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CMA INTER (G2 PAPER-10)

COMPANY AUDIT

MAIN BOOK

HIGHLIGHTS OF THIS BOOK:

- EXHAUSTIVE COVERAGE OF MODULE
- COMPLETE COVERAGE OF NEW SYLLABUS
- SIMPLE AND CONCISE LANGUAGE
- LOGICAL ARRANGEMENT OF TOPICS
- DIAGRAMMATIC PRESENTATION WHERE NEEDED

APPLICABLE FOR JUNE 25 AND ONWARDS EXAMINATION

AS PER NEW SYLLABUS 2022

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COMPANY AUDIT

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1.1

• NATURE, SCOPE, OBJECTIVES AND SIGNIFICANCE OF AUDITING

Evolution of Auditing

1. In the early days of commerce and business the concept of auditing did not exist. This was may be due to the small nature of business and day to day personal control of the proprietor. Audit can be traced back to the period 3600-3200 B.C. Initially, the audit was mainly done that of public accounts only. From historical records it appears that the ancient Egyptians, Greeks and Romans were used to conduct the government accounts audit.
2. The accounts of the corporation of the city of London were audited in 12th Century. Later in Shakespeare's "Timor of Athens" the steward Flavins makes the remark "If you suspect my husbandry or falsehood, call me before the exacts auditor, and set me on the proof" which indicates the existence of an audit in the 14th century also. In 1314, auditors were officially appointed to check the public accounts in England. In 1494, Luca Piccioli, a French celebrated mathematician, brought the concept of Double Entry book keeping and auditing in practice.
3. Gradually and especially after the Industrial Revolution in the 18th century, the nature, type and size of business organizations changed. The large-scale business came into existence causing dilution in the regular and direct control of the proprietor
4. This made it necessary to get the transactions made by the staff and representatives of owners, checked and verified by an independent person and this has given rise to the concept of auditing. In 1866, the England's Exchequer and Audit Department was created by Act of Parliament. In 1870, The Institute of Accountants in the form of a society was formed in England It got a Royal Charter in 1880 and was turned into The Institute of Chartered Accountants in England and Wales.
5. In India, the sophisticated system of accounting and auditing can be found in the reign of Maurya's, Guptas and Mughals too. The first legislation relating to companies in India, the Joint Stock Companies Act, 1857, introduced the provisions of annual audit but was made optional. Later, the Companies Act, 1913, made it compulsory. This Act was replaced in 1956 by the Companies Act, 1956. The Act and the subsequent amendments not only made the audit compulsory but sought to ensure that only the independent professionals with requisite qualifications should be appointed as statutory auditors of companies. In 1965, an amendment in the Act took place and concept of Cost Audit was introduced.

6. The amendment in the Income Tax Act, 1961, which took place in 1984, introduced the concept of Tax Audit. Sales Tax (VAT), Trust Act, Co-operative Societies Act etc. which brought the concept of Of different audits into practice. Provision for Special Valuation audit section 14A and 14AA of Excise Act, 1944 with effect from India under CAG, DPC (Act). Again, the Companies Act, 1956 has been revised as Companies Act, 2013.
7. A number of technological, economic changes, social events, globalization, liberalization, privatization etc. have influenced auditing to a great extent in the course of its development and caused considerable changes and improvements in the techniques, principles, standards, reporting, professional ethics and responsibilities of auditor.

Concept and Definitions of Auditing

A. Narrow Perspective:

The term "audit" has been derived from the Latin word "audire" which means 'to hear'. In early days, the person appointed to check the accounts, used to hear the explanations required from responsible officers and that's why, he was called as an "auditor".

Some of the definitions given by a few well-known experts in the field indeed highlight the above narrow perspective. According to Taylor and Perry - "Audit is defined as an investigation of some statements of figures involving examination of certain evidence, so as to enable an auditor to make a report on the statement.

In the words of **F.R.M De Paula**- "An audit denotes the examination of Balance Sheet and Profit and Loss Account prepared by others together with the books of accounts and vouchers relating thereto in such a manner that the auditor may be able to satisfy himself and honestly report that, in his opinion, such Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of affairs of the particular concern according to the information and explanations given to him and as shown by the books".

According to **Prof. Montgomery**- "Auditing is a systematic examination of the books and records of business or other organization, in order to ascertain or verify and to report upon the facts regarding its financial operations and the result thereof.

In the words of **M. L. Shandilya**- "Auditing may be defined as inspecting, comparing, checking, reviewing, vouching, ascertaining, scrutinizing, examining and verifying the books of accounts of a Of a business concern with a view to have a correct and true idea of its financial state of affairs.

According to **Spicer & Pegler**- "Audit such an examination of the books of accounts and vouchers of a business, as will enable the auditor to satisfy himself that the Balance Sheet is properly drawn up, so as to give a true and fair view of the state of affairs of the business, and whether the profit and loss account gives a true and fair view of the profit or loss for the financial period according to the best of his information and explanations given to him and as shown by the books, and if not, in what respect he is not satisfied".

Thus, in its narrow sense, the scope of an audit is limited to only authenticating the accounting records and thereby to assure the accuracy and reliability of the financial statements and reports

Reports

B. Broader Perspective:

Over time, with the changes in socio-economic environment, the concept of audit has also changed. Today auditing is not confined to mere authentication of financial accounting records. It is now considered to be an independent appraisal activity that extends itself towards evaluation of non-financial aspects as well.

As per the **General Guidelines on Internal Auditing** issued by The Institute of Chartered Accountants of India, "auditing is a systematic and independent examination of data, statement, records, operation and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the proposition before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report". According to them, "...auditing is the accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria".

According to SA 200, Basic Principles Governing an Audit, "an audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such examination is conducted with a view to expressing an opinion thereon".

Thus, in the broader perspective, auditing is a holistic appraisal of all the relevant aspects (be it financial or otherwise) of an enquiry sought after a stated purpose

➢ ESSENTIAL FEATURES OF AUDITING:

The essential features of auditing are enumerated below;

1. It involves evaluation & verification of the **relevance, reliability and adequacy of evidence** in support of verifiable information such as vouchers, documents, explanations.
2. It is **analytical, critical and investigative** review of systems of Accounting & Internal Controls.
3. The information audited may be **financial or non-financial.**
4. There should be standards or criteria for evaluation of the information in a **systematic & scientific manner.**
5. The auditor should be competent and **independent, qualified & possessing** prescribed qualification & certificate of practice.
6. It ensures **reliability of information and authenticity** of assertions made in the financial statements relating to enterprises, whether profit-oriented or not and whether it is required by law or not, to enable the auditor to form his opinion on these statements with regard to true &and & fair view of state of affairs of Business and of profit or loss made during financial period disclosed therein.

Nature of Auditing

Auditing has generally been associated with only accounting and financial records. Thus, International Auditing and Assurance Standard Board (IAASB) opined that "the objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework". Similarly, **Mautz** defines auditing as being "concerned with the verification of accounting data, with determining the accuracy and reliability of accounting statements and reports."

In the above definitions, the emphasis is clearly on verification of accounting data with a view to reporting on the reliability of the accounting statements. Verification of accounting data involves Involves a careful evaluation of evidence available to the auditor in support of various transactions. Transactions. Thus, an auditor examines internal evidence, i.e., the records, vouchers. To assess the quality of the internal evidence, he also tests and evaluates the relevant systems in the organization. He also obtains external evidence such as confirmation of bank balances. In some cases, he may decide to conduct physical counts and surveys or even call for independent expert opinion regarding technical matters.

However, developments in the last few decades have extended the scope of auditing. Auditing today is no longer concerned only with financial accounting records, it may also involve a review of compliance with law, costing records, operations and performances. Therefore, a more comprehensive definition is required to describe modern auditing. **The Institute of Chartered Accountants of India** has defined auditing as 'a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose'.

In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report. This definition does not confine auditing to accounting records. It recognizes that auditing can extend to such areas as managerial performances, cost data and operations.

Another good description of auditing is given by **Arens, Elder and Beasley**. According to them, "auditing is the accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria. Auditing should be done by a competent independent person."

This definition emphasizes the following points.

1. The information under audit need not necessarily be accounting information. However, information must be in a verifiable form.
2. There should be standards or criteria for evaluation of the information.
3. The auditor should not only be a competent person but he should also have an independent mental attitude.

➢ RELATIONSHIP BETWEEN ACCOUNTING AND AUDITING

The basic objective of accounting is to record all the economic events that change the financial position of the entity and to prepare a statement of performance and a statement of affairs for each accounting period. On the other hand, auditing and more specifically financial auditing is undertaken to appraise the authenticity and reliability of the of the accounting records and other relevant documents in order to arrive at a conclusive opinion as to whether the financial statements exhibit a true and fair view of the financial performance and state of affairs of the organization. Thus auditing, in its conduct, aims to detect all material misstatements and frauds and thereby put a check on the accountants and management. In other words, auditing is the critical aspect of accounting.

No.	Accounting	Auditing
1.	It is the collection, classification and summarization of data for preparation of books of accounts, and to make financial statements.	Auditing is an analytical and critical examination of books of accounts, financial records and the financial statements prepared thereon.
2.	It is the recording of transactions at the time of occurrence.	It is the post mortem examination of recorded transactions.
3.	It measures the business events in monetary terms, records them, and communicates the financial results through Financial Statements.	Auditing reviews financial records to form an opinion on the authenticity of Financial Statements.
4.	Its primary responsibility is of the management towards the shareholders or owners, to maintain the financial records in such a manner that Financial Statements can be prepared from the records.	The auditor is an independent person appointed by the business entity to review the Financial Statements and to give his opinion thereon.
5.	An accountant is not expected to review or report on the Financial Statement but to report the compilation of records to the management.	An auditor is required to submit a report with his opinion on 'true and fair' assertions made in the Financial Statements to the owners.
6.	An accountant works for the management.	The auditor is an independent person account- able to the owners or shareholders and not to the management.
7.	No such liability is there in accounting.	In certain circumstances, the auditor could be held liable to third parties also.
8.	Maintenance of accounts may not be mandatory forsmall individuals or partnership firms, e. g. under section 44AA of the Income Tax Act, but could be mandatory under other laws, e.g., for companies under the Companies Act.	Audit could be exempt for various individuals or small partnerships, e. g. under section 44AB of theIncome tax Act, and even in case where maintainingbooks of accounts is a statutory requirement undersection 44AA, but may be mandatory under otherlaws e. g. for Companies under the companies Act.
9.	Accounting is done as per the principles set by IndianAccounting standards (Ind AS)	Auditing is done as per the principal set in standardson auditing.

AUDIT AND INVESTIGATION

It is to be noted that both Auditing and Investigation have a fact-finding character. Both involve a systematic and critic al examination of the available evidence, yet these are quite distinct from each other as follows:

	BASIS	AUDIT	INVESTIGATION
1.	Meaning	Auditing is an independent and systematic examination of the evidence underlying the accounting or other data in accordance with the generally accepted auditing practices to ascertain the true and fair view of the financial statements of an enterprise.	An investigation may be defined as an examination of accounts and records with a view to ascertain any fact for some special purpose which varies from assignment to assignment.
2.	Scope	The audit has a wide scope. In statutory audit, the scope is determined by the relevant law and in case of a private audit (e.g., management audit) by a client.	The scope of investigations, on the other hand, is limited as regards the period or areas to be covered.
3.	Objective	In audit, the accounts and records are verified as to their truth and fairness.	Investigation is for special purpose (e.g., investigation on the behalf of incoming partner)
4.	Audit Procedure	The audit is conducted in accordance with the generally accepted auditing principle.	Investigations involve an extended auditing procedure.
5.	Evidence	An auditor will evaluate the accounting records predominantly based on persuasive evidence.	An investigator can draw his conclusions only on the basis of substantial or sometimes conclusive evidence.
6.	Approach	Auditor is skeptical and not suspicious.	Whereas an investigator starts with suspicion and collects evidence to either confirm or dispel that suspicion.
7.	Periodicity	Auditing is a routine exercise (normally con- ducted annually).	Investigation may spread over a period longer than one year.

1.1.4 Scope of Auditing

In ancient period, the scope of audit was really limited. But over the time the same has extended considerably.

The scope of an audit of financial statements is determined by the auditor having regard to the terms of the engagement, the requirements of relevant legislation and the pronouncements of The Institute of Chartered Accountants of India. Moreover, the auditor must also ensure that no relevant aspect of the organization is left unchecked even if it is not specifically mentioned in the terms, regulations or pronouncements. Again, the terms of engagement cannot, limit the scope of an audit in relation to matters which are prescribed by legislation or by the pronouncements of The Institute of Chartered Accountants of India.

According to SA-200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing, the scope of audit should cover the following aspects:

1. The auditor shall assess the reliability and sufficiency of the information contained in the underlying accounting records and shall undertake appropriate audit procedures for this purpose.
2. Appropriate audit procedure may include either Compliance Procedures (i.e., study of accounting system and internal control) or Substantive Procedures (i.e., testing the authenticity, accuracy and completeness of information in accounting records).
3. The auditor has to determine whether the relevant information is properly disclosed in the financial statements in conformity with the applicable generally accepted accounting principles and statutory requirements (i.e., requirements as per Accounting Standards and Companies Act).
4. The auditor's work shall involve an exercise of judgement. He shall be principally concerned with items that either individually or as a group are material in relation to the affairs of an organization

Thus, the duty of the auditor shall not be limited to mere verification of accounting entries based on the available vouchers and other documents, but he shall evaluate the authenticity of the transaction, appropriate recoding of the same in the books of accounts as well as compliance of the accounting and reporting process with prevalent statutes in this respect.

➤ BASIC PRINCIPLES GOVERNING AN AUDIT (DISCOPA3)

SA 200 issued by The Institute of Chartered Accountants of India gives the following basic principles that govern the auditor's responsibilities whenever an audit is carried out:

1. **Integrity, objectivity and independence:** The auditor should be straight-forward, honest, sincere and free form any influence on his audit work. He should maintain impartiality and be free of any interest.
2. **Confidentiality:** He should not disclose the client's information to anybody without the client's permission or under any regulatory requirement.
3. **Skills and competence:** The audit should be performed and audit report be prepared by adequately trained, experienced and competent person.
4. **Work performed by others:** The auditor should carefully supervise the work performed by others (such as his subordinates, other auditors, experts etc.) as remains responsible for the work delegated by him to his assistants, other auditors or experts.
5. **Documentation:** Proper working papers should be maintained by the auditor to evidence the audit work. Working paper which is maintained is to demonstrate that the audit is in adherence to the basic principles.
6. **Planning:** The auditor should obtain the knowledge about client's business to determine the nature, timing and the extent of the audit procedures.
7. **Audit evidence:** The auditor should obtain sufficient appropriate audit evidence through performing the compliance and substantive procedures.
8. **Accounting system and internal controls:** An understanding of the accounting system and the related internal controls help in determining the nature, timing and extent of other audit procedures.
9. **Audit conclusions and reporting:** On the basis of conclusions drawn from the audit evidence obtained the auditor should give unqualified report or qualified report or adverse report or the disclaimer report.

Objectives of Auditing

Objectives of Auditing

- Primary Objectives
- Secondary Objectives

According to SA 200, Overall Objective of the Independent Auditor and the Conduct of an Audit as per Standard of Auditing, in conducting an audit of financial statements, the overall objectives of the auditor are:

1. To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
2. To report on the financial statements, and communicates as required by the SAs, in accordance with the auditor's findings".

1. Primary Objective: The main objective of an audit is to determine whether the financial statements present a " true & fair view" of the financial position and financial performance of a business during the period. The Balance Sheet shows the financial position on a particular date (say, the last day of the financial year), and the profit & loss Accounts shows the financial performance of the business over that period (income and expenditure during the whole financial year). Section 143 of the companies Act, 2013 requires the auditor of the company to state if in his opinion the financial statements present "true and fair view" of the state of the company's affairs at the end of its financial year, and of the profit and loss for its financial year. Such an opinion by the auditor increases the reliability of the Company's financial statements.

2. Secondary Objective: The auditor is also responsible for detecting frauds and errors in the books of accounts and financial records of the client's business. Such detection of frauds and errors is called the secondary objective of audit because the primary responsibility for safeguarding the business assets rests with the management. If the auditor suspects the presence of material misstatements or defalcations in the records of the business, he is expected to look into the matter with greater detail by applying various audit procedures to satisfy himself about their existence or non-existence. He is also to report on the existence of such misstatement and their magnitude through his audit report.

In the process of adhering to the above objectives, an audit also attains certain **social objectives** as follows:

1. To protect the shareholders' interest of shareholders.
2. To stop evasion of taxes
3. To safeguard against capital erosion
4. To ensure fair return on investors
5. To ensure reasonable price to customers
6. To ensure fair compensation to workers
7. Complying with polices regarding corporate social responsibilities

Significance of Auditing

❖ From Legal Point of View:

1. **Filing of Income Tax Return** – Income Tax authorities generally accept the profit and loss account that has been prepared by a qualified auditor and they do not go into details of the accounts.
2. **Borrowing of Money from External Sources** – Money can be borrowed easily on the basis of audited balance sheet from the external sources. Most of the financial institution sanctions various loans on the basis of audited financial statements.
3. **Statement of Insurance Claim** – In case of flood, fire, other natural calamities and the like unexpected happenings the insurance company may settle the claim for loss or damages on the basis of audited accounts of the previous year.
4. **Sales Tax Payments** – The audited books of accounts may generally be accepted by the sales tax authorities.
5. **Action Against Bankruptcy** – The audited accounts serve as a basis to determine action in bankruptcy and insolvency cases.

❖ From Internal Control Point of View

1. **Quick Discovery of Errors and Frauds** – Errors and frauds are located at an early date, so that in future no attempt is made to commit such frauds as one is rather careful not to commit an error or a fraud as the accounts are subject to regular audit.

2. **Moral Check on the Employees** – The auditing of the accounts keeps the accounts clerks and the accountants regular and vigilant as they know that the auditor would complain against them if the accounts are not prepared up to date or if there is any irregularity.

3. **Advice to the Management** – It may happen that the management may consult the auditor and seek advice on certain technic al points although it is not the duty of the auditor to give advice.

4. **Uniformity in Accounts** – If the accounts have been prepared on a uniform basis, accounts of one year can be compared with other years and if there is any discrepancy, the cause may be enquired into.

❖ From External Affairs Point of View

1. **Settlement of accounts** – The audited accounts would facilitate the settlement of accounts of a deceased partner.

2. **Valuation of assets and goodwill** – If the business is to be sold as a going concern basis, there may not be much difficulty regarding the valuation of assets and goodwill as the accounts have already been audited by an independent person.

3. **Future trend of the business** – From the audited books of accounts, the future trend of the business can be assessed easily with certainty.

➢ ADVANTAGES OF AUDIT

The advantages of audit are as follows:

1. Audit is a tool, which different stakeholders can use to protect their interests in the enterprise.
2. Audit is not only a corrective measure but has a deterrent effect. It serves as a moral check on the employees from committing defalcations or embezzlements.
3. The employees of the organisation remain alert and vigilant as regards the updating of books of accounts and other records.
4. Audited accounts are considered more reliable by different cadres of Government. For example, the tax audit report filed with the taxation authorities.
5. It facilitates detection of wastages and losses and helps in instituting corrective actions.
6. Audited accounts are taken to be more reliable and useful during corporate restructuring exercises, valuations etc.
7. Banks, Financial Institutions and Government require audited accounts before granting any financial assistance to the enterprise.

8. Audited accounts are taken to be more helpful in the settlement of accounts between the partners and thus avoiding any dispute amongst them.

➢ INHERENT LIMITATIONS OF AN AUDIT

There are some inherent limitations of audit.

As per SA 200, the objective of an audit is to express an opinion as to the true and fair view of the financial statements. The user should not believe that this option is as assurance as to the future viability of the enterprise or the efficiency or effectiveness with which the management has conducted the affairs of the enterprise. Again, the scope of audit is determined by the terms of engagement, requirement of relevant legislation and pronouncements of The Institute of Chartered Accountants of India (CA). Thus, the appointing authority cannot restrict the scope of an audit in relation to those matters which are prescribed by the relevant legislation and the pronouncements of The Institute of Chartered Accountants of India (CA). While the auditor is responsible for forming and expressing his opinion on the financial statements, the responsibility for their preparation is that of the enterprise. Management's responsibility includes the maintenance of adequate accounting records and internal controls, selection and application of accounting policies and safeguarding the assets of the enterprise. The audit of financial statements does not relieve the management of its responsibilities. Despite these guidelines issued by the The Institute of Chartered Accountants of India (CA), it is very important to note the following inherent limitations of audit.

1. An audit does not guarantee that all the material misstatements will be detected because of the following inherent limitations of audit:

a. Test nature of the audit;

b. The audit evidence available to the auditor is persuasive rather than conclusive in nature;

c. Inherent limitations of internal control

2. Professional scepticism means an approach that would ensure that if something is wrong it is detected. This behavior of auditor helps him in identifying and evaluating (a) matters that increase the risk of material misstatements resulting from fraud or error, (b) circumstances that make the auditor to suspect material misstatements, (c) the question of reliability of management's representations. The auditor is entitled to accept the records and documents as genuine unless there is some evidence to the contrary.

3. Materiality is one of basic fundamental concepts in process of Auditing as well as Accounting. Auditor has to constantly & continuously judge whether transaction is material or not. It is used

by him in his Audit Planning. Materiality means important cost wise, profit wise, effect wise, value wise; which influences economic decision of user. What is material in one circumstance, may not be material in another circumstances. Therefore, changes need to be done accordingly.

➤ CLASSIFICATION OF AUDITING

A. ORGANIZATIONAL STRUCTURE-WISE CLASSIFICATION

1. Statutory Audit

Statutory audit is the checking of accounts as required by law. A statute or law may require having an annual audit of financial records of a company or any other entity. The law may require the audit to be conducted in the specified manner. The manner of reporting, contents of the report and the authority to which the report of auditors should be presented are all specified by the statute. Statutory audits are mandatory in nature. The statutory auditor is generally the principal auditor in an organization.

1. In the case of companies, the Companies Act, 2013 governs the audit of accounts, its reporting, and manner of preparing the audit report.
2. In the case of audit of a government body, the scope and audit programmers are set by the Comptroller and Auditor General (CAG) of India and the Companies Act, 2013.
3. In the case of audit of an insurance company or a nationalized bank, the audit is governed by specific statutes and IRDAI/RBI (Insurance regulatory & Development Authority of India & Reserve Bank of India) guidelines. Co-operative banks are also governed by the Co-operative Societies Act, 1912

The statutory auditor of a company is appointed by the board /shareholders in the General Meeting and shareholders cannot delegate this power to directors even by passing a special resolution.

A statutory auditor can be appointed by the Central Government if shareholders fail to appoint an auditor. A statutory audit should be performed by a qualified Chartered Accountant holding a valid Certificate of Practice (COP) and not by any other person.

Advantages of Statutory Audit

The auditor expresses his independent opinion after following relevant audit procedures and checking the external and internal evidences necessary for the conduct of audit. He comments on the truthfulness and fairness of statement of affairs of the 14rganization as on certain date and also about the fact that no misstatement or misrepresentation has been made in the Financial

Statements under report.

Financial Statements which may further be used by different users for various purposes such as:

1. By the shareholders, for their economic decisions and for exercising their voting rights.
2. For timely tax assessments.
3. For determining the purchase or sale consideration in case of ongoing concern.
4. Settlement of partners' accounts in case of admission, retirement or death of partner on account of goodwill or otherwise.
5. Before the court, in case of settlement of disputes with employees, creditors or debtors.
6. For determining the actual value of business or shares in case of merger, acquisition, etc.
7. For getting financial assistance from financial institutions, banks or investors.
8. In case of non-profit organisations, for getting government grants and availing tax exemptions.
9. Evaluation of the internal control systems and strengthening it by removing the inherent weaknesses, and checking the efficacy of the internal checks.
10. For checking the integrity of the management which manages the funds and affairs on behalf of the real owners or shareholders.
11. For other users of financial statements like creditors, investors and government agencies, it ensures that any assertions in the Financial Statements are neither overstated/understated nor misrepresented.
12. For the proper distribution of profits by way of payment of wages and other benefits.
13. For ensuring of proper distribution of profits as dividends.
14. For ensuring that all legal requirements are fulfilled and statutory compliances are adhered.
15. For settlement of insurance claims or other recoveries from government bodies or otherwise.

2. Non-Statutory Audit

When audit is conducted without any legal requirement, it is called non-statutory audit or private audit. This kind of audit is arranged purely voluntarily or sometimes as per internal rules of the organisations. Here the auditor is appointed as per an agreement which determines the nature and scope of audit to be conducted, the rights and duties of the auditor, requirement of reporting etc. Sole-proprietors, partnership firms, non-profit seeking organisations such as clubs, associations of persons, hospitals, etc, get their accounts audited to make them reliable and acceptable to their stakeholders. Some of these benefits are stated below:

Advantages of Auditing for Sole Proprietors

1. It evaluates the internal control system and strengthens it by removing weaknesses, if any.
2. It increases the reliability and authenticity of Financial Statements.
3. It helps in timely finalization of Annual Financial Statements and tax assessments.
4. It keeps a moral check on the working of employees.
5. It helps them in obtaining funds easily from financial institutions, based on more reliable Financial Statements available to the banks and financial institutions.
6. It helps in settling Trade disputes, Labour disputes and Insurance claims

Advantages of Auditing for Partnership Firms & Others

The added advantages besides other advantages are enumerated below;

1. It helps in settlement of accounts among the partners on the basis of more reliable accounting records.
2. It protects the interest of minors, sleeping partners/ partners who are not involved in day-to-day operations, and keeps a check on persons who are working on behalf of others.
3. It helps in partnership firms for settlement of goodwill at the time of admission, retirement and death of partners.
4. It enables firm to get loans from banks, financial institutions as they rely on audited accounts of firm.

Due to these advantages, even the entities which are not under any statutory obligation of statutory audit get their accounts voluntarily audited to get the underlying benefits.

B. OBJECTIVE-WISE CLASSIFICATION OF AUDIT

1. Internal Audit

The Institute of Chartered Accountants of India describes Internal Audit as "an independent management function, which involves a continuous and critic al appraisal of the functioning of entity with a view to suggest improvements thereto and to add value and strengthen the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system. Internal Audit, therefore, provides assurance that there is transparency in reporting, a part of good governance".

Internal Audit being an independent appraisal function ensures objectivity and consultation which enhances the value and improves an organisation's operations. It not only includes matters related to finance but also critical appraisal of the policies and procedures of the company. Internal Audit is based on principle of "early detection & prevention of further damage". It points out irregularities, non-compliances timely and not after year end as in case of Statutory Audit.

2. Independent Financial Audit

An independent financial audit may be conducted by a qualified auditor at the request of a client, which may be a sole-proprietorship, partnership, non-profit organisation or any other entity. Its objective is to comment on the truthfulness and fairness of the Financial Statements, and it may be compulsory under some Acts which govern the entity.

C. PERIODICITY-WISE CLASSIFICATION OF AUDIT

1. Periodical or Final Audit

Final Audit is conducted at the end of the accounting year, after the books of accounts have been closed. It does not interrupt with the regular functioning of the client's accounting or operations functions and ensures completion of work in one session due to continuity. The auditor may use statistical sampling methods and techniques which lead to time effectiveness. The possibility of tampering with the books of accounts during the audit is considerably reduced as the audit work starts only after the books are closed.

Advantages and Limitations

Final audit is cost effective and ensures continued focus, planned approach to work and non-Interference with client's accounting work being continued.

However, a major disadvantage of annual audit is that all the errors and frauds are found at the end of the accounting year, which makes it very difficult to fix responsibility for defalcations. It delays the presentation of Audited Financial Statements to the shareholders and to prevent the delay, the auditor uses sample testing, which also reduces the possibility of detection of frauds and errors.

2. Interim Audit

Interim audit is the audit conducted between two annual audits. It may be conducted for a specific period, such as a quarter or half year, with an interim object of declaration of interim dividend or valuation of shares on a certain date, in case of mergers

It is carried out by professionals, but has no legal status as the figures may be altered subsequently.

It is useful for:

1. Ascertainment of interim profit and loss and declaration of interim dividend.
2. Change in the structure of a partnership firm.
3. Determining goodwill and net worth of any business for acquisition purpose.
4. Investigation of any suspected fraud.
5. Obtaining loans from financial institutions.

3. Continuous Audit

According to the Institute of Internal Auditors, USA, continuous auditing is "a method used to perform control and risk assessments automatic ally on a more frequent basis. Continuous auditing changes the audit paradigm from periodic reviews of a sample of transactions to ongoing audit testing of 100 percent of transactions. It becomes an integral part of modern auditing at many levels. technology is a key to enabling such an approach."

Continuous audit may be defined as the examination and verification of a firm's financial transactions and their supporting documents, continuously throughout the year, at regular or irregular intervals.

Basic Features of Continuous Audit

1. It is a process conducted throughout the year.
2. It is conducted at regular or irregular intervals.
3. It focuses on testing 100% of transactions.
4. Technology is important to enable it.
5. It provides advance notice about errors and irregularities detected.
6. Surprise visits by the auditor are involved

Necessary of Continuous Audit

1. Internal controls are inadequate.
2. The transactions run in large numbers.
3. The management is interested in getting statements of accounts audited periodically for enabling better management of resources.

The Advantages of Continuous Audit

1. Early location of errors and frauds: It helps in detecting errors and frauds immediately on their occurrence, and not at the year end when it would become difficult to install corrective control mechanisms.
2. Quick rectification: rectification of errors at an early stage is possible.
3. Guidance: Continuous guidance to client.
4. Finalizations of accounts completion in time: Just at the end of the accounting period.
5. Moral check: Make employees of the client alert and more efficient in conducting their work.
6. Improves statutory auditor's focus: It relieves statutory auditors of routine testing and allows them to focus efforts on more valuable activities

Demerits of Continuous Audit

1. The records and figures in the books of accounts, which have already been checked by the auditor,
2. Frequent visits made by the auditor may cause inconvenience at times inconvenient at work.
3. The client may suffer due to the clash of duties between his staff and that of the auditor clash Of
4. It is more expensive because the auditor has to devote more time to this audit.
5. The work of audit becomes too mechanical and repetitive work.

D. **SCOPE WISE CLASSIFICATION OF AUDIT**

1. Complete Audit: A complete audit is an audit where the scope of audit is not confined to specific limits, which may be set by the management or any other authority. The auditor is required to check all the possible aspects of a business, including manufacturing operations, data flow processes, accounting records and procedures, etc. In general, business practices, it is not feasible to get a complete audit conducted.

2. Partial Audit: A partial audit is a non statutory audit, which restricts the scope of the auditor to checking of certain specific aspects only. The auditor's powers to enquiry are restricted by his terms of engagement. He may not be allowed to obtain information which falls outside the purview of the scope defined for him. E.g., an auditor may be appointed to check the accuracy of recording of transactions relating to c ash sales, or he may be appointed to conduct an audit for the month of Diwali only.

3. Detailed Audit: Detailed audit is also known as audit-in-depth. It involves checking of transactions from the time of their recording till their final effect on the Financial Statements. Every stage that a transaction goes through in the accounting process is closely examined by the auditor using various audit evidences.

E. SUBJECT MATTER -WISE CLASSIFICATION OF AUDIT.

1. Cost Audit

Cost Audit involves an examination of cost books, cost accounts, cost statements and subsidiary and prime documents with a view to satisfying the auditor that these represent true and fair view of the cost ofproduction. This includes the examination of the appropriateness of Cost Accounting system.

The Institute of Cost Accountants of India on the other hand, defines cost audit as "a system of audit introduced by the Government of India for the review, examination and appraisal of the cost accounting records and attendant information, required to be maintained by specified industries."

Cost Audit renders invaluable services to various parties connected with the business directly or indirectly.It acts as a tool of control in the hands of management enabling it to identify the areas of inefficiency and wastage.

2. Management audit

Management audit is a comprehensive and critical review of each and every aspect of the management process. It is basically a tool of management control. It covers all areas of management like planning, organising, co-ordination and control. It assists managers at all levels in the effective discharge of managerial functions.

Management audit is a forward-looking, independent and systematic evaluation of the activities of the management for the improvement of the organisational profitability and attainment of other predefined objectives of the organisation through well directed management function. It acts as a guide, which helpsin improving the efficiency of the management.

3. Operational Audit

Operational Audit involves examination of all the operations and activities of the entity under audit. The objective of operational audit includes the examination of the control structure of the entity, the relation of department controls to general policies and its relation with control of other departments. It provides anappraisal of whether the department is operating in conformity with prescribed standards and procedures laid down by the management.

It checks whether standards of efficiency and economy are maintained. It is concerned with formulation of plans and checking of the implementation of systems and controls in respect of other departments of the entity. It also checks whether capacity utilization in production department and achievement of short- term targets in marketing departments and other activities are so economically performed to achieve the predefined overall goals of the entity.

Operational audit, in its initial stages, was developed as a branch of internal auditing. Internal audit focuses on accounting operations of the entity but operational audit has a wider scope of working and covers all other operations, such as production and marketing too.

Operational audit is one of the management tools to get first hand information. It is more useful in an entity where the management is at a distance from actual operations. It is very useful in large organisations where management cannot control the actual operations due to layers of delegation of responsibility. The management information system has various tools like routine performance report from department heads, internal audit reports, surprise checks, periodic inspections and investigation to control the managers responsible for their departments. The operational audit is also one of the tools used in large or geographically vast entities to control the operation at first stage and to fill up the gaps of information provided by department heads through periodic reports.

4. Tax Audit

Tax audit can be defined as 'an examination of financial records to assess correctness of calculation of taxable profit, to ensure compliance with provisions of the Income Tax Act and also ensure fulfilment of conditions for claiming deductions under Income Tax Act.' Tax audit is required in addition to the financial audit since taxable income largely differs from accounting profit because of various allowances,disallowances, deductions and exemptions suggested under tax laws.

In India, the Income Tax Act, 1961 contains a number of provisions requiring tax audit of an entity. Section 44AB gives the provisions relating to the class of taxpayers who are required to get their accounts auditedfrom a chartered accountant. The audit under Section 44AB aims to ascertain the compliance of various provisions of the Income-tax Law and the fulfilment of other requirements of the Income-tax Law. The prime objective of tax audit is to stop tax evasion.

5. Social Audit

Business is a social institution and evolves out of social environment. In course of earning profit businesstakes resources from society, so in return they should discharge certain duties to society also for long termsustainability. In order to measure and examine how far the business concerns have been able to dischargetheir social responsibility, that is, how much contribution has been made by the concern towards social welfare, the concept of 'social audit' was introduced in business arena.

Social audit is defined as the system of independent evaluation of operations of an organisation, examination of records relating to social responsibility accounting and critical appraisal of the impact of organisationson the society.

Social audit is not mandatory in most of the countries including India. This exercise is often undertaken bybusiness houses voluntarily.

6. Propriety Audit

Propriety audit is the independent and systematic evaluation of the appropriateness of management decisions on the basis of public interest, financial discipline and behavioral standards. In other words, it is an evaluationas to whether decisions have been undertaken in tune with the accepted rules, standards, policy and delegated power. The objective of propriety audit is to ensure safeguard of assets, check misappropriation of funds,misutilization of delegated authority and increase the productivity of management etc.

