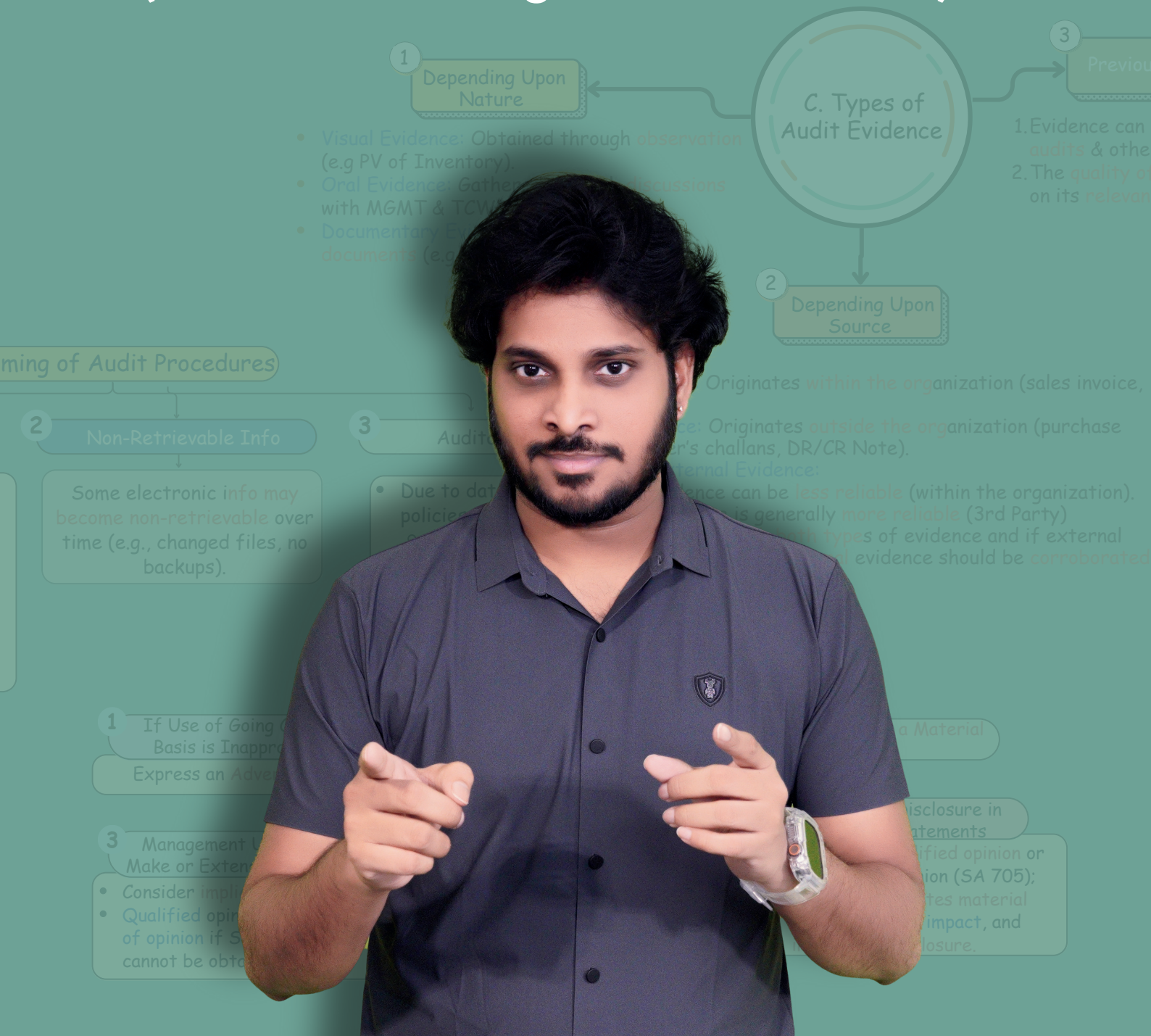


CA INTER

Auditing

CHART NOTES

(Best to read along with GOAT Notes)



AUDIT CHART NOTES

CA Inter Audit - Your Visual Route to Audit Mastery!

This Chart Book is the **next evolution** in the **GOAT Notes series**, designed specifically for rapid revision, visual clarity, and effortless recall. Built on the trusted foundation of our concept-rich **GOAT Notes**.

This edition presents the **entire CA Inter Audit syllabus** in just **130 pages**, without compromising technical accuracy or exam relevance.

Whether you're revising a chapter, preparing for a mock test, or revisiting key concepts before the exam, **these charts** will cut your revision time by more than half—while reinforcing every keyword and audit term that matters.

✓ Terminology-Backed. ✓ Exam-Oriented. ✓ Memory-Friendly.

Uncompromised Terminology - Every chart sticks to ICAI's language.
Built from **GOAT Notes** - The same clarity, the same standards.

Your Audit Superpower in 130 Pages!

With this Chart Book in hand, revision no longer feels like a burden.

It's crafted to sharpen recall, boost confidence, and
help you stay exam-ready anytime, anywhere.

Wishing all students clarity, confidence, and outstanding success in their journey!

⚠ Important Note

This Chart Book is a powerful revision companion, but it is **not a substitute for the GOAT Notes**. For complete conceptual clarity and exam-ready preparation, **Especially for MCQs and analytical understanding, we strongly recommend studying the GOAT Notes thoroughly.**

The Chart Notes are best used for retention, recall, and presentation of descriptive answers, especially during revision phases.

Dear Students,

We've worked really hard to make this book as accurate and error-free as possible. We even went through multiple rounds of proofreading to ensure everything is clear and correct. But, being human, there's always a chance that some small errors might have slipped through.

If you do come across any, let us know and help us improve future editions of the book!

Thank you for your trust and support and wishing you all clarity, confidence and success

Warm regards,





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Chapter 1 - Nature, Scope and Objective of Audit

1. Origin and History of Auditing Profession

1. **Origin:** Auditing is **ancient**; Concepts of periodical checking and verification existed early on.
2. **Etymology:** "Audit" comes from Latin "audire," meaning "to hear". Auditors in medieval times listened to **accounts being read out**.
3. **ICAI:** Established in 1949 as a **statutory body to regulate** Chartered Accountancy in India.

2. Meaning, Nature of Auditing and Aspects to be covered in Auditing

A Audit Definition

An **independent examination** of financial information of any entity to **express an opinion** thereon.

C Aspects Covered

- Conformity with **books of accounts**.
- Supported by **sufficient appropriate evidence**.
- No omissions, duplications, or fictitious entries.
- **Clarity and unambiguity** of information.
- **Compliance** with relevant **accounting standards**.
- Present a **true and fair view** of results, assets, and liabilities.



B Nature of Auditing

- **Independence:** The **auditor's judgment** must be **unbiased and free** from external influence.
- **Financial Information:** Applies to **both profit and non-profit entities** of any **size or legal form**.
- **To Express Opinion:** Primary purpose is to express opinion on FS, **enhancing user confidence**.
- **Purpose:** To **enhance confidence of users** in financial statements by giving an opinion on their **compliance with an applicable reporting framework**.

3. Relationship Between Audit and other disciplines

A Need for Diverse Knowledge

Auditing is **interdisciplinary**, drawing on **Accountancy, Law, Behavioural Science, Statistics, Economics, Financial Management**.

Key Relationships:

- **Accountancy & Business Laws:** Essential for **understanding and interpreting** financial statements.
- **Human Behaviour:** Crucial for **effective communication and information gathering**.
- **Statistics:** Used for **sampling** as **checking all transactions** is impractical.
- **Economics:** Helps **understand the client's operating environment**.
- **Financial Management:** Important for **effective audit procedures** (e.g working capital, ratios).

B Interrelationship

1. **Accounting:** As **auditing reviews** its outputs.
2. **Law:** To **understand** relevant **business laws**.
3. **Economics:** To grasp the client's **operating environment**.
4. **Behavioural Science:** For **effective human interaction**.
5. **Statistics & Mathematics:** For sampling and verification.
6. **Data Processing:** Especially for **specialized EDP auditing**.
7. **Financial Management:** To understand techniques like **ratio analysis** and **capital budgeting**.
8. **Production:** To comprehend client's business functions like **cost systems and marketing**.

4. Objectives of an Auditor as Per SA 200

A

Objective

- Obtain **reasonable assurance** that financial statements are **free from material misstatement** (due to fraud or error).
- Report** on the financial statements and **communicate findings** as required by Standards on Auditing (**SAs**).

B

Detailed Explanation

- Reasonable vs. Absolute Assurance:** Reasonable assurance is a **high level**, but **not absolute** assurance (a complete guarantee).
- Audit Process:** Conducted using **professional skill**, following **SAs**, gathering evidence to achieve reasonable assurance.
- Misstatements:** Caused by **fraud, error, or both**; auditor **assesses impact** on the whole statement.
- Reporting:** Opinion communicated in a **written report** based on findings.

5. Scope of Audit



Content

- Scope of Audit:** Defines the **range of audit work**; aims to **boost user confidence** in financial statements.
- Enhancing Confidence:** Auditors **give an opinion** on whether statements **comply** with an applicable **financial reporting framework**.
- Reporting Framework:** The chosen framework must suit the **entity's nature**, meet **objectives** and **comply with law**.
- Example:** In India, **Companies** use the framework under **Schedule III** of the Companies Act, 2013.

A. Scope of Audit Includes

1

Coverage of All Aspects of Entity

Audit must cover all **relevant aspects of the entity** related to the financial statements.

2

Reliability and Sufficiency of Financial Information

- Reliability:** Auditor ensures **accounting records** (bills, vouchers, documents) are **trustworthy and adequate**.
- Assessment:** Evaluated through **review** of **accounting systems, internal controls** and testing procedures.

3

Proper Disclosure of Financial Information

- Disclosure:** Auditor checks if **all relevant info** is **disclosed as per legal / statutory requirements**.
- Transaction Summaries:** Financial statements must accurately **summarize transactions and events**.
- Management Judgments:** Includes **selection of policies** like depreciation or inventory methods.
- Evaluation of Policies:** Auditor reviews if **policies are suitable and consistently applied**.
- Historical Data:** **Recognizes** that financial statements are **based on past economic events**.

B. Scope of Audit DO NOT Include

- Tasks Beyond Auditor's Competence:** Auditors **don't assess physical conditions** of assets (e.g., machinery/buildings); such tasks **require technical experts** like engineers.
- Document Authentication:** Auditors are **not experts in verifying** the genuineness of documents; this needs **specialized knowledge**.
- Official Investigation:** Audit is **not an investigation**. Auditors lack legal powers like **searching premises** or **recording witness statements**.
- Audit vs. Investigation:** Audit is **different from investigation**. Investigations are **detailed and focused** (e.g., on fraud), and may follow if **fraud is suspected**.
- Objective of Audit:** The audit aims to **give reasonable assurance** that financial statements are **free from material misstatements** (fraud/error), enabling the auditor to **give an opinion**.

6. Inherent Limitations of an Audit

Introduction

The audit has **inbuilt limitations** and **cannot give absolute assurance** that financial statements are free from misstatements due to fraud or error.

A Nature of Financial Reporting

- **Management Judgments:** Financial statements involve **subjective decisions** and judgments by **management**, introducing **uncertainty**.
- **Management Responsibility:**
 - **Preparing financial statements** per the financial reporting framework.
 - Ensuring **effective internal controls**, though these may have **inherent limitations**.
- **Internal Control Limitation**
- **Example:** Even with **controls** (e.g. stamp & signature on purchase bills), **collusion** (e.g. between accountant & authorized person) can **override them** — showing internal controls are **not foolproof**.

B Nature of Audit Procedures

1. **Practical Limitations on Audit Evidence**
 - Auditor **uses samples**, not all transactions.
 - Opinion is **based on limited audit procedures**, creating a practical limitation.
2. **Legal Limitations on Audit Evidence**
 - Management may **withhold information**.
 - Auditor **can't force disclosure**, only report non-cooperation — a legal limitation.
3. **Dishonesty in Management**
 - Dishonest management may **create fraudulent schemes**.
 - They may present **fabricated documents**, leading to **acceptance of invalid evidence**.
4. **Related Party Transactions**
 - Entities may do **fictitious transactions** with **related parties**.
 - Auditor may miss them if **unaware of relationships** or if audit procedures don't detect them.

C Audit is Not an Investigation

- Audit is **not a legal investigation**.
- Auditors **cannot guarantee** financials are free from fraud or errors.

D Timeliness and Relevance of Information

- Information **loses relevance** over time.
- Auditors **can't verify everything** in detail.
- There's a **trade-off between reliability** vs. cost of information.
- **Past data** may become **irrelevant if conditions** have changed.

E Future Events

- **Uncertain future events** may affect business continuity.
- **Factors like market shifts**, new business models, or **unforeseen changes** could force operations to stop.

7. Define an Engagement and Benefits of External Audit Engagement

A Meaning of Engagement

- An engagement is a **formal agreement** between the **auditor and client**.
- It **outlines audit services** and is **documented** in an engagement letter.

B External Audit Engagements

Primarily to **increase user confidence** in financial statements; they are **reasonable assurance** engagements. **Mandatory** for some entities (e.g., companies in India), **Voluntary** for **others seeking benefits**.

C Benefits of Audit

1. **Shareholders:** Rely on **independent audits**.
2. **Moral Check:** **Discourages fraud** among employees.
3. **Government:** Helps determine **tax liabilities**.
4. **Bankers:** Used for **credit decisions**.
5. **Detection of Misstatements** (Fraud or Errors).
6. Review of **Internal Controls effectiveness**.

8. Is Audit- Mandatory or Voluntary?

1 Legal Requirement for Audit

Not always legally **mandatory**. **Mandatory for certain** entities (e.g companies under specific laws).

2 Non-Corporate Entities

May be **mandatory** for non-corporate entities under **tax laws** (e.g turnover thresholds).

3 Government Grants

May be **required to obtain** government grants

4 Voluntary Audit

Often chosen voluntarily for its **benefits** or **due to internal rules**.



9. Who Appoints the Auditor?

Private Companies

Appointed by **members** (shareholders) in the AGM.

Government Companies

Appointed by the **Comptroller and Auditor General** of India (CAG).

Partnership Firms / LLPs

Appointed by the **Partners**.

Government Authorities

May appoint in **specific situations** per law

To Whom the Report is Submitted

Submitted to the **appointing party** (shareholders for companies, partners for firms).

10. Assurance Engagement & Elements thereof

A Meaning

1. **Definition:** Practitioner provides a **conclusion to enhance confidence** of intended users (other than the responsible party) on a subject matter evaluation against criteria.
2. **Purpose:** To **reduce the chance** of **incorrect information**, aiding confident user decisions.

B Elements

1. **A 3-Party Relationship:**
 - a. **Practitioner** (provides assurance, broader than auditor),
 - b. **Responsible party** (prepares subject matter),
 - c. **Intended users** (use report).
2. **Appropriate Subject Matter:** The **information being examined** (e.g., financial statements).
3. **Suitable Criteria:** The **benchmarks** used for evaluation (standards, laws, rules).
4. **Sufficient Appropriate Evidence:** **Quantity** (sufficient) and **Quality** (appropriate) of evidence obtained by the practitioner.
5. **Written Assurance Report:** **Conveys** the **conclusion** & is the **outcome** of the engagement



11. Meaning of Review and Difference between Audit and Review

- **Audit** provides **reasonable assurance** (high level, extensive procedures).
- **Review** provides **limited assurance** (lower level, fewer procedures, typically Inquiry and Analytical Procedures).
- **Both relate to financial statements** based on **historical** information.

12. Assurance Engagements and Prospective Financial Statements

1 Other Types of Assurance Engagements

1. Assurance engagements **exist for subject matters** beyond historical financial information.
2. Examples include **prospective financial information** or internal controls.

3 Focus of Such Assurance Engagements

1. Do **not examine historical** financial information.
2. Historical information is **about past actual events**.
3. Prospective information **focuses on the future** based on assumptions.

5 Limitations Due to Future Orientation

1. Relates to **future events**.
2. Evidence is **future-oriented**.
3. Practitioner **cannot confirm actual achievement** of results.

2 Definition of Prospective Financial Information

1. Financial **data based on assumptions** about Future events and actions.
2. Can be a **forecast, projection** or combined.

4 Moderate Assurance

1. Practitioner ensures management's assumptions are **not unreasonable**.
2. Information is **properly prepared**, presented, and all material **assumptions disclosed**.
3. Provides only a moderate level of assurance.

6 Practitioner's Report

Assures **nothing suggests assumptions** don't provide a reasonable **basis for projection**.

13. Qualities of an Auditor

1 Personal Qualities

- Should possess traits of a **good businessman**, including tact, **firmness, good temper**, integrity, discretion, **judgment, patience**. Must have high culture, trustworthiness.
- **Integrity and Independence** are key in their role.

2 Professional Qualities

Expert knowledge of **accounting principles and techniques**; knowledge of all **accounting areas** is essential.

14. Engagement and Quality Control Standards

Content

- SAs: **Audit of historical** financial information.
- SREs: **Review of historical** financial information.
- SAEs: **Assurance on non-historical** financial information (other than audit/review).
- SRSs: **Agreed-upon procedures**, compilation engagements.
- Purpose: **Establish high-quality standards** and guidance.

A

Standards on Auditing

- Apply to **audit of financial statements** by independent auditor.
- **Set high benchmarks** for historical financial information.
- **Covers:** Objectives, **documentation, planning**, risk, evidence, opinions.

B

Standards on Review Engagements

- Apply to **review of financial statements**.
- Provide **limited assurance** (lower than audit, fewer procedures).
- **Both SAs and SREs** apply to historical financial information.

C

Standards on Assurance Engagements

- Apply to **subject matters** other than historical financial information.
- **Examples:** Prospective financial information, **non-financial matters** (e.g., internal controls).

D

Standards on Related Services

- Apply to **agreed-upon procedures** on financial information &
- **Compilation** engagements (assists management; no assurance; **report states** no opinion expressed).

E

Standards on Quality Control

- **Purpose:** Firms' quality control system for all engagements.
- **SQC 1** requires firms to ensure compliance with **professional/legal standards** and appropriate reports.
- Applies to **all services covered** by Engagement Standards.

15. Need for EQC Standards

1

Need

- Ensure audits follow **established benchmarks** (global practices).
- Improve financial **reporting quality**.
- **Promote uniformity** in audits.
- Equip **professional accountants** with knowledge/skills.
- Ensure **audit quality**.

2

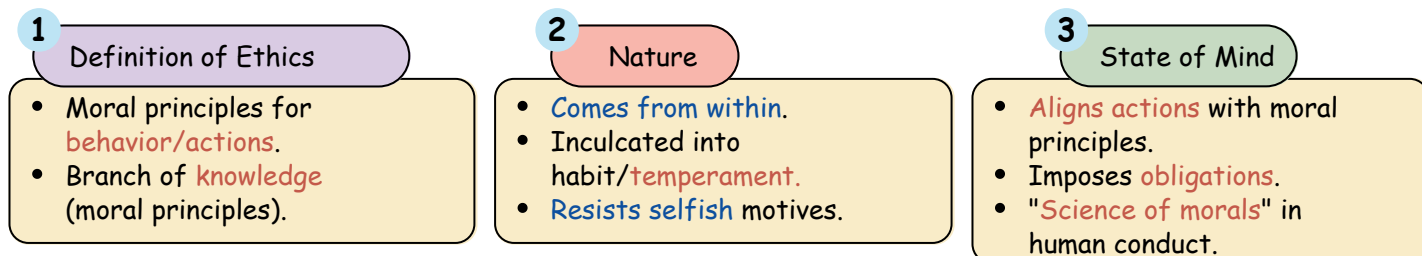
Duties in Relation to Engagement and Quality Control Standards

- Must follow Standards in **engagements**.
- Document **alternative procedures** if a standard procedure is ineffective.
- Document **reasons for departures**; draw attention to departures in report.
- Disclosure **alone doesn't excuse** non-compliance.

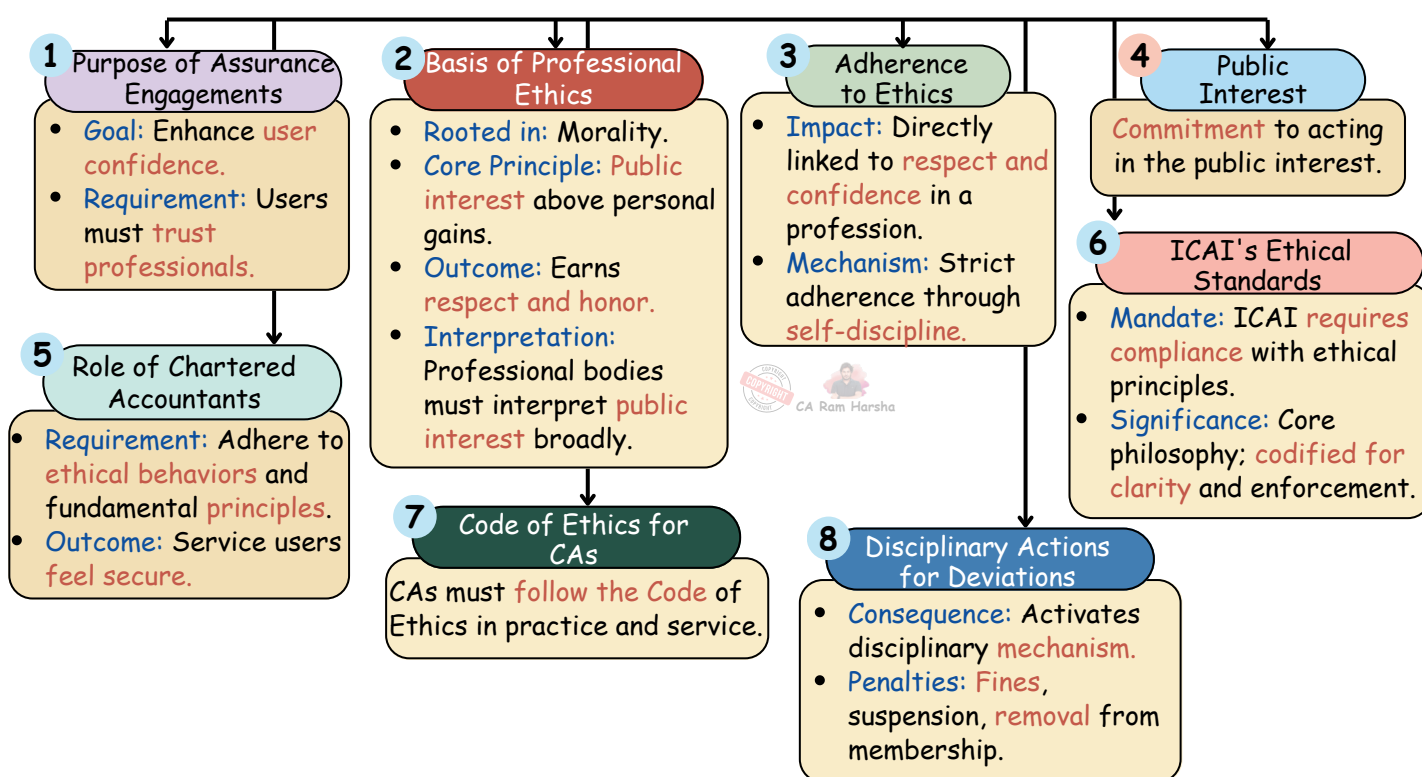
Chapter 2 - Ethics and Terms of Engagement

1. Part 1 - Ethics

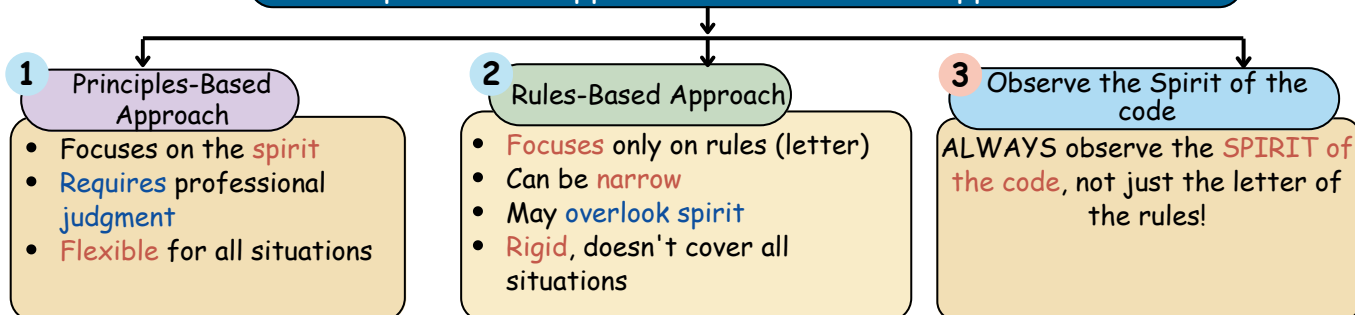
1. Meaning and Need for Professional Ethics



Need for Professional Ethics



2. Principles Based Approach Vs Rules Based Approach to Ethics



3. Fundamental Principles of Professional Ethics

Expected standard of behavior for professional accountants.

1 Integrity

- **Straightforward and honest** in relationships; fair dealing and truthfulness.
- Must **not be associated** with **false, misleading**, or negligently provided information.

2 Objectivity

- **Not compromise** professional judgment due to **bias, conflict** of interest, or undue influence.

3 Professional Competence and Due Care

- Maintain **required knowledge/skills** and act **diligently, thoroughly**, and timely.

4 Confidentiality

- **Respect** confidentiality of information obtained.
- **Supports public interest** by ensuring free flow of information with understanding it won't be shared **without consent**.
- **Disclosure only** when required / **permitted by law** or professional duty/right.

5 Professional Behaviour

- **Comply with laws** / regulations and **avoid actions** that **discredit** the profession.
- **Avoid activities** harming **integrity, objectivity**, or reputation.

4. Independence of Auditors

1 Professional Integrity & Independence

- **Essential:** Crucial for **all professions**, especially **accountancy**.
- **Definition:** Judgment is **not influenced** by others' **wishes or directions**.

2 Rules of Professional Conduct

- **Purpose:** Aim to **promote independence**.
- **Limitation:** Rules alone cannot ensure independence.
- **Core:** Independence is a **state of mind** and **personal character**.
- **Distinction:** **Not to be confused** with **legal standards** (which can change; independence quality is constant).

3 Two Perspectives of Independence

Independence of Mind (In Fact)

- Allows **unbiased judgment**.
- Ensures **integrity, objectivity**, and professional skepticism.

Independence in Appearance

- Avoiding situations where an **informed 3rd party** would conclude that **integrity, objectivity**, or professional skepticism is **compromised**.

4 Role of Chartered Accountants

- Independence must exist **both in fact and in appearance**. Relationship between auditor and client must **satisfy auditor's own independence** and appear independent to unbiased persons.

7 Duty of Chartered Accountants (CAs)

- CAs must decide if they can **act independently** in given circumstances.
- **Avoid positions** that might **compromise their independence**.

5 Importance for Listed Companies

- **Auditors of listed companies** lose usefulness if faith in their integrity / independence is lost.
- Auditor must be **objective, fearless**, and capable of giving an honest opinion.

6 Subjectivity of Independence

- Depends on the **state of mind** and character of the person.
- **What feels independent** to one person might **not to another** in similar circumstances.

5. Threats to Independence

1 Self-Interest Threats

Auditor/firm benefits from **financial interest** in client.

2 Self-Review Threats

Auditor **reviews their own judgment** or conclusions from previous work.

3 Advocacy Threats

Auditor **promotes client's opinion** to where objectivity is compromised.

4 Familiarity Threats

Auditors become **too close/sympathetic** to clients' interests.

5 Intimidation Threats

Auditors **deterred** from acting **objectively** / skeptically.

Note: For **Examples on Threats**, Refer **GOAT Notes of CA Ram Harsha**.
Soft copy of the same can be downloaded from shreshtaforcacma.com

6. Safeguards to Independence

- Auditors must always be **independent** and **appear independent**.
- Assess threats** before accepting work.
- If threats exist, **withdraw** or **take precautions** to eliminate them.
- If safeguards **cannot be applied**, **decline** the work.

7. Professional Skepticism

1 Professional Skepticism

A **questioning mind** and **critical assessment** of audit evidence, staying alert to unusual situations.

2 Professional skepticism involves being alert to

Contradictory evidence, unreliable information, **fraud indicators**, and the **need for extra audit** procedures.

3 Benefits

Lowers risks of missing unusual circumstances, **over-generalizing** findings and making **poor audit** decisions.

4 Accepting Documents and records as genuine

Treat as **genuine unless doubted**; always evaluate **reliability**. If doubt or fraud, investigate further.



5 Past Experience

Don't disregard prior good interactions, but always maintain skepticism regardless.

Part 2 - SA 210 Agreeing the Terms of Audit Engagement

8. Scope and Objective of SA 210

Scope

- Auditor's resp. in agreeing **terms with Mgmt/TCWG**
- Includes **establishing PRECONDITIONS**

Objective

Accept/Continue **ONLY** when:
a) Preconditions are **present**
b) **Clear & mutual understanding of terms** with Mgmt/TCWG



9. Preconditions For an Audit

1 Preconditions for an Audit

- Management uses an **acceptable financial reporting framework**.
- Management **agrees on the premise** of the audit.

2 Auditor's Responsibilities

Determine if the financial reporting framework is **acceptable**.

↓
Obtain management's agreement on responsibility for

- Preparing **financial statements** (per framework, fair presentation).
- **Necessary internal controls** (to prevent misstatement).
- Providing auditor with:
 - **All relevant information**.
 - **Additional** requested information.
 - **Unrestricted access** to persons

3 If Preconditions Are Not Present

- Discuss with **management**.
- **Reject** the audit engagement.
 - Unless required by law/regulation.
- **Reasons for rejection**: **Unacceptable framework** OR **management disagreement** on their responsibilities (FS prep, internal controls, access).

4 Limitation on Scope

- **Do not accept** engagement if **management imposes a scope limitation** leading to a **disclaimer of opinion**.
 - **Unless required by law/regulation**.



10. Audit Engagement Letter [Refer Format in ICAI material]

1 Purpose & Agreement

- **Sent by auditor to client** to reduce misunderstandings.
- Auditor must **agree on terms with Mgmt** or TCWG (Those Charged With Governance).
- For non-statutory audits, it's a contract; **crucial to avoid conflicts**.
- **Terms** must be **in writing** for clarity.

2 Key Contents of the Letter

- **Objective and scope** of the audit.
- **Auditor's responsibilities**.
- **Management's responsibilities**.
- **Identification** of applicable **financial reporting framework**.
- **Reference to expected form** /content of reports, with **possible variations**.

3 Circumstance Where Engagement Letter Is Not Required

- If terms are **prescribed in detail by law** or regulation.
- Auditor **only needs to state** that the law/**regulation applies** and **management acknowledges** its responsibilities.

11. Change In Terms of Engagement as Per SA 210

1 Reasons for Change

Change in **circumstances, misunderstanding**, or scope restriction.

3 Non-Acceptance & Withdrawal

- If **no reasonable justification** for change, or **management doesn't allow** original engagement to continue, auditor must **withdraw**.
- **Assess obligation to report** withdrawal to other parties.

2 Acceptance of Change

- Auditor may **accept** if **reasonable justification** exists and work complies with SAs.
- **New terms must be agreed** and recorded in a new engagement letter.
- New report shall **NOT** refer to original engagement.

4 Considerations for Lower Assurance

- Determine **reasonable justification**.
- **Assess legal/contractual** implications.
- **Previous work** may be relevant, but report will be for new engagement.
- New report will **not mention the original audit** or procedures.

12. Matters to be considered before agreeing to change terms

1 Change to Lower Assurance

Reasonable justification required if changing to a **lower assurance** engagement (e.g., audit to review).

2 Legal or Contractual Implications

Assess legal/contractual impacts of **changing to a review** or other related service.

3 Relevance of Previous Work

If justified, **previous audit work** may be relevant; however, **subsequent work and the final report** must be **appropriate** as per the **new engagement**.

4 Avoiding Confusion in Reporting

The **new report** shall **NOT** mention the original **audit engagement** or any procedures performed in it to **avoid confusion** for users.

5 Recording New Terms

New terms must be agreed upon and **recorded** in a new engagement letter or other suitable **written agreement**.

CA Ram Harsha

13. Sending New Engagement Letter in Recurring Audits

1 Initial Audit

An **engagement letter** must be **issued** when an auditor is **newly appointed**.

2 Recurring Audit

When the previous year's **auditor is reappointed**, a new letter is issued based on **circumstances and professional judgment**.

3 Re-issuance Triggers

A new letter is needed if there are:

- **Misunderstandings** (objective/scope).
- **Revised terms** of engagement.
- **Changes in legal/regulatory** requirements, **financial reporting framework**, or audit reporting.
- Recent **change in top management**.
- **Significant change** in the entity's business.

SQC 1: Quality Control for Audit and Review Firms

1 Scope & Objective

- **Goal:** Ensure **compliance** (professional standards, regulations, legal) & **appropriate reports**.
- Achieved via **Quality Control System (QCS)** policies & procedures.

3 Leadership Responsibilities for Quality

- Promote a **culture of quality**.
- **CEO / Managing Partners** hold ultimate **QCS responsibility**.
- **Leadership set an example for high-quality** audit work.
- **Operational QC managers** need experience, ability, authority.

5 Acceptance & Continuance of Client Relationships

Gather **info to assess** before accepting /continuing:

- **Client Integrity** (owners, management, practices, attitude to accounting/controls, fee pressure, scope limits, money laundering, reasons for changing auditors).
- **Firm's Competence/Capability/Time/Resources**.
- Compliance with **Ethical Requirements**.
- Document **issue resolution** for acceptance decisions.
- **Conflict of Interest:** Resolve before acceptance.
- **If new info arises after acceptance:** Assess legal / **professional responsibilities** (including reporting) & possibility of withdrawal.

7 Engagement Performance

- **Consistency in Quality:** Briefing teams (objectives, standards), **supervision, training, performance review**.
- **Consultation:** For difficult/**contentious matters** from Individuals internally / externally like **other firms, professional /regulatory bodies**).

9 Engagement Documentation

- P&P for **timely assembly** of final files.
- **Final Audit Files:** Complete assembly **within 60 days** of auditor's report.
- **Safe Custody P&P:** Confidentiality, integrity, accessibility, retrievability.
- **Ownership:** Firm's property (unless law/regulation specifies otherwise). May disclose to clients if doesn't affect validity/independence.
- **Retention Period:**
- Long enough for **monitoring QCS compliance**, or longer if law requires.
- Typically **at least 7 years** from auditor's report (or group auditor's report if later).

2 Elements of QCS

QCS covers:

- **Leadership** for quality
 - **Ethical requirements**
 - Acceptance / **Continuance of clients**
 - **Human Resources**
 - Engagement Performance
 - **Monitoring**
- QCP must be **documented & communicated**.

4 Ethical Requirements

- Ensure **firm, personnel, and experts** comply with **Code of Ethics**.

Independence

- **Communicate** requirements.
- Identify & **Address threats**.
- **Withdraw** if threats can't be eliminated.
- **Engagement Partners (EPs)** report threats promptly.
- Prompt notification of breaches for appropriate action.
- Annual **written confirmation of independence compliance** from relevant personnel.

6 Human Resources

- P&P for sufficient personnel with **capabilities, competence & ethical principles**.
- Covers **Recruitment, Compensation, Training, Career Development, Performance Evaluation**.
- Focus on **continuing professional development**.

10 Monitoring

- **P&P to evaluate QCS:** Are policies /**procedures relevant, adequate, and operating effectively?**
- **Periodic inspections** of completed engagements to **assess QCS compliance**.

8 Engagement Quality Control Review (EQCR)

- Significant judgments reviewed by **EQCR Reviewer (EQCRr)** before report issue.
- **Extent of Review:** Depends on complexity/risks.
- EP is **still responsible**.
- **Mandatory for ALL** listed entity audits. (Firm sets criteria for other engagements).
- **Disagreements** (EP vs. EQCRr): Resolve before report issue. If **EQCRr recommendations rejected, resolve via P&P (consulting another practitioner /firm/professional body)**.

SA 220 Quality Control for an Audit of Financial Statement

1 Scope & Objective

- **EP Role:** Responsible for **QC at engagement level** (per SA 220) to align with firm's SQC.
- **Goal:** Audit complies with **standards**; Audit report issued is appropriate.

3 Leadership Responsibilities for Quality on Audits

- **EP's Overall Responsibility:** Audit **Quality**.
- **EP Actions Emphasize:**
 1. Comply with **standards & firm QC**.
 2. Appropriate **audit report**.
 3. Encourage **team concerns**.

5 Acceptance and Continuance of Client Relationships and Audit Engagements

Before Accepting, check:

1. Client **integrity**.
2. **Team competence**/resources.
3. **Ethical** compliance.
4. **Prior audit issues**.

7 Engagement Performance

- **EP's Direction:** Directs, supervises; ensures standards compliance.
- **Review:** Ensure sufficient evidence for conclusions/report.
- **Consultation:** For difficult issues (internal/external).
- **EQCR** (Listed Entities Mandatory):
 - EP **discusses significant matters** with EQCRr.
 - **NO Audit Report Date** until EQCR done.
 - **Resolve differences** of opinion per firm P&P.

2 Responsibilities of Engagement Partner

- **Leadership** (Quality)
- **Ethical** (Compliance)
- **Acceptance/Continuance** (Clients)
- **Team Assignment**
- **Engagement Performance**
- **Monitoring**

4 Relevant Ethical Requirements

- **Independence:** **Identify & address** threats; apply safeguards.
- **Reporting:** EP **reports unresolved threats** to firm for action.

6 Assignment of Engagement Teams

Ensure **team & experts** have competence/capabilities.

8 Monitoring

- **Evaluate Firm QC:** Ensure P&P are **relevant, adequate, effective**.
- **Consider Results:** Assess impact of firm's **monitoring deficiencies on audit**.

9 Documentation

EP must document:

- **Ethical issues & resolution.**
- **Independence conclusions.**
- **Client acceptance/continuance** conclusions.
- **Consultation** details.

Chapter 3 - Audit Report

1. SA 700 Forming an Opinion and Reporting on Financial Statements

A. Introduction

- 1 Scope of SA 700
- 2 Need for SA 700
- 3 Auditor's Objective

- Auditor's responsibility to **form opinion** on financial statements.
- Form & content** of the auditor's report.

- Global Consistency:** Comparability & relevance.
- Credibility:** Promotes trust in global marketplace.
- User Understanding:** Helps users; highlights unusuals.

- Form Opinion:** Based on audit evidence **evaluation**.
- Express Opinion:** Clearly, in a written report.

B. Forming an Opinion

- 1 Auditor's Opinion
- 2 Basis for Opinion
- 3 Factors to Consider

Opinion: Financial statements are prepared, in all material respects, **as per** applicable financial reporting framework.

Conclude if reasonable assurance obtained that FS are **free from material misstatement** (fraud/error).

- Sufficient appropriate audit evidence **obtained**.
- Uncorrected misstatements** (individual/aggregate) are **not material**.
- Evaluations **performed**.

C. Evaluations by the Auditor

- 1 Evaluate Financial Statements
- 2 Qualitative Aspects of Accounting Practices
- 3 Factors to Consider

Compliance with applicable financial reporting framework.

a Qualitative Aspects (per SA 260)

- Management Judgments:** Involve **amounts & disclosures**.
- Possible Bias:** Auditor **may detect bias**.
- Misstatements:** The **Lack of neutrality** and **uncorrected misstatements** leads to risk of material misstatement.

Consideration

- Review entity's **accounting practices**.
- Look for **indicators of management judgment bias**.

Auditor evaluates:

- Significant accounting policies **disclosed & consistent**.
- Management **estimates reasonable**.
- Info is relevant, **reliable**, comparable, **understandable**.
- Adequate disclosures** (material transactions/events).
- Appropriate **terminology used**.

b Indicators of Lack of Neutrality

- Selective Correction:** Correcting misstatements that **increase earnings**, ignoring those that decrease earnings.
- Management Bias in Estimates:** Addressed by SA 540.

c Bias vs. Misstatements

- Bias **Indicators** ≠ **Misstatements**.
- Bias **influences** whether FS are **free from MMS**.

4 Fair Presentation Framework

In Case of FPFW, **Further evaluate:**

- Overall **Presentation, structure, content**.
- FS **represent** underlying transactions for **fair presentation**.

5 Reference to Reporting Framework

Auditor also evaluates **whether FS adequately refer** to the framework.

D. Key Definitions of SA 700

1 General Purpose Financial Statements (GPFS)

FS prepared under a GPFW.

2 General Purpose Framework

Financial reporting framework meeting common info needs of many users.

3 Types of Financial Reporting Frameworks

Can be Fair Presentation Framework OR Compliance Framework.

4 Fair Presentation Framework

- Requires compliance with framework.
- And acknowledges that management may:
 - Provide additional disclosures (explicit/implicit) for fair presentation.
 - Depart from framework (rare) to achieve fair presentation.

5 Compliance Framework

- Requires compliance with framework.
- Does NOT acknowledge need for:
 - Additional disclosures.
 - Departures from requirements.

E. Form of Opinions [Types]

1 Unmodified Opinion

Issued when FS are prepared, in all material respects, per applicable financial reporting framework.

2 Modified Opinion (Refer SA 705)

- Issued when:
 - FS materially misstated (based on evidence). OR
 - Unable to obtain SAAE to conclude FS are free from Material Misstatement (MMS).

3 Unmodified Opinion Wording

- Use phrases like:
 - "Present fairly, in all material respects..."
 - "Give a true and fair view..."
- Above Both Phrases are equivalent.

4 Prohibited Wordings

- DO NOT use: "with the foregoing explanation" or "subject to".
- These suggest a conditional or weakened opinion.

F. Comprehensive Audit Report Format

1. Title
2. Addressee
3. Auditor's Opinion
4. Basis for Opinion
5. Material Uncertainty Related to Going Concern [SA 570]
6. Key Audit Matters [SA 701]
7. Emphasis of Matter Paragraph [SA 706]
8. Other Matter Paragraph [SA 706]
9. Responsibilities of Management
10. Auditor's Responsibilities
11. Other Information Para [SA 720]
12. Report on Other Legal/Regulatory Requirements
13. Signature of the Auditor
14. Place of Signature [Ordinarily the city where the report is signed]
15. Date of the Auditor's Report
The date must be on or after the date of approval of the financial statements.
16. UDIN (Unique Document Identification Number)

G. Explanation of Content of Audit Report

Core Elements

- 1 **Title**
Must be "Independent Auditor's Report."
- 2 **Addressee**
To shareholders or those charged with governance, based on terms/law.
- 3 **Auditor's Opinion (Heading: "Opinion")**
 - Identifies entity & states (F/S) were audited.
 - Lists titles of each F/S.
 - Refers to notes & policies.
 - Specifies F/S date & period.
- 4 **Basis for Opinion (Heading: "Basis for Opinion")**
 - Audit conducted as per Standards on Auditing (SAs).
 - Refers to "Auditor's Responsibilities" section.
 - Statement of independence and compliance with ethical requirements.
 - Auditor obtained SAAE.

Key Considerations

- 5 **Going Concern (SA 570)**
 - Auditor obtains evidence if going concern is appropriate.
 - Concludes on material uncertainty casting doubt on entity's ability to continue.
 - Material uncertainty requires F/S disclosure for fair presentation.
- 6 **Key Audit Matters (KAM) (SA 701)**
Applicable for:
 - Listed entities, where
 - Law/regulation requires, or
 - at auditor's discretion (e.g., public interest, financial/charitable entities).
- 7 **Other Information (SA 720)**
Addresses inconsistencies/matters Between F/S and Other Information in Annual Report.



Responsibilities of Auditor

- 8 **Responsibilities for Financial Statements**
 - Management's responsibility for F/S preparation (as per AFRFW), internal controls (for MMS prevention) and appropriateness of going concern basis.
 - This section identifies those responsible for oversight of Financial Reporting Process.
- 9 **Auditor's Responsibilities**
 - Primary:** Obtain reasonable assurance (high, but not guarantee) F/S free from material misstatement (MMS) due to fraud or error; issue AR with an opinion.
 - Additional (under SAs):**
 - Exercise professional judgment & skepticism.
 - Identify / assess MMS risks, design/perform audit procedures, obtain S&A evidence.
 - Understand internal control (for effective audit).
 - Evaluate accounting policies, estimates, disclosures.
 - Assess going concern assumptions.
 - Evaluate presentation /structure /disclosures (for fair presentation framework).
 - Describe division of responsibility for Group Audits (SA 600).
- 10 **Communication Responsibilities**
 - To governance (TCWG): scope, timing, significant findings, internal control deficiencies.
 - Independence (for listed entities): Compliance with ethical requirements, disclose affecting relationships & safeguards.
 - KAM: Describe KAMs (for listed & others, unless restricted).
- 11 **Location of Responsibilities Section (3 options)**
 - Within report body.
 - As appendix.
 - On official website (if permitted).

Other Reporting Responsibilities & Signatures

12 Other Reporting Responsibilities

Legal/regulatory reporting (e.g. "Report on Other Legal and Regulatory Requirements"), presented immediately after F/S report.

13 Signature of Auditor

- Engagement partner's **personal name**.
- If firm, **personal name + audit firm name**.
- Includes **MRN & FRN**.

14 Place of Signature

City where signed.

15 Date of Auditor's Report

- No earlier than** obtaining SAAE.
- No earlier than F/S approval** by authority.

16 UDIN

All certificates / reports issued on or after Feb 1, 2019, must have **UDIN**.

17 Prescribed Layout

If law requires **specific layout**, refer to **SAs only** if that layout includes **minimum elements**.

2. SA 705 Modifications to the Opinion in the Independent Auditors Report

A Scope & Objective

- Scope:** Deals with issuing an appropriate report when **modifying opinion** (per SA 700) and its form/content.
- Objective:** Express a **clear, appropriately modified** opinion when:
 - F/S are **materially misstated (MMS)**.
 - Unable to **obtain SAAE**.

B Circumstances for Modification

- F/S are **not free from MMS** (based on S&A AE).
- Unable to obtain SAAE** to conclude F/S are free from MMS.

C Types of Modified Opinions

1 Qualified Opinion (Q.O.)

- MMS is **Material but NOT Pervasive**.
- Unable to obtain SAAE**, and possible effects of undetected MMS are **Material but NOT Pervasive**.

2 Adverse Opinion (A.O.)

MMS is **Material AND Pervasive**.

3 Disclaimer of Opinion (DOO)

- Unable to obtain SAAE**, and possible effects of **undetected MMS** are **Material AND Pervasive**.
- Rare cases of **multiple uncertainties** preventing opinion.

D Definition of Pervasive

- Describes **impact of MMS/undetected MMS** that:
 - Not confined** to **specific elements/accounts**.
 - If confined, **represent a substantial proportion** of F/S.
 - Relates to **disclosures fundamental** to **users' understanding**.

E Determining Type of Opinion

Depends on:

- Nature of Matter:** F/S are MMS **or** Inability to obtain S&A AE.
- Pervasiveness** of effects or possible effects.

F Consequence of Management-Imposed Limitation

- A. **Request Removal:** Auditor requests management to **remove limitation** (if leading to Q.O./DOO).
- B. **Refusal to Remove:**
 1. **Communicate** to TCWG.
 2. Determine if **alternative procedures** can obtain S&A AE.
- C. **Unable to Obtain AE** (even through alternatives):
 - If possible effects **Material but NOT** Pervasive → Qualify Opinion.
 - If possible effects **Material AND Pervasive:**
 1. Withdraw (if possible by law).
 2. If withdrawal not possible → Disclaim Opinion.
- D. **Communicate MMS before Withdrawal:** Communicate any identified MMS to TCWG.

G Reference in Audit Report for Modified Opinion

- **Heading of Opinion & Basis for Opinion** sections will reflect the **type of modification** (e.g., "Qualified Opinion," "Basis for Qualified Opinion").
- **Basis for Opinion** section **describes the matter** giving rise to **modification**.

H Basis for Opinion Section in Modified Opinion

- A. **MMS in F/S (Specific Amounts):**
 - **Describe & Quantify** financial effects of MMS (unless impracticable).
 - **State** if quantification is **not practicable**.
- B. **MMS in Narrative Disclosures:** Explain how narrative is misstated.
- C. **MMS by Non-Disclosure:**
 - **Discuss with TCWG**.
 - Describe **nature of omitted** information.
 - Unless prohibited, include **omitted disclosures** (if practicable based on S&A AE).
- D. **Inability to Obtain Evidence:** **Describe the reasons** for inability.
- E. **In Case of Disclaimer of Opinion:** **In Basis for Opinion, DO NOT INCLUDE:**
 - **Reference to Auditor's Responsibilities** section OR
 - **Statement that SAAE** obtained.

Note : Any other matter that could have **led to a modified opinion** and its **effect** should be **included in BFO**

I Auditor's Responsibilities section in D.O.O

Amend Auditor's Responsibilities to include only:

- **Statement** that auditor is **responsible to conduct audit** per SAs to issue report.
- Statement that, **due to matters in Basis for Disclaimer**, auditors could **not obtain SAAE**.
- Statement on **independence and other ethical responsibilities**.
- **Note:** **KAM** section shall **not be included** unless required by law/regulation.

J Communication with TCWG

When a **modified opinion is expected**, communicate with TCWG about:

- **Circumstances** leading to modification.
- **Wording** of the modification.

3. SA 701 Communicating Key Audit Matters in the Independent Auditor's Report

A Scope & Applicability (Who/What)

- **Scope:** Auditor's job to **identify & report** most significant matters from the audit.
- **Applicability:**
 - **Mandatory:** Listed Entities (GPFS).
 - **If Required By Law/Regulation.**
 - Auditor's **choice** (e.g., Public Interest entities).

PROHIBITION ON KAM
NO KAM if a Disclaimer of Opinion (DOO) is issued.

F Communication with TCWG (Internal communication)

- Auditor **MUST** communicate to TCWG:
 - Identified **KAMs**.
 - OR, if **no KAMs** determined, the **conclusion** that there are **none**.

B Definition of KAM (What is it?)

Matters from TCWG communication that required **Significant Auditor Attention**.

D Purpose of KAM (Why communicate?)

- **ENHANCE VALUE:** Adds **transparency**, insights to report.
- **USERS' UNDERSTANDING:** Helps users understand **entity & key judgments**.
- **NOT a substitute for:**
 - Financial Reporting Framework **disclosures**.
 - **Modified Opinion** (SA 705).
 - **Separate** opinion on individual matters.
 - **Going Concern material uncertainty** (SA 570).

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C Determining KAM (How to identify?)

- From matters **communicated with TCWG** needing significant auditor attention.
- **Considerations:**
 - Higher/**Significant Risks** (SA 315).
 - **Significant Management Judgments** (e.g., estimates with high uncertainty).
 - Impact of **Significant Events/Transactions**.

E Communication in Report (How to present?)

- **Separate Section:** Titled "Key Audit Matters."
- **Introductory Paragraph:**
 - States KAM are "**most significant**" matters in current period's audit.
 - Explains KAM addressed "**in context of audit as a whole**," NO separate opinion.
- **Description for each KAM:**
 - **Why** it was a KAM.
 - **How** the auditor addressed it.

4. SA 706 EOMP and OMP in the Independent Auditor's Report

Core Idea: Additional communication in the auditor's report.

1. Emphasis of Matter Paragraph (EOMP)

1 Objective

Draw **attention** to matters **PRESENTED/DISCLOSED** in F/S that are **FUNDAMENTAL** to users' understanding of F/S.

2 Definition

Paragraph in auditor's report referring to a matter **appropriately Presented/Disclosed** in F/S, judged as **FUNDAMENTAL** to users' understanding of F/S.

3 Conditions to use

- Auditor **NOT required** to **modify** opinion (SA 705).
- Matter **NOT determined** as a Key Audit Matter (**KAM**) (SA 701).

4 Presentation (Manner)

- **Separate section, heading:** "Emphasis of Matter"
- Clearly express **Matter & Reference** relevant disclosure in F/S.
- **State:** "Auditor's **opinion** is **NOT modified**" concerning the matter.

5 EOMP is NOT a SUBSTITUTE for

- A **Modified Opinion** (SA 705).
- **Disclosures** required by **AFRFW** in F/S.
- Reporting under **SA 570** (material uncertainty regarding Going Concern).

2. Other Matter Paragraph (OMP)

1

Objective

Draw attention to **matters other than those presented/disclosed in F/S** But **relevant to users' understanding of the audit, auditor's responsibilities, or report.**

2

OMP Definition

A para that refers to **matters other than those presented/disclosed in F/S** But **relevant to users' understanding of the audit, auditor's responsibilities, or report.**

3

Usage Conditions (MUST meet BOTH)

- **NOT** prohibited by law or regulation.
- Matter **NOT** determined as a **Key Audit Matter (KAM)** (SA 701).

4

Presentation (Manner)

Separate section, heading: "Other Matter" (or another appropriate heading).

5

Communication with Governance

If **EOMP** or **OMP** is expected, auditor **SHALL COMMUNICATE** this with Those Charged with Governance (TCWG), including the exact wording of the paragraph.

