulated by BoD of respective bank & agreed upon by statutory auditors. • Special consideration should be given to proper reporting of sundry creditors for purposes of calculating DP.		
7	Stock Audit • Stock audit should be carried out by the bank for all accounts having funded exposure of > ₹ 5 crores. • Auditors can also advise for stock audit in other cases if the situation warrants the same. • Branches should obtain stock audit reports from lead bank in cases where Bank is not leader of consortium of WC. • Report submitted by stock auditors should be reviewed & special focus should be given to comments made by stock auditors on valuation of security & calculation of DP.		

10.6 – Audit of Revenue Items

Audit Approach & Procedures		Misc. Topics	
1	Auditor's Concern Obtaining reasonable assurance that recorded income arose from transactions, which took place during relevant period & pertained to bank, there is no unrecorded income & income is recorded at appropriate amount.	1	Reversal of Income - If any advance, including BP/BD, becomes NPA at close of any year, entire interest accrued & credited to income a/c in past periods, should be reversed or provided for if it is not realised. This will apply to Govt. guaranteed accounts also. - In respect of NPAs, fees, commission & similar income that have accrued should cease to accrue in current period & should be reversed or provided for w.r.t. past periods, if uncollected. - Further, in case of banks which have wrongly recognised income in past should reverse interest if it was recognised as income during current year or make a provision for equivalent amount if it was recognized as income in previous year(s). - Enquire if there are any large debits in Interest Income account that have not been explained.
2	RBI's Directions In respect of any income which exceeds - 1% of total income of bank if income is reckoned on gross basis or 1% of net profit before taxes if income is reckoned net of costs, should be considered on accrual as per AS 9. If any item of income is not considered to be material as per above norms, it may be recognised when received.	2	Take-Out Finance - Method of financing whereby a loan that is procured later is used to replace initial loan. It is a long-term financing that the lender promises to provide at a particular date or when particular criteria for completion of a project are met. Objectives of Take-out Finance: (a) To expand sources of Finance for infrastructure projects. (b) To address sectoral/group/entity exposure issues. (c) To boost availability of longer tenor debt finance. - In case of take-out finance, if based on record of recovery, account is classified by lending bank as NPA, it should not recognize income unless realised from the borrower/taking-over institution (if the arrangement so provides).
3	Revenue Certainty Banks recognise income (such as interest, fees & commission) on accrual basis, i.e., as it is earned; if it is not unreasonable to expect its ultimate collection.	3	Income on Investments Interest Income on Investments: includes income derived from Govt. securities, bonds & debentures of corporates and other investments by way of interest & dividend, except income earned by way of dividends, etc., from subsidiaries and joint ventures abroad/in India. Profit on Sale of Investments: Net profit or loss on sale of investments is taken to P & L A/c. Profit/Loss on Revaluation of Investments: In terms of RBI guidelines, investments are to be valued at periodical intervals & depreciation or appreciation in valuation should be recognised and taken to profit and loss account.
4	Revenue Uncertainty - In respect of NPA, banks should not recognize income until it is actually realised. - When credit facility is classified as NPA for first time, interest accrued & credited to income account in corresponding previous year which has not been realized should be reversed or provided for. This will apply to Government guaranteed accounts also.		
5	Income Recognition Policy - Policy of income recognition should be objective & based on record of recovery rather than on any subjective considerations. - Income from NPA is not recognized on accrual basis but is booked as income only when it is actually received.		

10.7 – Audit of Revenue Items (Expenses)

Interest Expended	Operating Expenses	Provisions and Contingencies
(a) Obtain analysis of various types of deposits O/S at end of each quarter & compute a weighted average interest rate. Rate so computed should be compared with actual average rate & enquire into difference, if material. (b) Compare average rate of interest paid on deposits with corresponding figures for PY(s) & enquire into difference, if material. (c) Verify calculation of interest & ensure the following: • Interest has been provided on all deposits upto date of B/S. • Interest rates are in accordance with bank's internal regulations, RBI directives & agreements with depositors. • Interest on Savings A/c should be checked on test check basis in accordance with rules. • Interest on inter-branch balances has been provided at rates prescribed by head office. (d) Ascertain whether there are any changes in interest rate on saving deposits & term deposits during the period.	• Evaluate IC system relating to expenses, including authorisation procedures in order to determine the NTE of his other audit procedures. • Examine whether there are any significant deviations in respect of major items of expenditure. • Perform an analytical review for payments & provisions on monthly basis. • Verify expenses with reference to supporting documents and check calculations wherever required.	• Ascertain compliance with regulatory requirements for provisioning as contained in RBI circulars. • Obtain understanding as to how Bank computes provision on standard assets & NPA. It includes basis of classification of loans into standard, sub-standard, doubtful and loss assets. • Obtain detailed break up of standard loans, non-performing loans and agree outstanding balance with general ledger. • Obtain statement of computation of tax provision from bank's management & verify nature of items debited & credited to P & L Account to ascertain that same are appropriately considered in computation of tax provision. • Other provisions for expenditure should be examined <i>vis-a-vis</i> circumstances warranting provisioning and adequacy of same by discussing & obtaining explanations from bank's management.



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