In India, propriety audit is not separately practiced. However, the Companies Act, CARO and other legislations contain sufficient provisions that require performance of propriety audit in the context of conventional statutory audit.

7. Forensic Audit

Forensic audit involves examination of legalities by blending the techniques of propriety audit, regularity,investigative and financial audits. The objective is to find out whether or not true business value has beenreflected in the Financial Statements and in the course of examination to find whether any fraud has takenplace.

Major accounting scandals involving Enron, World Tel, Parmalat and Satyam have been widely reported.In all these cases, the methods and purpose of manipulations in the Financial Statements were peculiar tothe motives of such manipulations.

The Companies (Auditors' Report) Order, 2016, requires auditors to report, amongst others, "whether anyfraud on or by the company has been noticed or reported during the year. If yes, the nature and the amountinvolved are to be indicated". In this background, the techniques of forensic auditing have gained importance.

8. Performance Audit

A performance audit is an independent assessment of an entity's operations to determine if specific programs or functions are working as intended to achieve stated goals. Performance audits are typically associated with government agencies at all levels as most government bodies receive federal funding.

Performance audits serve a fundamental purpose of government accountability. Through performance audits government entities are held to objective standards of executing the responsibilities that they are legally authorized and charged to carry out.

9. Secretarial Audit

Secretarial audit is also a relatively new concept and is coming to be recognized with growing complexities the corporate laws. Compliance with the provisions of various corporate laws is as important to be in the Any failure to comply with corporate laws may invite heavy penalty and/or even imprisonment.

It is therefore imperative for corporate entities to ensure compliance with the applicable legal requirements which are numerous. A secretarial audit assures the corporate body that the legal requirements have beenduly complied with and in time. If non-compliances are noticed by the auditor, management will have to rectify the situation with mush lesser problems and costs.

10. Human Resource Audit

Human Resource Audit is a comprehensive method of objective and systematic verification of current practices, documentation, policies and procedures prevalent in the HR system of the organization. An effective HR audit helps in identifying the need for improvement and enhancement of the HR function. Italso guides the organization in maintaining compliance with ever-changing rules and regulations. HR audit, thus, helps in analyzing the gap between 'what is the current HR function' and 'what should be/could be the best possible HR function' in the organization.

Though HR auditing is not mandatory like financial auditing, yet, organizations these days are optingfor regular HR audits in order to examine the existing HR system in line with the organizations policies, strategies and objectives, and legal requirements. HR auditor can be internal or external to the organization.

11. Information Systems Audit

According to Ron Weber, "Information systems auditing is an organizational function that evaluates assetsafeguarding, data integrity, system effectiveness, and system efficiency in computer-based information systems". The effectiveness of an information system's controls is evaluated through an information systems audit. An audit aims to establish whether information systems are safeguarding corporate assets, maintaining the integrity of stored and communicated data, supporting corporate objectives effectively, and operatingefficiently. It is a part of a more general financial audit that verifies an organization's accounting records and financial statements.

The factors that led to the development of Information System Audit are:

1. The consequences of losing the data resource;
2. The possibility of misallocating resources because of decision based on incorrect data or decision rules;
3. The possibility of computer abuse if computer systems are not controlled;
4. The high value of computer hardware, software, and personnel;
5. The high costs of computer error;
6. The need to maintain the privacy of individual persons; and
7. The need to control the evolutionary use of computers.

12. Environmental Audit

Environmental audit is an excellent management tool for relating productivity to pollution. Environmentalaudit is the examination of the correctness of environmental accounts. In broader sense, environmental auditing is the examination of accounts of revenues and costs of environmental and natural resources, theirestimate, depreciation and values recorded in the books of accounts.

In India, recognizing the importance of environmental audit, its procedure was first notified under the Environment (Protection) Act, 1986 by the Ministry of Environment of Forests. Under this Act, every person carrying operations of an industry, operation or process requiring consent under Section 25 of the Water (Prevention & Control of Pollution) Act, 1974

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• BRIEF INTRODUCTION TO AUDITING STANDARDS

Concepts

Standards on auditing are a set of well-defined guidelines which are followed by auditors in conducting audit of the client's accounts. These are formulated by professional bodies of accountants based on the collective deliberations and suggestions received from various interested groups or potential stakeholders including industry, academia and regulators. The Standards provide principles and techniques expected to be followed by an auditor in order to improve the quality of his audit work.

Purpose of Standards of Auditing

Standards of auditing serves a number of purposes as follows:

1. Standards act as a ready reference of the procedures to be followed by an auditor under a given
2. Adherence to Standards reduces audit risk considerably.
3. An auditor conducting the audit work based on the relevant standards can always defend himself against possible allegations of negligence
4. Standards improve the quality of audit work and thereby restore the public trust on the profession.

International Auditing and Assurance Standards Board (IAASB)

In 1977, the International Federation of Accountants (IFAC) was established with a view to bring harmony in the profession of accountancy on an international scale. In pursuing this objective, the IFAC Board established the International Auditing and Assurance Standards Board (IAASB)

The IAASB functions as an independent standard setting body under the auspices of IFAC. The objective of the IAASB is to serve public interest by developing and issuing high quality auditing standards and by facilitating the convergence of international and national standards, thereby enhancing the uniformity and quality of audit practice throughout the world and strengthening Public confidence on the audit profession globally.

Auditing and Assurance Standards Board (AASB)

The Institute of Chartered Accountants of India is one of the founder members of the International Federation of Accountants (IFAC). Hence, it is one of the membership obligations of the Institute of Chartered Accountants of India to actively propagate the pronouncements of International Auditing and Assurance Standards Board (IAASB) of the IFAC to contribute towards the global harmonization and acceptance of the Standards issued by IAASB.

Accordingly, The Institute of Chartered Accountants of India constituted the Auditing Practices Committee (APC) in 1982 to develop Statements on Standard Auditing Practices (SAPs). In July 2002, the APC was converted into the Auditing and Assurance Standards Board (AASB). The composition of the AASB is fairly broad-based and attempts to ensure participation of all interest groups in the standard setting process. Apart from the elected members of the Council of The Institute of Chartered Accountants of India, the Board includes members from profession, members from SEBI, RBI, IRDA, IIMs, industry associations etc

The following are the objectives and functions of the Auditing and Assurance Standards Board:

1. To review the existing and emerging auditing practices worldwide and identify areas in which Standards on Quality Control, Engagement Standards and Statements on Auditing need to be developed
2. To formulate Engagement Standards, Standards on Quality Control and Statements on Auditing so that these may be issued under the authority of the Council of the Institute.
3. To review the existing Standards and Statements on Auditing to assess their relevance in the changed conditions and to undertake their revision, if necessary.
4. To develop Guidance Notes on issues arising out of any Standard, auditing issues pertaining to any specific industry or on generic issues, so that those may be issued under the authority of the Council of the Institute.
5. To review the existing Guidance Notes to assess their relevance in the changed circumstances and to undertake their revision, if necessary.
6. To formulate General Clarifications, where necessary, on issues arising from Standards.
7. To formulate and issue Technical Guides, Practice Manuals, Studies and other papers under its own authority for guidance of professional accountants in the cases felt appropriate by the Board.

Structure of Pronouncements Issued by AASB

In order to facilitate understanding of the scope and authority of the pronouncements of the AASB issued under the authority of the Council of The Institute of Chartered Accountants of India, a revised preface titled Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services has been issued which has come into effect from April 1, 2008. Accordingly, the pronouncements by AASB are covered by the following two broad categories of Standards:

A. Engagement Standards: The following Standards issued by the Auditing and Assurance Standards Board under the authority of the Council are collectively known as the Engagement Standards:

1. Standards on Auditing (SAs), to be applied in the audit of historical financial information.
2. Standards on Review Engagements (SREs), to be applied in the review of historical financial information.
3. Standards on Assurance Engagements (SAEs), to be applied in assurance engagements, other than audits and reviews of historical financial information.
4. Standards on Related Services (SRSs), to be applied to engagements involving application of agreed- upon procedures to information, compilation engagements, and other related services engagements, as may be specified by The Institute of Chartered Accountants of India.

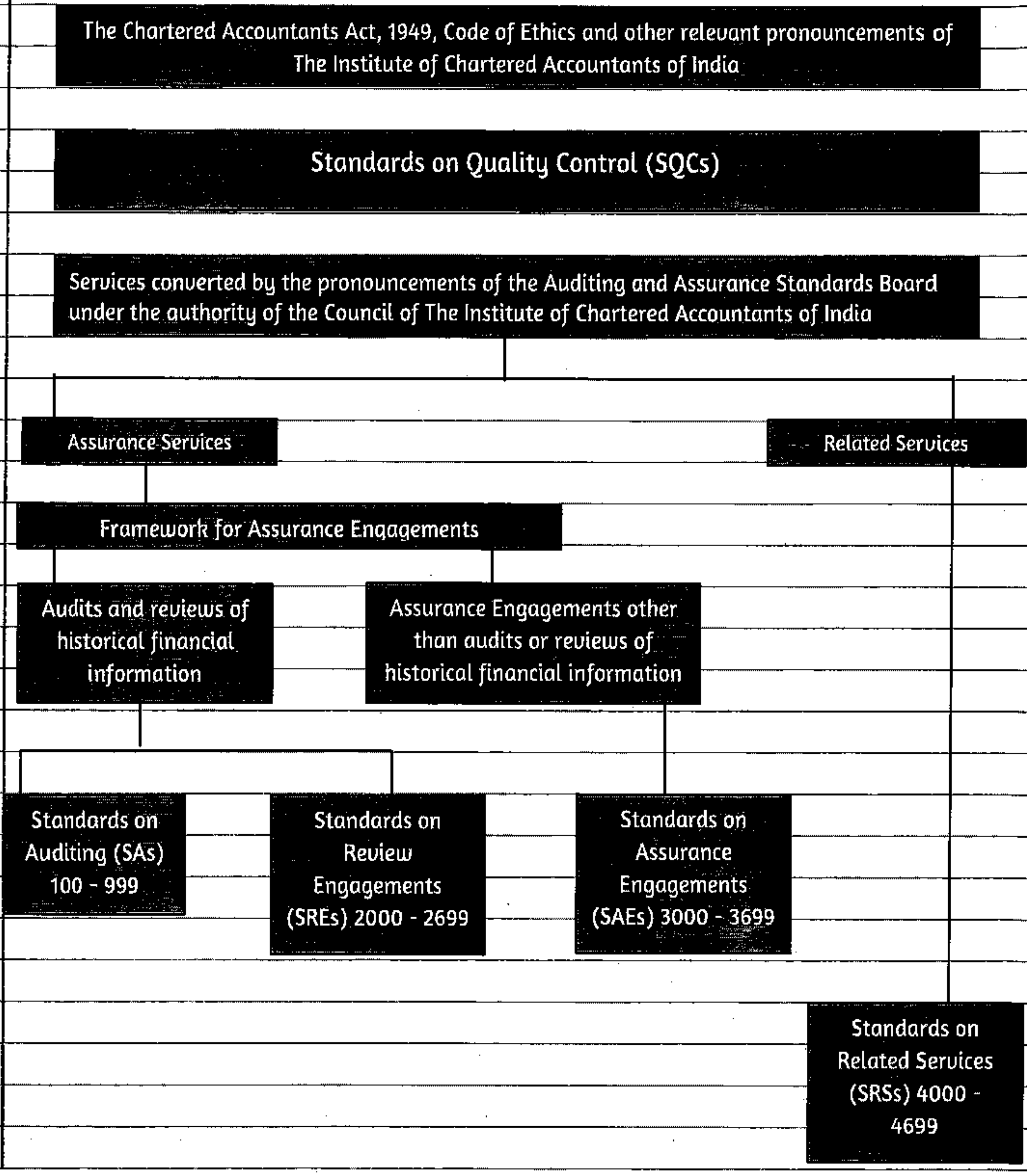
B. Standards on Quality Control (SQCs): These are issued by the AASB under the authority of the Council and are to be applied for all services covered by the Engagement Standards as described above

In addition to above, AASB issues the following:

1. **Statements on Auditing:** These are issued with a view to securing compliance by professional accountants on matters which, in the opinion of the Council, are critical for the proper discharge of their functions. Statements are, therefore, mandatory.
2. **General Clarifications:** These are issued by the Board under the authority of the Council of the Institute with a view to clarify any issues arising from the Standards. General Clarifications are mandatory in nature.
3. **Guidance Notes:** these are issued to assist professional accountants in implementing the Engagement Standards and the Standards on Quality Control issued by the AASB under the authority of the Council. Guidance Notes are also issued to provide guidance on other generic or industry specific

audit issues, not necessarily arising out of a Standard.

The Structure of Standards issued by AASB under the authority of the Council of The Institute of Chartered Accountants of India is given in the following diagram (Source: The Institute of Chartered Accountants of India)



Procedures for Issuing Standards on Auditing

Auditing and Assurance Standards Board (AASB) of the Institute formulates the auditing standards. Broadly, the following procedure is adopted for the formulation of Standards on Auditing (SAs):

a. The Auditing and Assurance Standards Board identifies the areas where auditing standards need to be formulated and the priority in regard to their selection.

b. In the preparation of Auditing Standards, AASB is assisted by study groups/task force constitute to consider specific project. Study group comprising of a cross section of members of the Institute. The study group/task force will consider the specific subject and prepare the primarily draft of Standards.

c. Based on the work of the study groups, an exposure draft of the proposed Standards is prepared by the Committee and issued for comments by members of The Institute of Chartered Accountants of India

d. After taking the comments into consideration, AASB finalize the draft and submit to the Council of the Institute.

e. The Council on its review of the draft, makes suitable modifications in consultations with the AASB and then Standards/Statements is issued under the authority of the Council. While formulating the auditing standards, the Board also takes into consideration International Standards on Auditing (ISA) issued by the International Auditing Practices Committee (IAPC), applicable laws, customs, usages and business environment in the India.

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• AUDIT ENGAGEMENT, PROGRAM, DOCUMENTATIONS, EVIDENCE, NOTE BOOK

Audit Engagement

In case of statutory audit, the appointment of the auditor and his duties and responsibilities are governed by the respective statutes. In all other organizations, however, these are decided by the agreement between the auditor and the client. Such an agreement plays a significant role in the conduct of audit of the client because if the auditor is held responsible for anything beyond the nature and scope of the current engagement, he can be relieved without any doubt. In addition, existence of an agreement can easily avoid any misunderstanding or ambiguity in future. Thus, it is desirable that before commencement of audit, the auditor and the client must agree on the terms of engagement and the auditor should send an audit engagement letter in the interest of both of them.

As per SA-210, Agreeing the Terms of Audit Engagements, an auditor and the client should agree to the terms of audit engagement prior to commencement of the audit. The agreed terms should then be recorded by the auditor in an audit engagement letter or any other suitable form of written agreement. However, if the law or regulation prescribes in sufficient detail the terms of audit engagement, the auditor need not record them in written agreement.

CONTENTS OF AUDIT ENGAGEMENT LETTER

As per SA-210, Agreeing the Terms of Audit Engagements, every engagement letter as per should contain the following:

1. Objective & scope of engagement
2. Management responsibility
3. Existence of inherent limitations
4. Need for use of Internal Auditor
5. Management confirmation letter
6. Restrictions & limitations of Auditor liabilities
7. Basis of computation of Audit fees
8. Billing arrangement
9. Form of report & Other communications of engagement

10. **Validity of report**
11. **Limits on submission of report to other authorities**

Audit Programme

An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions.

As per SA 300, Planning an Audit of Financial Statements, the auditor should prepare a written audit programme setting forth the procedures that are needed to be implemented while carrying out the audit plan. He may take into account the reliance to be placed on internal controls. The auditor has some flexibility in deciding when to perform audit procedures. But sometimes he may have no discretion as to timing, such as, observing the stock taking by the client's personnel. The audit programme should consider previous year's audit programmes and these may be modified, if necessary.

An audit programme may be classified into two categories:

1. Programme common to all types of audits - For example, checking of books of accounts; and
2. Special programme containing the work relating to a particular audit. For example, the audit programme for a partnership firm would be different from that of a company.

ADVANTAGES OF AUDIT PROGRAMME

The main advantages of an audit programme are enumerated below;

1. It serves as a ready check list of audit procedures to be performed.
2. The audit work can be properly allocated to the audit assistants or the article Clerks
3. The auditor may easily know the extent of work done at any point of time. Thus, the progress of work done can be under the supervision and control of the auditor.
4. Audit programme would not only be useful for the audit assistants in carrying the audit work but for the principal too as he would be in a position to account for the individual responsibilities.
5. A uniformity of the work can be attained as the same programme would be followed from time

to time.

6. t is a useful basis for planning the programme for the following year it is useful in selection of team members & delegation of responsibilities to them.

7. It may be used as evidence by the auditor in the event when any charge is brought against him.

8. It is useful in selection of Team members and delegation of responsibilities to them.

9. He can prove that there has no negligence on his part and he exercised reasonable care and skill while performing the task.

DISADVANTAGES OF AUDIT PROGRAMME

The main disadvantages of an audit programme are enumerated below;

1. The auditor's task becomes mechanical and the auditors may lose interest and initiative.
2. Drawing up of an audit programme may be unnecessary for a small concern.
3. Though audit programme helps in fixing responsibilities but inefficient staff may defend themselves by stating that the matter was not contained in the audit programme.
4. Rigid programs cannot be laid down for each type of business.

Audit Documentation (Audit Working Papers)

In course of audit of an organization, an auditor adopts various methods and procedures to accumulate and thereafter analyze audit evidences and other important documents to reach at some meaningful conclusion regarding his engagement. Audit working papers include all such records kept by an auditor in relation to the evidences accumulated, methods and procedures adopted and conclusions reached during the course of the audit.

As per SA-230, 'Audit Documentation', audit working papers (also called audit documentation) refer to the record of audit procedures performed, relevant audit evidences obtained and conclusions the auditor reached.

Such records can be kept either in physical form or in an electronic form.

PURPOSE OF AUDIT WORKING PAPERS

According to SA-230, 'Audit Documentation', audit working papers or audit documentation serves a number of purposes as follows:

1. Providing evidence of auditor's basis for a conclusion about the achievement of the overall

objectives of the auditor.

2. Providing evidence that audit was planned and performed in accordance with Standards of Audit (SAs) and applicable legal and regulatory requirements.

3. Assisting the engagement team to plan and perform the audit.

4. Assisting members of the engagement team responsible for the supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA220, 'Quality Control for an Audit of Financial Statements'.

5. Enabling the engagement team to be accountable for its work.

6. Retaining a record of matters of continuing significance to future audits.

7. Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.

8. Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

CONTENTS OF AUDIT WORKING PAPERS

As per SA-230, 'Audit Documentation', an auditor should follow the guidelines mentioned below to decide on the form, content and extent of audit documentation (or working papers).

1. The auditor shall prepare audit working papers on a timely basis. They should be prepared while performing the task itself rather than after the audit work is performed.

2. The auditor shall prepare audit working papers that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

a) the nature, timing and extent of audit procedures performed to comply with the SAs and applicable legal and regulatory requirements;

b) the results of the audit procedures performed and the audit evidence obtained; and significant matters arising during the audit, the conclusion reached thereon and significant

c) professional judgments made in reaching those conclusions.

3. In documenting the nature, timing and extent of audit procedures performed, the auditor shall record:

a) the identifying characteristics of the specific items or matters tested;

b) who performed the audit work and the date such work was performed; and

c) who reviewed the audit work performed and the date and extent of such review.

4. The auditor shall document discussions of significant matters with management, those charged with governance and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

5. If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency.

6. If, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement in a SA, the auditor shall document how the alternative audit procedures performed achieved the aim of that requirement, and the reasons for the departure.

TYPES OF WORKING PAPER FILES

In case of recurring audits, some working papers files may be classified into permanent audit files and current audit files: while the former is updated with the information of continuing importance, the latter contains information relating to audit of a single period. The contents of these files are given below:

PERMANENT AUDIT FILE	CURRENT AUDIT FILE
(a) Legal and organisational structure of the entity, e.g., Memorandum of Association and Article of Association in case of a company.	(a) Correspondence relating to acceptance of annual reappointment.
(b) Extracts or copies of legal documents, agreements and minutes relevant to the audit.	(b) Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit.
(c) A record of study and evaluation of internal controls.	(c) Copies of management letters.
(d) Analysis of significant ratios & trends.	(d) Analysis of transactions and balances.
(e) Copies of the audited financial statements of previous year(s).	(e) Copies of communication with other auditors, experts and third parties.
(f) Notes regarding signific ant accounting policies.	(f) Audit programme.
(g) Significant audit observations of the earlier years.	(g) Conclusions reached on significant aspects of audit.

OWNERSHIP AND CUSTODY OF AUDIT WORKING PAPERS

Working papers are the property of the auditor, the portions or extracts of which can be had at his discretion. These working papers should be kept in safe custody and in confidential manner for such time as is sufficient to meet the requirements of his practice or to satisfy any related legal or professional requirement of record retention. However, if required by some legislation, the auditor has to make working papers available to the regulatory authority(s). In case of Chantry Martin &

Co, it was held that the audit working papers are the property of the auditor and he is entitled to retain them.

The Institute of Chartered Accountants of India has prescribed that the members have to retain the working papers for a period of 7 years (as per SQC 1), otherwise, the member is guilty of professional misconduct.

Audit Evidence

While auditing, the auditor comes across various assertions of the management. The auditor has to evaluate these assertions so that he would be able to express his opinion on the financial statements. This evaluation can be made in the light of some facts and reasons. These facts and reasons are called Audit Evidence.

As per SA-500, 'Audit Evidence', the term 'audit evidence' includes information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

In short, substantive evidence collected by an auditor from various sources to base his opinion on the financial statements of the organization is called audit evidence.

Audit evidence is an important element of audit process. In order to form his unbiased opinion on the reliability and fairness of the financial performance and financial state of affairs, an auditor needs to objectively examine the financial statements based on sufficient and appropriate evidence. Opinion based on casual and subjective evaluation may leave material misstatements or frauds undetected and as a result the auditor may be held guilty of professional negligence.

The auditor, therefore, should always try to obtain sufficient and appropriate audit evidence and analyze them thoroughly before arriving at any opinion. Only by doing so, the auditor can keep the audit risk to a substantially low level.

In SA-200, it is recognized that reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. Here, sufficiency refers to the quantity and appropriateness refers to the quality of audit evidence.

❖ NEED FOR AUDIT EVIDENCE

Audit evidence is an important element of audit process. In order to form his unbiased opinion on the reliability and fairness of the financial performance and financial state of affairs, an auditor needs to objectively examine the financial statements based on sufficient and appropriate evidence. Opinion based on casual and subjective evaluation may leave material misstatements or frauds undetected and as a result the auditor may be held guilty of professional negligence.

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❖ AUDITOR'S JUDGEMENT WHILE OBTAINING AUDIT EVIDENCE

The auditor should evaluate whether he has obtained sufficient appropriate audit evidence so that reasonable conclusions can be drawn therefrom. It is to be noted that sufficiency and appropriateness are interrelated and apply to evidence obtained from both substantive and compliance procedures. Sufficiency refers to the quantum of audit evidence obtained and appropriateness relates to its relevance and reliability. The following factors influence auditor's judgement while obtaining audit evidence:

the nature of the item;

1. the adequacy of internal controls;
2. the nature and size of the business carried on by the entity;
3. Situations which may exert an unusual influence on the management;
4. The financial position of the entity;
5. The materiality of the item;
6. The experience gained during the previous audits;
7. The results of auditing procedures, including fraud or error which may have been found;
8. The type of information available;
9. The trend indicated by accounting ratios and analysis.

❖ TYPES OF AUDIT EVIDENCE

Depending upon the source, audit evidences may be of two types—internal evidences and external evidences. These are discussed below

1. **Internal Evidences**

These are evidences collected from within the organization. For example, sales invoices, counterfoils of cash memos, goods received notes, credit notes and debit notes, etc.

2. **External Evidences**

These are evidences collected from outside sources. For example, quotations, confirmation from debtors and creditors, etc

❖ RELEVANCE AND RELIABILITY OF AUDIT EVIDENCE

In order to arrive at an appropriate conclusion regarding the truthfulness and fairness of financial statements, the audit evidences under examination must be relevant and reliable.

As per SA-500, relevance of audit evidence deals with the logical connection with the purpose of audit procedure and is therefore affected by the direction of testing. On the other hand, the reliability of audit evidence depends on its source - internal or external and on its nature - visual, documentary or oral. While the reliability of audit evidence is dependent on the circumstances under which it is obtained, the following generalizations may be useful in assessing the reliability of audit evidence:

1. External evidence (e.g., confirmation received from a third party) is generally more reliable than internal evidence;
2. Internal evidence is more reliable when related internal control is satisfactory;
3. Evidence in the form of documents and written representation is usually more reliable than oral representations;
4. Evidence obtained by the auditor himself is more reliable than that obtained through the entity.

❖ METHODS TO OBTAIN AUDIT EVIDENCE

Auditor obtains evidence in performing compliance and substantive procedures by any one or more of the following methods –

1. Inspection - It consists of examining records, documents, or tangible assets. Inspection of records and documents provides evidence of varying degrees of reliability depending on their nature, source and the effectiveness of internal controls over their processing.

2. **Observation** - It consists of witnessing a process or procedure being performed by others.
3. **Inquiry and Confirmation** - Inquiry consists of seeking appropriate information from a knowledgeable person inside or outside the entity, Confirmation consists of the response to an inquiry to corroborate information contained in the accounting records.
4. **Computation** - It consists of checking the arithmetic al accuracy of source documents and accounting records or performing independent calculations.
5. **Analytical Review** - It consists of studying signific ant ratios and trends and investigating unusual fluctuations and items.

❖ AUDIT PROCEDURE TO OBTAIN AUDIT EVIDENCE

As per SA-315 and SA-330, audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

1. Risk assessment procedures; and
2. Further audit procedures, which comprise:
   a) Test of control or Compliance Procedure, and
   b) Test of details and analytical procedures known as Substantive Procedure.

Risk assessment procedures are the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion level (assertions are management representations, explicit or otherwise, that are embodied in the financial statements).

Compliance procedures or Tests of controls are those activities performed by the auditor during the control testing stage that gather evidence as to the operational effectiveness of internal control procedures upon which the auditor has planned reliance.

Management impliedly asserts that internal control procedures are effective as to both their design and operation. If controls are effective, then the auditor can plan reliance on the controls and reduce the time spent in gathering audit evidence. This is because the objective of an audit is similar in many respects to the objectives of internal control procedures. One of the primary objectives of a financial statement audit is to gather evidence as to whether account balances and classes of transaction are materially complete, valid and accurate. This is very similar to the primary objective of internal control procedures - to provide management with assurance that account balances and classes of transaction are complete, valid and accurate. Thus, if controls are effective, the auditor can plan reliance on the controls and reduce the amount of evidence that he would otherwise gather as to the completeness, validity and accuracy of account balances and classes of transaction.

In the audit planning stage, the auditor gathers evidence as to the effectiveness of design of control procedures and decides which control procedure, if any, upon which he will plan reliance.

In the control testing stage, the auditor gathers evidence as to the effectiveness of operation of those controls upon which the auditor has planned reliance.

The activities that the auditor employs to gather this evidence are referred to collectively as tests of control (sometimes referred to as compliance tests or compliance procedures).

Tests of control include observation of an internal control procedure being performed, inspection of evidence that the control procedure was performed (and performed at the appropriate time), and inquiry about how and when the procedure was performed. Where the information system is computerized, evidence may also be gathered using CAATs (Computer Assisted Audit Technique) such as a generalized audit software or an embedded audit module.

Substantive procedures (or substantive tests) are those activities which are performed by the auditor during the substantive testing stage of the audit that gather evidence as to the completeness, validity and / or accuracy of account balances and underlying classes of transactions.

Management impliedly asserts that account balances and underlying classes of transaction do not contain any material misstatements. In other words, that they are materially complete, valid and accurate. Auditors gather evidence about these assertions by undertaking activities referred to as substantive procedures.

For example, an auditor may

a. physically examine inventory on balance date as evidence that inventory shown in the accounting records actually exists (validity assertion);

b. arrange for suppliers to confirm in writing the details of the amount owing at balance date as evidence that accounts payable is complete (completeness assertion); and

c. make inquires of management about the collectability of customers' accounts as evidence that trade debtors is accurate as to its valuation (accuracy assertion).

Evidence that an account balance or class of transaction is not complete, valid or accurate is evidence of a substantive misstatement.

There are two categories of substantive procedures - analytical procedures and tests of detail.

Analytical procedures generally provide less reliable evidence than the tests of detail.

It may be noted that analytical procedures are applied in several different audit stages whereas tests of detail are only applied in the substantive testing stage.

Audit Note Book

In the course of conducting audit of an organization, the audit staff may come across various misstatements, frauds or any other issues which need further clarification from the management or investigation and in-depth observation later on. In order to avoid any chance of such issues being unanswered, the audit staff generally records the same in a separate note book and raises the issue in future. Such a record is known as Audit Note Book.

Generally separate note books are prepared for each client.

❖ CONTENTS OF AUDIT NOTE BOOK

1. Name of the business enterprise.
2. Organization structure.
3. Important provisions of Memorandum of Association (MOA) and Articles of Association (AOA).
4. Communication with the previous auditor, if any.
5. Management representations and instructions.
6. List of books of accounts maintained by the enterprise.
7. Accounting methods, internal control systems followed by the enterprise, applicable laws etc.
8. Key managerial personnel.
9. Errors and fraud discovered.
10. Matters requiring explanations or clarifications.
11. Special points that need attention in the audit report.

1.4

• AUDIT RISK, ASSESSMENT OF AUDIT RISK, INTERNAL CONTROL, INTERNAL CHECK, INTERNAL AUDIT - INDUSTRY SPECIFIC, INTERPLAY BETWEEN INTERNAL AUDIT AND STATUTORY AUDIT, RISK BASED INTERNAL AUDIT, INTERNAL FINANCIAL CONTROL AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Audit Risk and Its Assessment

CONCEPT OF AUDIT RISK

A statutory auditor is required to express an opinion as to whether the financial statements prepared by the entity exhibit a true and fair view of the financial performance and financial position of the entity. However, in spite of his sincere efforts, it may not be possible for an auditor to guarantee that the audited accounts are free from all sorts of material misstatements; rather, there is every possibility that an auditor expresses an incorrect opinion in his report.

Audit risk refers to the risk that an auditor gives an inappropriate opinion when the financial statements are materially misstated. In other words, it is the risk that an auditor fails to express an appropriate opinion on the financial statements of the entity. Consider the following example. A Ltd. spent `50 lakh to repair a machinery. The repair was likely to improve the capacity of the existing machine by 30%. Accordingly, the cost of repair should be capitalized and not to be treated as a revenue expenditure. Unfortunately, the accountant debited the amount in the Repairs and Maintenance A/C and changed the same as a revenue expenditure in the Statement of Profit and Loss instead of debiting the Machinery A/c. The auditor, while auditing the accounts of the company overlook the same and did not report anything regarding the error. In this situation, the auditor's opinion is inappropriate resulting into audit risk.

WHAT IS NOT AUDIT RISK?

The following two, however, does not come under the purview of audit risk.

1. Audit risk does not include the risk that the auditor may express an opinion that the financial statements are materially misstated when actually they are not so.
2. Audit risk also doesn't include the business risk of the auditor such as loss due to litigation, negative publicity, etc. It is something very technical and related to the audit of the financial statement of the client.

TYPES OF AUDIT RISK

- AUDIT RISK
  - RISK OF MATERIAL MISSTATEMENT
    - INHERENT RISK
    - CONTROL RISK
  - DETECTION RISK

Audit risk can broadly be classified into – Risk of Material Restatement and Detection Risk.

A. **Risk of Material Misstatement**

It may be defined as the risk that the financial statements are materially misstated prior to the audit exercise either due to any unintentional error or any organized fraud. This risk may exist at two levels:

1. **At Overall Financial Statement Level:** It refers to the possibility that material misstatement relates pervasively to the financial statements as a whole and may potentially affect multiple assertions.
2. **At Assertion Level:** It refers to the possibility that material misstatement may exist while classifying the transactions, calculating the balances or disclosing some material information.

The risk of material misstatement at the assertion level has two components as follows:

a) **Inherent Risk:** This refers to the possibility of material misstatement due to complex transactions or even due to organized fraud. Accordingly, this risk may be higher for some classes of transactions, account balances and disclosures. For example, transactions such as fire damage or acquiring another company are non-recurring and hence the auditor runs the risk of focusing too much or too little on the unique event.

b) **Control Risk:** This refers to the possibility of material misstatement due to ineffective design, implementation and maintenance of internal control system. Thus, a sound internal control system significantly reduces this risk. However, internal control can reduce but cannot eliminate the risk completely because of its inherent limitations. For example, due to inefficient internal control system in the organizations, there may be a risk that bank reconciliations have not been prepared for any month or not appropriately reviewed, resulting in misstatement of bank balance.

B. Detection Risk

This refers to the possibility that the audit procedures applied by the auditor to reduce the audit risk to an acceptably low level will not be able to detect a misstatement which, either individually or in aggregate, may be material. For example, if the auditor applies a testing method that checks the accuracy of the invoice rather than the occurrence of the particular sale, he may run into a detection risk.

As audit risk comprises risk of material misstatement and detection risk, it may be said that, Audit risk = Risk of material misstatement × Detection risk.

ASSESSMENT OF AUDIT RISK

As per SA 315, Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment, the auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.

The risk assessment procedures shall include the following:

1. Inquiries of management and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.
2. Analytical procedures.
3. Observation and inspection. These are discussed below.

a) **Inquiries of Management and Others Within the Entity:** Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority. For example

1. inquiries directed towards those charged with governance may help the auditor understand the environment in which the financial statements are prepared;
2. inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.

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

b) **Analytical Procedure[2]:** This means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks.

Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold. Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

However, when such analytical procedures use data aggregated at a high level, the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist.

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

Examples of such audit procedures include observation or inspection of the following:

1. The entity's operations.
2. Documents (such as business plans and strategies), records, and internal control manuals.
3. Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of directors' meetings).
4. The entity's premises and plant facilities.

Some other relevant factors are as follows:

a) **Information Obtained in Prior Periods:** The auditor's previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about such matters as past misstatements and whether they were corrected on a timely basis, the nature of the entity and its environment, and the entity's internal control, significant changes that the entity or its operations. This information may assist the auditor in gaining a sufficient understanding of the entity to identify and assess risks of material misstatement.

b) Discussion among the Engagement Team: The discussion among the engagement team about the susceptibility of the entity's financial statements to material misstatement provides an opportunity for experienced team members to share their insights based on their knowledge of the entity, allows the team members to exchange information about the business risks, assists the engagement team members to gain a better understanding of the potential for material misstatement of the financial statements in the specific areas assigned to them, and provides a basis upon which engagement team members communicate and share new information obtained throughout the audit that may affect the assessment of risks of material misstatement or the audit procedures performed to address these risks.

c) **The Required Understanding of the Entity and Its Environment, Including the Entity's Internal Control:** An understanding of the entity and its environment helps the auditor a lot in assessing the risk of material misstatements. Factors such as industry, and regulations have significant bearing on an entity. The industry in which the entity operates may give rise to specific risks of material misstatement arising from the nature of the business or the degree of regulation. For example, long-term contracts may involve significant estimates of revenues and expenses that give rise to risks of material misstatement. Similarly, relevant regulatory issues such as applicable financial reporting framework, taxation, government policies, regulatory framework for a regulated industry can well be the potential source of the risk of material mis- statements. In addition, the nature and structure of the entity (complex or simple), ownership and relations. between the owner and stakeholders may also give rise to audit risk.