5. SA 710 Comparative Information - Corresponding Figures and Comparative Financial Statements

A

Scope

- Auditor's **responsibilities** for **comparative info** in FS audit.
- SA 510 applies if **prior FS** were **predecessor audited / unaudited.**

B

Nature of Comparative Information

- Depends on **AFRFW.**
- **2 Reporting Approaches:**
 - **Corresponding Figures:** Opinion **refers to current period only.**
 - **Comparative Financial Statements:** Opinion refers to **each period presented.**
- **Approach** often dictated **by law / regulation.**

C

Objectives

- Obtain **SAAE** that comparative info is presented per **AFRFW.**
- **Report consistent** with **responsibilities.**

D

Meaning of Comparative Information

Amounts and disclosures of prior periods included in FS.

E

Audit Procedures

- **Verify & Classify:** Ensure inclusion, **proper classification**, agreement to **prior amounts / disclosures.**
- **Consistency:** Verify **accounting policy consistency** or proper accounting / disclosure of changes.
- **MMS in Comparative Info:** Perform **additional procedures** if identified.
- **Prior Period Audited by Same Auditor:** Follow **SA 560.**
- **Written Representations (SA 580):** Obtain for all periods in opinion and **specific prior P&L items.**

G

Audit Reporting for Comparative Financial Statements

- **Definition:** (a) **Prior period amounts/disclosures** for comparison; (b) If audited, referred to in opinion; (c) **comparable detail to current period.**
- **Auditor's Opinion:** Must **refer to each period** presented and audited.
- **Difference of Opinion (Same Auditor):** **Disclose substantive reasons** in an Other Matter paragraph (as per SA 706).
- **Prior Period Audited by Predecessor:** Include an **Other Matter paragraph** stating about predecessor, opinion type/reasons, and report date. If **MMS exist in prior period**, communicate with governance and notify predecessor.
- **Prior Period Not Audited:** Include an **Other Matter paragraph** stating unaudited. **Doesn't reduce SA 510 responsibility** for opening balances.

F

Audit Reporting regarding Corresponding Figures

- **Definition:** **Prior period figures read only** in relation to **current period**; level of detail based on current period relevance.
- **Auditor's Opinion (General):** Does **NOT** refer to **corresponding figures** normally.

Exceptions

- A. **Unresolved Prior Period Modifications:** If prior report was qualified/disclaimer/adverse and matter is unresolved:
 - **Modify current opinion.**
 - **Basis for Modification:** **Refer to both current and corresponding figures** if material to current period; otherwise, explain impact on comparability.
- B. **Material Misstatement in Prior Period (Unmodified Opinion):** If **uncorrected:** **qualified or adverse opinion** on **current period.**
- C. **Prior Period Not Audited:** **State** this in an Other Matter paragraph. Doesn't reduce SA 510 responsibility for opening balances.
- D. **Prior Period Audited by Predecessor:** **Include** an Other Matter paragraph **stating predecessor, opinion type/reasons** and auditor's report date.

6.SA 299: Joint Audit of Financial Statements

A**Meaning**

- Joint Audit involves **2 or more individuals** /firms **auditing financial statements**.
- Its **aim is to pool resources** and expertise for **quality, timely results**.

B**Advantages**

- Shared **expertise** and mutual **consultation**.
- Lower workload**, better quality, **improved client service**.
- Healthy competition** and leveraging **local expertise**.

C**Disadvantages**

- Fees shared**.
- Psychological issues** (e.g superiority complexes)
- Coordination challenges** and risk of neglecting common areas.
- Uncertain about **liability**.

D**Responsibilities of Joint Auditors****Individual or Separate Responsibilities:**

- For divided work, each auditor is **responsible only for their allocated parts**.
- Allocation can be by: **assets/liabilities, income/expenditure, areas, units, or period**.

Joint Responsibilities (Indivisible):

- For **undivided work** and **collectively decided matters**.
- Ensuring financial statements **comply with statutory requirements**.
- Verifying presentation/disclosure** as per AFRFW.
- Ensuring **audit report** complies with **standards** /statutes.

E**Audit Reporting in Case of Joint Audit**

- Generally, **joint auditors** issue a **single report**.
- Disagreement:** A joint auditor is **not bound by the majority**; can **issue a separate report**, **cross-referencing** others.

F**Coordination among Joint Auditors**

- Proper **coordination is essential**.
- Matters affecting **others' work** must be **communicated** before the report date.
- Each joint auditor can **rely on others' work**; no review required.

G**Special Considerations under SA 299**

- Engagement Partner Role:** Involved in **audit planning**.
- Overall Audit Strategy:** Jointly **established** as per SA 300.
- Joint Audit Plan:** **Developed before audit start**, covering allocation, **common areas, reporting**, significant factors preliminary engagement **activities and resources**.
- Risk Assessment:** Each auditor must **assess** and **communicate risks**.
- Audit Procedures:** **Discussed & documented** for **common** and **specific areas**.
- Engagement & Management Letters:** **Common letters** required.
- Work Allocation:** Must be **documented, signed by all** and **communicated** to governance.

7. Audit of Branch Office Accounts

A. Books of Accounts (Section 128)

1 Books of Accounts

- Companies must **maintain true & fair view** books at registered office (or notified place).
- Must **use accrual basis & double-entry system**. Can be electronic.

2 Branch Books of Accounts

- Can be **maintained** at the branch.
- Summarized returns** sent to registered office **periodically**.

3 Audit of Branches (Section 143(8))

- Audited by:**
 - Company's auditor.
 - Another qualified auditor (appointed under Section 139).
- For foreign branches:** Company's auditor, an accountant, or local qualified person.

4 Reporting by Branch Auditor

- Branch auditor reports** to company's auditor (for inclusion).
- Fraud reporting also** applies to **branch** auditor.

B. SA 600 Using the Work of Another Auditor

1 Definitions

- Principal Auditor:** Reports on entity's **financial information**, including **components audited** by others.
- Other Auditor:** Audits **component** financial information for the principal auditor.
- Component:** **Division, branch**, subsidiary, etc., part of principal audit.

2 Using Another Auditor's Work

- Clear understanding of **roles and effective coordination** needed.
- Principal auditor can **rely on other auditor's work**, unless direct examination is required by special circumstances.

3 Principal Auditor's Procedures

- Inform **other auditor** on **work usage** and arrange **coordination** (at planning stage).
- Communicate **special considerations**, inter-component transactions, **reporting, and timetable**.
- Review or discuss other auditor's** procedures and findings.
- Perform additional procedures** if necessary (based on engagement/competence).
- May **visit other auditor** to enhance coordination.



8. Reporting Requirements Under The Companies Act, 2013

Reporting on Other Legal and Regulatory requirements [Other Reporting Requirements]

1 Reporting Requirement on Matters (Section 143(1))

Auditor shall inquire into specific matters:

- **Loans & Advances:** Properly secured, terms not prejudicial.
- **Book Entries:** Transactions not prejudicial to company's interests.
- **Shares/Securities Sold:** Not at less than purchase price (except banking/investment cos.).
- **Loans/Advances as Deposits:** Check if shown as deposits.
- **Personal Expenses:** Check if charged to revenue.
- **Shares for Cash:** Verify cash received, correctness of books/balance sheet.

Reporting: Positive responses can be ignored; adverse comments must be stated with reasons.

2 Reporting on Accounts Examined (Section 143(2))

- Auditor reports to members on examined accounts & financial statements.
- Report considers Act, accounting / auditing standards, other rules.
- Reports whether F/S provide a true and fair view of:
 - State of affairs (year-end).
 - Profit/Loss.
 - Cash flows.
 - Other matters as per Rule 11.

3 Additional Reporting Requirements (Section 143(3))

- Report shall include:
 - **Info & Explanations:** Whether sought & obtained; if not, details & effect.
 - **Books & Returns:** Proper books maintained, adequate branch returns received (if not visited).
 - **Branch Audit Report:** Consideration of Reports & how they were dealt with.
 - **Agreement:** B/S & P&L agree with books & returns.
 - **Accounting Standards:** F/S comply with AS.
 - **Adverse Observations:** Comments with adverse effects on company functioning.
 - **Director Disqualification:** If any director disqualified under Sec 164(2).
 - **Qualifications/Reservations:** On accounts or related matters.
 - **Internal Financial Controls (IFCs):** Adequacy & operating effectiveness.
 - **Exemptions:** Does not apply to OPCs, Small Companies, or private companies with Turnover < Rs. 50 Cr AND Borrowings < Rs. 25 Cr.
 - **Rule 11 Matters:**
 - **Pending Litigations:** Impact disclosure.
 - **Foreseeable Losses:** Provisions for material foreseeable losses on long-term contracts/derivatives.
 - **IEPF Transfer:** Delay in transferring amounts to IEPF.
 - **Funding/Intermediary Representations:** Obtain management representation on specific funding /intermediary transactions (no onward lending/guarantee to ultimate beneficiary) and limited assurance on such.
 - **Dividends:** Compliance with Section 123 for declared/paid dividends.
 - **Accounting Software:** Use of software with audit trail feature, not tampered, preserved as per statutory requirements (e.g 8 years).
 - **Reporting:** Positive/negative response; negative/qualifications require reasons.


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4 Reporting on Other Matters (Section 143(11))

Central Government may require additional statements for specified companies (e.g., CARO 2020).

5 Reporting on Frauds (Section 143(12))

- If reason to believe fraud committed by/on company:
 - **Frauds ≥ Rs. 1 crore:** Report to CG (ADT 4).
 - **Frauds < Rs. 1 crore:** Report to Audit Committee or Board.

Note: Include fraud matters in CARO 2020, Para 3 CLAUSE (xi).

CARO 2020

Clause i
Fixed Assets

1. Register	Properly maintained?
2. Physical Verification	Is it done at proper intervals ? and discrepancies (if any) properly dealt in BOA ?
3. Title Deeds	Is it in Company's name ?
4. Revaluation	- Whether PPE AND Intangible Assets revalued? - Is it done by Registered Valuer? - Specify Amt of Change if change is ≥ 10% of Net CV of each class of PPE & Intangibles
5. Benami Transactions	Whether any proceedings initiated against the company under BT act & if appropriately disclosed in FS

Clause ii
Inventories

1. Physical Verification	- Is it done at proper intervals? Discrepancies ≥ 10% in the aggregate of each class of Inventory noticed are properly dealt in BOA?
2. Working Capital Loans	- Whether WC sanctioned in excess of 5 crores on security of Current Assets? - Whether Qtrly returns and statements filed with Banks or FI are in agreement with BOA?

Clause iii
Loans Advances Investments Guarantees

Whether company has provided loans or advances in the nature of loans (secured or unsecured) guarantees or provided security to any other entity? If so,
1. Break up between related parties and others
2. Terms & Conditions - Not prejudicial to Co's Interest
3. Repayment receipts are regular ?
4. Overdue > 90 days - Took Reasonable steps to recover ?
5. Renewals/ Extensions done - Specify Aggregate amount of such dues renewed, extended or settled by fresh loans.
6. Demand Loans - Specify the aggregate amt, percentage thereof to total loans & Aggregate amount of Loans granted to Promoters, RP's .

Clause iv
Compliance with Sec 185 & 186

- Whether **complied** with Sec 185, 186 ?
- If not**, Provide **details** thereof

Clause v
Deposits

Verify compliance with **Sec 73 to 76**, **RBI Directives** & Orders from **CLB, Courts, Tribunals**

Clause vi
Cost Records

- Whether **maintaining** Cost records - prescribed u/s 148(1)
- Whether such **accounts & records** are maintained?

Clause vii
Statutory Dues

1. Undisputed Dues	Whether company is regular in depositing it ? If not, extent of arrears o/s more than 6 months on B/S Date?
2. Disputed Dues	Amount Involved & Forum where it is pending

Clause viii
Undisclosed Income

- Transactions **not recorded in BOA** are **discovered** during the Year, If so whether **properly recorded** in BOA.

Clause ix
Defaults in Repayment

1. Lender wise Defaults	To be mentioned if defaulted in repayment of loans or interest - Nature, name of lender, Amt not paid, Whether Principal or interest, No of Days Delay, Remarks if any.
2. Wilful Defaulter	Is company declared as wilful defaulter by any lender?
3. Diversion of Funds	If loans not applied for the purpose obtained, Mention Amount of loan diverted
4. Short terms funds diverted	If ST funds used for LT Purpose, indicate the nature & amount used
5. Loans taken for Subsidiaries	Nature of Transactions & Amount
6. Loans against Pledge of Shares	- If so, Report details thereof. - Also report if defaulted in repayment.

Clause x End use of Funds

1. IPO/FPO

- Whether **money** for the respective purpose **were utilized** for the **purpose for which they were raised**
- If not, Report the **Details of defaults, delays & subsequent rectifications**.

2. Preferential Allotment

- If Preferential Allotment or Private Placement of shares made during the year, Verify **Compliance with sec 42**
- Whether Amount raised have been **used for the purpose** that it was raised, If not provide details of **amount and nature of Non compliance**.

Clause xi Fraud Reporting

- Whether Fraud on the **company or by the company** is **noticed or reported** during the year, If so, **Nature & Amount** involved
- Whether **report u/s 143(12)** has been filed by auditors in **ADT-4** with **CG**.
- Whether auditor considered **Whistle Blower Complaints** recd during the year



Clause xii Nidhi Companies

Whether Nidhi Company has complied with

- NOF** to **deposits** in the **ratio of 1:20**,
- Maintaining **10 % Unencumbered term deposits**,
- Any default in payment of interest on deposits or repayment, **report** the details of it.

Clause xiii Related Party Transactions

Whether in compliance with **Sec 177 & 188** & **disclosed** in the **FS** as reqd by **AS**.

Clause xiv Internal Audit System

- Whether company has **ICS commensurate with size & nature** of business?
- Whether **Int. Auditor's Report** for the period were **considered** by Stat Auditor?

Clause xv Non - Cash Transactions

Whether company **entered into** Non cash Transactions with **directors** & if so **Sec 192 provisions** have been **complied** with.

Clause xvi NBFC

1. 45 IA of the Act

Whether **reqd to be registered** & has it been obtained

2. Certificate of Registration

Whether Company has conducted **any NBFC activity w/o valid CoR**.

3. Core Investment Company

- Whether the company is a **CIC**, If it **Continues to fulfil** the criteria of **CIC**,
- If **exempted or unregistered** **CIC**, Continues to fulfil such criteria,
- If group has **more than one** **CIC**, Mention **number of CIC's** part of the **Group**

Clause xvii Cash Losses

Whether Incurred **Cash Losses** in **FY** & Immediate **Pre FY**. If so, State the **amount** of Cash Losses.

Clause xviii Resignation of Auditors

Whether there is **resignation of Stat Auditors** during the year, if so, Whether incoming auditor is taken into **consideration** the **issues, objections or concerns** raised by outgoing auditors.

Clause xix Material Uncertainty

Based on various informations (**ratios, ageing analysis**) and **auditor's knowledge** - If he is of the opinion that No material uncertainty exists at the date of **B/S Date**

Clause xx CSR Compliance

1. Other than Project expense

Unspent amount trfd to Fund specified **within 6 months of expiry of FY**.

2. Project Expense

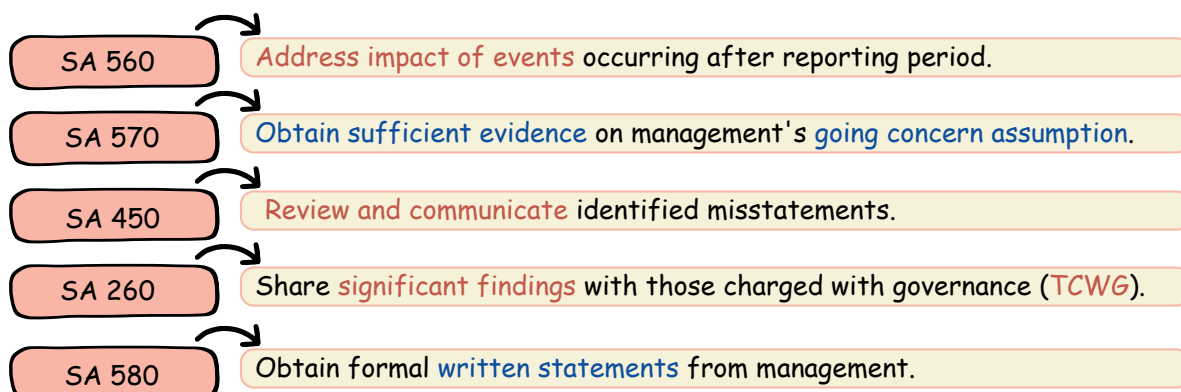
Whether Unspent amount trfd to **special account u/s 135(6)**

Clause xxi CFS

- Applicable for **AR on CFS**
- Whether there is **Qualification /Adverse** marks by the respective auditors in **CARO Report** of the companies included in **CFS**,
- If so, **details of the Companies** & **paragraph numbers** of the **CARO Report**

Chapter 4 - Completion and Review

1. Procedures to be performed Before Signing the Audit Report



2. SA 560 Subsequent Events

A

Definitions

- **Subsequent Events:** Events after financial statements date but before auditor's report date, and facts known after auditor's report date.
- **Date of the Financial Statements:** End date of latest period covered by F/S.
- **Date of Approval of Financial Statements:** When F/S are finalized and asserted by authority.
- **Date of the Auditor's Report:** When auditor dates the report per SA 700.
- **Date the Financial Statements are Issued:** Auditor's report and F/S are made available to 3rd parties.



B

Types of Subsequent Events

- **Adjusting Events:** Provide evidence of conditions existing at F/S date (e.g., debtor insolvency, legal claim settlement).
- **Non-Adjusting Events:** Provide evidence of conditions arising after F/S date (e.g. new share issue, merger, inventory destruction).

C

Scope and Objective of SA 560

- **Scope:** Deals with auditor's responsibilities for subsequent events.
- **Objectives of Auditor (SA 560):**
 - Obtain SAAE for appropriate adjustment or disclosure of events between F/S date and auditor's report date.
 - Respond appropriately to facts known after auditor's report date that might have required report amendment.

D

Audit Procedures for Subsequent Events

1. Perform procedures to obtain SAAE that all events requiring adjustment or disclosure are identified.
2. No additional procedures on matters satisfactorily addressed.
3. **Audit Procedures:**
 - a. Understanding Management's procedures to identify subsequent events.
 - b. Inquiries with Management and TCWG.
 - c. Reading minutes of meetings and inquiring about unrecorded matters.
 - d. Reading latest interim financial statements.
 - e. Reviewing accounting records, budgets, and financial information after F/S date.
4. **Verification of Adjustments:** Verify events requiring adjustments /disclosures are appropriately reflected.
5. **Written Representations:** Obtain per SA 580, confirming all subsequent events accounted for.

E. Facts identified Before the date of F/S issued to public

1

Discuss with Management

If fact **becomes known after** auditor's report date but before F/S issue:

- Discuss with management and TCWG.
- Determine if F/S **need amendment**.
- Inquire how management **intends to address**.



2

Management Amends F/S

- Perform audit procedures **specific to amendment**.
- **Extend** audit procedures to **new auditor's report date**.
- Provide a **new auditor's report**.
- Ensure new report is **not dated earlier than approval** of amended F/S.

3

Management doesn't amend the F/S

1.If Report NOT Yet Provided:

- **Modify** Opinion (as per SA 705) BEFORE issuing report.

2.If Report ALREADY Provided:

- **Notify Mgmt & TCWG: DO NOT issue FS & Auditor's Report** until amendments made.

3.If UNAMENDED F/S ARE Issued:

- **Take Appropriate Action: To prevent reliance** on the auditor's report.

[NOT IN INDIA] Limited Amendment Option: (If law allows)

- **Amend report with additional date** for restricted amendment.
- New/**Amended report with Emphasis of Matter/Other Matter** paragraph stating **restricted procedures**.

F. Facts identified After the date of F/S issued to public

Auditor is under **no obligation to perform further audit procedures** after F/S issued.

1

Discuss with Management

- Discuss with management and TCWG.
- Determine if **F/S need amendment**.
- Inquire how **management plans** to address.

Management Amends Financial Statements

- **Perform necessary audit procedures** on amendment.
- Review management's **steps to inform recipients** of previously issued F/S.
- Extend audit **procedures to new report date**; new report not dated earlier than approval.
- Provide a **new auditor's report**.

Amendment Restricted to Subsequent Events [Not in India]

Include an **Emphasis of Matter (EOM)** or **Other Matter (OM)** paragraph in the report, **reasons and earlier report**

If Management Does Not Amend

- **Notify management/governance** that auditor will **seek to prevent future reliance** on report.
- If no action, **take appropriate action** to prevent reliance.

3. SA 570 Going Concern

A. Significance of Going Concern in Financial Reporting

Does Management intend to liquidate or cease operations?

YES

Entity is NOT a Going Concern

- Financial Statements on **Liquidation Basis**
- Inventories written down to **lower realizable prices**
- Assets **recorded at Expected** liquidation value

NO

Entity IS a Going Concern

- Assets & Liabilities at **Normal Realization/Discharge**

SA 570 - Auditor's Responsibilities

Outlines auditor's role in **assessing entity's GC status** and its **implications** for the audit report.

B. Primary Responsibility for Assessment of Going Concern

1 Management's Responsibility

- Primary:** Management must **assess ability to continue** as a **going concern**.
- Required even if FR framework **doesn't explicitly state it**

2 Making Judgements on uncertain future

Involves judgments about **inherently uncertain future outcomes**.

3 Factors Affecting Judgment

- Degree of Uncertainty:**
 - Increases with future date** of event/outcome.
- Entity-Specific Factors:**
 - Size, Complexity, Nature,** Condition of business.
 - Sensitivity to External Factors.
- Timing of Information:**
 - Judgments based **only on info available** at assessment time.
 - Later events can **lead to different outcomes**.

C. Objective of the Auditor under SA 570

1 S&A Evidence on Appropriateness

Obtain **SAAE** on management's use of the going concern basis

2 Whether a Material Uncertainty Exists

Conclude

- Events** or conditions that **may cast significant doubt**.

3 Report as per SA 570

Report findings as per requirements of SA 570

D. Responsibilities of the Auditor under SA 570

1 Auditor's Responsibilities

Obtain **SAAE** on appropriateness of **going concern basis** and conclude on **material uncertainty**.

2 What if AFRFW silent on this?

Applies even if **framework doesn't explicitly require assessment**.

3 Silence in Audit Report is not a guarantee on Going Concern

Auditor **cannot predict future events**; **absence of reference in Report is not a guarantee of GC**.

E. Risk assessment Procedure related to Going Concern

1

Auditor shall consider if events/conditions exist that may cast significant doubt on going concern during risk assessment procedures (SA 315).

3

Remain alert throughout the audit

For evidence of events / conditions casting significant doubt.

2

Evaluate Management's Preliminary Assessment

- If performed:
 - Discuss assessment,
 - Identify events/conditions,
 - evaluate management's plans.
- If not performed:
 - Discuss basis for using going concern,
 - Inquire about casting doubt events/conditions.

F. Examples of Events or Conditions Casting Significant Doubt

1

Financial Events or Conditions

- Net liability position,
- Maturing borrowings,
- Negative operating cash flows,
- Operating losses,
- Inability to pay creditors,
- Non-compliance with loan terms.

2

Operating Events or Conditions

- Intent to liquidate,
- Loss of key management / customers,
- Labour difficulties,
- Shortages supplies,
- New Strong competitors.

3

Other Events or Conditions

- Non-compliance with regulatory requirements,
- Pending legal proceedings,
- Changes in laws,
- Uninsured catastrophes.

G. Evaluate management's assessment of going concern

1

Evaluation of Management's Assessment

Ability to continue as a going concern.

2

No need to rectify lack of analysis by Management

- Not auditor's responsibility,
- But auditor may conclude on appropriateness of the going concern basis.

3

Detailed Evaluation in other circumstances

Auditor may need to evaluate management's process, assumptions, and feasibility of plans.

4

Period of Assessment

- Cover same period as management's assessment as per AFRFW / law.
- Minimum 12 months from F/S date; request extension if shorter.



H. Additional Audit Procedures if events or conditions are identified

1

Objective

When events/conditions cast significant doubt on going concern, obtain S&A audit evidence to determine if a material uncertainty exists, considering mitigating factors.

3

Examples of Additional Audit Procedures

- Financial analysis (cash flow, interim F/S),
- Loan and Financing Terms (breaches, borrowing facilities),
- Legal and Regulatory (litigation, reports),
- Governance and
- Commitments (minutes, customer orders),
- Subsequent Events, Asset Disposals.

2

Additional Audit Procedures to Obtain Evidence

- Request Management's Assessment if not performed.
- Evaluate likelihood and feasibility of management's plans for future actions.
- Analyse Cash Flow Forecasts: reliability of data, support for assumptions.
- Consider Additional Information available.
- Written Representations from Management /TCWG regarding plans / feasibility.

I. Auditors Conclusions on Existence of Material uncertainty

- 1 Appropriateness on using GC
Evaluate **SAAE** obtained and conclude on appropriateness of management's use of going concern basis.
- 2 Conclusion on Material Uncertainty
 - **Material uncertainty** exists
 - **Significant doubt** on entity's GC ability.
- 3 Definition of Material Uncertainty
The **magnitude of potential impact** and **likelihood of occurrence** that Requires appropriate disclosure of the uncertainty's **nature & implications**.

J. Evaluate Adequacy of Disclosures of Material Uncertainty

- 1 If Material Uncertainty Exists
 - If appropriate going concern but material uncertainty, **determine if F/S**
 - Adequately disclose key events/conditions** and management's **plans**, and
 - Clearly **disclose the existence** of a material **uncertainty and its implications** (inability to realize assets / discharge liabilities).
- 2 If No Material Uncertainty Exists
Evaluate if **F/S provide adequate disclosures** about **identified events** / conditions as per AFRFW.

K. Audit Reporting under SA 570

- 1 If Use of Going Concern Basis is Inappropriate
Express an **Adverse opinion**.
- 2 Use of Going Concern Basis is **Appropriate but a Material Uncertainty Exists**

Adequately Disclosure in Financial Statements

 - Express an **unmodified opinion**;
 - Include a **separate section** "Material Uncertainty Related to Going Concern"
 - **Drawing attention** to relevant note,
 - **Stating material uncertainty**, and
 - That auditor's opinion is **not modified**.

Inadequate Disclosure in Financial Statements

 - Express a **Qualified opinion** or an **Adverse opinion** (SA 705);
 - BFO section **states material uncertainty**, its **impact**, and **inadequate disclosure**.
- 3 Management Unwilling to Make or Extend Assessment
 - Consider **implications**;
 - **Qualified opinion** or a **Disclaimer of opinion** if S&A audit evidence cannot be obtained.

4. SA 450 Evaluation of Misstatements Identified during the Audit

A

Objective of the Auditor under SA 450

1. **Uncorrected Misstatements:** Misstatements **accumulated during audit** that have not been corrected.
2. **Auditor's Objective:** Before forming opinion:
Evaluate effects of Identified misstatements and uncorrected misstatements on F/S.

B

Accumulation of Misstatements identified in Audit

- **Accumulation of Misstatements:** Accumulate misstatements identified during audit, **except** those clearly **trivial**.
- **Examples of Misstatements:** **Inaccuracies**, omissions, **wrong capitalization**.
- **Revision of Overall Audit strategy and plan:** Revise if
 - **Nature** of misstatements **indicates** other potential **misstatements** or
 - If aggregate misstatements **approach materiality**.
- **Request to Management:** May request management to **review, identify, and make adjustments** to F/S.
- **Additional Audit Procedures:** If management corrects, **perform procedures** to ensure **no misstatements remain**.



C. Communication & Correction of Misstatements identified

1

Timely Communication

Communicate all accumulated misstatements to appropriate **level of management**.

2

Request Management to Correct Misstatements

Request corrections to **maintain accurate records** and **reduce future risks**.

3

Management Refuses to Correct

- **Understand reasons;**
- **Evaluate** if F/S are **free of material misstatement**.

4

Evaluating effect of Uncorrected Misstatements

- **Re-evaluate Materiality levels:** **Confirm appropriateness** based on actual financial results.
- **Materiality of Uncorrected misstatements:** Determine if material individually or in aggregate, considering **size, nature, circumstances**, and prior period effects.

5

Communication with TCWG

- Communicate **uncorrected misstatements**,
- Request **corrections**,
- **Discuss prior period effects**.

6

Written Representation

Request from management/TCWG that **uncorrected misstatements** are **immaterial**; include summary.

D. Documentation of Misstatements Identified shall include

- **Trivial level:** The **amount below which** misstatements are clearly trivial.
- **Accumulated Misstatements:** All accumulated, **indicating whether corrected**.
- **Conclusion on Uncorrected Misstatements:** Auditor's **conclusion on materiality** (individually/aggregate) and **basis for conclusion**.

5. SA 580 Written Representations

A. Meaning of Written Representation and Using as Audit Evidence

1 Definition of Written Representations

- Written statements **from management to the auditor** confirm matters / **support other audit evidence**;
- Excludes F/S or assertions** therein.

2 Written Representations as Audit Evidence

- Included in:** All information **used to form the audit opinion**.
- Considered **audit evidence** (like inquiry responses).
- A **necessary source** of audit evidence.
- Management **modifying or refusing** to provide WRs indicates **potential significant issues**.

3 Written Representations as Audit Evidence

Prompts **management to consider matters** more rigorously, improving quality.

4 Limitations of Written Representations:

- Alone, **do not provide SAAE**;
- Don't reduce** auditor's **responsibility to obtain other evidence**.

B. Scope and Objective

1 Scope of SA 580

Deals with **auditor's responsibility** to obtain written representations **from management** (and TCWG, if appropriate).

2 Objectives of the Auditor

- For Management Responsibilities:** Obtain representations **confirming fulfilment of responsibilities** for F/S **preparation** and **providing complete information**.
- Decided by auditor or SA:** Obtain representations to **support other audit evidence** if **necessary or required by SAs**.
- Respond **appropriately to representations** provided or not provided.

3 From Whom to Obtain Written Representations

- Management with **appropriate responsibilities** for the F/S and knowledge.
- Written representations** relate to:
 - Management's **fulfilment of responsibilities**
 - Corroborate other audit evidence** for both the overall F/S and specific assertions.



C. Written representation about Management Responsibilities

1 Confirm about Management's fulfilment of their responsibility

Management must represent **fulfilment of F/S preparation** in accordance with **AFRFW**, including fair presentation.

2 Management's Knowledge of Process for P&P of F/S

Expected to have **sufficient knowledge**.



3 Informed Representations

Auditor may request inclusion of **confirmations of inquiries**; management may **seek specialist input** (e.g. Actuaries, Engineers, Internal Counsel)

4 Qualifying Language

Auditor may accept "**to the best of its knowledge and belief**" if made by responsible and knowledgeable individuals.

D. Written Representation about Completeness of Information

1 Provision of Information

Management must represent **all relevant information** and access provided.

2 Completeness of Transactions

Management must represent **all transactions recorded and reflected** in F/S.

E. Why Written Representations about Management Responsibilities [Need]

1

Audit evidence

Audit evidence alone is **not sufficient** to confirm management has **fulfilled responsibilities for F/S** preparation, Providing information, and **completeness of transactions**.

2

Limitations of Audit Evidence

Auditor **cannot judge solely** on other evidence.

- **Prepare F/S** in accordance with **AFRFW**.
- **Provided information** based on their **agreed responsibilities**.

3

Purpose of Written Representations

Confirm **management's acknowledgement** and understanding of its responsibilities.

F. Reconfirmation of Responsibilities through written representations

Auditor may ask for reconfirmation if

- Signatories **no longer hold responsibilities**,
- **Terms** from previous year,
- Management **misunderstands**, or
- Circumstances **changed**.

G. Description Of Management's Responsibilities in The Written Representations

Responsibilities shall be **described in the same manner** as outlined in the **terms of the audit engagement**.



I. Written Representations about Information Provided to The Auditor

1

Additional Written Representation

May request additional representation **beyond management's responsibility** for information provided.

2

Example

Communication of Deficiencies: Management **confirms known deficiencies** in internal control communicated to auditor.

J. Written Representations about Specific Assertions

- May **request for specific assertions** in F/S.
- **Purpose:** To support auditor's understanding of **management's judgment**, intent, or **completeness** of an assertion.

K. Date and Period Covered by Written Representation

1

Date of Written Representations

As near as possible to, **but not after**, the **date of auditor's report**; covers all F/S and periods mentioned.

2

Importance of Timing

Auditor **cannot** express opinion or **date report before receiving**.

3

For All Periods mentioned in Audit Report

For **All Periods** mentioned in Audit Report. This **reaffirms previous representations** for prior periods.

4

What if Current Management is Not Present in All periods mentioned?

Current management is **responsible** and must provide representations for **ALL periods**, even if not present previously.

L. Conclusions and Reporting under SA 580

1 Requested Representation is Not provided

1. Discuss,
2. Re-evaluate management's integrity,
3. Take appropriate actions, including DOO as per SA 705.

2 Written representation Not Reliable

- If concerns about competence/integrity or inconsistent with other evidence:
 - Perform more procedures to resolve.
 - If unresolved, reconsider management integrity.
 - Assess impact on all evidence.
 - Disclaimer of Opinion (SA 705).

M. Obtaining evidence about Judgements and Intentions

Consider:

- Entity's past history,
- Reasons for particular course of actions,
- Ability to pursue action,
- Existence or absence of other information that Conflict information.



6. SA 260 Communication with those Charged with Governance

A. An Effective 2 way communication is Important

1 For Benefit of Auditor and TCWG

Develops a constructive working relationship supporting the audit, while preserving auditor independence & objectivity.

2 For the Benefit of the Auditor

Relies on TCWG for entity information, audit evidence sources, and transaction insights.

3 For the Benefit of TCWG

Helps TCWG oversee financial reporting process, thereby reducing risks of material misstatement.

B. Who are "Those Charged with Governance" [TCWG]

1 Who are TCWG ?

Person(s) or organization(s) responsible for overseeing strategic direction and ensuring accountability, including financial reporting.

2 Includes Management Personnel

May include management personnel in some entities.

3 Depending on Governance Structures

Governance structures differ greatly (e.g., separate/single boards, legal roles, overlap with management).

4 Engaging party has to determine TCWG

- Agree with Engaging Party: Discuss & Confirm relevant persons.
- Understand Entity (SA 315): Use knowledge of governance structure to identify appropriate communicators based on the matter.



Examples

- **Boards:** Separate (Supervisory/Executive) vs. Single Unified
- **Legal:** Company Directors (part of legal structure)
- **Overlap:** TCWG = Management (Owner-Manager) vs. Separate TCWG/Management
- **Collective:** Board of Directors, Supervisory Board, Partners, Trustees
- **Smaller Entities:** One person (Owner-Manager, Sole Trustee)
- **Undefined:** Family-owned, Not-for-profits (informal)

C. Scope and Objective of SA 260

1

Scope

Deals with auditor's responsibility to communicate with TCWG



2

Objectives of the Auditor

- **Communication of Responsibilities of the Auditor:** Clearly communicate auditor's responsibilities and planned scope/timing.
- **Obtain Relevant Information:** From TCWG relevant to the audit.
- **Timely Observations:** Provide TCWG with significant and relevant observations for their oversight role.
 - **Promote Two-Way Communication:** Encourage effective two-way communication.

E. Matters to be communicated

1

Auditor's Responsibilities

Forming and expressing an opinion; audit does not relieve management/TCWG of responsibilities.

2

Planned Scope and Timing

Overview, including significant risks identified.

3

Significant Findings

- Qualitative aspects** of entities' accounting practices (policies, estimates, disclosures).
- Significant difficulties encountered during the audit.
- Significant matters discussed with management, written representations requested (if TCWG and management are different).
- Modification of Auditor's Report:** Circumstances affecting the form and content of the auditor's report.
- Other significant matters:** Relevant to financial reporting oversight.

4

Communication of Auditor's Independence in case of Listed Companies

- Compliance with Independence:** Statement confirming compliance with independence ethical requirements.
- Relationships & Fees:** Details of matters impacting independence, total fees for audit & non-audit services.
- Safeguards Applied:** Safeguards are measures taken to eliminate or reduce threats to independence.

F. Establish Communication Process

- Form, Timing, and Content:** Auditor must communicate the form, timing, and general content of communications.
- Written Communication:** Communicate significant findings in writing if oral insufficient.
- Scope of Written Communication:** Need not cover all matters.
- Adequacy of Communication Process:** Evaluate if two-way communication adequate; if not, assess effect on risks / evidence and take action.
- Documentation:** Document oral communications (what, when, whom); Retain copy of written communication.



7. SA 265 Communicating Deficiencies in Internal Control to TCWG and Management

A Scope and Objective

- **Scope:** Deals with **auditor's responsibility** to communicate **deficiencies in internal control** to TCWG and management.
- **Understanding Internal Control:** For identifying / **assessing risks of material misstatement**; not for expressing opinion on effectiveness of internal control.
- **Identification of Deficiencies:** May be identified **during risk assessment** or other audit stages.
- **Communication of Deficiencies:** Specifies **which deficiencies** must be communicated.
- **Objective of the Auditor:** Appropriately **communicate identified deficiencies** important enough to merit attention.

C Matters / Factors that decide Significant Deficiency

- **Likelihood of deficiencies** leading to material misstatements.
- **Susceptibility to Loss** or Fraud of related asset/liability.
- **Subjectivity and complexity** in determining estimates.
- Financial statement amounts exposed.
- **Volume** of activity in affected account/transactions.
- **Importance of Controls** to Financial Reporting: (e.g., general monitoring, **fraud prevention** / **detection**, accounting policies, **related parties**, period-end reporting).
- **Cause and Frequency** of exceptions.
- **Interaction** with Other Deficiencies.

E Communicating Significant deficiency to TCWG

- **Determine Significant deficiency:** Based on **audit work**, assess if deficiencies are significant.
- **Communication to Governance and Management:**
 - **To Those Charged with Governance:** **Communicate** significant **deficiencies** in writing, on a **timely basis**.
 - **To Management:** Communicate **significant deficiencies** (in writing) and **other** deficiencies important for **management's attention**.

B Definition of Deficiency and Significant Deficiency

- **Deficiency in Internal Control:** Exists when a **control is ineffective** or missing to prevent / detect / correct **misstatements timely**.
- **Significant Deficiency (SD):**
 - a. **Definition:** A DIC (or combination) important enough **to merit the attention** of "Those Charged with Governance" (TCWG).
 - b. **Determining Significance (Factors):**
 - **Likelihood of misstatement** occurrence.
 - **Potential magnitude** of the misstatement.
 - c. **Misstatements Not identified:** **SDs** can exist **even if no misstatements were found** during the audit.

D Indicators of Significant Deficiencies

1. **Ineffective Control Environment:**
 - Management transactions **not scrutinized by governance**.
 - **Management fraud** (material or not) **not prevented by controls**.
 - **No remedial action** by management on prior SDs.
 - Missing or **ineffective risk assessment process**.
 - Ineffective response to significant risks (e.g no controls).
2. **Auditor-Detected Misstatements:**
 - Misstatements found by auditor that **internal control missed**.
3. **Prior Period Material Misstatements:**
 - Material errors/frauds from prior periods found and **disclosed in current financial statements**.
4. **Management Inability to Oversee F/S Prep:**
 - **Evidence** that management **cannot adequately oversee** financial statement preparation.

F Contents of Written Communication [Letter of Weakness]

- Description of **deficiencies and explanation** of potential effects.
- Context **Information for understanding**.
- **Specific Explanations:**
 - Audit purpose is to **express an opinion** on F/S.
 - Internal control was considered to design audit procedures, **not to express opinion** on IC effectiveness.
 - Reported matters are **limited to deficiencies identified** that are of sufficient importance.

Chapter 5 - Audit Documentation

1. Meaning and Objective of Documentation as Per SA 230

1

Meaning

Record of audit procedures, evidence, and conclusions.

2

Auditor's Objective

- Provide sufficient basis for auditor's report.
- Evidence of compliance with Standards on Auditing (SA) and legal/regulatory requirements.

2. Nature and Purpose of Documentation

A

Nature

- Evidence for auditor's conclusions on achieving overall audit objectives.
- Evidence of audit planning /performance as per SAs & legal /regulatory requirements.

B

Purpose

- Assists engagement team: planning & performance.
- Helps direction, supervision, review.
- Ensures team accountability.
- Retains record for future audits.
- Enables quality control (SQC 1) & external inspections.

3. Form, Content and Extent of Documentation and Factors Affecting There of Content

1

Manner of Documentation

An experienced auditor (with no prior connection) must understand:

- Nature, Timing, Extent (NTE) of procedures.
- Results & evidence obtained.
- Significant matters, conclusions, professional judgments.

Experienced Auditor means:
Reasonable knowledge of FRF, Accounting Standards, Auditing Standards, client's business.

2

Documentation of NTE

- Record identifying characteristics of items tested.
- Who performed work & completion date.
- Who reviewed work, date, & extent of review.
- Discussions of significant matters (nature, when, with whom).
- How inconsistencies with final conclusion were addressed.

3

Factors Affecting Documentation (Form, Content, Extent)

- Entity size & complexity.
- Nature of audit procedures.
- Identified risks of material misstatement.
- Significance of audit evidence.
- Nature & extent of exceptions.
- Need to document conclusion /basis if not readily determinable.
- Audit methodology & tools used.

4. Examples of Audit Documentation

1

Examples

- Audit programmes.
- Financial Information analyses.
- Significant issue memoranda.
- Key matter summaries.
- Confirmation/representation letters.
- Checklists.
- Significant correspondence (incl. emails).

2

Includes

- Copies of significant entity records (e.g contracts / agreements)
- Note: Does not replace entity's accounting records.

3

Does NOT Include (unnecessary)

- Superseded drafts (working papers/FS).
- Incomplete /preliminary notes.
- Minor correction versions.
- Duplicate copies.

5. Audit File, Timely Preparation, Assembly, Retention and Ownership of Documentation

A Audit File

Folder/media containing **all documentation** for an engagement.

D Retention

- **No deletion** before period ends.
- **SQC 1** policy required.
- **Period:** Typically **≥7 years** from **report date** (or group report date, whichever later).

B Timely Preparation

- Must be **timely**.
- Enhances **quality**, supports effective review.
- Ensures **accuracy** (versus post-work).

E Ownership

- Auditor's property (per SQC 1), unless **legally stated otherwise**.
- **Sharing with client** at discretion but must **not undermine work validity** or independence.

C Assembly of Final Audit File

- **Completed timely** after auditor's report date (**SQC 1**).
- **Limit:** Usually **≤60 days** after report date.
- Administrative process only (no new procedures/conclusions;
- E.g., **deleting superseded, sorting, cross-referencing**, sign-offs, documenting evidence before report date).

6. Documentation of Significant Matters and Related Significant Professional Judgments

A Documentation of Significant Matters

- Significance requires **objective analysis**.
- **Examples:**
 - Matters leading to **significant risks**.
 - Results indicating **potential material misstatement** or need to revise risk assessment.
 - **Difficulties** in applying **audit procedures**.
 - Findings potentially **leading to modified audit opinion** or Emphasis of Matter (**EOM**) paragraph.

B Documentation Related to Professional Judgment

1. **Importance:** **Documentation form /content/ extent** depend on judgment level.
2. **Purpose:** **Explains conclusions**, reinforces quality.
3. **Situations Requiring Documentation:**
 - **Rationale for Conclusions:** For significant information considered.
 - **Subjective Judgments:** Basis for conclusions (e.g accounting estimates reasonableness).
 - **Concerns on Authenticity of Documents:** Basis for **conclusions when further investigation** undertaken.

7. Audit Summary Memorandum

A Purpose

Describes:

- Significant **matters identified**.
- **How** significant matters were **addressed**.

B Benefits

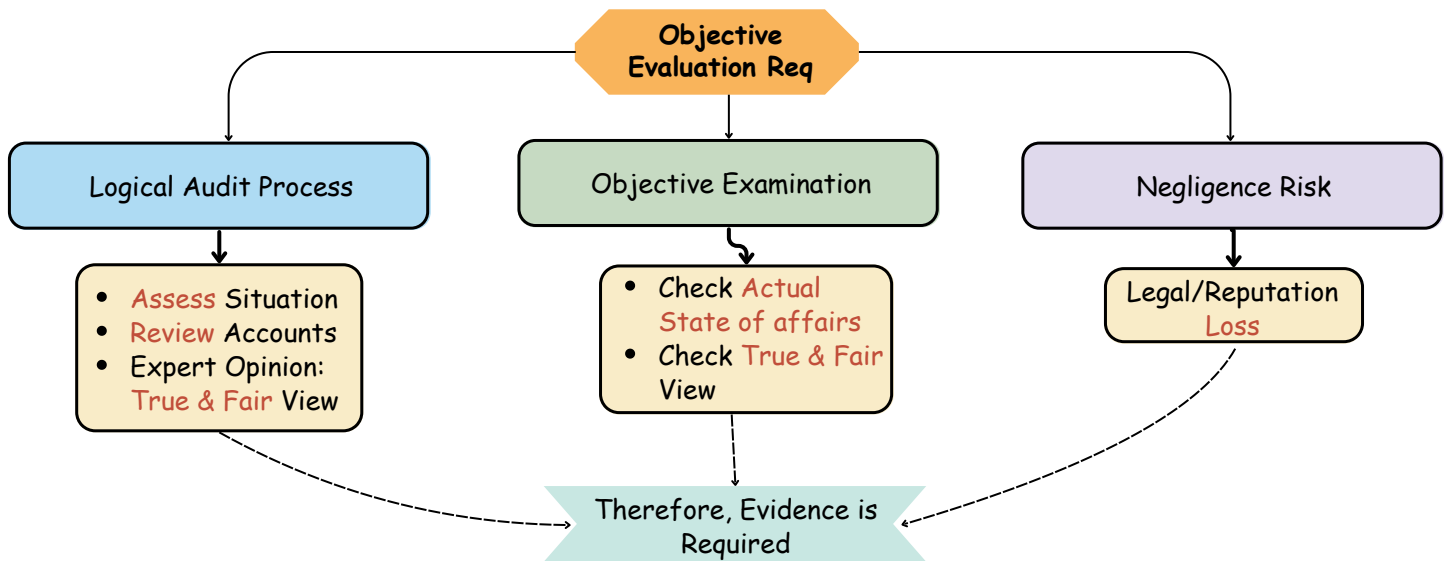
- Aids effective/ **efficient review** & **inspection** (especially for large/complex audits).
- Helps auditor **consider & address significant matters**.

C Achievement of SA Objectives

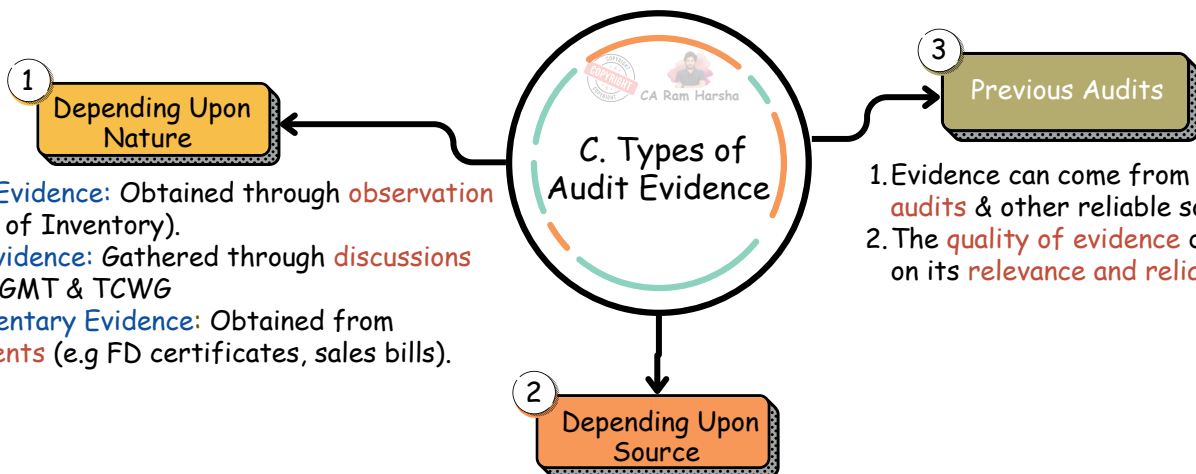
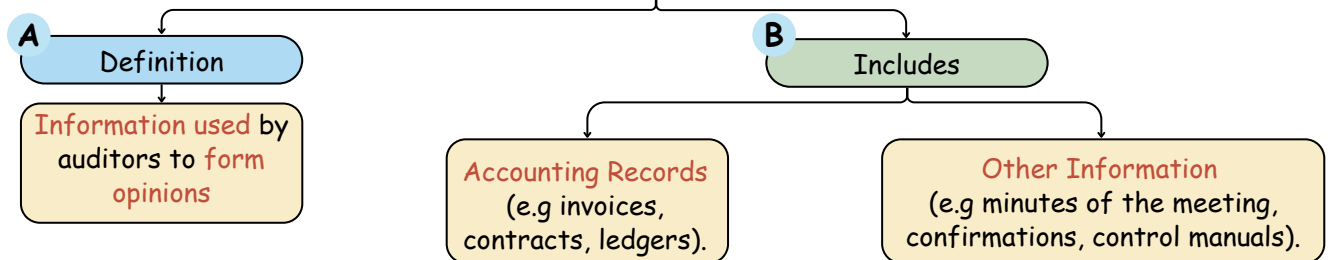
- Helps evaluate if **any individual SA objective** is **not achieved**.
- Ensures **overall audit objectives** are met.

Chapter 6 - Audit Evidence

1. SA 500 - Audit Evidence



B. Audit Evidence and Inclusions

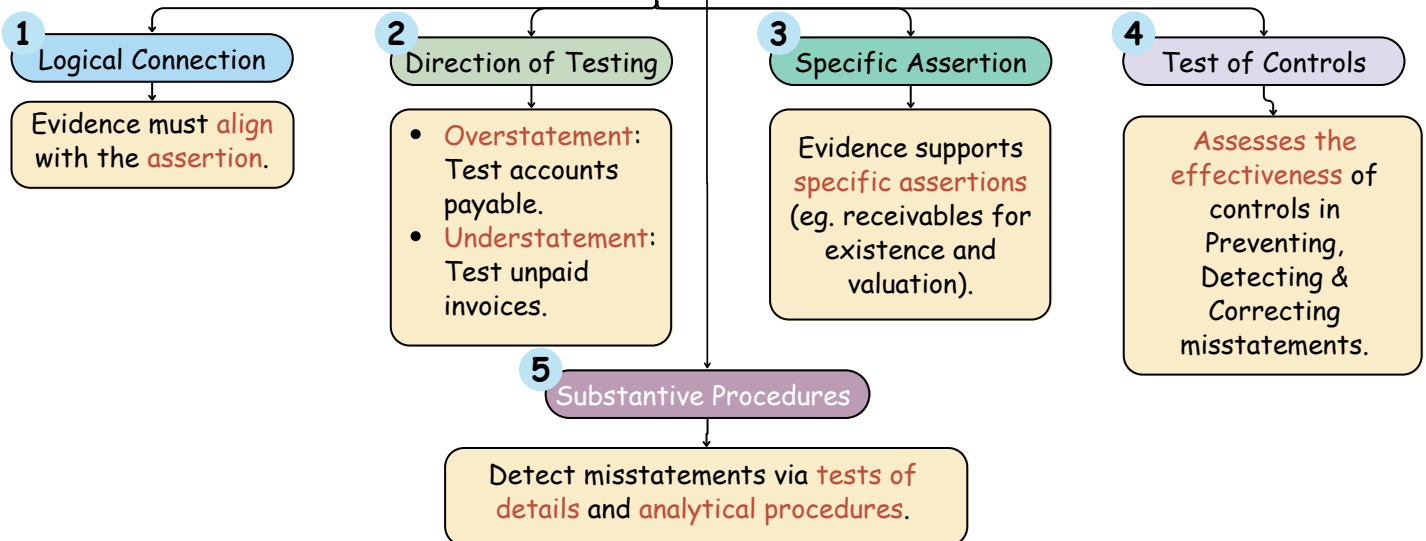


- **Visual Evidence:** Obtained through **observation** (e.g PV of Inventory).
- **Oral Evidence:** Gathered through **discussions** with MGMT & TCWG
- **Documentary Evidence:** Obtained from **documents** (e.g FD certificates, sales bills).

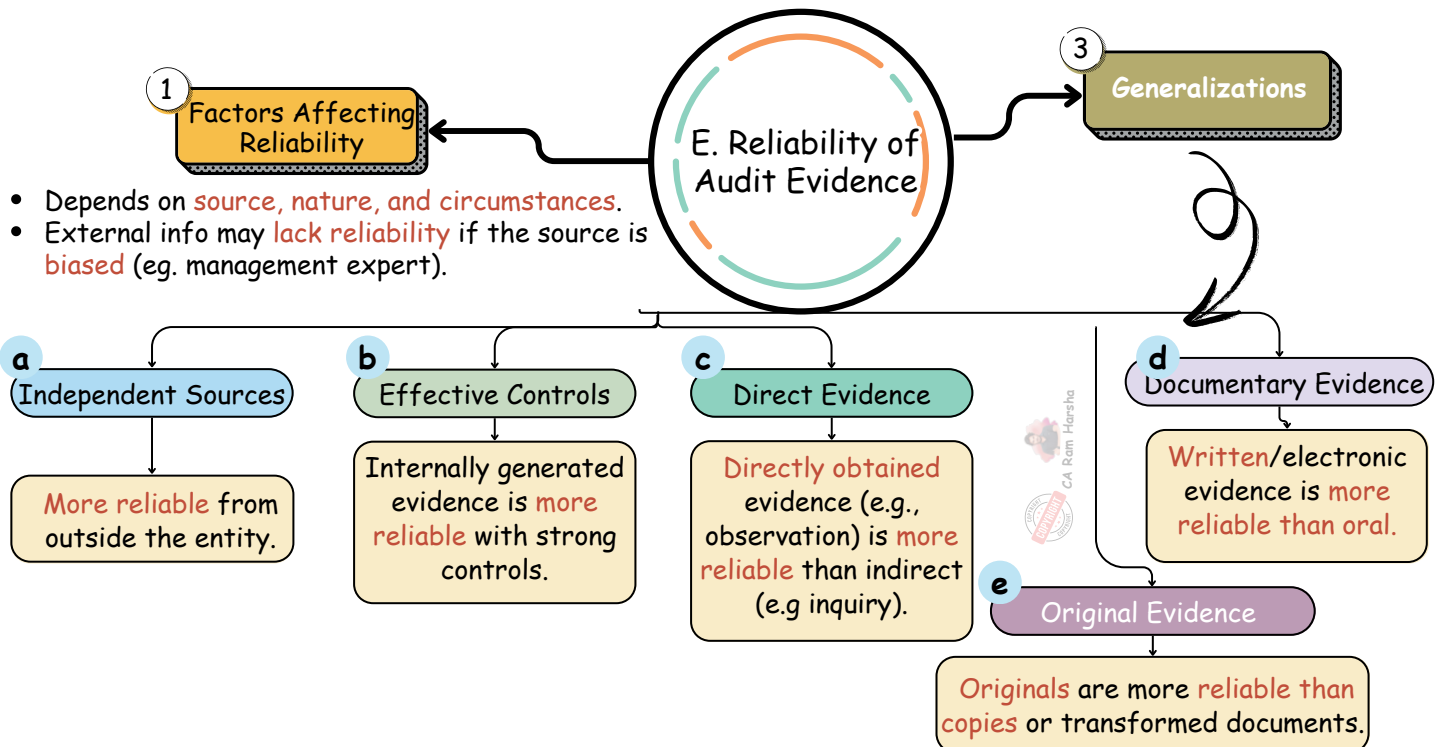
1. Evidence can come from **prior audits** & other reliable sources.
2. The **quality of evidence** depends on its **relevance** and **reliability**.

- **Internal Evidence:** Originates **within the organization** (sales invoice, GRN).
- **External Evidence:** Originates **outside the organization** (purchase invoices, supplier's challans, DR/CR Note).
- **Internal and External Evidence:**
 - **Internal** evidence can be **less reliable** (within the organization).
 - **External** evidence is generally **more reliable** (3rd Party)
 - Auditors should **match both types** of evidence and if external evidence is unavailable, **internal** evidence should be **corroborated**.

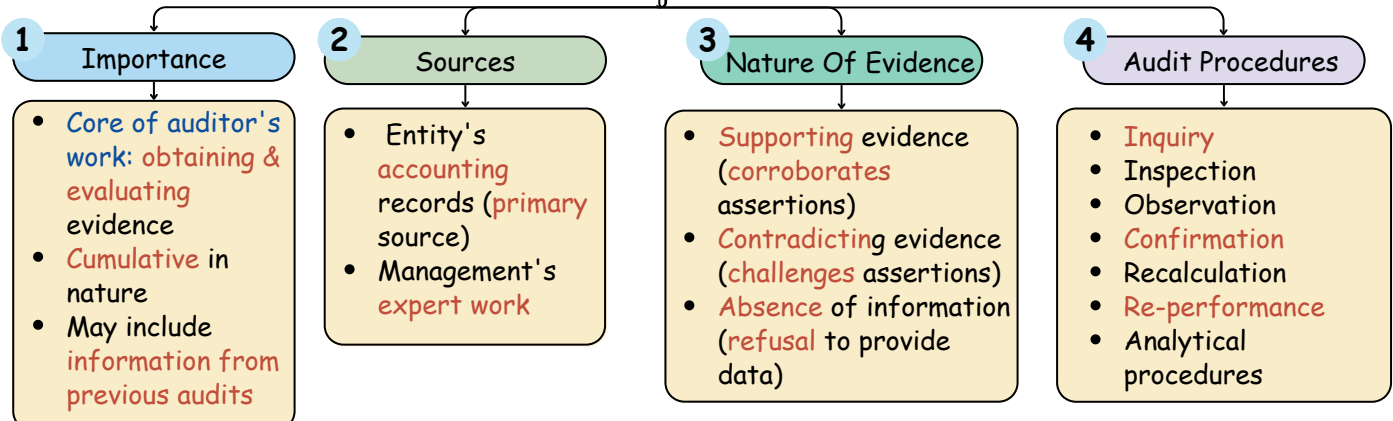
D. Relevance of Audit Evidence



E. Reliability of Audit Evidence



F. Need for SAAE



NOTE: Inquiry alone cannot provide sufficient evidence for:

- Absence of material misstatements
- Operating effectiveness of controls

G. Sufficiency and Appropriateness of Audit evidence

Interrelation

- Sufficiency and appropriateness are interrelated
- Both aspects must be considered together when evaluating evidence

1 Sufficiency Of Audit Evidence

- Measures Quantity of evidence needed
- Determined by:
 1. Risk of Misstatement:
 - a. Higher risk → more evidence reqd
 - b. Lower risk → less evidence req
 2. Quality of Evidence:
 - a. Higher quality → less quantity reqd
 - b. Lower quality → more evidence reqd

2 Appropriateness Of Audit Evidence

- Measures Quality of evidence based on:
 - Relevance: Logical relationship to assertion being tested
 - Reliability: Influenced by source, nature, and circumstances

Factors Influencing Sufficiency

a Materiality

- Less material assertions → less evidence reqd
- More material assertions → more evidence reqd

b Risk of Material Misstatement

- Inherent Risk: Susceptibility to misstatement before controls
- Control Risk: Risk of control failure to prevent/detect errors
 1. Lower risk → less evidence
 2. Higher risk → more evidence

c Size of Population

- Smaller, homogeneous populations → less evidence
- Larger, heterogeneous populations → more evidence

H. Source of Audit Evidence

1 Testing Accounting Records

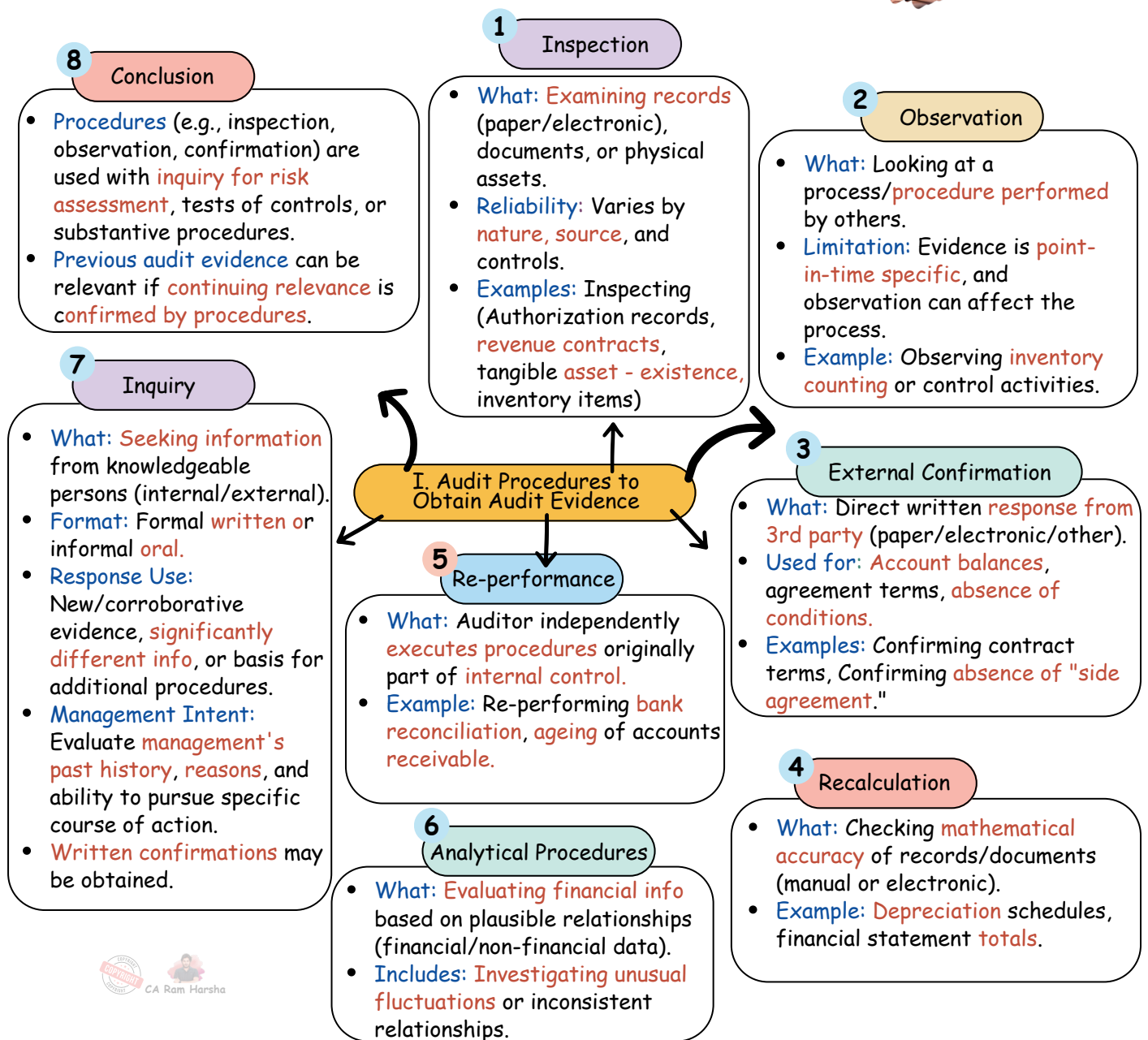
- Obtain audit evidence by performing procedures on accounting records.
- Examples: Analysis, review, re-performing procedures followed in financial reporting processes, and reconciling information.
- Determine internal consistency and agreement with financial statements.

2 Consistent Audit Evidence

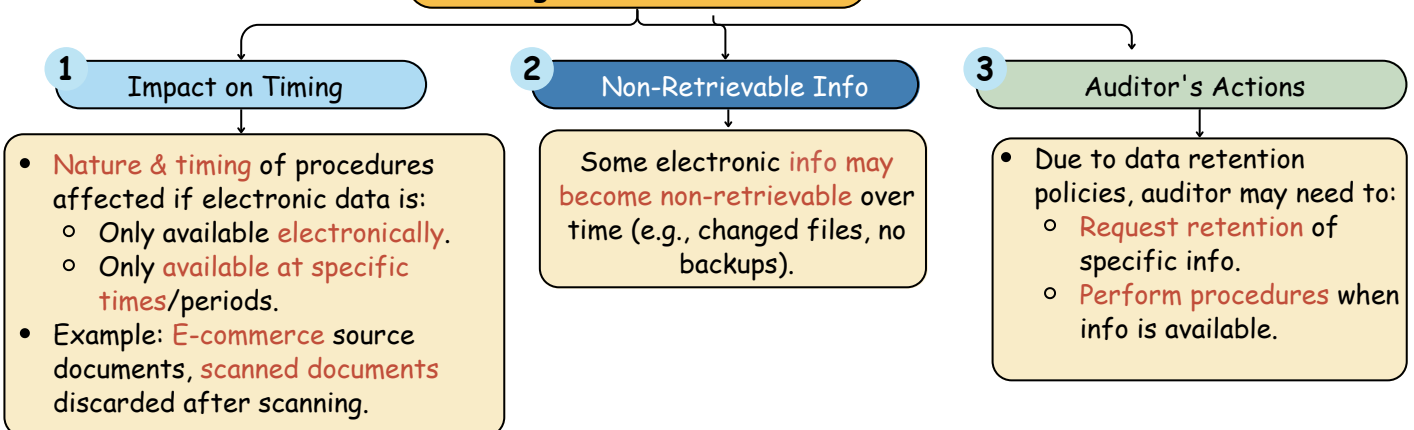
- More assurance is gained when evidence is consistent across different sources and types.
- Reliability: Information corroborated by independent sources (e.g., external support for accounting records or management representations) is more reliable.

3 External Sources (Independent)

- Audit evidence from sources independent of the entity.
- Includes:
 - Confirmations from 3rd parties
 - Analysts' reports, and
 - Comparable data about competitors.



J. Timing of Audit Procedures



K. Risk Assessment and Further Audit Procedures

Audit Evidence: Obtained by performing audit procedures.

1 Risk Assessment Procedures

- **Purpose:** Understand entity/environment, understand internal control, identify & assess risks of material misstatement (fraud/error) at financial statement & assertion levels.

2 Further Audit Procedures

Tests of Controls

- **Purpose:** Evaluate operating effectiveness of controls to prevent, detect, correct material misstatements at assertion level.
- **When performed:** Required by SA's or when auditor chooses.

Substantive Procedures

- **Purpose:** Detect material misstatements at the assertion level.
- **Includes:**
 - Tests of details (account balances, transactions, disclosures).
 - Substantive analytical procedures (evaluating relationships in financial/non-financial data).

8 Audit Opinion

Based on the Overall Representation of financial statements (e.g., Income Statement shows "results of operations," Balance Sheet shows "financial position"). Auditor examines specific (explicit/implicit) and negative assertions to form this overall opinion, combining individual judgments.

1 Meaning

Assertions are management's representations (explicit/implicit) in financial statements, used by auditors to identify potential misstatements.

2 Usage

- **Management:** Asserts recognition, measurement, presentation, disclosure of financial elements.
- **Auditor:** Uses assertions to identify misstatement types, categorized into 3 areas.

7 Negative Assertions

Can be Explicit (directly stated absence) or Implied (absence of an item implies non-existence).

- **Explicit Negative Assertion**
Example: Stating no contingent liability exists.
- **Implied Negative Assertion**
Example: No "building" item on the balance sheet implies no building owned.

L. Concept of Assertions

5 Consideration of Law & Regulation

Compliance with laws/regulations can be an assertion, especially for entities with government stakeholders.

6 Nature of Assertions

Can be Explicit (specifically stated for clarity, preventing misleading info) or Implied (generally understood, not stated).

3 Categories of Assertions

- **Transactions & Events (T&E):** Occurrence, Completeness, Accuracy, Cut-off, Classification.
- **Account Balances:** Existence, Rights & Obligations, Completeness, Valuation & Allocation.
- **Presentation & Disclosures:** Occurrence & Rights, Completeness, Classification & Understandability, Accuracy & Valuation.

4 Combination

Auditors can combine assertions if all underlying aspects are covered.

M. Information Prepared by Management's Expert - Used as Audit Evidence

When using a management expert's work as audit evidence, the nature, timing, and extent of audit procedures are affected by factors such as:

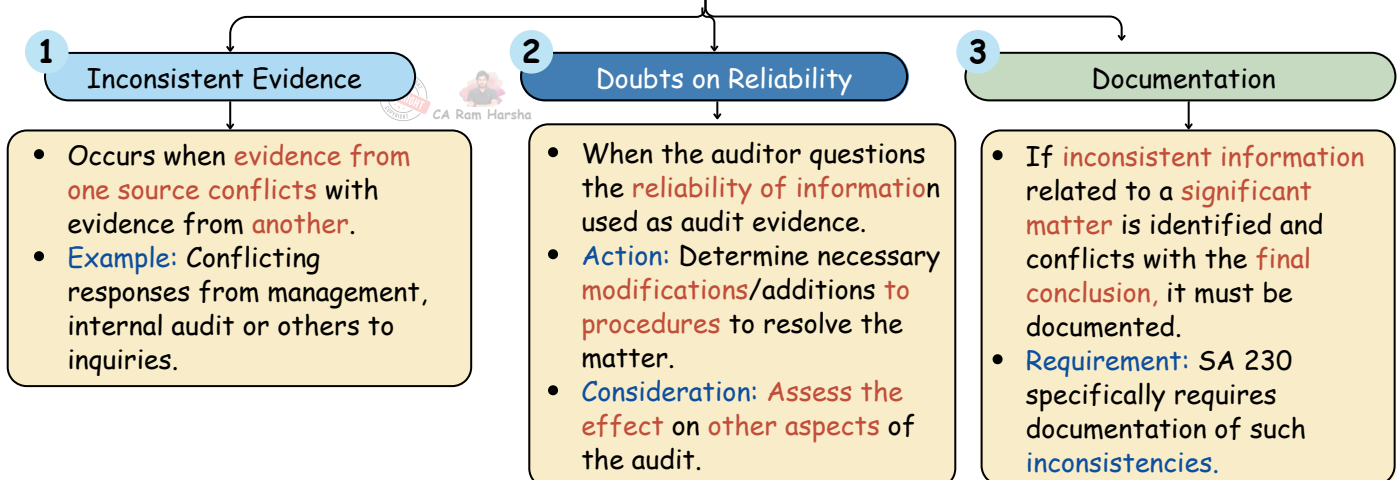
- Nature/complexity of the matter.
- Risk of MMS in the matter.
- Expert's work: Nature, Scope, Objectives.
- Expert's status: Employee vs. Outsider.
- Management's control over expert.
- Expert's adherence to standards.
- Auditor's knowledge of expert's field.
- Auditor's past experience with expert.

N. Information Prepared by Management

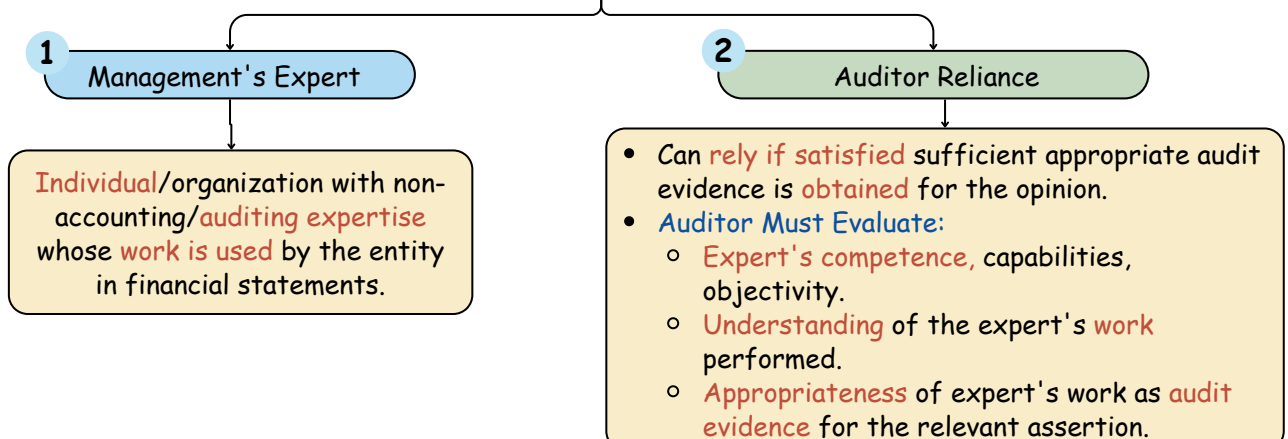
When using information produced by the entity, the Auditor evaluates its reliability by

- Obtaining evidence on the accuracy and completeness of the data.
- Evaluating if the information is sufficiently precise and detailed.

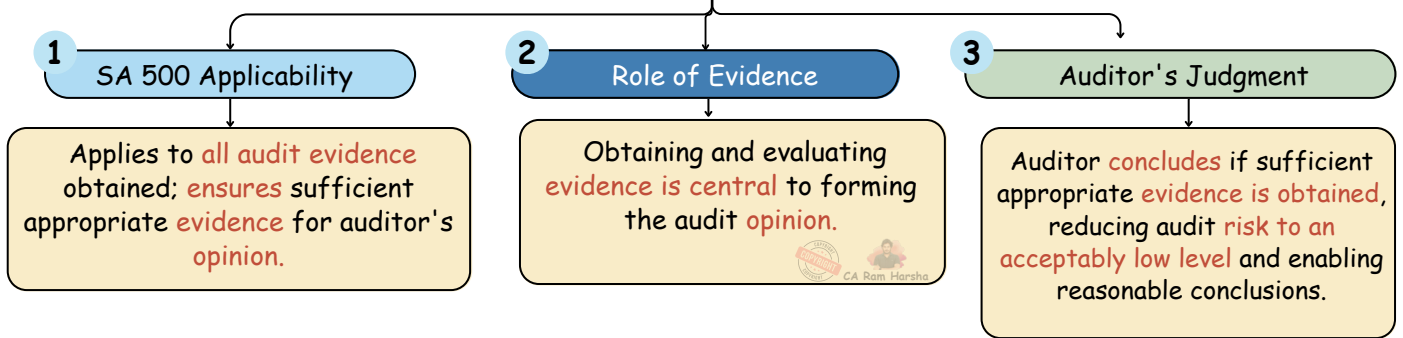
O. Audit Procedures - Inconsistency or Doubts over Reliability of Audit Evidence



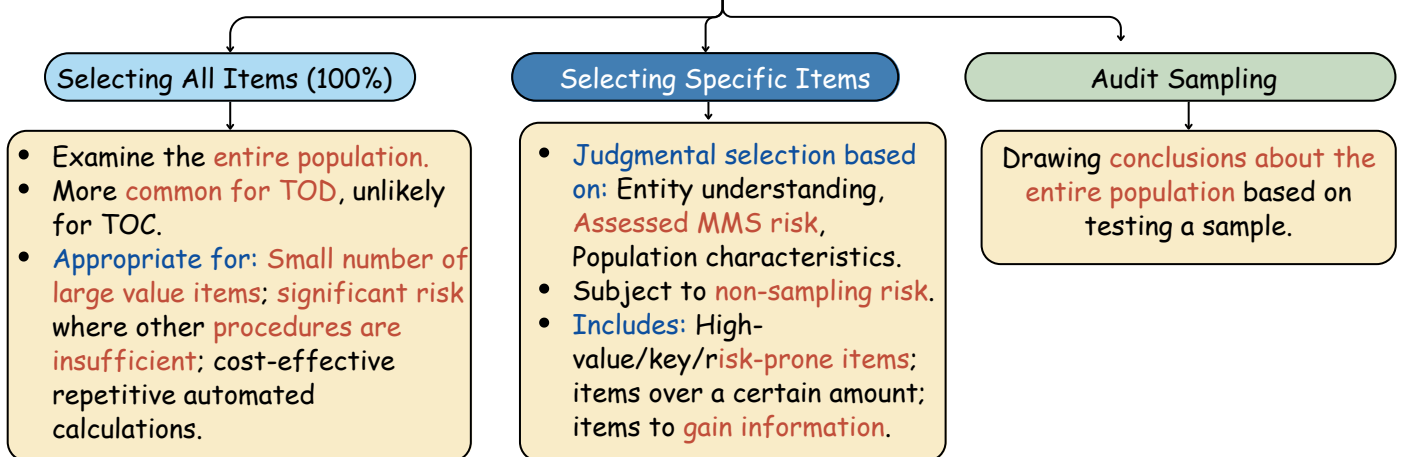
P. Factors for Reliance on Management Expert



Q. Evaluation of Audit Evidence

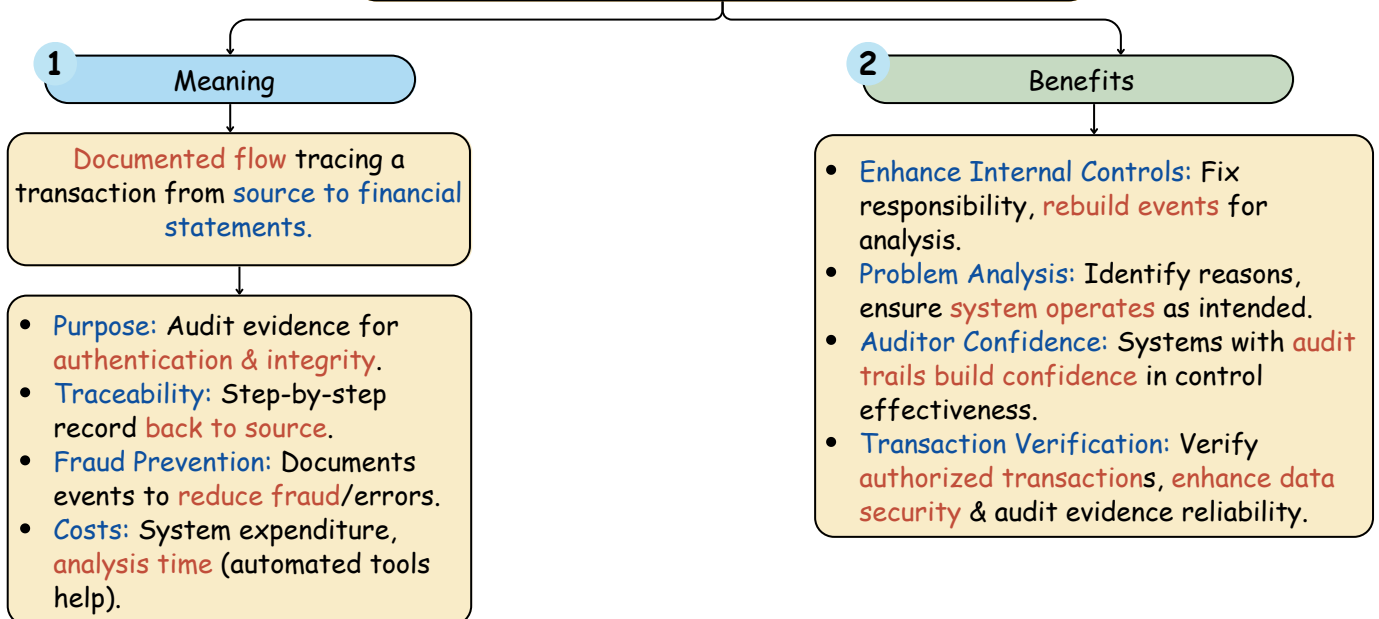


R. Means of Selecting Items for TOC and TOD



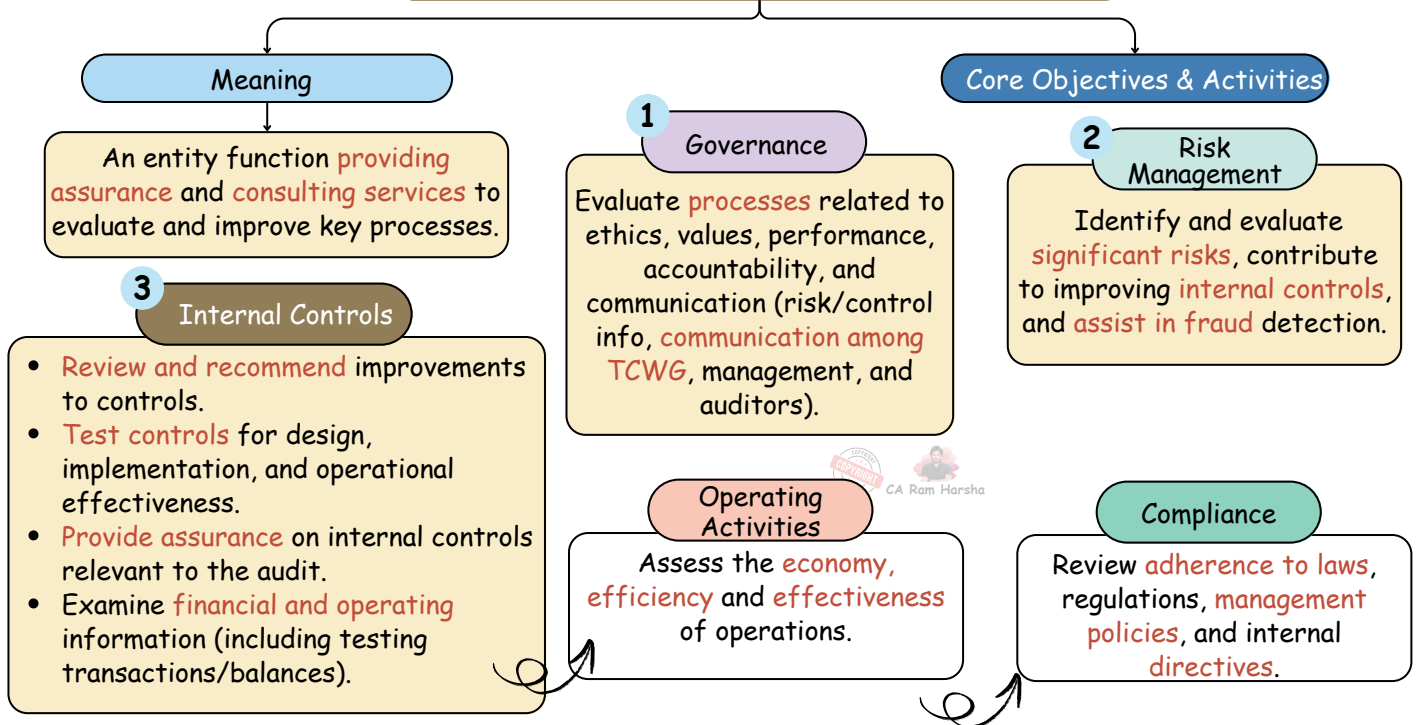
2. Concept Of Audit Trail

Meaning and Benefits of Audit Trail

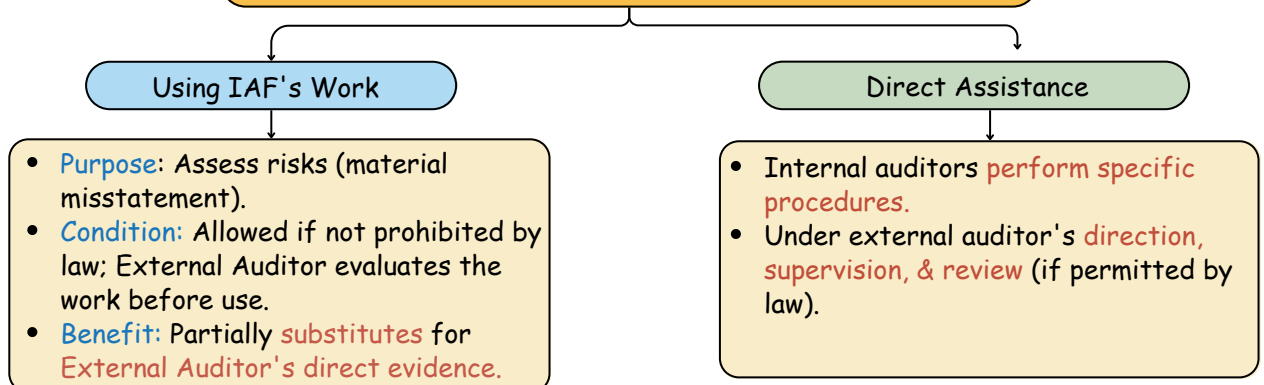


3. SA 610 Using the Work of Internal Auditor

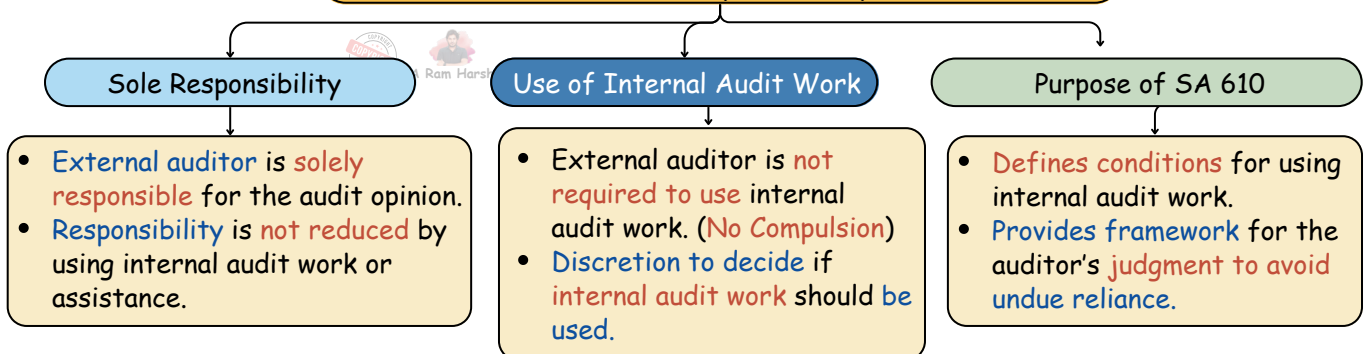
A. Internal Audit Function and Objectives

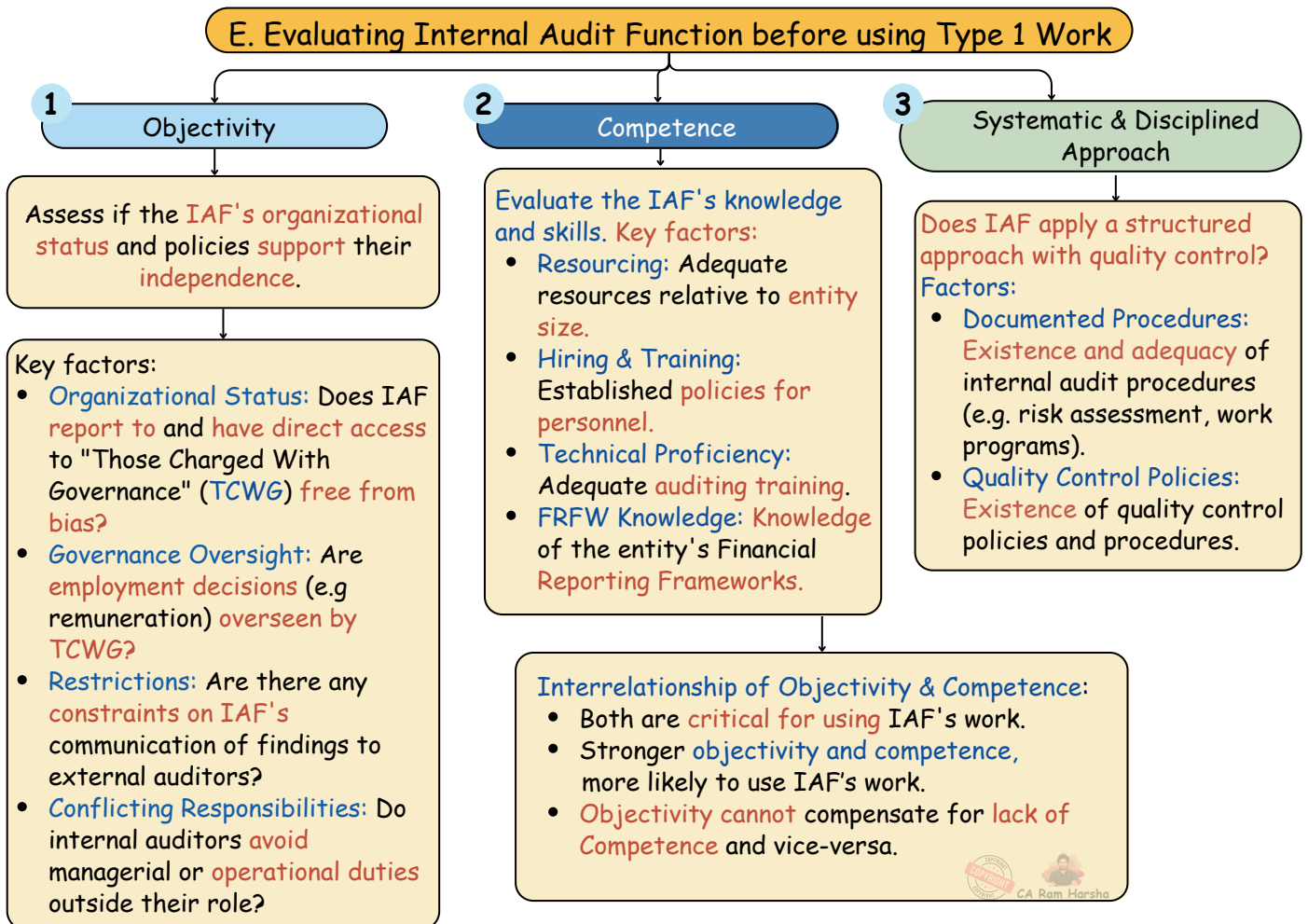
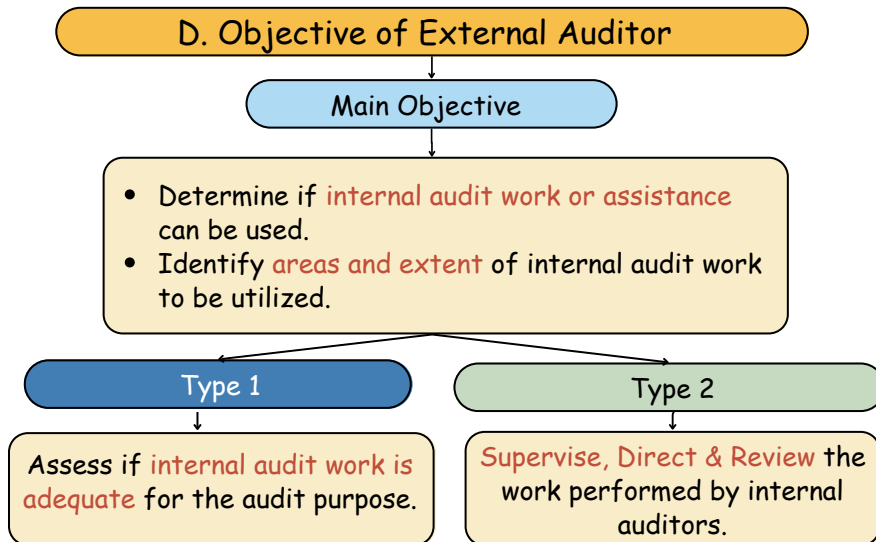


B. Two Types of usage of work of Internal Auditor



C. External Auditor's responsibility under SA 610





F. IAF work shall not be used by External auditor in following circumstances

- IAF lacks **Objectivity**.
- IAF lacks **Competence**.
- IAF lacks **Systematic Approach/Quality Control**.

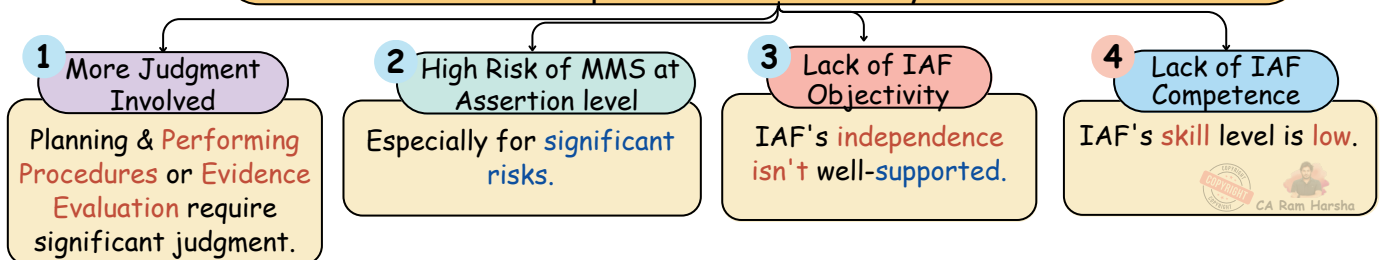
G. Nature and Extent of work of IAF to be used by External Auditor

External auditors decide to use IAF work based on its nature and scope, and its relevance to their audit strategy.

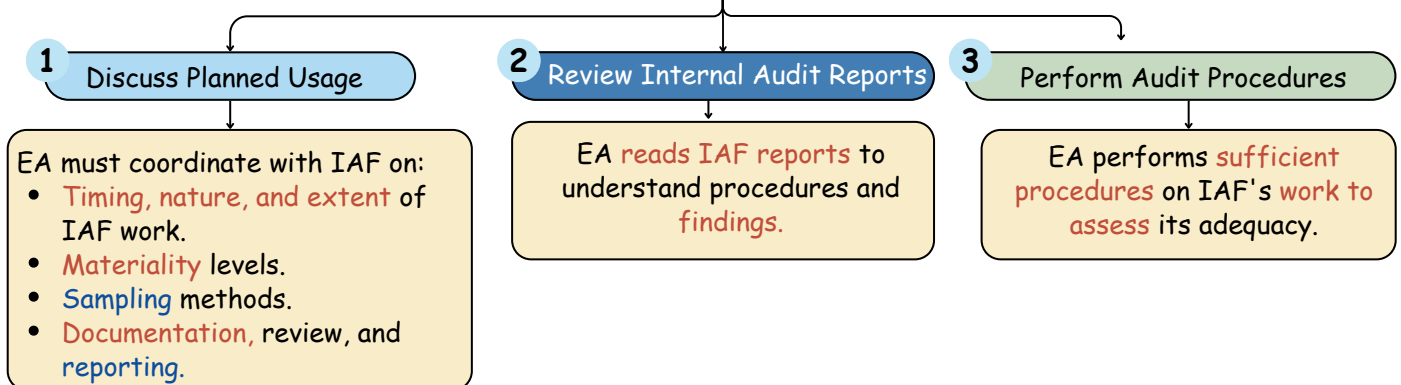
Examples of IAF work that can be used:

- **TOC:** Testing controls' **operating effectiveness**.
- **Substantive Procedures:** Those requiring **limited judgment**.
- **Inventory Observations:** Observing **counts**.
- **Tracing Transactions:** Following transactions **through systems**.
- **Regulatory Compliance:** Testing **adherence** to regulations.

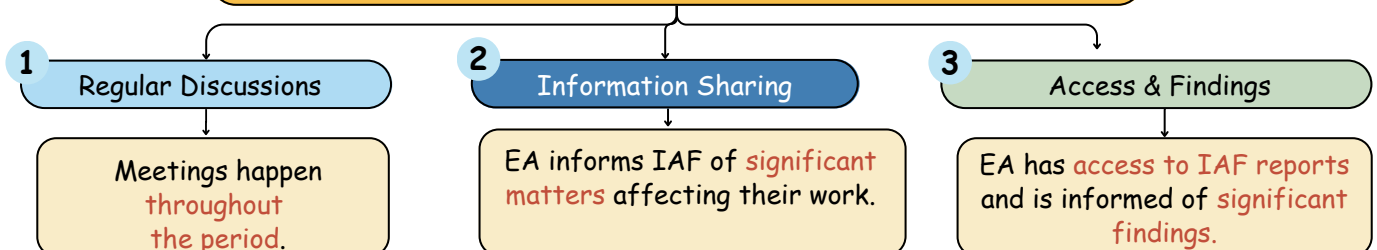
H. Circumstances where IAF work is used Less and EA shall perform more directly

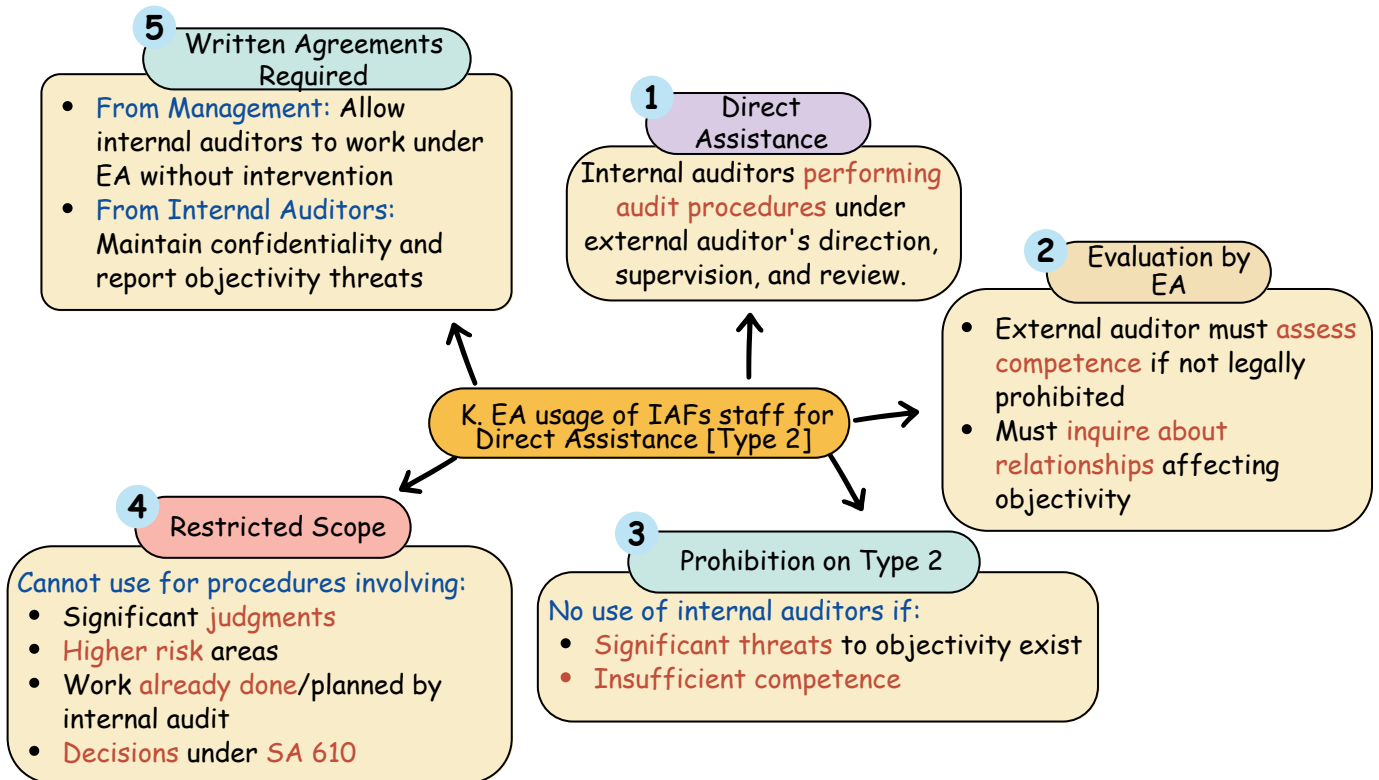


I. EA Procedures when he planned to use the work of IAF

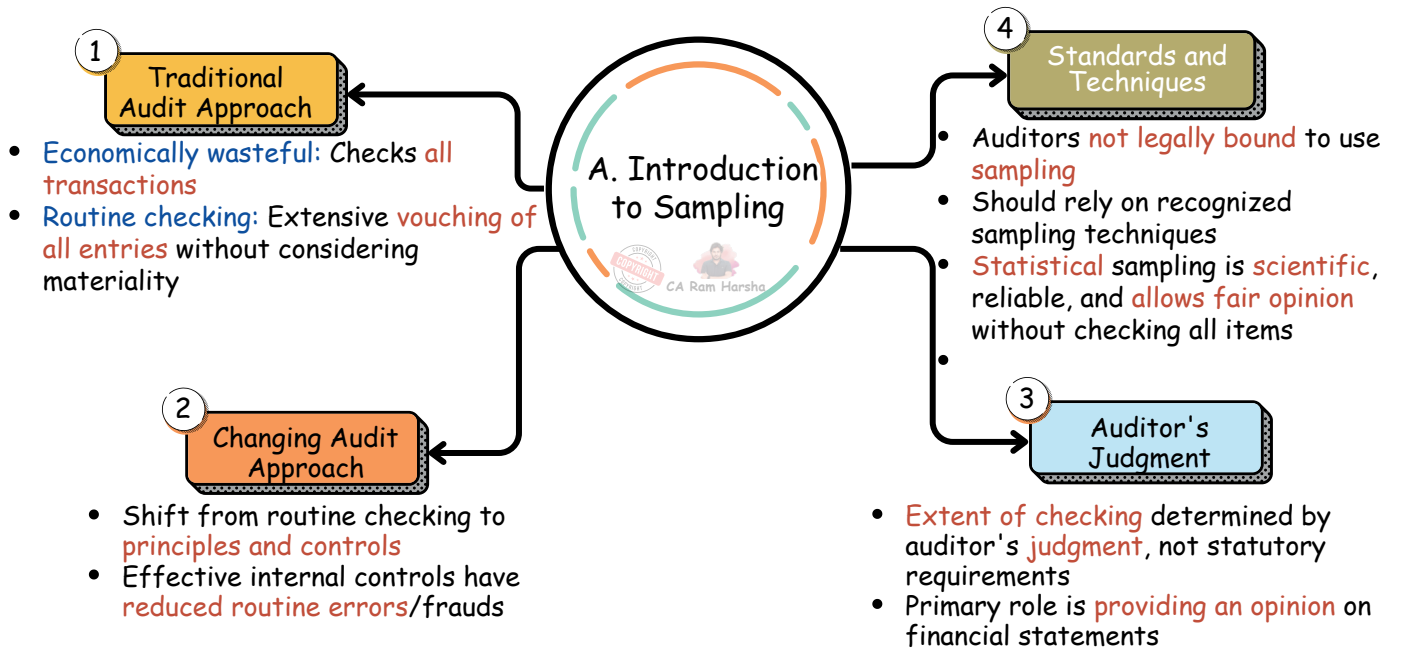
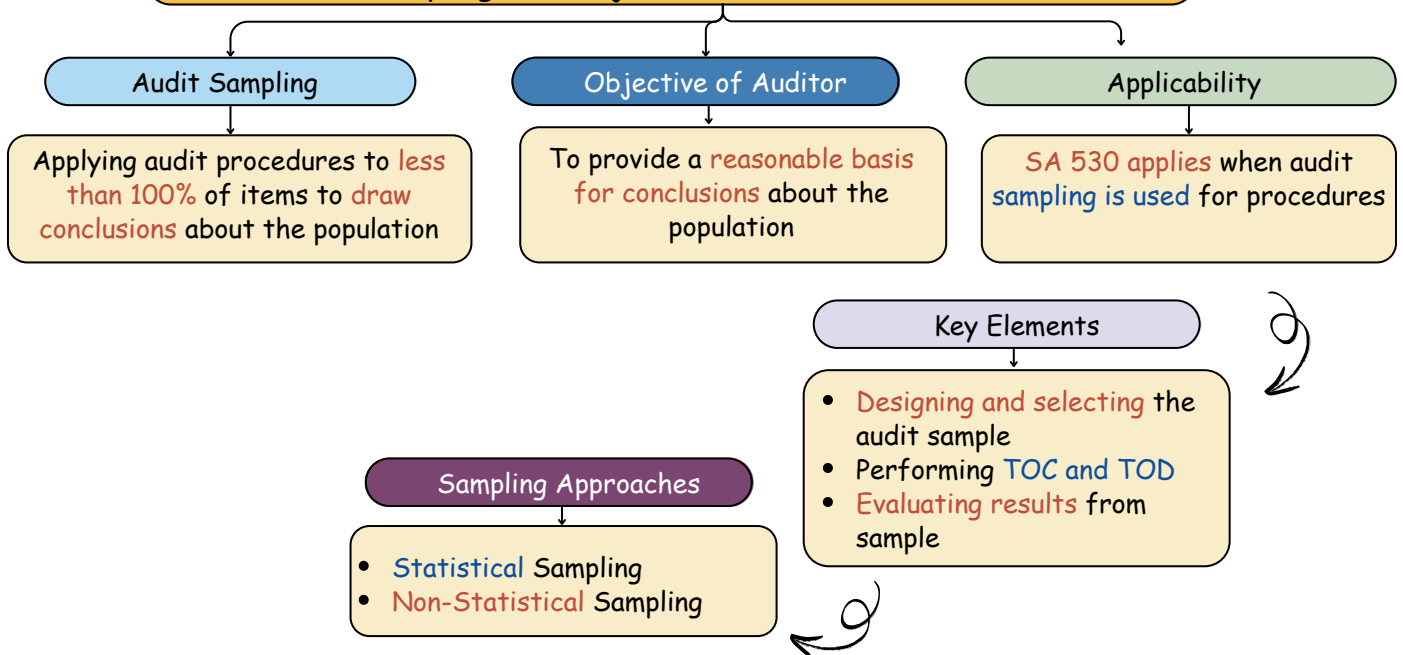


J. Effective Coordination between External Auditor and IAF





4. SA 530 Audit Sampling

**B. Audit Sampling and Objective of Auditor under SA 530**

C. Definition of Population and Characteristics of Population

1 Appropriateness

- **Meaning:** Population must be relevant to **specific audit objective**
- **Purpose:** Procedures applied on **sample, conclusions drawn** on population
- **Example:** Testing A/R **overstatement** → Use A/R listing; Testing A/P **understatement** → Use disbursements, unpaid invoices

2 Completeness

- **Meaning:** Must **include all relevant items** throughout entire audit period
- **Purpose:** Ensures **reasonable conclusions**
- **Example:** When testing control activity, **population must cover** all related activities for the period

Def of Population: Entire Set of Data from which sample is drawn.