An understanding of internal control assists the auditor in identifying types of potential misstatements and factors that affect the risks of material misstatement, and in designing the nature, timing, and extent of further audit procedures. However, internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by inherent limitations of internal control. Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analyzing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit.

Information obtained by performing risk assessment procedures and related activities may be used by the auditor as audit evidence to support assessments of the risks of material misstatement. In addition, the auditor may obtain audit evidence about classes of transactions, account balances, or disclosures and related assertions and about the operating effectiveness of controls, even though such procedures were not specifically planned as substantive procedures[3] or as tests of controls.

During the audit, information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example, the risk assessment may be based on an expectation that certain controls are operating effectively. In performing tests of those controls, the auditor may obtain audit evidence that they were not operating effectively at relevant times during the audit. Similarly, in performing substantive procedures the auditor may detect misstatements in amounts or frequency greater than is consistent with the auditor's risk assessments. In such circumstances, the risk assessment may not appropriately reflect the true circumstances of the entity and the further planned audit procedures may not be effective in detecting material misstatements.

Internal Control

CONCEPT OF INTERNAL CONTROL

Internal control is the process, effected by an entity's Board, management, and other personnel, designed to provide reasonable assurance regarding achievement of the objectives in the following categories:

1. Reliability of financial reporting,
2. Effectiveness and efficiency of operations, and
3. Compliance with applicable laws and regulations.

SA 265 defines the system of internal control as "all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information".

Therefore, internal control system is the total system of control established by the management of an organization so as to ensure achievement of organizational objective effectively and efficiently.

SCOPE OF INTERNAL CONTROL

Internal control comprises both administrative control and accounting control.

1. **Administrative Control:** It ensures adherence to management's plans and procedures. Therefore, administrative control relates to the production process, quality control, pricing strategies etc.
2. **Accounting Control:** It refers to the control system which ensures recording of transactions in the books of accounts adhering to the established accounting policies and principles. Accounting control relates to maintaining proper books of accounts, recording transactions timely, checking arithmetical accuracy of books of accounts, rotation of duties of staffs, etc. Accounting control is again divided into two sub-sections namely (a) Internal Check and (b) Internal Audit.

BASIC ELEMENTS OF INTERNAL CONTROL

An effective system of internal control should have the following basic elements:

1. Financial and Other Organization Plans: This may take the form of manual suitably classified by flow charts. It should specify the various duties and responsibilities of both management and staff, stating the powers of authorization that reside with various members.
2. Competent Personnel: In any internal control system, personnel are the most important element. When the employees are competent and efficient in their assigned work, the internal control system can be operated efficiently and effectively.
3. Division of Work: In any internal control system, each and every work of the organization should be divided in different stages and should be allocated to the employees in accordance with quality and skill.
4. Separation of Operational Responsibility from Record Keeping: In order to ensure reliable records and information, record-keeping function must be separated from the operational responsibility of the concerned department.
5. Separation of the Custody of Assets from Accounting: To protect assets from misuse and misappropriation, it is required that the custody of assets and their accounting should be done by separate persons.
6. Authorization: In an internal control system, all the activities must be authorized by a proper authority.

7. Managerial Supervision and Review: The internal control system should be implemented and maintained in conformity with the environmental and elemental changes of the concern. There must be regular supervision and review of the effectiveness of the internal control system of the organization.

OBJECTIVES OF INTERNAL CONTROL

Each organization must have a system of internal control in place for achieving the predetermined goals. In addition to accomplishing the desired goals and objectives of the organization, this system plays a very important role in any organization in several other ways. The main objectives of internal control are:

1. To ensure that the business transactions take place as per the general and specific authorization of the management.
2. To make sure that there is a sequential and systematic recording of every transaction, with the accurate amount in their respective account and in the accounting period in which they take place.
3. To ensures that all recorded transactions fairly represent the economic events that actually occurred, are lawful in nature, and have been executed in accordance with management's general authorization.
4. To ensure that all valid transactions are accurately recorded as per the accounting policies and standards.
5. To provide security to the company's assets from unauthorized use.
6. To review the working of the business, locate weak points in operations and to take corrective measures for proper working.
7. To ensure there is the optimum utilization of the firm's resources.

In this respect, SA-315, Risk Assessment and Internal Control, advocates the following objectives of internal control:

1. To ensure that transactions are executed as per management's authorization
2. To ensure that transactions are recorded in proper way to facilitate preparation of financial information for maintaining record of assets.
3.. To ensure that assets are protected from unauthorized use, sale, etc.
4.. To ensure that assets are verified at frequent intervals.

ADVANTAGES OF INTERNAL CONTROLS

1. Efficiency, effectiveness and economy: A good internal control system ensures that the resources are utilized only for their intended purposes and helps to overcome the risk associated with the misuse of organization's funds and other resources.
2. Prevention of errors and irregularities: It prevents errors and irregularities by detecting them in a timely manner, thereby promoting reliable and accurate accounting records.
3. Safeguard from irregularities or misappropriations: A good internal control system ensures the protection of organization resources from misappropriation.
4. Employees' satisfaction and productivity: It enhances employee satisfaction and productivity by segregation of duties and delegation of responsibilities.

TYPES OF INTERNAL CONTROL

The type of internal control system to be employed in an organization depends upon the requirements and nature of the business. Generally, there are two types of Internal Control in an Organization: preventive and detective controls. Both types of controls are essential to an effective internal control system. From a quality standpoint, preventive controls are essential because they are proactive and emphasize quality. However, detective controls play a critical role by providing evidence that the preventive controls are functioning as intended.

A. Preventive Control: Preventive Controls are designed to discourage errors or irregularities from occurring. They are proactive controls that help to ensure achievement of departmental. Examples of preventive controls are:

1. Segregation of Duties: Duties are segregated among different people to reduce the risk of error or inappropriate action. Normally, responsibilities for authorizing transactions (approval), recording transactions (accounting) and handling the related asset (custody) are divided.
2. Approvals, Authorizations, and Verifications: Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor's approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.
3. Security of Assets (Preventive and Detective): Access to equipment, inventories, securities, cash and other assets is restricted; assets are periodically counted and compared to amounts

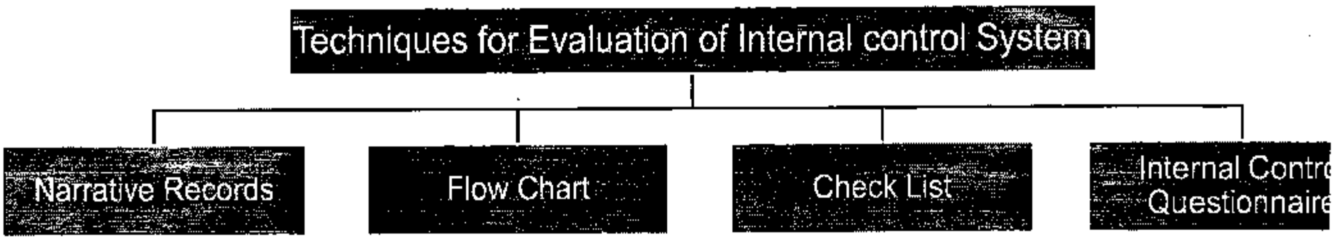
shown on control records.

B. Detective Control: Detective Controls are designed to find errors or irregularities after they have occurred. Examples of detective controls are:

1. Reviews of Performance: Management compares information about current performance to budgets, forecasts, prior periods, or other benchmarks to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow-up.
2. Reconciliations: An employee relates different sets of data to one another, identifies and investigates differences, and takes corrective action, when necessary.
3. Physical Verification of Inventories: The auditor may conduct physical verification of inventory to detect any misappropriation.

TECHNIQUES FOR EVALUATION OF INTERNAL CONTROL SYSTEM

The following methods are generally suggested for evaluation of internal control system



A. Narrative Record: It is a complete and exhaustive description of the system. It is appropriate in circum- stances where a formal control system is lacking, like in the case of small businesses. Gaps in the control system are difficult to identify using a narrative record.

B. Check List: The Internal Control Checklist is a tool to help evaluate and strengthen internal controls, promote effective and efficient business practices, and improve compliance in a department or functional unit. The checklist is not meant to be absolute but informative when reviewing controls in a given area. In fact, checklist is a series of instructions and/or questions which the auditor or the audit staff must follow and answer. When he completes the instructions, he initials the space against the instruction. Answers to the checklist instructions are usually 'Yes', 'No' or 'Not Applicable'.

C. Flow Chart: It is a pictorial representation of the internal control system depicting its various elements such as operations, processes and controls, which help in giving a concise and comprehensive view of the organization's working to the auditor. A complete flow chart would depict the process of raising documents, personnel involved in doing so, the flow of documents through various departments, maintenance of records, flow of goods and consideration, and dealing with results. The internal control evaluation process becomes easier through a flow chart as a broad picture of all the controls involved can be gauged in a glimpse.

d. Internal Control Questionnaire: This is the most widely used method for collecting information regarding the internal control system and involves asking questions to various people at different levels in the organization. The questionnaire is in a pre-designed format to ensure collection of complete and all relevant information. The questions are formed in a manner that would facilitate obtaining full information through answers in 'Yes' or 'No', whereby the answer 'Yes' is satisfactory, whereas the answers 'No' appear to indicate a weakness. However, not always the questionnaire is designed to receive responses in 'Yes-No' format as the same may not provide adequate information. Hence, questionnaire may receive descriptive responses also.

CHECKLIST VS. INTERNAL CONTROL QUESTIONNAIRE

Sl. Nc	Basis	Check List	Internal Control Questionnaire
i.	Point of Time	It is issued at the commencement of audit and reported back after completion of audit.	It can be issued at any point of time and reported back immediately.
ii.	Issued To	It is issued to the audit staff to be followed by them during audit and reported back at completion.	It is issued to various people at different levels in the organisation.
iii.	Contents	It contains instructions to be followed by audit assistants.	It contains questions to be answered by the employees of the organization.
iv.	Objective	It works as a guideline for audit staff so that no major issues remain unchecked	This is used to collect the information tc know about the internal control system and to evaluate the weaknesses therein

INHERENT LIMITATIONS OF INTERNAL CONTROL

Internal controls can provide only a reasonable assurance that objectives have been achieved. This is because, some limitations are inherent in all internal control systems. These are as follows:

1. Breakdowns: Even well-designed internal controls can break down. Employees may misunderstand instructions or commit mistakes. Errors may also result from application of new technology.

2. Judgment: The effectiveness of internal controls is highly impaired when decisions are made with human judgment under pressure

3. Management Override: High level personnel may be able to override prescribed policies and procedures for personal gain or advantage.

4. Collusion: Internal control systems may become ineffective due to collusion among employees. Several individuals may act collectively to alter financial data or other management information in a manner that cannot be identified by control systems.

5. Control Over Common Business Activities: Internal control system is suitable for common and reparative business activities only.

6. Costly System: Operating an internal control system often turns up to be very costly. If the losses incurred on account of errors and frauds exceed the benefits of internal control system, then the system becomes completely redundant for the entity.

Internal Check

CONCEPT OF INTERNAL CHECK

Internal Check is an integral part of the internal control system. It is a process in which the duties of various staff of a business are arranged in such way that work performed by one is automatically checked by the next staff while performing his duties. As a consequence, any error or fraud committed by the previous staff is automatically detected and corrected by the next one and thus misstatements are easily prevented. For example, suppose a customer presents a cheque of ₹1000 to the bank for payment. As per the bank policy, the work of the encashment of cheques is divided among three employees. One shall investigate the cheque, and make entries in the books of accounts. The second employee shall check this entry and send it to the third employee making cheque payments who will make the final payment. Thus, any mistake by any previous employee will be automatically detected by the next one and thereby errors and frauds can be prevented.

According to The Institute of Chartered Accountant of England and Wales, London, "Internal Check System is a system of instituting checks on the day-to-day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being the prevention or early detection of errors and frauds".

Thus, internal check or internal check system may be defined as a system of allocation of duties among the staff of the entity in such a manner that the chances of any duplicity of work are eliminated and at the same time work done by the previous employee is automatically checked by the next one.

OBJECTIVES OF INTERNAL CHECK

The objectives of internal check are as follows:

1. Lessen the possibility of fraud and error.
2. Identify fraud and error at an early stage due to independent checking.
3. Improve the efficiency of the workforce, by implementing division of labor.
4. Allocate the duties and responsibilities of each worker in a way that they can be easily identified and held responsible for the actions performed.
5.. Receive confirmation of facts and entries both physical as well as financial by way of presentation and necessary maintenance of records.
6. Exercise moral pressure on the workforce with the implementation of a continuous receive process.
7. Reduce the workload of independent auditors by adopting an internal check system.

ESSENTIAL CHARACTERISTICS OF INTERNAL CHECK SYSTEM

Following are the essential characteristics or principles of a good internal check system.

1. **Division of work:** The entire task should be divided among the staff in such a way that no single person is allowed to complete the work solely by himself from the beginning to the end.
2. **Provision of check:** There must be clear instruction that the work performed by any staff must be checked by the next staff.
3. **Responsibility:** Responsibility of each individual must be properly defined and fixed.
4. **Use of technology:** As far as possible, various technology enabled devices should be used to minimize human error.
5. **Rotation of employees:** A system of transfer or rotation of employees from one responsibility

to another must be followed by the business.

6. Control over employees: Generally, chances of frauds are high in case there is direct contact between staff and the customers. So, a manager can keep eyes in those areas to make internal check system more effective.

7. Supervision: A strict supervision should be exercised to ensure that the prescribed internal checks and procedures are fully operative.

8. Periodical review: The system of internal check is reviewed from time to time to introduce improvements.

ADVANTAGES OF INTERNAL CHECK SYSTEM

A good system of internal check offers many benefits as follows:

To the Auditor	To the Client
- It saves time and cost of checking all records. - Auditor may apply test checking approach. - Auditor devotes more time to appraise critical areas. - This improves quality of audit work.	- It reduces chances of errors and frauds. - As work is distributed among the employees based on their skill the entire work process gets completed smoothly. - A moral pressure can be built on the employees. - So, they remain reasonably honest. - Final accounts are prepared promptly.

AUDITOR'S LIABILITY FOR RELYING ON THE INTERNAL CHECK SYSTEM

Reliance on an effective internal check system and thereby streamlining the audit process enables the auditor to devote more time in examining the critical areas of accounting including valuation of closing stock, valuation of assets and liabilities, determining the reasonableness of provisions etc. However, such reliance simultaneously increases the risk of the auditor. This is because, even a sound internal check system cannot guarantee the elimination of all errors and frauds in the accounts. Hence, if the auditor relies on the internal check system and performs test checking rather than a detail checking, he cannot escape his responsibility of any such error or fraud remaining undetected. This was also held in the famous case law of Mc. Bride Ltd vs. Rooke and Thomas, Canada (1941). Thus, the auditor should always keep in mind that resorting to test checking by relying on internal check system of the organization no way reduces the liability of the statutory auditor.

Internal Audit

Internal audit is a part of the internal control system of an organization. Traditionally internal audit was seen as a continuous evaluation appraisal of financial operations within a given organizational framework. However, today it is recognized as an independent appraisal of various operating activities of the entity. Thus, an internal auditor is not only to see that a purchase transaction has been appropriately recorded in the books of accounts but also to see that there was a valid purchase requisition, the order was placed to the vendor who was in the approved list of the entity, the terms were reasonable and the goods was duly received and included in the stock.

As per the Committee of Internal Audit, formed by The Institute of Chartered Accountants of India, internal audit is, "An independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggesting improvements thereto and add value to and strengthen overall governance mechanism of the entity, including the entity's risk management and internal control system."

As per SA 610, Using the Work of Internal Auditor, internal audit is a function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control process.

Thus, internal audit is a continuous appraisal of the different operational activities of the entity, including verification of the books of accounts, by a competent employee of the organization, with an objective to report on the effectiveness of operations so that governance, risk management and internal control process can be improved further.

SCOPE AND OBJECTIVES OF THE INTERNAL AUDIT FUNCTION

The objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance. The activities of the internal audit function may include one or more of the following:

1. Monitoring of internal control: The internal audit function may be assigned specific responsibility for reviewing controls, monitoring their operation and recommending improvements thereto.

2. Examination of financial and operating information: The internal audit function may be assigned to review the means used to identify, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.

3. Review of operating activities: The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non- financial activities of an entity.

4. Review of compliance with laws and regulations: The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

5. Risk management: The internal audit function may assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.

6. Governance: The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

ADVANTAGES OF INTERNAL AUDIT

Internal audit offers a number of advantages as follows:

1. Assistance to Management: Internal audit helps management in executing various plans and policies effectively and efficiently.

2. Detection Errors and Frauds: Through internal audit, frauds and errors can be detected easily.

3. Prevention of Errors and Frauds: By ensuring continuous evaluation, it contributes a lot in preventing the errors and frauds.

4. Reduction in Wastage: Internal audit identifies the weaknesses and deficiencies of the organization and thereby helps in reducing wastages.

5. Safeguarding Assets: Internal audit ensures that proper measures are in place to safeguard the assets.

6. Increased Efficiency: It helps in improving the effectiveness of the internal control system and thereby improves the overall efficiency of the entity.

INTERNAL AUDIT IN INDIA

Section 138 of the Companies Act, 2013 read with Rule 13 of Companies (Accounts) Rules, 2014, specifies certain classes of companies which are required to appoint Internal Auditors who shall either be a Chartered Accountant, Cost Accountant or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company. The following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely:

1. every listed company;
2. every unlisted public company having-
3. paid up share capital of fifty crore rupees or more during the preceding financial year; or
4. turnover of two hundred crore rupees or more during the preceding financial year; or
5. outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
6. outstanding deposits of twenty-five crore rupees or more at any point of time during the preceding financial year; and
7. every private company having-

a) turnover of two hundred crore rupees or more during the preceding financial year; or

b) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

The internal auditor may be an employee of the company. The scope, functioning, periodicity and methodology for conducting the internal audit shall be finalized by the Audit Committee of the company or the Board in consultation with the Internal Auditor.

INTERPLAY BETWEEN INTERNAL AUDIT AND STATUTORY AUDIT – STATUTORY AUDITOR'S RELIANCE ON THE WORK OF INTERNAL AUDITOR

As per SA 610, Using the Work of Internal Auditor, the external auditor can use the work of an internal auditor after conducting an evaluation of internal audit functions.

Accordingly, the external auditor shall consider the following factors to determine the extent to which he can rely on the work of an internal auditor:

1. whether internal audit is undertaken by an outside agency or by a separate audit department within the entity.
2. the scope of internal audit, management action and the internal audit report.

3. experience and qualification of internal auditor.
4. the technical compliance by internal auditor.
5. authority vested on internal auditor and level of management to whom he is accountable.
6. whether professional care has been taken by the internal auditor in conducting audit work.

After the evaluation, if the external auditor is satisfied with all the above criteria and if the law doesn't prohibit, he can decide to rely upon the work of an internal auditor.

The external auditor, in such a case, shall discuss his plans to use direct assistance of the internal audit function with the internal auditor. He shall carefully undergo the reports of internal audit function and obtain an understanding of the nature and extent of the audit procedures that has been applied and the related findings. In addition, the external auditor shall also perform sufficient and appropriate audit procedure on the body of work of the internal audit function as a whole to determine its adequacy for purposes of the statutory audit. He shall also inform the management about his decision to rely on the internal audit function. Additionally, the external auditor shall obtain a written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions without their intervention. A written agreement from the internal auditors shall also be obtained that they will keep confidential specific matters as instructed by the external auditor. Moreover, the external auditor also needs to document adequately the basis of his decision to use the work of internal auditor in an appropriate manner.

Whatever is the nature and extent of use of direct assistance from an internal auditor, an external auditor cannot escape his liability for his opinion in the audit report. His reliance on the work of the internal auditor can, in no way, reduce his responsibility and he will be held responsible for all damages arising out of any material mis- statement in the accounts remaining undetected because of his reliance on the work of the internal auditor. An external auditor cannot be relieved by the law under the plea that he relied upon the work of an internal auditor.

INTERNAL CONTROL VS. INTERNAL CHECK VS. INTERNAL AUDIT

S. No.	Point of Distinction	Internal Audit	Internal Control	Internal Check
1.	Mode of Checking	In an internal audit system, each component of work is checked.	In internal controls systems, work of one person is automatically checked by another.	It operates in routine to doubly check every part of a transaction at the time of occurrence and recording of the same
ii.	Objective	Its objective is to evaluate the internal control system and to detect frauds and errors.	Its objective is to ensure adherence to management policies, safeguarding of assets, prevention and detection of frauds and errors, accuracy and completeness of accounting records.	Its objective is to ensure that no one employee has exclusive control over any transaction or group of transactions and their recording in the books
iii.	Point of Time	In an internal audit system, work is checked after it is done.	In an internal control system, checking is done simultaneously with the conduct of work. Every transaction is checked as soon as it is entered.	Methods of recording transactions are devised where work of an employee is checked continuously by correlating it with the work of others.
iv.	Thrust of system	The thrust of internal system is to detect errors and frauds.	The thrust of internal check system is to prevent errors.	The thrust of internal control lies in fixing of responsibility and division of work to avoid duplication.
v.	Cost Involvement	In an internal audit system, work is checked specially; therefore, cost is involved in addition to accounting	The system proves to be costly incase of small businesses becausea greater number of employees are engaged	It is a part of internal controland a method of division of work, therefore does not addto the cost.
vi.	Report	The internal auditor submits his report to the management	Internal Controls provide for builtin MIS reports	The summary of day-to-day transactions work as report forthe senior.

CONCEPT OF RISK BASED INTERNAL AUDIT

Risks are inherent in every organization. Thus, the success of an organization largely depends on how well it can manage its risks. In recent times, many corporate failures may be attributed to poor risk management approaches followed by the management. Effective internal controls, however, contribute to a great extent in minimizing the adverse impact of inherent business risks. Institute of Internal Auditors (IIA) defines risk based internal auditing (RBIA) as a methodology that links internal auditing to an organization's overall risk management framework. RBIA allows internal audit to provide assurance to the board that risk management processes are managing risks effectively, in relation to the risk appetite. Thus, while traditional internal audit only provides control assurance based on routine audit, RBIA provides Assurance on the effectiveness of risk management in addition to control assurance. To put it differently, RBIAs give auditors a larger role in your risk reduction program. Beyond simply diagnosing the problems, they are also a part of the creation of effective controls and maintaining risk management efforts over time. By following RBIA internal audit should be able to conclude that:

1. Management has identified, assessed and responded to risks above and below the risk appetite.
2. The responses to risks are effective but not excessive in managing inherent risks within the risk appetite.
3. Where residual risks are not in line with the risk appetite, action is being taken to remedy the same.
4. Risk management processes, including the effectiveness of responses and the completion of actions, are being monitored by management to ensure they continue to operate effectively.
5. Risks, responses and actions are being properly classified and reported.

This enables internal audit to provide the board with assurance that it needs on three areas:

1. Risk management processes, both their design and how well they are working.
2. Management of those risks classified as 'key', including the effectiveness of the controls and other responses to them.
3. Complete, accurate and appropriate reporting and classification of risks.

TRADITIONAL INTERNAL AUDIT VS. RISK BASED INTERNAL AUDIT

Sr. No.	Traditional IA Approach	Risk Based IA Approach
1.	Audit plan is based on the audit cycle	Audit plan is based on the results of the business risk evaluation. Risky areas are covered first and more frequently.
2.	Important risks might not be covered during the audit plan	Provides assurance that important risks are being managed properly
3.	Focuses on deficiencies in controls and cases of non-compliance with policies and procedures	Focuses on risks that are not properly controlled andoverly-controlled
4.	IA resources are spread over all business activities	More efficient use of IA resources by concentrating on risk areas
5.	Business risks are not being mapped	The importance of risks is established during the risk assessment phase and in agreement between IA
6.	Disagreement with the business management over the action plans leading to delays in implementation	Facilitates consensus with line management on the needed action plans thus improving timely the implementation of corrective measures

ADVANTAGES OF RISK BASED INTERNAL AUDIT

1. **Consistency:** Developing a consistent and comprehensive approach to risk management makes it easier for an organization to adapt to changing conditions. Adjusting audit schedule to risk management framework will also help switch tactics quickly when business objectives need to change.

2. **Transparency:** A risk-based approach to audit enables the internal auditors to identify risks correctly and allows management to put the right internal controls in place for the best performance. This provides a better understanding of the risks and enables organization to better manage them.

3. **Specificity:** Ranking and mapping risks with RBIA will allow allocate activity and funds to the areas that need the most attention, creating a unique risk management program rather than relying on external frame- works and recommendations. While compliance frameworks are necessary for many industries, they don't account for every potential risk the entity could face; relying on those requirements alone could result in risks going unnoticed and unattended.

Internal Financial Control and Internal Control over Financial Reporting

INTERNAL FINANCIAL CONTROL (IFC)

BACKGROUND

The Satyam Scam of 2009 and the failure of statutory audit process to detect the financial fraud of such a huge scale committed by the management brought to notice various loopholes in the 3 regulatory and legal frame- work dealing with board of directors and auditors of the company. The scam compelled the Indian regulators to search for best practices across the world like Sarbanes Oxley regulations in United States (US), Turnbull Guidance in United Kingdom (UK) and JSOX in Japan to raise the standard of corporate governance in India. Consequently, this motivated the regulators to introduce the Internal Financial Control regulations within the ambit of the Companies Act, 2013.

CONCEPT OF IFC

As per Section 134(5)(e) of Companies Act, 2013, the term 'internal financial controls' means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

STATUTORY PROVISIONS REGARDING IFC

The following are the statutory provisions associated with IFC.

1. For listed entities only:

a) As per Section 134(5)(e) of Companies Act, 2013, the Directors' Responsibility Statement shall state that directors have laid down IFC to be followed by the company and that such controls are adequate and operating effectively.

2. For all entities, listed or unlisted

a) Section 143(3)(i) of Companies Act, 2013, the auditor's report should state whether the company has adequate IFC system in place and the operating effectiveness of such controls.

b) Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 states that the director's report should contain details in respect of adequacy of internal financial controls with reference to the financial reporting.

3. For all companies having independent directors

a) Section 149 (7) and Schedule IV of the Companies Act, 2013, requires that the independent directors should satisfy themselves on the integrity of financial information and ensure that financial controls and systems of risk management are robust and defensible.

4. For all entities having Audit Committee

a) Section 177 of the Companies Act, 2013 states that the Audit Committee may call for comments of auditors about internal control systems before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

BENEFITS OF INTERNAL FINANCIAL CONTROL

With adequate and effective internal financial controls, some of the benefits that the companies would experience include:

1. Senior Management Accountability.
2. Improved controls over financial reporting process
3. Improved investor confidence in entity's operations and financial reporting process.
4. Promotes culture of openness and transparency within the entity.
5. Trickling down of accountability to operational management.
6. Improvements in Board, Audit Committee and senior management engagement in financial reporting and financial controls.
7. More accurate, reliable financial statements.
8. Making audits more comprehensive.

Internal financial controls also become important as they help derive values in the form of:

1. Fresh independent look at key business processes.
2. Identification of potential operating process opportunities.
3. Updated formal, centralized, and managed internal financial controls documentation for the company.
4. Enhanced support to CEO/CFO certifications.
5. Enhanced control environment, thereby mitigating risk.

6. Better understanding of inherent and residual control risks in internal controls.
7. Rationalizing the number of controls across organization - moving to smart and automated controls.
8. Standardizing policies and procedures for multi-location/ multi-business companies.
9. Fostering a control conscious work culture for people behind controls
10. Providing assurance to the CEO/ CFO as well as improves business performance.

INTERNAL FINANCIAL CONTROL OVER FINANCIAL REPORTING (IFC-FR)

BACKGROUND

The definition of Internal Financial Control essentially suggests that the intent of the regulators is to have control framework beyond financial controls. However, an auditor cannot be expected to comment on the operational conduct of the business as a whole. Hence, it can be logically inferred that reporting of Internal Financial Control by auditors as required in Section 143(3)(i) is on financial reporting aspect only. This led to the introduction of the term Internal Financial Control over Financial Reporting (IFC-FR or ICFR).

MEANING OF IFC-FR

As per the Guidance Note, Audit of Internal Financial Controls Over Financial Reporting, issued by Institute of Chartered Accountants of India, IFC-FR shall mean, "A process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles".

A company's internal financial control over financial reporting includes those policies and procedures:

a. Pertain to the maintenance of the records that, in reasonable detail, accurately and fairly reflect the trans- actions and dispositions of the assets of the company:

b. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statement in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and director of the company.

c. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect of the financial statement.

Thus IFC-FR = Maintenance of Financial records + Authorization of transactions in accordance with GAAP + Safeguarding of assets of the company

IFC VS. IFC-FR

Internal Financial Control over Financial Reporting (IFC-FR) covers those controls which are elements of Financial Reporting i.e., of balance sheet, profit and loss accounts. IFC-FR processes like order to cash, procurement to pay, Human Resource, Inventory Management cover risks only to the extend having direct or indirect impact on financial reporting. Therefore, IFC-FR majorly ensures controls which provide reasonable assurance that financial statements are free from material misstatements.

Internal Financial Control (IFC), in addition to ICFR, covers controls which ensure efficient and effective unction's of business, controls which safeguard assets and ensure compliance of policies. To put it differently, IFC as a concept is much wider in scope when compared to IFC-FR. In fact, IFC = IFC-FR + Operational Controls + Anti-fraud Controls.

Thus, it can be said that IFC-FR is a concept which is more intended towards users/readers of financial statement whereas IFC is more intended towards functions and management of the business.

1.5

• AUDIT SAMPLING, AUDIT TECHNIQUES AND ANALYTICAL PROCEDURE (INCLUDING SCRUTINY OF TRIAL BALANCE AND GROUPING SCHEDULES)

Audit Sampling

❖ CONCEPT OF AUDIT SAMPLING

In case of a large organization with umpteen number of transactions, it is not feasible for the auditor to verify each and every transaction to form his opinion on the financial performance and the state of affairs. The auditor, in such a large organization with adequate internal control in place, should certainly apply partial checking to form his opinion. However, the success of part checking largely depends on appropriateness of the sample selected.

According to SA-530, Audit Sampling, issued by The Institute of Chartered Accountants of India (CA), sampling in the context of auditing is the application of audit procedures to less than 100% of the items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis to draw a conclusion about the entire population.

❖ BENEFITS OF AUDIT SAMPLING

Audit sampling offers a number of benefits as follows:

1. It reduces the workload of the auditor.
2. It saves time and cost.
3. As it substantially reduces the time for audit work, the auditor may devote more time for critical
4. In order to decide on the extent of sampling, the auditor evaluates the effectiveness of internal
5. It gives dependable result as it is based on statistical sampling methods.

❖ FACTORS TO BE CONSIDERED FOR AUDIT SAMPLING

The factors to be considered for audit sampling are as follows:

1. Objectives of audit: Audit sampling has to be done keeping in mind the objective of the audit procedure.
2. Nature of population: Audit sampling technique must be selected based on the degree of heterogeneity
3. Internal Control System: Adequate internal control helps the auditor to reduce his sample size.

4. Materiality of Items: For material items the auditor must increase the sample size to reduce the risk.
5. Sampling Risk: Audit sample must be so designed as to keep the sampling risk within the acceptable limit
6. Non-sampling Risk: This is the risk factor emanating from human error. The auditor must take due care to avoid non-sampling risk.
7. Tolerable Error: It is the limit of error which does not significantly impact auditor's opinion. For material items, the limit should be kept low.

❖ **APPROACHES TO SAMPLING**

The approaches or methods can be classified as follows:

1. **Non-Statistical Sampling or Judgmental Sampling**

Under this technique, the sample size and its composition are determined based on auditor's own experience and knowledge and no statistical tool is applied to select the sample. The method is easy but subject to personal judgement.

2. **Statistical Sampling**

This approach is more scientific and does not depend on auditor's personal judgement. The approach includes the following methods:

a) **Random Sampling:** In this method of sampling each item of the population or within a given group (popularly known as stratum) has a known chance of selection. Random sampling can again be of two types:

i) **Simple Random Sampling:** Under this method of sampling, each unit of the population has an equal chance of being selected in the sample. Here selection is normally done either by choosing a random number manually from a random number table or allowing the computer programme to select a random number and then identifying the population unit that corresponds to the random number by using any predefined rule. However, this method essentially requires the population units to be reasonably homogeneous or similar in nature.

ii) **Stratified Sampling:** This method requires a given heterogeneous population to be first divided into a number of sub-populations (known as stratum) with homogeneous items and then selecting equal or unequal proportion of items from each group to form a representative sample of reasonable size. For example, trade receivable balances may be divided in five groups with specified ranges and then selection of trade receivables of a certain percentage can be done from each group.

b) **Systematic/ Interval Sampling:** This method requires selecting items using a constant interval between selections with the first selection being random. The interval can be based on a number (like every 30th item in the list) or a monetary value (like 30000 of cumulative value of sales after the last selection).

c) **Monetary Unit Sampling:** This method uses the monetary value of the transaction rather than the items as the basis for sample size determination and item selection. It is also known as value-based sampling or value-weighted sampling.

d) **Multi-Stage Sampling:** This method is suitable when data are stored in more than one level. For example, an organization may have stock stored at a number of shops. Here, the first step would be to randomly select a few shops and then to randomly select a few stock items from the shops already selected. If applied cautiously, this method proves to be very effective.

❖ **RISK ASSOCIATED WITH SAMPLING**

According to SA-500, an auditor may use audit sampling in selecting items required to conduct an effective test to provide appropriate audit evidence. However, it cannot be denied that such a method will always involve some amount of risk. This risk associated with sampling can broadly be divided into two categories:

A. **Sampling Risk:** Since sample is only a selected part of the population, it can never reflect all the characteristics of the population. Thus, there will always be some amount of risk unavoidable in this process. This sampling risk can again be of two types as follows:

1. **Sampling Risk associated with Compliance Procedure (i.e., Test of Control):** Here, the auditor, based on sampling procedure, may come to the conclusion that that the controls are more effective (or less effective) while they are not.
2. **Sampling Risk associated with Substantive Procedure (i.e., Test of Details):** Here, the auditor, based on sampling procedure, may come to the conclusion that that the financial statements are free from any material misstatements while they are not.

B. **Non-Sampling Risk:** While conducting sampling, error may also arise due to improper processing of data, lack of expertise to analysis, etc. These are called non-sampling error or bias. Accordingly, risk of any wrong opinion on the part of the auditor due to such errors is called non-sampling risk.

Non-sampling risk is avoidable. If the sampling is done by experienced audit clerks and they remain alert while analyzing the selected transaction, non-sampling risk can be reduced to minimum or even zero. On the other hand, sampling risk is unavoidable. The auditor can only reduce it to the possible extent by adhering to a proper method of sampling and by increasing the sample size reasonably.

❖ STAGES IN AUDIT SAMPLING

Audit sampling requires the following steps:

1. Sample Design: Here, the auditor selects the appropriate method based on the consideration of objectives of audit and nature of population.

2. Sample Size Determination: Auditor decides the sample size to minimize the sampling risk. He generally applies statistical techniques to avoid subjectivity.

3 . Sample Selection: At this stage, using the selected methods, sample units are drawn from the population.

4. Performance of Audit Procedure: Audit procedure is then performed on the selected sample units. If the procedure cannot be applied on the selected unit, the same is replaced. Based on the results of the audit procedure, the auditor forms his opinion.

Audit Techniques

While conducting the audit of an organization, an auditor resorts to various techniques. Some of these are invariably applied in all cases whereas some others are used only, if situation so demands. These are popularly known as Audit Techniques.

Some of the common techniques which have wide application are discussed below:

1. Routine Checking

Routine checking may be defined as the procedure to check whether the transactions are properly entered in the books of accounts and whether the posting and carry forwards are done accurately. In other words, routine checking is done to ensure that mathematical accuracy is maintained while recording transactions in the books of accounts. This is quite helpful to detect errors and frauds of very simple nature.

Routine checking is normally performed by audit clerks. They examine the correctness of casting and balancing of the books of primary entry, correctness of posting to ledgers, correctness of casting, balancing and carry forwards of ledger accounts, correctness of trial balance and correctness of the final accounts i.e., Statement of Profit and Loss and Balance Sheet.

Routine checking ensures arithmetical accuracy and, in the process, detect the material misstatements, if any. It provides the base for the subsequent audit work to find out serious and organized frauds.

2. **Test Checking**

In large organizations with huge number of transactions recorded in the books of accounts, conducting a detail examination of all accounts becomes a mounting task for the auditor. Additionally, due to the prevalent periodic audit system, the auditor is required to submit his report within a definite time period. Thus, in organizations, where there exists a sound internal control, the auditor selects a few transactions out of a number of similar transactions and conduct in-depth examination of those. If no irregularities are found, then it is assumed that all the transactions have been recorded properly. This procedure is known as test checking.

The rationale behind test checking lies in the 'Sampling Theory' of Statistics. According to this theory, a well representative sample will always reflect most of the characteristics of the aggregate, i.e., population. Moreover, as the sample size increases, the deviations between the results based on sample and that of aggregate or population will get reduced. Thus, under test checking, the auditor applies an appropriate sampling technique to draw a representative sample from the population items (transactions or disclosure issues) and apply audit procedures only to those selected items and thereby form his overall opinion on the class.

Test checking, based on appropriate sampling technique, helps the auditor to form his opinion based on a limited examination of transactions. It also saves time and cost of audit work.

However, it also involves sufficient amount of risk. Use of faulty sampling technique, sampling risk (which is unavoidable) and non-sampling risk may result in non-detection of material errors and frauds. The auditor, in such cases, cannot deny his responsibility due to application of test checking instead of routine checking or other appropriate audit procedures.

Thus, test checking is never recommended for seasonal industries, for transactions of non-recurring in nature, for transactions of legal importance, for accounting estimates, for rectification and adjustments and for presentation and disclosures.

3. **Auditing in Depth**

Auditing in depth refers to the procedure where a few selected transactions are meticulously examined from their beginning to their conclusion. In other words, it is a system which reviews each and every single aspect of a transaction during its execution as well as recording. It is particularly helpful in case of large organizations where detailed examination of all records at every stage of a transaction is almost impossible. Hence, through this system, the auditor selects a few representative transactions of material importance from a particular category and then conducts a detailed stage by stage examination. If no irregularity is found, the auditor may come to a conclusion that the entire category of transactions is likely to be free from any material irregularity.

Audit in depth is a three-step process where (a) the auditor first reviews the effectiveness of the internal control system, (b) then selects a few transactions of material importance from each category and (c) finally conducts examination of each and every stage of the execution and recording of the selected transactions based on sufficient documentary evidence.

4. Cut-off Examination

For some entities, there may be a number of items especially at the end of an accounting period that may have their impact carried to the next accounting period. Work in progress, goods in transit, goods sent on approval basis lying with the customers, outstanding and prepaid items are only a few. Even purchase and sale transactions during the end of the accounting period may have their impact on the next year. Improper treatment of these items and inclusion of items relating to one year in the next or previous year (like purchase and sales) may seriously distort the financial results and mislead the decision makers. Hence, an auditor, during the course of his audit work, should apply definite procedure to separate transactions at the end of one accounting period from those at the commencement of the next accounting period. Such a procedure is known as Cut-off Examination or Cut-off Procedure. Here, the auditor first decides a cut-off date (in case of annual audit, generally balance sheet date is considered to be the cut-off date) and then examines all the transactions that occurred within a definite time period prior and post such cut-off (known as cut-off period) date to discriminate transactions of current year from that of the next year. This is essential to eliminate any scope of manipulation in accounts.

5. Surprise Checking

Under traditional audit practices, an auditor generally informs the client about his routine checking plan and timing of next visit well in advance. This is considered essential so that the client's staff can keep the books of accounts complete in all respects and readily available for verification. Unfortunately, this also provides them ample scope for concealing any wrongdoings whatsoever. Thus, it is generally recommended that an auditor must also conduct surprise tests of some material items without any prior communication with the client's office. These surprise checks, as a part of the normal audit procedure, are likely to increase the efficiency of the audit work. Hence, surprise checking may be defined as an audit procedure where verification of some material items is conducted on a non-routine and surprise basis.

6. **Walk Through Tests**

Walk through test may be defined as tracing one or more transactions through the accounting system and observing how it is actually passed through the internal control system. For example, the auditor may decide to trace a purchase transaction from its initiation to its completion and recording. This will require him to see how are requisitions generated, orders placed with the suppliers, goods received and taken to the stores, bills processed and finally the accounting treatment done. If the auditor is satisfied about the appropriateness of all the relevant stages of the transaction, he may conclude that the internal control is functioning well. Accordingly, the auditor may decide to put reliance on the system to a certain extent and plan his audit work to verify some selective transactions only. Alternatively, if walk through test reveals serious weakness of the internal control system, the auditor may opt for verifying.

Analytical Procedure

CONCEPT OF ANALYTICAL PROCEDURE

Traditional audit techniques such as routine checking or test checking help an auditor to identify the existence of material misstatements or misappropriation of relatively simple in nature. However, the books of accounts may contain complex errors or planned frauds that are difficult to identify by these traditional methods. Existence of such errors or frauds may be quite fatal as that will eventually make the audit report unreliable. Hence, the auditor should apply some innovative procedures to deal with a situation of that kind. Analytical procedure has become very effective in this respect.

According to SA 520, Analytical Procedures, analytical procedure means evaluation of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedure also encompasses such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Nature of Analytical Procedures

As per SA520, the nature of analytical procedures includes the following:

1. Analytical procedures consider comparison of entity's financial information with

a) Comparable information of prior periods.

b) Any anticipated results of the organization like budget or forecast or any estimation by the auditor like estimation of depreciation.

c) Similar information of any other comparable entity belonging to the same industry or the industry averages.

2. Analytical procedures may also include consideration of relationships:

a) Among different items of financial data that is expected to follow a predictable pattern like the operating profit margin.

b) Between financial and non-financial information like the number of employees and the total compensation cost.

c) Analytical procedures consider application of diverse analytical tools that may range from a simple comparison to complex analysis involving advanced statistical techniques.

d) Analytical procedures may be applied either on standalone or on consolidated financial statements. Moreover, they can be applied on any component or individual information of the statements.

APPLICATION OF ANALYTICAL PROCEDURE

According to SA 520, analytical procedures can be applied at different steps of the audit work. These include:

1. Audit Planning: During the planning stage, the auditor may apply analytical procedures to have an understanding of the nature of client's business.
2. Substantive Test: In order to reduce the audit risk by relying on substantive procedures, the auditor may apply substantive analytical procedures either alone or in combination with the test of details (i.e., vouching and verification).
3. Investigation of Unusual Items: If the analytical procedures performed in the organization identify any inconsistency in relationships or any significant deviation from the respective expected value of the items, the auditor should investigate such items
4. Overall Conclusion: The auditor may also apply the results of analytical procedures to assess how far the conclusions drawn based on individual components or elements of the financial statements are consistent and whether there is any need to revise them.

TOOLS AND TECHNIQUES OF ANALYTICAL PROCEDURES

As per SA-520, analytical procedures include application of the following tools and techniques:

1. Trend Analysis: Under this method, analysis is done for to assess fluctuation of the amount of any item over the year or years.
2. Testing of Reasonableness: This is done by comparing certain items or account balances with other accounts or balances. Some examples are as follows;
   a) Raw material consumption to production (quantity)
   b) Percentage of wastage and scrap against production and raw material consumption
   c) Work-in-progress based on material issued
3. Ratio Analysis: This technique calculates different ratios between various items of financial statements in order to study their relationships. Some common ratios include:
   a) Gross Profit Ratio
   b) Receivable Turnover Ratio
   c) Inventory Turnover Ratio
4. Sources of Information: Analytical procedures also require analyzing the following sources of information.
   a) Interim financial information
   b) Budgets
   c) Management Accounts
   d) Non-financial information etc

Scrutiny of Trial Balance and Grouping Schedule

SCRUTINY OF TRIAL BALANCE

CONCEPT OF TRIAL BALANCE

A Trial Balance is defined as a statement of debit and credit balances of individual general ledger accounts. It is prepared primarily to test first-hand arithmetical accuracy of books of accounts and to facilitate quick preparation of financial statements. It is generally prepared at the end of an accounting period, e. g., a month a quarter or year. It is also known as a list of balances of General Ledger Accounts

In a mechanized accounting system, each Account head of a Chart of Accounts is given a code following a codification logic in order of Balance Sheet, Income Statement and Clearing Accounts to ensure compliance with the entity's declared accounting and reporting policies, disclosure requirements mandated by relevant regulations. Any Trial Balance adheres to the same codification in assembling the account balances and gives a bird's eye view of all accounts based on which the organization may prepare financial statements. In manual accounting system, it also helps testing arithmetical accuracy of books of accounts and detecting clerical errors. However, it can only detect errors other than errors of principle, compensating errors and errors of complete omission.

In addition to the above, a Trial Balance also facilitates identification of any unusual increase/decrease in number in any account head or unusual nature of balances, e.g., credit balance in Depreciation A/c or debit balance of TDS Payable A/c, etc. by providing a summarized view of account balances. It also helps in budgetary control of incomes, expenses, element-wise working capital, and capital expenditure.

SCRUTINY OF TRIAL BALANCE BY AUDITOR

An auditor can use Trial Balance to reap important benefits. He can reasonably be assured about the arithmetical accuracy of the accounts when the trial balance has tallied. An appraisal of Trial Balance may also help him in identifying the areas where analytical procedures should be undertaken. For example, when the Trial Balance for a given period end shows an unusual change in specific account balances or unusual nature of account balances, the auditor may decide to conduct trend analysis and/or variance analysis with reference to the balance of corresponding previous period to identify reasons for such unusual changes or unusual nature of balances.

However, while undertaking the scrutiny of Trial Balance to reap the above benefits, the auditor should ensure that:

1.it has been prepared after a declared cut-off date for considering primary accounting entries for business transactions and other journal entries,

2. the codification logic has been adhered to while preparing the trial balance.

3.it has been prepared strictly based on 'As the Books written' without any adjustments inserted from any sources other than Financial Ledgers on a given date/or period end.

4. before the grouping schedule is prepared ledger accounts are corrected based on adverse observations emerging from Trial Balance scrutiny.

SCRUTINY OF GROUPING SCHEDULE

CONCEPT OF GROUPING SCHEDULE

Grouping Schedules or clusters of related ledger account heads under specified account groups and sub-groups are prepared before aggregated financial numbers are carried forward to Income Statement, Balance Sheet, and Notes to Accounts. This is an essential step before proceeding forward to draft financial statements in compliance with requirements of all the four 'Frameworks of Accounting.'

OBJECTIVES OF GROUPING SCHEDULE

The objectives of preparing Grouping Schedule are as follows:

1. Compilation of heads of accounts according to the line items prescribed under relevant regulations for preparation and reporting of financial statements of the organization.
2. Preparation of Notes to Accounts and clustering ledger account heads to comply with disclosure requirements as mandated by respective provisions of laws and regulations governing the accounting of the organization.
3. Exercising budgetary control both at granular level and group of accounts level in conformity with the process followed for forecasting, budgeting, and budgetary control, and
4. Automating presentation of financial analyses required for different purposes and by different stakeholders using an automated computing process and or disjointed excel sheets. Following is an example of Grouping Schedule relating to Balance Sheet.

GL Account Code	Primary Group	Secondary Group	Tertiary Group
Non-Current Assets	**Property, Plant & Equipment**	**Land**	
		Building	
		Plant & Machinery	
		Furniture & Fixture	
		Motor Vehicles, etc.	
	Intangible Assets	**Intellectual Property Rights**	
		ICT Software, etc.	
	Investments		
		Shares of Companies	
		Government Bonds	

GL Account Code	Primary Group	Secondary Group	Tertiary Group
Current Assets	**Receivables**	**Government Entities**	
		MSMEs	
		Others	
	Inventory	**Raw Materials**	
		Finished Goods	
		Work-in-Progress	
		Stores and Spare Parts	
	Investments		
	Cash and Cash Equivalents	**Short term Deposits**	
		Cash Balances	

❖ **AUDITOR'S ROLE WITH RESPECT TO GROUPING SCHEDULE**

Under a mechanized accounting system with a descent and pretested reliable software, accounts are finalized and financial statements are prepared automatically based on organization's policy for Grouping Schedules. While this automated process minimizes infiltration of human bias, chances of unintentional errors and organized frauds cannot be ruled out completely. Management, by inappropriately compiling the heads, may still misguide the users in their process of interpreting the line items. In addition, any attempt of relational analysis may also be jeopardized. As a result, methodology adopted in designing the Grouping Schedule may be a potential cause of concern for the auditor. The auditor, in this respect, should ensure that –

1. the composition of Grouping Schedules for various line items of the financial statements has

adhered to the prescription of the relevant regulations.

2. the composition of the Grouping Schedule for various line items has been decided only by the person(s) authorized for this purpose.

3. appropriate customization of the accounting software has been done to meet organization's accounting and reporting requirements.

4. the composition of the Grouping Schedule has not been altered without appropriate authorization triggered by any legal and/ or regulatory authority.

A scrutiny of the Grouping Schedule helps the auditor confirm that the composition of individual line items in the financial statements are appropriately computed and are in compliance with the organizational policy and provisions of relevant laws and regulations.

1.6

• APPLICATION OF TECHNOLOGY IN AUDITING AND AUDIT TRAIL

Application of Technology in Auditing

❖ AUDITING IN AN AUTOMATED ENVIRONMENT

In recent years, there is growing application of computer assisted information systems in organizations for processing and storage of accounting records and other information. This has truly revolutionized the accounting and administrative controls, information flow and and finalization of annual accounts. In many organizations, the processes, operations. by using computer systems – also known as Information Systems (IS) or Information Technology (IT) systems which makes the environment automated.

Automated environment offers a lot of advantages:

a. It enables accurate data processing. As a result, computation becomes more reliable.
b. It can process high volume of transactions easily.
c. It makes business processes faster.
d. It improves control efficacy and security.
e. It minimizes the human errors.
f. It offers better integration among business processes.

In an automated environment, auditing also undergoes through significant changes as Automated environment offers a lot of advantages:

❖ COMPONENTS OF AUTOMATED ENVIRONMENT

Following are the general components of an automated environment.

1. Databases - Oracle 19C, MS-SQL Server;
2. Operating systems - Windows, Unix, Linux;
3. Hardware and Storage devices – servers, disks, tapes, network storage;
4. Network devices - switches, routers and firewalls;
5. Networks - local area networks, wide area networks, virtual private networks, etc.;
6. Physical and environmental landscape –IT facilities like Data center, physical access control mechanisms like biometric based access system, CCTVs, adequate HVAC system, fire suppression system etc.

In addition, there are application software such as Package Software (e.g., Tally, QuickBooks), Small ERPs (e.g., Tally ERP, SAP, Business One, Focus ERP) and ERP applications for medium to large enterprises (e.g., SAP ECC, Oracle Enterprise Business Suite).

❖ AREAS OF USE OF COMPUTER IN AUDITING

The following are certain areas where the use of computer in auditing may be useful:

1. Preparation of detailed audit programming.
2. Preparation of audit planning, scheduling and assignment of available manpower to different assignments in hand.
3. Checking of validity, consistency and reasonableness of entries.
4. Reviewing the internal control of the system.
5. Retrieving requires key information from the files for making comparison with the set of standard information.
6. Doing arithmetical computations and checking the arithmetical computations.
7. Doing analytical review of the data by way of comparison, ratio analysis, trend analysis, of reason- ableness and so on.
8. Selecting representatives for vouching, verification-debtors accounts may be planned to be listed if they comply with certain predetermined criteria.
9. Preparation of flow- charts.
10. Preparation of audit reports, documenting working papers and writing other etc.

❖ CONTROLS IN AN AUTOMATED ENVIRONMENT AND AUDITOR'S ROLE

Authenticity and reliability of information in an automated environment largely depends on the controls in place in such environment. Thus, auditing in an automated environment requires an auditor to evaluate the same before applying the audit procedures. There are following types of controls in an automated environment.

1. Application controls

Application controls are those controls (manual and computerized) that relate to the transaction and standing data pertaining to a computer-based accounting system. Application controls need be ascertained, recorded and evaluated by the auditor as part of the process of determining the of material misstatement in the audit client's financial statements.

2. Input controls

Control activities designed to ensure that input is authorized, complete, accurate and timely are referred to as input controls. The auditor needs to apply specific input validation checks to evaluate the same.

a) **Range checks:** These ensure that information input is reasonable in line with expectations.

b) **Compatibility checks:** These ensure that data input from two or more fields is compatible. For example, a sales invoice value should be compatible with the amount of sales tax charged on the invoice.

c) **Validity checks:** These ensure that the data input is valid.

d) **Exception checks:** These ensure that an exception report is produced highlighting unusual situations that have arisen following the input of a specific item.

e) **Sequence checks:** These facilitate completeness of processing by ensuring that documents processed out of sequence are rejected.

f) **Control totals:** These also facilitate completeness of processing by ensuring that pre-input, manually prepared control totals are compared to control totals input.

g) **Check digit verification:** This process uses algorithms to ensure that data input is accurate.

3. Processing controls

Processing controls exist to ensure that all data input is processed correctly and that data files appropriately updated accurately in a timely manner. The processing controls for a specified application program should be designed and then tested prior to 'live' running with real data.

4. Output controls

Output controls exist to ensure that all data is processed and that output is distributed only to prescribed authorized users. While the degree of output controls will vary from one organization another (dependent on the confidentiality of the information and size of the organization), common controls comprise use of batch control totals, exception reports etc. The auditor must ensure that output is kept confidential and available to authorized users only.

5. Master file controls

The purpose of master file controls is to ensure the ongoing integrity of the standing data contained in the master files. It is vitally important that stringent 'security' controls should be exercised over all master files. The auditor must ensure that master file controls are effective and adequate.

The above evaluation largely determines the auditor's workload and scope of the audit work.

❖ TESTING METHODS IN AN AUTOMATED ENVIRONMENT

An auditor applies four types of tests to identify the reliability of controls and associated risks. These are inquiry, observation, inspection and reperformance. Though inquiry is the most it must always be used with any of the three other methods to produce better results. Again, reperformance, though the most effective method, is time consuming and less efficient. Thus, keeping in mind the risk assessment, internal controls in place, desired level of evidence required, past history of errors and complexity of the business processes, the auditor needs to decide the appropriate method of testing. Some of the common testing in an automated environment include the following:

1. Obtain an understanding of the processing of an automated transaction by doing a walkthrough of one end-to-end transaction using a combination of inquiry, observation and inspection.
2. Observe how a transaction is recorded by a user in different scenarios.
3. Inspect the configuration of an application control.

For example, the auditor may perform a test check (negative testing) and observe the error message displayed by the system or he may inspect the technical manual of systems and applications.

Audit Trail

❖ CONCEPT OF AUDIT TRAIL

Audit trail may be defined as the documents, records relating to transactions that enables an auditor to trace the transactions from the source documents to the summarized total in reports. It is an orderly, step-by- step record of transactions that serves as a proof of a transaction's history, right from recording to tracking all changes that may take place. For example, a sequentially numbered sales invoice copies would normally be listed in a Register and subsequently filed either in numerical or chronological order. Thus, it would be possible to trace particular invoice from the daybook to the original file by reference to the number or date of the invoice.

In an automated environment accounting software provides the ideal example of audit trails. For example, when a transaction is entered in the software, the software will maintain a record of it. Any further edits made to the details, such as a change in the name or amount will also be by the software along with the user who made the changes and the time of change. Even if some transactions were to be deleted, the software will track that as well and keep the record of everything since the original entry was made.

❖ STATUTORY REQUIREMENT FOR AUDIT TRAIL

According to Rule 3(1) of Companies (Accounts) Rules, 2014, as amended by Companies Amendment Rules, 2021, for the financial year commencing on or after the 1st day of April, 2022, every company which uses accounting software for maintaining its books of account, shall use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled.

In simple words, the expectation is to maintain the edit log of every transition right from to tracking the changes that may take place.

❖ HOW DOES AN AUDIT LOG OPERATE?

An automatic record has automated logs, unlike a manual record that needs one to input the The operations depend on the nature of IT infrastructure of the entity. It varies as per the systems, applications, and devices.

Audit trails record every activity that occurs within your system. It takes details of when, how by whom the activity was done. It also shows the response of your system to the activities that took place.

Edit Log feature of software allows tracking the edits for masters and every transactions, the date details and username when changes are made, generation of difference report etc. Thus, through audit trail it is possible to identify unauthorized changes causing material very easily.

❖ BENEFITS OF AUDIT TRAIL

A well-functioning audit trail offers the following benefits:

1. **User Accountability:** In an automated environment, a well-functioning audit trail system records the activities of every user. This promotes appropriate user behavior because everyone is held accountable for their doings. Thus, introduction of virus to the system or unauthorized alteration of data can be prevented. Additionally, it helps to identify the intruders.

2. **Promotes Organization's Data Security:** A well-functioning audit trail system ensures data security as it protects data from unauthorized access and fraudulent activities by staff and external parties.

3. **Allows Reconstruction of Events:** An excellent audit log system allows organizations to understand the operations of users, including cyber attackers. Data retrieval is also possible in some cases.

4. **Detection of System Interference and Errors:** A functioning audit trails system indicates upcoming system interference, failures, and errors. Such detections allow an organization to respond accordingly to allow a smooth continuation of its operations.

❖ AUDITOR'S DUTY TO REPORT ON AUDIT TRAIL

According to Rule 11 of Companies (Audit and Auditors) Rules, 2014, as amended by Companies (Audit and Auditors) Amendment Rules, 2021, an auditor needs to report whether the company, respect of financial years commencing on or after the 1st April, 2022, has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

OBJECTIVES

A. Multiple Choice Questions

1. Which of the following is not an audit risk?
A. Inherent Risk
B. Detection Risk
C. Control risk
D. Omission Risk

2. Permanent Audit File does not contain
A. A record of study and evaluation of internal control system
B. Significant audit observations of earlier years
C. Copies of management letters
D. Analysis of significant ratios and trends

3. Audit Procedures to obtain audit evidences include
A. Compliance Procedure
B. Substantive Procedure
C. Both of A and B
D. Neither A nor B

4. SA 530 stands for
A. Audit Documentation
B. Audit Sampling
C. Responsibility of Joint Auditor
D. Agreeing the terms of Audit Engagements

5. Which of the following is not a part of Temporary Audit file?
A. Correspondence relating to acceptance of annual reappointment.
B. Audit programme.
C. Extracts of minutes of board meetings
D. Legal and organisation structure of the company.

6. SA 230 stands for
A. Quality control for an audit of Financial Statements
B. Agreeing the terms of Audit Engagements.
C. Audit Documentation
D. Responsibility of Joint Auditor

7. Internal Audit is mandatory for every unlisted public company having paid up share capital of
A. ` 100 crores during the preceding financial year
B. ` 50 crores during the preceding financial year
C. ` 500 crores during the preceding financial year
D. ` 200 crores during the preceding financial year

8. Check list contains the instructions to be followed by the
A. Employer of the organisation
B. Employee of the organisation
C. Banker to the organisation
D. Audit staff engaged by the auditor of the organisation

9. SA 210 stands for
A. Audit Planning
B. Audit Working Papers
C. Agreeing the terms of Audit Engagements
D. Audit Documentation

10. Test checking requires application of ____________.
A. mathematical theory
B. sampling theory
C. geometry theory
D. stakeholder theory

B. State True or False

1. There is no difference between statutory and external audit- **FALSE**

2. An investigation is done with the generally accepted auditing procedure- **FALSE**

3. The primary objective of the audit is for detecting frauds and error in the books of accounts and financial records of the client's business- **FALSE**

4. The concept of true or fair is a fundamental concept in auditing- **FALSE**

5. An audit engagement is the initial stage of an audit during which the auditor notifies the client that he has accepted the audit work- **TRUE**

6. An audit programme is a detailed plan of the auditing- **TRUE**

7. An Audit note book is a bound book in which a large variety of matters observed during the course of audit are recorded- **TRUE**

8. Internal Auditing is a function distinct from authorisation and recording- **TRUE**

9. Internal auditor of a company cannot be its Cost Auditor- **FALSE**

10. Risk based internal auditing (RBIA) is a methodology that links internal auditing to an organisation's overall risk management framework- **TRUE**

11. Auditing in depth refers to the procedure where a few selected transactions are meticulously examined from their beginning to their conclusion- **TRUE**

12. Analytical procedure includes trend analysis- **TRUE**

C. Fill in the Blanks

1. Audit is derived from Latin word **AUDIRE**

2. Audit programme act as a **CHECKLIST** of audit procedures to be performed.

3. The reliability of audit evidence depends on its source **INTERNAL** or **EXTERNAL**.

4. An audit report is the **FINAL** product of every audit.

5. Audit working papers are the record of the **PLANNING** and execution of the audit engagement.

6. Internal Audit is an Independent **APPRAISAL** activity.

7. Cut off procedures are generally applied to **TRADING** transactions.

8. The Internal Auditor is appointed by the **DIRECTORS**

9. IFC = IFC-FR + **OPERATIONAL CONTROL** + Anti-fraud Controls

10. This risk associated with sampling can broadly be divided into two categories – sampling and **NON SAMPLING RISK**

2.1

• STATUTORY AUDIT, BRANCH AUDIT AND JOINT AUDIT, ROLE OF AUDIT COMMITTEE

The term 'statutory' signifies anything regulated by laws of the state. Accordingly, an audit which is conducted under any specific statute or Act may be called 'statutory audit'

In a company form of organization, the management is separated from ownership. Though shareholders are the owners of company's properties, they do not actively take part in the management of the company; instead, the company is managed by a group of managers who are entrusted with the proper utilization of the resources procured by the company with the objective of maximization of shareholders' wealth. Therefore, in this context, the management's stewardship must be properly vouched by an independent third party. This is why, audit of the books of accounts by a qualified and independent auditor has been made mandatory in every company.

Company Auditor's Eligibility

QUALIFICATIONS OF A COMPANY AUDITOR

As per Section 141 of Companies Act, 2013, the following persons should be considered as qualified for being a company auditor:

1. A person shall be eligible for appointment as an auditor of a company, only if he is a Chartered Accountant [Section 141(1)].
2. A firm can also be appointed by its firm name to act as the auditor of a company if majority of its partners practicing in India are qualified for appointment as company auditor [Section 141(1)].
3. Where a firm, including a limited liability partnership, is appointed as an auditor of a company, only the partners who are Chartered Accountants shall be authorized to act and sign on behalf of the firm [Section 141(2)].

Note: In this context, the meaning of the term 'Chartered Accountant' shall be interpreted based on the provisions of The Chartered Accountants Act, 1949 as follows:

1. "Chartered Accountant" means a person who is a member of the Institute [Section 2].
2. A person is a member of the Institute if his name appears in the Register of the Institute [Section 3].

1. **The following persons shall be entitled to have his name entered in the Register [Section 4]:**

a) any person who is a registered accountant or a holder of a restricted certificate at the commencement of this Act.

b) any person who has passed such examination and completed such training as may be prescribed for members of the Institute.

c) any person who has passed the examination for the Government Diploma in Accountancy or an examination recognized as equivalent thereto by the rules for the award of the Government Diploma in Accountancy before the commencement of this Act and fulfils such conditions as specified by the Central Government in this behalf.

d) any person who, at the commencement of this Act, is engaged in the practice of accountancy in any State and fulfils such conditions as specified by the Central Government in this behalf. any person who has passed such other examination and completed such other training without India as is recognized by the Central Government or the Council as being equivalent to the examination and training prescribed for members of the Institute.

e) any person domiciled in India, who at the commencement of this Act is studying for any foreign examination and is at the same time undergoing training, whether within or without India, have passed the examination or completes the training within five years after the commencement of this Act.

In order to become the member of the Institute, the aforesaid persons must reside in India or must be in practice in India. For any person outside India with all other requisite qualifications, the Central Government or the Institute may impose additional conditions. Moreover, any qualified persons will have to formally apply for the membership to the Institute with requisite fees. His name will be included in the Register only if the application is accepted.

DISQUALIFICATION OF A COMPANY AUDITOR

As per Section 141(3), read with Rule 10 of Company (Audit and Auditor) Rule 2014, the following persons shall not be eligible for appointment as an auditor of a company:

1. a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
2. an officer or employee of the company;
3. a person who is a partner, or who is in the employment, of an officer or employee of the company;
4. a person who, or his relative or partner:

a) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company, of face value not exceeding one lakh;

b) is indebted to the company, or its subsidiary, or its holding or associate company or Subsidiary of such holding company, in excess of rupees five lakh;

c) has given a guarantee or provided any security in connection with the indebtedness of any Third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees one lakh;

5. a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;

For this purpose, the term 'business relationship' shall be construed as any action entered into for a purpose, except–
(a) commercial transaction which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Companies Act, 2013 or the Chartered Accountants Act, 1949 regulations made under those Acts;
(b) commercial transactions which are in the ordinary course of business of the company at arm's length price– like sale of products or services to the auditor as customer.

6. a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;

7. a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

8. a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

9. a person who, directly or indirectly, renders any service referred to in Section 144 to the company or its holding company or its subsidiary company.

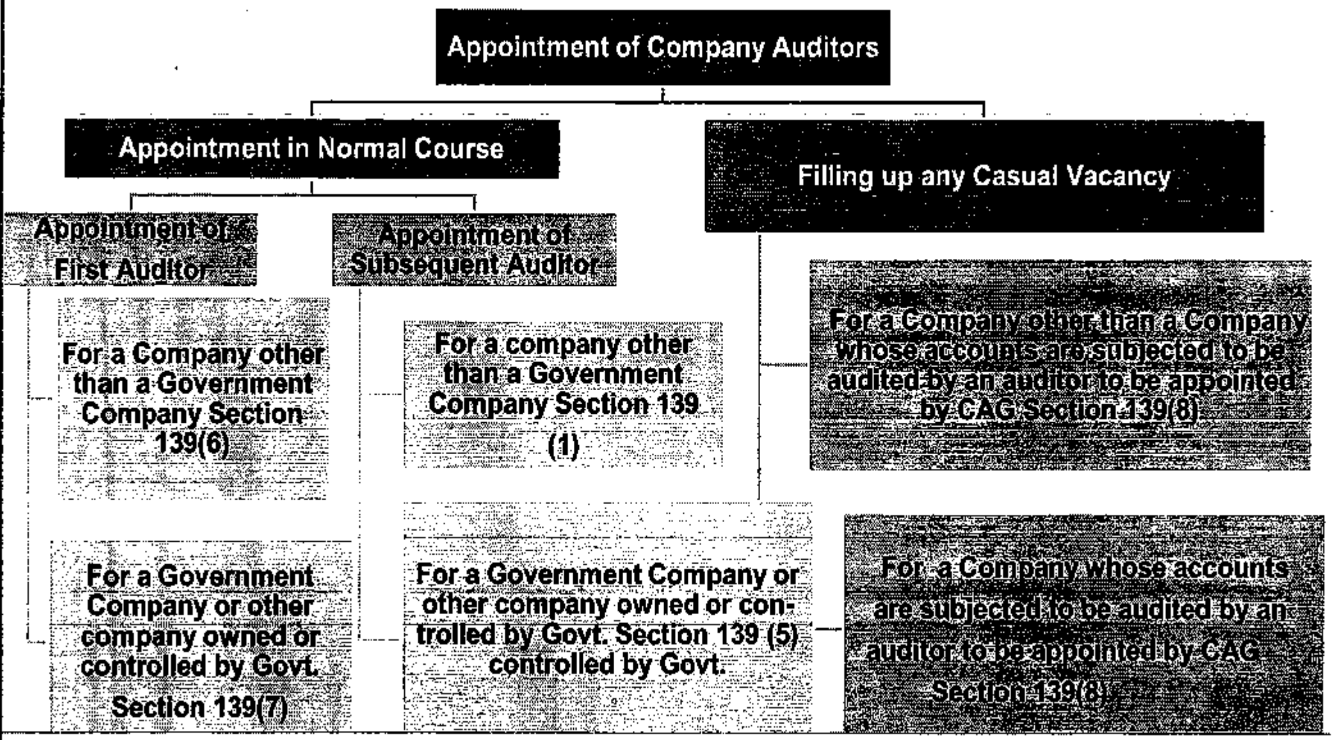
Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor [Section 141(4)]

Note: According to Section 144 of the Companies Act, 2013, an auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be. However, such services shall not include the following services, whether rendered directly or indirectly to the company or its holding company or subsidiary company.

(a) accounting and book keeping services;
(b) internal audit;
(c) design and implementation of any financial information system;
(d) actuarial services;
(e) investment advisory services;
(f) investment banking services;
(g) rendering of outsourced financial services;
(h) management services; and
(i) any other kind of services as may be prescribed.

Appointment of a Company Auditor

Appointment of a company auditor is governed by Section 139 of Companies Act,2013



APPOINTMENT IN NORMAL COURSE

I. PROVISIONS RELATING TO APPOINTMENT OF FIRST AUDITOR

A. In case of a company other than a Government Company [Section 139(6)]

1. The first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within thirty days from the date of registration of the company.
2. In the case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall appoint such auditor within ninety days at an extraordinary general meeting.
3. The auditor, so appointed, shall hold office till the conclusion of the first annual general meeting.

B. In case of a Government Company [Section 139(7)]

1. In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within sixty days from the date of registration of the company.
2. In case the Comptroller and Auditor-General of India does not appoint such auditor within the aforesaid period, the Board of Directors of the company shall appoint such auditor within the next thirty days.
3. Further, in the case of failure of the Board to appoint such auditor within the next thirty days, it shall inform the members of the company who shall appoint such auditor within sixty days at an extraordinary general meeting.
4. The auditor, so appointed, shall hold office till the conclusion of the first annual general meeting.

Note: For the aforesaid purpose 'Government Company' shall mean a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government Company.