3 Reliability

- **Meaning:** Population must be sufficiently **complete and accurate**
- **Purpose:** Auditor performs procedures to **ensure reliability**
- **Evidence:** Auditor must obtain evidence about **accuracy and source**
- If population is **not reliable**, sample will **not be relevant** for audit objective

D. Sampling Unit

Sampling Unit

Individual items in population

Extrapolation

Audit procedures applied to selected units, with **conclusions projected to the entire population**. (Sample conclusions = Population conclusions).

Example

For trade receivables, **sampling units** can be **customer balances** or **individual invoices**.

E. Approach to Sampling

Types of Sampling

- **2 Approaches:** Statistical and Non-Statistical.
- **Auditor's Judgment:** Determines which approach to use.
- **Note:** Sample size **does NOT differentiate** between these approaches.

Statistical Sampling

- **Random selection.**
- Uses **probability theory**.
- **Measures** sampling **risk**.
- Employs **mathematical/statistical methods**.

Non-Statistical Sampling

Does **not use the features of statistical** sampling.



F. Representative Sample

- **Representative:** Sample should **closely mirror** the population.
- **Sample Size:** Must be sufficient for **statistically meaningful results**.
- **Sampling Process (Performed on):**
 - **TOC** (Tests of Controls): To **find deviations** in internal controls.
 - **TOD** (Tests of Details): To **find misstatements** in **balances/transactions**.

G. Difference Between Statistical Sampling and Non-Statistical Sampling

Statistical Sampling

- **Scientific:** Uses **probability** for sample size, objective selection, and reliable projection.
- **Suitable:** **Large, similar** item populations (e.g., compliance, receivables, payroll).
- **Reduces Bias:** **Objective** selection.
- **Recommended:** Large organizations with many transactions statistical sampling is recommended
- (e.g. 45,000 purchase transactions - random sampling under statistical).

Non-Statistical Sampling

- **Subjective:** Relies on auditor **judgment/experience** for sample size/selection.
- **Risk of Bias:** Objectivity **not assured**.
- **Not Scientific:** Lacks scientific rigor;
- **Measurement risk:** results' **closeness to population** cannot be measured.
- **Not Representative:** Due to **bias/unscientific** selection.
- **Year-end checking:** Assess cut - off procedures and identify risks at year end

H. How Sampling is different from Traditional methods

Good Satisfaction

Auditors gain sufficient assurance with less checking using sampling, as **even 100% checking doesn't guarantee** absolute **satisfaction**.

Representative Sample

Randomly chosen **samples reflect population** features.

Sample Reliability

Depends on **effective internal controls**.



Test of Controls

Sampling **assesses control effectiveness**. Strong controls **permit smaller samples**; weak controls **require larger samples**.

Professional Judgment

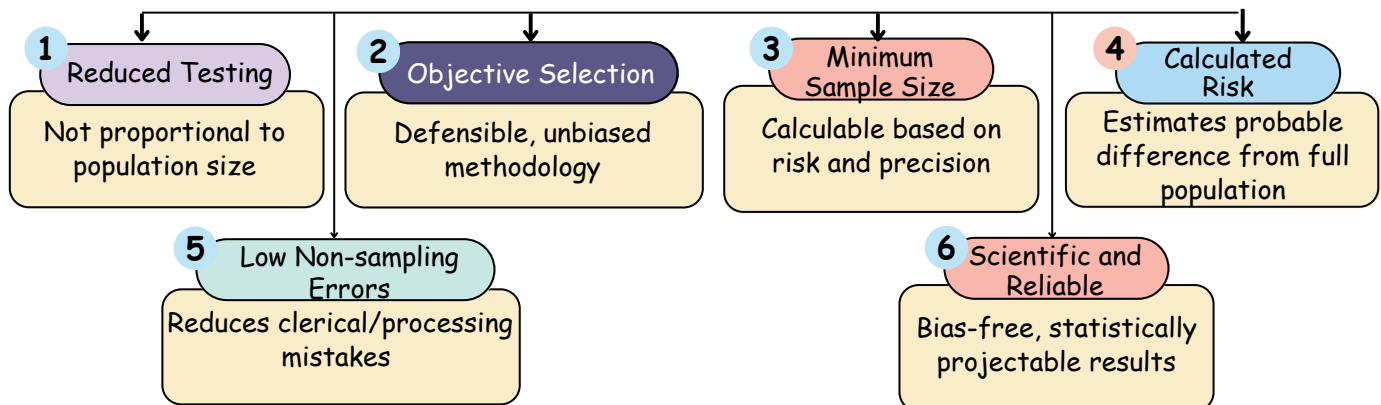
Sampling is an **estimation process** with **potential errors**. Acceptable error tolerance is based on **auditor's judgment** (e.g., tolerating **2% error**, expecting **98% reliability**).

I. Factors for Extent of Checking on a Sampling Plan

- Organization **Size**
- Internal **Control State**
- **Books & Records** Adequacy/Reliability
- **Tolerable Error** Range
- Desired **Confidence Level**

Tolerable Error: Maximum acceptable population error. **Smaller tolerable error** → **Larger sample size**.

J. Advantages of Statistical Sampling



K. When Not to Use Statistical Sampling

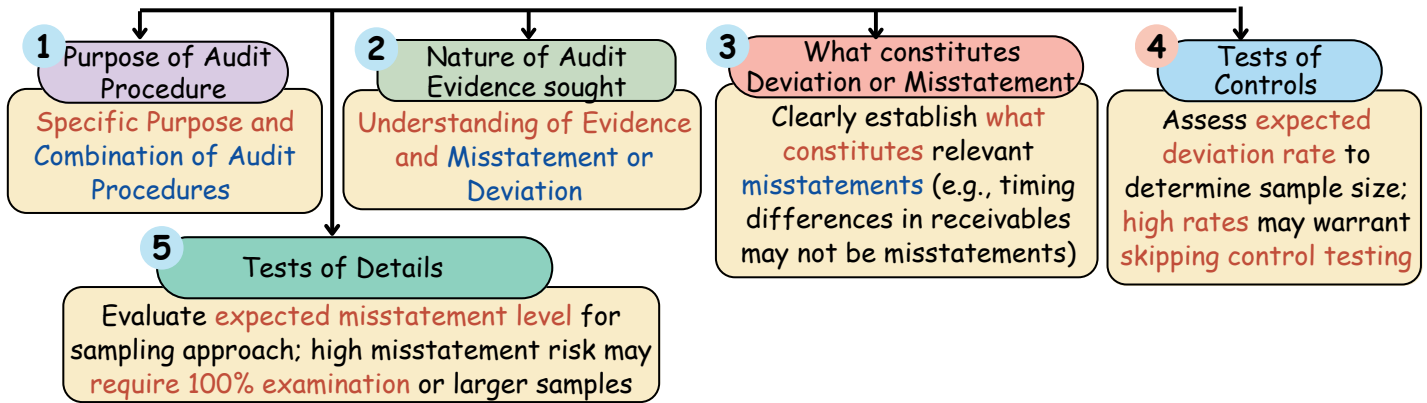
- **Exact Accuracy Required:** Legal/regulatory precision needs that accuracy
- **Technical Knowledge Gap:** Insufficient sampling expertise
- **Better Alternatives:** More efficient approaches available



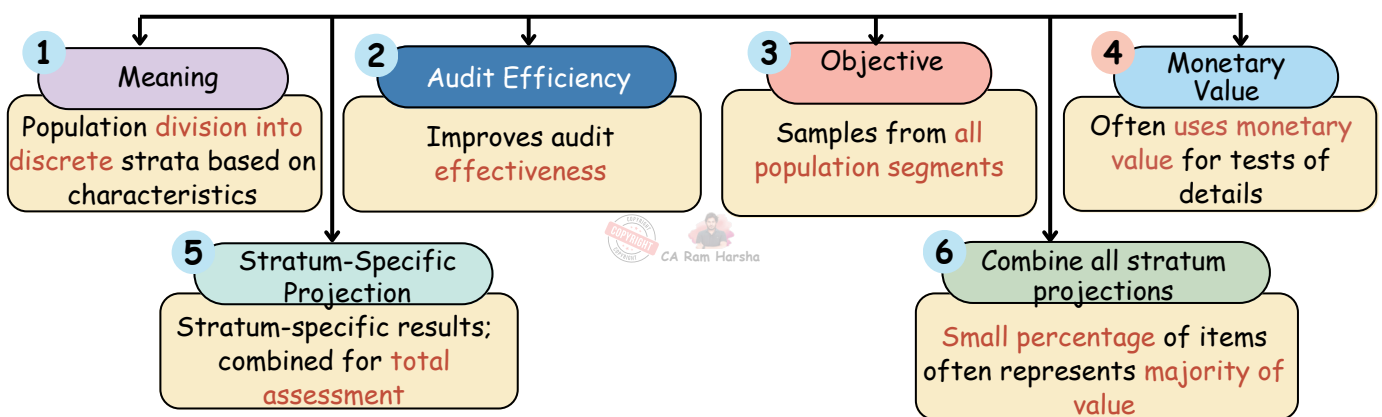
L. Requirements as to Sample design, Sample size and Sample selection

- **Sample Design:** Consider audit purpose and population characteristics
- **Sample Size:** Sufficient to reduce sampling risk to acceptable level
- **Sample Selection:** Ensure each item has a chance of selection

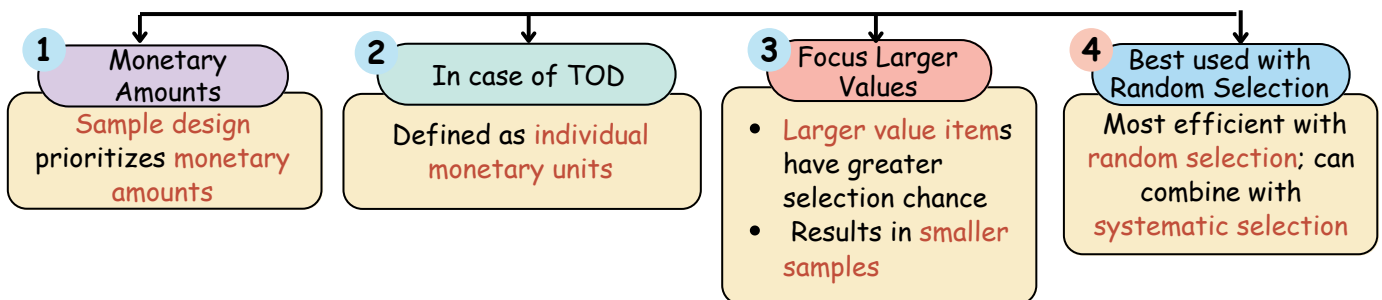
M. Factors while choosing Sample Design

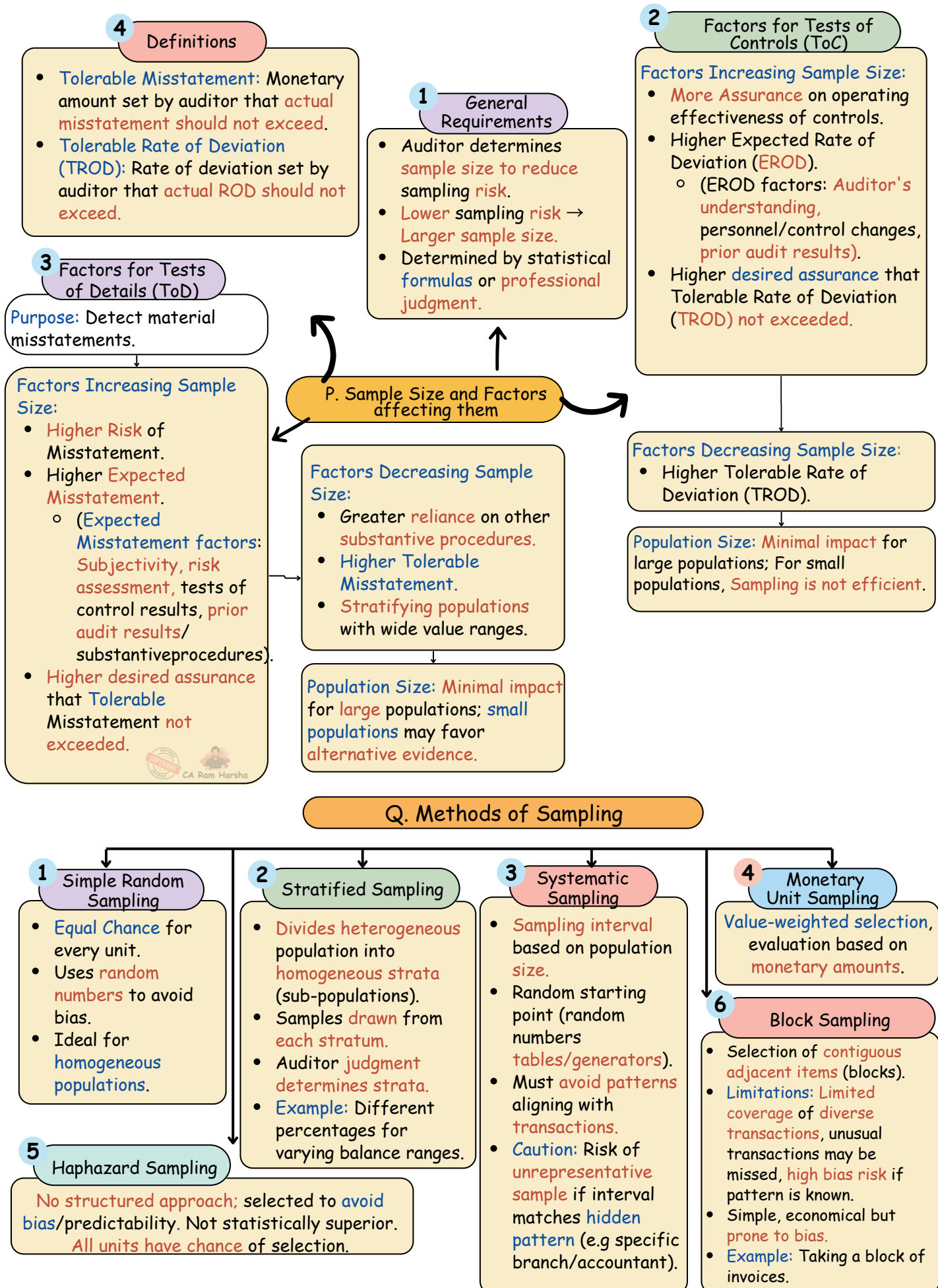


N. Stratification

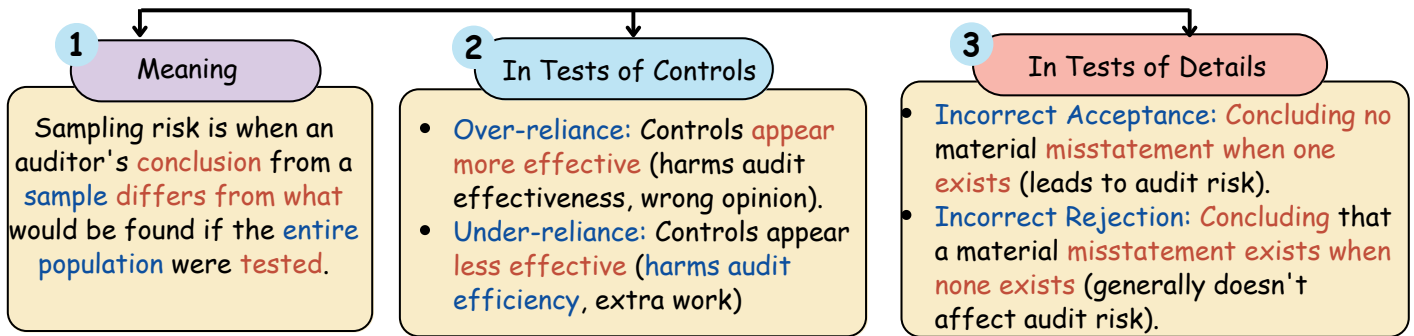


O. Value-Weighted Selection

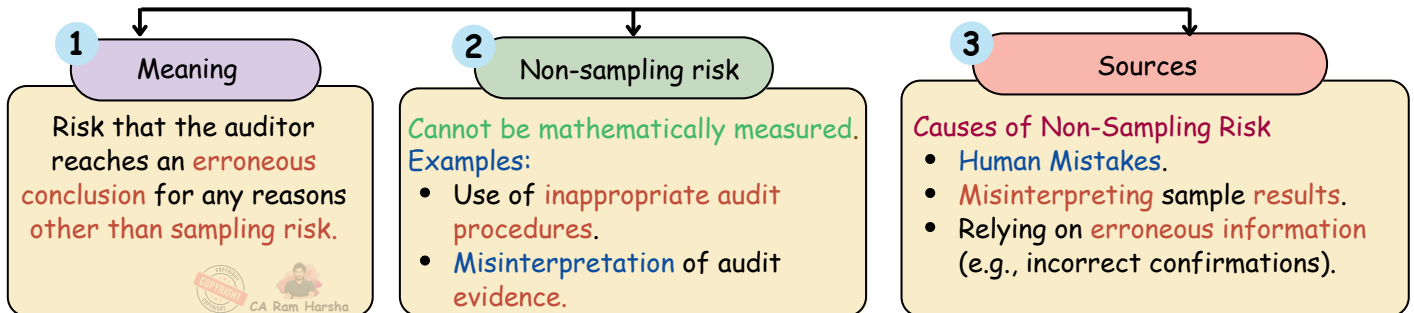




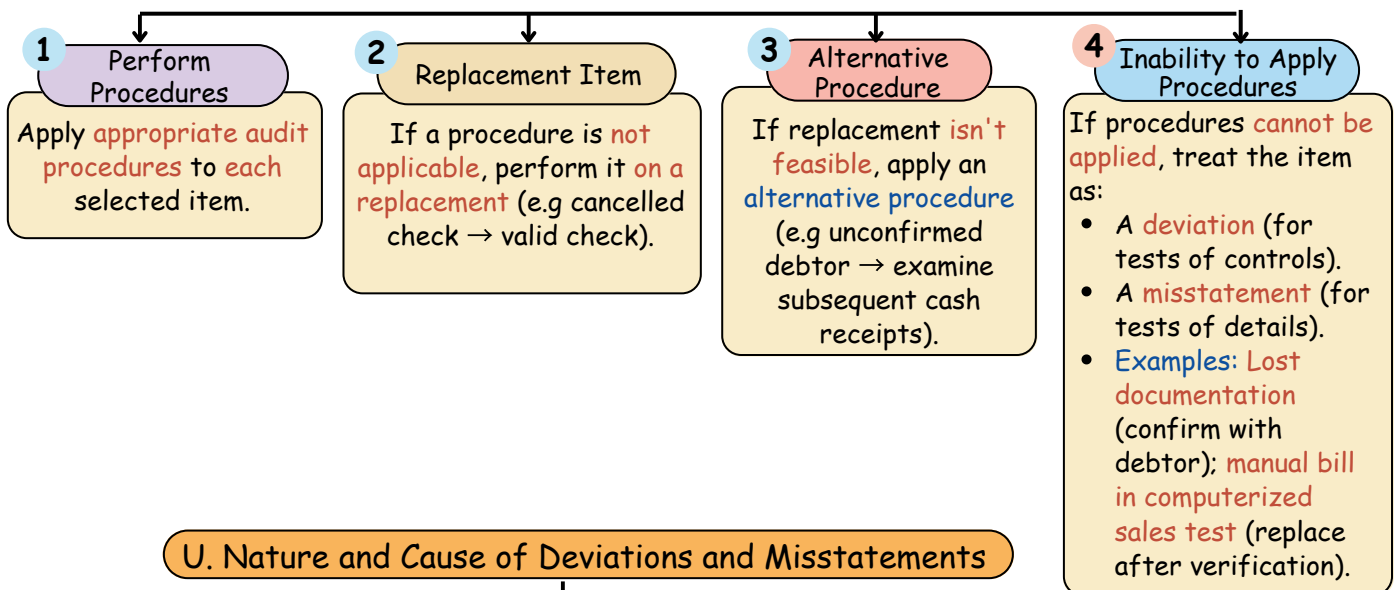
R. Sampling Risk



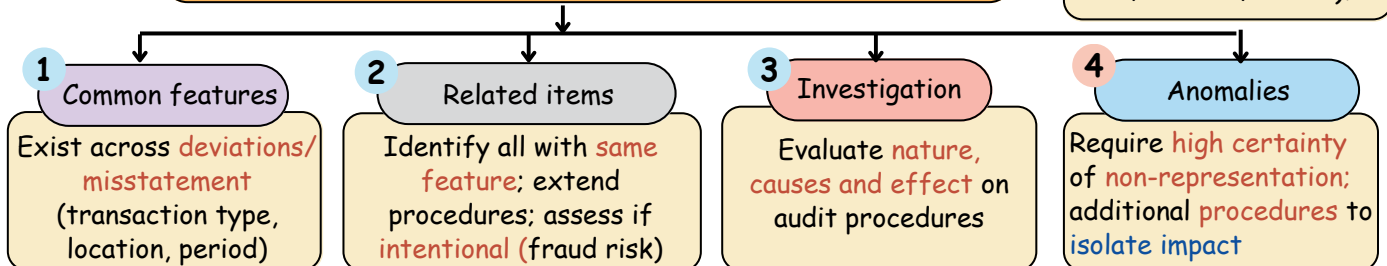
S. Non-Sampling Risk



T. Performing Audit procedures on selected sample

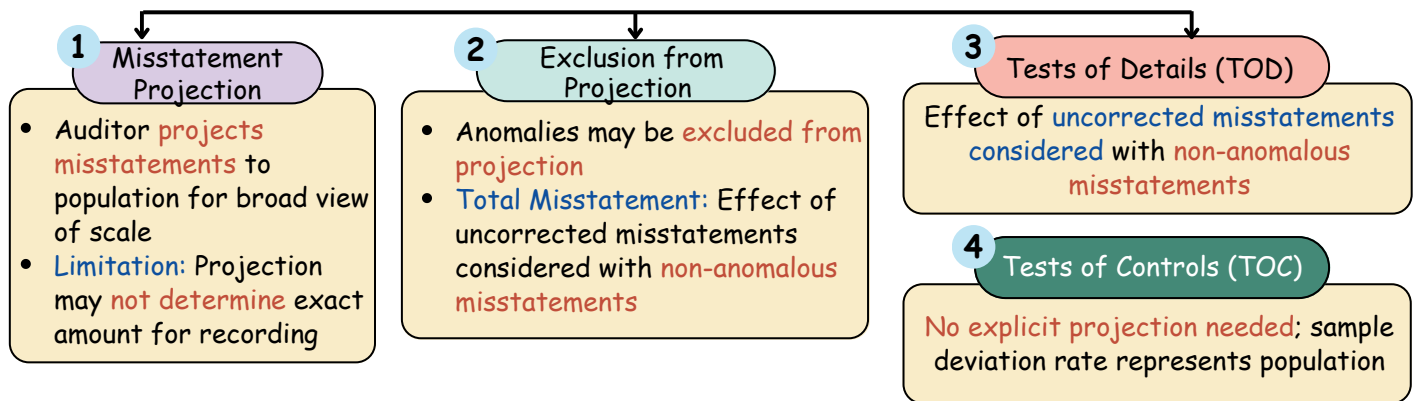


U. Nature and Cause of Deviations and Misstatements

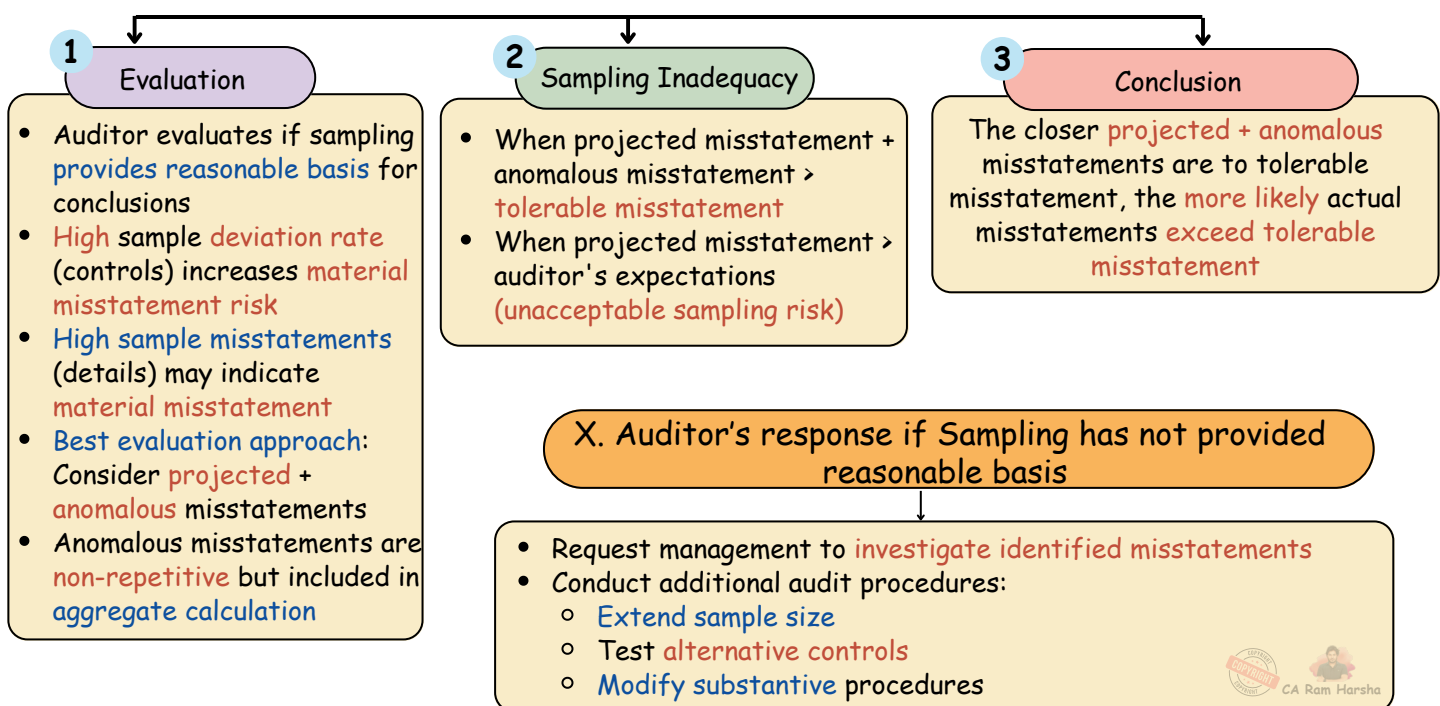


Definition: Anomaly = misstatement/deviation demonstrably **not representative of population**

V. Projection of Misstatements



W. Evaluation of Sampling Results



Y. Precautions while applying test checking

- Study accounting system **thoroughly before sampling**
- Evaluate internal **control system properly**
- Identify areas **unsuitable** for sampling (statutory compliance, unusual transactions)
- Plan and **explain sampling methods** to staff
- Classify/**stratify transactions** and balances appropriately
- Determine **adequate sample size** to meet audit objectives
- Select **samples without bias**
- Analyze **sample errors properly**

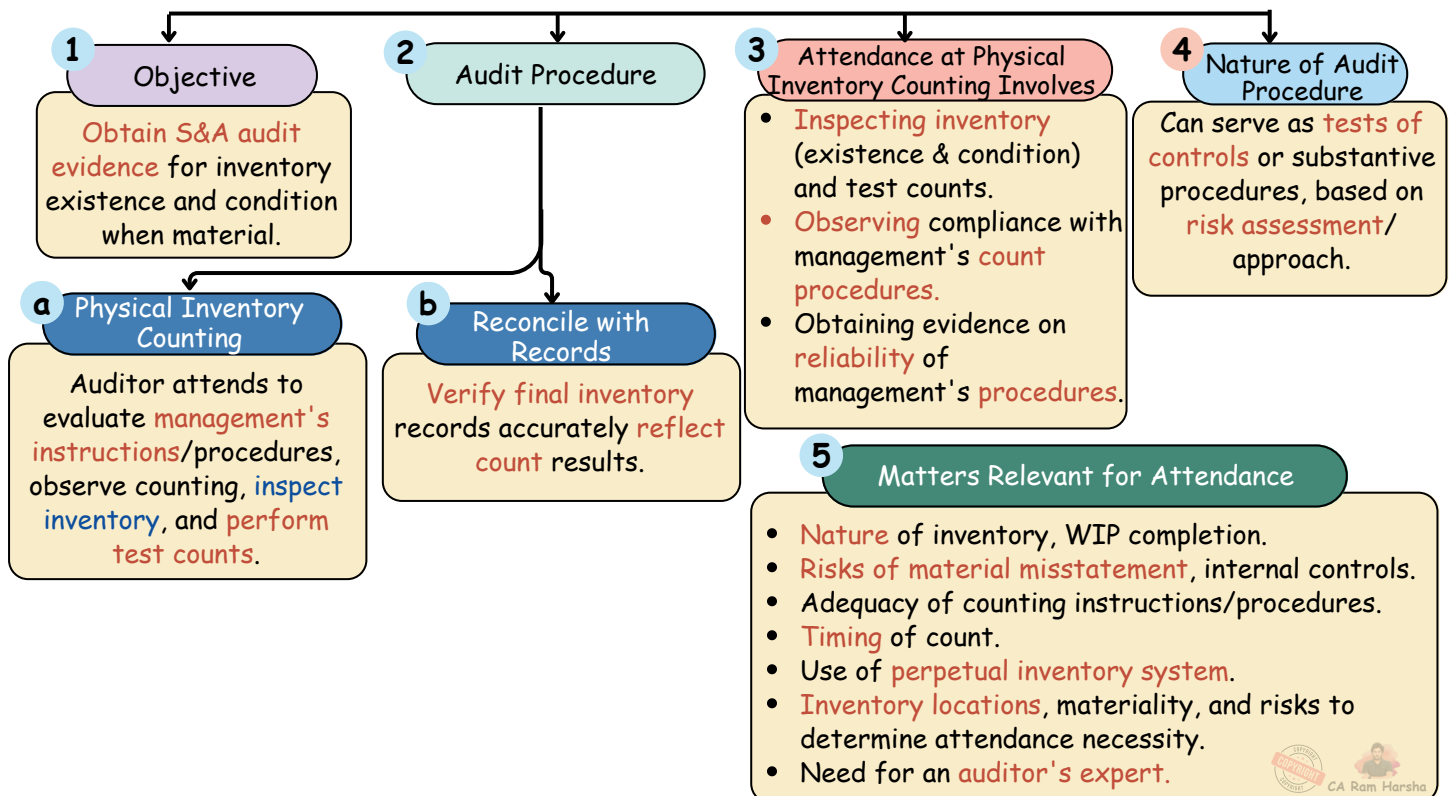
5. SA 501 Audit Evidence - Specific Considerations for Selected Items

A. Scope and Objective

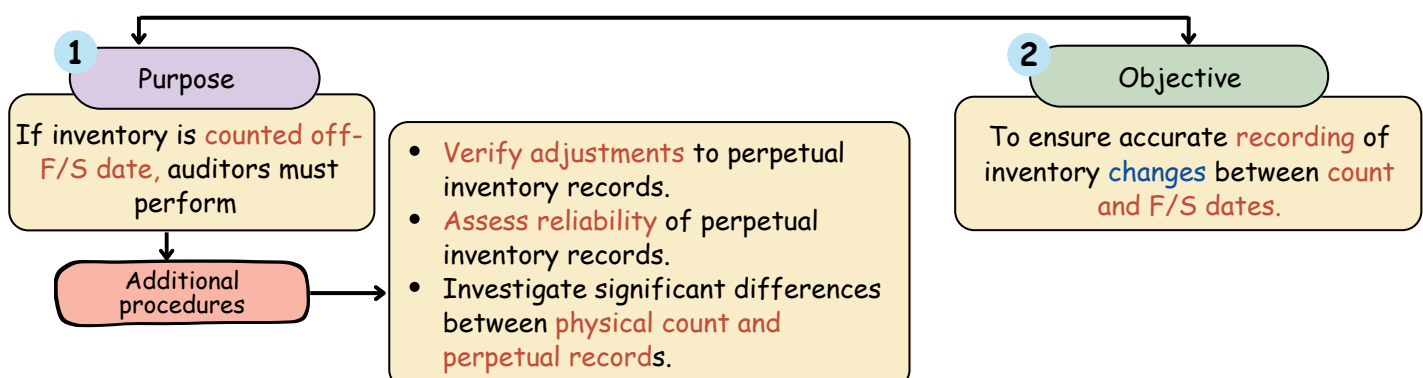
Obtain S&A evidence on:

- **Inventory existence**/condition
- **Completeness of litigations**/claims
- **Segment information** disclosure compliance

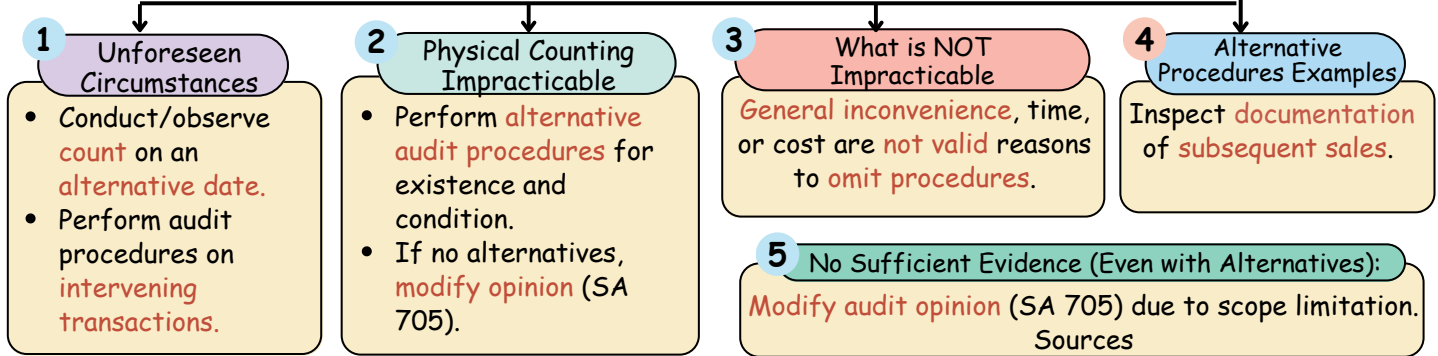
B. Considerations Related to Attendance at Physical Inventory Counting



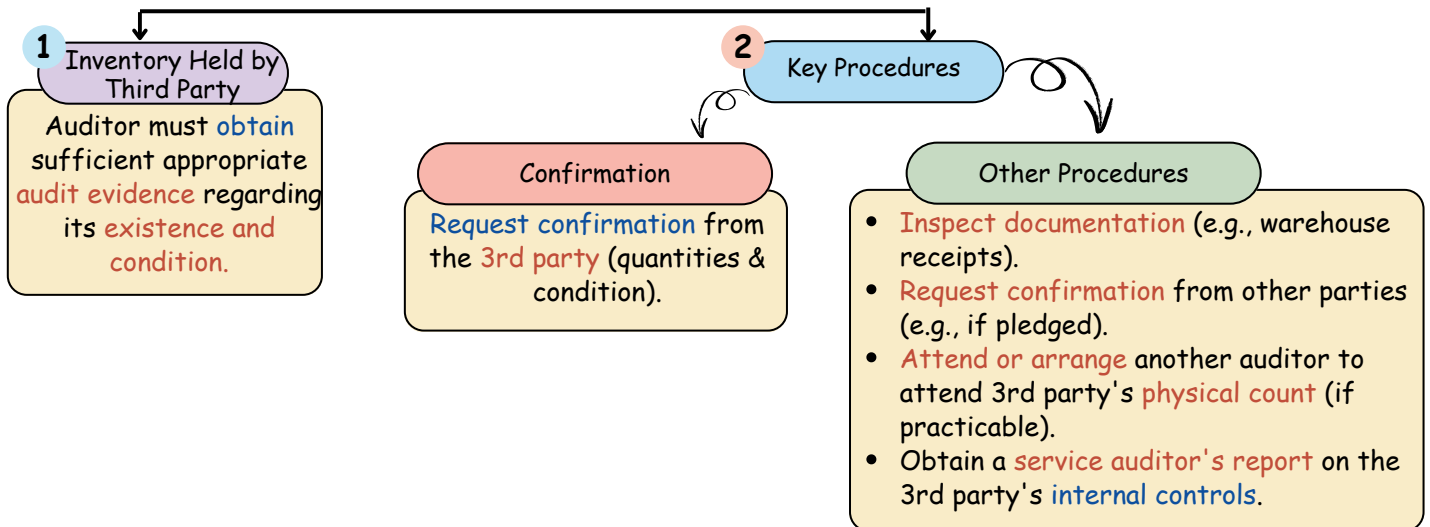
C. Audit Procedures when Inventory Counting at Other than the Date of the F/S



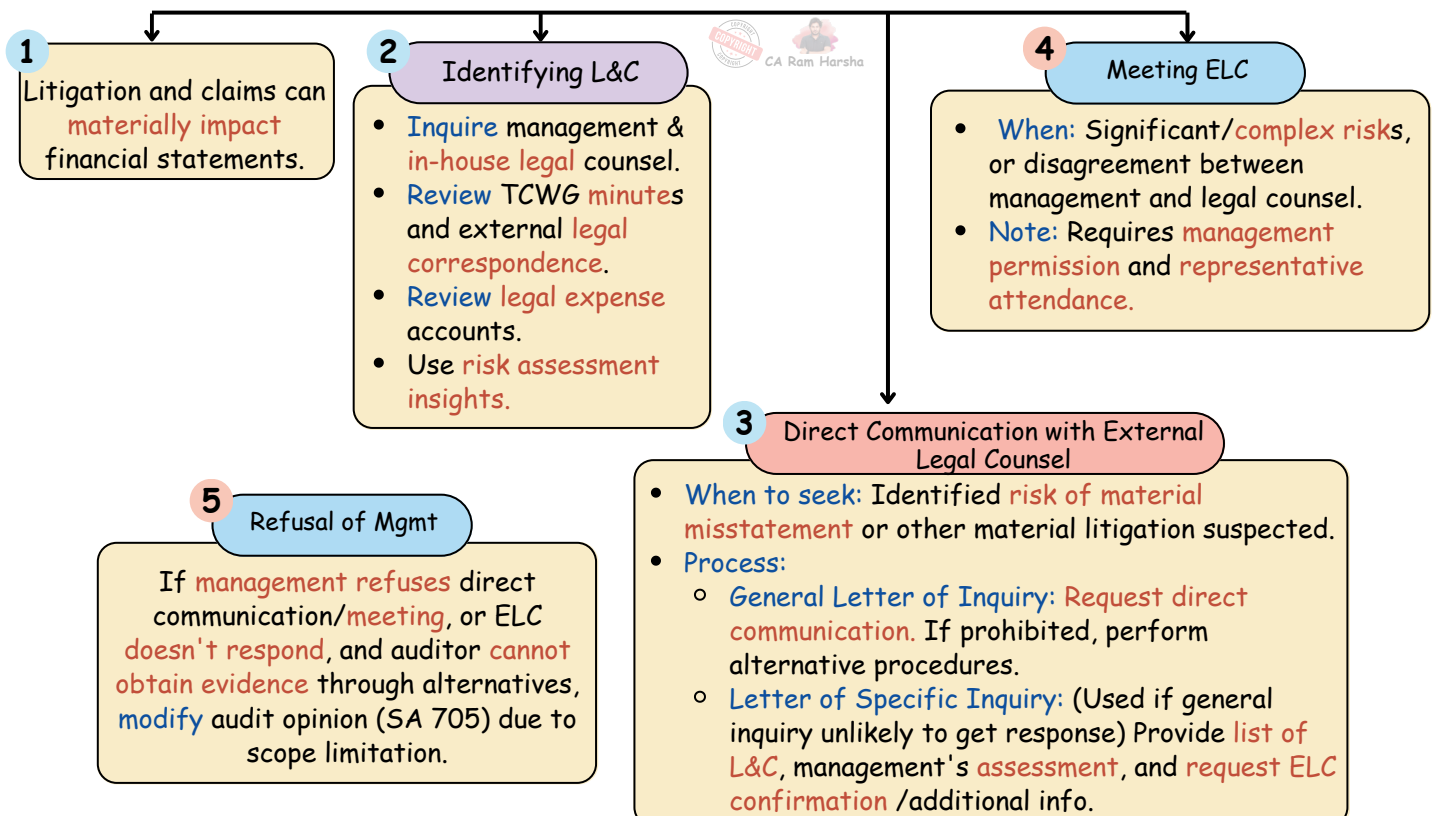
D. Auditor unable to attend Inventory counting



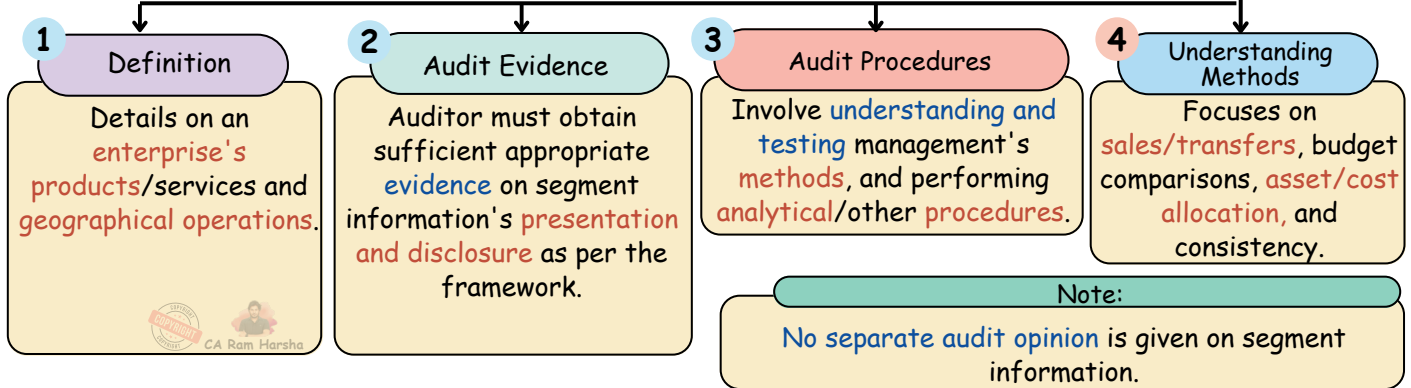
E. Audit Procedures - Inventory Under Control the of Third Party



F. Audit Procedures regarding Litigation and Claims



G. Segment Information

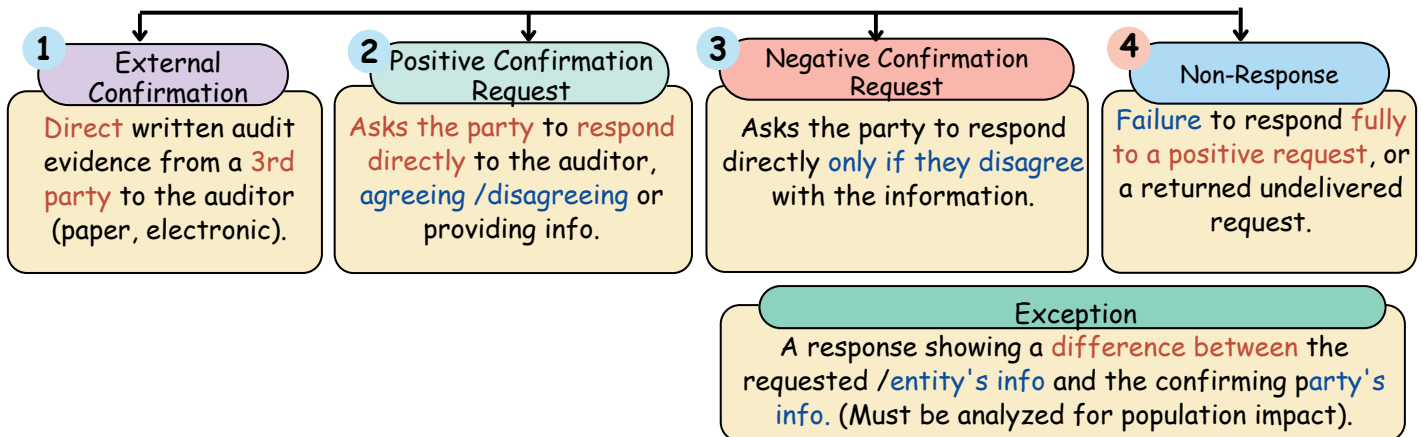


SA 505 External Confirmations

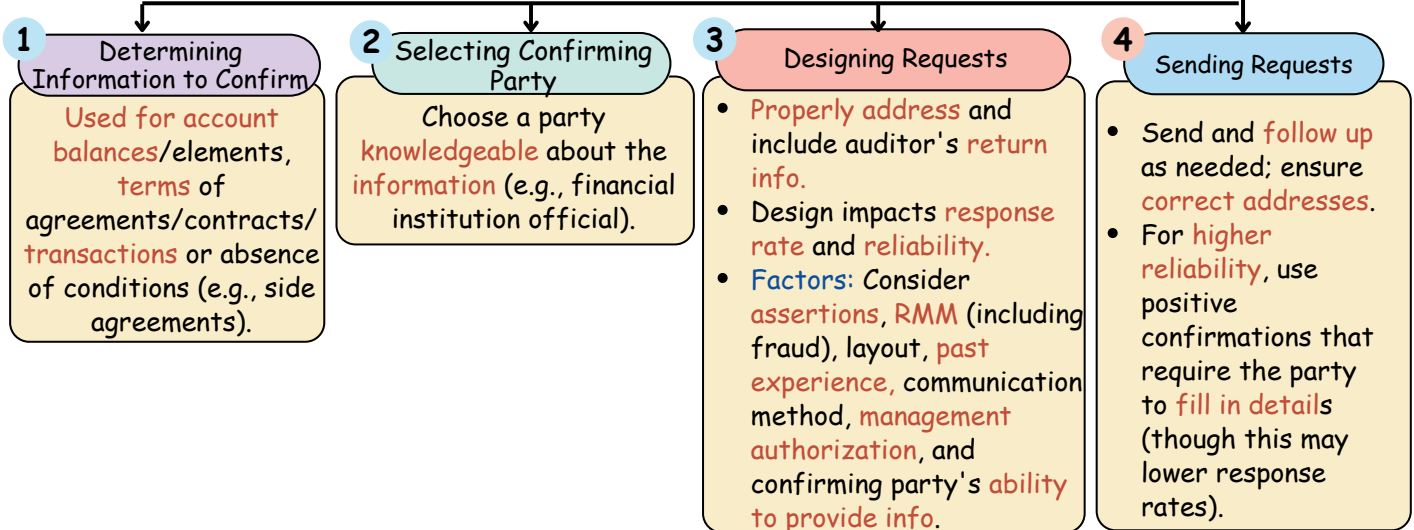
A. Scope and Objective of SA 505



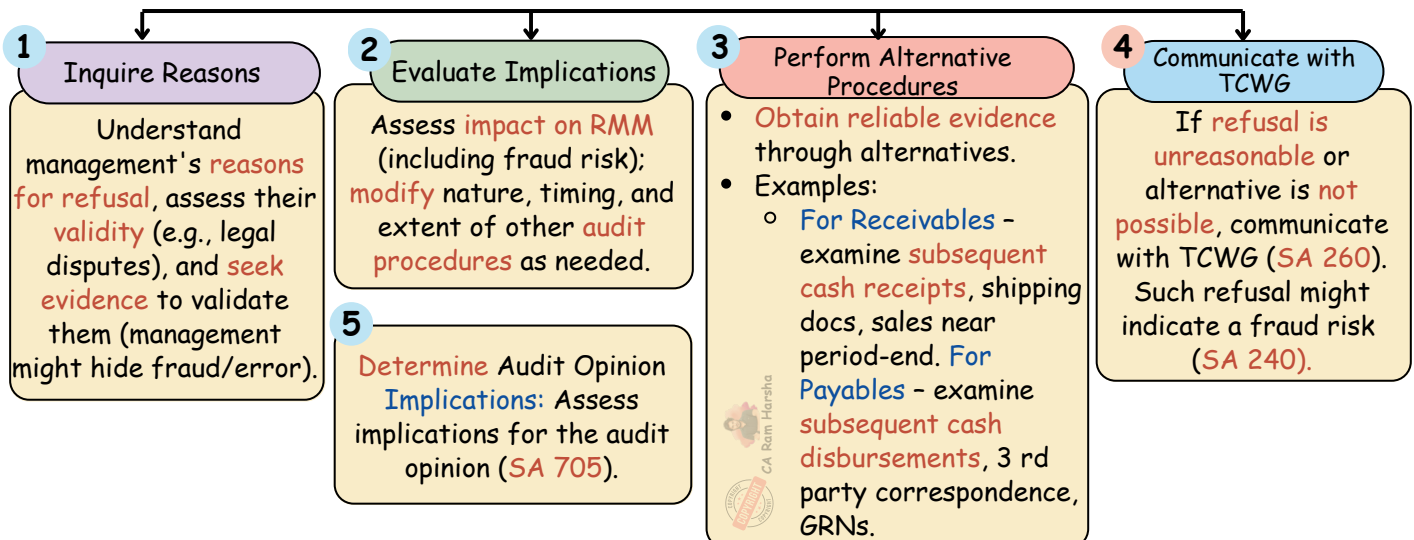
B. Key Definitions under SA 505



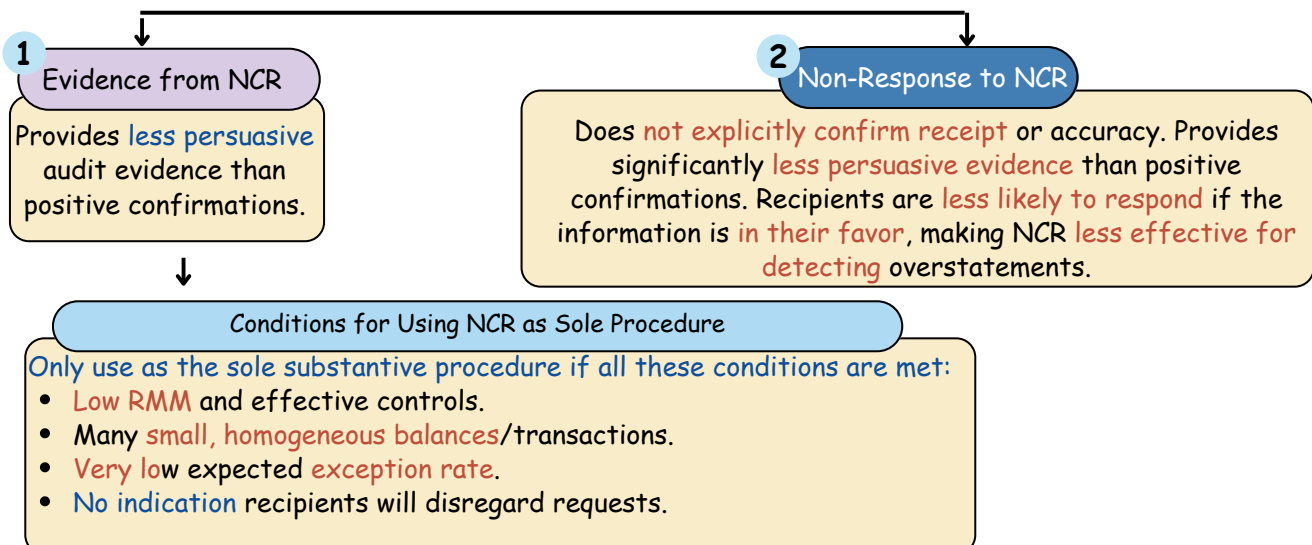
C. External Confirmation Procedure



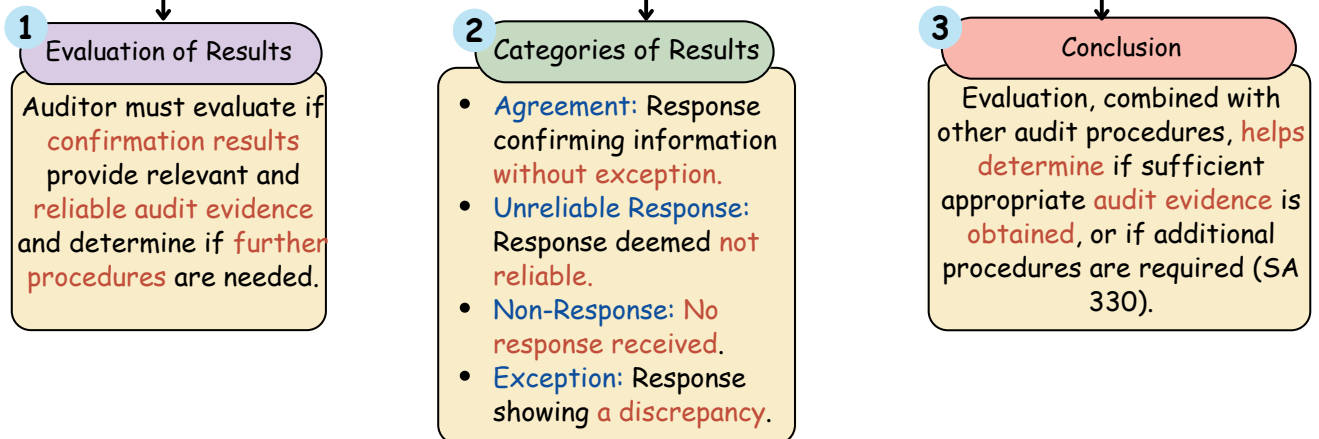
D. Management Refusal to allow External Confirmation Procedure