II. PROVISIONS RELATING TO APPOINTMENT OF SUBSEQUENT AUDITOR

A. In case of a company other than a Government Company [Section 139(1), read with Rule 3 and 4 of Company (Audit and Auditors) Rule 2014]

1. Every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.
2. Before such appointment is made, the written consent of the auditor to such appointment and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as prescribed, shall be obtained from the auditor.
3. The certificate shall also indicate whether the auditor satisfies the criteria provided in Section 141.
4. The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within fifteen days of the meeting in which the auditor is appointed in Form ADT-1 [Rule 4(2)].

B. In case of a Government Company [Section 139(5)]

1. In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year.
2. The auditor, so appointed, shall hold office till the conclusion of the annual general meeting.

III. APPOINTMENT IN CASE OF FILLING A CASUAL VACANCY [SECTION 139(8)]

A. In case of a company other than a company whose accounts are subject to audit by an auditor appointed by the CAG

1. Any casual vacancy will be filled by the Board of Directors within thirty days.
2. If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board.
3. The auditor, so appointed, shall hold the office till the conclusion of the next annual general

meeting.

B. In case of a company whose accounts are subject to audit by an auditor appointed by the CAG

1. Any casual vacancy will be filled by the Comptroller and Auditor-General of India within thirty days.
2. In case the Comptroller and Auditor-General of India does not fill the vacancy within the aforesaid period, the Board of Directors shall fill the vacancy within next thirty days.

Note: Though not defined clearly, 'casual vacancy' for the aforesaid purpose usually implies cessation service of an existing auditor due to his death, resignation, disqualification, etc.

Re-appointment of a Company

As per Section 139(9), a retiring auditor may be re-appointed at an annual general meeting, if:

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

Automatic Re-appointment of a Company Auditor

According to Section 139(10), where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

Role of Audit Committee's Recommendation in Appointment of Auditors

Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

Ceiling on the Number of Audit Assignments

As per Section 141(3)(g), a person or a partner of a firm shall not be eligible for appointment as the auditor of a company if –

1. Such person is in full time employment elsewhere; or
2. Such person or partner is, at the date of such appointment or reappointment, holding appointment as auditor of more than twenty companies, other than one person companies, dormant companies, small companies and private companies having paid up capital less than ₹100 crore.

Accordingly, the following points shall be kept in mind:

a) Every qualified chartered accountant who is not in full time employment can be the auditor of a maximum of twenty companies.
b) In case of a partnership firm, the limit will be twenty companies for each individual partner. Hence, for a firm with three partners, the overall limit will be (20 × 3) = 60 companies.
c) While computing the ceiling in case of a partnership firm, a partner with full time employment elsewhere should not be taken into account.
d) If any chartered accountant is a partner in a number of audit firms, then all the firms together will be entitled to audit 20 companies with respect to such common partner.
e) Similarly, if a chartered accountant is practicing individually and is also the partner in other firm or firms, the overall ceiling with respect to him as individual and also the partner will be 20 companies.
f) While calculating the above ceiling, a joint audit assignment will be taken as one unit. Moreover, if an auditor is appointed to audit even a part of company's accounts, it will be considered as one unit.
g) Every auditor, as an individual or as a partner of a firm can accept a maximum of 60 tax audit assignments.

Note: If any chartered accountant in practice, at any time, holds appointment of more than the specif number of audit assignments of companies, he shall be deemed to be guilty of professional miscondu (Council General Guidelines 2008, Chapter VIII)

Resignation by a Company Auditor

According to Section 140(2) of Companies Act, 2013 read with Rule 8 of Company (Audit and Auditors) Rule 2014, a company auditor resigning from his post must comply with the following steps:

1. The auditor shall file within a period of thirty days from the date of resignation, a statement in the prescribed Form ADT-3 with the company and the Registrar, indicating the reasons and other

facts as may be relevant with regard to his resignation.

2. In case of companies referred to in sub-section (5) of Section 139, i.e., Govt. Companies or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the auditor shall file such statement with the Comptroller and Auditor-General of India.

If the auditor does not comply with the above provision, he or it shall be punishable with fine of fifty thousand rupees or the amount equal to the remuneration of the auditor, whichever is less, and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees. [Section 140(3)]

Rotation of Company Auditor

A. ELIGIBLE COMPANIES

The provisions for rotation of auditors shall be applicable to –

1. Every listed company excluding one person companies and small companies.
2. Every unlisted public company having paid up share capital of rupees ten crore or more;
3. Every private limited company having paid up share capital of rupees fifty crore or more;
4. All other companies having public borrowings from financial institutions, banks or public deposits of rupees fifty crore or more.

B. MAXIMUM TERM

1. No individual shall be appointed or reappointed as auditor for more than one term of five consecutive years.
2. No audit firm shall be appointed or reappointed as auditor for more than two terms of five consecutive years.

C. ADDITIONAL CONDITIONS FOR ROTATION

1. An individual auditor or an audit firm who/which has completed his/its term shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term.
2. On the date of appointment, no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall

be appointed as auditor of the same company for a period of five years:

3. Every company, existing on or before the commencement of this Act, which is required to comply with provisions of Section 139(2), shall comply with requirements of this sub-section within a period which not be later than the date of the first AGM of the company held within the period specified in Section 96(1), after 3 years from the date of commencement of Companies Act.

4. The above provisions shall not prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.

D. ROTATION OF PARTNERS IN THE AUDIT FIRM

According to Section 139(3), the members of a company may resolve to provide that -

1. in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or
2. the audit shall be conducted by more than one auditor.

E. MANNER OF ROTATION OF AUDITORS BY THE COMPANIES ON EXPIRY OF THEIR TERM

As per Section 139(4), the Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors in pursuance of Section 139(2). Accordingly, the Central Government has prescribed the following provisions under Rule 6 of the Company (Audit and Auditor) Rules 2014.

1. Where a company is required to constitute an Audit Committee u/s 177 of the Act, the Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.
2. Where a company is not required to constitute an Audit Committee u/s 177 of the Act, the Board shall consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

Note: For the purpose of the rotation of auditors –

1. the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;
2. the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

The term "same network" shall include the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

Note: For the purpose of rotation,

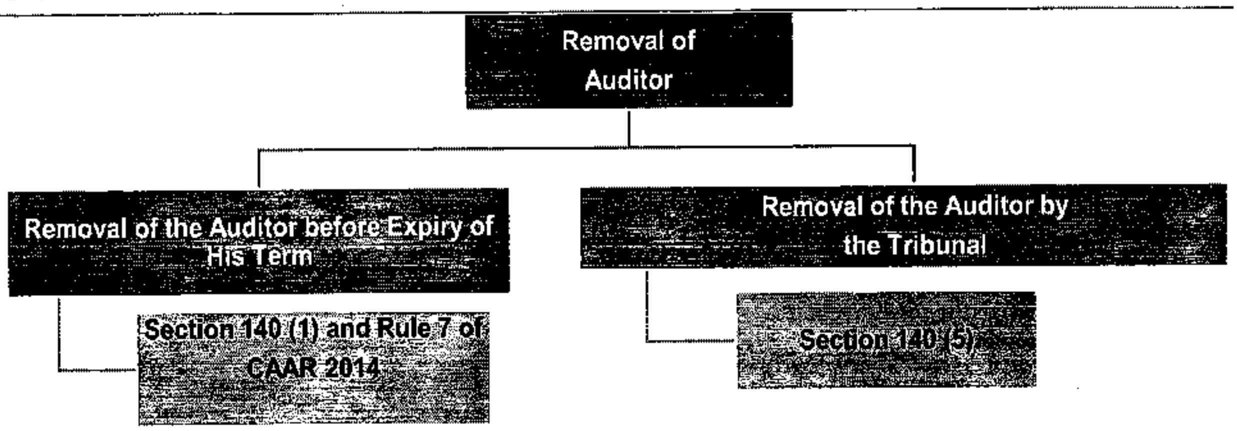
1. a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;
2. if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

Remuneration of Company Auditor

Section 142 of Companies Act, 2013 contains the statutory provisions in relation to remuneration of auditors are contained in. These are as follows:

1. The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. The Board may, however, fix remuneration of the first auditor appointed by it.
2. The above remuneration shall be in addition to the fee payable to an auditor and shall include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him. However, it must not include any remuneration paid to him for any other service rendered by him at the request of the company

Removal of the Company Auditor



A. REMOVAL OF THE AUDITOR BEFORE EXPIRY OF HIS TERM

The auditor appointed under Section 139 may be removed from his office before the expiry of his term, subject to the fulfilment of the following conditions under Section 140 (1) read with Rule 7 of CAAR 2014:

1. An application to the Central Government for removal of the auditor shall be made in Form ADT-2. The application shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.
2. The application shall be made to the Central Government within thirty days of the resolution passed by the Board.
3. The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution for removal of the said auditor.
4. The auditor concerned shall be given a reasonable opportunity of being heard.

B. REMOVAL OF THE AUDITOR BY THE TRIBUNAL

As per Section 140(5), an auditor can be removed from his office by the Tribunal in the following manner:

1. The Tribunal either suo motu or on an application made to it by the Central Government or by any person concerned, may, by order, direct the company to change its auditor, if it is satisfied that the auditor has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.
2. If the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order to the removal of the auditor from his office.
3. The Central Government may appoint another auditor in his place.
4. An auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this Section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under Section 447.

Note: For this purpose, the word 'auditor' shall include a firm of auditors.

Moreover, in case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.

Rights of the Company Auditor

Effective discharge of duties on the part of the auditor requires certain rights and power which are company auditor:

1. **Inspect Books of Accounts and Vouchers:** Every auditor of a company shall have the right of access, at all times, to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place. In addition, auditor of a holding company shall also have the right of access to the records of all its subsidiaries and associate companies in so far as it relates to the consolidation of its financial statements with that of its subsidiaries [Section 143(1)].

2. **Obtain Information and Explanations:** The auditor shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as the auditor [Section 143(1)].

3. **Inspect Branch Offices and Branch Accounts:** The company auditor is also entitled to inspect the accounts of any branch office in case he considers it necessary in order to discharge his duties as the company auditor. He can do so, even if a separate auditor has already been appointed to audit the branch accounts [Section 143(8)].

4. **Receive the Report of Branch Audit from the Branch Auditor:** In case a separate auditor has been appointed to audit the branch accounts, the company auditor has the right to receive the branch audit report from the branch auditor so appointed and use it to prepare the overall audit report [Section 143(8)].

5. **Sign the Audit Report and Other Documents:** The company auditor also has the right to sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of sub-section of Section 141 [Section 145].

6. **Have Audit Report Read at the AGM:** The company auditor has the right to have the report read before the company in the General Meeting (especially in case the qualifications, observations or comments on financial transactions or matters, mentioned in the auditor's report, have any adverse effect on the functioning of the company) and the same shall be open to inspection by any member of the company [Section 145].

7. **Receive Notices and Attend General Meetings:** The company auditor is entitled to receive all notices of, and other communications relating to, any general meeting and to attend such meetings

either by himself or through his authorized representative, who shall also be qualified to be an auditor. The auditor shall also have the right to be heard at such meeting on any part of the business which concerns him as the auditor [Section 146].

8. Attend the Meeting of the Audit Committee: The auditors of a company shall have a right to attend the meetings of the Audit Committee and to be heard in the meetings when the Committee considers the auditor's report, but shall not have the right to vote [Section 177(7)].

9. Right to be Indemnified: The auditor of a company shall also have the right to be indemnified for any expenses incurred by him in defending himself in case the judgement in any law suit (whether civil or criminal) against the company goes in favor of the auditor.

The above rights of a company auditor are protected by law and no clause of the Articles of Association of a company or resolution adopted in any meeting can supersede them.

Duties of the Company Auditor

The Companies Act, 2013 provides a comprehensive list of duties of a company auditor. These are enumerated below:

1. DUTY TO INQUIRE:

As per Section 143(1), it is the duty of the auditor to inquire into the following matters:

1. whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
2. whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
3. In case of a company other than an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
4. whether loans and advances made by the company have been shown as deposits;
5. whether personal expenses have been charged to revenue account;
6. where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

2. DUTY TO REPORT ON FINANCIAL STATEMENTS OF THE COMPANY

As per Section 143(2), the auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act after taking into account the provisions of this Act, the accounting and auditing standards etc. Additionally, he has also to report whether in his opinion and according to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year.

3. DUTY REGARDING INCLUSION OF CERTAIN MATTERS IN THE AUDIT REPORT

As per Section 143(3), the auditor's report shall also clearly state –

1. Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements.
2. Whether, in his opinion, proper books of account as required by the law have been kept by the company and proper returns adequate for the purposes of his audit have been received from branches not visited by him.
3. Whether the report on the accounts of any branch office of the company audited by a person other than the company's auditor has been sent to him and the manner in which he has dealt with it in preparing his report.
4. Whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns.
5. Whether, in his opinion, the financial statements comply with the accounting standards.
6. The observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company.
7. Whether any director is disqualified from being appointed as a director under subsection (2) of Section 164.
8. Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.
9. Whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls.

10. The auditor's report shall also include his views and comments on the following matters, namely:

a) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;

b) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;

c) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company;

d) i. whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or Invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries.

ii. whether the management has represented, that, to the best of it's knowledge and belief, Other than as disclosed in the notes to the accounts, no funds have been received by the cm company froany person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and

iii. based on such audit procedures that the auditor has considered reasonable and appropriate the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (1) and (2) contain any material mis-statement.

e) whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.

f) whether the company, in respect of financial years commencing on or after the 1st April, 2022, has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for transactions recorded in the software and the audit trail feature has not been tampered with the audit trail has been preserved by the company as per the statutory requirements for record retention.

4. DUTY TO PROVIDE REASONS FOR ANY NEGATIVE REMARKS/QUALIFICATION.

According to Section 143(4), where any of the above-mentioned matters required to be included in the audit report is answered in the negative or with a qualification, the report shall state the reasons therefor.

5. DUTY TO COMPLY WITH THE DIRECTIONS OF CAG

As per section 143(5), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the auditor shall, in his report, include–

1. The directions, if any, issued by the Comptroller and Auditor-General of India regarding the manner of audit of accounts; and
2. The action taken on such directions and its impact on the accounts and financial statement of the company.

6. DUTY TO COMPLY WITH AUDITING STANDARDS

Section 143(9) provides that it is the duty of every company auditor to comply with the applicable auditing standards in conduct of his audit.

7. DUTY TO REPORT ANY FRAUD TO THE CENTRAL GOVERNMENT

According to Section 143(12) read with Rule 13 of the Company (Audit and Auditors) Rules 2014 –

1. If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.
2. The auditor shall report the matter to the Central Government as under:
   a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five days;

b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;

c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and

f) The report shall be in the form of a statement as specified in Form ADT-4.

3. In case of a fraud involving lesser than the amount specified in sub-rule (1), the auditor shall report the matter to Audit Committee constituted under Section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:

a) Nature of Fraud with description;
b) Approximate amount involved; and
c) Parties involved.

The provisions of this section regarding the duties of an auditor also apply to the cost accountant conducting cost audit under Section 148 and the company secretary in practice conducting secretarial audit under Section 204 [Section 143(14)].

<u>8. DUTY TO PAY PENALTY</u>

As per Section 143 (15), if any auditor, cost accountant or company secretary in practice fails to comply with the provisions of sub-section (12) of Section 143, he will be liable –

1. in case of a listed company, to pay a penalty of five lakh rupees; and
2. in case of any other company, to pay a penalty of one lakh rupees.

9. DUTY TO MAKE COMMENTS SOUGHT BY THE AUDIT COMMITTEE ON CERTAIN MATTERS

According to Section 177(5), it is the duty of the company auditor to offer comments on internal control systems, the scope of audit, including the observations of the auditors and review of financial statement, if asked by the Audit Committee.

10. OTHER DUTIES UNDER COMPANIES ACT, 2013

In addition to the above, the auditor shall have the following duties under the Companies Act, 2013

1. To report on the accounts of the company which will be included in the prospectus of the company while issuing new shares [Section 26].
2. To sign on the audit report [Section 145].

Liabilities of the Company Auditor

The duties of a company auditor have been specified in various provisions of the Act. Accordingly, if a company auditor fails to discharge his specified duties, he will be legally held liable. Moreover, there are a number of occasions where an auditor may be held liable to his appointing authority, the Government or any other persons.

The liabilities of an auditor may be discussed as follows:

STATUTORY LIABILITIES

I. UNDER COMPANIES ACT, 2013

A. Civil Liabilities: The civil liabilities as per Companies Act, 2013 are stated below:

1. **For Misstatement in the Prospectus:** As per Section 35, where a person has subscribed for securities of a company acting on any statement included in the prospectus, or on the inclusion or omission of any matter in the prospectus which is misleading and thereby has sustained any loss or damage and where the auditor as an expert has either made such statement or has given written consent to the issue of the prospectus, he shall be held liable.

2. **Liability for Misfeasance:** Misfeasance implies breach of trust or negligence in the performance of duties. As per Section 340, a company auditor may be charged with misfeasance only at the time of liquidation of the company, if it is found that he –

a) has misapplied, or retained, or become liable or accountable for, any money or property of the company; or

b) has been guilty of any misfeasance or breach of trust in relation to the company.

B. Criminal Liability: The criminal liabilities of an auditor under the Companies Act, 2013 are as follows:

1. **Criminal Liability for Misstatement in the Prospectus:** As per Section 34, where the auditor has authorized the issue of any prospectus which includes any statement which is untrue or misleading or where the prospectus has included or omitted any matter which may mislead, the auditor shall be held liable under Section 447.

Accordingly (i.e., as per Section 447), for any fraud, involving an amount of at least ten lakh rupees or one per cent of the turnover of the company, whichever is lower, the auditor shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Moreover, where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

However, where the fraud involves an amount less than ten lakh rupees or one per cent of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both.

2. **Punishment for Non-compliance with Sections 139, 144 and 145 of the Act:** As per Section 147 -

a) If an auditor contravenes the provisions of Section 139, 144 or 145, he shall be punishable with fine which shall not be less than ₹25,000 but which may extend to ₹5,00,000 or four times the remuneration of the auditor, whichever is less.

b) If an auditor has contravened the above provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to 1 year and with fine which shall not be less than ₹50,000 but which may extend to ₹25,00,000 or eight times the remuneration of the auditor, whichever is less.

c) Convicted auditor shall be liable to refund the remuneration received by him from the company and pay for damages to the company, statutory bodies or authorities or to members or creditors of the company for loss arising out of incorrect or misleading statements of particulars made in his audit report.

d) In case where the audit of a company is being conducted by an audit firm, if it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, the partner or partners concerned of the audit firm as well as the firm itself shall be liable for fine jointly and severally. However, for criminal liability other than fine, only the partner or partners will be liable.

3. **Punishment for Refusal or Failure to Produce Documents:** As per Section 217, if any auditor fails without reasonable cause or refuses to produce to an inspector or any person authorized by him in this behalf any book or paper, to furnish any information, to appear before the inspector personally when required, to answer any question which is put to him by the inspector, or to sign the notes of any examination referred to in sub-section (7) of Section 217, he shall be punishable with imprisonment for a term which may extend to six months and with fine ranging from twenty-five thousand rupees to one lakh rupees, and also with a further fine which may extend to two thousand rupees for every day after the first during which the failure or refusal continues.

4. **Fraud in Relation to a Company in Winding-up:** As per Section 336, if any auditor is engaged in any fraudulent activities in relation to any company in winding up, he shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.

5. **Punishment for False Statement:** As per Section 448, if any auditor deliberately makes any false statement in any return, report, certificate, financial statement, prospectus, statement or other document required by the act or deliberately omits any material fact, he shall be liable under Section 447 and shall be subject to the punishment as stated earlier in point (a).

6. **Punishment for False Evidence:** As per Section 449, if the auditor intentionally gives false evidence upon any examination on oath or solemn affirmation or in any affidavit, deposition or solemn affirmation, in or about the winding up of any company or about any matter under this Act, he shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to seven years and with fine which may extend to ten lakh rupees.

II. UNDER OTHER ACTS

1. **Liabilities under Income Tax Act, 1961:** As per Section 278 of the Act, if any auditor abets or induces in any manner another person to make and deliver an account, statement or declaration relating to any income chargeable to tax which is false and which the auditor either knows or does not believe to be true, the auditor shall be punished.
2. **Liabilities under Chartered Accountants Act, 1949:** Schedule I and II of the Act contains a list of instances where a Chartered Accountant shall be held guilty of professional misconduct under Section 22 of the Act.
3. **Liabilities under Life Insurance Act, 1956:** As per Section 104 of the Act, if an auditor makes any false statement in any return, report or other such forms to be issued under this Act, he shall be sentenced to imprisonment or fine or both.
4. **Liabilities under Banking Regulation Act, 1949:** As per Section 46 of the Act, if an auditor in any return, balance sheet, or other document willfully makes a statement, which is false in any material particulars, knowing it to be false, or willfully omits to make a material statement, he shall be held liable.

CONTRACTUAL LIABILITIES

The scope of any audit work is determined by the written contract entered into between the auditor and the client. Thus, if any of the terms of the said contract is contravened, the auditor may be held liable under the Indian Contract Act, 1872.

In case of absence of any written contract between the auditor and the appointing authority, the auditor is expected to conduct complete audit. Hence, if in such a circumstance, he conducts only partial audit and any error or fraud is discovered later on, he shall be held liable.

Moreover, an auditor shall also be held liable if he discloses any secret information of the client to any third party. In the case Wilde and Others vs. Cape and Dalgleish (1897) also, it was held that if the client suffers any loss due to the auditor not complying with the contract, the auditor will have to compensate the client for such loss.

Branch Audit

Section 128(1) of the Companies Act, 2013 provides that every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statements for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

The Board of Directors may, however, decide to keep all or any of the aforesaid books of account and other relevant papers at such other place in India. In such circumstances, the company shall, within seven days thereof, file with the Registrar a notice in writing giving the full address of that other place.

Section 128(2) further specifies that, where a company has a branch office in India or outside India, it shall be deemed to have complied with the provisions of Section 128(1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarized returns periodically are sent by the branch office to the company at its registered office or the other place as decided.

Hence, given the provisions of Section 128(1) and 128(2), there arises the scope of auditing the records of transactions effected at branch office(s) in India or outside India, whether such records are kept at the registered office, branch office or any other place.

Accordingly, Section 143(8) of the Companies Act, 2013, read with Rule 12 of CAAR 2014, states the following provisions relating to the accounts of a branch office of a company:

1. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under Section 139.
2. Where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.
3. The duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of Section 143.

4. Similarly, if the branch auditor is appointed separately, the duties and powers of the branch auditor shall be as same as applicable to the company auditor under sub-sections (1) to (4) of Section 143.

5. The branch auditor shall submit his report to the company's auditor.

6. Provisions of sub-section (12) of Section 143 regarding reporting of fraud by the auditor shall also extend to the branch auditor to the extent it relates to the concerned branch.

Joint Audit

Joint audit refers to the process of conducting the audit of a single organization by more than one auditor. Large Companies with diversified business operations often resort to this process of auditing where they employ multiple auditors to conduct statutory audit. The basic aim in applying joint audit is to pull the resources of multiple auditors to conduct audit efficiently and within lesser amount of time

Benefits of Joint Audit

The benefits of joint audit are as follows:

1. Joint audit reduces the workload of a single auditor.
2. Since different auditors may be engaged to handle different parts of accounts, timely completion of work is possible even in a large organization.
3. The auditors may share their expertise and solve critical problems in the process.
4. Joint audit improves the quality of audit work to a great extent.
5. There may be healthy competition among the auditors which improves the quality and speed of the audit work.
6. Under joint audit, it is possible to get the benefit of extensive knowledge of different auditors at the same time.

Limitations of Joint Audit

The limitations of joint audit are enumerated below:

1. Established auditors may have a superiority complex over the less experienced one.
2. It is not suitable for a small entity due to substantial cost burden.
3. At times, lack of coordination among the auditors may slow down the speed of work.
4. There may be uncertainty about the liability of any work.
5. Areas of common concern may be neglected.
6. The auditors have to share the fees

Guidelines on Joint Audit

SA 299, Responsibility of Joint Auditor, has prescribed the following guidelines with respect to joint audit:

A. DIVISION OF WORK:

1. Where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves. The division of work would usually be in terms of audit of identifiable units or specified areas. In some cases, due to the nature of the business of the entity under audit, such a division of work may not be possible.
2. In such situations, the division of work may be with reference to items of assets or liabilities or income or expenditure or with reference to periods of time.
3. Certain areas of work, owing to their importance or owing to the nature of the work involved, would often not be divided and would be covered by all the joint auditors.
4. The division of work among joint auditors as well as the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity.

B. CO-ORDINATION

Where, in the course of his work, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgement by, other joint auditors, he should communicate the same to all the other joint auditors in writing. This should be done by the submission of a report or note prior to the finalization of the audit.

C. RELATIONSHIP AMONG JOINT AUDITORS AND THEIR RESPONSIBILITY

In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible

1. in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
2. in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;
3. in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
4. for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and
5. for ensuring that the audit report complies with the requirements of the relevant statute.

If any matters of the nature referred to in (B) above are brought to the attention of the entity or other joint auditors

D. DEPENDENCE ON OTHER AUDITORS

Each joint auditor is entitled to assume that the other joint auditors have carried out their part of the audit work in accordance with the generally accepted audit procedures. It is not necessary for a joint auditor to review the work performed by other joint auditors or perform any tests in order to ascertain whether the work has actually been performed in such a manner. Each joint auditor is entitled to rely upon the other joint auditors for bringing to his notice any departure from generally accepted accounting principles or any material error noticed in the course of the audit.

E. REPORTING RESPONSIBILITIES

Normally, the joint auditors are able to arrive at an agreed report. However, where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report. A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

Role of Audit Committee

Concept of Audit Committee

Regulators across the world have suggested strict corporate governance codes to minimize corporate frauds by management. Since, an independent audit report may, to a great extent, reveal the existence of frauds in corporate accounts, ensuring independence of audit can significantly help in enhancing fair conduct or good governance. Thus, governance codes have been designed to incorporate a number of regulations to ensure auditor's independence, elimination of the scope of any conflict of interest on the part of the auditor as consultant, review of auditor's performance etc. by establishing a separate committee known as Audit Committee.

The concept of audit committee is not new in India. Clause 49 of the Listing Agreement as issued by SEBI had specified such a requirement long ago. However, such a requirement was limited to only listed companies and not for all others. The new Companies Act 2013 has broadened the scope further by bringing it in the purview of the Act.

Provisions of Companies Act 2013 regarding Audit Committee

A. FORMATION OF AUDIT COMMITTEE: As per Section 177(1) read with Companies (Meetings of Board and its Powers) Rules, 2014, the Board of directors of every listed company and the following classes of companies shall constitute an Audit Committee of the Board-

1. all public companies with a paid-up capital of ten crore rupees or more;
2. all public companies having turnover of one hundred crore rupees or more;

3. all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

B. COMPOSITION: The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority: Moreover, majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement. [Section 177(2)]

C. BROAD FUNCTIONS OF AUDIT COMMITTEE: As per Section 177(4) of the Act, The Board shall In writing, the terms of reference for the Audit Committee which shall, inter alia, include —

1. the recommendation for appointment, remuneration and terms of appointment of auditors of the company; review and monitor the auditor's independence and performance, and effectiveness of audit process;
2. examination of the financial statement and the auditors' report thereon;
3. approval or any subsequent modification of transactions of the company with related parties:
4. scrutiny of inter-corporate loans and investments;
5. valuation of undertakings or assets of the company, wherever it is necessary;
6. evaluation of internal financial controls and risk management systems;
7. monitoring the end use of funds raised through public offers and related matters.

D. POWER OF AUDIT COMMITTEE

1. Committee may ask for Auditor's Comment: The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, the observations of the auditors and review of financial statement before their submission to the Board. The Committee may also discuss any related issues with the internal and statutory auditors and the management of the company. [Section 177(5)]

2. Investigation: The Audit Committee shall have authority to investigate into any matter in relation to the items specified in Section 177(4) or referred to it by the Board. For this purpose, the Committee shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company. [Section 177(6)]

3 Board's Report and Audit Committee: The Board's report under sub-section (3) of section 134 shall disclose the composition of an Audit Committee and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in such report along with the

reasons therefor. [Section 177(8)]

4. Whistle Blowing Policy: Every listed company and company accepting public deposits or borrowing in excess of fifty crore rupees from banks and financial institutions shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed. [Section 177(9)]

5. Safeguards against Victimization: The vigil mechanism under sub-section (9) shall provide for adequate safeguards against victimization of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases. The company shall disclose establishment of such mechanism on its website, if any, and in the Board's report. [Section 177(10)]

2.2

• COST AUDIT

Concept and Definition of Cost Audit

In a competitive business world, decisions on pricing policy, product or service mix, utilization of idle capacity etc. often requires dependable cost data. Hence, an independent and critical appraisal of the cost records and cost accounts is imperative. Cost audit is the independent and critical examination of the cost data to authenticate the results relating to ascertainment of cost and adherence to the available regulatory guidelines.

According to the Institute of Cost and Management Accountants of England, cost audit represents the verification of cost accounts and a check on the adherence to cost accounting plan. Cost audit, therefore, comprises:

1. Verification of cost accounting records such as the accuracy of the cost accounts, cost reports, cost statement, cost data and costing techniques, and
2. Examination of these records to ensure that they adhere to the cost accounting principles, plans, procedures and objectives.

According to The Institute of Cost Accountants of India, cost audit is an independent examination of cost and other related information in respect of a product or group of products of an entity whether profit oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

Importance of Cost Audit

The growing importance of cost audit can be attributed to the following facts:

1. Cost audit provides authentic data on cost data and thereby helps in making decisions on pricing policy, product mix, outsourcing, discontinuance of product etc.
2. Cost audit identifies the inefficiencies and thereby helps in improving the productivity.
3. Cost audit helps in ensuring the optimum utilization of limited resources. The benefits are extended to the customers.
4. Cost audit appraises the cost control mechanism followed in the organization
5. Audited cost data may form the basis for determining the standard cost data.

6. Government often decides on extending or abolishing tariff protection based on audited data on cost structure of the product.

Regulatory Framework of Cost Audit

Section 148(1) of the Companies Act 2013 authorizes the Central Government to make it mandatory, by order, the maintenance of cost records (relating to the utilization of material or labor or to other items of cost as may be prescribed) for certain classes of companies.

Section 148(2) also empowers the Central Government to issue orders to make audit of cost records of above-mentioned companies mandatory.

Accordingly, the Ministry of Corporate Affairs issued the Companies (Cost Records and Audit) Rules 2014 on 30.06.2014 which was further amended through Companies (Cost Records and Audit) Amendment Rules 2014 and made effective from 31.12.2014. The Rules were further amended subsequently (The latest being the amendments in 2019).

This Rule has divided the list of companies required to maintain the cost records into two categories namely (i) regulated sector and (ii) non-regulated sector as follows:

REGULATED SECTORS

	Industry /Sector/ Product/Service	Customs Tariff Act (wherever applicable)
1	Telecommunication services made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature and regulated by the Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act, 1997 (24 of 1997); including activities that requires authorization or license issued by the Department of Telecommunications, Government of India under Indian Telegraph Act, 1885 (13 of 1885);	Not applicable
2	Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003 (36 of 2003);	Generation – 2716; Other Activity – Not Applicable
3	Petroleum products; including activities regulated by the Petroleum and Natural Gas Regulatory Board under the Petroleum and Natural Gas Regulatory Board Act, 2006 (19 of 2006);	2709 to 2715; Other Activity – Not Applicable
4	Drugs and pharmaceuticals;	2901 to 2942; 3001 to 3006.
5	Fertilizers;	3102 to 3105.
6	Sugar and industrial alcohol;	1701; 1703; 2207.

NON REGULATED SECTOR

No	Industry/ Sector/ Product/ Service	(wherever applicable)
1	Machinery and mechanical appliances used in defense, space and atomic energy sectors excluding any ancillary item or items; Explanation. - For the purposes of this sub-clause, any company which is engaged in any item or items supplied exclusively for use under this clause shall be deemed to be covered under these rules.	8401; 8801 to 8805;8901 to8908.
2	Turbo jets and turbo propellers;	8411
3	Arms and ammunitions and Explosives	3601 to 3603; 9301 to 9306
4	Propellant powders; prepared explosives (other than propellant powders); safety fuses; detonating fuses; percussion or detonating caps; igniters; electric detonators;	3601 to 3603
5	Radar apparatus, radio navigational aid apparatus and radio remote control apparatus;	8526
6	Tanks and other armored fighting vehicles, motorized, whether or not fitted with weapons and parts of such vehicles, that are funded (investment made in the company) to the extent of ninety per cent or more by the Government or Government agencies	8710
7	Port services of stevedoring, pilotage, hauling, mooring, re-mooring, hooking, measuring, loading and unloading services rendered by a Port in relation to a vessel or goods regulated by the Tariff Authority for Major Ports;	Not applicable.
8	Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered by airports and regulated by the Airports Economic Regulatory Authority under the Airports Economic Regulatory Authority of India Act, 2008 (27 of 2008);	Not applicable.
9	Iron and Steel	7201 to 7229; 7301 to 7326
10	Roads and other infrastructure projects corresponding to Para No. (1) (a) as specified in Schedule VI of the Companies Act, 2013; (18 of 2013)	Not applicable
11	Rubber and allied products being regulated by the Rubber Board constituted under the Rubber Act, 1947 (XXIV of 1947).	4001 to 4017
12	Coffee and tea;	0901 to 0902
13	Railway or tramway locomotives, rolling stock, railway or tramway fixtures and fittings, mechanical (including electro mechanical) traffic signaling equipment's of all kind;	8601 to 8608, 8609

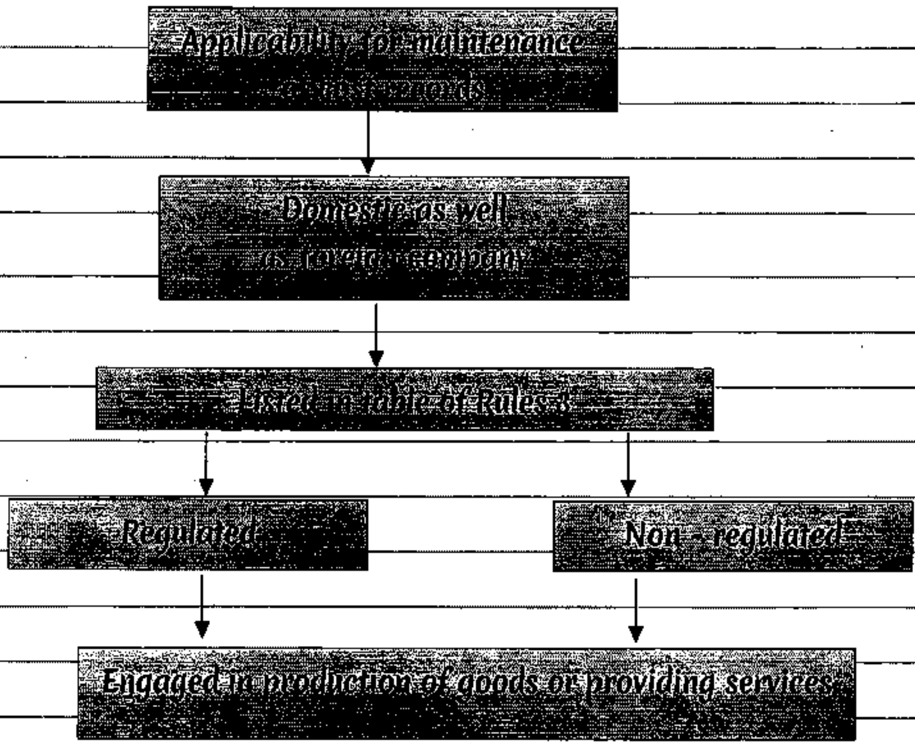
	Industry/ Sector/ Product/ Service	Heading (wherever applicable)
	Cement;	2523; 6811 to 6812
	Ores and Mineral products;	2502 to 2522; 2524 to 2526; 2528 to 2530; 2601 to 2617
	Mineral fuels (other than Petroleum), mineral oils etc.;	2701 to 2708
	Base metals;	7401 to 7403; 7405 to 7413; 7419; 7501 to 7508; 7601 to 7614; 7801 to 7802; 7804; 7806; 7901 to 7905; 7907; 8001; 8003; 8007; 8101 to 8113
	Inorganic chemicals, organic or inorganic compounds of precious metals, rare-earth metals of radioactive elements or isotopes, and Organic Chemicals;	2801 to 2853; 2901 to 2942; 3801 to 3807; 3402 to 3403; 3809 to 3824.
	Jute and Jute Products	5303, 5307, 5310
	Edible Oil;	1507 to 1518
	Construction Industry as per para No. (5) (a) as specified in Schedule VI of the Companies Act, 2013 (18 of 2013)	Not applicable.
	Health services, namely functioning as or running hospitals, diagnosticcentres, clinical centres or test laboratories;	Not applicable.
	Education services, other than such similar services falling under philan-thropy or as part of social spend which do not form part of any business.	Not applicable
	Milk powder;	0402
	Insecticides;	3808
	Plastics and polymers;	3901 to 3914; 3916 to 3921; 3925
	Tyres and tubes;	4011 to 4013
	Paper;	4801 to 4802
	Textiles;	5004 to 5007; 5106 to 5113; 5205 to 5212; 5303; 5310; 5401 to 5408; 5501 to 5516

No	Industry/ Sector/ Product/ Service	Heading (ever applicable)
30	Glass;	7003 to 7008; 7011; 7016
31	Other machinery;	8402 to 8487
32	Electricals or electronic machinery;	8501 to 8507; 8511 to 8512; 8514 to 8515; 8517; 8525 To 8536; 8538 to 8547.
33	Production, import and supply or trading of following medical devices, namely: 1.Cardiac stents; 2.Drug eluting stents; 3.Catheters; 4.Intra ocular lenses; 5.Bone cements; 6.Heart valves; 7.Orthopaedic implants; 8.Internal prosthetic replacements; 9.Scalp vein set; 10.Deep brain stimulator; 11.Ventricular peripheral shud; 12.Spinal implants; 13.Automatic impalpable cardiac deflobillator; 14.Pacemaker (temporary and permanent); 15.Patent ductus arteriosus, atrial septal defect and ventricular septal defect closure device; 16.Cardiac re-synchronize therapy; 17.Urethra sinecure devices; (xviii)Sling male or female; 18.Prostate occlusion device; and Urethral stents	9022

Following are the important provisions of Companies Act 2013 and Companies (Cost Records and Audit) Rules 2014 as amended up to date.

1. Application of Cost Records [Rule 3]

Rule-3 of the Companies (Cost Records and Audit) Rules, 2014 provides that all companies under regulated and non-regulated list, engaged in the production of goods or providing services, having an overall turnover from all its products and services of ₹35 crore or more during the immediately preceding financial year, are required to include cost records in their books of account. These companies shall also include Foreign Companies defined in Sub-section(42) of Section 2 of the Act, but exclude a company classified as a Micro Enterprise or a Small Enterprise as per the turnover criteria provided under Micro, Small and Medium Enterprise Development, 2006



2. Applicability for Cost Audit [Rule4]

1. Every company specified in item (A) of rule 3 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees fifty crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees twenty-five crore or more.

2. Every company specified in item (B) of rule 3 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees one hundred crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees thirty-five crore or more.

3. The requirement for cost audit under these rules shall not apply to a company which is covered in rule 3; and

a) whose revenue from exports, in foreign exchange, exceeds seventy-five per cent of its total revenue; or

b) which is operating from a special economic zone;

c) which is engaged in generation of electricity for captive consumption through Captive Generating Plant. For this purpose, the term "Captive Generating Plant" shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005".

Section 148(4) of Companies Act, 2013 further states that an audit conducted under this section shall be in addition to the audit conducted under Section 143

3. **Maintenance of Records [Rule 5]**

1. Every company under these rules including all units and branches thereof, shall, in respect of each of its financial year commencing on or after the 1st day of April, 2014, maintain cost records in form CRA-1.

Provided that in case of company covered in serial number 12 and serial numbers 24 to 32 of item (B) of Rule 3 (i.e., Non-regulated sectors), the requirement under this rule shall apply in respect of each of its financial year commencing on or after 1st day of April, 2015.

2. The cost records referred to in sub-rule (1) shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

3. The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, control over the various operations and costs to achieve optimum economies in utilization of resources and these records shall also provide necessary data which is required to be furnished under these rules.

Applicability of Cost Audit

- Applicability of Cost Audit
- Non-regulatory Sectors

4. Appointment of Cost Auditor [Rule 6]

As per Section 148(3) of the Companies Act 2013, cost audit shall be conducted by a Cost Accountant who shall be appointed by the Board. No person appointed under Section 139 as an auditor of the company shall be appointed for conducting the audit of cost records. The auditor so appointed shall comply with the cost auditing standards.

Rule 6 of the Companies (Cost Records and Audit) Rules 2014 –

1. The category of companies specified in rule 3 and the thresholds limits laid down in rule 4, shall within one hundred and eighty days of the commencement of every financial year, appoint a cost auditor.

Provided that before such appointment is made, the written consent of the cost auditor to such appointment, and a certificate from him or it, as provided in sub-rule (1A), shall be obtained.

The cost auditor appointed under sub-rule (1) shall submit a certificate that –

a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Cost and Works Accountants Act, 1959(23 of 1959) and the rules or regulations made thereunder;

b) the individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Act, so far as may be applicable;

c) the proposed appointment is within the limits laid down by or under the authority of the Act; and

d) the list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct."

2. Every company referred to in sub-rule (1) shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of 30 days of the Board meeting in which such appointment is made or within a period

of 180 days of the commencement of the financial year, whichever is earlier, through electronic mode, in Form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

3. Every cost auditor appointed as such shall continue in such capacity till the expiry of 180 days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

However, the cost auditor appointed under these rules may be removed from his office before the expiry of his term, through a board resolution after giving a reasonable opportunity of being heard to the Cost Auditor and recording the reasons for such removal in writing.

Provided further that the Form CRA-2 to be filed with the Central Government for intimating appointment of another cost auditor shall enclose the relevant Board Resolution to the effect;

Provided also that nothing contained in this sub-rule shall prejudice the right of the cost auditor to resign from such office of the company

3A) Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within 30 days of such appointment of cost auditor.

3B) The cost statements, including other statements to be annexed to the cost audit report, shall be approved by the Board of Directors before they are signed on behalf of the Board by any of the director authorized by the Board, for submission to the cost auditor to report thereon.

Note: in the case of companies which are required to constitute an audit committee, the Board shall appoint an individual, who is a cost accountant, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee.

5. Disqualification of Cost Auditor

Persons disqualified u/s 141(3) shall not be appointed as the cost auditor of a company. Similarly, auditor of a company appointed u/s 139 shall not act as the cost auditor of the company.

6. Remuneration of Cost Auditor

As per Section 148(3) of the Companies Act 2013 read with Rule 14 of the Companies (Audit and Auditors) Rules 2014, the remuneration of the cost auditor shall be decided by the Board as recommended by the Audit Committee, if any, which shall be ratified by the shareholders subsequently. In the case of companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

7. Rights and Duties of Cost Auditor

The rights, duties and obligations as applicable to the company auditors shall also apply to a cost auditor appointed under Section 148 and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.

8. Submission of Cost Audit Report

As per Section 148(5) read with Rule 6 of the Companies (Cost Records and Audit) Rules 2014:

1. Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in Form CRA-3.
2. The cost auditor shall forward his duly signed report to the Board of Directors of the company within a period of 180 days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report, particularly any reservation or qualification contained therein.
3. The company covered under these rules shall, within a period of 30 days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 in Extensible Business Reporting Language format in the manner as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014".

Provided that the Companies which have got extension of time of holding Annual General Meeting under section 96 (1) of the Companies Act, 2013, may file Form CRA-4 within resultant extended period of filing financial statements under section 137 of the Companies Act, 2013.

4. If the Central Government is of the opinion that any further information or explanation is necessary, it may call for such further information and explanation and the company shall

furnish the same within such time as may be specified by that government.

9. Forms Relevant to Cost Records and Cost Audit

Companies (Cost records and Audit) Rules 2014 provides for four different forms for separate purposes as follows:

1. CRA-1 for the manner in which cost records shall be maintained.
2. CRA-2 for intimation of appointment of cost auditor by the company to Central Government
3. CRA-3 for cost audit report
4. CRA-4 for filing of cost audit report with the Central Government

10. Penal Provisions in Case of Default

According to Section 148(8), while complying with the aforesaid provisions if any default takes place –

1. On the part of the company, the company shall be punishable with fine between ₹25,000 and ₹5,00,000 and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine between ₹10,000 and ₹1,00,000. [sub-section (1) of Section 147]
2. The cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of Section 147.

11. Reporting Requirements of Cost Audit as per CRA-3

As per Companies (Cost Records and Audit) Rules 2014 as amended up to date, a cost auditor needs to report the following in CRA-3.

1. Whether he has obtained all the information and explanations, which to the best of his knowledge and belief were necessary for the purpose of the audit.
2. Whether in his opinion, proper cost records, as per rule 5 of the Companies (Cost Records and Audit) Rules, 2014 have been maintained by the company in respect of its product(s)/ service(s) under reference.
3. Whether in his opinion, proper returns adequate for the purpose of the cost audit have been received from the branches not visited by him.
4. Whether in his opinion, and to the best of his information, the said books and records give the information required by the Companies Act, 2013, in the manner so required.
5. Whether in his opinion, the company has adequate system of internal audit of cost records

which to his opinion is commensurate to its nature and size of the business.

6. Whether in his opinion, information, statements in the annexure to the cost audit report give a true and fair view of the cost of production of product(s)/rendering of service(s), cost of sales, margin and other information relating to product(s)/service(s) under reference.

7. Whether detailed unit-wise and product/service-wise cost statements and schedules thereto in respect of the product /service of the company duly audited and certified by him are kept in the company.

2.3

• SECRETARIAL AUDIT

Applicability and Conduct of Secretarial Audit

THE COMPANIES ACT 2013: As per the provision of Section 204(1) of the Companies Act, 2013 Read with Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014:

1. Every listed company;
2. Every public company having a paid-up share capital of 50 crore rupees or more; or
3. Every public company having a turnover of 250 crore rupees or more; or
4. Every company having outstanding loans or borrowings from banks or public financial institutions of 100 crore rupees or more.

- is required to annex with its Board's Report made in terms of Section 134(3) of the Companies Act, 2013, a Secretarial Audit Report, given by a Company Secretary in practice, in Form MR-3.

As per Section 204(2), it shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

Moreover, Section 204(4) further provides that if a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the company secretary in practice, who is in default, shall be liable to a penalty of two lakh rupees.

SEBI REGULATIONS: As per Regulation 24A of the SEBI(LODR) Regulations, 2015, every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex a secretarial audit report given by a company secretary in practice, in such form as specified, with the annual report of the listed entity.

In addition to the above, every listed entity shall submit a secretarial compliance report in such form as specified, to stock exchanges, within sixty days from end of each financial year. (Amended by the SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2021 w.e.f. 5.5.2021).

Qualification of a Secretarial Auditor

According to the provisions of Section 204, only a member of the Institute of Company Secretaries of India holding a certificate of Practice (i.e., PCS) is qualified to conduct secretarial audit of the company.

Appointment of Secretarial Auditor

As per Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014, read with Section 179 of the Companies Act, 2013, secretarial auditor is required to be appointed by means of resolution at a duly convened board meeting. It is advisable for the Secretarial Auditor to get a letter of engagement from the company. Secretarial Auditor should accept the letter of engagement. The company shall report any change in the secretarial auditor during the financial year to the members through the Board's Report. The qualifications, observations or comments / remarks of the secretarial Audit Report shall be read at the annual general meeting of the company along with the explanation and comments of the Board of Directors (Clause 13 of Secretarial Standard 2).

Secretarial Audit Report

Section 204 of Companies Act, 2013 provides that Secretarial Audit Report is to be submitted in a format pre- scribed under Rules. As per sub-rule (2) of Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the format of the Secretarial Audit Report shall be in Form MR-3. Section 134 and Sub- section (3) of Section 204 further provides that the Board of Directors, in its report, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in the secretarial audit report.

In addition, Regulation 24A of the SEBI (LODR) Regulations, 2015 requires that every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex a Secretarial Audit Report given by a company secretary in practice, in such form as specified, with the annual report of the listed entity. Every listed entity shall submit a Secretarial Compliance Report in such form as specified, to stock exchanges, within sixty days from end of each financial year. SEBI vide its Circular dated February 08, 2019 notified the formats for Annual Secretarial Audit Report and Annual Secretarial Compliance Report for listed entities

2.4

• AUDIT OF VARIOUS ITEMS OF FINANCIAL STATEMENTS (WITH SPECIAL EMEPHASIS ON AUDIT OF INVENTORY AND PPE

Audit of Financial Statement Items - Concept

In India, the preparation of financial statements of companies are guided by accounting standards issued by The Institute of Chartered Accountants of India. These accounting standards constitute the broader framework of generally accepted accounting principles, also known as the Indian GAAP. In addition, the Companies Act, 2013, through Schedule III, provides the format to be followed while preparing the financial statements.

Audit of financial statements, therefore, refers to the process of examination of a company's financial statements and related disclosures in the 'Note to Accounts' section with respect to various items recorded in the financial statements.

Vouching and Verification

The traditional methods associated with the audit of financial statement items are known as Vouching and Verification.

Vouching refers to the examination of accuracy, authority and authenticity of transactions that appear in the books of accounts with the help of vouchers of these transactions. Thus, vouching examines whether –

1. all transactions undertaken by the entity have been recorded and nothing has been purposefully left out.
2. transactions recorded in the books of accounts are supported by documentary evidence.
3. no fraudulent transaction has been recorded in the books of accounts.
4. transactions that have been recorded belong to the current accounting year (in case of accrual basis of accounting).
5. necessary vouchers relating to entries recorded in books are with the client.
6. all transactions are properly authorized by the person responsible to do so.
7. transactions have been recorded at the correct value and such values have been calculated correctly.
8. transactions recorded in the books of accounts are related to the organization.

9. proper accounting entries have been made against the transactions.

Verification, on the other hand, can be defined as a process of substantiation of assets and liabilities recorded in the books of account, by means of physical inspection and examination of legal and official documents, and then forming expert opinion as to the existence, ownership, possession, classification and valuation of assets and liabilities of an entity.

Thus, verification includes –

i. Examination of existence of the assets or liabilities on the reporting date.

ii. Examination of ownership and control of the asset or liabilities on the reporting date.

iii. Examination of possession of the assets on the reporting date.

iv. Examination of charges, if any, against the assets.

v. Examination of accounting of assets or liabilities.

vi. Examination of correctness of valuation of assets or liabilities.

vii. Examination of adequacy of disclosures as required by the relevant regulation

Audit of financial statements applies both vouching and verification in examining various items of financial statements.

Role of Management Assertions in Designing the Audit Procedure in Audit of Financial Statements

The dictionary meaning of the term 'assertion' is 'a confident and forceful statement of fact or belief'. However, when used in the context of auditing, it refers to some implicit or explicit claims. While preparing the financial statements of an entity, company's management makes various implicit or explicit claims i.e., assertions with regard to completeness, cut-off, existence/occurrence, valuation/ measurement, rights and obligations and presentation of assets, liabilities, income and expenditures and disclosure in accordance with the applicable accounting or financial reporting standards. Since an auditor is to appraise the truthfulness and fairness of financial performance and position as exhibited in the financial statements, he must design the audit procedure in such a way that these assertions by management are verified appropriately.

These assertions comprise the following:

Assertions with respect to Revenue and Expenses	Example (Purchase of Goods)
Occurrence	Recorded purchases represent goods actually received during the year.
Completeness	All purchases made during the year have been recorded and there is no understatement.
Cut-off	Purchase shall include all goods received and in transit as they belong to the relevant period.
Measurement	All purchases have been measured appropriately based on supporting vouchers.
Presentation and Disclosure	Required disclosures as per regulation, if any, have been appropriately done.

Assertions with respect to Assets and Liabilities	Example (Machinery)
Existence	The machinery included under the head 'Property, Plant and Equipment' as shown in the Balance Sheet do exist as at the period end.
Rights and Obligations	Company owns and controls the machinery.
Cut-off	Purchase and sale of machinery during the year are only included and affected in the machinery balance.
Completeness	All machinery owned and controlled by the organization are included under the head 'Property, Plant and Equipment'.
Valuation	The machinery has been valued accurately following the valuation principles and depreciation charge is appropriate.
Presentation and Disclosure	Required disclosures as per the regulations, if any, have been appropriately done.

Audit of Income Statement

A. REVENUE FROM OPERATION

Revenue from operation comprises sale of goods, sale of services and other operating revenues. Other operating revenue includes any revenue earned by the company from its operations other than its principal activities. For example, Discount Received, Bad Debt Recovery etc. For a finance company, revenue from operation primarily includes interest income and income from other financial services.

1. Audit Procedure to be Followed

Apart from evaluating the adequacy of internal control with respect to revenue related transactions, the auditor shall resort to the following audit procedure to audit the revenue from operations.

a. Occurrence:

i. The auditor should ensure that all revenue items recognized are genuine and no sale transactions have been recorded twice.

ii. He may test check a few invoices with accounting entries. Further, he should check the sequence of sales invoices, review the recording of unusual transactions, verify the return transactions with sales invoice, challan, credit note and stock records.

iii. He should also obtain confirmation from few customers to check whether the transactions are genuine.

iv. He should ensure that no fake sale transactions have been recorded.

v. For services, he must see that revenue has been recognized based on the policy undertaken.

b. Cut-off

He shall see whether revenue from operation includes the sale made and services performed during the year only.

c. Completeness

The auditor should verify that all sales effected during the year have been included in revenue. He should apply the cut-off procedure to ensure that revenues are recognized in the current accounting period and check if year end sale transactions have been tempered.

d. Measurement

1. The auditor shall see that revenues are accurately measured based on applicable Accounting Standards.
2. Trade discount allowed to the customers should be checked. No separate entry for trade discount should be passed in the books. If there is any significant variation in trade discount allowed to different customers, the auditor is required to inquire into the reason for such variations.
3. The sales tax, insurance charges, etc. collected through sales invoices must be recorded under separate accounts.

e. Presentation and Disclosures

The auditor shall ensure the following disclosure for revenue from operation in respect of a company other than a finance company as per Schedule III (Part 2)

1. Disclosure should be available for each class of goods.

2. Revenue from operations shall disclose separately in the notes revenue from - (a) Sale of products; (b) Sale of services; (c) Other operating revenues; Less: (d) Excise duty.

3. In respect of a finance company, revenue from operations shall include revenue from - (a) Interest; and (b) Other financial services

4. Discount other than usual trade discount must be disclosed. Similarly, transactions with related parties should be separately disclosed in the Notes.

5. In the case of companies rendering or supplying services, gross income derived from services rendered or supplied under broad heads.

B. OTHER INCOME

Other income comprises interest income (for companies other than a finance company), dividend income, net gain on sale of investments and other non-operating income such as royalties, lease rentals etc.

Audit Procedure to be Followed

The auditor shall resort to the following audit procedure to audit the other income:

a. Occurrence

The auditor shall obtain a list of new fixed deposits opened during the year along with the information on rate, tenure and date of investment.

He shall obtain a confirmation of interest income from bank. Also obtain a copy of Form 26AS of Income Tax to confirm the interest income and related TDS.

3. He should investigate the investment ledger further to see the new investments made in other securities such as corporate bonds, debentures and shares and check the interest and dividend income generated therefrom.

4. He should trace a sample of dividend/interest received from the cash book through dividend/interest warrants to investment certificates and their deposit into the bank.

5. He should also check the net gain or loss on sale of investment based on relevant documents such as DEMAT and Trading Account details, transfer deeds etc.

b. Cut-off

The auditor must ensure that interest income does not include any unearned interest and includes interest accrued on investment.

c. Completeness

The auditor must ensure that all interest received and accrued and dividend received have been recorded and the recording has been done appropriately.

d. Measurement

1. The auditor must check the accuracy of interest calculation on new fixed deposits and fixed deposits existing on the opening date of the year.
2. He should also see that dividend income received is accurate.
3. In certain cases, dividends and interest are received by the client after deduction of tax at source. The auditor should ensure that dividends and interests are recorded at gross amounts.
4. If interest or dividend is received for the pre-acquisition period, the auditor should see whether proper adjustment has been made with the cost of investment for this preacquisition dividend or interest.

e. Presentation and Disclosure

The auditor shall ensure the following disclosure as per Schedule III (Part 2):

1. Other income shall be classified as: (i) Interest Income (in case of a company other than a finance company);
2. Dividend Income; (iii) Net gain/loss on sale of investments; (iv) Other non-operating income (net of expenses directly attributable to such income).

C. PURCHASES

It is another important element of financial statements and is includes purchase of raw materials to be included in the cost of materials consumed in case of a manufacturing organization and purchase of merchandise in case of a trading organization. As a part of an audit exercise, the auditor examines the purchase transactions and related internal control to ensure that there is no material misstatement in the amount of purchase and accounts payable reported in the financial statements.

Audit Procedure to be Followed

The auditor shall resort to the following audit procedure to audit purchases:

a. Occurrence

1. The auditor must ensure that only genuine purchases have been recorded in the books of accounts. He may examine the purchase orders, goods received notes and purchase invoices to satisfy himself.
2. Photocopy of purchase invoices should not be allowed. Moreover, purchase invoices must be in the name of the entity.
3. He shall see whether all the purchases are approved by the relevant authority. The same is extremely important for purchases from related parties.

b. Cut-off

The auditor shall see that only purchases during the year have been recognized as expense.

c. Completeness

1. He should apply the cut-off procedure to ensure that purchases effected during the year are only recognized in the current accounting period.
2. The auditor should see that purchase invoice should be booked only once the risk and reward incidental to the ownership has been transferred. He should be careful with delivery terms such as F.O.B and C.I.F etc.
3. The auditor must check the return transactions carefully based on relevant documents.
4. He shall ensure correct accounting for goods-in-transit.

d. Measurement

1. The auditor shall see that purchase transaction values have been correctly calculated considering the trade discount applied.
2. Information relating to input tax credit shall be verified. The auditor shall see that appropriate adjustments have been made in this respect.

e. Presentation and Disclosure

The auditor shall see that the following disclosure as per Schedule III (Part 1) has been appropriately done:

1. In the case of manufacturing companies, —
   a. raw materials under broad heads;
   b. goods purchased under broad heads;
2. In the case of trading companies, purchases in respect of goods traded in by the company under broad heads.
3. Transactions with related parties.

D. EMPLOYEE BENEFIT EXPENSES

Employee benefit expenses represents the total amount payable by the organization to its employees and essentially includes, apart from the wages and salaries in cash, all types of perquisites, post-employment benefits including gratuity, superannuation, leave encashment, provident fund contribution, ESI contribution as well as employee welfare expenses etc. In a company, often, these expenses constitute a significant portion of total cost and hence an auditor must put especial emphasis while auditing these items.

While conducting an audit of employee benefit expenses, an auditor must, at the beginning, obtain a detail understanding of the company's recruitment, promotion and retirement policies, remuneration schemes, various post-employment benefits. He should evaluate the internal control associated with these expenses. He should also apply substantive procedure to determine the reasonability of monthly cash outflow, consistency with the previous year's figures etc. so as to determine an expectation of monthly expenses and whether the same is consistent with peers.

Audit Procedure to be Followed

In addition, the auditor shall resort to the following audit procedure:

a. Occurrence

1. The auditor should ensure that all expenses included in the 'employee benefit expenses' are genuine.
2. He should obtain a complete list of employees with data on new hires, their appointment dates and remuneration terms and conditions.
3. For a sample of newly appointed employees, he may conduct a complete examination of their appointment and remuneration paid as per terms.
4. Similarly, he may collect a list of employees resigned or terminated during the year and see that their payments have been appropriately decided and settled.
5. He should obtain the pay roll register and conduct and examination of reasonability of remuneration and investigate irregularities, if any.
6. He should also see that all adjustments such as outstanding salary, PF contribution, deposit of TDS, PF and ESI premium have been appropriately recorded.

b. Cut-off

The auditor must ensure that only employee benefit expenses relating to current year have been recognized.

c. Completeness

1. The auditor shall see that all the employee benefit expenses have been appropriately recorded in the books of accounts.
2. He should also check whether all the amount of money deducted from salary have been duly deposited and if not, the same have been shown as a current liability.

d. Measurement

1. The auditor must see that the total amount of remuneration is correctly determined. He may conduct a test on a sample to check the same.
2. He should check whether statutory deductions have been accurate and post-employment benefits have been determined as per the policy adopted.

e. Presentation and Disclosure

The auditor must see that the following disclosure requirements as per Schedule III (Part 1) have been duly complied with:

(i) Employee Benefits Expense shall be shown separately as (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), (iv) staff welfare expenses.

E. DEPRECIATION AND AMORTIZATION

Depreciation is the charge representing the cost of a tangible asset allocated over its effective life. The similar charge for an intangible asset is known as amortization. Depreciation and amortization constitute a significant portion of a company's total expenditure and hence have a direct bearing on profitability. Hence, the auditor needs to be extra careful in determining the appropriateness, accuracy and accounting of depreciation and amortization.

While conducting the audit of depreciation and amortization charges, the auditor should obtain a detail understanding of the organization's depreciation policy, accounting policy relating to depreciation and should check the validity of the charge and calculation accuracy.

Audit Procedure to be Followed

In addition, the auditor shall resort to the following audit procedure:

a. **Occurrence**

1. The auditor shall obtain the fixed asset register and identify the items of assets acquired, sold and discarded during the year. This will help him to determine the items of assets eligible for depreciation and amortization during the year.
2. He may select a sample of assets on materiality considerations and verify the rates and amount of depreciation and amortization calculated.

b. **Cut-off**

The auditor needs to ensure that depreciation is charged on the assets purchased from its date of put to use and not form purchase date. Moreover, he shall also see that, in case the company has a policy of charging depreciation on time basis, deprecation on items acquired during the year is calculated from the date of put to use to year end and for items sold, from the beginning of the year up to the date of sale.

c. **Completeness**

1. He must ensure that depreciation and amortization have been charged on all eligible tangible and intangible assets respectively and no fake assets have been considered for this purpose.
2. The auditor shall see that the amount of depreciation and amortization have been appropriately accounted in primary books and posted to appropriate accounts.

3. He shall also ensure that depreciation on revalued amount has been properly accounted from revaluation reserve.
4. He should also ensure that for any retrospective change in the method of depreciation, due effect has been given in the Income Statement.

d. **Measurement**

1. The auditor shall see that the rate of depreciation is consistent with the rates suggested in Schedule II and the amount of depreciation and amortization has been calculated accurately based on the rates and time involved.
2. He shall ensure that the rates have been decided in conformity with the effective life of assets.
3. He should also see that residual value has been properly determined.
4. The auditor shall also see that in case of change in estimation of useful life or in case of impairment, the amount of depreciation has been calculated appropriately.

e. **Presentation and Disclosure**

The auditor must see that the following disclosure requirements as per Schedule III (Part 1) have been duly complied with:

1. Accounting policy for depreciation and amortization.
2. Useful life of assets as per Schedule II.
3. Residual value and the method of depreciation.

F. FINANCE COST

Generally, Finance Cost comprises of interest cost on structured debt instruments such as Debentures as well as traditional institutional finance such as Bank Loan, secured or unsecured. In order to conduct the audit of finance cost, the auditor must procure the schedule of loan and information relating to all structured debt instruments, the rate of interest applicable and the tenure of such loan based on which he shall be able to determine the amount of interest.

Audit Procedure to be Followed

In addition, the auditor shall resort to the following audit procedure:

a. **Occurrence**

1. The auditor shall see whether interest has been provided on all eligible debt instruments and loans.
2. He shall verify the amount of interest payment form bank statement and shall check the same with accounting entries in the cash book and general ledger.
3. He shall see that interest was paid and provided only in respect of loans outstanding either for a

part of the year or for entire year.

b. **Cut-off**

The auditor shall ensure that interest has been provided only for the period the loan was outstanding during the year.

c. **Completeness**

The auditor shall ensure that interest due but not paid has also been considered as Accrued Interest and the same is appropriately accounted and shown in the financial statement.

d. Measurement

1. The auditor must verify the calculation of interest payable based on the rate, loan amount outstanding and the period for which the loan remains outstanding during the year.
2. He shall be extra careful with loan items repaid during the year and debentures redeemed during the year.

e. **Presentation and Disclosure**

The auditor must see that the disclosure requirements as per Schedule III (Part 1) and various Accounting Standards (or Ind ASs) have been duly complied with.

G. OTHER EXPENSES

Other Expenses in the Statement of Profit and Loss include Power and Fuel, Rent, Repairs, Insurance, Travelling and Miscellaneous Expenses. These are some essential and incidental expenses to run the organization. While conducting the audit of these expense, the auditor generally investigates whether the expenditure relates to the current accounting year, whether the same is a revenue expenditure and is valid as per the policy of the organization, its classification in appropriate heading, authorization and relevance for the business.

Audit Procedure to be Followed

In addition, the auditor shall resort to the following audit procedure:

a. **Occurrence**

1. The auditor needs to ensure that all expenditure charged against the revenue are genuine. For this purpose, he should vouch the expenditure based on relevant documents.
2. With respect to rent he should obtain a monthly expense schedule along with the rent agreements and verify whether the agreement is in the name of the company and whether the rent for all the months has been recorded.
3. With respect to power and fuel expenses, the auditor should collect a monthly expense schedule and see that the expense for all the months has been recorded.

4. With respect to insurance expenses, the auditor should obtain a summary of insurance policies taken along with their validity period and see that the expense shown is genuine.

5. With respect to legal and professional expenses, the auditor should collect a consultation-wise summary and see that the expense is genuine. For monthly retainership agreements, he shall verify that expense for all 12 months has been recorded. For non-recurring expenses a test on selected sample may be preferable.

6. For all other expenses, the auditor shall conduct examination on selected sample of transaction to ensure their validity.

b. **Cut-off**

The auditor should ensure that expenses charged against the revenue are related to current year only. He should be extra cautious with rent and insurance expenses as the often involve advance payments.

c. **Completeness**

The auditor should ensure that the transactions are properly authenticated as per the policy of the company, appropriately classified and proper accounting entry has been done for their payment and adjustments (e.g., outstanding and prepaid expenses).

d. **Measurement**

(i) In case of monthly expenses as per agreement, the auditor should verify the calculation of the expense and adjustment for outstanding and prepaid expense, if any. He should be extra careful with escalation clause and rent agreements terminated during the year. For other expenses he shall evaluate whether the same is reasonable based on the data available for past years. He may perform analytical procedures such as expenditure per unit of production analysis to assess overall reasonableness of expenditure.

e. Presentation and Disclosure

The auditor must see that the disclosure requirements as per Schedule III (Part 1) have been duly complied with, especially whether other expenses have been classified in appropriate heads.

Audit of Balance Sheet Items

A. PROPERTY, PLANT AND EQUIPMENT

Property, Plant and Equipment constitute a significant portion of total assets of an entity. According to the Guidance Note on Audit of Property, Plant and Equipment issued by The Institute of Chartered Accountants of India, the term 'Property, Plant and Equipment' refers to such tangible items that (a) are held for use in the production or supply of goods or services, for rental to others or for administration purposes; and (b) are expected to be used during more than one period. Thus, PPE includes land, buildings, plant and equipment, furniture and fixture, vehicle, office equipment, computers etc. In addition to the Guidance note, audit process for PPE is also governed by the relevant Accounting Standard (AS 10 or Ind AS 16) in organizations which are required to comply with Accounting Standards.

Audit Procedure to be Followed

a. Existence

1. The auditor must ensure physical verification of the assets to confirm that they exist and are under the possession of the client.
2. He must tally the physical verification report with the asset register maintained by the company as at the reporting date. He shall ensure that PPE additions up to the date of verification have been updated in the register.
3. He shall demand explanations for any discrepancies found in the above process.
4. He shall specifically ensure that assets that are not in the working condition have been accounted for as deletions.

b. Rights and Obligations

1. The auditor should verify that PPE additions have been approved by the responsible official and such additions are as per the capital expenditure budget approved by the board for the financial year concerned.
2. He shall also verify whether appropriate internal processes and procedures like inviting competitive quotations or floating tenders were done before finalizing the vendor.
3. The auditor shall check that PPE purchase invoices are in the name of the client that entails the legal ownership. For land and building, the auditor shall verify the title deed of the property. In case any charge is created on any immovable property due to any loan taken from a bank or financial institution and hence the original title deed is with the lender, the auditor shall ask the management to obtain a written confirmation from the lender in this respect.
4. In relation to all deletions, he shall verify management's rationale for deletion. He may also seek any report from the technical expert, if any, that led to such decision of deletion.
5. He shall also verify whether such deletions are appropriately authorized, followed the established internal procedures (like inviting tenders etc.) and properly recorded in the books of accounts.

c. Cut-off

The auditor shall see that the Net Block of assets shown in the Balance Sheet comprises all assets existed and under the ownership of the company on the reporting date and depreciation pertains to the current period only.

d. Completeness

1. He shall also verify the PPE schedule (asset class wise) maintained by the management and tally the closing balances to the entity's books of accounts.
2. He should check the arithmetical accuracy of the movement in PPE schedule and reconcile the opening balance with the closing balance of each class of asset by considering the additions and disposals during the year.

e. Valuation

1. The auditor shall see that all items of PPE have been carried at cost less accumulated depreciation less accumulated impairment1 loss. The cost, for this purpose, includes all costs incurred to acquire or construct the PPE and all subsequent costs to replace part of it. However, day-to-day servicing cost should not be included. They should be charged to profit and loss.
2. He shall also verify the installation certificate to know the date of installation of the asset. This information will be important in calculating the pro-rata depreciation.
3. The auditor shall verify whether depreciation has been charged on all items except the freehold land. He shall also see that the depreciation method reflects the pattern in which the future economic benefits are expected to be derived from the assets. In case of company, the auditor shall also ensure that depreciation has been calculated in compliance with Schedule II of the Companies Act 2013.
4. He shall verify whether the management has undertaken any impairment assessment for any item of PPE and if so, the auditor shall verify the calculation of recoverable value and subsequent adjustment in the carrying amount of the said asset. He shall also check the accounting treatment.

f. Presentation and Disclosure

1. In case of a company, the auditor should ensure that the all items of PPE have been disclosed in the balance sheet of the company under the head 'Non-current Assets' and subhead 'Fixed Assets' as 'Tangible Asset' as per Schedule III of the Companies Act 2013.
2. He shall also ensure that all the relevant information has also been disclosed in the 'Notes to Accounts' section.