E. Negative Confirmations Request as an Audit Procedure

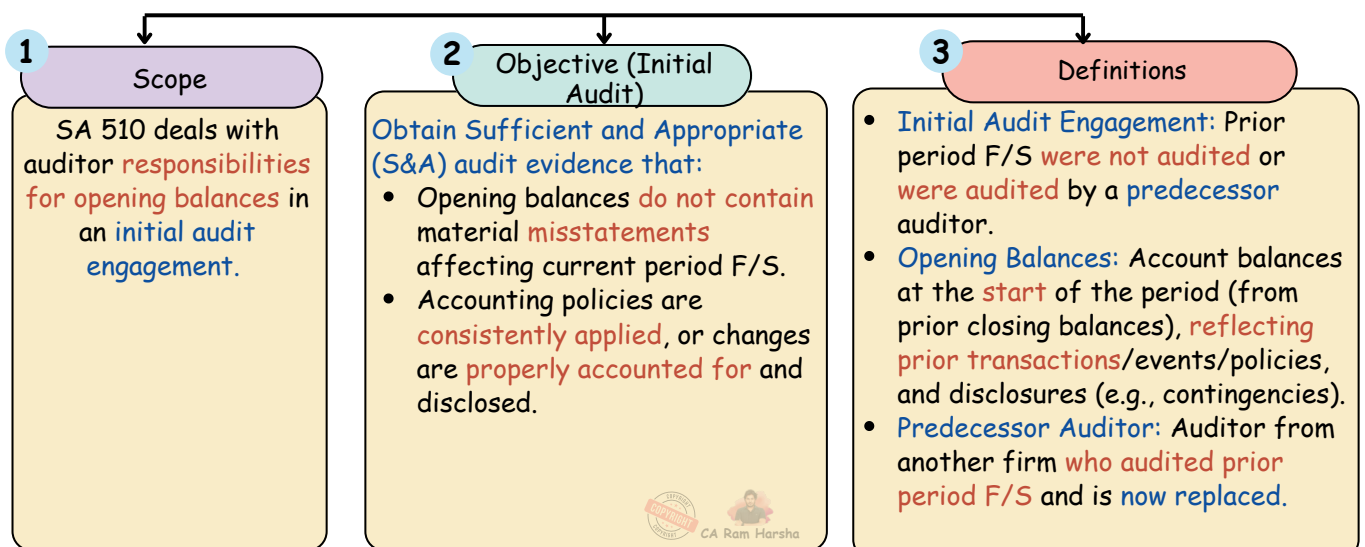


F. Evaluating the Evidence Obtained Through External Confirmations

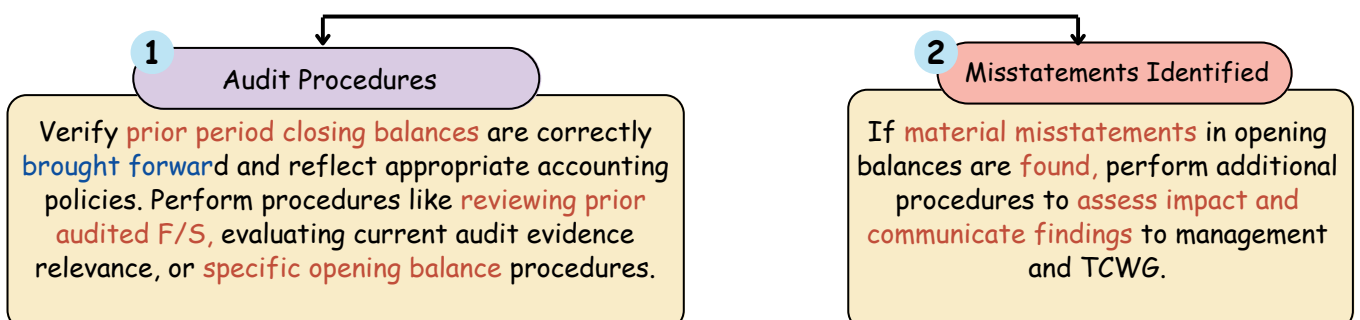


7. SA 510 Initial Audit Engagements - Opening Balances

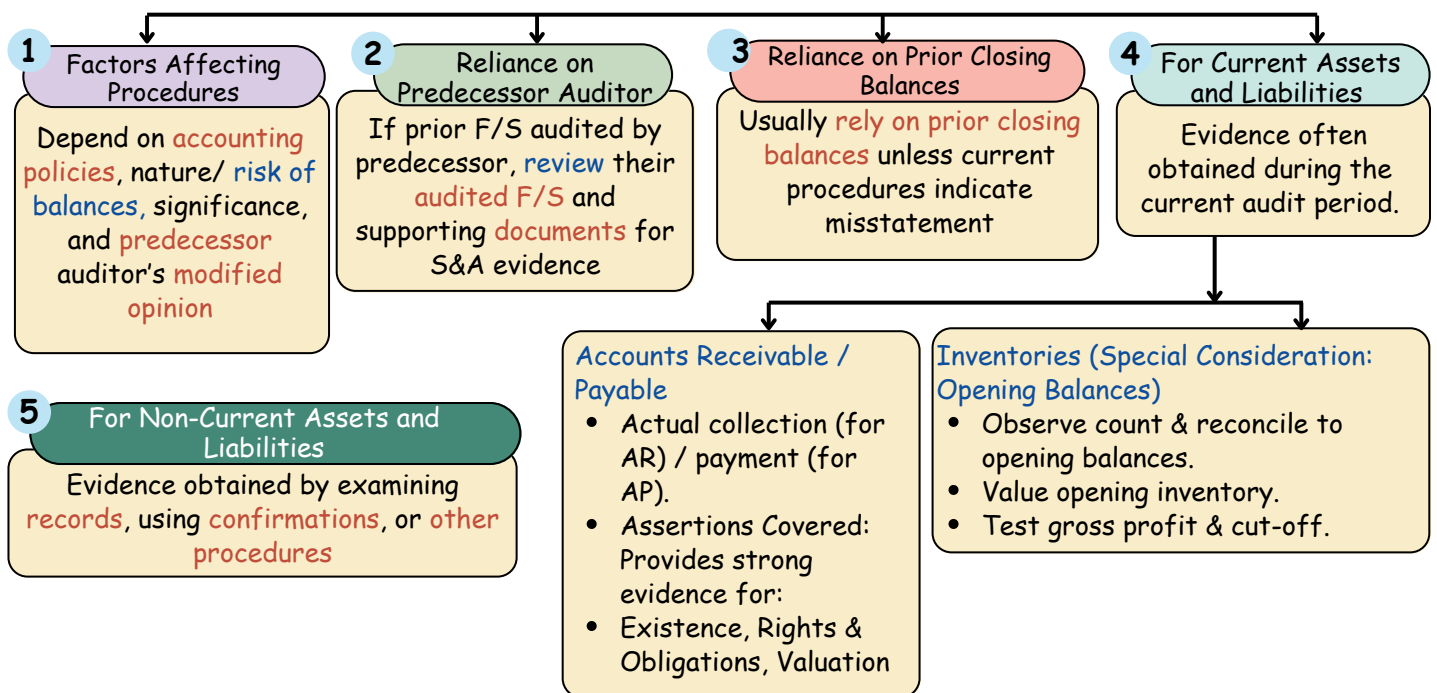
A. Scope and Objective of SA 510



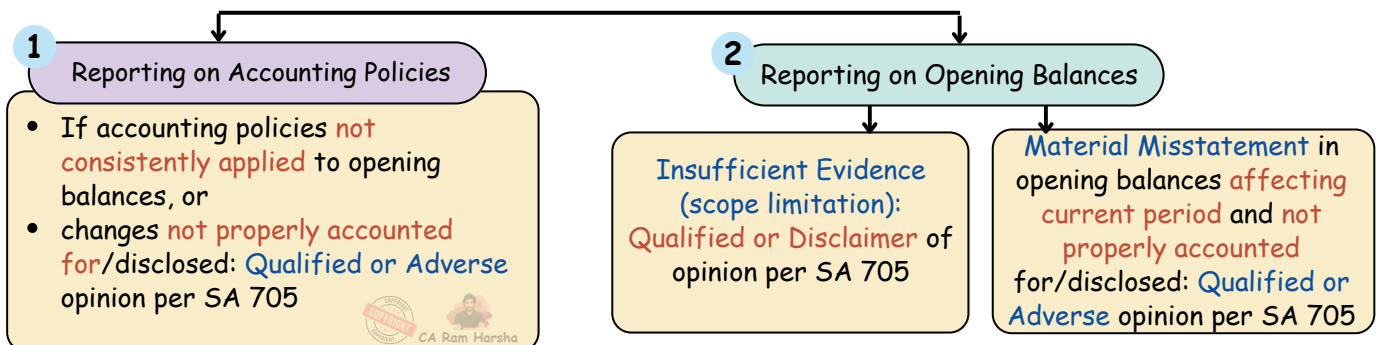
B. Audit Procedures for Opening Balances



C. Nature and Extent of Audit Procedures for Opening Balances

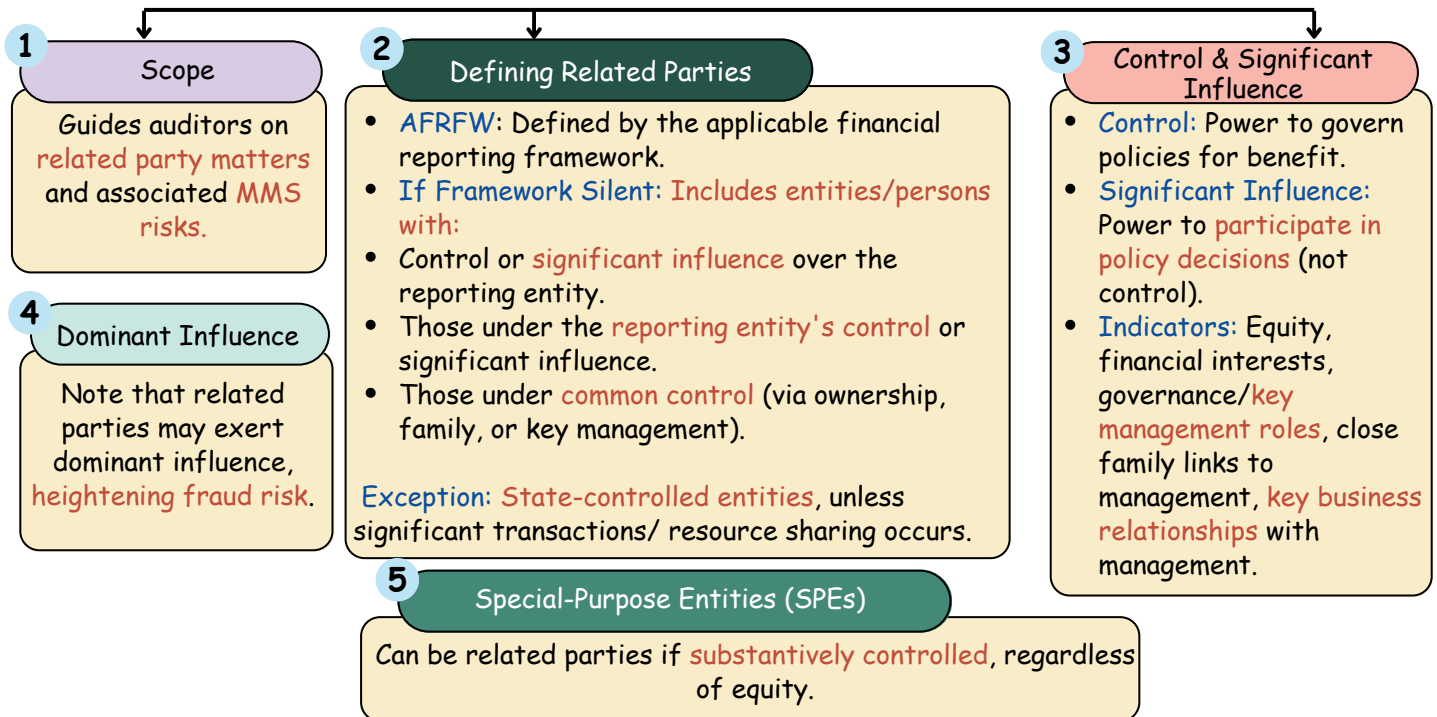


D. Auditors Conclusion and Reporting under SA 510

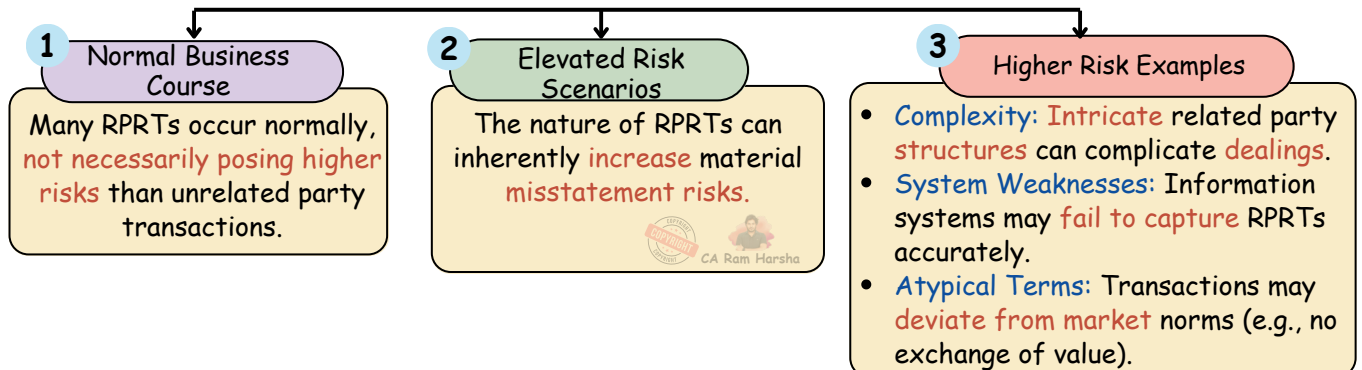


8. SA 550 Related Parties

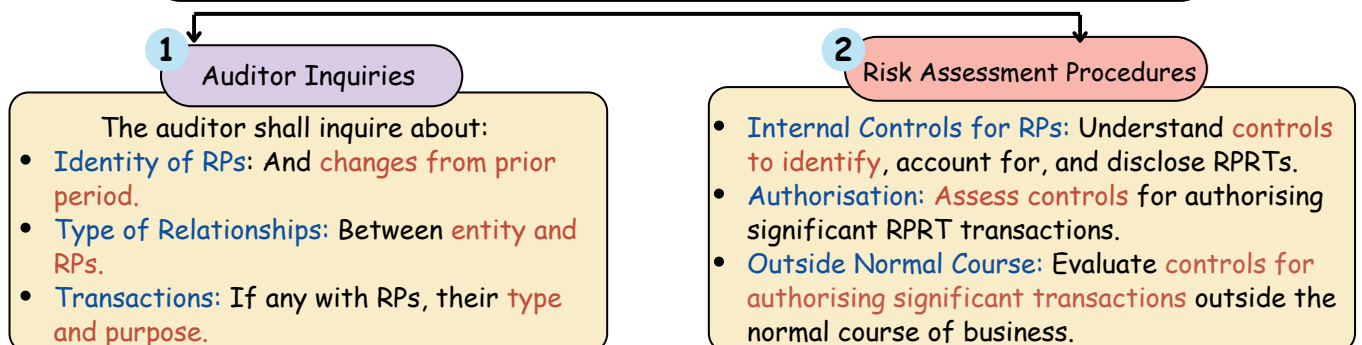
A. Scope and Meaning of Related Party



B. Nature of Related Party Relationships and Transactions [RPRTs]



C. Understanding of Entities RPRTs



D. Considerations Specific to Smaller Entities for RPRTs

1 Control Environment in Smaller Entities

Often have **different CE**,
E.g:

- Governance may **lack outside members**.
- **Owner-managers** might handle governance directly.

2 Informal Control Activities

Typically **less formal**; **documented processes** for RPRTs may be **missing**.



3 Role of the Owner-Manager

Can either:

- **Mitigate risks** through oversight.
- **Increase risks** via RPRT involvement.

4 Auditor's Approach

Auditor understands RPRTs and Internal Controls via:

- **Inquiring** of management.
- Observing management's **oversight**.
- **Inspecting** documentation.

E. Verification of Existence of RPRTs

1 Alertness for Related Party Information

Auditor must be alert for RP information when **reviewing records and documents**.

2 Records/Documents to Inspect (Examples Include)

- Entity's **income tax returns**.
- Information supplied to **regulatory authorities**.
- **Shareholder registers** (for principal shareholders).
- Conflict statements from **management & governance**.
- Entity's **investment records** and **pension plan** records.
- Agreements with **key management or governance**.
- Significant **contracts not in the ordinary course** of business.
- Specific **invoices/correspondence** from entity's professional advisors.
- **Life insurance policies** acquired by the entity.
- Significant **contracts renegotiated** during the period.
- **Internal auditors' reports**.
- Documents for **securities** regulators (e.g., prospectuses).

9. SA 520 Analytical Procedures

A. Meaning and Objective of Analytical Procedures

1

Meaning

- Evaluation of **Financial Information**
- By Analyzing **Plausible Relationships**
- Among **Financial and Non-Financial Data**



Includes Investigating Significant **Fluctuations or Inconsistencies**

2

Objective

- Obtain Relevant and **Reliable Audit Evidence**
- Using **Substantive Analytical Procedures**
- Help Form **Overall Conclusion**
- **Near End of Audit**
- Confirm **F/S Consistency** with **Auditor's Understanding**

3

Example

Examples from the source are included to illustrate the "**Meaning**" and investigation aspect.

- Example 1: Rent Payments involves **comparing entity rent to industry data** to identify inconsistencies.
- Example 2: Wages Verification uses a **relationship between financial** (wages per worker) and **non-financial** (number of workers) **data**

A. Analytical Procedures - Comparisons of Entity Financial Information

1

Compare with Prior Periods

financial information with prior periods.

2

Comparing with Anticipated Results

Compare **actual results** with **budgets, forecasts, or auditor's expectations**

3

Compare with Industry Information

Compare entity's **ratios** with **industry averages** or other entities of similar size.

B. Analytical Procedures - Consideration of Relationships

1

Predictable Patterns

Compare **relationships** within financial elements **expected to follow predictable patterns**

2

Financial and Non-Financial Data

Compare **relationships** between **financial data** and **non-financial data**

C. Purpose of Analytical procedures

1

Purpose of Analytical Procedures

- Use **comparisons** and relationships to check if **account balances** or other data seem **reasonable**.
- Help **detect unusual transactions, mistakes, or potential manipulations**.

2

Thus, Analytical procedures benefits

- **Unusual Transactions:** Identify **unusual events, amounts, ratios, or trends** that might signal audit risks, including fraud.
- **Risk of Misstatement:** Assist in **pinpointing risks** of material misstatement.

D. Examples of Analytical Procedures

- **Relationships between BS and PL** Compare Balance Sheet and Profit & Loss balances **across different periods**.
- **Physical Reconciliation** Match physical asset counts with financial records.
- **Account Confirmations** Confirm balances with **external parties** (bankers, receivables, payables) and reconcile with books.
- **Reconciliation Statements** Prepare reconciliations to **confirm outstanding income** or expense amounts.
- **Gross Profit Ratio** Compare current year's gross profit ratio **with the previous year's** to identify issues like inventory theft or price/cost variations.
- **Sundry Account Receivables** Discrepancies might indicate **unrecorded goods supplied** or unadjusted receipts.
- **Sundry Account Payables** Discrepancies could mean **unrecorded consignments** or unadjusted payments.
- **Inventory Variations** Investigate excesses/**shortages in materials/stores** to **find misappropriation** or recording errors.
- **Interest and Dividends Reconcile** amounts collected with accrued/outstanding amounts to find income adjustment errors.
- **Inter-firm Comparisons** Compare the entity's **results with another firm** in the same industry to understand profitability differences.
- **Intra-firm Comparisons** Compare the entity's **own Profit and Loss balances** across periods to analyze profitability changes.
- **Expense Ratios** Set up and compare expense ratios (e.g., expenses to sales) with the **previous year** to assess expenditure variations or profit manipulation.
- **Abnormal Cost Reductions** Investigate significant drops in costs to ensure all **expenses have been properly accounted for**.

E. Timing of Analytical Procedures

Used in 3 Stages: Planning, Testing and Completion phase

1

During the planning phase

Help auditors understand the **client's business** and **identify potential risks**.

2

Benefits

The information **guides the nature, timing and extent** of further audit procedures.

3

Data Used

Use both **financial and non-financial** data.

F. Substantive Analytical Procedures [SAP]

1

Meaning

SAP and Test of Details are both used at the **assertion level** to gather audit evidence.

2

Application

SAP is applied when the auditor judges it can **reduce audit risk** to an acceptable level.

3

Inquiries from Management

Auditor may ask about:

- Data **reliability and availability**
- Results of entity's **own analytical procedures**

4

Use of Management Data

Allowed if the data is **reliable and properly prepared**.

G. Factors for Substantive Analytical Procedures [ISM uses the word "Audit"]

1 Data Availability

Reliable and relevant data makes SAP effective.

2 Disaggregation

More detailed data improves misstatement detection.

3 Account Type

SAP works better for income statement items (e.g., sales) than balance sheet items.

4 Source of Data

- Routine transactions (e.g., sales) = predictable = good for SAP
- SCOTs (e.g., R&D) = judgment based = less suitable

5 Predictability

Effective where relationships are predictable (e.g., sales vs. cost of sales).

6 Nature of Assertion

Best for Completeness and Valuation, less effective for Rights & Obligations.

7 Inherent Risk

If risk is high, use test of details; SAP alone may not be enough.

H. Techniques of Substantive Analytical Procedure

1 Trend Analysis

- Definition: Compare current balances with prior periods to spot unusual changes.
- Purpose: Check if figures align with known trends.
- Example: Rising salary expenses may hint at fraud if not justified.

2 Ratio Analysis

- Definition: Study relationships between accounts (e.g., sales & receivables).
- Purpose: Detect mismatches by comparing ratios across time or industry.
- Example: Use Gross Profit Ratio or Trade Receivables Turnover.

3 Reasonableness Tests

- Definition: Use non-financial data to assess account balance logic.
- Purpose: Helpful for areas like accruals or income statement items.
- Example: Match interest expense to loan obligations or rent income to occupancy.

4 Structural Modelling

- Definition: Apply statistical models (e.g., regression) using financial & non-financial data.
- Purpose: Predict what account balances should be.

I. Analytical Procedures - As Sole Substantive Audit Procedures

1 Suitability of Procedures

- Auditor must assess if SAP is **appropriate** for the assertions, based on:
 - Risk of material misstatement (**ROMM**)
 - Test of details** (if any)

2 Reliability of Data

- Data used must be evaluated for:
- Source**
 - Comparability
 - Relevance & nature**
 - Controls over its preparation

3 Development of Expectation

Auditor develops an **expected value/ratio** to check if recorded amounts align and **spot possible misstatements**.



4 Acceptable Difference

Define the **acceptable range** between **actual and expected values** - beyond which **further investigation** is required.

J. Suitability of a Particular Analytical procedure for given assertion

1 Applicability

SAP works best for **large volumes of predictable transactions** over time.

2 Assumption

Based on the belief that **stable relationships exist** among data unless proven otherwise.

3 Procedure Suitability

Depends on its **effectiveness in detecting misstatements** that could be material.

4 Predictive Models

Even simple models can be **effective, especially** where inputs (e.g., payroll data) are stable.

5 Level of Assurance

Varying Levels: Analytical procedures offer different assurance.

1. High Assurance

- Precise prediction (e.g., rental income via rates/units).
- Impact: Can eliminate further verification.

2. Lower Assurance

- Broad comparison (e.g., gross margin % trends).
- Impact: Corroborates other evidence; less persuasive alone.

6 Factors Influencing Suitability

Depends on:

- Nature** of assertion
- Risk of MMS**
- E.g., weak sales controls → rely on test of details for receivables

7 Combination with Tests of Details

SAP is **stronger when used with tests of details** for the **same assertion**.

E.g., for accounts receivable, use:

- Ageing analysis
- Cash receipt testing

K. Factors for Determining Reliability of Data

Definition

Reliability depends on the **source, nature, and circumstances** of the data.

Factors Affecting Reliability

1

Source

More reliable when from **independent sources** outside the entity.

2

Comparability

Data must fit the **entity's context**; e.g., broad industry data may need adjustments.

3

Nature & Relevance

More reliable if based on **expected outcomes**, not aspirational goals.

Testing Controls Over Preparation

1

Operating Effectiveness

Auditor may test **how well controls work** when preparing data for SAP.

2

Non-Financial Info Controls

Controls over **non-financial data** can also be tested for reliability.

L. Evaluation of whether the Expectation is Sufficiently Precise - To identify MMS

1

Predictability of Expected Results

Precision improves when expected results are **predictable** (e.g., gross profit margins) vs. discretionary expenses (e.g., R&D, advertising).

2

Degree of Disaggregation

SAP is **more effective** when applied to **disaggregated information** (e.g., individual components) rather than the **entire entity**.



3

Availability and Reliability of Information

Design of SAP depends on **availability and reliability** of:

- **Financial data** (e.g., budgets, forecasts)
- **Non-financial data** (e.g., units produced/sold)

M. Amount of Difference that is Acceptable

1

Acceptable Difference

The difference between **recorded amounts and expected values** that can be accepted **without further investigation**.

2

Factors

Influenced by **materiality, desired level of assurance**, and risk of misstatement (individual or aggregate).

3

SA 330 Requirement

- **Higher risk** → **more persuasive evidence** needed
- Therefore, lower acceptable difference without investigation

4

Relationship

As **risk increases**, the **acceptable difference decreases** to ensure sufficient audit evidence.

N. Investigating Results of Analytical Procedures

If fluctuations or relationships identified by analytical procedures differ significantly from expected values or relevant information, the auditor must:

1

Inquire of Management

- Request **explanation for the fluctuations** or inconsistencies
- **Evaluate** management's **response** using other audit **evidence**

2

Perform Additional Audit Procedures

1. If no adequate explanation is given, perform additional procedures **to detect any material misstatements**.



O. Overall Conclusions

1

Purpose of Analytical Procedures

To **corroborate conclusions** from the audit of financial components.

2

Auditor's Opinion

Helps in **forming reasonable conclusions** to support the auditor's opinion on financial statements.

3

Identifying New Risks

May **uncover previously unrecognized risks** of material misstatement.

4

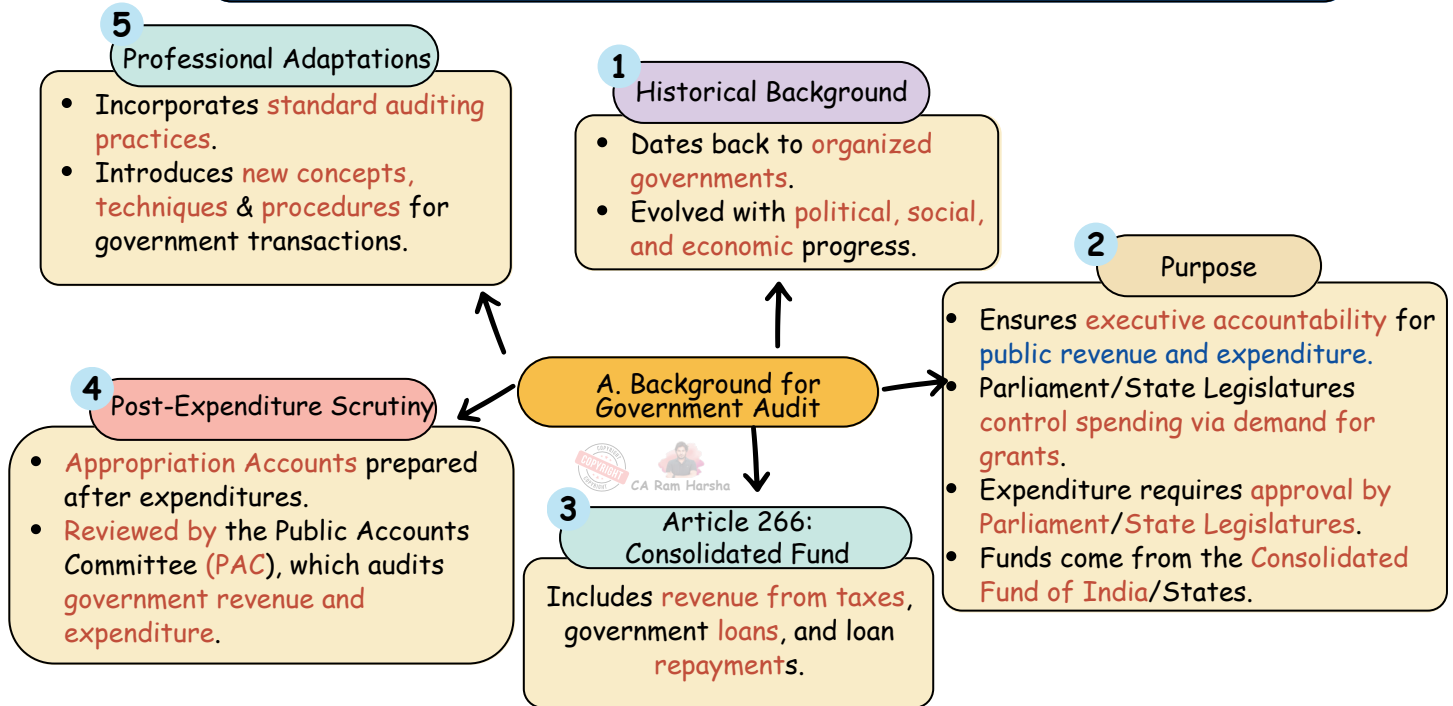
Action Required (SA 315)

Auditor must:

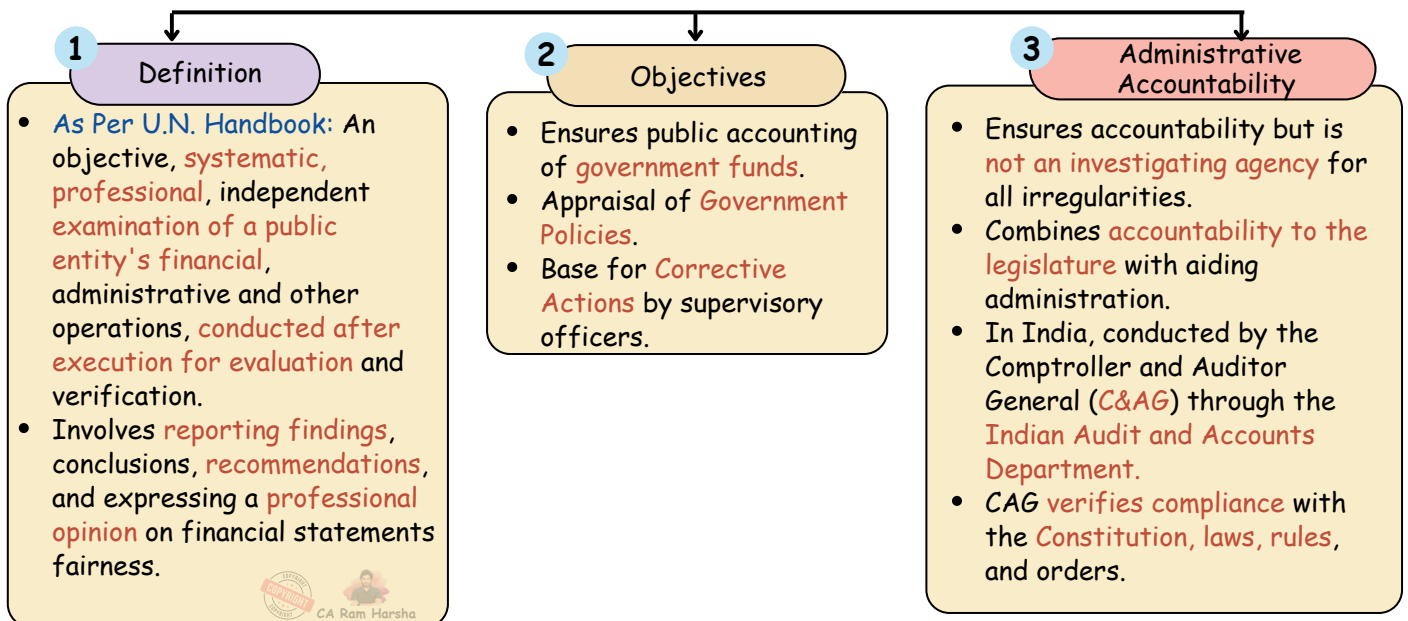
- **Revise assessment of risks**
- **Modify further audit** procedures accordingly

Chapter 7 - Different Types of Entities

1. Government Audit



B. Meaning and Objectives of Government Audit



C. Legal Framework around CAG

1 Appointment & Removal

Appointed by the President; removable **only like a Supreme Court Judge** (proven misbehaviour/incapacity, 2/3rd majority in both Houses).

2 Salary & Service Conditions

Determined by Parliament; cannot be **varied to disadvantage** after appointment. Administrative powers by President in **consultation with C&AG**.

4 Constitutional Provisions

- **Articles 149** (duties/powers defined by Parliament law),
- **Articles 150** (form of accounts prescribed by President based on CAG advice),
- **Articles 151** (reports submitted to President/Governor, laid before Legislature).

3 Tenure

Fixed tenure by the **C&AG** (Duties, Powers and Conditions of Service) Act, 1971; salary **equals Supreme Court Judge**.

D. Duties of CAG

1 Compile and Submit Accounts

- **Compiles accounts for Union, States, UTs;**
- Prepares annual accounts (e.g., appropriation accounts) showing receipts / disbursements for submission to **President / Governor / Chief Administrator**.

2 Provides Information and Assistance

Aids governments in preparing annual **financial statements**.

3 General Provisions Relating to Audit

Audits/reports on expenditure from **Consolidated Fund**, Contingency Funds, **Public Accounts** & departmental profit/loss/**balance sheets**.

4 Audit of Receipts and Expenditure

Audits **receipts/expenditure** of bodies substantially financed by **grants/loans** from the **Consolidated Fund** ($\geq \text{₹}25$ lakhs and $\geq 75\%$ of total expenditure).

5 Audit of Grants or Loans

Verifies **procedures / conditions** for grants/ loans from **Consolidated Fund** for specific purposes.

6 Audit of Receipts

Audits **all receipts payable** into the **Consolidated Fund**; ensures effective **checks on assessment**, collection, allocation.

7 Audit of Stores and Inventory

Audits/reports on accounts of **stores/inventory** in government offices.

8 Audit of Government Companies

Duties under Companies Act, 2013: appoints auditors, directs auditors, auditors submit reports to CAG.

E. Powers of CAG

1 Inspection of Accounts

Inspects any office of **accounts** under government control.

2 Access to Documents

Requires relevant **accounts, books, papers** to be sent.

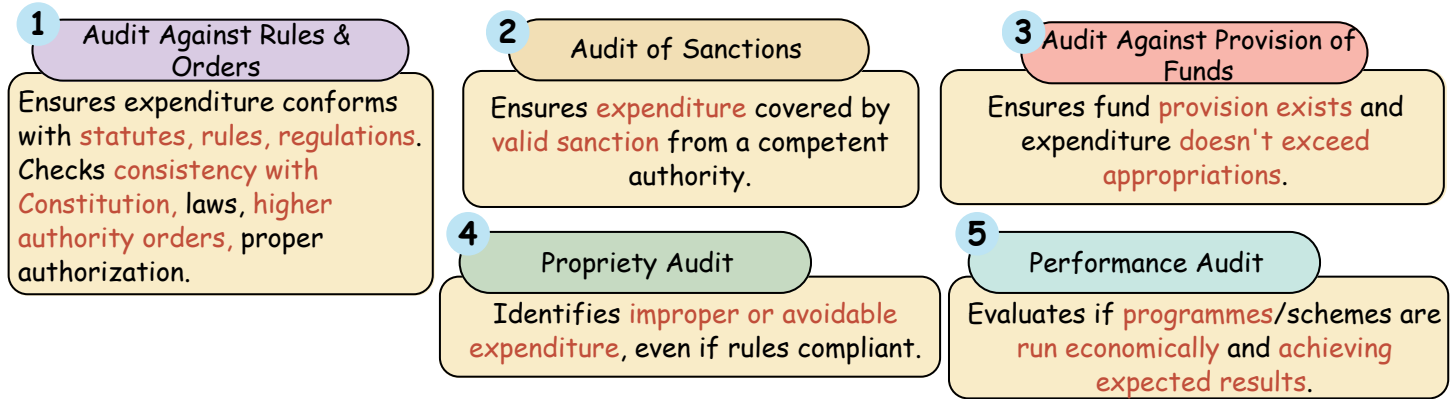
3 Questions and Observations

Asks **questions** or makes **observations** to person in charge; **calls for information** needed for reports.

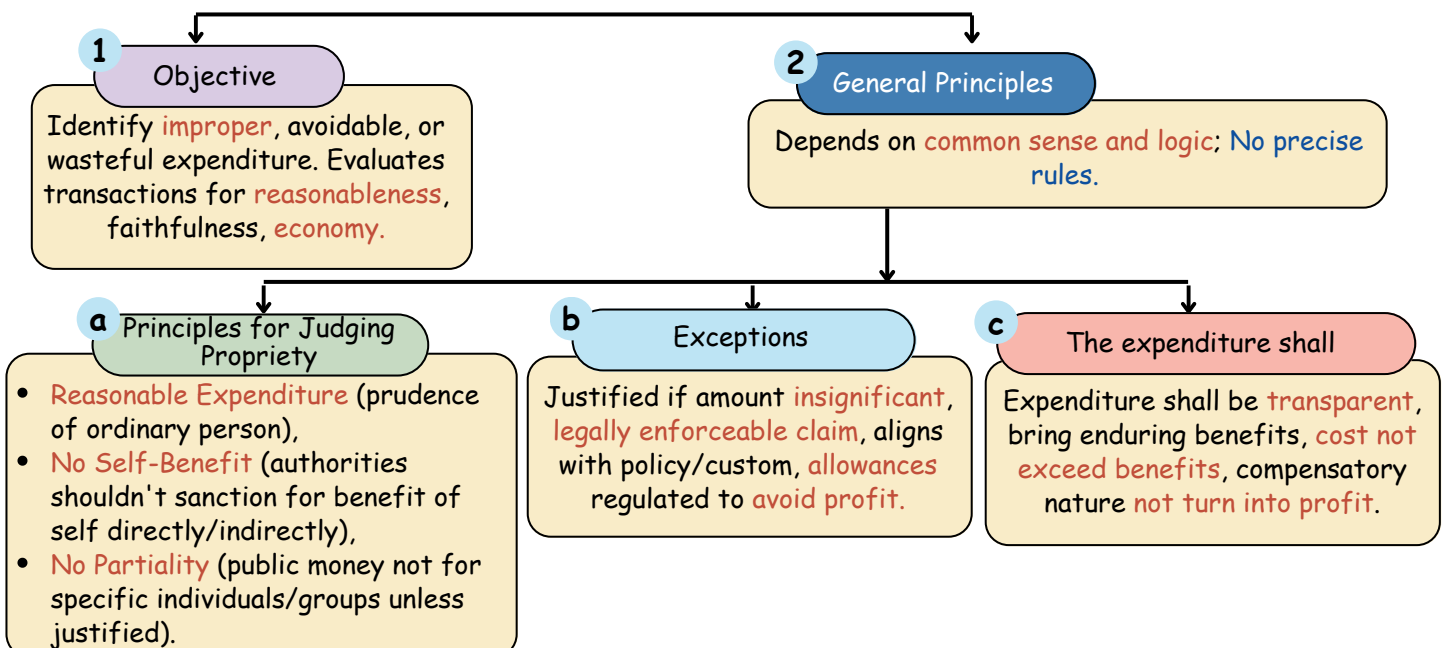
4 Audit Scope and Checks

Can **dispense with detailed audits** and apply **limited checks**.

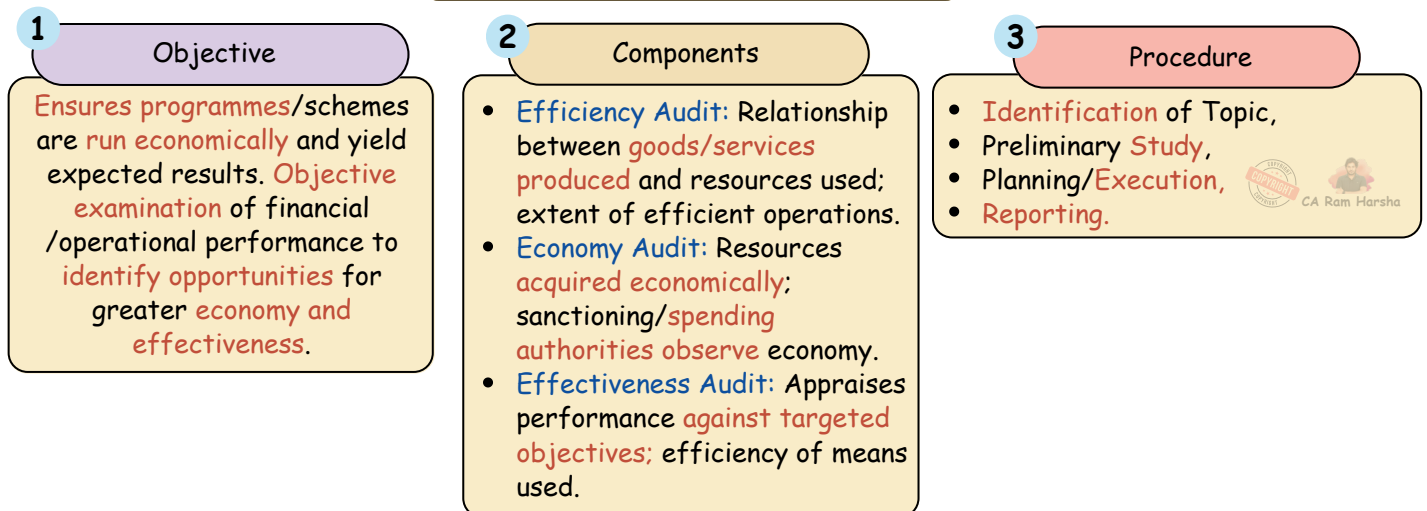
F. Audit of Government Expenditure



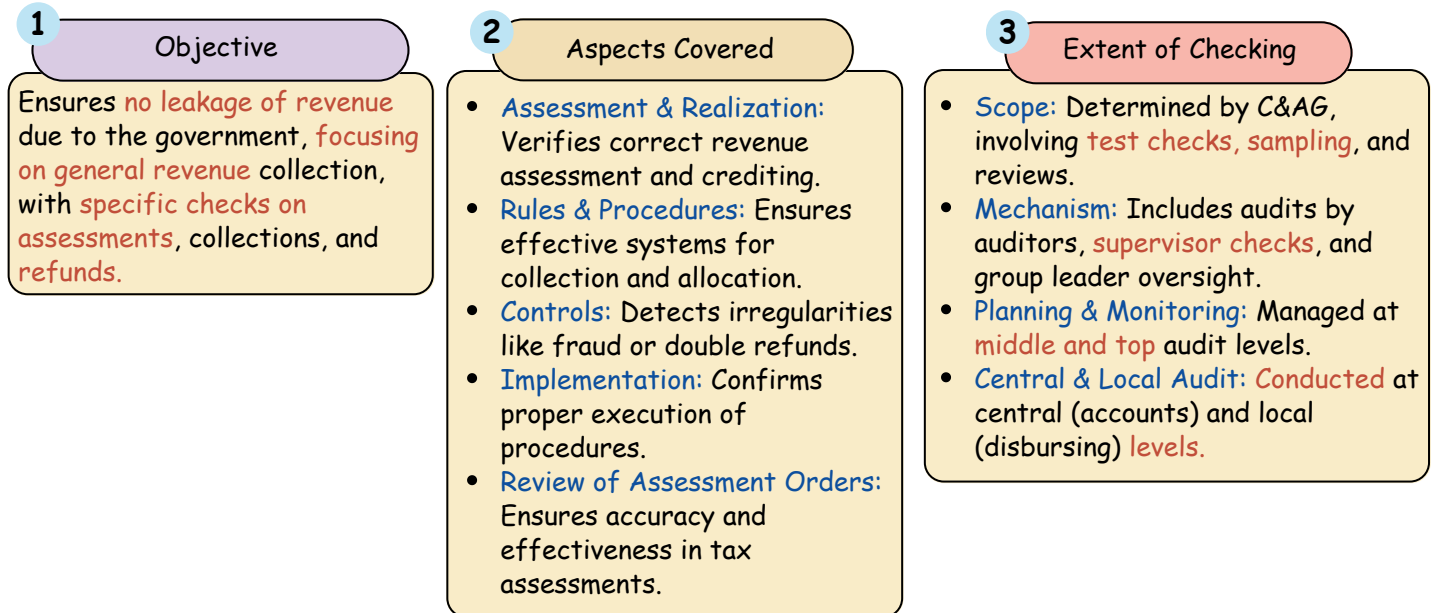
G. Propriety Audit



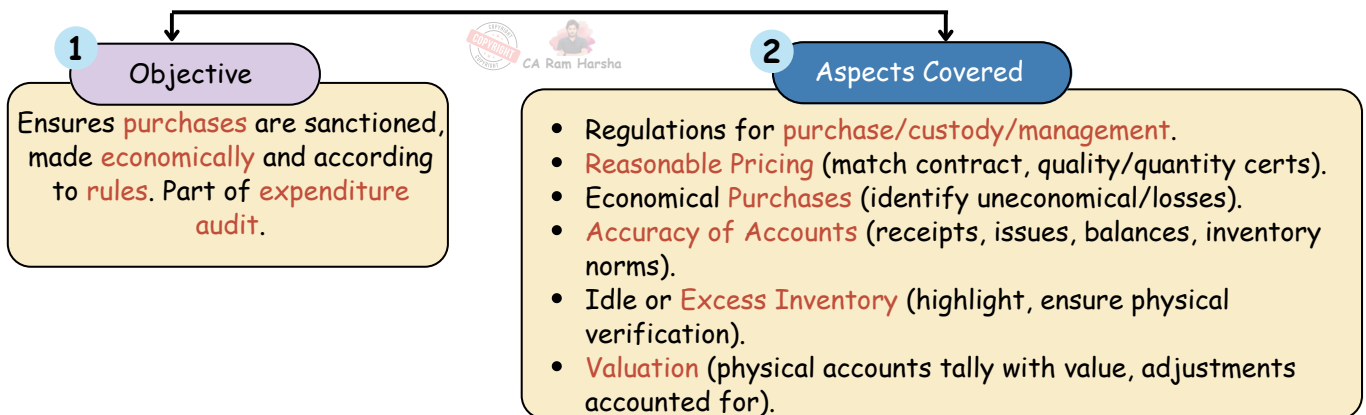
H. Performance Audit



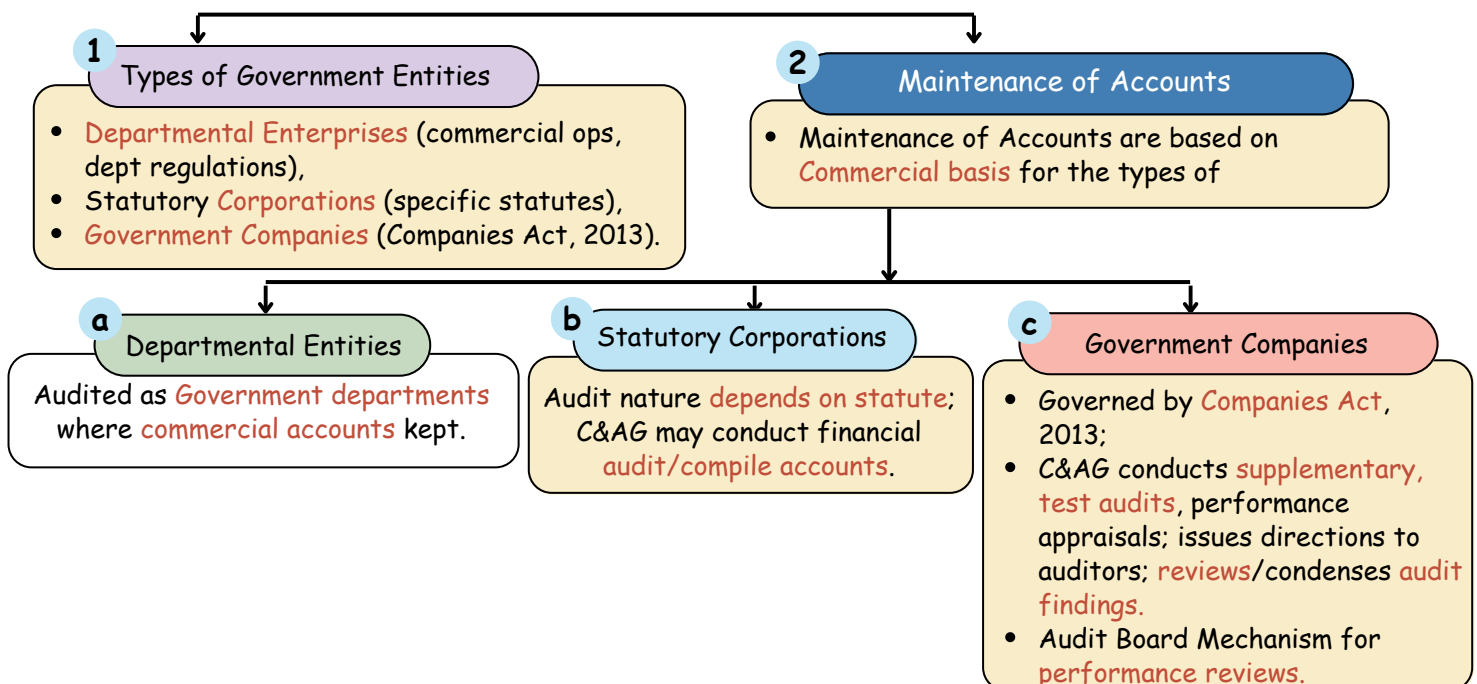
I. Audit of Government Receipts



J. Audit of Stores and Inventories



K. Concept of Audit of Commercial Accounts



L. Role of CAG in Government Companies under Companies Act 2013

a Appointment of Auditors (Sec. 139)

- CAG appoints **First Auditor** [Sec. 139(5)] or Subsequent Auditor [Sec. 139(7)].
- **Directs auditors** on audit manner.
- Auditor **submits report** copy to **CAG** [Sec. 143(5)].

b Supplementary Audit (Sec. 143(6))

- **CAG has right** to conduct Supplementary Audit **within 60 days** of receiving report. Requests additional info.
- **CAG's comments** sent to entitled persons (members, trustees, etc.) and **presented at AGM** with statutory report.
- Note: It's an **extension of original audit**.

c Test Audit (Sec. 143(7))

- **CAG** may order a **Test Audit** if necessary. Governed by Sec. 19A of C&AG Act, 1971.
- **Conducted** by CAG directly.

d Two-Layer Audit System

Statutory Auditors (Qualified CAs) + **CAG's Audit** (Supplementary, Test audits).

e Audit Standards

CAG combines **government and commercial audit** principles; focuses on autonomy, accountability and the three Es: **Economy, Efficiency, Effectiveness**.

M. Reporting Procedures under Government Audit

1 Importance of Reporting

Effectiveness **depends on reporting findings** to proper authority for **action/prevention**.

2 Right and Obligation to Report

C&AG's right is **inherent, safeguarded** by Constitution / Enactments.

3 Reporting as per Article 151

Reports submitted to President/Governor and then **laid before legislatures**.

4 Publicity of Reports

Should be publicised for **awareness, remedial action**, proper public **opinion climate**.