B. PATENT AND COPYRIGHT

A patent is an exclusive right granted by the Government to the manufacturer to dispose of or otherwise benefit from the result of the invention of a production process. It is an official document, which secures to an investor exclusive right to make, use and sell his invention. On the other hand, a copyright is an exclusive right granted by the Government to publish or republish a book, report, or any other literary work, music composition or other work of art etc. The right is primarily granted to the author of the literature or creator of the art work. However, the author/ creator may transfer the same to any other person for using the same for commercial purpose. In India, copyright is valid for the lifetime of the author/creator and even fifty years after his death.

Audit Procedure to be followed to verify the assertions

a. Existence

1. A schedule of patents and copyright held by the company should be procured from the management.

2. The document of each patent and contract paper of each copyright should be physically verified by the auditor to ensure that it has been duly registered.

3. The auditor shall ensure that the patent is in active use in production of goods or rendering services.

b. Rights and Obligations

1. The ownership of patents and copyrights should be verified by inspection of the certificate of patent issued in the name of the client and the contract paper of copyright.

2. If it has been purchased, the agreement surrendering it in favor of the client should be examined.

3. The last renewal receipt should be examined to ascertain that the patent has not lapsed.

4. The auditor has to verify that renewal fees have been paid on due dates by being charged to revenue and not to the patent account.

5. The auditor must ensure that the copyrights shown in the financial statement are yet to expire.

c. Cut-off

The auditor shall see that the value of these assets shown in the Balance Sheet comprises all assets existed and under the ownership of the company on the reporting date and amortization pertains to the current period only.

d. Completeness

1. The auditor should check the patent and copyright register carefully in order to verify that all the items have been properly included therein. He must ensure that patents and copyrights acquired

during the year has been entered in the register and items lapsed during the year has been removed properly.

2. He shall verify the arithmetical accuracy of the above movements in asset schedule.

e. Valuation

1. The auditor should ensure that patents and copyrights are being shown at cost less amortization charges.
2. He shall also see that the amortization rate follows the pattern in which the benefits are expected to be consumed.
3. In case it is purchased from a third party, the cost of the patent and copyright is the acquisition cost. Also, the cost of registration of the same in the client's name should be included in the valuation, while the renewal fees for patents should be charged off to revenue. The auditor should examine the same.
4. If the patent has been developed by the client in house, all development expenses, legal charges, including registration fees and other direct costs incurred in creating it, should be capitalized (as per Ind AS 38 or AS 26).
5. The cost of patent should be written off over the legal term of its validity or over its useful commercial life, whichever is shorter. The cost of the copyright should be written off over the legal term of its validity.

f. Presentation and Disclosure

1. In case of a company, the auditor should ensure that the patents and copyright have been disclosed in the balance sheet of the company under the head 'Non-current Assets' and subhead 'Other Intangible Asset' as per Schedule III of the Companies Act 2013.
2. He shall also ensure that all the relevant information has also been disclosed in the 'Notes to Accounts' section.

C. INVESTMENTS

Investments are the assets held by an enterprise for earning income by way of dividends, interest and rentals, for capital appreciation, or for other benefits to the investing enterprise. An investment constitutes a significant portion of the total assets. As per Schedule III of the Companies Act 2013, investments can be (a) Non-current investments or (b) Current Investments. An investment may be represented by investments in government securities, shares, debentures, mutual funds, etc.

Audit procedure to be Followed

a. Existence

1. The auditor shall collect a schedule of all short and long-term investments from the management with all possible details including their name, nature, investee entity, purchase price, date of purchase, tenure, date of interest payment (for debt securities), rate of interest (for debt securities), past year's rate of dividend (for share and mutual funds).
2. He shall tally the aggregate figure of the schedule with the figure shown in the balance sheet. He shall also examine the investment register and verify the amount shown in schedule with the register. The auditor must ensure that only those investments which belong to the client are shown in the balance sheet.
3. He shall physically verify all the certificates, and de-mat statement details to check that they are in the name of the client on the reporting date. Verification of certificates should be done in a single sitting to avoid producing same certificates more than once.
4. In case the certificate of investment is yet to be received, purchase of the same should be verified based on allotment advice, broker's note and receipt, etc. Similarly, for sale of investment between the balance sheet date and date of verification, broker's note may be checked. For sale of shares or other listed securities, trading account statement may be verified.
5. In case investments are not held by the entity in its own custody, then a certificate should be obtained from the relevant authority.

b. Rights and Obligations

1. The auditor shall verify the Memorandum and Article of the company to determine the power of the company to invest the surplus funds outside.
2. By verifying all the certificates, he shall determine the rights of the company in respect of the investments made, especially, the interest and dividend.
3. The auditor shall also see that all interest has been duly received and included in income. Outstanding interest if any should be recalculated and verified with the figure shown.

c. Cut-off

The auditor shall see that the value of investments shown in the Balance Sheet comprises all investments existed and under the ownership of the company on the reporting date.

d. Completeness

1. The auditor shall ensure that the schedule of investment is exhaustive.
2. He shall also ensure that all movements in the investment ledger have been appropriately

recorded.

e. Valuation

1. The auditor shall see that all costs incurred in connection with purchase of investments have been capitalized. However, in case the investment is purchased at cum-interest price, he shall see that cost doesn't include the interest component.
2. He shall also see that bonus shares received by the company are recorded in the investment ledger without attributing any cost to it. In case of right shares purchased by purchasing the right also, the cost of right entitlement must also be capitalized.
3. He shall see that any pre-acquisition dividend is credited to the investment account itself and not considered in the Statement of Profit and Loss..
4. The auditor shall also verify that the value of the investment has been determined following the relevant accounting standards keeping in mind the nature of investments.

f. Presentation and Disclosure

1. In case of a company, the auditor should ensure that the investments have been disclosed in the balance sheet of the company under the head 'Non-current Assets' and 'Current Asset' within the subhead 'Financial Assets' as per Schedule III of the Companies Act 2013.
2. The auditor shall also ensure that all the relevant information has also been disclosed in the 'Notes to Accounts' section.

D. Inventories/Stock in Trade

Inventory includes raw materials, loose tools, spare parts, semi-finished goods or work-in- progress, packing materials as well as finished goods ready for sale. Even for some organisations it includes stock at branch (in case of branch accounting), stock with customers (in case of hire purchase accounting), stock with consignee (in consignment arrangement), stock with customer on sale or approval (in case of sales on approval).

The responsibility for properly determining the quantity and value of inventories rests with the management of the entity. The management satisfies this responsibility by carrying out appropriate procedures which include verification of all items of inventory at least once in every financial year. This responsibility is not reduced even where the auditor attends any physical count of inventories in order to obtain the audit evidence. However, mere presence at the time of physical stock count does not relieve the auditor from his duty, rather the auditor is required to follow a detailed procedure to verify the inventories.

Audit Procedure to be Followed

a. Existence

1. The auditor should review the client's plan to verify inventory physically. He shall see that the process is properly supervised. He must ensure that all stock count sheets are signed by a responsible official of the client.
2. Where the client follows periodic system stock count should be done at the end of the period. On the other hand, where the client follows perpetual system, stock count should be done at interim dates.
3. The auditor must satisfy himself about any inventory lying at public warehouses or with third party

b. Rights and Obligations

1. The auditor shall also vouch recorded purchases to underlying documentation such as purchase invoice, purchase order, Goods Received Notes etc to determine that client is the owner of such goods.
2. He shall evaluate consignment agreement and any collateral agreement and examine the terms and conditions binding on the client.
3. He shall also obtain confirmation from the third parties for inventories lying with them.

c. Cut-off

The auditor shall see that the value of investments shown in the Balance Sheet comprises all investments existed and under the ownership of the company on the reporting date.

d. Completeness

1. The auditor should perform analytical procedure to identify any abnormality.
2. He should collect non-financial information such as weights and measures and check the same with physical verification reports.
3. He shall also perform purchase and sale cut-off test to identify misappropriation near the year end. He shall also ensure that no item is omitted from inventories and no invalid item is included in inventories. For this purpose, information of all stock lying with customers (under hire purchase system or sale on approval system), at branch and with consignee must be procured and verified.
4. He shall reconcile physical inventory amounts with perpetual records including stores ledger. The value of the inventory should also be tallied with the amount recorded in the books as adjustment entry of closing stock.

e. Valuation

1. The auditor must determine the appropriateness of the method of issuing inventory (LIFO, FIFO, Weighted Average, etc.) for valuation purpose.

2. Value of raw materials must be examined based on the cost of purchase, carriage inwards, duties paid, market price of raw materials and estimated cost of disposal. The auditor shall see that lower of cost and NRV has been considered as the value. Relevant documents for this purpose would be purchase invoice, voucher for transport cost, etc.

3. He shall also ensure that work-in-progress has been valued considering the completed stage of production and all direct and relevant indirect costs (up to works cost).

4. He shall ensure that cost of finished goods includes all direct and relevant indirect costs. In case the finished goods are expected to fetch value lower than the cost, the auditor shall see that the same is valued at NRV

5. He shall also see that damaged goods are valued at net realizable value. Moreover, he shall ensure that all obsolete goods have been written off fully.

f. Presentation and Disclosure

1. In case of companies, as per Part I of Schedule III of the Companies Act, 2013 all items of inventories shall be included in the head 'Current Assets' under the subhead 'Inventories'.

2. Additionally, in notes to accounts the following disclosures shall be made.

a. Inventories shall be classified as – (a) Raw materials (b) Work-in-progress (c) Finished goods (d) Stock in trade (in respect of goods acquired for trading) (e) Stores and spares (f) Loose goods (g) Others (specify nature).

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

c. Mode of valuation shall be stated.

E. LOANS

With reference to Part I of Schedule III of the Companies Act 2013, the format of Balance Sheet, loans represent long term as well as short term loans and advances.

Audit Procedure to be Followed

a. Existence

1. At first, the auditor must obtain separate schedules of long-term and short-term loans and advances. He should verify whether the balances shown in the schedule agree with the respective ledger accounts.

2. He should also attempt to obtain written confirmation from those who have been granted the loans and advances.

3. In case of claims made against insurance companies, railways, etc. the auditor should verify that only claims that were admitted have been shown as loans and advances. For this purpose, all the related correspondence has to be examined.

4. He shall also obtain the copies of statutory returns like IT return and GST return filed with appropriate authorities and verify whether the amount recorded as per the books tallies with the claims actually made.

b. Rights and Obligations

1. The auditor should see that loans and advances have been authorized by the Memorandum and Articles of Association.

2. He shall be extra cautious in verifying the authorization for related party loans and advances.

3. In case loans and advances have been granted against any security, the auditor shall verify the mortgage deed for the terms and conditions. For unsecured loans, he shall judge the possibility of its recovery.

4. In case advances granted to the employees, the auditor shall examine whether the instalments have been deducted from their salary regularly.

c. **Cut-off**

The auditor shall see that the value of loans shown in the Balance Sheet comprises all loans given by the company and outstanding on the reporting date.

d. **Completeness**

1. The auditor should see that all the loans and advances that are outstanding on the reporting date have been recorded.

2. He should also see that all the money recovered against the advances have been appropriately recorded against the respective advances.

e. **Valuation**

1. He shall obtain an aging schedule of different loans and a list of loans under litigations.

2. He should also verify the previous year's estimate of doubtful loans and after a discussion with the management verify the adequacy of the allowances for doubtful accounts during the current year.

3. The auditor shall also assess the movement of bad loans to Provision Account or write offs. He shall see that write-offs are properly authorized by a responsible official.

f. Presentation and Disclosure

1. In case of a company, the auditor must see that loans and advances have been shown under Non-

current Assets and Current Assets under subheads Loans as per Part I of Schedule III of the Companies Act 2013.

2. He shall also ensure that all the relevant information has also been disclosed in the 'Notes to Accounts' section.

F. TRADE RECEIVABLE

A receivable shall be classified as a trade receivable, if it is in respect of the amount due on account of goods and services rendered in the normal course of business, the term trade receivable suggests particularly the amount recoverable from customers, but in practice, it is applied to a wide range of claims which a business may carry as an asset in its books. Advances or loans cannot, however, be included under this head.

Audit Procedure to be Followed

a. **Existence**

1. The auditor should obtain a schedule of debtors duly signed by a responsible officer and examine it with reference to individual debtors' accounts.
2. The auditor should carry out an examination of the relevant records himself about the validity, accuracy and recoverability of the trade receivables balances.
3. The auditor should check the agreement of balances as shown in the schedules of trade receivable with those in the ledger accounts.
4. While examining the schedules of trade receivables with reference to the trade receivables' ledger accounts, the auditor should pay special attention to the following aspects:

a. Where the schedules show the age of the debts, the auditor should examine whether the age of the debts has been properly determined.

b. Where the amount outstanding are made up of items which are not overdue, having regard to the credit terms of the entity.

C. Whether transfer from one account to another are properly evidenced.

b. **Rights and Obligations**

1. The auditor must ensure that the company has valid claims in respect to the amount shown as debtors.
2. He shall examine the bills and notes receivables to see whether those are legally held by the company.

c. **Cut-off**

The receivable balance must represent the sundry debtors and other receivables held by the company on the reporting date only.

d. **Completeness**

1. The auditor should ensure that all debtors and receivables have been included in Trade Receivables. In case of dispute, he must obtain confirmation from debtors in this respect.
2. Inspect relevant correspondence such as court order declaring insolvency of a debtor. Correspondence between the client and his lawyer for bad debts written off.
3. Verification of subsequent realizations is a widely used procedure, even in cases where direct confirmation procedure is followed.

e. **Valuation**

1. The provision for bad and doubtful debts is to be recomputed and compared it with past period for assessing its reasonableness.
2. The calculation of discount on bills must be verified.
3. Rebates and discount allowed in excess of normal terms should be investigated.
4. Bad debt written off should be examined.

f. **Presentation and Disclosure**

The auditor must ensure the following reclosures as per Part I of Schedule III with respect to "Trade Receivable" in notes to accounts:

1. Trade receivables shall be sub-classified as:

a. Secured, considered good

b. Unsecured, considered good

c. Trade Receivables which have significant increase in Credit Risk; and

d. Trade Receivables - credit impaired.

1. Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
2. Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.
3. For trade receivables outstanding ageing schedule shall be given.

G. **CASH AND CASH EQUIVALENTS**

Cash and Cash equivalent includes cash in hand, stamps in hand, balances held with bank in current accounts/ margin money accounts, cash credit accounts (debit balance), fixed deposits, and cheques in hand, etc. It is the most liquid form of assets of an organization and hence utmost professional skepticism needs to be exercised while auditing such balances.

Audit Procedure to be Followed

a. Existence

1. The auditor shall exercise special care to verify cash balances. They shall be preferably checked by surprise. Physical verification of cash in hand would be utmost essential in this context.
2. If the company maintains any rough Cash Book or details of daily balances, the auditor shall perform test check to see that entries in the Cash Book are accurate. In case he finds any slip indicating temporary advance given to an employee which has been included in the cash balance, he should have them initiated by responsible official.
3. The auditor shall also perform a cash sensitivity analysis (by calculating total receipts and payments month wise) to determine if there is any abnormal variation in the same in a month. In such a case the auditor shall enquire into the same and demand explanation from the management.
4. He shall also obtain the Bank reconciliation Statements for every bank account as at the reporting date to rule out possibility of any error in the cash book. The BRSs must be signed by the accountant and approved by responsible official. He shall also ask the management to reconcile all discrepancies.
5. He shall also communicate with the respective banks and obtain written confirmation regarding the balances held in different bank accounts and deposits.

b. Rights and Obligations

The auditor shall verify that all the deposits are in the name of the client. For this purpose, the confirmation of the banker and certificate of such deposits shall be examined.

c. Cut-off

The cash balances must represent the amount of cash and cash equivalents on the reporting date.

d. Completeness

The auditor shall ensure confirmation of 100% of the bank accounts. He shall also be careful to include all items of cash in hand in the total balance.

e. Valuation

In addition to performing the above steps, the auditor shall also see that all bank balances representing holding of foreign currencies have been appropriately restated at the exchange rate prevailing on the date of reporting.

f. Presentation and Disclosure

The auditor shall ensure the disclosures as per the relevant Accounting Standards and Part 1 of Schedule III of the Companies Act 2013.

H. Share Capital

Every company starts with procurement of capital. In case of public limited companies, applications are invited for subscription to shares from the public. For this purpose, the company issues a prospectus or statement in lieu of prospectus. On receipt of applications, company makes allotment to eligible applicants and eventually they become the members of the company. Also, in this process companies often appoint underwriters to underwrite the issue. An auditor while auditing the Share Capital of the company must carefully examine all these related aspects.

Audit Procedure to be Followed

a. **Existence**

1. The auditor must conduct a reconciliation between the opening and closing balance of share capital to know whether there was any new issue, capitalization or buyback of equity shares or redemption of preference share.
2. In case of change he must ensure that the revised capital is within the limit of authorized capital of the company.
3. He must examine that the transactions effecting the change in share capital are genuine and properly authorized. He should examine the resolutions of meetings of the BOD and shareholders for this purpose.

b. **Rights and Obligations**

1. He should ensure that the new issue satisfies all the regulatory requirements of Companies Act, 2013, SEBI regulations and guidelines.
2. In specific, he shall see that no shares have been issued at discount. In case shares have been issued at premium, he shall see that the balance of Share Premium has been utilized only for the purposes permitted.
3. With respect to issue of sweat equity shares, right shares, bonus shares etc. he shall ensure that the rules have been duly complied with.

c. **Cut-off**

The balance of Share Capital must represent the amount of share capital on the reporting date.

d. **Completeness**

The auditor must ensure that all changes made in share capital have been duly given effect and accounting entries are adequate.

e. **Valuation**

The auditor must verify that the proceeds collected are correct. For this purpose, he shall verify the calculation of total proceeds received, its allocation to various heads and also underwriter's commission payable and settlement of their accounts with liability.

f. Presentation and Disclosure

The auditor shall ensure the following disclosures as per the Part 1 of Schedule III of the Companies Act 2013:1. For each class of equity shares, the company must disclose (i) no. and amount of shares authorized, (ii) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid; (iii) par value per Share; a reconciliation of the number of shares outstanding at the beginning and at the end of the period, (v) the rights, preferences and restrictions attaching to each class of shares; shares in the company held by each shareholder holding more than five per cent. shares specifying the number of shares held, (vi) shares reserved for issue under options and contracts or commitments for the sale of shares or disinvestment, including the terms and amounts; (vii) terms of any securities convertible into equity shares issued along with the earliest date of conversion in descending order starting from the farthest such date; (viii) calls unpaid (showing aggregate value of calls unpaid by Directors and officers); (ix) forfeited shares (amount originally paid up), (x) shareholding of promoters etc.

I. OTHER EQUITY

As per Schedule III, Division 2, Other Equity comprises of the following elements:

1. Share application money pending allotment;
2. Equity component of compound financial instruments;
3. Reserves and Surplus including Capital Total reserve, Securities Premium, Other Reserves and Retained Earnings;
4. Debt instruments through Other Comprehensive Income;
5. Equity Instruments through Other Comprehensive Income;
6. Effective portion of Cash Flow Hedges; (vii)Revaluation Surplus;
7. Exchange differences on translating the financial statements of a foreign operation;
8. Other items of Other Comprehensive Income;
9. Money received against share warrants.

While some of the above sources are eligible for dividend payment, others must be utilized for specified purposes only – such as Securities Premium and Capital Redemption Reserve.

In Schedule III, Division I, these are however excluded or shown as separate line item.

Audit Procedure to be Followed

a. Existence

1. The auditor must trace and tally the opening balance of reserves with their closing balances and needs to identify the changes, if any.

2. In case there is addition during the year, such as issue of new shares at premium, transfer to General Reserve from current year's profit, revaluation profit etc., the auditor needs to ensure that such additions are genuine, properly authorized by appropriate resolutions in the meetings of BOD and members. Similarly, for any reduction in balances, the auditor needs to find out the resultant transaction and its validity.

b. Rights and Obligations

The auditor must ensure that addition and utilization of balances of various items have been in compliance with the relevant Act and Regulations. The utilization of reserves must be for specified purposes only, as applicable.

c. Cut-off

The balance of each item of Other Equity must represent the amount of share capital on the reporting date only.

d. Completeness

The auditor must ensure that all changes made in Other Equity items have been duly given effect and accounting entries are adequate.

e. Valuation

The auditor must ensure that the additions and utilizations from various balances of Other Equity have been calculated appropriately. For example, in case of utilization of accumulated profits for dividend payment, the amount so utilized must satisfy the conditions laid down in Companies (Declaration and Payment of Dividend) Rules, 2014.

f. Presentation and Disclosures

The auditor shall ensure the following disclosures as per the Part 1 of Schedule III of the Companies Act 2013:

1. 'Other Reserves' shall be classified in the notes as-

a. Capital Redemption Reserve;

b. Debenture Redemption Reserve

c. Share Options Outstanding Account; and

d. others- (specify the nature and purpose of each reserve and the amount in respect thereof);

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

2. Retained Earnings represents surplus i.e balance of the relevant column in the Statement of Changes in Equity;
3. A reserve specifically represented by earmarked investments shall disclose the fact that it is so represented;
4. Debit balance of Statement of Profit and Loss shall be shown as a negative figure under the head 'retained earnings'. Similarly, the balance of 'Other Equity', after adjusting negative balance of retained earnings, if any, shall be shown under the head 'Other Equity' even if the resulting figure is in the negative; and
5. Under the sub-head 'Other Equity', disclosure shall be made for the nature and amount of each item.

J. BORROWINGS

Borrowings represent loans of both long term and short term in nature. While long term borrowings are procured for business expansion or buying any fixed assets, short term borrowings are done mostly for working capital financing.

Audit Procedure to be Followed

a. **Existence**

1. The auditor should collect a schedule of all borrowings with details regarding the date of procurement of the loan, period of loan, rate of interest, amount of loan and assets pledged against the loan, if any.
2. He shall examine the loan agreements to ensure that the loans have been taken in name of the client. He shall tally the loan recorded with the loan agreement.
3. In case of bank loan, he shall obtain a confirmation from the bank regarding the amount of loan outstanding and shall tally the same with the balance of loan shown in the books.

b. **Rights and Obligations**

1. He must examine the Articles of Association and Memorandum of Association and take note of the rules and regulations in this respect. He shall ensure that the loan agreement adheres to all such rules
2. He shall verify that the procurement of loan has been properly authorized. In case of a company, such authorization must be in the form of a resolution of the Board.
3. He shall examine the loan agreements and take note of the conditions of such loan. He shall also verify that all such conditions are duly complied with.
4. The auditor should collect a certificate from the lender regarding the asset pledged with the

lender and shall verify the information from the register of mortgage maintained by the client. He shall also enquire about the nature of the charge - fixed or floating as a pledged asset with fixed charge cannot be sold without the permission of the lender. The auditor shall verify any irregularities in this regard.

c. **Completeness**

1. The auditor shall ensure that information regarding all loans has been produced before him and no loan that was paid earlier in full has been shown as outstanding. Also, he must ensure that information about the assets pledged and the nature of charge is complete.
2. He shall verify all new loans taken during the year and check the minutes of the meetings of the Board for authorization of the same.

d. **Valuation**

1. The auditor shall check whether the accounting policies and methods of recording the loan are appropriate and applied consistently.
2. He shall also examine whether the interest payable on such loan has been paid in due time and the same has been accounted for accordingly. In case any interest is outstanding, the auditor shall verify the same.
3. In case of amortizing loan (i.e., loans of which principal amount is repayable in instalments) taken by a company, the auditor shall determine the current maturities of the loan.

e. **Presentation and Disclosure**

1. The auditor must see that the outstanding amount of loan (non-current portion) has been shown under Non- Current Liabilities or Current Liabilities and under subhead Borrowings as per Part 1 of Schedule III of the Companies Act 2013.
2. In case of long-term amortizing loans, the auditor shall see that all current maturities (instalments falling due within next twelve months) are shown under the head Current Liabilities and disclosure of the same is given in form of a footnote.
3. He shall also ensure that all restrictive covenants (i.e., conditions) are appropriately disclosed in the financial statements.
4. The auditor shall also see that the charge has been appropriately reported in the Balance Sheet.
5. In case the value of the security falls short of the amount of loan outstanding, he shall examine whether the loan is classified as secured only to the extent of market value of the security.

K. TRADE PAYABLE

The term 'Trade Payable' comprises both trade creditors (i.e., sundry creditors) as well as bills payable. This represents the liability of an organization to its suppliers.

a. Sundry Creditors

Audit Procedure to be followed to verify the assertions

a. Existence

1. At first, the auditor shall examine whether an effective internal control system exists in the organization relating to the transactions with creditors.

2. He shall collect a schedule of trade creditors from the management with all possible details including the name of the creditor and amount payable. He shall verify the same with the balance of individual creditor's account in the ledger.

3. With prior permission from the client, he shall collect confirmation from some selected creditors regarding the amount payable to them. Such information shall be checked with the balances of creditors.

4. If the ledgers are maintained under self-balancing system, information from the General Ledger shall be cross verified from the Creditors' Ledger Control/ Adjustment Account.

b. Rights and Obligations

The auditor shall also examine that all the terms and conditions of the contract with the supplier have been duly complied. He shall ensure that the goods purchased have actually been received and/or services have been provided in due course. For this purpose, Goods Inward Book may be examined.

c. Cut-off

The balance of sundry creditors must represent only the balances outstanding on the date of reporting.

d. Completeness

1. The auditor shall ensure that no trade creditor is excluded from the schedule. He may collect a confirmation from the management in this respect.

2. He shall be extra cautious while verifying the transactions near the end of the year.

e. Valuation

1. The auditor shall see that the total of balances as per the schedule of creditors tallies with the total of balances of all creditors' account.

2. He may select a few sample credit sale transactions and shall verify the correctness of recording

the same based on invoice, Goods Received Note, Purchase Day Book and respective ledger heads.

3. The auditor shall also verify the transactions relating to return of goods from Return Outward Book and see that the same has been correctly posted to creditors' accounts.

4. In case any discount is received from the supplier, the same shall be examined from the correspondence with creditors. Its accounting treatment shall also be verified.

5. If any amount payable to a specified creditor remains outstanding for long or if any cheque issued to a creditor is not encashed for long, the same should be examined to avoid possibility of fraud.

f. Presentation and Disclosure

The auditor shall ensure the following disclosures as per Part 1 of Schedule III of the Companies Act 2013.

1. In case of a company, the auditor must see that the total balance of creditors has been shown under Current Liabilities and under subhead Trade Payables as per Schedule III of the Companies Act 2013. It shall further be segregated into (i) total outstanding dues of micro enterprises and small enterprises; and (ii) total outstanding dues of creditors other than micro enterprises and small enterprises.

2. He shall also ensure that all the relevant information has also been disclosed in the 'Notes to Accounts' section.

L. BILLS PAYABLE

These are negotiable instruments used by creditors to discharge their liabilities. Basically, a creditor accepts a bill in favor of the debtor i.e., the client in this case.

Audit Procedure to be followed to verify the assertions

a. Existence

1. The auditor shall collect a schedule of bills payable from the management with all possible details including the name of the creditor and amount payable, date when the bill will become due etc. He shall verify the same from Bills Payable Book and Bills Payable Account. He shall specifically ensure that the bills are still outstanding and their due date has not expired.

2. He shall also see that the acceptance and dishonor of bills have been recorded in the respective creditors account.

b. Rights and Obligations

1. He shall examine the bills payable and identify the conditions therein. He shall see that the conditions have been duly complied with. He must also see that they met the legal requirements.

2. In case acceptance of a bill creates any charge on any asset, the auditor shall see that the same

has been reported in the Balance Sheet.

c. **Cut-off**

The balance of Bills Payable must represent only the balances outstanding on the date of reporting.

d. **Completeness**

1. The auditor shall see that the schedule collective from the management is exhaustive and no bills payable is excluded from it. He may collect a written confirmation from the management in this respect.
2. The auditor shall be extra cautious to verify that no bill which has already expired has been included in the above schedule.

e. **Valuation**

1. The auditor shall ensure that total of the schedule tallies with the balance of the bills payable account.
2. To verify the dishonored bills, the auditor shall examine the correspondence between the client and the creditor. He shall also verify the notification issued by the notary public and bank statement.
3. In case of renewal of bills dishonored, the auditor shall examine the correspondence between the client and the creditor. If any interest was payable for such renewal, he shall see that the same has been properly recorded in the creditor's account.

f. **Presentation and Disclosure**

1. In case of a company, the auditor must see that the total balance of bills payable has been shown under Current Liabilities and under subhead Trade Payables as per Schedule III of the Companies Act 2013. It shall further be segregated into (i) total outstanding dues of micro enterprises and small enterprises; and (ii) total outstanding dues of creditors other than micro enterprises and small enterprises.
2. He shall also ensure that all the relevant information has also been disclosed in the 'Notes to Accounts' section.

Audit of Some Special Transactions

a. **Alteration of Share Capital [Section 61]**

The audit procedure to be applied in this context are:

1. The auditor must confirm that alteration was authorized by articles.
2. He shall verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
3. He shall verify that alteration had been effected in copies of Memorandum, Articles, etc.
4. He shall obtain the reasons for which the memorandum of the company is altered.
5. He shall check whether there is any change in the voting percentage of shareholders due to consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares.
6. He has to confirm that the alter share capital's denomination should be more than rupee one.
7. He has to verify that proper accounting entries have been passed. Register of members may also be checked to see that the necessary alterations have been effected therein.

b. **Issue of Bonus Shares [Section 63]**

The audit procedure to be applied in this context are:

1. The auditor must confirm that issue of Bonus Share was authorized by articles.
2. He shall verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
3. He shall check that the company has issue fully paid-up bonus shares to its members only.
4. He shall confirm that the issue of bonus shares shall not be made by capitalizing reserves created by the revaluation of assets.
5. He shall check whether the company has made any default in payment of interest or principal in respect of fixed deposits or debt securities issued by it.
6. He must check whether the company has made any default in payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus.
7. He shall check whether the partly paid-up shares are made fully paid-up.

c. Splitting of Shares

The audit procedure to be applied in this context are:

1. The auditor shall confirm that alteration was authorized by articles.
2. He should verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
3. He should verify that alteration had been effected in copies of Memorandum, Articles, etc.
4. He should verify that proper accounting entries have been passed. Register of members may also be checked to see that the necessary alterations have been effected therein.

d. **Re-issue of Forfeited Shares**

The audit procedure to be applied in this context are:

1. The auditor should ascertain that the board of directors has the authority under the Articles of Association of the company to reissue forfeited shares. Check the relevant resolution of the Board of Directors.
2. He should vouch the amounts collected from persons to whom the shares have been allotted and verify the entries recorded from re-allotment. The auditor should check the total amount received on the shares including received prior to forfeiture, is not less than the par value of shares.
3. He should verify that computation of surplus amount arising on the reissue of shares credited to Capital Reserve Account and
4. Where partly paid shares are forfeited for non-payment of call, and re-issued as fully paid, the reissue is considered as an allotment at a discount and compliance of the provisions of Section 53 is essential. The auditor needs to ensure the same.

e. Issue of Debentures [Section 71]

The term "Debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not. Debenture is an important source of long-term debt capital of a company.

A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting. No company shall issue any debentures carrying any voting rights. Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.

The audit procedure to be applied in this context are:

1. The auditor should verify that the prospectus had been duly filed with the registrar before the date of allotment of debentures.
2. He should check the amount collected in the cash book with the counterfoils of receipts issued to the applicants and also cross check the amount into the application and allotment book.
3. He should examine the debenture trust deed and note the conditions contained therein as to issue and repayment.
4. If the debentures are covered by a mortgage of a charge, it should be verified that the charge has been correctly recorded in the register of mortgage and charges and it has also been registered with the registrar of the companies.
5. Compliance with SEBI guidelines should also be ensured.
6. Where debentures have been issued as fully paid up to vendors as a part of the purchase consideration, the contract in this regard should be checked.

f. Redemption of Debentures

A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. If debentures are redeemable, it can be redeemed in any of the following way:

1. By way of periodical drawing i.e., by creating Debenture Redemption Reserve Account.
2. By way of payment on fixed date.
3. By payment whenever the company desires to do so.

The audit procedure to be applied in this context are:

1. The auditor should inspect the debentures or trust deed for the terms and conditions regarding redemption of debentures.
2. He should see the Director's minute book authorizing the redemption of debentures.
3. He should also vouch the redemption with the help of debenture bonds cancelled and the cash book.
4. He should also examine the accounting treatment thoroughly.

g. Payment of Dividend

1. Provisions of Companies Act, 2013 Regarding Payment of Dividend

Dividend is the part of the divisible profits of the company which is actually paid to the shareholders. Companies Act, 2013 provides detailed provisions regarding declaration and payment of dividend as follows:

i. Sources of Dividend:

As per Section 123(1), No dividend shall be declared or paid by a company for any financial year except –

a. out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2), or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or out of both; or

b. out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government:

ii. Transfer to Reserves:

A company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company.

iii. Payment of Dividend out of Accumulated Profit:

Where, owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the free reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf.

Accordingly, Companies (Declaration and Payment of Dividend) Rules, 2014 provides that in the event of inadequacy or absence of profits in any year, a company may declare dividend out of free reserves subject to the fulfilment of the following conditions:

1. The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year: However, this rule will not be applicable to a company, which has not declared any dividend in each of the three preceding financial years.
2. The total amount to be drawn from such accumulated profits shall not exceed one-tenth of the

sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

3. The amount so drawn shall first be utilized to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

4. The balance of reserves after such withdrawal shall not fall below fifteen per cent of its paid-up share capital as appearing in the latest audited financial statement.

Section 123(1) further provides that –

1. No dividend shall be declared or paid by a company from its reserves other than free reserves.
2. No company shall declare dividend unless carried over previous losses and depreciation not provided in previous year or years are set off against profit of the company for the current year.

Note: 'Free Reserves' for this purpose shall mean such reserves which are available for distribution as dividend. It shall not include any amount representing unrealized gains, notional gains or revaluation of assets, or any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value.

iv. Interim Dividend

The Board of Directors of a company may declare interim dividend during any financial year or at any time during the period from closure of financial year till holding of the annual general meeting out of the surplus in the profit and loss account or out of profits of the financial year for which such interim dividend is sought to be declared or out of profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend.

In case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

V . Procedure of Dividend Payment:

Section 123(4) states that the amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.

Moreover, as per Section 123(5), no dividend shall be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and shall not be payable except in cash. However, the company may capitalize its profits or reserves for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.