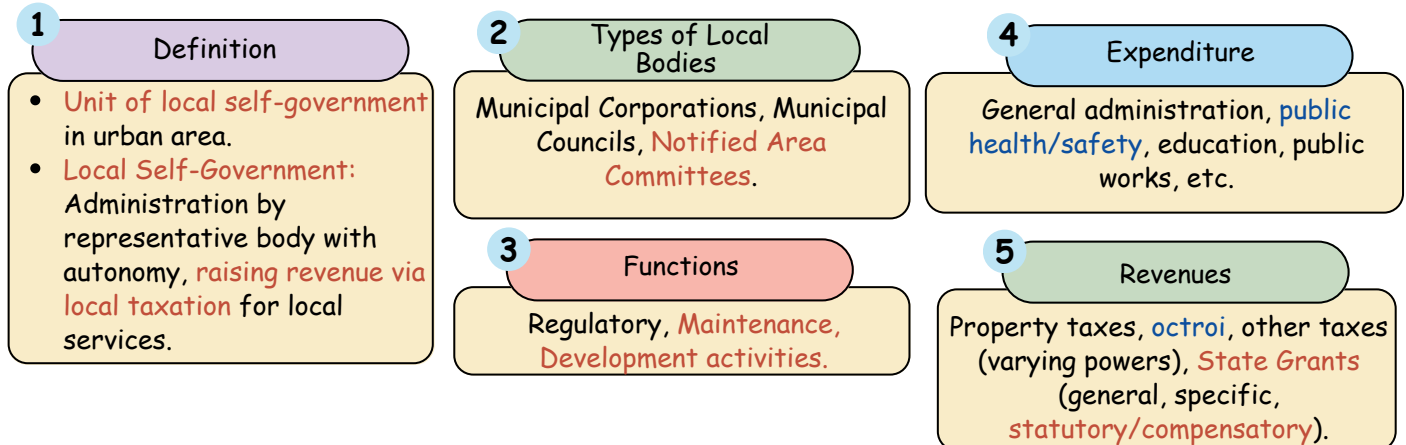
5 Objectivity in Reporting

Factual reporting; **conclusions left** to the reader; ensures **total objectivity**.

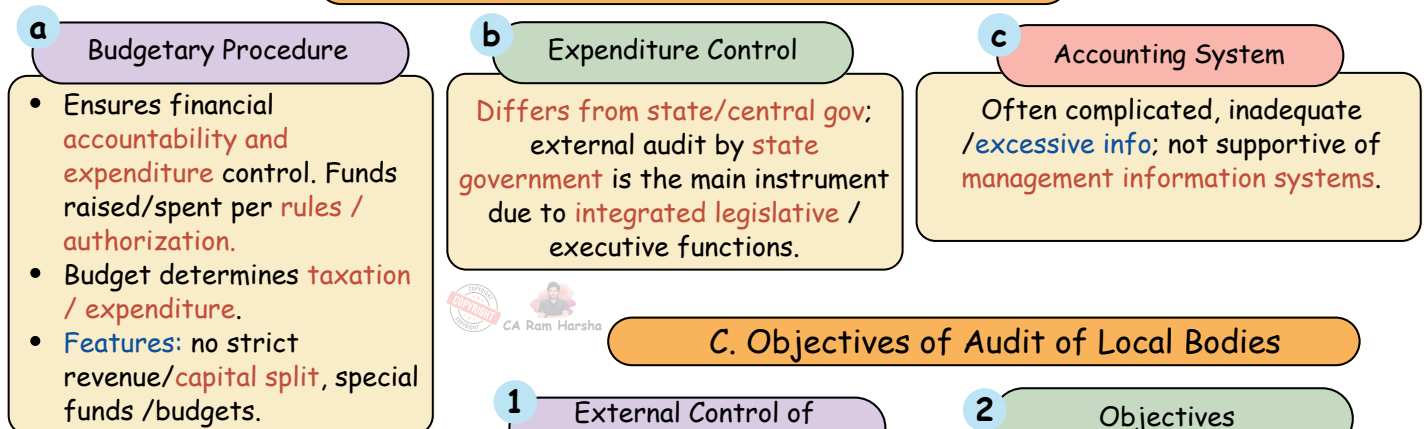


2. Audit of Local Bodies

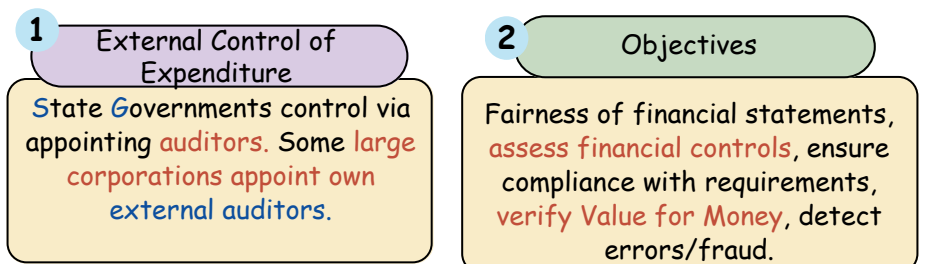
A. Background of Local Bodies



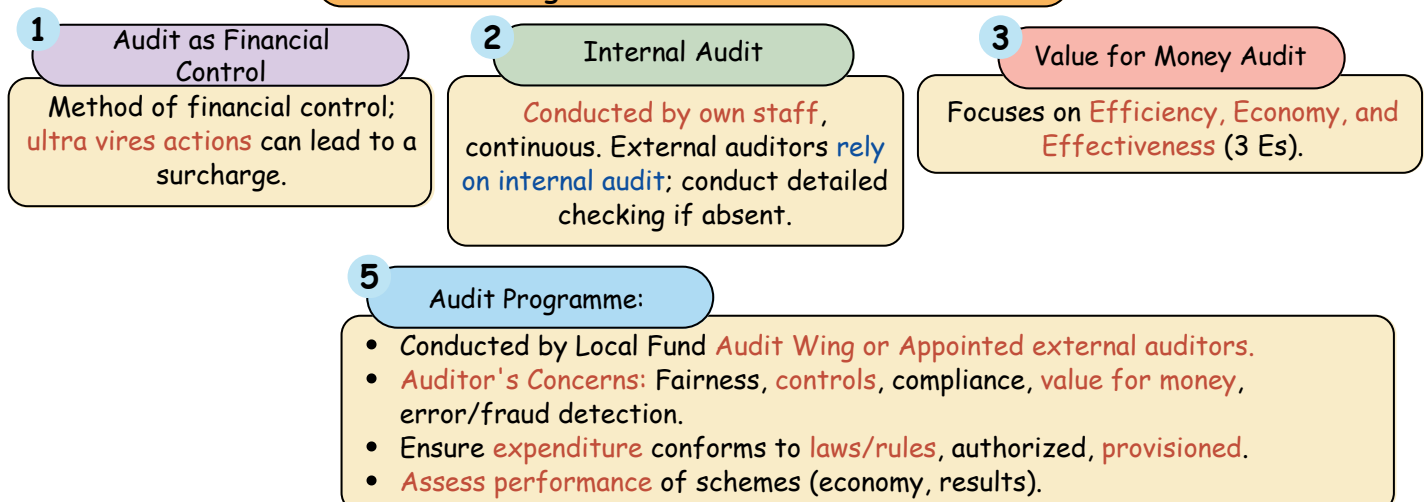
B. Financial Administration of Local Bodies



C. Objectives of Audit of Local Bodies

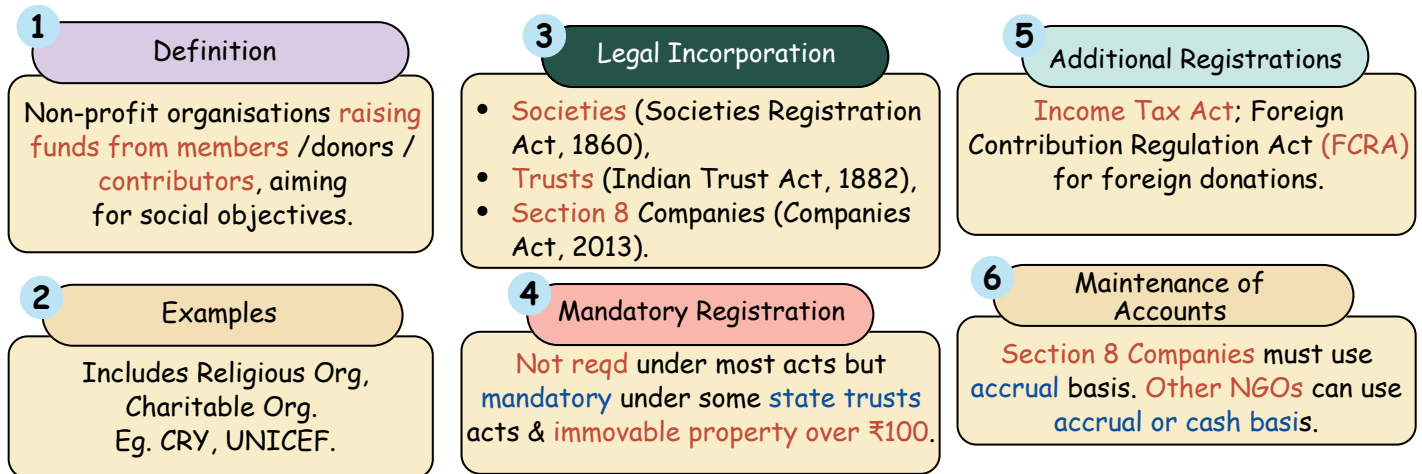


D. Audit Programme for Audit of Local Bodies

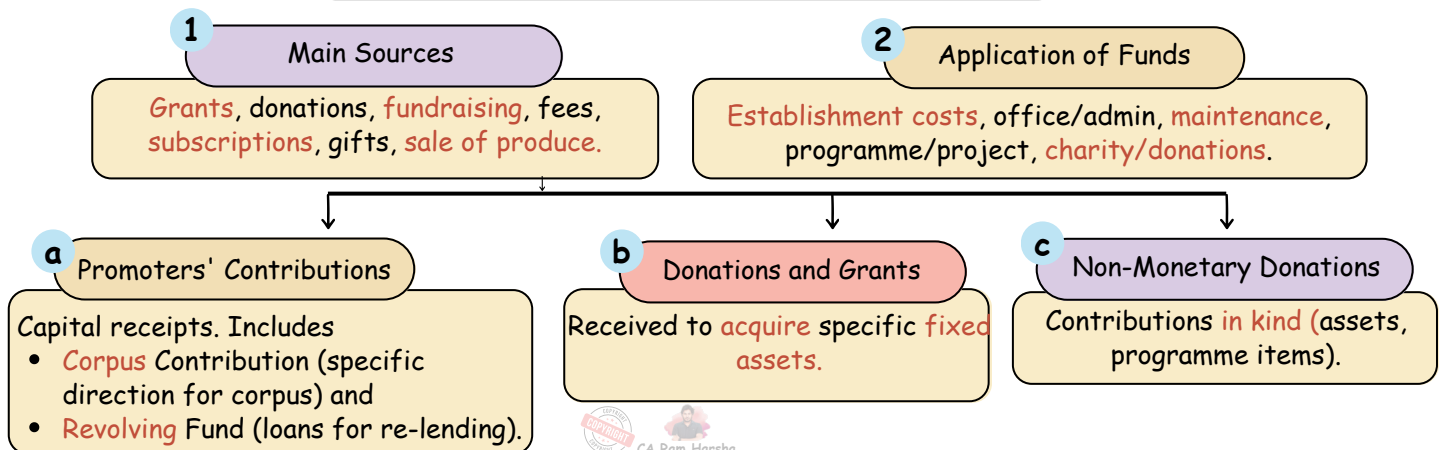


3. Audit of Non - Governmental Organisation (NGO'S)

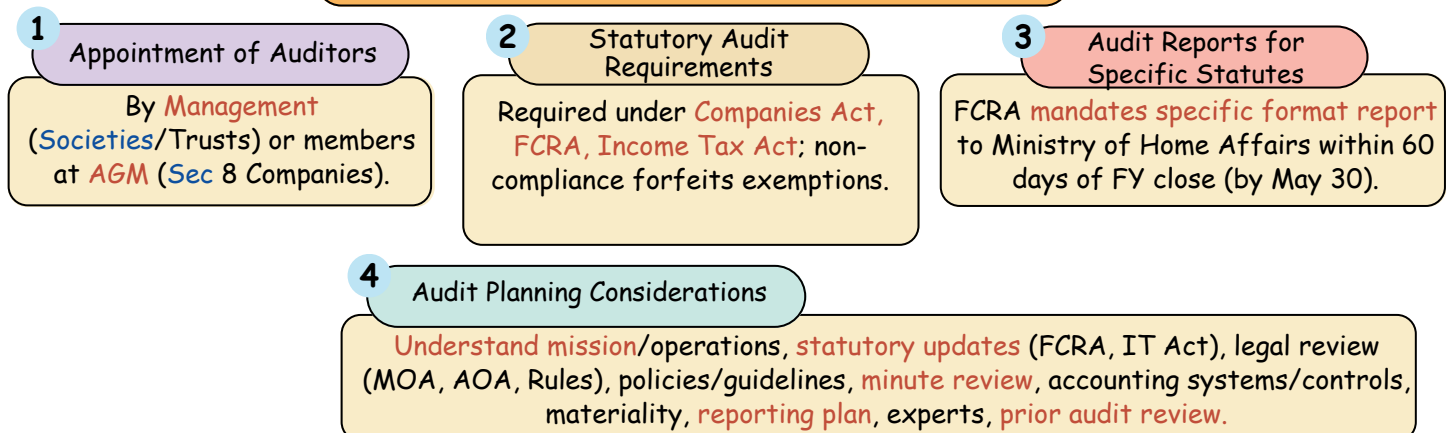
A. Background of NGO's



B. Sources and Applications of Funds of NGO's



C. Audit of NGOs



D. Audit Programme of NGO

1

Audit Programme



Ensures **all assets, liabilities, income, expenditure** are audited in a **sequential order**. Key checks:

- **Corpus** Fund (donor letters, investments),
- **Reserves**,
- **Earmarked** Funds (donor/scheme rules),
- Loans (agreements),
- **Fixed Assets** (acquisitions, depreciation, title),
- Investments (register, approvals),
- Cash in Hand (physical verification),
- **Bank Balance** (reconciliation),
- **Inventory** (verification, valuation),
- Programme/Project Expenses (donor agreements),
- **Establishment Expenses** (deductions, office expenses).

2

Audit of Receipts

- **Verify Contributions/Grants** (agreements, bank, **FCRA compliance**),
- Internal Controls (collection, deposit),
- **Membership Fees** (register, reconciliation),
- Subscription (register, reconciliation),
- Interest/**Dividends** (investments).

4. Audit of Sole Trader

A. No Legal Obligation

They are **not legally required** to have accounts **audited**. Often done due to regulatory or bank requirements.

B. Appointment of Auditor

- Appointed by the sole proprietor. **Incoming** auditor must **communicate** with **previous auditor**.
- Scope and Conditions **determined by the sole proprietor** (full/partial audit, **exclusions**, responsibility for financials)

C. Contract of Appointment

Should be **in writing** to define scope/ limitations. **If not**, auditor should **write** to client and **get confirmation**.

D. Similarities with Partnerships

Advantages and **audit procedures** are **similar** to those for a **partnership firm**.

5. Audit of Partnership Firm's

A. Special Points in Audit of a Partnership Firm

- 1 Letter of Appointment**
Signed by **authorized partner**, clearly **states scope/limitations**.
- 2 Partnership Deed**
Signed by **all partners**, registered; **review** details (capital, ratios, interest, responsibilities).
- 3 Reading the Minutes**
Review **policy decisions** (cap-ex, loans, assets, contracts)
- 4 Business Authorization**
Ensure **activities align with** partnership **agreement**.
- 5 Adequacy of Books**
Assess if books are **reasonable & adequate**.
- 6 Partner Interests**
Section 8 Companies must use accrual basis. Other NGOs can use accrual or cash basis.
- 7 Profit and Loss Sharing**
Confirm **division** according to **agreed ratios**.
- 8 Compliance with Tax Laws**
Ensure **provision for tax** made **before** calculating **Profits** (Sec 44AB)

B. Matters to Consider Before Audit

Review Partnership Agreement details: **name**, **duration**, capital contribution, **ratios**, reserves, **depreciation**, borrowing, **interest**, salaries, duties, **bank operations**, restrictions on partner powers.



C. Advantages of Audit of a Partnership Firm

- Helps **settle disputes**.
- Reliable evidence for **dissolution/** retirement/ **death settlements**.
- Audited accounts are **trusted by banks** for loans and buyers.
- Useful for **negotiations during admission** of new partner.
- **Safeguard against undue advantage** by working partners (for inactive partners).

6. Audit of LLP's

- A Overview of LLP Act**
 - Governed by **LLP Act**, 2008.
 - Features of **Company & Partnership**.
 - **Min 2 Partners** (including 2 Designated Partners with DPIN).
 - **Small LLP criteria:** **Contribution** ≤ ₹25 lakhs or **T/O** ≤ ₹40 lakhs (or prescribed higher limits).
- B Books of Accounts**
Must maintain **records of money received/expended**, assets/liabilities, **inventory, costs**.
- C Requirement of Audit**
 - **Audit is required** as per Rule 24 of LLP Rules, 2009.
 - **Exceptions:** LLPs with **T/O** ≤ ₹40 lakhs or **contribution** ≤ ₹25 lakhs (or prescribed higher limits).
 - Partners may **voluntarily** decide to **audit**.
- D Appointment of Auditor Including filling of Casual Vacancy**
 - **Authority:** **DP appoint** Auditor; other partners - if DP fails.
 - **Time Limits:** **1st auditor** within **1 month** of registration; **Subsequent auditor** **30 days** prior to year-end.
- E Returns to be maintained and Regulatory Compliance**
 - **Annual Return (Form 11):** File with ROC **within 60 days** of financial year end.
 - **Statement of Account and Solvency (Form 8):** Submit within **30 days from the end of the 6 months period** of the financial year.
- F Advantages of Audit**
Refer advantages for Partnership Firms (similar).
- G Auditor's Duty**
 - Obtain written instructions (**Engagement Letter**).
 - Refer to **Minutes Books** for relevant resolutions.
 - Review the **LLP Agreement** for business **nature**, **capital**, **interest**, drawings, salaries, ratios, **borrowing powers**, partner **rights/duties**, settlement methods.
- H Reporting**
Auditor must report: **Correctness/reliability** of records, information/explanations obtained, **restrictions imposed**

7. Audit of Charitable Institution

- A Background**
Study the constitution (society, trust, company) & verify compliance with the law under which set up.
- B Subscriptions and Donations**
- Check receipt books, control over unused books.
 - Agree collections with records (acknowledgments, cash book, lists).
 - Examine internal controls over collections/deposits.
 - Ascertain changes in subscription amounts.
- C Legacies and Grants**
Verify with relevant papers, correspondence, minute books; ascertain reasons for any disallowed expenses.
- D Investment Income**
Vouch with dividend / interest counterfoils, investment schedules; physically inspect securities; investigate non-income-generating; check dividend receipt for ex/cum-dividend sales/purchases.
- E Rents**
Verify amounts/due dates (Rent Register, agreements); vouch receipts.
- F Special Functions**
Vouch gross receipts/expenses (e.g., concerts); verify ticket proceeds.
- G Income Tax Refunds**
Confirm claim/ recovery of TDS refunds from investment income.
- H Expenditure**
- Grants Payment: Ensure for charitable purposes within objectives; verify no trustee/director/member benefited.
 - Verify securities / inventories (inspection, physical verification).
 - Check cash/bank balances.
 - Confirm funds for special purposes are utilized appropriately.

CA Ram Harsha

8. Audit of Educational Institutions (School, College or University)

- A General**
- Examine Trust Deed, Regulations or Act of Legislature under which set up.
 - Review minutes of Managing Committee/Governing Body (compliance, bank ops, expenditure sanction).
- B Audit of Fee Received from Students**
- Verify Students' Fee Register with class registers; match receipts with cash book; confirm all revenue accounted for.
 - Check fee carry-forward/arrears write-off (proper sanction). Check admission fees (credit to Capital Fund unless decided otherwise). Confirm authorized free studentships/concessions. Ensure internal checks for demands. Verify fines (proper authority). Check hostel dues recovery before caution money refund.
 - Report old heavy arrears. Caution money/deposits shown as liabilities.
- C Legacies, Grants, and Donations**
Verify with papers / minutes; ensure specific-purpose donations utilized accordingly.
- D Investment Income**
Vouch with counterfoils, inspect securities; verify dividend receipt; Ensure endowment fund investments are kept separate & excess income reinvested.
- E Assets and Liabilities**
Report old arrears. Caution money /deposits as liabilities. Verify inventories (Inventory Register, physical check); check inspection system for receipts/issues.
- F Compliances**
- Confirm TDS refunds claimed / recovered.
 - Verify annual statements; ensure separate statements for specific funds.
- G Expenditure**
- Vouch all capital expenditure (verify Committee sanction).
 - Check establishment expenses (investigate unusually high).
 - Verify salary increases (sanctioned/minuted).
 - Ensure proper authorization for bills/receipts.

9. Audit of Hospital

1. **Register of Patients:** Verify with bills; check **bills with attendance**; ensure all patients are billed.
2. **Collection of Cash:** Check cash collections with **receipts, bills**, counterfoils, Cash Book.
3. **Income from Investments and Rent:** Use Property/**Investment Register**; confirm all income collected.
4. **Legacies and Donations:** Verify specific-purpose application.
5. **Reconciliation of Subscriptions:** **Trace collections; reconcile dues**/collected/outstanding.
6. **Authorization and Sanctions:** Vouch purchases/expenses; verify capital expenditure sanction (Trustees/Committee); ensure **staff appointments**/increments authorized.
7. **Grants and TDS:** Verify grants; ensure **TDS refunds claimed**.
8. **Budgets:** **Compare actuals** with **budgeted**; report significant variations.
9. **Internal Check:** Review checks for stores (medicines, linen, instruments); ensure purchases/issues recorded/authorized.
10. **Depreciation:** Verify applied at **appropriate rates**.
11. **Registers:** Inspect bonds, **shares, title deeds**; compare with Property/ Investment Registers.
12. **Inventories:** Obtain year-end inventories; physically **verify percentage**; compare with ledger.
13. **Management Representation & Certificate:** Obtain for various aspects.

10. Audit of Club

1. **Entrance Fee:** Vouch **receipts with applications**, counterfoils, minutes.
2. **Subscriptions:** Vouch with **counterfoils**, Register of Members; **reconcile total due**, collected, outstanding.
3. **Arrears of Subscriptions:** Confirm carry-forward; **verify current arrears**/advance receipts.
4. **Arithmetical Accuracy:** Check **Register of Members totals**.
5. **Irrecoverable Member Dues:** Identify arrears, confirm **recovery efforts**, report **irrecoverable amounts** in Audit Report.
6. **Pricing:** Verify **charges for foodstuffs**, drinks, services.
7. **Member Accounts:** Trace **debts from subsidiary registers** to confirm amounts recoverable.
8. **Purchases:** Vouch purchases; **trace to inventory registers**.
9. **Margins Earned:** Vouch **purchases of food/drink items**; test sale prices for normal gross profit; physically verify/value unsold stores.
10. **Inventories:** Physically **verify assets** against registers /inventories.
11. **Investments:** Inspect **securities**, verify **values**/custody.
12. **Management Powers:** Examine secretary's **financial powers**; report **excesses for Committee confirmation**.

11. Audit of Cinema

A Audit of Receipts from Daily Show Collections

- **Verify:** Entrance by **printed tickets**, tickets **serially numbered**/bound, different series per show & class / advance booking, proper ticket **inventory maintained**.
- Audit **computerized ticketing** system for **reliability & authenticity**.
- Ensure proper **show statements** and **cash collected** is **tallied**.
- **Vouch Cash Book** with statements & tickets.
- Verify cash deposits in bank.
- Ensure **free passes recorded & authorized**.
- **Reconcile Entertainment Tax** with **tickets issued**.

B Income from Advertisement

Verify **charges collected** for **Advt Slides & advertiser agreements**.



D Expenditure

- Vouch **advertisements, repairs**, maintenance exp.
- Verify publicity & **electricity expenses**.
- Confirm **depreciation on machinery/furniture** (generally higher rates).
- Vouch **film hire payments** (distributor agreements).
- Examine **unadjusted advances to distributors**
- **Provision for irrecoverable advances**.

C Restaurant Income

- Enquire **arrangement for share of restaurant income**
- **Check accounts** if **restaurant** is run by **cinema** (sales of foodstuff)
- Audit similar to **club for F&B A/c**.
- Verify **other incomes** (parking, display windows).

12. Audit of Hire Purchase Companies

A

Hire Purchase

- **Definition:** Agreement to **hire goods** with an **option to purchase**. Possession delivered, payment in instalments. **Ownership passes** on **final instalment**. Hirer can **terminate anytime** before ownership transfer.
- **Key Terms:** Hirer, Owner, Deposit.

B

Audit Procedure

- **Steps to verify:** Ensure agreement is in **writing & signed**.
- **Verify agreement details:** Hire - purchase price, cash price, **start date**, **instalment details** (number, amount, due dates, payee, location), description of goods.
- Ensure **instalments** are being **received regularly**.

13. Audit of Leasing Entities

1

Lease Agreement

Lessee gets **right to use asset** for rent.

2

Types of Leases

Finance Lease

- Transfers **substantial risks / rewards**;
- Ownership **transfers / purchase option** at low price, lease term covers **major part of life**,
- **PV of payments** $\approx$ **FV**.
- **Accounting** treated like **a loan**;
- Asset on lessee's **Balance Sheet**;
- Lessee **claims interest/depreciation**.

Operating Lease

Does **not transfer risks / rewards**.

Finance Lease Process

- Lessee **selects asset**
- **Lessor orders / delivers**
- Agreement **signed**
- Lessee **pays rentals / maintains the asset**
- End of Lease Period - **Asset is returned or renewal / purchase option**.

Auditor's Procedures

- Verify **object clause**.
- Assess **lessee's creditworthiness**.
- Examine lease **agreement details** (parties, equipment, **location**, **tenure**, payments, late charges, return clause, **subletting** prohibition, lessor rights).
- **Review proposal**, retain invoice, verify acceptance letter, **check Board resolution**, confirm insurance copies.

14. Audit of Hotels

A

Internal Control

Ensure **proper control over**: cash receipts / disbursements, **purchasing / stocking**, customer billing, recording / custody of **edibles / assets**.

D

Sharing Income from Travel Agents

Ensure **recovery from agents**; verify commission payments (agreements).

F

Fixed Assets

Ensure **depreciation applied**; Fixed Assets **Register updated**.

B

Room Sales and Cash Collections

- Verify **room charges** (guest register)
- Reconcile **sales with bills**
- Verify **credit customer bills**;
- Ensure timely **payment / billing**.
- Verify restaurant bills (Kitchen Order Tickets - KOT).
- Compare **occupancy rates**, investigate deviations.
- Check **compliance with Statutory / Foreign Exchange Regulations**.

C

Receipts from Function Halls

Verify **special receipts** from **auditorium, banquet halls, shops**.

E

Inventory

- Ensure **proper documentation / transfers**; locked areas.
- **Verify physical inventory** (materiality, location)
- Verify **control over consumables / assets**.

H

Expenditure

Trace inventory **consumption to bills**; verify foreign collaborator payments; **compare expenses / receipts with prior year**; check **renovation expenses**; verify salaries/wages.

G

Casual Labour

Confirm **adequate records**; check wage payments for accuracy; **prevent manipulation**.

15. Audit of Trusts & Societies

A

Legal Framework

- Charitable entities can be **trusts, societies, or section 8 companies**.
- **Governed by Public Trust / Indian Trusts Act (Trusts), Societies Registration Act (Societies), Companies Act (Sec 8 Companies)**.
- **Additional laws**: Income Tax Act, FCRA (for foreign contributions).

C

Financial Statements

Prepare **Balance Sheet, Income & Expenditure Statements annually**. Unique requirements may apply per state laws.

D

Auditor's Responsibility

- Obtain **list of books**, verify compliance.
- Follow **Accounting Std and SA**.
- Use **audit tests** based on internal controls, materiality.
- Maintain **detailed working papers**.
- Base the **Audit opinion** on complete / **accurate info**.

E

Trusts

Auditor must ascertain:

- Regular **A/c maintenance**
- Proper **application of donations** (objectives/donor directions)
- **Agreement of cash balance** with Accounts
- Maintenance of **property registers**
- Compliance with **prior audit recommendations**,
- Irregularity, breaches, misuse
- Proper **recording of anonymous donations**.

B

Books of Account

Must maintain: **Cash book**, Ledger, **Journal**, **copies of bills/receipts**, original bills for payments, additional **books for true/fair view of A/C's**.

F

Societies

Auditor's focus:

- Governing **legislation/objectives**;
- **FCRA/IT Act** registration;
- **Adequacy of internal controls** for donations
- Accounting policies for donations;
- Recognition of **reimbursed expenses**;
- **Registrar inquiry reports**;
- Any cases of **irregular, illegal, improper expenditure**, waste of society funds.

16. Audit of Co-Operative Societies

A. Background of Cooperative Societies Audit

1

Background

- Cooperative [co-op]: **Autonomous association** to meet member needs via joint enterprise.
- Governed by Co-operative Societies Act** /State-specific Acts.
- Auditor **must be familiar** with the applicable **Act**.
- Aims to **eliminate middlemen**

2

Role of Auditor

Guidance, **System Installation**, Internal Audit, **Mgmt accounting Services**, **Taxation services**.



B. Audit of Cooperative Societies u/s 17

1

Audit Authority

Registrar/Authorized person must **audit accounts at least once** every year.

2

Scope

Examination of **overdue debts**, valuation of **Assets & Liabilities**.

4

Registrar

Person **appointed under the Act**.

3

Access and Information

Registrar/Authorized person has **access to all books** /accounts /securities & **right to require info** from officers.

C. Multi State Cooperative Societies [MSCS] under MSCS Act 2002

1

Overview of MSCS

Applies to societies whose **objects extend beyond a single State**. Funds cannot be used for **political purposes**.

2

Books of Accounts

Must **maintain books for money received/expended**, sales/purchases, **Assets/Liabilities**, Cost details in case of Production/Manufacturing societies

D. Qualifications and Disqualifications of Auditors of MSCS

A

Qualification

Only a Chartered Accountant can be appointed.

B

Disqualification

- Body corporate**,
- Officer/employee**,
- Member/employee of officer/employee**,
- Indebted/ guaranteed/ secured debt > Rs. 1000**.

C

Vacation of Office

Deemed vacated if auditor **becomes disqualified** after appointment.

D

Appointment

First auditors by **Board** (1 month of registration) or **GM** if BOD fails;
Subsequent auditors by **members** at each **AGM**.

E

Tenure of First Auditors

Till **first AGM**.

E. Powers of Auditors of MSCS

1

Right of Access

Access to all books, accounts, vouchers at all times, anywhere.

2

Inquiry and Information

Inquire officers / employees and request necessary **information** / explanation.

F. Duties of Auditor of MSCS (Sec. 73)

1 Duty to Make Inquiry (Sec. 73(2))

- **Inquire into loans/advances** (security, terms not prejudicial),
- **Book entries** (not prejudicial),
- **Personal expenses** (not charged to revenue),
- **Shares for cash** (cash received, balance sheet correct).

2 Duty to Report (Sec. 73(3))

Report to members on: Accounts examined, Whether the balance sheet and P&L give a true & fair view.



3 Duty to State Matters (Sec. 73(4))

State whether **necessary info** obtained, proper books kept, **branch reports** dealt with, statements **agree with books**; state **reasons for negative** / qualified answer.

G. Special Audit of MSCS under CG order

1 Order by CG

- If affairs **not as per co-op principles** / prudent practices, or likely serious **injury** or **endangers solvency**
- Condition: **CG/SG holds $\geq 51\%$** of paid-up share capital.

2 Procedure

- **CG** may appoint **special auditor** (CA or existing). Powers same as Sec 73. Reports to **CG**.
- If **no action within 4 months**, **CG** sends report/comments to society and requires circulation/**reading at GM**.
- **Expenses:** Determined by **CG**, paid by society. Recoverable as arrears of land revenue if unpaid.

H. Power to Inquiry u/s 78 and Inspection u/s 79 of MSCS Act

A Eligibility

Creditor, $\geq 1/3$ rd board members, or $\geq 1/5$ th total members can apply.

B Authority

Application to **Central Registrar**.

C Inquiry By Whom

Registrar **himself or authorized person**.

D Notice

15-day notice to **society** before initiating.

E Powers

- Access **books / documents / properties**. May require officers to **call GM (7 days' notice)**;
- Can call meeting themselves if they fail. Can issue summons,
- **Examine** under **oath**.

F Report

Central Registrar communicates **report within 3 months** to **society & applicant**.

I. Special Features of Audit of Cooperative Societies

A Examination of Overdue Debts

- Classification (6m-5y, >5y),
- Comparison it to total working capital with PY,
- Assessment (good/ bad),
- Ensure adequate provisions.

D Valuation of Assets and Liabilities

- Verify existence, ownership, valuation;
- Account for all known liabilities;
- Disclose contingent liabilities.

G Verification of Members Register

Verify entries, confirm loan balances (personally in some cases).

B Overdue Interest

- Meaning:** Interest on accounts where principal is overdue.
- Exclude it from interest income for profit; credit to Overdue Interest Reserve;
 - Transfer to P&L only after realization.

E Adherence to Co-operative Principles

- Check functioning aligns with objectives/member benefits
- Ensure propriety principles (economy, no waste, direct purchases).

I Audit Classification

- Auditor assigns class based on Registrar's criteria
- Mgmt can appeal to registrar.

C Certification of Bad Debts

Auditor authorization required in some state acts; otherwise Managing Committee authorization.

F Compliance with Act and Rules

Auditor must identify non-compliance.

H Special Report to Registrar

Report irregularities (personal profiteering, fraud, mismanagement, reckless advances).

J Discussion of Draft Audit Report

Auditor discusses with managing committee before finalization.

J. Special issues in Cooperative societies Act 1912

A Qualifications of Auditors

CA or diploma holders/experienced (per state acts).



B Appointment

- Appointed By the Registrar.
- Acts on behalf of Registrar,
- Reports to both Registrar and society.
- Fees based on statutory scale.

C Books, Accounts, Records

SG prescribe books (receipts /expenditure, sales/purchases, assets/liabilities); subsidiary books for large societies.

D Restrictions on Shareholding (Sec. 5)

Max 20% of total shares or FV ₹ 1,000.

E Restrictions on Loans (Sec. 29)

Only to members unless Registrar approves.

F Restrictions on Borrowings (Sec. 30)

Cannot accept from non-members unless bye-laws permit.

G Investment of Funds (Sec. 32)

Specific options (Co-op /other approved banks, Indian Trusts Act securities, shares of limited liability societies, CG/SG permitted moneys).

H Appropriation of Profits (Sec. 33)

Must transfer prescribed % to Reserve Fund before distributing dividends/bonuses.

I Contributions to Charitable Purposes (Sec. 34)

Up to 10% of net profits (after Reserve) with Registrar sanction.

J Use of Reserve Fund

Working capital, investments, public purposes promoting objectives.

K Contribution to Education Fund

Mandatory contribution to State Federal Society. Treated as Charge on P&L

L Other Appropriations

- Transfers to other reserves /dividends after GB approval.
- Accounting entries after GB approval.
- Auditors must spot contradictions between statutory provisions & accounting principles.

Chapter 8 - Audit Strategy and Planning

1. Audit Strategy and Plan

A. Benefits of Planning Activities

1

Importance

Essential for **effective & timely execution**, ensures **compliance**, enhances **engagement**.

2

Benefits to Auditor

- Focus on **important areas**.
- **Identify & resolve** problems timely.
- **Organize & manage** for efficiency & effectiveness.
- Select **competent team**.
- Facilitate **direction, supervision, review**.
- **Coordinate work** (components, experts).

3

Impact on Audit Risk

Reduces **audit risk** to **acceptable low level**; minimizes **inappropriate opinion**.

4

Relevant Standard

SA 300: "Planning an Audit of FS"
Objective: **Effective audit performance**

B. Planning is a Continuous Process

A

Nature of Planning

- **Not a discrete phase**; it's a **continual, iterative** process.
- **Starts after prior audit completion**; continues until current audit completion.
- **Plan reviewed periodically** for new areas.

B

Considerations in Planning

- **Understanding legal & regulatory framework** & entity compliance (e.g., TRAI, RBI).
- Application of **analytical procedures**.
- **Determination of materiality** (per SA 320).
- Assessing need for **expert's assistance**.
- **Performing risk assessment procedures** to identify & assess RMM.



C. Involvement of Various Members in Planning Process

1

Responsibility for Planning

- Auditor **responsible for overall audit strategy** & audit plan development.
- May **discuss planning elements** with management, but **effectiveness must not be compromised**.

2

Involvement of Engagement Team

- Engagement **Partner & key team** members must be **involved in planning** & team discussions.
- **Enhances planning effectiveness** & efficiency via experience / insight.

3

Discussion with Entity's Management

- May discuss planning elements to **facilitate engagement**.
- Crucially, **do not compromise audit effectiveness**.
- **Do NOT discuss** matters related to **surprise checks**.

D. Elements of Planning

1

Preliminary Engagement Activities

- Client **acceptance & continuation** procedures.
- Compliance with **ethical requirements**.
- Establishing **engagement terms** understanding.

2

Planning Activities Include

- Establishing **overall audit strategy**.
- Developing an **audit plan**.

E. Preliminary Engagement Activities

1 Acceptance & Continuation of Client Relationship

- Obtain info before accepting / continuing:
 - Integrity (owners/management).
 - Team competence.
 - Implications from current/previous engagements.
 - Initial engagements - Communicate with predecessor auditor.

2 Relevant Ethical Requirements

- Continuously evaluate compliance (incl. independence).
- Engagement Partner (EP) alert for non-compliance.
- EP takes appropriate action for non-compliance.
- EP's Independence Conclusion:
 - Obtain info to identify threats.
 - Evaluate breaches of firm policy.
 - Take action (safeguards) to eliminate/reduce threats (withdraw if not).
 - Report unresolved matters to firm promptly.

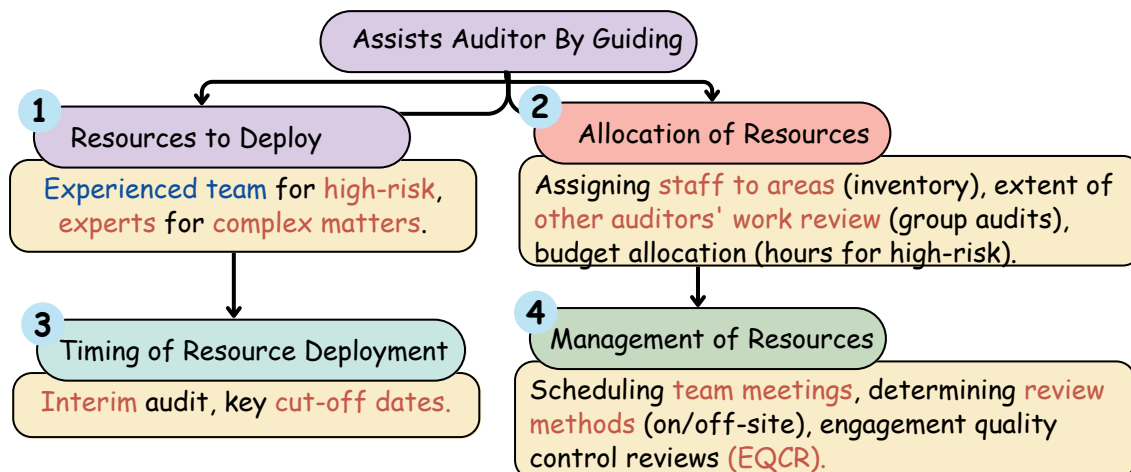
3 Establish Terms of Engagement

- Send engagement letter before audit to avoid misunderstandings.
- Ensure no client confusion on terms.



F. How Overall Audit Strategy assists the Auditor

Purpose of Overall Audit Strategy: Sets scope, timing, direction; guides detailed audit plan.



G. Factors to consider while establishing Overall Audit strategy

1 Characteristics of Engagement (Scope)

- Applicable financial reporting framework.
- Nature of business segments needing specialized knowledge.
- Industry-specific reporting requirements.
- Use of prior audit evidence.

4 Results of Preliminary Activities

- Uses past audit knowledge.
- Past internal control effectiveness results.
 - Emphasis on professional skepticism.

2 Reporting Objectives (Timing)

- Helps plan procedures & communications.
- Entity's reporting timetable.
 - Organizing meetings (NTE discussion with management).
 - Discussing report type/timing with management.
 - Communicating audit status.
 - Team communication/review nature & timing.

3 Significant Factors Directing Team Efforts

- E.g: Identifying MCOTs, ABs, Disclosures
- Transaction volume (affecting internal control reliance).
 - Significant industry developments (regulatory / reporting).
 - Changes in F/R framework (Accounting standards).
 - Changes in legal environment.

5 NTE of Resources Required

- Assign experienced team for high-risk areas.
- Budget resources, devote more time to high RMM areas.

H. Development of an Audit Plan

- 1 Audit Plan Development**
Addresses **strategy matters**, ensures **efficient resource use** to meet objectives.
- 2 Importance of Client Understanding**
Essential for **proper plan & audit conduct**.
- 3 SA-300 Requirements for Audit Plan**
Includes descriptions of:
 - **NTE** of planned Risk Assessment Procedures (**RAPs**).
 - **NTE** of planned Further Audit Procedures (**FAPs**) at assertion level.
 - Other **planned audit procedures** (SA compliance).
 - Plans for **type, timing, scope** of procedures (incl. sampling, workload).
- 4 Detail Level**
More detailed than overall **strategy**, **focuses** on specific procedures per team member.
- 5 Planning of Audit Procedure (Continuous)**
 - **RAPs** planned/**executed early**.
 - **FAPs** **planning depends** on **RAP outcomes**.
 - **FAPs** execution may begin while planning **continues for other areas**.

I. Relationship Between Overall Audit Strategy and Audit Plan

- 1. Strategy vs. Plan:** Strategy **sets broad approach**; Plan **addresses specific matters** identified in strategy.
- 2. Scope, Timing, Direction:** Strategy determines these; Plan describes **how strategy implemented**.
- 3. Detail Level:** Plan is **more detailed** than strategy
- 4. Development:** Planning for procedures is **ongoing throughout audit** as plan adapts.
- 5. Connection:** **Strategy** established **first**, then **Plan** developed to achieve strategy objectives using resources.
- 6. Inter-relationship:** **Not discrete/sequential**; inter-related, **changes in one affect the other**.

J. Changes to Audit Plan [Planning Decisions]

- 1. Flexibility:** Auditor shall update/**change strategy & plan** as necessary.
- 2. Reasons for Change:**
 - a. Unexpected events.**
 - b. Changes in conditions.**
 - c. New information** discovered during audit.
- 3. Need for Modifications:** Ensures **audit remains effective** under revised circumstances.
- 4. Dynamic Nature:** Plan must be **dynamic & flexible** for changing circumstances.
- 5. Example:** Detailed **checking evidence** contradicting **internal control testing** may prompt plan change.

K. Planning, Supervision and Review of Work of Engagement Team Members

A Inclusion in Planning

Auditor shall plan **NTE** of **direction, supervision, and review** of Engagement Team work.

B Factors Influencing Direction, Supervision, and Review

1. Entity **size & complexity**.
2. **Specific audit areas**.
3. **Assessed Risks of Material Misstatement (RMM)**.
4. **Capabilities & competence** of individual team members.



L. Documentation of Overall Audit Strategy and Audit Plan

A Purpose of Documentation

1. **Record of key planning decisions**.
2. Facilitates **team communication** on significant matters.
3. Records **planned NTE** of risk assessment & audit procedures.
4. Helps review/**approval of procedures** before performance.

B Documentation Includes

1. Overall Audit **Strategy**.
2. Audit **Plans**.
3. Significant **changes to strategy/plan** with reasons.

C Record of Significant Changes

1. Explains **why changes made**.
2. Reflects **final strategy & plan** adopted.
3. Shows **appropriate response to changes** during audit.

2. Audit Programme

M. Audit Programme

1 Definition

Detailed plan of verification procedures applied to F/S & accounts to gather sufficient evidence for informed opinion.

2 Purpose

Provides instructions on techniques to achieve audit objectives in specific circumstances.

3 Evolving (Not One-Size-Fits-All)

1. Nature, size, composition of businesses vary.
2. Internal controls differ.
3. Nature of auditor services varies.

4 Necessity of Tailored Programmes

1. Prevents time waste on irrelevant matters.
2. Addresses special/specific situations.
3. Ensures alignment with specific engagement circumstances.



N. Assistants Keep an Open Mind for Changes

A Standard Programme

Auditor frames programme based on business nature / size / composition, internal control dependability & scope of work.

B Minimum Essential Work

Programme provides this.

C Alterations Based on Experience

1. Additions: For relevant situations initially missed.
2. Deletions: For unnecessary / irrelevant work.

D Encouraging Open-Mindedness (for Assistants)

1. Maintain an open mind beyond the given programme.
2. Note and report significant matters to seniors/partners.

O. Periodic Review of Audit Programme

1 Periodic Review

Must undergo regular review for continued adequacy (to obtain knowledge & evidence).

2 Risk of Obsolete Programme

- Client business policy changes can make it outdated.
- Obsolete programme → negligent audit work, legal consequences (e.g shift from vehicle to real estate financing).

3 Utility Enhancement

Review programme & client operations to identify/correct inadequacies/redundancies.

4 Content

Beyond tasks includes instructions like checking extent, sampling plan, other execution guidelines.

5 Adherence by Assistants

Must strictly adhere until officially updated by principal.

6 Addressing Rigidity Concerns

Not true if periodic reviews done; keeping it updated ensures flexibility / relevance.

P. Points to be kept in Mind while constructing Audit Programme

1 Planning

- Starts **post-previous year's audit**.
- Review / modify** based on **internal control**, preliminary evaluation, **compliance & substantive** procedures.

2 Internal Controls (ICs)

- Rely** if **effective/efficient**.
- Option **not to rely** if **other efficient evidence** available.

3 Timing & Coordination

- Consider procedure timing**, client assistance, **staff availability**, other auditors/experts involvement.
- Some procedures have **fixed timing**.

4 Programme Key Points

- Stay **within scope**.
- Written programme.
- Identify **best evidence**.
- Include **only relevant steps**.
- Specify objectives & instructions**.
- Anticipate errors**.
- Coordinate procedures for related items.

Q. Audit Programme is Designed to provide Audit Evidence

A Evidence Determination

Auditor's **primary task**; requires **expert knowledge/experience**.

B Transaction Impact

Procedures depend on **prior knowledge of available evidence** for each transaction.

D Specific Examples

- Cash**: **Physical count**.
- Pledged Investment**: **Banker's certificate**.
- Book Debts**: **Ledger, Invoices, statements, Confirmation**.

E Evidence Weight/Priority

Assign weight; use **multiple procedures** for **reliability**.

F Broader Evidence

Not limited to client; identify all **normally existing evidence** for transaction.

C Audit Evidence Types

- Documentary, **Physical**.
- Statements** (Mgmt, Employees, 3rd Parties).
- Auditor Calculations**.
- Internal Controls**.
- Data Inter-relationship.
- Subsidiary / **Memo Records**.
- Minutes**.
- Subsequent actions**.

R. Advantages of Audit Programme

- Clear Instructions**: **Guides assistants** with Instructions.
- Total Perspective**: Overview, especially for **major audits**.
- Staff Selection**: Aids in **assigning work** based on **capabilities**.
- Reduces Omissions**: Ensures **systematic work**, no ignored records.
- Responsibility/Traceability**: **Assistants sign**, work is traceable.
- Progress Monitoring**: Helps principal **track audit progress**.
- Future Guide**: Useful for **subsequent year audits**.
- Evidence of Due Diligence**: Defends against negligence claims/ **charges against Auditor**.

S. Disadvantages

- Mechanical Work**: Assistants may **lack objective understanding of audit**.
- Rigidity/Inflexibility**: Fails to **adapt to business changes**.
- Outdated Programmes**: **Overlooks changes** in business conduct.
- Required Alterations**: **Changes in staff/ICs** need programme updates.
- Blame Game**: **Inefficient assistants** may blame lack of instructions.
- Kills Initiative**: **Rigid programmes** stifle enterprising assistants.

T. Precautions [Purported disadvantages can be over come]

- Imaginative Supervision**: Ensure assistants **understand objectives**; prevent blind adherence.
- Receptive Attitude**: Foster **environment for concerns/observations**.
- Encourage Objectivity**: Assistants to observe objectively, **report significant matters**.

Chapter 9 Risk Assessment and Internal Control

A. Meaning of Audit Risk

1

Definition

- The risk of expressing an **inappropriate opinion** when FS are **materially misstated**.
- For example, **Unmodified Opinion GIVEN** → **Modified Opinion REQUIRED**.

2

Consequences

- Auditor **Reputation Damage**.
- Regulatory Action** (Professional Bodies).
- Legal Action** (Intended Users).
- Eg: Fake Revenue → Inflated Profit → Audit Risk.

3

Exclusions

Does **not include** expressing a **modified** opinion when statements are **not misstated**, nor business risks like litigation.

B. Components of Audit Risk

1

RMM

The risk that financial statements are **materially misstated** prior to audit.

2

Misstatement Examples

- Charging **capital expenditure** to revenue,
- Incorrect disclosures**,
- Inappropriate accounting policies**,
- Errors in estimates**, fake expenses,
- Overstating receivables/inventories**.

3

Levels of RMM

- Financial Statement Level**: **Pervasive**, whole FS affected.
- Assertion Level**: Specific transactions / balances / disclosures; Impacts N.T.E. of audit.



C. Components of Risk of MMS

- RMM consists of Inherent Risk (**IR**) and Control Risk (**CR**).
- These are entity's **risks**, **existing independently** of the auditor.

D. Inherent Risk (IR)

1

Definition

Susceptibility of an assertion to a material misstatement before considering controls.

2

Characteristics

Exists pre-controls; **higher** for **complex calculations** or external influences (e.g., obsolescence).

3

Influencing Factors

External (e.g., technological advancements) and **entity-specific** (e.g., misunderstanding complex accounting standards).

4

Assessment

- Varies **per Assertion / Transaction / Disclosure**.
- Drives **design of Tests of Controls (ToC)** & **Substantive Procedures (SP)**.

5

Examples

Complex Accounting Standard (AS) misinterpretation, High business failure rate in an industry.

E. Control Risk (CR)

1

Definition

Risk that a material misstatement will **not be prevented**, detected, or **corrected timely** by internal controls.

2

Characteristics

Reflects internal control inefficiency; **higher CR** means **weaker controls**.

3

Examples

Cash / cheque book control **not followed**, expired fire extinguishers, **petty cash breaches**.

F. Detection Risk

1

Definition

1. Risk that **Auditor's Procedures performed** will **not detect Material Misstatement**, (individually or aggregated)
- Ex: **Audit Procedures Used**, but Undetected **MMS still exists**.

2

Components of DR

- **Sampling Risk: Sample Conclusion Differs** from Population (Sample Not Representative).
 - Ex: Non-Representative Revenue Sample.
- **Non-Sampling Risk: Erroneous Conclusion** for **Non-Sampling Reasons** (Inappropriate Procedures / Application Errors).
 - Ex: **Not Attending WIP**, Inventory Count, **Relying on Alternatives**.

3

Control by Auditor

- **ONLY Component** of audit risk, Auditor **CAN** Control.
- **Reducing DR** → Keeps Overall **AR Low**.

4

How to Reduce DR

- Broader Scope of **Checks**.
- **Larger Sample Sizes** (Reduces Sampling Risk).
- Experienced / **Competent Team**.



G. Assessment of Risk is a Matter of Professional Judgment

- **Definition:** Audit Risk is a **function of RMM and DR**.
- **Nature:** Assessment based on **audit procedures to obtain information** and evidence.
- **Judgment:** Involves professional judgment, **not precise measurement**.
- **Distinguishing Feature:** Exercised by auditors with **training, knowledge, and experience**.

H. Combined Assessment of RMM

1

Approach

1. Auditor can Assess IR & CR: Separately OR Combined.
2. **Reason:** Audit **Techniques / Methodologies / Practicality**.
3. SAs Generally **Don't Refer Separately**.

2

Expression of Risk

- Can be **quantitative** (e.g percentages) or
- **Non-quantitative** (e.g high, medium, low).

3

Importance

Appropriate **risk assessments** are **crucial**.

I. Interrelationship Between Components

- **Inverse Relationship:** RMM and Detection Risk have an inverse relationship.
- **Higher RMM** requires **more in-depth** audit (reduced DR),
- While **lower RMM** allows **less extensive** procedures (higher DR).

J. Identifying and Assessment of Risk of MMS as per SA 315

- **Objective:** Identify RMM at Financial Statement and Assertion levels.
- **Assess Risk:** Analyze RMM significance.
- **Minimize Audit Risk:** Reduce audit risk to an **acceptably low level** by planning procedures based on **risk assessment**.

K. Concept of Risk Assessment Procedure

1

Definition

Audit procedures to understand the **entity and environment**, including **internal control**, to **identify and assess RMM**.

2

Purpose

Provides a basis for **identifying and assessing RMM**; alone it doesn't provide sufficient audit evidence.

3

Evaluate Impact

Assess if risks are **pervasive**.

4

Relate Risks to WCGR

Relate risks to "**What Can Go Wrong**" at assertion level.

5

Consider Likelihood and Magnitude

Evaluate **likelihood and potential magnitude** of **misstatements**.

6

Use of Information as Audit Evidence

Information serves as **evidence for assessing RMM**, gaining **audit evidence**, and **understanding** control effectiveness.

L. Risk Assessment Procedures Includes

1

Inquiries (Management & Others)

- **Purpose:** **Identify RMM**.
- **Who:**
 - **Governance** (FS Prep Env)
 - Internal Audit (IC, **Mgmt Response**)
 - **Employees** (Accounting Policy Appropriateness for **Complex Trans.**)
 - **Legal Counsel** (Litigation, **Compliance**, **Fraud**, Warranties, Business Arrangements)
 - Marketing / Sales (**Strategies**, Trends, Customer Contracts)
 - **Risk Mgmt Function** (**Operational** / Regulatory Risks affecting FR)
 - **IT Personnel** (System Changes, **Failures**, **Risks**)

2

Analytical Procedures (AP)

- **Purpose:** Identify **Unusual Transactions** /Trends /Ratios (Financial & Non-Financial).
- **Examples:** Profit-Employees, **Sales-Sq Footage**.
- Unusual Relationships → **Indicate Risks** (especially Fraud).
- **Types:** Ratio Analysis, **Trend Analysis**, Reasonableness Test, **Structural Modelling** (Regression).



3

Observation & Inspection

- **Purpose:** Understand Entity & Environment.
- Examples:**
1. **Observing Operations** (Production & Accounting).
 2. Inspecting Documents, **Records**, **SOPs**.
 3. **Reviewing Mgmt Reports/Minutes**.
 4. Observing **Client Premises** (Factory, Offices).

M. Concept of Significant Risks

1

Definition

- **Inherent Risks** with High Likelihood & High Magnitude of **MMS**.
- **Assertions affected** → Higher IR.

2

Examples of SR

- **Fraud Risks** → **MMS**.
- **Related Party Transactions** (Outside Normal Course).

3

Factors to Determine SR

- Is it a **Fraud Risk**?
- Recent **Significant Changes** (Economic/Regulatory)?
- **Complexity** of Transactions?
- Significant **Related Party Transactions**?
- **Degree of Subjectivity** in Measurement (FI)?
- **Non-Routine** / Unusual Transactions?

4

Clarifications

- **Non-Routine:** Unusual (Size/Nature), **Infrequent**.
- **Judgmental Matters:** Accounting Estimates with **Significant Measurement Uncertainty**.

N. Risk of MMS is greater for Non-Routine Transactions

1. **Mgmt Intervention:** Higher **Mgmt Involvement** for Accounting Treatment.
2. **Manual Processing:** Increased **Error Risk** due to Manual Data Handling.
3. **Complex Calcs/Principles:** Inherent **Complexity** → Increased **MMS Risk**.
4. **Control Implementation Difficulty:** **Non-routine transactions** can make it **hard for an entity** to implement **effective risk controls**.

O. Risk of MMS is Greater for Judgemental Matters

Reasons: Differing **interpretations of accounting principles**, subjective/**complex judgment**, assumptions about **future events** (e.g., fair value).

P. Documenting Risks

1. Document engagement **team discussion and significant decisions reached**.
2. Record **key elements** of understanding **entity, environment, and internal controls**, including sources and procedures.
3. Document **identified and assessed risks** at financial statement and assertion levels.
4. Maintain a **Risks and Controls Matrix**.



2. SA 320 Materiality in Planning and Performance of an Audit

A. Concept of Materiality

1 Definition of Material Items

- FS must **disclose all Materials Items**
- Influencing **User Decisions**.
- **NOT Always Size**; Small Items → Serious Issues (Fraud / IC Flaws).

4 Materiality in FRFW

- Often Discussed for FS Preparation.
- **Characteristics of Material Misstatements:**
 - **Likely to Influence User Decisions**.
 - **Judgments** based on **Size, Nature** or Both.
 - Based on **Common User Needs** (NOT Specific Individual Users).
- **If FRFW Silent:** Above **Characteristics** → Auditor's **Reference Frame**.

2 Quantitative Limits (Examples)

- **Schedule III** : Income / Expenditure **>1% Revenue OR ₹1L** (Whichever **Higher**).
- **Notes:** Shareholders **>5% Shares** (Specify No. of shares held).

3 Relevant SAs

- **SA 320:** **Addresses** Auditor's Responsibility → Apply Materiality (Planning & Execution).
- **SA 450:** **Evaluate Effect of Misstatements** (Identified / Uncorrected) on FS.

B. Assumptions about users of F/S in the context of Materiality

1. **Reasonable Knowledge:** Business, **Economics, Accounting** & Diligence.
2. **Materiality Awareness:** **FS Prepared** / Audited with **Materiality Levels**.
3. **Uncertainty Recognition:** Understand **Estimates, Judgments**, Future Considerations.
4. **Economic Decision-Making:** Use **FS Info** for Reasonable **Economic Decisions**.



C. Performance Materiality

1. **Need:**
 - a. Individual Misstatements (**MMS**) **Hard to Test**.
 - b. MMS Considered **Material in Aggregate** → Leads to **Performance Materiality Concept**.
2. **Definition of Performance Materiality (PM):**
 - a. **Lower Threshold:** Set by Auditor (**Below Overall Materiality**).
 - b. **Purpose:** Reduces Chance of Undetected/**Uncorrected MMS** Exceeding **Overall Materiality**.
 - c. **Specific PM (SPM):** PM can apply to **specific Class of Trans/Acct Balances/Disclosures** at levels **lower than** their specific materiality.

D. Use of Benchmarks in Determining materiality

1. **Professional Judgment:** Auditor's PJ → Apply % to Chosen Benchmark (for FS Materiality).
2. **Factors Influencing Benchmark:**
 - a. **FS Elements** (Assets, Liab., Equity, Rev, Exp).
 - b. User **Focus Areas** (Profit, Rev, Net Assets).
 - c. Entity **Nature & Context** (Life Cycle, Industry, Economy).
 - d. **Ownership & Financing** (e.g., Debt-Financed → Focus on Assets/Claims).
 - e. **Benchmark Volatility** (e.g., Volatile PBT → Use Gross Profit/Total Rev).

E. Examples and Selection of Benchmarks

1 Examples of Benchmarks

- Profit Before Tax (PBT)
- **Total Revenue**
- Gross Profit & Total Expenses
- **Total Equity** / Net Asset Value

2 Selection of Benchmark (Relevant Financial Data)

- **Prior Periods'** FS Results/Positions
- Current Period's **Results**/Position
- **Budgets/Forecasts** (**Adjusted for:** Entity Changes, Industry/Economic Changes)
- **Example:** Volatile PBT → Use **Normalized PBT** (Based on Past).

3 Applying a Percentage

- Professional Judgment **Determines %** applied to chosen BM.
- PBT % Typically **Higher Than Total Revenue %**.

F. Materiality levels for Particular COTs, ABs and Disclosures

1. **Concept:** Misstatements **BELOW Overall Materiality** CAN Influence User Decisions (if sensitive/significant).
2. **Factors:**
 - **Legal/Regulatory Impact:** Laws / Regs / FRFW affect user expectations.
 - Ex: **Related Party Transactions**, Management Remuneration.
 - **Industry-Specific Key Disclosures:** **Critical disclosures** for specific industries.
 - Ex: R&D Costs (Pharma).
 - **Focus on Specific Business Aspects:** Users' **attention** on separately **disclosed aspects**.
 - Ex: Newly Acquired Business.



G. Revision and Documentation of Materiality

1 Revision in Materiality (When?)

- New **Circumstances**.
- New **Information**.
- Actual vs. Anticipated Financial Results (Significant Diff.).
- **Higher Risk** Estimates.
- Enhanced **Client Understanding**.
- Ex: **Actual = Anticipated** → Revise Materiality → Adjust Performance Materiality / Procedures.

2 Documentation of Materiality (What?)

- **Overall Materiality** (FS as a Whole).
- **Specific Materiality** (For COTs/ABs/Disclosures, if any).
- **Performance Materiality** (General).
- **Revisions Made** to Above.

H. Materiality and Audit Risks are throughout the Audit

1 Materiality Applied In

- **Planning & Performing** Audit.
- Evaluating **Misstatements** (Identified/Uncorrected).
- Forming **Auditor's Opinion**.

2 Audit Risk (AR)

- **Definition:** **Inappropriate Opinion** on Materially Misstated FS.
- **Formula:** $AR = RMM \times DR$.

3 Materiality & AR Usage (Throughout Audit)

- **Risk Assessment:** **Identifying & Assessing RMM**
- **Audit Procedures:** Determining **NTE of FAPs**.
- **Evaluating Misstatements:** Effect on **FS & Opinion**

3. Understanding of Entity

A. Understanding the Entity and Its Environment

1 Industry, Regulatory and External

A. Industry Conditions: Competition, Technology, Risks from Nature/Regs. (Ex: Market Comp, Seasonal activity)
B. Regulatory: Environment (Legal, Political & FRFW. (Ex: Acct Principles, Tax Laws).
C. External: **Economic Conditions** Interest, Inflation, Financing.

2 Nature of Entity

- **Purpose:** Identify RMM & Related Parties Transactions.
- **Includes:** **Operations** (Revenue, Products/Services, Production), **Ownership/Governance, Investments.**
- **Ex:** Key Customers, Debt Structure, Accounting Principles.

3 Selection & Application of Accounting Policies

Evaluate: Policies Appropriate? Comply with **FRFW & Industry Standards.**

4 Objectives, Strategies & Business Risks

- **O&S:** Understand to **Identify RMM.** (Objectives = Plans; Strategies = Methods).
- **Business Risks (BR):** Broader than RMM; Financial Consequences. **Understanding BR → RMM Likelihood.** (Auditor NOT responsible for all BR).
- **Ex:** Lack of Expertise (New Tech), **New Product Liability**, Demand Misestimations.

5 Measurement & Review of Financial Performance

- **Purpose:** Identify Mgmt **Pressures → Misstate FS.**
- **Ex:** KPIs (Fin/Non-Fin), **FS Analyses** (Budgets, Variances), External Reports (Credit Ratings).

B. Understanding is a Continuous Process

1 Need for UEE

- **Audit Planning.**
- Identify **Special Attention Areas.**
- Client **Business Knowledge** (Essential).

2 Audit Risk (AR)

Dynamic, Ongoing Info (Gather, Update, Analyze) **THROUGHOUT** Audit.

3 Importance

- Identify & **Assess RMM** (in FS).
- Set **Materiality** (SA 320).
- Assess **Acct Policy Appropriateness.**
- **Identify Special Audit Areas:**
 - **Related Party Transactions.**
 - **Going Concern Appropriateness.**
 - **Business Purpose** of Transactions.
- Establish Expectations (for Analytical Procedures).
- **Assess Audit Evidence** (Sufficiency & Appropriateness), incl.:
 - **Mgmt Assumptions.**
 - **Mgmt Oral/Written Representations.**



4. Internal Controls

A. Meaning and Benefits of Internal Controls

A

Meaning of Internal Control (SA-315)

- **What:** Process (Designed, Implemented, Maintained).
- **By Whom:** Governance, **Management**, **Personnel**.
- **Purpose** (Reasonable Assurance for):
 - Financial Reporting **Reliability**.
 - Operations **Effectiveness & Efficiency**.
 - Asset **Safeguarding**.
 - Law/Regulation **Compliance**.
- **Note:** IC design / implementation / maintenance depends on **Entity Size** / Complexity.

B

Benefits of Understanding IC (for Auditor)

- Identify Potential **Misstatement Types**.
- Identify **RMM Factors**.
- Design **NTE** of Further Audit Procedures (**FAPs**).

B. Inherent Limitations of Internal Controls

IC provide **ONLY Reasonable Assurance**.

1. **Human Judgment:** Errors in Judgment / **Design Errors**.
2. **Lack of Understanding:** Individuals may not grasp control purpose → Ineffective Use / **Incorrect Actions**.
3. **Collusion/Mgmt Override:** Controls can be **bypassed**.
 - Ex: Side agreements → Improper **Revenue Recognition**.
4. **Mgmt Judgments:** Mgmt chooses controls based on **Risk Assumption**.
5. **Small Entities Limitations:**
 - a. Segregation of Duties (SoD) **Impractical** (Fewer Employees).
 - b. Owner-Managed → Better Oversight **BUT Easier Override** (Less Structured).
 - c. **Auditor's Role:** Consider these factors when assessing risks.



C. Components of Internal Controls

1. **Control Environment**
2. **Risk Assessment Process**
3. **Information System**
4. **Control Activities**
5. **Monitoring of Controls**

D. Control Environment and Its elements

Control Environment (CE)

- **What:** Governance, Mgmt Functions, TCWG/Mgmt's Attitudes & Actions.
- **Role:** Sets Tone for Org Controls.

Elements of CE

1 Integrity & Ethical Values

- TCWG Values → IC Effectiveness.
- Communicated via Policies, Codes, Mgmt Actions.

3 Participation by TCWG

- Independence from Mgmt.
- Experience, Stature, Scrutiny.
- Appropriate Actions.
- Interaction with Internal / External Auditors.

5 Organizational Structure

- Framework for Planning, Executing, Controlling, Reviewing.
- Includes Key Authority, Responsibility, Reporting Lines.

2 Commitment to Competence

Mgmt Ensures Requisite Skills/Knowledge for Jobs.

4 Management's Philosophy

Approach to:

- Business Risk-taking.
- Financial Reporting.
- Information Processing & Personnel.

6 Assignment of Authority

How Authority / Responsibility Assigned & Reporting Hierarchies Established.

7 Human Resource Policies

- Relate to Recruitment, Training, Evaluation, Promotion, Compensation.
- Ex: Recruitment Focus (Qualifications, Integrity, Exp); Training (Roles/Responsibilities).

CE & Fraud Deterrence:

- **Positive Impact:** Reduces RMM, May Lower Fraud Risk. NOT Absolute Deterrent to Fraud.
- **Deficiencies:** Weakens IC Effectiveness (esp. for Fraud Risks).
◦ Ex: Mgmt Failure on IT Security → Improper Changes / Unauthorized Trans.
- **CE's Role:**
◦ Does NOT Directly Prevent/Detect/Correct MMS.
◦ INFLUENCES Auditor's Evaluation of OTHER Controls (Monitoring, Specific Activities).
- **Auditor's Assessment:** CE Affects Auditor's RMM Evaluation.



E. Risk Assessment Process

1 Understanding Entity's Process

- Entity identifies risks needing management.
- Assists Auditor in identifying RMM.
- Auditor evaluates appropriateness (PJ).

2 Auditor Assesses Entity's Process for

- Identifying Business Risks (relevant to FR objectives).
- Ex: Doctor's Prescription vs. Bill.
- Evaluating Significance of identified risks.
- Determining Likelihood of risks.
- Deciding actions to Manage/Mitigate risks.

F. Information Systems and Related Business Process

1. **Classes of Transactions:** Identify Significant Transactions (to FS).
2. **Transaction Procedures:** Understand Flow (Initiation → Recording → Processing → Correction → GL → Reporting).
3. **Accounting Records:** Assess Records & Supporting Info (Used for Transaction Flow).
4. **Capturing Significant Events:** Evaluate how IS Captures FS-Significant Events/Conditions. Ex: Bill to Accounts Recordings.
5. **Financial Reporting Process:** Understand FS Preparation Process.
6. **Controls Over Journal Entries:** Assess JE Controls. Ex: Voucher Controls.

G. Control Activities

1

Meaning

- **Policies & Procedures** → Ensure Mgmt Directives Carried Out.
- Ex: Authorizations, **SOD**, Physical Controls, **Performance Reviews**.

2

Application

IT/Manual Systems; Various Org/Functional Levels.

3

Auditor's Focus

ONLY on Control Activities Related to **Significant Classes of transactions / Acct balances / Disclosures** (relevant to RAP).

4

Determining Relevant CAs (When?)

- **Significant Risks Exist** (Substantive Procedures alone INSUFFICIENT for AE).
- Considered **relevant based on Auditor's Professional Judgment**.
- Ex: Day-end counting, Product counts for Material Items.

H. Monitoring of Controls

1

Definition

- Process to **Assess IC Effectiveness** Over Time.
- Ex: Internal Audit, Walkthrough Test.

2

Process

Timely **Assessment & Remediation**.

3

Types of Monitoring

- **Ongoing Activities** (Built into Regular Mgmt/Supervisory Reviews).
- **Separate Evaluations** (Periodic Assessment).

4

External Info Use

- May **involve external party info**.
- Ex: **Customer Complaints**, Regulatory Comments (Indicating Problems / Needs).

I. Controls Relevant to Audit

1

Relevant Controls

Auditor **understands IC** relevant to audit (mostly FR related but NOT all)

2

Professional Judgment (PJ)

Auditor's PJ determines **relevance**.

4

Controls NOT Relevant to Audit

- **Operational controls** may not be relevant.
- Ex: Airline flight schedule system; Understanding ALL IC in every unit/process not necessary.

3

Factors Influencing Relevance

- **Materiality**.
- Significance of Associated Risk.
- Entity **Size & Operations**.
- Entity Nature, Org, Ownership.
- **Diversity & Complexity** of Operations.
- Legal/Regulatory Requirements.
- Circumstances & **Applicable IC Component**.
- Nature/Complexity of IC Systems (incl. Service Orgs).
- **Control Prevents/Detects/Corrects** MMS (Individually/Combined).

J. Controls Over the Completeness and Accuracy of Information

1 Relevance to Audit

Relevant if Auditor **Uses Info for FAPs** (Further Audit Procedures).

2 Example

Revenue Audit:

Auditor Evaluates: Purchase Order Register Control → Ensures **Correct Purchase Recording**.



3 Operational & Compliance Controls

- Relevant if involve **Data Auditor Evaluates/Uses** for Audit Procedures.
- **Examples:**
 - **Purchases:** Use **POs** for **Accuracy & Completeness**.
 - **Bank Statements:** Verify Recorded **Payments Completeness**.

K. Internal controls over safeguarding of assets

1 Safeguarding Assets

Controls relate to both Financial Reporting (**FR**) & **Operations Objectives**.

2 Financial Reporting Objective

Auditor **Focuses on Controls** Relevant to **FR Reliability**.

- **Ex: Access Controls** (Passwords) for **Cash Disbursement Data/Programs**.
- **Ex: Assets > ₹5,000** for FS Audit Consideration.

3 Operational Objective

- Usually **NOT Relevant to FS Audit**.
- **Ex:** Preventing **Excessive Material Use** / Meeting **Input-Output Ratio Targets**.

4 Examples of Safeguarding Controls

- **Asset Tagging**.
- **Physical Verification of Assets** (at Reasonable Intervals).

L. Nature and Extent of The Understanding of Relevant Control

1 Evaluating Control Design

Assess if control(s) can **Effectively Prevent/Detect/Correct MMS**.

2 Implementation of Controls

- Control **Implemented = Exists** & Entity Uses.
- **Design** Evaluated **FIRST**.
- Improper Design → **Possible Significant Deficiency**.

3 Risk Assessment Procedures (for Design & Implementation)

- **Inquire Entity Personnel**.
- **Observe** Specific Control Application.
- **Inspect Documents/Reports**.
- **Trace Transactions** (through FR-relevant IS).

4 Understanding vs. Testing Effectiveness

- **Understanding NOT enough** for Operating Effectiveness Testing (Unless Automation ensures consistency).

M. Benefits of Internal Control Evaluation

1 Purpose

Auditor **evaluates internal control** to **ensure accounting system adequacy** and proper information recording.

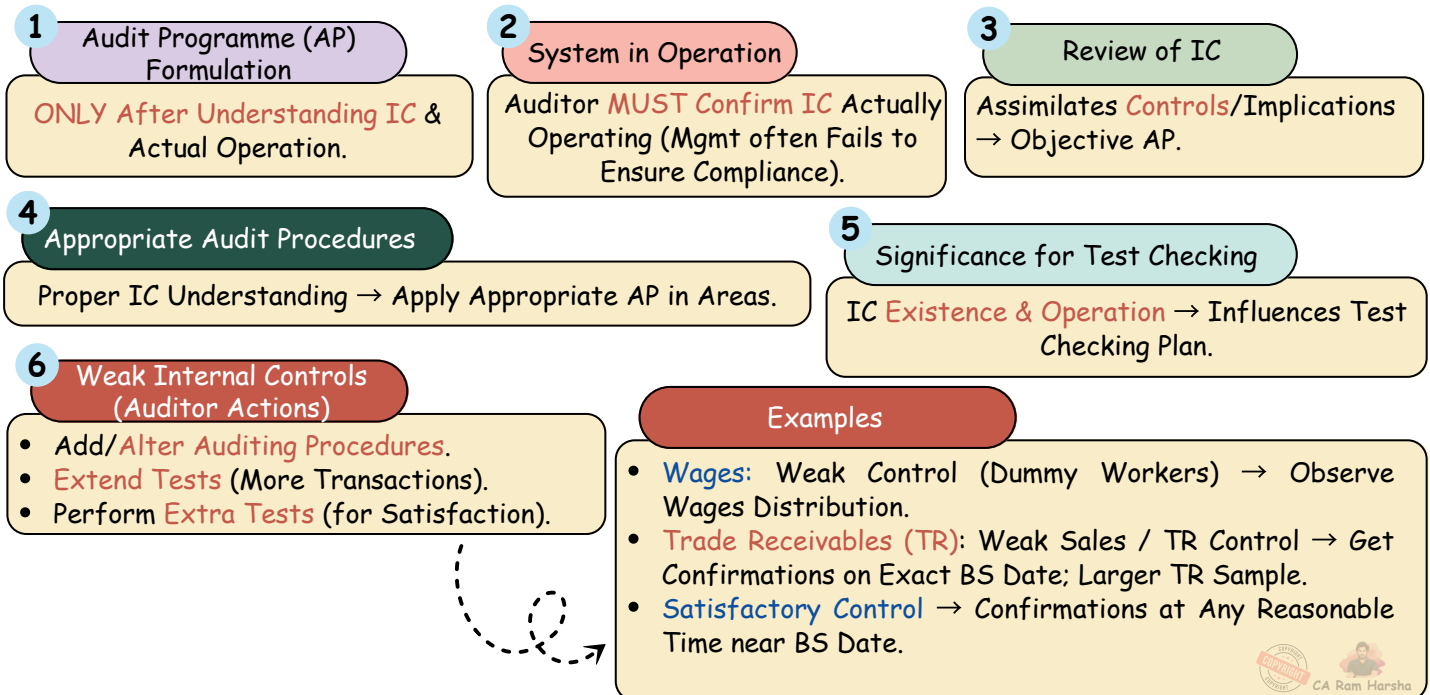
3 Benefits

- Determines **system adequacy**,
- Verifies **internal audit department effectiveness**,
- Ensures **asset safeguarding**,
- Assesses accurate **transaction recording**,
- Evaluates **report reliability**,
- Identifies audit **examination scope**,
- Determines suitable techniques,
- **Highlights weak areas**, and provides suggestions for improvement.

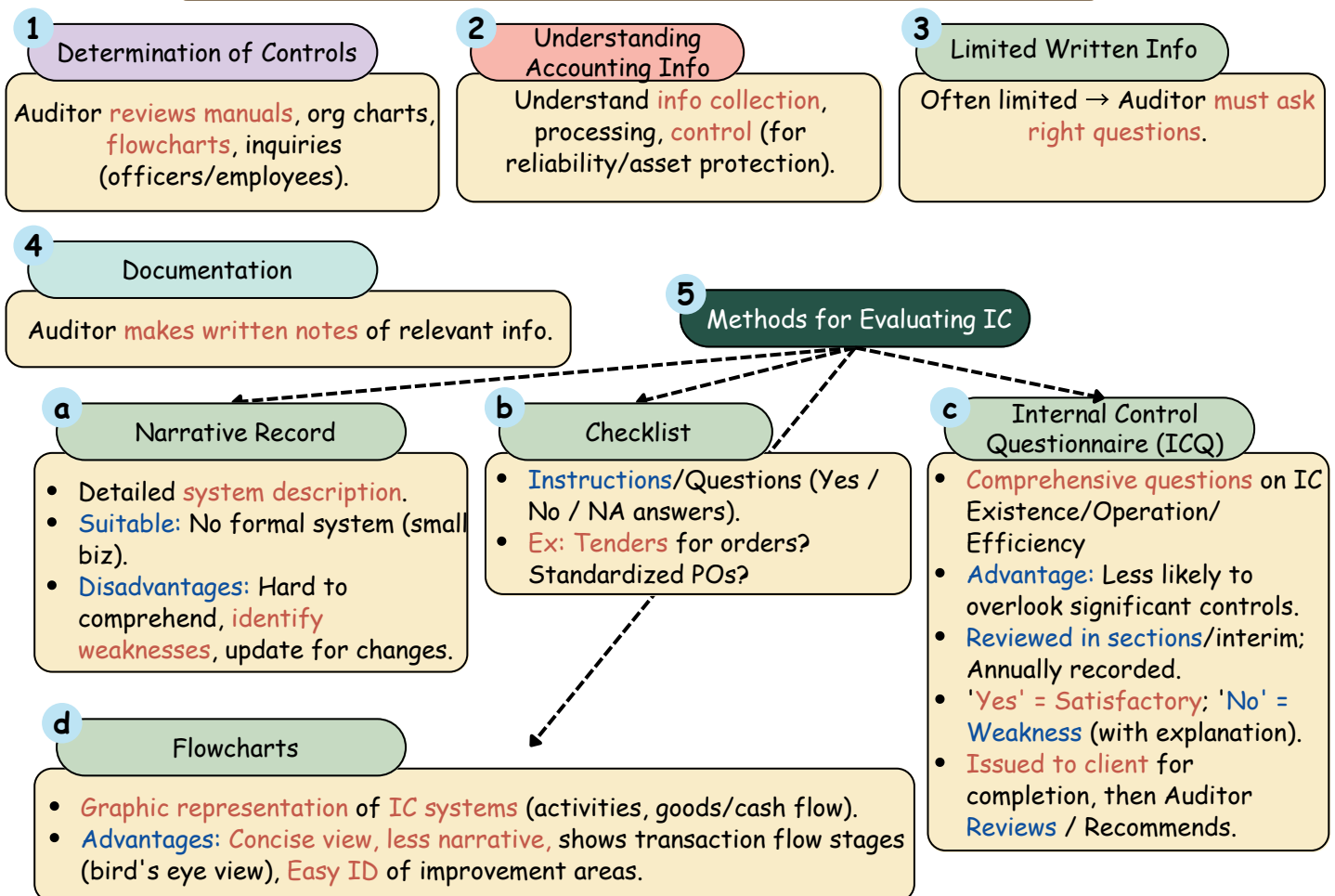
2 Auditor's Understanding

Helps **determine NTE** of other audit procedures.

N. Development of Audit Programme After Understanding of Internal Controls



O. Methods of Evaluation of Internal Controls



Examples of ICQs

A Purchases

- Centralized in Purchase Dept.
- Only approved suppliers
- Supplier list maintained
- Multiple sources for key materials
- Orders based on authorized requisitions
- Competitive quotes (2+ suppliers)
- Pre-numbered, authorized orders
- Materials received by Receiving Dept.
- Receiving staff can't approve orders/invoices
- Inspection upon receipt
- Pre-numbered Goods Received Notes

**B** Creditors

- **Invoice Processing:**
 - Invoices sent to Accounts Dept.
 - Entered in Bill Register before checking.
 - Advance payments noted on invoices.
- **Invoice System:**
 - Ensures all invoices processed.
 - Quantities reconciled with purchase invoices and stock.
- **Matching and Checking:**
 - Invoices matched with GRNs and purchase orders.
 - Prices and terms verified.
 - Duplicate invoices flagged.
- **Reconciliation:**
 - Supplier statements compared with ledger.
 - Unpaid creditors lists reconciled periodically.

C Inventories

- **Storage & Insurance:** Stocks in assigned areas, insured, cover reviewed.
- **Stock Records:** Perpetual records, reconciled, shortages/excesses approved.
- **Norms:** Defined stock level norms.

D Fixed Assets

- **Capital Expenditure:** Budgets approved, authority restricted, capital purchases controls.
- **Verification:** Periodic checks, written procedure, damage/obsolete reports.
- **Corrections:** Discrepancies investigated & corrected with authority.

P. Why Test of Controls and what it Includes

1 Purpose

After Understanding IC, **ToC ensures IC System** is in Actual Operation.

2 Testing Period

Can cover **Multi-Year Period** (e.g., 3 years).

3 ToC Goals

Provide Evidence of:

- **Accounting & IC System Design Effectiveness.**
- **IC Operation Effectiveness** (Throughout Period).

4 ToC Components

Includes Control Environment tests (**Strength Reduces CR**).

5 Dual Purpose Procedures

Understanding Controls can provide **Effectiveness Evidence** (Acts as ToC).

6 Example

Sales Controls (Brief):

- Inventory Check,
- **Authorized Advice,**
- Standard Forms,
- **Special Credit Approval,**
- Clear Terms,
- **Creditworthiness Review.**

7 ToC Includes (Methods)

1. **Inspection:** Documents (Auth, Compliance).
2. **Inquiries & Observation:** (Who Performs vs. Should).
3. **Re-performance:** (e.g., Bank Rec).
4. **Testing IT Controls:** (Specific Apps, Access, Program Changes).

8 Procedural Tests

Test Compliance (Initiation, Auth, Recording, Doc) at **Each Transaction Stage**.

9 Deviations from Controls

- **Inquire on Deviations** (Assess Implications).
- **Amend Control Risk** (CR) Assessment (If Significant, Unless Other ToC Support).
- Adjust **Substantive Procedures** (Modify NTE if CR Revised).

5. Automated Environment

A. Meaning and Features of Automated Environment

A Definition

Business setting where **processes, operations, accounting**, decisions use computer systems (IT).

B Key Features

- Reduced **manual intervention**,
- System-driven,
- **Faster operations**,
- **Accurate data**,
- Large volume capability,
- **Integration, enhanced security**,
- Reduced human errors,
- **Access to latest info**,
- **Strong connectivity**.

C System Complexity

- **ERP systems** (SAP, Oracle) increase complexity;
- **Off-the-shelf software** indicates less automation.

B. Understanding and Documenting Automated Environment

A Auditor's Role

Understand **entity's IT environment** (department, activities, **dependencies**, risks, controls) for financial statement audit.

C Documentation

Auditor must document **IT environment understanding**.

B Key IT Understanding Points

- Info Systems used (single/multiple)
- **Purpose** (financial/non-financial)
- IT Location (local/global)
- **Architecture** (desktop, client-server, web, cloud)
- Version (functions, risks differ)
- **System Interfaces** (between multiple systems)
- **In-House vs. Packaged systems**
- **Outsourced IT activities**
- Key IT Personnel (CIO, CISO, Sys Admins)



C. Risks arising from use of IT Systems

A Understanding IT Risks

- **Inaccurate Processing** (incorrect data)
- Unauthorized Access (sensitive data)
- **Backend Changes** (bypassing controls)
- Excessive Access (privileged users)
- **Inadequate Segregation of Duties**
- Unauthorized System/**Program Changes**
- **Poor Change Management**
- **Data Loss** (Integrity and availability)

B Impact if Not Mitigated

- **Substantive Checking**: **Increased** due to non-reliance on system-generated data.
- **Controls**: **Non-reliance** on automated controls, system calculations; more audit work.
- **Reporting**: **Modified auditor's report** possible (e.g., for Internal Financial Controls).

D. Types of Controls in Automated Environment

1

General IT Controls (GITC)

- **Definition:** Policies/procedures supporting application controls; apply across environments.
- **Purpose:** Ensure info integrity, data security.
- **Components:**
 - **Data Centre & Network Operations:** Ensure production systems meet financial reporting objectives; covers computer operations, batch jobs, backups, performance monitoring, BCP/DRP.
 - **Program Change Controls:** Ensure modified systems meet financial reporting objectives via change management (tracking, testing).
 - **Access Security Controls:** Ensure authenticated/authorized access to programs/data (security policies, data/physical security).
 - **System Development & Maintenance Controls:** Ensure systems developed/implemented meet financial reporting objectives (project management, testing, QA).
- **Characteristics:** Mitigate IT risks across multiple systems; "pervasive" / "indirect".

2

Application Controls

- Automated/manual controls at business process level.
- Ensure data completeness, accuracy, integrity.
- Embedded in IT systems (e.g., ERPs).



3

IT-Dependent Controls

- Manual controls relying on IT system data/reports.
- Effectiveness depends on source data reliability.
- Require GITC for effectiveness.

4

Application Controls

GITC support Application Controls for complete/accurate info processing.

E. Testing Methods used in Automated Environment

A

Methods

1. **Inquiry:** Most efficient, combine with inspection for best evidence.
2. **Observation:** Observe users processing transactions.
3. **Inspection:** Examine configurations, system logs, user manuals; determine changes.
4. **Reperformance:** Best evidence, time-consuming. Conduct test checks (negative testing), observe error messages.

B

Professional Judgement

- Application depends on risk assessment, control environment, desired evidence, business complexity.
- **Key points:**
 - **Walkthroughs:** Understand end-to-end transaction processing.
 - **Configuration Inspection:** Review application configurations for compliance.
 - **System Logs:** Examine logs to identify changes.
 - **Manuals:** Review technical/user manuals.
 - **Negative Testing:** Perform test checks and observe error messages.

F. Characteristics of Manual and Automated Elements of Internal Control

1 Internal Control Elements

Both **manual & automated elements** in internal control systems affect **transaction initiation**, recording, processing, reporting.

2 Manual Controls

- Include **approvals, reviews, reconciliations**, follow-ups.
- Operate **independently**, use **IT info**, or monitor IT/automated controls.

3 Automated Controls

Use **electronic records** for transaction **initiation, recording, processing**, reporting (replacing paper).

4 Impact of Manual Elements (in Automated Environments)

- **Useful for:** Unusual/non-recurring transactions, **hard-to-define errors**, changing circumstances, **monitoring automated controls**.
- **Limitations (Less Reliable):** Susceptible to **bypass, errors, inconsistency**. **Unsuitable for high-volume/recurring transactions** or activities where **automation is adequate**.

Audit Approach in an Automated Environment

Risk Assessment

- Identify **significant accounts/disclosures**,
- Qualitative/**quantitative considerations**,
- Relevant Financial Statement Assertion likely **misstatement sources**, and its risks.

Reporting

Evaluate **control deficiencies** (significant, material weaknesses), remediation, **Internal Controls Memo/Management Letter**, **Auditor's report**

Understand and Evaluate

- Document **understanding of business processes** (flowcharts/narratives),
- Prepare risk and control matrices (**RCM**),
- Understand **control design** via **walkthroughs**,
- Consider **entity level controls** and segregation of duties,
- **understand IT General controls** and **Application controls**.



Test for Operating Effectiveness

- **Assess NTE** of controls testing,
- Reliability/**completeness of source data**,
- **Testing of key reports/spreadsheets**,
- **Sample testing**,
- **Competence/independence of staff**.

G. Data Analytics for Audit

1 DA Definition

Processes, tools, techniques to **extract** meaningful **info** from electronic **data**.

2 CAATs

Tools/techniques auditors use to **analyze electronic data** for audit evidence.

3 Significance/Uses for Auditors

1. **Completeness Check:** Verify data / **population completeness**.
2. **Audit Sampling:** Random / **systematic sample selection**.
3. **Re-computation:** Reconstruct **trial balances** from transaction data.
4. **Mathematical Reperformance:** Verify calculations (depreciation, interest).
5. **Journal Entry Analysis:** As per **SA 240** (fraud risks).
6. **Fraud Investigation:** **Tools for detection** / investigation.

H. Digital Audit

1

Digitization in Business

Entities **adopt digitization** (new tech, automation) to **evolve business models/operations**.

2

Auditors' Use of Technology

Auditors **integrate digital tech** throughout audit process (planning to opinion).

3

Key Technologies Used by Auditors

AI, data analytics, other tech used to understand processes, enhance audit quality, **focus on high-risk areas**.

4

Benefits of Digital Audit

Enables better **risk identification** via technology.

I. Assess and Report Audit Findings in IT environment

1

Findings in IT Environment

Assess/report IT environment/control findings/**exceptions to management** & TCWG (Those Charged With Governance).

2

Evaluation of Findings

Use **professional judgment**; assess findings **quantitatively & qualitatively**, individually & in aggregate.

3

Key Considerations

- **Weaknesses** in IT controls?
- Impact on overall audit?
- **Report deficiencies** to management (Internal Controls Memo/Management Letter).
- **Communicate significant deficiencies** in writing to TCWG.

4

Assessing Impact

Auditor **must assess each finding/exception's impact on audit**.

5

Deficiency in Internal Control (exists if)

- Control **not designed/implemented/operated** to prevent/detect/correct misstatements timely.
- Control is **missing**.

6. Internal Financial Controls with Reference to F/S

A

A. IFCOFR and Reporting Requirements

Objective & Purpose of Internal Financial Controls (IFC)

- **Safeguard Assets** (Protect misuse or loss)
- Prevent/**Detect Frauds** & Errors.
- Ensure **Legal Compliance**.
- Maintain **Accurate Accounting Records**.
- Enable Timely, **Reliable Financial Reporting**.



Responsibility

- **Directors/Management**: Primarily responsible for implementing/**maintaining IFC**.
- **Auditors**: Evaluate, validate and **report on IFC** design/**operating effectiveness**.

Companies Act, 2013 Emphasis:

1

Sec 134(5)(e)

Listed Cos - Directors' Responsibility Statement:

- IFC laid **down**.
- IFC **adequate & operating effectively**.

2

Sec 143(3)(i)

Auditor's Report:

- Adequate **IFC system in place**.
- IFC **operating effectively**.
- **Exemption**: Not for OPC/Small Private Cos if **Turnover < ₹50 Cr AND Borrowings < ₹25 Cr**.

3

Sec 177(4)(vii)

Audit Committee:

- Evaluate **IFC**.
- Evaluate **Risk Management Systems**.

4

Sec 149(8) & Schedule IV

Independent Directors:

- Ensure financial **info integrity**.
- Ensure robust/**defensible financial controls & risk management**.

B

Difference Between IFC and IFCOFR

IFC = Policies and Procedures
IFCOFR = Reporting Controls and Auditor Expresses Opinion.

SA 330 - Auditors Response to Assessed Risk

A Scope & Objective (SA 330)

- **Deals with:** Auditor's **response to RMM** from SA 315.
- **Objective:** Obtain **SAAE** by responding to assessed risks.
- **Requirements:** Overall **F/S level responses**; Further procedures **responsive to risk** at assertion level.

B Designing Further Audit Procedures

- **Consider:** **Reasons for risk assessment** (inherent risk, control risk/reliance).
- Obtain **more persuasive evidence** for **higher risks**.

C Tests of Controls (ToC)

- **Perform when:** **Relying on controls** for substantive procedures alone are insufficient.
- **More persuasive evidence** for higher reliance.

D Nature & Extent of TOC

- Combine **inquiry with other procedures** (inspection, reperformance).
- **Consider:** **How/when applied**, consistency, who applied the controls.
- **Determine reliance** on indirect controls.
- **Inquiry + Inspection / Reperformance** for **greater assurance**.
- **Adjust testing** based on control nature.

E Factors Influencing Extent of Testing

- **Frequency** of control.
- **Length** of reliance.
- **Expected deviation rate**.
- **Relevance** / reliability of evidence.
- Evidence from **related controls**.

H Evaluating Operating Effectiveness of Controls

- **Detected misstatements** indicate **ineffective** controls.
- **Absence of misstatements** ≠ control **effectiveness**.
- **Material misstatement** = strong indicator of **significant deficiency**.

F Timing of TOC

- Test for **specific period** /throughout period of reliance.
- **Point-in-time evidence** can suffice.
- For period reliance, verify **effective operation** throughout relevant times.

G Using Audit Evidence from Previous Audits

- **Consider:** Other IC elements (control environment, monitoring), Control **Characteristics** (manual/automated), **GITC effectiveness**, prior deviations, Risks from lack of change, **RMM**/reliance level.
- Confirm **continuing relevance** (if significant changes occurred).

I Specific Inquiries When Deviations Detected

- **Assess if ToC provides** sufficient reliance basis.
- Determine if **additional ToC needed**.
- **Address RMM** with substantive procedures.

J Substantive Procedures (SPs)

- Performed for **all material classes**/balances/disclosures, **regardless of risk** (due to judgment/override limitations).
- **Purpose:** Detect **material misstatements at assertion level**.
- **Types:**
 - Tests of Details:** Verify **transactions** (vouching), **balances** (verification) - e.g: purchase invoices, fixed asset physical verification.
 - Substantive Analytical Procedures:** Evaluate financial data using **plausible relationships**; investigate fluctuations / **inconsistencies**; use ratios (e.g: predict rental income).
- **Nature & Extent:**
 - Substantive Analytical Procedures alone if **sufficient**.
 - **Tests of details** if supported by **control testing**.
 - Combine **analytical + tests of details** is best.
 - **Increase extent** for unsatisfactory **results** of control tests.
 - Consider **sample size**/alternative methods when designing tests of details.

Chapter 10 - Audit of Banks

1. Brief Overview of Banking

A Peculiarities in Banks

1. Huge Volumes & Complexity
2. Wide Geographical Spread
3. Range of Products & Services
4. Extensive Use of Technology
5. Strict Regulatory Vigilance

C Functions of RBI in Banking

1. **Regulation by RBI:** RBI is the **Central Bank** of India and **regulates the banking** industry.
2. **RBI Responsibilities:** **Supervises the Indian financial system** (banks and NBFCs). Formulates monetary and **credit policies**.
3. **Important RBI Functions:** **Issues/regulates currency**. Acts as **banker to governments** and other banks. Regulates commercial and other banks' activities.
4. **Bank Licensing:** Banks need an **RBI license** to start or open branches. RBI can **inspect any bank**.
5. **Banking Operations:** Conducted at branches; administrative offices **oversee policies, controls, and regulatory compliance**.

F Understanding of Bank Accounting System

1. **Transaction Volume:** Voluminous transactions require **robust systems for data integrity**.
2. **Internal Controls:** Banks continuously improve internal controls for **security, convenience, and efficiency**.
3. **Bank Categorisation (Based on Computerisation Level):** Non-Computerised, Partially Computerised, Fully Computerised.
4. **Core Banking System (CBS):**
 - a. Enables **branch interconnectivity** and access from any branch.
 - b. Auditors must ensure RBI norms are incorporated in computerised systems.
 - c. Auditors should exercise **Professional Scepticism**.
5. **Difference between Computerised and Non computerised Banks:**
 - a. Computerised banks offer **anywhere, anytime transaction** availability and **shortest processing time**, leading to higher productivity.
 - b. Non-computerised banks are **manual, limited to working hours**, and have **longer processing times**.

B Types of Banking Entities

1. **Commercial Banks:** Widest spread, offer a **range of products and services**.
2. **Regional Rural Banks (RRBs):** Cater to **rural communities**.
3. **Co-operative Banks:** Similar to commercial banks but operate under Co-operative **Principles, focus on agriculture/rural sectors**.
4. **Payments Banks:** New type introduced by RBI, accept restricted deposits, cannot issue loans or credit cards. Offer **accounts, ATM/Debit cards, internet/mobile banking**.
5. **Development Banks:** Focus on **funding infrastructure** to promote economic growth.
6. **Small Finance Banks:** Provide banking **facilities to unserved sectors** (small farmers, micro businesses).

D Regulatory Framework for Banking Companies

Key acts include **RBI Act, 1934**, Banking Regulation Act, 1949, **Companies Act, 2013**. Several other acts govern specific banking aspects like **PMLA, IT**, etc..

E Additional Reports by Statutory Central Auditors

1. Report **IFC over Financial Reporting**
2. Long Form Audit Report (**LFAR**),
3. SLR Compliance Report,
4. **Report on Treasury Operations**, and
5. Report on **Income Recognition & Asset Classification**,
6. Report on **Adverse Credit - Deposits Ratio**,
7. Report on **GHOSH and Jilani Committees**.



G Audit Plan and Points to be considered

Consider **nature/level of operations**, adverse features, compliance level, and **risks from internal control weaknesses**.

H

Control Environment in a Bank

1. **Key elements include** Segregation of Duties, transaction verification/approval, regular reconciliation, setting limits, reporting and approval of exceptions and physical security/contingency planning.
2. **Auditors consider questions like**
 - a. Who performs the control,
 - b. What evidence is generated,
 - c. When and how frequently performed,
 - d. Where evidence is retained,
 - e. Why the control is performed, and
 - f. How it is performed and exceptions resolved.



2. Procedure for Conducting Audit of a Bank

1

Engagement Team Discussion

1. **Engagement Team Discussion:** Team discusses the bank and its environment, including controls,
2. **Purpose of Discussions:** To assess potential for material misstatements.
3. **Matters to Discuss:** Matters to discuss include likely errors, prior year errors, fraud methods, need for professional skepticism, and responses to various risks (Engagement, Pervasive, Specific)
4. **Advantages** include assessing fraud risk, planning responses, delegating work, and deciding on specialist involvement.

3

Understanding the Bank and Its Environment

1. Understand the entity, internal control, and accounting process to identify/assess risks (SA 315).
2. **Risk Management Process:** Governance bodies approve policies. Risks are identified, measured, and monitored against limits.
3. **Control activities** (segregation of duties, verification) are implemented.
4. Monitoring activities assess/update models,
5. Maintain Reliable information systems that provide financial, operational & compliance information in a consistent manner.

2

Initial Considerations by Statutory Auditor

1. **Communication with Previous Auditor** is required in writing before accepting the position.
2. **Acceptance & Continuance:** Perform procedures as per SA 220 regarding client relationship and engagement risk.
3. **Declaration of Indebtedness:** Auditor declares no non-performing credit facilities from the bank.
4. **Terms of Audit Engagements:** Agreed and documented as per SA 210.
5. **Internal Assignments:** Audit firm cannot undertake statutory audit if associated with internal assignments in the same year.
6. **Establish the Engagement Team:** Assign qualified professionals based on the bank's size/complexity.

4

Other Steps

- Engagement Team Discussions (reiterated)
- Develop the Audit Plan (SA 300).
- Determine Audit Materiality using professional judgment.
- Consider Going Concern.
- Maintain Professional Scepticism (SA 240) to detect fraud/misstatements.
- **Stress Testing:** RBI mandates banks to adopt a board approved Stress Testing framework.
- **Basel III Framework:** Banks must follow criteria for regulatory capital.
- **Reliance on/Review of Other Reports:** Auditor reviews previous audit, internal inspection, RBI inspection, concurrent audit, security verification reports, Manager's charge, Handing over report.

3. Appointment and Reporting by Auditors of Bank

A Provisions of Appointment

Eligibility/Qualifications/Disqualifications are same as company auditors under Section 141 of Companies Act

C Remuneration of Auditor

1. **Banking Company:** Fixed as per **Section 142** of Companies Act, 2013 by company in general meeting.
2. **Nationalised Banks, SBI, & RRBs:** Fixed by **RBI** in consultation with **CG**.
3. **Powers:** Same as company auditor under Companies Act, 2013 (access to books, accounts, etc.).

B Authority to Appoint Auditor

Read Last to First

1. **Banking Company:** **Shareholders** at **AGM** with **RBI** approval.
2. **Nationalised Bank:** **BOD** with **RBI** approval.
3. **State Bank of India:** **CAG** in consultation with **CG**.
4. **Regional Rural Banks :** **BOD** with **CG** approval.

D Reporting by Auditor

1. **Reporting to CG (for Nationalised Banks):** Report includes
 - a. verifying **true and fair view** of financial statements,
 - b. Confirmation of **satisfactory information/explanations**,
 - c. Ensuring **transactions within powers** and adequacy of branch returns.
2. **Format of Report:**
 - a. Must **comply with** Standards on Auditing (**SA**).
 - b. **Unaudited** Branches Disclosure is required.
 - c. Report must **comply with Section 143** of Companies Act, 2013.
 - d. **CARO, 2020** is **not applicable** to banking companies.
3. **Long Form Audit Report (LFAR):** Auditors of **public, private, and foreign** banks must submit LFAR by 30th June annually. Matters are outlined by RBI.
4. **Reporting to RBI (or Fraud Reporting):** Auditors must **report fraudulent activities** or **suspicious transactions** to the RBI. SA 240 requires reporting fraud to **RBI and the bank's head**. Focus is on evaluating the system.
5. **Duty to Report on Frauds u/s 143(12):** Applies to **company auditors** and is in **addition to RBI** reporting.



4. Advances of a Bank

A Meaning and Types of Advances

1. **Definition:**
 - a. Advances are a **major asset and income source** shown on the asset side of the balance sheet.
 - b. Loans/credits with a **repayment period and interest**.
 - c. Auditors need in-depth knowledge of **regulations, processes, and controls**
2. **Examination:** **Large advances** (Year-end balance > ₹10 crore or 10% of branch advances, whichever is less) require **100% examination**. Others are sampled.
3. **Types:**
 - a. **Funded Advances:** Involve **actual fund transfer** (Term loans, Cash credits, Overdrafts, etc.).
 - b. **Non-Funded Advances:** **No** actual funds **transfer** (Letters of credit, Bank guarantees).
4. **Advances Comprise:** **Term Loans**, **Cash Credits**, **Over drafts**, **Demand Loans**, **Risk- sharing Participation**, **Interest bearing staff loans**
5. **Disclosures in Balance Sheet:**
 - a. **Classified by type** (Bills purchased/discounted, Cash credits/Overdrafts/Demand Loans, Term loans).
 - b. Further **categorized by security** (Secured by tangible assets, Covered by guarantees, Unsecured).
 - c. Also disclosed by **geography** (India, Outside India) and **sector** (Priority sectors, Public sector).

B

Classification of Advances - Based on Sector

- Banks must follow guidelines for lending to **Priority Sectors** (Agriculture, MSME, Education, Housing, etc.).
- RBI sets lending targets.**

C. Classification of Advances

1

Based on Security

- Primary Security:** **Principal security** from borrower.
- Collateral Security:** **Additional security.**
- Examples of Securities:** **Goods, Gold,** Immovable Property, Shares and Securities, Insurance Policies.

2

Mode of Creation of Security

- Mortgage:** **Registered** (Deed) or **Equitable** (Delivery of title deeds).
- Pledge:** Delivery of goods as **security** (ownership with pledger).
- Hypothecation:** **Ownership and possession** remain with borrower (who acts as agent). Borrower submits statements (stocks, debtors) for drawing power.
- Assignment:** **Transfer of debt** or rights (book debts, insurance policies).
- Set-Off:** **Combine accounts** of the same person/capacity. Applies to **time-barred debts**. All branches **treated as one** for the purpose of set off.
- Lien:** Legal charge allowing lender to **seize/liquidate assets**.

5. Audit of Advances and Prudential Norms

A

Definition of NPA

Non-Performing Assets (NPA):

- Definition:** An asset **stops generating income.**
- Criteria for NPA:**
 - Term Loan:** Interest/principal **overdue for > 90 days.**
 - Overdraft/Cash Credit (OD/CC):** Account remains '**out of order**'.
 - Bills Purchased/Discounted:** Bill **overdue for > 90 days.**
- Note**
 - NPA Classification:** Based on record of recovery. **Classification is borrower-wise, NOT facility-wise.**
 - 'Out of Order' (OD/CC):** **Outstanding exceeds SL/drawing power, or NO credits for 90 days, or insufficient credits to cover interest.**
 - Overdue:** Any amount **not paid** on the due date.



Category of NPA	Meaning	Provision % of O/S Amt	
1. Substandard Assets	Assets that have been classified as NPA for ≤ 12 months.	15%	
2. Doubtful Assets	Assets that have been in the Substandard category for > 12 months. Subcategories:	Secured Portion	Unsecured Portion
	1. Doubtful up to 1 Year (D1)	25%	100%
	2. Doubtful 1 to 3 Years (D2)	40%	100%
	3. Doubtful > 3 Years (D3)	100%	100%
3. Loss Assets	Assets where loss has been identified by the bank, auditors, or RBI inspection but not fully written off.	100%	100%

B. Special NPA Norms

1

Accounts Regularized Near Balance Sheet Date

- Handled **carefully;**
- Classify as **NPA** if **inherent weakness** indicated.
- Auditors **check sample transactions before/after year-end;**
- Reversed credits** after year-end **show weakness.**

2

Government Guaranteed Advances

- Central Govt. **Guaranteed** treated as **Standard** if guarantee **not invoked.**
- But Income **Recognition as NPA.**
- State Govt. **Guaranteed**
 - Classified as **NPA** if **overdue > 90 days** for both **classification and income** recognition;
 - No provisioning** relaxation.

3 Advances Under Consortium

1. Loans by 2+ banks jointly; Lead Bank has higher share.
2. Asset Classification is based on record of recovery for each member bank. If funds remitted to lead bank but not transferred, the account is NPA for non-receiving banks.
3. Members must ensure recovery share transfer or get consent.
4. Lead Bank computes/allocates Drawing Power (DP).

5 Advances Against Term Deposits, NSCs, and KVPs

1. Not NPAs if adequate margin available.
2. Interest can be recognised on Accrual.

7 Advances to Staff

Part of advances portfolio. Classified as NPA only if instalments overdue > 90 days. Salary advances shown under 'Others' in Other Assets.

4 Accounts with Erosion in Security Value/Fraud

- a. Erosion means diminution in security value.
- b. Classification:
 1. **Doubtful Asset**: If realisable security value < 50% of assessed value by bank/RBI. Provisioning as per doubtful norms.
 2. **Loss Asset**: If realisable security value < 10% of outstanding amount. Classify as Loss and write off fully.

6 Agricultural Advances Affected by Natural Calamities

Governed by RBI Master Circular. Banks offer relief (convert short-term to term loans, reschedule, sanction fresh loans). NPA classification based on rescheduled terms.

8 Agricultural Advances:

Two types: Long Duration Crops (LDC) and Short Duration Crops (SDC).

- NPA Norms:
 - SDC: if instalment overdue for 2 crop seasons.
 - LDC: if instalment overdue for 1 crop season.
- Crop season determined by State Level Bankers' Committee.

C. Computation of Drawing Power

1 Drawing Power (DP)

Limit firm can withdraw from working capital limit.

3 Rules for DP/SL

- Accounts must stay within both DP and SL.
- Irregular accounts (exceeding limits, unapproved security, irregular) reported to Management/HO.
- Drawings must be covered by current assets adequacy.
- DP calculated from current stock statement (not older than 3 months).
- Older stock statements render account irregular.
- DP computation follows Board guidelines and auditors' agreement.
- Special focus on sundry creditors in DP calculation.

2 Sanctioned Limit (SL)

Total exposure bank can take. DP calculated based on primary security minus margin; SL is maximum exposure.

4 Auditor's concerns

- **Scrutiny of Borrower Documents**: Review stock statements, returns; compare with audited accounts and investigate deviations.
- **Stock Audit**:
 - Required for funded exposure > ₹5 crores. Auditors can recommend Stock Audit for other cases.
 - Obtain reports from lead bank in consortium lending. Review reports focusing on Security Valuation and DP Calculation



D. Audit of Advances

1

Objectives of Audit

- Ensure **outstanding advances** are accurate and represent amounts due.
- Verify **loan/supporting documents** are complete/appropriate.
- Ensure **no unrecorded** advances.
- Ensure appropriate **valuation and recoverability**.
- Ensure advances are **disclosed, classified and described** as per policies/regulations.
- Verify **Provisions are made as per RBI norms**, Accounting Standards and practices.

2

Evaluation of Internal Controls Over Advances [Compliance Procedures]

- Auditor reviews controls covering **Credit Worthiness verification**.
- **Documentation** execution, **End Use of Funds** compliance.
- **Margin of Safety** maintenance .
- **Creation of Security** (transferring/registering security, inspecting goods),
- **DP - Updating register, A/c staying within sanctioned limits, Irregular a/c** are reported to controlling authority.
- Regular **Review of accounts**.

3

Substantive Audit Procedures

- Obtain evidence by verifying **recorded amounts, checking documentation**, reviewing account operations.
- Ensuring security **valuation/enforceability**.
- Checking **compliance with RBI norms** for classification/provisioning.
- Performing **analytical procedures**.

4

Extent of Substantive Procedures

- Examine **all Large Advances**.
- **Problem Accounts** examined in detail.
- Special **focus on advances sanctioned** during the year or commented on by RBI/internal audit.



6. Audit of Incomes

- **Interest Earned:** Interest on **advances, investments**, RBI balances, etc..
- **Other Income:** **Commission** (bills, remittances, LCs, guarantees), **loan processing fees**, Dr/Cr card fees, locker rent, government business **commission, brokerage**, profit on **sale of investments/assets, dividends**, miscellaneous income.

A

Audit of Income

- Objective:** Ensure recorded income is from **valid transactions, pertains to the period, is not unrecorded**, and is at the appropriate amount.
- Accrual Basis:**
 - Material income** (>1% of total income/net profit) is recorded on accrual basis.
 - Income **below threshold** may be **cash** basis.
- Revenue Certainty:**
 - Income recognised on **accrual basis** unless **collection is uncertain**.
 - Interest on NPAs:** **No income** is recognised on **NPAs until realised**. Previously accrued interest is reversed or provided for. **Unrealised interest** is recorded in a **memorandum account**.
 - Advances Against Specific Securities (TD, NSCs):** Interest recorded on **due date** if **adequate margin** exists.
- Bills Purchased:**
 - Discount for outstanding **bills apportioned**.
 - Unexpired discount** is '**Other Liabilities**' Interest on rediscounted bills **not netted off from discount**.
- Bills for Collection:**
 - Customer credited **after actual collection**.
 - Commission **recognised after collection**.
- Renegotiations:** **Fees/commissions** recognised on accrual basis **over the extended credit period**.
- Partial Recoveries in NPAs:**
 - Banks** need a consistent policy for **appropriating recoveries**.
 - Interest realised** on NPA can be taken to income.
 - Ensure **interest credits aren't** from **fresh facilities**.
- Other Incomes:** Interest on investments, Profit on Sale of Investments/Assets, Revaluation gains/losses.

B. Reversal of Income

1

Reversal of Interest on NPAs

- Entire **accrued interest on NPAs** (including bills and CG-guaranteed accounts) must be **reversed or provided for** if not realised.
- Applies to **Government guaranteed accounts**.

2

Fees and Commission on NPAs

Cease to accrue and must be reversed/provided for past uncollected periods.



3

Wrongly Recognised Income

- Reverse** if recognised during current year;
- Provide for if **recognised in previous years**.

4

Auditor's Enquiries

- Enquire about **large unexplained debits** in interest income and
- check **action on borrower** discrepancies.

5

Income on Leased Assets

Unrealised finance income accrued **before becoming NPA** must be **reversed** or provided for.

6

Takeout Finance

- Loan replacing an **initial loan with long-term financing**.
- Used in property development based on project completion.
- Income Recognition**: If classified as NPA, income recognised **only when realized from borrower** or taking-over institution.
- Objectives include **expanding financing, addressing exposure/mismatch** issues and boosting long-term debt for projects.

7. Audit of Expenses

Interest Expense

Interest on **Deposits, Borrowings**.

Operating Expenses

Payments to employees, rent, taxes, **depreciation, fees** (directors, auditors), legal, postage, **insurance, advertising**, repairs, other expenses.

Provisions and Contingencies

Provisions for **NPAs, Taxation, Diminution in investments, contingencies**.

A

Audit of Interest Expenditure

Auditor ensures expense is reasonable by analyzing ratios. Procedures include:

- Obtain **quarterly analysis** of deposits and compute weighted average interest rate
- Comparing with **actual and prior years** and investigating differences.
- Obtain **general ledger break-up** and **perform cost analysis** for variances.
- Test check interest calculations** to ensure
 - Interest** is provided **on all deposits up** to the balance sheet date.
 - Rates** comply with bank/**RBI regulations**.
 - Savings interest follows rules** and inter-branch interest is provided.
 - Verify **interest rate changes**.
 - Ensure **interest is accrued** on the **entire borrowing** portfolio.
 - Re-compute interest** accrual considering parameters.



B Audit of Operating Expenses

- Audit operating expenses by: evaluating authorization controls,
- Checking expense trends
- Performing analytical comparisons.
- Verifying supporting documentation and calculations.



D Disclosure of Prior Period Items

Banking Regulation Act format does not mandate disclosure but significant impacts should be disclosed if warranted.

C Audit of Provisions and Contingencies

- Ensure compliance with regulatory requirements for provisioning as per RBI circulars.
- Understand bank's provisioning process for standard/NPAs.
- Verify loan classification on a sample basis.
- Reconcile classifications with general ledger.
- Audit tax provisions by verifying computation.
- Review provisions for expenses and assess adequacy.

8. Form and Content of Financial Statements

Content

1 Applicability of Section 29

Sub-sections (1) and (2) govern form/content of financial statements for banking companies. Applicable to Nationalised Banks, SBI, and RRBs.

2 Preparation of Financial Statements

Balance Sheet and Profit and Loss Account as per Forms in the 3rd Schedule to the Banking Regulation Act, 1949. Form A for Balance Sheet, Form B for P&L Account.

3 Compliance with Accounting Standards

Compliance with Accounting Standards under Section 133 of Companies Act, 2013, Rule 7 of Companies (Accounts) Rules, 2014, and Accounting Standards issued by ICAI.

Chapter 11 - Items OF Financial Statements

1. Audit of Items of Financial Statements

1 Financial Statement Audit

- Examines financial statements and disclosures by an independent auditor
- Provides report on truth and fairness of financial statements and disclosures

2 Management Responsibility

- Management is responsible for preparing and presenting financial statements
- Financial statements must include assertions and representations

3 Key assertions

Definition

- Assertions are explicit or implicit representations by management in financial statements
- They address potential misstatements and guide auditor testing

4 Auditor's Role

- Creates audit program to verify management assertions
- Obtains SAAE for each assertion related to:
 - Account balances
 - Classes of transactions
 - Related disclosures

Include

Definition

- **Completeness:** All transactions and balances recorded
- **Cut-off:** Transactions recorded in correct accounting period
- **Valuation/ Measurement:** Assets, liabilities, and transactions properly valued
- **Rights and Obligations:** Entity owns/controls assets and has obligations
- **Presentation and Disclosure:** Financial statements appropriately presented

2. Income Statement Captions Comprising Revenue and Expense Balances

1 Occurrence

- **Definition**
 - Transactions recognized in financial statements have occurred and relate to the entity
- **Examples**
 - Employee benefit expense incurred during the period for personnel employed by the entity (excludes unauthorized personnel)
 - Sales represent goods ordered, dispatched, and invoiced

2 Completeness

- **Definition**
 - All transactions that should be recorded have been recognized in financial statements
- **Examples**
 - Employee benefit expenses for all employees fully recorded
 - All genuine sales recorded

3 Cut-off

- **Definition**
 - Transactions and expenses reported in correct accounting period
- **Examples**
 - Employee benefit expenses relate only to current accounting period
 - Sales from past/future years excluded; only current period sales included
 - Accounts properly adjusted for items belonging to relevant period

4 Measurement

- **Definition**
 - Transactions recorded accurately in financial statements with appropriate documentation/posting
- **Examples**
 - Employee benefit expense measured correctly; tax deductions reconciled and accounted for
 - Sales reflect correct invoice amounts including discounts

3. Balance Sheet Captions Comprising Assets, Liabilities and Equity Balances

1 Existence

- Confirms assets / liabilities / equity actually **exist at the period-end**.
- Example:** Inventory listed must physically exist.

2 Completeness

- All applicable balances are **recorded without omission**.
- Example:** Includes all inventory owned (even if held by 3rd parties) but excludes consigned goods.

3 Cut-off

- Transactions are recorded in the **correct accounting period**.
- Example:** Year-end inventory **excludes next-year items** but **includes all current-year items**, regardless of location.

4 Valuation

- Balances are **appropriately valued** to avoid misstatement.
- Example:** Inventory valued at **lower of cost or net realizable value** (per AS 2), excluding unrelated/abnormal costs, using consistent methods (FIFO/Weighted Average).

5 Rights and Obligation

- Entity **holds legal rights** to assets and **acknowledges liabilities**.
- Example:** Inventory ownership is verified (e.g., via invoices); **consigned goods are excluded**.



6 Presentation and Disclosure

- Items are **correctly classified**, described, and disclosed.
- Example:** **Inventory breakdown** (raw materials, finished goods, etc.), **goods-in-transit details**, and valuation method disclosed.

Balance Sheet Items

1. Audit of Share Capital

1 Existence of Share Capital

- Verify **authorized, issued, and paid-up capital** against **previous audited** financial statements.
- Obtain **written representation** from the Company Secretary if **no changes occurred**.
- Ensure **paid-up capital** does **not exceed authorized** capital by reviewing the MOA.

4 Sweat Equity Shares

- Issued to employees/directors** under Section 54.
- Verify **compliance with special resolution**, SEBI rules, and pari passu ranking.

5 Reduction of Capital

- Ensure **compliance with Section 66** (special resolution, AOA authorization, no deposit defaults).
- Check **Tribunal orders**, filings with ROC, and accounting entries.
- Confirm **Schedule III disclosures** and **Tribunal conditions**.
- Buybacks:** Exempt from **reduction requirements** (Section 66(6)); comply with Section 68.

2 Completeness of Equity Balances

- Obtain **certified resolutions** for changes in capital.
- Ensure **compliance with the Companies Act 2013** for fresh issues (Return of Allotment, Minimum Subscription, Bank account maintenance).
- Prohibit share issuance** at a **discount** (except sweat equity).
- Verify **consideration type** (cash/non-cash) and SEBI compliance.
- Check **filings with MCA** (Forms SH-7, PAS-3) and RBI (FGPR for FDI).
- Confirm **fee and stamp duty** calculations for share capital increases.

3 Valuation of Equity Balances

- Shares Issued at Premium**
 - Transfer **premiums to securities premium** account (Sec 52).
 - Ensure **proper usage** (bonus shares, preliminary expenses, buybacks, etc.).
- Shares Issued at Discount**
 - Prohibited except for sweat equity** or debt restructuring (Sec 53).

6 Disclosures for Share Capital

- For each class of shares, disclose
 - Authorized**, issued, subscribed, fully/partially paid shares, par value, and reconciliation.
 - Rights, preferences**, and restrictions.
 - Shares held by **holding/subsidiary companies**, promoters ($\geq 35\%$), and reserved shares (options/contracts).

6 Disclosures for Share Capital

2. **5-Year History**
 - Fully paid shares issued without cash.
 - Bonus shares and buybacks.
3. **Convertible securities terms**,
4. Unpaid calls, and forfeited shares.
5. **Promoter Shareholding Table**
 - Details of shares held by promoters (% change computed yearly).
6. **Unused Issue Proceeds**
 - Disclose utilization/investment of unspent funds.

7 Additional Regulatory Information

Funds Advanced/Loaned to Intermediaries

- Dates, amounts loaned or invested in intermediaries.
- Details of further investments/guarantees by intermediaries.
- Compliance declarations for FEMA, Companies Act.

Funds Received from Funding Parties

- Dates, amounts received from Funding Parties
- Details of further investments/guarantees on behalf of beneficiaries.
- Compliance declarations for FEMA, Companies Act.

2. Audit of Reserves and Surplus

1 Definition of Reserves

- Reserves are amounts appropriated out of profits (not intended to meet liabilities)
- Include:
- Liabilities
 - Contingencies
 - Commitments or
 - Diminution in asset value as of B/S date.

2 Purpose of Reserves

- Internal financing source used based on type:
 1. **Revenue Reserves**: Available for distribution/purposes like:
 - a. Supplementing profits in lean years
 - b. Financing business expansion
 - c. Augmenting working capital
 - d. Strengthening financial position
 2. **Capital Reserves**: NOT available for distribution; used for specific limited purposes:
 - Securities premium
 - Capital redemption reserve

3 Revenue Reserve Treatment as Capital Reserve

- If revenue profits for asset replacement reserves are for capital purposes
- Then treated as capital reserve

5 Utilization of Capital Reserves

- Capital reserves can be used for:
 - Writing down fictitious assets or losses
 - Issuing bonus shares if permitted by Articles

6 Specific Restrictions

Securities premium (Section 52) and Capital redemption reserve (Section 55) can only be utilized for purposes specified under the Companies Act 2013

4 Source of Capital Reserves

Created from capital profits, such as:

- Sale of fixed assets
- Profit on share sales

Audit Procedure for Reserves & Surplus

1 Existence of Reserves and Surplus

- Verify opening balances with previous year's audited statements
- Check current year transactions for additions/utilization

2 Completeness of Reserves and Surplus

- Trace surplus/deficit movements in P&L Statement
- Verify changes in Statement of Changes in Equity
- Check board approvals for dividends

3 Valuation

- Follow AS-4/IND AS 10 for dividend recognition
- Verify securities premium transactions and board resolutions
- Ensure compliance with Section 52 for premium utilization

4 Disclosures

- Classify reserves per Schedule III: Capital Reserves, Capital Redemption Reserve, Securities Premium etc.
- Show allocations of surplus (dividends, bonus shares, transfers)
- Display additions/deductions under each head
- Term earmarked investments as "fund"
- Show negative P&L balance under "Surplus"

3. Audit of Borrowings

Audit Procedures

- 1 **Existence of Borrowings**
 - **Verify validity:** Board minutes for approvals, **loan agreements** for details, independent balance confirmations (**SA 505**)
 - **Check contracts:** Lease/hire purchase, **debenture trust deeds**.
 - **Confirm discharge:** Retired debt.
 - **Mgmt Representation:** Confirm valid claims
- 2 **Completeness of Borrowings**
 - **Obtain Schedule:** Short & Long term borrowings (**opening / closing** balances, new & repaid).
 - **Trace:** Balances to GL.
 - **Subsequent Events:** Review for unrecorded liabilities.
 - **Confirmations:** Obtain, **follow up, reconcile**.
- 3 **Valuation of Borrowings**
 - **Policies:** **Consistent application**.
 - **Recompute:** Interest, **Amortisation** of premiums/ discounts.
 - **Foreign Currency Loans:** Verify rates, restatements (**AS 11**).
 - **Classification:** **Short/long-term loans** based on due dates.
 - **Compliance:** Co's Act 2013 (Sec 180, 185, 186), **AOA/MOA limits**.
 - **Loan Covenants:** Compliance, reclassification if breached, **obtain waiver confirmation**
- 4 **Disclosure of Borrowings**
 - **Long-Term:** Classification (bonds, **term loans, DPL, deposits, RP's**), **Secured & unsecured**, Repayment terms, **default period**, redeemed particulars.
 - **Short-Term:** **Classification** (demand, related parties, deposits), secured/unsecured, repayment terms, default period.
 - **Current Maturities:** Disclose **separately**.
 - **Note:** Disclose **alternative use** if not for specific purpose
- 5 **Other Long-Term Liabilities**
 - **Classify:** Trade Payables, Others.

1 **Disclosure of Borrowings secured by Current Assets**

- State whether **quarterly returns/statements** filed with banks/**financial institutions** agree with **books of accounts**
- If not, **provide reconciliation summary & explain** material discrepancies

Additional Regulatory Information - Borrowing

2 **Wilful Defaulter**

- If **declared wilful defaulter** by any bank/financial institution/lender:
 - **Date of declaration** as wilful defaulter
 - **Details** of defaults (amount and nature)
- **Definition:** Person/ Entity **categorized** as wilful defaulter **by bank/FI** as per RBI guidelines

4 **Utilization of Borrowed Funds and Share Premium**3 **Registration of Charges or Satisfaction**

Disclose **details and reasons** if charges/satisfaction **not registered with ROC** within statutory period

A. **Funds Advanced or Loaned to Intermediaries:**

1. **Date and amount of funds loaned / invested** in intermediaries with details
2. Date and amount **further loaned / invested** by intermediaries to ultimate beneficiaries
3. **Date and amount of guarantees / securities** provided to/for ultimate beneficiaries
4. **Declaration of compliance** with FEMA, Companies Act and PMLA Act.

B. **Funds Received from Funding Parties:**

1. **Date and amount received** with Funding Party details
2. Date and amount **further advanced / invested** to intermediaries /ultimate beneficiaries
3. **Date and amount of guarantees / securities** provided to/for ultimate beneficiaries
4. Declaration of compliance with **FEMA, Companies Act, and PMLA Act**.

4. Audit of Trade Receivables

1 Test of Controls
(Sales & Receivables)

- Bona fide sales only.
- Sales to approved customers.
- Sales properly recorded.
- Debtors settled by cash/approval.
- Segregation of duties (accounting, collection, reminders).
- Timely collections.
- Reminders/legal action for overdue.
- Regular balance review.
- Follow-up system & adequate bad debt provision (ageing).

2 Post-Control Audit
Procedures

Auditor determines procedures for debtor balance verification post-TOC.

Audit Procedures for Trade Receivables

1 Existence of Trade Receivables

- Prevent duplicate invoices, auto-record in GL.
- Verify ageing report vs. GL.
- Check realizations (invoice-wise/FIFO).
- Investigate long overdue balances.

Direct Confirmation

- Confirm balances from customers (significant/random).
- Balance date: Year-end or close to it (auditor & company agree).
- Form: With balance (customer confirms) or without balance (customer states).
- Maintain control over requests, independent handling of replies.
- Alternate procedures for unconfirmed: subsequent cash receipts, detailed transaction analysis.

Analytical Procedures

- Review sales/receivables trend for unusual patterns.
- Measure average collection period.
- Inquire management for trend changes
- Document the same.

2 Completeness

- Cut-off Procedures:
 - Last few days' invoices: check goods dispatched.
 - Goods dispatched before year-end: invoiced & included.
 - Goods dispatched after year-end: excluded.
- Match invoices to shipping logs; Correct period recording.
- Test ageing report invoices for accuracy (amounts, dates, customers).
- Review credit memos (authorization & period inclusion).
- Examine bill-and-hold transactions for legitimacy.
- Check for unusual trends via analytical procedures.

3 Valuation

- Review doubtful accounts allowance process, consistency with prior years.
- Obtain ageing report, compare with prior year.
- Identify debtors under litigation, evaluate provisions.
- Check provisions at appropriate rates.
- Verify bad debt write-offs approved by authorized personnel (e.g., Board).
- Prepare schedules for movements (bad debts, provisions, write-offs), compare with prior years.
- Check write-off authority.

4 Disclosure

- Restate foreign currency receivables per AS 11.
- Disclose Related Party Transactions per AS 18/IND AS 24.
- Report Section 189 transactions in CARO, 2020.

5. Cash and Cash Equivalents

Audit Procedure for Cash

1 Existence

- Perform **surprise cash checks** (year-end & later).
- Simultaneously verify **all cash balances** (cashier, petty, branch, imprest).
- Ensure **cashier signs cash count** (with denominations).
- Verify authorized & **recorded slips/LOUs** for advances.
- **Analyze monthly cash trends**, investigate variations.

3 Valuation

Restate **foreign currency bank accounts** at closing exchange rates.



4 Disclosure

Comply with Schedule III (Part I) Companies Act, 2013:

- **Classify:** **Balances with banks**, Cheques/drafts on hand, **Cash on hand**, Others (specify).
- Separately **disclose earmarked balances** (e.g., unpaid dividends).
- State **margin money**/security balances **separately**.
- Mention **repatriation restrictions**.
- **Disclose** bank deposits with **maturity >12 months separately**.

2 Completeness

- **Obtain BRS** for all bank accounts; verify periodic prep & authorized signatures.
- **Verify BRS details:**
 - **Bank book matches confirmations/statements.**
 - **Cheques issued but not presented:** check subsequent clearance/reclassification if stale.
 - **Cheques deposited but not credited:** use deposit slips & subsequent statements.
 - **Review unrecorded bank charges/credits** & Ensure material adjustments.
- **Direct confirmation from banks** (100% of balances).
- **Test:** Agree book balances to confirmation /statements.
- **Unresolved discrepancies:** Obtain written explanations.
- **Non-replies:** Alternate testing (bank statements in auditor's presence, branch visits).

6. Audit of Inventories

1 Existence

- Review client count plan, **participate in count**.
- Segregate consigned goods.
- **Participate in counting/Test Counts:** **Observe adherence**, supervision, **tagging/recording**, reconcile test counts/ tags/ summary, **check for empty/obsolete items**.
- **Conduct cut-off testing** (last 5-10 receiving/shipping reports).
- **Exclude 3rd party stock**, account for all stock sheets.
- **Investigate physical vs. recorded differences**.
- **Perpetual:** count at **interim dates**;
- **Periodical:** count at **year-end**.

2 Completeness

- **Analytical Procedures:** Compare with **industry/budgets/trends**, compute **inventory turnover**, vertical analysis, compare **budgets vs. actuals**, verify non-financial info (weights).
- **Cut-off Tests:** Match **shipping & receiving docs** to records. Test for omitted transactions.
- Verify **arithmetical accuracy of listings**.
- Reconcile **physical counts** with **perpetual records**.
- Reconcile **inventory held** with **3rd parties** (transporter, ports).
- Ensure consigned goods **segregated**.

3 Rights and Obligation

- Vouch **purchases to supporting documents** (POs, invoices, payments).
- Review consignment/**collateral agreements**, purchase commitments.
- **Check invoices** for ownership evidence.
- Obtain **confirmations for 3rd party inventory** (declarations on letterheads).

4

Valuation

- Verify reasonable valuation methods (**FIFO/weighted average**).
- **Raw Materials**: Include **carriage inward**, non-refundable duties. If standard costs, **inquire basis**, compare to actual, **check differences**.
- **Work-in-Progress**: Ascertain valuation basis/production stages, overhead allocation (compare costing/financial data), exclude abnormal waste.
- **Finished Goods**: Verify reasonable cost inclusion, value at NRV if lower than cost.
- **Obsolete/Damaged/Slow-Moving**: Examine for **proper valuation**/realizable value. **Request ageing split**. Compare recorded vs. actual costs. **Calculate turnover ratio** to identify obsolete. Verify **correct application of cost** or **NRV**. Test overhead allocation rates.

5

Disclosures

- **Comply with Schedule III (Part I) Companies Act, 2013.**
- **Classify**:
 - Raw materials,
 - WIP,
 - Finished goods,
 - Stock-in-trade,
 - Stores & spares,
 - Loose tools,
 - Others (specify).
- **Disclose goods-in-transit separately** under sub-heads.
- State **mode of valuation**.

7. Audit of property, Plant and Equipment (PPE)

Intro & Clarifications

- **Definition**: Land, Building, Plant & Equipment, Furniture & Fixtures, Vehicles, Office Equipment, Computers, etc.
- **Valuation**: Assess **Revenue vs. Capital expenditure**.
- **Recognition Criteria**: Probable **future economic benefits**, reliable cost measurement. Costs include **initial acquisition**/construction, additions, **replacements, servicing**.
- **Measurement at Recognition**: Measured at **cost**.
- **Elements of Cost**: **Purchase price** (less discounts/rebates), **directly attributable costs** to bring asset to location/condition, **dismantling** /removal/**restoration costs**.
- **Directly Attributable Costs Examples**: **Employee benefits, site prep**, delivery/handling, installation/assembly, **testing** (net of proceeds), **professional fees**.
- **Costs Excluded from PPE**: **New facility opening**, new product/service introduction, **new location business** (training), **administrative costs**.
- **Expense Classification**: Revenue expenses (e.g., repairs) **charged to P&L**.



1

Existence

- **Review entity's PPE** physical verification plan (staff/third party, periodicity).
- Examine **supervision evidence** during verification.
- **Obtain PPE** physical verification report and perform:
- **Assess tagging with IDs** and capture in working papers.
- **Reconcile physically verified PPE** with fixed asset register.
- **Verify discrepancies** (shortages, non-working assets), ensure accounting & management approval.
- Confirm **additions are entity-owned**, exclude third-party assets.
- **Non-working/inactive assets** accounted as deletions post-approval; depreciation ceases.

2

Completeness

- **Verify PPE schedule movement**: $OB + \text{Additions} - \text{Deletions} = CB$.
- **Check arithmetical accuracy**, reconcile with prior year financials.
- **Additions**: Verify costs meet AS 10 (Revised) criteria; **test supporting docs** (invoices, installation certs); verify approvals & procurement.
- **Deletions**: Understand rationale, verify management approval; **check disposal process** (quotes/tenders); ensure **accurate accounting of deletion & gain/loss**.

3

Valuation

- Verify **depreciation charged on all PPE** (except freehold land).
- Assess **depreciation method** reflects economic benefit pattern (**SLM, WDV**).
- Ensure **impairment assessment** as per AS 28.

4 Rights and Obligations

- **Additions:** Verify **purchase invoices** in entity's name.
- **Land & Buildings:** Check conveyance/**sale deed** for legal ownership.
- Insist on verifying original title deeds for immovable properties.
- **Pledged properties:** request confirmation from lenders holding deeds.
- **Review register of charges** for any charges on PPE.

5 Disclosures

Comply with **Schedule III** (Part I) Companies Act, 2013:

- **Classify by categories** (Land, Buildings, P&M, F&F, Vehicles, etc.).
- **Separate disclosure** for **leased assets**.
- **Reconciliation of gross & net carrying amounts** (additions, disposals, revaluations, adjustments).
- **Revaluations:** Disclose **reduced/increased figures** & date of changes (first 5 years).

8. Audit of Intangible Assets

1 Definition

- Non-monetary, identifiable, **no physical substance**.
- Used for **production, supply, rental, or administrative purposes**.

2 Examples

- Scientific/**technical knowledge**, licenses, IP, trademarks.
- **Software, patents, copyrights, goodwill** (acquisition or internal).

3 Recognition Criteria

- Must meet **identifiability**, control and economic benefits.
- **Internally generated goodwill** not recognized (AS 26).

4 Physical Media

- **Intangibles may exist** on physical media (e.g. disks, films).
- Cost of physical substance is **insignificant**.

5 Intangible vs Tangible

- Some assets have **both elements**: **judgment** needed.
- Software **integral to hardware**: treated as **fixed asset**.
- **Software not integral**: treated as **intangible**.

Audit Procedures for Intangibles

1 Existence

- Confirm **active use** (production, services).
- **For unused:** ensure **deletion and ceased amortization**.

2 Completeness

- **Verify movements:** Opening + Additions - Deletions = Closing.
- **Ensure AS 26 criteria** for additions, no recognition for research phase.
- Confirm **approvals for additions/deletions**.

3 Valuation

- Check **amortization and its method**.
- **Perform impairment assessment (AS 28):** Carrying vs Recoverable amount.

4 Rights and Obligations

- **Confirm legal ownership** (invoices/contracts in entity's name).
- **Test completeness and ownership** during verification.

5 Disclosures

- **Classify by categories** (Goodwill, Trademarks, etc.).
- Provide **reconciliation of gross/net carrying amounts**.
- **Disclose revaluation/write-off figures** for the first 5 years.

9. Audit of Trade Payables and Other Current Liabilities

1

Existence

- Prevent duplicate invoices.
- Reconcile AP ageing with GL.
- Investigate reconciling items/large journal entries.
- Direct Confirmation:
 - Send to significant vendors.
 - Confirm balances at BS date or close to it (auditor & company agree).
 - Form: With balance (creditor confirms) or without balance (creditor states).
 - Keep selection method confidential until trial balance shared.
 - Control dispatch/receipt of confirmations.
 - Reconcile discrepancies.
 - For non-replies: review subsequent payments/vendor invoices.
- Analyze balances for identifiable transactions.
- Examine related party payables for authorization/arm's length.



2

Analytical Procedures

- Review trends in purchases /expenses & accounts payable; identify unusual trends.
- Inquire about reasons for trend changes.

4

Valuation

- Review process for identifying /writing back old creditor balances.
- Check ageing of payables; review vendor disputes.
- Ensure write-backs approved.
- Verify restatement of foreign currency payables (AS 11).
- Assess management's process for identifying unpaid MSME suppliers; test check.

3

Completeness

- Perform cut-off procedures for year-end invoices (proper inclusion).
- Ensure all goods received before year-end are booked & included in payables.
- Match invoice dates to gate entry records for correct period.
- Review subsequent expense vouchers for audit period relevance.
- Verify statutory dues (GST, TDS, PF) for reasonableness & timely deposits (challans).
- Advances Received: Verify underlying documentation; perform ageing analysis.

5

Disclosures

Comply with Schedule III (Part I) Companies Act, 2013:

- MSME payables details:
 - unpaid principal/interest (separate),
 - Interest paid (MSMED Act/beyond appointed day),
 - Accrued/unpaid interest,
 - Future interest due.

Other Current Liabilities

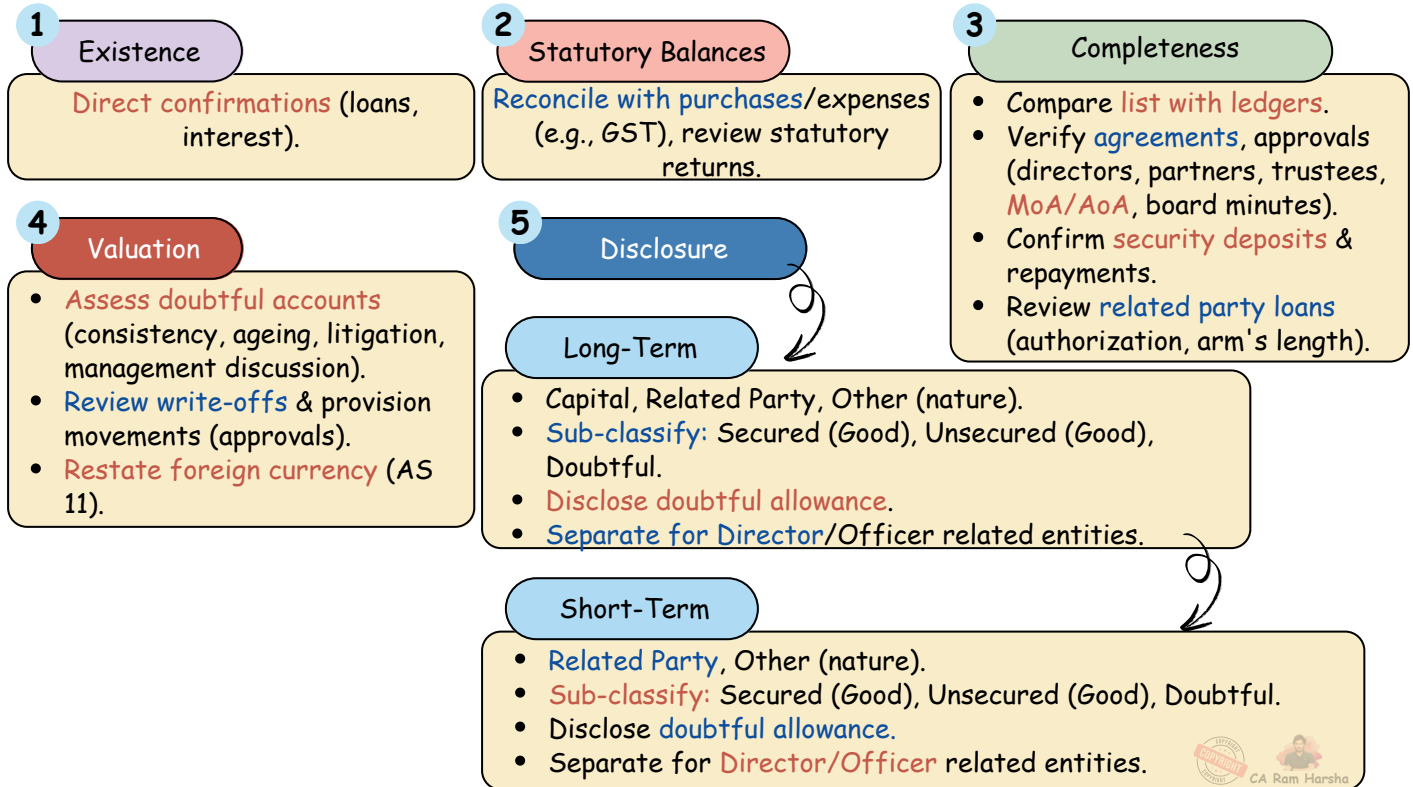
- Current Maturities of Finance Lease Obligations
- Interest Accrued but Not Due on Borrowings
- Interest Accrued and Due on Borrowings
- Income Received in Advance
- Unpaid Dividends

Application Money for Allotment of Securities

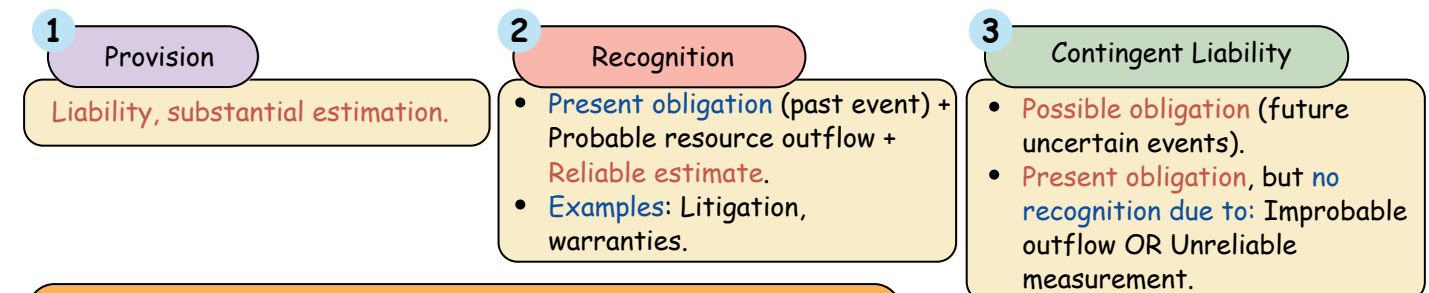
- Money received for securities allocation, pending refund/allotment.
- Disclose terms: shares, premium, allotment period.
- Specify sufficient authorized capital.
- Reasons for delay in allotment.
- Non-refundable: shown under Equity.
- Refundable: shown under Other Current Liabilities.

- Unpaid Matured Deposits/Debentures
- Others (Specify Nature)

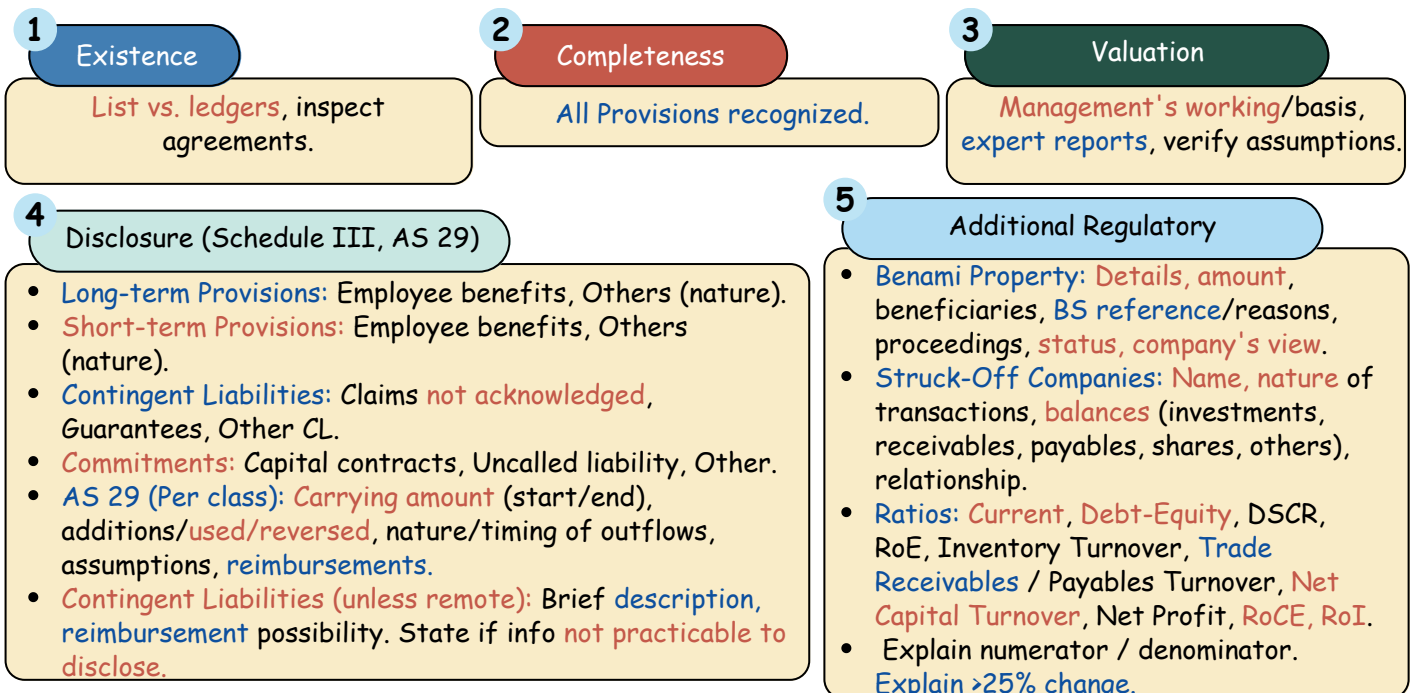
10. Audit of Loans and Advances and Other Current Assets



11. Audit of Provisions and Contingent Liabilities



Audit Procedures



Profit and Loss Items

1. Audit of Sale of Products and Services

1 Sales and Collections Cycle

- Process from sale to payment.
- Key P&L item, **high misstatement risk** (SA 315).

2 Understand Org

- Products/services, **demand**, major items, **discontinuance**, sales terms (credit/cash).

3 Understand Mgmt Controls

- **Segregation of duties**,
- **Credit limit checks**,
- **Authorization of sales orders**,
- Issuing invoices,
- **Delivery of goods**,
- **Recognition of sales**.

4 Common Controls & Testing

- **Pre-numbered invoices**, sales order approval, **PO authorization**, write-off approval.
- **Test controls**; strong controls **reduce substantive testing**; **report deficiencies** (SA 265).

5 Substantive Procedures

- **Random sample**: check POs, invoices, customer statements; verify **numbered invoices**;
- **Ensure sequence accounted for**.

6 Substantive Analytical Procedures

- **Sales trend analysis**, prior period comparison, **category analysis**, build sales expectation, **examine prices/discounts**, **analyze sales discounts/returns**.



Audit Procedure for Sales

1 Occurrence

- **No duplicated/cancelled invoices**.
- **Test invoices** vs. sales journal.
- Customer confirmations.
- **No fictitious customers/sales**.
- **Authorized shipments** (year-end focus).
- Unearned revenue not recognized.
- **Collectability certainty**.
- **Review invoice sequence**, sales returns ratio, unusual journal entries.
- **Match sales returns** with supporting docs.

2 Completeness

- **Cut-off procedures** (revenue in correct period; date of invoice vs. delivery).
- Verify **post-year-end credit notes** (fictitious sales).
- **Trace shipping docs** to sales journal.
- **Check quantities in sales register**.
- **Reconcile stock**, financial, statutory (GST) records.
- Review **GST returns vs. revenue**.

3 Measurement

- **Trace transactions** (inception to payment), accuracy, discounts.
- **AS 11 for export sales**.
- **Understand GAAP** (point-of-sale vs. percentage of completion).
- **Related-party transactions**: collectability, **authorization**, **arm's length**.

4 Disclosure (Schedule III, Part II)

- **Non-Finance**: Sale of products/services, **Grants/donations** (Sec 8), Other operating revenue. **Less**: Excise duty.
- **Finance**: Interest, Other financial services.
- **Notes**: **Revenue by head**, **brokerage/discounts** (non-trade), related-party transactions.

2. Audit of Other Incomes

- 1 **Definition**
 - Income **not from core business** (e.g., FD interest, loan interest, MF returns).
- 2 **Recognition - Interest Income**

Time proportion basis (outstanding amount, rate).
- 3 **Recognition - Dividends**

Right to payment established + Probable **economic benefit** + Reliably **measurable** amount.
- 4 **Recognition - Gain/(Loss) MF Sales**

Upon title transfer; difference between **redemption price** & **carrying value**.

Audit Procedure for Other Incomes

- 1 **Occurrence**
 - Interest (FD)**: List of FDs, recompute, **trace to bank confirmations**, reconcile with Form 26AS.
 - Dividends**: Verify **right to receive** established.
 - MF Gain/Loss**: Verify upon title transfer, **redemption price vs. carrying value**; verify with MF statements.
- 2 **Completeness**

Ensure all other income recorded (no under/overstatement).
- 3 **Measurement**
 - Verify as per **accounting standards**.
- 4 **Disclosure (Schedule III, Part II)**
 - Interest Income** (non-finance).
 - Dividend Income**.
 - Net gain/loss** on investment sales.
 - Other **non-operating income** (net of direct expenses).
- 5 **Additional Regulatory**
 - Disclose **unrecorded income** (tax assessments, search / survey cases).
 - Confirm if such income** & assets are **recorded** in books during the year.

3. Audit of Purchases

- 1 **Understand Org/Production**

Types of products/services, **domestic/overseas**, terms, major vendors, credit period, quality checks, **purchase terms** (credit/cash).
- 2 **Control Points**
 - Segregation of duties**,
 - Competitive** quotes,
 - Purchase committee,
 - Authorization** (price/orders),
 - Goods receipt/acknowledgment,
 - Quality/quantity checks** (GRN),
 - Vendor invoice approval,
 - 2-way/3-way match**.
- 3 **Testing Controls**

Test effectiveness; if effective, **reduce substantive** testing.
- 4 **Common Internal Controls**
 - Competitive quotes,
 - Numbered POs**,
 - PO authorization (over limits),
 - GRN generation**,
 - Quality inspection,
 - 2-way/3-way match**,
 - Invoice authorization.
- 5 **Sample Testing**
 - Random **samples of POs**,
 - GRNs,
 - Purchase invoices**,
 - Inward gate entry,
 - Vendor reconciliations** /statements.
- 5 **Substantive Analytical Procedures**
 - Purchase **trend analysis**,
 - Comparisons,
 - Category-wise**,
 - set purchase expectation (based on sales),
 - Investigate variances** (discounts, price changes).

Audit Procedures

1 Occurrence

- Verify fictitious vendors (selection process, existence).
- Confirm goods receipt (inward register).
- Check quality inspection & GRN (prepared, signed).
- Ensure invoice approval.
- Confirm 2-way/3-way match & stock update.

Special Considerations:

- Original invoices, risk/reward transfer (FOB, CIF),
- Invoices in entity name,
- Verify input tax booking & reconciliation with tax returns,
- Arm's length for related parties,
- Capitalize or expense based on judgment, Review Journal Entries

2

Completeness

All purchases recorded (no under/overstatement).

4

Cut-off Testing

- Ensure purchases in correct period.
- Examine last 5 inward records vs. purchase book.
- Verify goods-in-transit (per terms).
- Obtain management representation.

6

Disclosure (Schedule III, Part II)

- Purchases of stock-in-trade.
- Changes in inventories (FG, SIT, WIP).
- Related-party transactions.

3

Measurement

Verify appropriate measurement.

5

Analytical Procedures

Consumption analysis:

- Compare vs. prior years,
- Ask management for variations.

Stock composition analysis

- Compare vs. prior year.
- Compare creditor/stock turnover ratios vs. prior years.
- Reconcile closing stock with opening, purchases, consumption.

4. Audit of Employee Benefits Expenses

1

Definition

All payments to employees (perquisites, post-employment benefits like gratuity/PF, welfare, training).

2

Understanding Entity Processes

Hiring, appraisal, retirement.

- Test controls for effectiveness; if effective, reduce substantive testing.

3

Measurement

Verify appropriate measurement.

5

Analytical Procedures

Monthly expense reasonability, comparison with prior periods, set expense expectation (operations & industry trends) vs. records.

4

Sample Testing

Appointment letters, appraisal letters, attendance records, HR policies, employee master.

Common Internal Controls

Attendance records, updated employee master, payroll processing/disbursement authorization, accurate deduction computation (taxes), accrual of benefits (gratuity, leave, bonus).

1

Occurrence

- Understand attendance capture.
- Verify fictitious employees: In-person meetings (sample), review bank/ID proofs.

2

Completeness

- Obtain employee list (new, leavers, continuing).
- New Hires: Verify appointment letters, salary processing.
- Resigned: Verify full & final settlements (gratuity, leave encashment), employee acknowledgment.
- Check accurate provisions (bonus, gratuity, leave encashment).

3

Measurement

- Review 12-month salary registers.
- Compile monthly payroll reasonability (avg. salary/employee vs. prior periods).
- PF/ESI: Verify accuracy (rate to basic wages), compare amounts, review monthly challans (timely deposits).

4

Analytical Procedures

Analyze units produced per employee (vs. prior periods, industry trends), ask management for variations.

5

Disclosure (Schedule III, Part II)

Salaries and wages, Contribution to provident & other funds, Expenses for ESOP/ESPP, Staff welfare expenses.

Audit Procedures

5. Audit of Depreciation and Amortisation

1 Significance

Direct **impact on P&L**; ensure appropriateness, **accuracy, compliance**.

2 Key Audit Attributes

- **Accounting Policy**: Understand, **ensure compliance** (Co. Act/standards).
- **Consistency**: Applied consistently YOY, disclose changes.
- **Residual Value**: Calculated **after adjusting residual value**.
- **Validity & Accuracy**: Charges are valid, accurate, in correct period.
- **Component Depreciation**: Significant **components depreciated** separately (e.g., aircraft airframe/engines).
- **Depreciation Method**: Most **appropriate method used** per component.

Audit Procedures

1 Occurrence

- Understand **entity's process**.
- **Review Fixed Asset Register for risks**: capitalizing revenue expenses, **expensing capital**, fake assets (physical verification).

2 Completeness

- List of **additions/deletions** with approvals.
- **Intangible assets** properly amortized.
- Depreciation starts from "**ready to use**" date.
- Depreciation on revalued amounts from revaluation reserve.
- **IT Act depreciation** aligns with **Co. Act** additions, opening WDV matches Tax Audit Schedule.

3 Measurement

- Verify **rates & calculations** (sample).
- **Analytical procedures** (re-compute reasonableness).
- Based on **useful lives** (PPE, intangibles).
- **Residual values** accurately assessed.
- Computed **prospectively after useful life changes**.

4 Disclosures

- Accounting policy.
- Useful lives (Schedule II).
- Residual values.
- Depreciation method.

6. Audit of Other Expenses

1 Includes

- **Power/Fuel**, Rent, Repairs (Building, P&M), **Insurance**, Travelling, **Legal/Professional**, Miscellaneous.

2 Audit Focus Areas

- Pertains to **current period**.
- **Revenue, not capital**.
- Valid supporting documents.
- Correct classification.
- **Authorized** (delegation of authority).
- **Related to business** (not personal).

5 Power & Fuel Expense

- **Month-wise schedule**, power bills.
- Verify **12 months**.
- Compile **units, rate, verify accuracy**.
- Analyze **monthly trends** (link to production), investigate **variances**.

Audit Procedures

1 Occurrence

Expenses actually incurred.

2 Completeness

All expenses recorded (no under/overstatement).

3 Measurement

Expenses accurately **measured**.

4 Rent Expense

- **Month-wise schedule**, rent agreements.
- Verify **12 months**, align with agreement.
- Consider **escalation** (straight-line recording).
- Agreement in **entity name**, for business premises.

6 Insurance Expense

- **Policy summary**, validity periods.
- Verify **prepaid vs. expense classification** (based on days).

7 Legal & Professional Expenses

- **Month-wise**, consultant-wise summary.
- **Retainership**: Verify **12 months**.
- **Non-recurring**: Vouch samples for attributes.
- **Caution for disputes**: Ensure provisions, **auditor disclosure**.

8 Travel, Repairs, Printing, Miscellaneous

- Select **samples, vouch for attributes**.
- Monthly summary for trend analysis.
- **Analytical procedures** (e.g., expense per unit).

9 Analytical Procedures (General)

- Compare expense per unit (vs. prior years, industry trends).
- Ask management for variations.

10 Required Disclosures

Classify as: Rent, Insurance, Power/Fuel, Repairs/Maintenance (Building, P&M, Others), Legal/Professional, Printing/Stationery, Travel, Miscellaneous.

Additional Information (Disclosures):

- **CSR (Sec 135):**
 - Required amount,
 - Incurred,
 - Year-end shortfall, Previous shortfall, Reason,
 - Nature of activities,
 - Related party transactions,
 - Provision movements.
- **Crypto/Virtual Currency:**
 - P&L on transactions,
 - Amount held at reporting date,
 - Deposits/advances for trading/investment.





WINNER!

Let's aim Exemption in Auditing! Yes, it's absolutely achievable, and I'm ready to put in the work for you. But remember, it takes two hands to clap. So, come on—join me! Together, we can conquer this and achieve success.

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K. Audit Reporting under SA 570

- 1 If Use of Going Concern Basis is appropriate but a Material Uncertainty Exists
- 2 Use of Going Concern Basis is appropriate but a Material Uncertainty Exists

- 3 Management Unwilling to Make or Extend Assurance Consider implications: Qualified opinion or adverse opinion if S&A cannot be obtained

ABOUT US

A Pioneer Institute in the digital classroom space, **founded by CA Ram Harsha.**

He has always catered to serve quality. As a result today, **'SHRESHTA' stands as the most preferred institution among students.** We are privileged to provide the highest standard of coaching facility for CA and CMA students at most affordable prices, turning many of our students' dreams into reality.

A Standards on Auditing

- Apply to audit of financial statements by independent auditor.
- Set high benchmarks for historical financial information.
- **Covers:** Objectives, documentation, planning, risk, evidence, opinions.

B Standards on Review Engagement

- Apply to review of financial statements.
- Provide **limited assurance** (lower than audit, fewer procedures).
- Both SAs and SREs apply to historical financial information.