Any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.

vi. **Restriction on Declaration of Dividend:**

As per Section 123(6), a company which fails to comply with the provisions of sections 73 and 74 shall not, so long as such failure continues, declare any dividend on its equity shares.

vii. **Unpaid Dividend**

Section 124 of the Companies Act, 2013 states that –

1. Where a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.
2. The company shall, within a period of ninety days of making any transfer of an amount under sub-section to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the web-site of the company, if any, and also on any other web-site of the company, if any, and also on any other web-site approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.
3. If any default is made in transferring the total amount referred to in sub-section (1) or any part thereof to the Unpaid Dividend Account of the company, it shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of twelve per cent per annum and the interest accruing on such amount shall ensure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.
4. Any person claiming to be entitled to any money transferred under sub-section (1) to the Unpaid Dividend Account of the company may apply to the company for payment of the money claimed.
5. Any money transferred to the Unpaid Dividend Account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall

be transferred by the company along with interest accrued, if any, thereon to the Fund established under sub-section (1) of section 125 and the company shall send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority shall issue a receipt to the company as evidence of such transfer.

6. All shares in respect of which dividend has not been paid or claimed for seven consecutive years or more shall be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed:

Provided that any claimant of shares transferred above shall be entitled to claim the transfer of shares from Investor Education and Protection Fund (IEPF) in accordance with such procedure and on submission of such documents as may be prescribed.

7. If a company fails to comply with any of the requirements of this section, such company shall be liable to a penalty of one lakh rupees and in case of continuing failure, with a further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of ten lakh rupees and every officer of the company who is in default shall be liable to a penalty of twenty-five thousand rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees.

According to Section 125(5), any person claiming to be entitled to any unclaimed dividend may apply to the authority of IEPF for the payment of the money claimed.

vii. Punishment for Failure to Distribute Dividends [Section 127]

Once a dividend is declared, a company must pay such dividend or at least post the warrant in respect thereof to every shareholder entitled to the payment of such dividend within a period of thirty days from the declaration of the dividend.

However, if the company fails to do so, then every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment which may extend to two years and with fine which shall not be less than one thousand rupees for every day during which such default continues.

Moreover, the company shall be liable to pay simple interest at the rate of eighteen per cent per annum during the period for which such default continues.

However, no offence under this section shall be deemed to have been committed:

where the dividend could not be paid by reason of the operation of any law;

2. where a shareholder has given directions to the company regarding the payment of the dividend

and those directions cannot be complied with and the same has been communicated to him;

3. where there is a dispute regarding the right to receive the dividend;

4. where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or

5. where, for any other reason, the failure to pay the dividend or to post the warrant within the period under this section was not due to any default on the part of the company.

2. **Audit Procedure for Final Dividend**

1. The auditor should examine the Articles of Association of the company to ascertain the differential rights of the shareholders, if any.
2. The auditor should also examine the minute book of directors' and shareholders' meetings to verify the dividend was properly recommended by the directors and whether it was passed by a resolution in the shareholders' meeting.
3. The auditor should verify whether the amount of dividend paid was calculated accurately.
4. He should ensure that the provisions of Companies Act, 2013 and Companies (Declaration and Payment of Dividend) Rules, 2014 have been complied with.
5. Based on the bank statements, the auditor must verify whether the total amount of dividend was transferred to a separate bank account in a scheduled bank within five days from the declaration of such dividend and whether dividend was paid to shareholders only out that account.
6. The auditor must ensure that dividend has been paid to the rightful owner. He should verify the Dividend Register and bank statements for this purpose. The auditor shall also reconcile the amount of dividend warrants outstanding with the Dividend Register and the balance in the Bank Account.
7. The auditor shall also verify whether sufficient effort was made by the management to distribute the dividend within 30 days from its declaration and shall enquire into all the cases where the dividend could not be paid within such time.

If the auditor comes across any irregularities regarding the above areas, he shall immediately enquire into the matter with the management and if not satisfied, shall also bring such irregularities to the notice of the shareholders.

2. **Audit Procedure for Interim Dividend**

1. The auditor should examine the Articles of Association of the company to ascertain whether payment of interim dividend is permitted by the articles or not.
2. The auditor should also examine the minute book of directors' meeting to verify resolution

approving the payment of interim dividend.

3. The auditor must critically appraise the justification in paying interim dividend based on interim accounts.

4. The amount of interim dividend shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.

5. The auditor must ensure that dividend has been paid to the rightful owner. He should verify the Dividend Register and bank statements for this purpose. The auditor shall also reconcile the amount of dividend warrants outstanding with the Dividend Register and the balance in the Bank Account.

3. **Audit Procedure for Unpaid Dividend**

1. The auditor should collect a statement or list containing every detail regarding the unpaid dividend such as the names of the shareholders, dividend payable to them, dividend warrant number, reason for the dividend remaining unpaid etc.

2. The auditor shall conduct an enquiry to identify whether there was any fault on the part of the company and if so, what action has been taken against the company.

3. The auditor shall verify the statement provided by the management in this respect with other supporting documents like Dividend Register, Returned Warrants, bank statement, etc. and shall determine whether the dividend amount has been accurately calculated.

4. The auditor shall also verify whether the unpaid dividend has been transferred to a separate account namely Unpaid Dividend Account within seven days from the expiry of 30 days allowed for declaration and payment of dividend.

5. The auditor must verify whether there is any fault on the part of the company and if so whether they have deposited the interest and the penalty.

6. The auditor shall also verify whether the company has published the details of unpaid dividend in its own website and also in other website(s) approved by the government for this purpose.

7. Any payment of previously unpaid dividend must be verified by the auditor to see that the same has been paid to the rightful owner.

8. In case any amount of dividend is remaining unpaid for more than seven years, the auditor shall verify whether the same along with the interest accrued thereon has been transferred by the company to IEPF.

9. The auditor shall also verify whether all the shares in respect of which unpaid dividend has been transferred to IEPF, have also been transferred to such fund.

2.5

• AUDIT REPORT, REPORT VS. CERTIFICATE, REPORTING REQUIREMENTS UNDER COMPANIES ACT, CONTENTS OF THE REPORTS AND MODIFICATIONS IN THE REPORT (WITH COVERAGE OF CARO)

Concept and Definition of Audit Report

After conducting an audit of an organization, it is the duty of the auditor to communicate, to the appointing authority, his opinion on the exhibition of true and fair view of financial performance and financial position of the organization. Audit report is the written communication on the part of the auditor to convey his opinion to the client.

According to Lancaster, 'a report is a statement of collected and considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of the full facts of the subject matter of the report.'

The preparation of audit report is essentially the last step in an audit assignment.

Audit Certificate

An audit certificate is a written confirmation of the exactness of the facts stated therein and does not involve any estimate or opinion. When an auditor certifies a statement, it implies that the contents of that statement are measurable and that he has verified the accuracy of the data.

According to Dicksee, a certificate is something that 'makes certain' and is thus necessarily limited to facts capable of absolute verification.

Audit Report vs. Audit Certificate

Audit certificates are fundamentally different from audit reports, though they are issued by the same auditor. The following are the differences between an audit report and an audit certificate.

NO	Points of Distinction	Auditor's Report	Auditor's Certificate
1.	Definition	An audit report is a document written in a standard format through which the auditor expresses his opinion regarding the reliability and correctness of an entity's financial statements.	An auditor's certificate is a written confirmation of the accuracy of the facts stated therein.
2.	Nature	It is an expression of opinion about the financial statements.	It is a confirmation of correctness and accuracy about some matters.
3.	Basis of audit	The report is based on assumptions and estimations	The certificate is based on actual figures and facts.
4.	Scope	The scope of the report is large.	Its scope is limited.
5.	Advice	In audit report, there is a scope of giving constructive advice to the company.	No scope of constructive advice exists in the case of the certificate.
6.	Basis	Audit report is based on facts, assumptions and estimations.	Audit certificate is based on actual figures.
7.	Guarantee	Audit report is an opinion by the auditor and does not guarantee the accuracy of the financial statements	Audit certificate is a formal statement by the auditors which guarantee the accuracy of the facts stated therein.
8.	Time of issue	The report is submitted to the appointing authority only after the audit is complete.	Certificates are issued as and when required.
9.	Liability of auditor	As a report is merely an opinion, if it is not correct,the auditor may not be held responsible, unless he is found to be negligent to his duty.	In case of the wrong certificate, the auditor will be held responsible.
10.	Format	Audit report has to be presented in prescribed format.	Audit certificate is not required tobe presented in any standard format.

Essential Characteristics of a Good Audit Report

The following are the essential characteristics of a good audit report:

1. Simplicity: An audit report should be simple and easily understandable to the users. It should be written is simple language and should be self-explanatory.
2. Clarity: The audit report should be clear and unambiguous. The auditor must clearly mention, in his report, the purpose of audit, sources of information, his findings and overall opinion.
3. Brevity: The report should be brief and specific. While everything relevant must be disclosed, the report should avoid unnecessary detailing.
4. Firmness: The report should firmly state whether, in the opinion of the auditor, the financial statements represent the true and fair view of the performance and state of affairs of the business.
5. Objectivity: The audit report should always be based on objective evidences. It is very much required to reduce or eliminate biases, prejudices, or subjective evaluations by relying on verifiable data.
6. Disclosure: The audit report should properly disclose all relevant facts and the truth. The relevance should be decided based on materiality of the concerned item.
7. Impartiality: The report should be unbiased. The recommendations must be impartial and objective.
8. Information-based: Only relevant and accurate information should be included in the audit report.
9. Timeliness: The report should be prepared and presented within the stipulated time. This will help in timely decision making.

Contents of Audit Report

The basic requirements of an audit report are guided by three regulatory sources, namely, the Companies Act, 2013, the Standards on Auditing and Companies (Auditor's Report) Order, 2020.

Requirements as per the Companies Act, 2013

The Companies Act, 2013 requires every limited company to get its accounts audited by a qualified auditor. The auditor critically appraises the books of accounts of the company and submit his report to the members of the company at the AGM. In this context, Section 143 and some other Sections of Companies Act, 2013 require the auditor to report on include the following in his audit report.

1. As per Section 143(2), the auditor, in his report, shall report whether to the best of his knowledge and information and as per his opinion, the accounts and the financial statements represent a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year.

2. According to Section 143(3), the auditor's report shall also state –

a) whether he has sought and obtained all the information and explanations from the management which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

c) whether the report on the accounts of any branch office of the company audited by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

e) whether, in his opinion, the financial statements comply with the accounting standards

f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;

h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.

3. Section 143(4) states that in case any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons thereof.

4. As per Section 143(5), in case of a Govt. company, where the CAG has issued any direction to the auditor appointed by it, the auditor, among other things, shall include (a) the directions issued by the CAG (b) the action taken thereon and its impact on the accounts and financial statement of the company.

5. According to Section 143(12), if the auditor of a company, in the course of his audit work, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government.

6. The auditor's report shall also include a statement on the matters prescribed by Companies (Auditor's Report) Order.

7. As per Rule 11 of Companies (Audit and Auditors) Rules 2014, the auditor's report shall also include his views and comments on the following matters:

a) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;

b) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;

c) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

Basic Elements/ Contents of Audit Report as per Standards on Auditing

As per SA-700 (Revised), Forming an Opinion and Reporting on Financial Statements, the basic elements of an audit report are as follows:

1. Title: In order to differentiate the audit report from other reports, it must have an appropriate title such as - Independent Auditor's Report.

2. Addressee: The auditor's report should be appropriately addressed as per the terms of engagement. Respective law, regulation or terms of engagement generally specify the person to whom the report is to be addressed. Normally, an audit report is addressed to the appointing authority. For example, in a public limited company, the audit report is addressed to the members i.e., shareholders.

3. Auditor's Opinion: The first section of the auditor's report shall include the opinion of the auditor and shall be named accordingly. This opinion section shall mention the name of the client, the fact that financial statements have been audited, the titles of the financial statements, reference to the summary of significant accounting policies and other explanatory information and the date and period of the financial statements audited.

4. Basis for Opinion: This section shall explain the basis for holding such opinion. Accordingly, it shall –

a) state that the audit has been conducted with applicable Standards on Auditing.

b) refer to the section that describes auditor's responsibilities under the Standards on Auditing.

c) Include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in this context.

d) State whether the auditor believes that the audit evidences obtained by him is sufficient and appropriate to provide a basis for the auditor's opinion.

e) Report on Going Concern Assumption: Where applicable, the auditor shall report in accordance with SA 570 (Revised) on Going Concern assumption.

f) Key Audit Matters: In case of audit of complete set of general-purpose financial statements of a listed entity, the auditor needs to communicate the key audit matters in accordance with SA 701. These are matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period. For instance, valuation of goodwill and other long-term assets, valuation of financial instruments, etc. Law or regulation may also require communication of key audit matters for other entities as well. Additionally, the auditor may also decide to communicate key audit matters for those who are of significant public interest.

g) Responsibilities for the Financial Statements: The report of an auditor should also include a section with heading 'Management's Responsibilities for the Financial Statements'. According to SA 200, management, and where appropriate, those charged with governance should accept responsibility for the preparation of financial statements and also for the internal control currently in force in the organization. An auditor's report must include reference to both responsibilities as it helps to explain the users the premise behind the audit conducted.

Accordingly, this section of the audit report shall describe management's responsibility for:

1. the preparation of the financial statements according to the applicable financial reporting framework and for the design, implementation and maintenance of an appropriate internal control relevant to the preparation of the financial statements that are free from material

misstatement, whether due to fraud or error.

2. assessing the entity's ability to continue as a going concern and whether the going concern basis of accounting is appropriate. SA 210 requires an auditor to agree management responsibilities in an engagement letter or other suitable form of written agreement.

h) Auditor's Responsibilities for the Audit of the Financial Statements: This section of the auditor's report shall state that:

1. The objectives of the auditor are to:

a) Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and

b) Issue an auditor's report that includes the auditor's opinion.

2. State that reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; And

3. State that misstatements can arise from fraud or error, and either:

a) Describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements; or

b) Provide a definition or description of materiality in accordance with the applicable FRF.

In addition to the above, the section shall further:

1. State that, as a part of an audit in accordance with SAs, the auditor has exercised professional judgement and maintained professional skepticism throughout the audit.

2. State that the auditor's responsibilities are:

a) to identify and assess the risk of material misstatements.

b) to obtain an understanding of internal control.

c) to evaluate the appropriateness of accounting practices followed and reasonableness of accounting estimates.

d) to comment on the appropriateness of management's use of going concern concept and whether there is any uncertainty that may cast significant doubt on the entity's ability to continue as a going concern.

i) Other Reporting Responsibilities:

1. If the auditor addresses other reporting responsibilities in the auditor's report that are in addition to the auditor's responsibilities under the SAs. These other reporting responsibilities shall be addressed in a separate heading titled "Report on Other Legal and Regulatory Requirements".

2. In case these other reporting responsibilities address the same topics as required by the SAs, the other reporting responsibilities may be presented in the same section as the related report elements required by the SAs.

j) Signature of the Auditor:

a. The report is signed by the auditor (i.e., the engagement partner) in his personal name.

b. Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm.

c. The partner/proprietor signing the audit report also needs to mention his membership number assigned by The Institute of Chartered Accountants of India.

d. They also include the registration number of the firm, wherever applicable.

k) Place of Signature: The auditor's report shall name specific location. It is ordinarily the city where the audit report is signed.

Date of the Auditor's Report: The date on which the auditor signs the report expressing his opinion on the financial statements of an entity is the date of the auditor's report.

Contents of Audit Report as per Companies (Auditor's Report) Order 2020

a. Notification

The Ministry of Corporate Affairs, Government of India notified Companies (Auditor's Report) Order 2020 on 25th February, 2020. This order was issued in supersession of Companies (Auditor's Report) Order 2016. Accordingly, CARO 2020 is applicable for all statutory audits commencing on or after 1st April, 2021 corresponding to the financial year 2020-21 and the matters specified therein shall be included in each report made by the auditor under Section 143 of the Companies Act, 2013 on the account of every company to which CARO 2020 applies.

b. Eligible Companies

It shall apply to every company including a foreign company as defined in clause (42) of Section 2 of the Companies Act, 2013 (18 of 2013) [hereinafter referred to as the Companies Act], except –

1. a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
2. an insurance company as defined under the Insurance Act,1938 (4 of 1938);
3. a company licensed to operate under section 8 of the Companies Act;
4. a One Person Company as defined in clause (62) of section 2 of the Companies Act and a small

company as defined in clause (85) of section 2 of the Companies Act; and

5. a private limited company, not being a subsidiary or holding company of a public company, having a paid-up capital and reserves and surplus not more than one crore rupees as on the balance sheet date and which does not have total borrowings exceeding one crore rupees from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act (including revenue from discontinuing operations) exceeding ten crore rupees during the financial year as per the financial statements.

c. Matters to be Included in Auditor's Report

1. Non-current Assets [Clause 3(i)]

a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment and full particulars of intangible assets;

b) whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; and whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

c) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company. If not, provide the details thereof in the prescribed format.

d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;

e) whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements.

2. Inventory [Clause 3(ii)]

a) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account;

b) whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

3. Investment, Providing Guarantee/security, Granting Loan or Advances [Clause 3(iii)]

a) whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so, -

1. whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-
2. the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates;
3. the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates;

b) whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest;

c) in respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

d) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

e) whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, if so, specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];

f) whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of Section 2 of the Companies Act, 2013;

4. Loan to Director and Investment by the Company [Clause 3 (iv)]

In respect of loan, investment, guarantees and security, whether provisions of Sections 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.

5. Acceptance of Deposits [Clause 3 (v)]

In case the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of Sections 73 to 76 or any other relevant provisions of the New Act and the rules framed thereunder, where applicable, have been complied with. If not, the nature of contraventions should be stated. If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not.

6. Maintaining Cost Records [Clause 3 (vi)]

Where maintenance of cost records has been specified by the Central Government under sub-section (l) of Section 148 of the New Act, whether such accounts and records have been made and maintained.

7. Statutory Dues [Clause 3 (vii)]

a) Is the company regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income tax, sales tax, wealth tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues with the appropriate authorities? And if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

b) In case dues of income tax or sales tax or wealth tax or service tax or duty of customs or duty of excise or value added tax or cess have not been deposited on account of any dispute, then the amount involved and the forum where dispute is pending shall be mentioned.

8. Disclosure of Unrecorded Income [Clause 3 (viii)]

Whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year;

9. Repayment of Loan [Clause 3 (ix)]

a) whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported.

b) whether the company is a declared willful defaulter by any bank or financial institution or other lender.

c) whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported;

d) whether funds raised on short term basis have been utilized for long term purposes, if yes, the nature and amount to be indicated;

e) whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case;

f) whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised;

10. Utilization of IPO/ Further Public Offer etc. [Clause 3 (x)]

a) whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;

b) whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance;

11. Reporting of Fraud [Clause 3 (xi)]

a) whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated;

b) whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;

c) whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;

12. Nidhi Company [Clause 3 (xii)]

a) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability;

b) whether the Nidhi Company is maintaining ten per cent. unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

c) whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof;

13. Related Party Transaction [Clause 3 (xiii)]

Whether all transactions with the related party are in compliance with Sections 177 and 188 of the Companies Act, 2013 whereas applicable and whether the details have been disclosed in the financial statement etc., as required by the applicable accounting standard.

14. Internal Audit [Clause 3 (xiv)]

a) whether the company has an internal audit system commensurate with the size and nature of its business;

b) whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor;

15. Non-Cash Transaction [Clause 3 (xv)]

a) Whether the company has entered into any non-cash transaction with the director or person concerned with him.

b) If so, whether the provision of Section 192 of the Companies Act, 2013 has been complied with.

16. Registration of the Company, Nature of the Company [Clause 3 (xvi)]

a) whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 (2 of 1934) and if so, whether the registration has been obtained;

b) whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934;

c) whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria;

d) whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group;

17. Cash Losses [Clause 3(xvii)]

Whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses;

18. Resignation of Statutory Auditor [Clause 3(xviii)]

whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors;

19. Information about Financial Assets and Liabilities etc. [Clause 3(xix)]

On the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date;

20. Unspent CSR Expenditure Amount [Clause 3(xx)]

a) whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act;

b) whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of sub-section (6) of section 135 of the said Act;

21. Qualification/Adverse Remarks [Clause 3(xxi)]

Whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements, if yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.

22. Reasons to be Stated for Unfavorable or Qualified Answers [Clause 4]

a) Where, in the auditor's report, the answer to any of the questions referred to in the previous paragraph, is unfavorable or qualified, the auditor's report shall also state the basis for such unfavorable or qualified answer, as the case may be.

b) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same maintained.

Auditor's Opinion in Audit Report

Different Types of opinion

The opinions expressed in audit reports issued by statutory auditors can broadly be divided into two categories

(A) Unmodified Opinion and (B) Modified Opinion.

1. Unmodified opinion:

Unmodified opinion: An audit report with an unmodified opinion is also known as 'Clean Report' or 'Unqualified Report'. An auditor expresses an unmodified opinion when he is satisfied that the financial statements exhibit a true and fair view of the state of affairs and operations in an enterprise during the period. To be more specific, an auditor issues an unmodified opinion when he finds that –

a) The Financial Statements have been prepared using the Generally Accepted Accounting Principles, which have been consistently applied;

b) The Financial Statements comply with relevant statutory requirements and regulations;

c) There are adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable; and

d) Any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the Financial Statement.

2. Modified Opinion:

While forming an opinion in accordance with SA 700 (Revised), if the auditor concludes that a modification to the auditor's opinion on financial statements is necessary, he shall express a modified opinion. SA 705, Modifications to the Opinion in the Independent Auditor's Report, suggests two such circumstances when an auditor should appropriately modify his opinion on the financial statements. These are:

a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatements; or

b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatements.

There can be three types of modified opinions – (1) Qualified Opinion, (2) Adverse Opinion and (3)

Disclaimer of Opinion.

1. Qualified Opinion

An auditor expresses qualified opinion on financial statements when:

a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, either individually or in aggregate, are material but not pervasive (i.e., not highly significant);

b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base his opinion, but concludes that the possible effects of undetected misstatements on the financial statements could be material but not pervasive.

Note: Meaning of the term 'Pervasive'.
The term 'pervasive' is used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence.
Pervasive effects on the financial statements are those that, in the auditor's judgment:
1. Are not confined to specific elements, accounts or items of the financial statements;
2. If so confined, represent or could represent a substantial proportion of the financial statements; or
3. In relation to disclosures, are fundamental to users' understanding of the financial statements.

In case of a qualified opinion, the heading of the 'Basis for Opinion' paragraph must be modified as 'Basis for Qualified Opinion'.

Some situations when an auditor should express a qualified opinion are:

1. Non-adherence to AS-2 with regard to inventory valuation at the lower of cost and net realizable value.
2. Auditor being prevented by the management from observing the counting of physical inventory where such action is material to the financial statements.

2. Adverse Opinion

An auditor expresses adverse opinion on financial statements when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, either individually or in aggregate, are both material and pervasive to the financial statements.

In case of an adverse audit report the heading of the 'Basis for Opinion' paragraph must be modified as 'Basis for Adverse Opinion'.

Some situations when an auditor should express an adverse opinion are:

a) Financial statements were prepared on going concern basis even after planning to cease the operation of the company within next six months.

b) Inadequate provision for doubtful debts.

3. Disclaimer of Opinion

The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

An audit report with a disclaimer of opinion must include the 'Basis for Disclaimer'.

Situations leading to reporting with a disclaimer of opinion are:

1. Auditor was prevented by the management from (a) observing the counting of physical inventory and (b) performing other procedures such as requesting external confirmation of debtors and creditors, and bank account balances.
2. Non-receipt of branch audit reports from a significant number of branches.

Deciding on Appropriate Modified Opinion.

As per SA 705, the objective of an auditor should be to express clearly an appropriately modified opinion on financial statements if the situation so demands. The decision on an appropriate modified opinion depends on two factors -

(a) the nature of matter that gives rise to the modification and

(b) auditor's judgement about the pervasiveness of the effects on the financial statements.

The following table explains such a decision by the auditor.

Nature of matter that gives rise to the modification Auditor's judgement about the pervasiveness of the effects on the financial statements.

Material but not pervasive Material as well as pervasive	Auditor's judgement about the pervasiveness of the effects on the financial statements	
	Material but not pervasive	Material as well as perva
Financial statements are misstated	Qualified Opinion	Adverse Opinion
Inability to obtain sufficient appropriate audit evidence	Qualified Opinion	Disclaimer of Opinion

Audit Report with 'Emphasis of Matter' and 'Other Matter' Paragraphs

1. any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.,
2. for the former and an 'Other Matter' paragraph for the latter.

A. 'Emphasis of Matter' Paragraph

As per SA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report, if the auditor, having formed an opinion on the financial statements, thinks it necessary to draw users' attention to a matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements, he can do so by way of clear additional communication in the auditor's report by including an 'Emphasis of Matter' paragraph provided:

a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and

b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term 'Emphasis of Matter';

b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and

C) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

1. An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
2. A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
3. Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
4. A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

B. 'Other Matter' Paragraph

If the auditor, having formed an opinion on the financial statements, considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, the auditor shall include an Other Matter paragraph in the auditor's report, provided:

This is not prohibited by law or regulation; and

1. When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.
2. When the auditor includes an Other Matter paragraph in the auditor's report, the auditor shall include the paragraph within a separate section with the heading 'Other Matter', or other appropriate heading.
3. Circumstances in which an 'Other Matter' paragraph may be necessary are:

a) When the matter is relevant to Users' Understanding of the Audit;

b) When the matter is relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report;

c) While reporting on more than one set of financial statements;

2.6

• REPORT ON INTERNAL FINANCIAL CONTROL OVER FINANCIAL REPORTING

Concept of Internal Financial Control

Internal Financial Control came into existence to promote risk management and governance process within the organization so that instances of organized frauds.

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

The importance of a sound internal financial control is paramount. Existence of adequate internal financial control not only reduces the burden of the auditor but also provides reasonable assurance about the appropriateness of the accounts and the results generated therefrom

Report on Internal Financial Control

As per Sec 143(3)(i) of Companies Act 2013, the report of the auditor should state as to whether the company has adequate Internal Financial Control system in place and the operating effectiveness of such controls.

Again, Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 requires the Board of Directors' report of all companies to state the details in respect of adequacy of internal financial controls with reference to the "financial statements".

Reporting on Internal Financial Control over Financial Reporting – Auditor's Responsibility

As mentioned earlier, Sec 143(3)(i) of Companies Act, 2013 requires that the report of the auditor should state as to whether the company has adequate Internal Financial Control system in place and the operating effectiveness of such controls.

Further, Rule 10A of Companies (Audit & Auditors) Rules 2014 states that:

a) For the financial years commencing on or after 1st April 2015, the report of the auditor should about existence of adequate Internal financial controls and its operating effectiveness.

b) The auditor of a company may voluntarily include the statement referred to in this rule for the financial year commencing on or after 1st April 2014 and ending on or before 31st March 2015.

As per the Guidance Note issued by The Institute of Chartered Accountants of India in this respect The auditor's objective in an audit of internal financial controls over financial reporting is to express an opinion on the effectiveness of the company's internal financial controls over financial reporting and the procedures in respect thereof are carried out along with an audit of the financial statements.

Globally, auditor's reporting on internal controls is together with the reporting on the financial statements and such internal controls reported upon relate to only internal controls over financial reporting.

Accordingly, the term 'internal financial controls' wherever used in this Guidance Note in the context of the responsibility of the auditor for reporting on such controls under Section 143(3)(i) of the Act, per se implies and relates to internal financial controls over financial reporting.

Therefore, 'internal financial controls over financial reporting' shall mean 'A process designed to provide rea- sonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal financial control over financial reporting includes those policies and procedures that –

a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;

b) provide reasonable assurance that transactions are recorded as necessary to permit preparation financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

An auditor needs to conduct an audit of IFC-FR though a proper planning followed by testing the design effectiveness of control and operating effectiveness of control and thereafter report on IFC over Financial Reporting.

The Guidance Note also provides that reporting on the adequacy and operating effectiveness of IFC-

FR would apply even in case of consolidated financial statements, for the respective components included in the consolidated financial statements only if it is a company under the 2013 Act. However, reporting on IFC will not be applicable with respect to interim financial statements, such as quarterly or half-yearly financial statements, unless such reporting is required under any other law or regulation.

2.7

• NATIONAL FINANCIAL REPORTING AUTHORITY (NFRA)

Background

In order to incorporate governance, the quality of accounting and auditing is critical. Keeping this in mind, the Central Government established the 'National Advisory Committee on Accounting Standards' (NACAS) under Section 210A of the Companies Act of 1956 to advise it on the formulation and laying down of accounting standards and auditing procedures. The NACAS was replaced by the National Financial Reporting Authority (NFRA) under the new Companies Act of 2013. The National Financial Reporting Authority (NFRA) is a quasi-judicial organization that oversees accounting and auditing issues.

Constitution

The National Financial Reporting Authority (NFRA) was constituted on 1st October,2018 by the Government of India under Sub Section (1) of section 132 of the Companies Act, 2013. The body will comprise of one Chairman who will be an eminent individual with competence in accounting, auditing, finance, or law as Chairperson. In addition, there can be a maximum of 15 members.

NFRA Structure

The following committees will make up the NFRA:

1. Accounting Standards Committee;
2. Auditing Standards Committee
3. Enforcement Committee.

Functions and Duties of NFRA

As per Section 132(2) of the Companies Act, 2013, the duties of the NFRA are to:

1. Recommend accounting and auditing policies and standards to be adopted by companies for approval by the Central Government
2. Monitor and enforce compliance with accounting standards and auditing standards;
3. Oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures for improvement in the quality of service;
4. Perform such other functions and duties as may be necessary or incidental to the aforesaid functions and duties.

Sub Rule (1) of Rule 4 of the NFRA Rules, 2018, provides that the Authority shall protect the public interest and the interests of investors, creditors and others associated with the companies or bodies corporate governed under Rule 3 by establishing high quality standards of accounting and auditing and exercising effective oversight of accounting functions performed by the companies and bodies corporate and auditing functions performed by auditors.

NFRA's Role in Auditing

a. Recommending Auditing Standards

As mentioned earlier, NFRA recommends auditing policies and standards to be adopted by companies for approval by the Central Government. For this purpose, the Authority –

1. shall receive recommendations from the Institute of Chartered Accountants of India on proposals for new accounting standards or auditing standards or for amendments to existing accounting standards or auditing standards;
2. may seek additional information from the Institute of Chartered Accountants of India on the recommendations received under clause (a), if required.

Further, the Authority shall consider the recommendations and additional information in such manner as it deems fit before making recommendations to the Central Government.

b. **Monitoring and Enforcing Compliance with Auditing Standards**

1. For the purpose of monitoring and enforcing compliance with auditing standards under the Act by a company or a body corporate governed under Rule 3, the Authority may:

a. review working papers (including audit plan and other audit documents) and communications related to the audit;

b. evaluate the sufficiency of the quality control system of the auditor and the manner of documentation of the system by the auditor; and

c. perform such other testing of the audit, supervisory, and quality control procedures of the auditor as may be considered necessary or appropriate.

2. The Authority may require an auditor to report on its governance practices and internal processes designed to promote audit quality, protect its reputation and reduce risks including risk of failure of the auditor and may take such action on the report as may be necessary.

3. The Authority may seek additional information or may require the personal presence of the auditor for seeking additional information or explanation in connection with the conduct of an audit.

4. The Authority shall perform its monitoring and enforcement activities through its officers or experts with sufficient experience in audit of the relevant industry.

5. The Authority shall publish its findings relating to non-compliances on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing.

6. The Authority shall not publish proprietary or confidential information, unless it has reasons to do so in the public interest and it records the reasons in writing.

7. The Authority may send a separate report containing proprietary or confidential information to the Central Government for its information.

8. Where the Authority finds or has reason to believe that any law or professional or other standard has or may have been violated by an auditor, it may decide on the further course of investigation or enforcement action through its concerned Division.

c. **Power to Investigate**

In addition to the above, the Authority also enjoys power to –

1. investigate any matter of professional or other misconduct under sub-section (4) of section 132 of the Act;
2. undertake investigation into any matter on the basis of its compliance or oversight activities; or
3. undertake suo-motu investigation into any matter of professional or other misconduct, after recording reasons in writing for this purpose.

If, during the investigation, the Authority has evidence to believe that any company or body corporate has not complied with the requirements under the Act or rules which involves or may involve fraud amounting to rupees one crore or more, it shall report its findings to the Central Government.

On the commencement of these rules-

a. the action in respect of cases of professional or other misconduct against auditors of companies referred to in rule 3 shall be initiated by Authority and no other institute or body shall initiate any such proceedings against such auditors:

Provided that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the Authority has initiated an investigation under this rule;

b. the action in respect of cases of professional or other misconduct against auditors of companies or bodies corporate other than those referred to in rule 3 shall continue to be proceeded with by the Institute of Chartered Accountants of India as per provisions of the Chartered Accountants Act, 1949 and the regulations made thereunder.

OBJECTIVES

A. Multiple Choice Questions

1. Any casual vacancy in a govt. company is filled by the CAG of India within ________ days.
A. 15
B. 30
C. 45
D. 60

2. Which of the following is not a content of audit report as per CARO?
A. Inventory
B. Acceptance of deposit
C. Recruitment of employees
D. Repayment of loan

3. No audit firm shall be appointed or reappointed as auditor for more than two terms of _________ consecutive years.
A. 3
B. 5
C. 7
D. 10

4. Each qualified chartered accountant not in full time employment can be the auditor of at most _________companies.
A. 10
B. 15
C. 20
D. 30

5. Which of the following is not a content of audit report?
A. Signature of the auditor
B. Date of the report
C. Attachment of audit evidences
D. Auditor's address

6. An auditor shall submit a unmodified report when _____________.
A. The financial statements exhibit true and fair view
B. The financial statements are partially correct
C. The financial statements are incomplete
D. The financial statements are unavailable

7. Cost Audit is covered under
A. Section 204
B. Section 148
C. Section 139
D. None of the above

8. Secretarial Audit is covered under section
A. Section 204
B. Section 148
C. Section 139
D. None of the above

9. An Audit Committee should have a minimum of ________ number of directors.
A. 4
B. 3
C. 5
D. 6

10. A cost auditor submits his report along with reservations and observations in Form No.
A. CRA 1
B. CRA 2
C. CRA 3
D. CRA 4

B. State True or False

1. An audit report should have a proper title- **TRUE**

2. Appointment of a statutory company auditor is governed by Section 139 of Companies Act, 2013- **TRUE**

3. Application for removal of a company auditor before the expiry of his term is to be made to the Central Govt. in form no. ADT-1- **FALSE**

4. SA 705 deals with modifications to the opinion in the independent auditor's report- **TRUE**

5. In case of a partnership firm the maximum no of companies to which the firm can be appointed as the auditor shall be limited to 10 companies- **FALSE**

6. An audit report is addressed to the authority appointing the Auditor- **TRUE**

7. The auditor gives a clean report when he doesn't have any significant reservation in respect of matters contained in the Financial Statements- **TRUE**

8. A disclaimer of opinion is issued by the auditor when he cannot form an overall opinion about the matters contained in the Financial Statements- **FALSE**

9. The Branch Auditor shall prepare report on the Accounts of the Branch examined by him and send it to Audit Committee- **TRUE**

10. Casual vacancy in the office of Cost Auditor is filled by Board of Directors- **TRUE**

C. Fill in the Blanks

1. Audit report reflects the work done by the **AUDITOR**
2. The audit report should be signed in the personal name of the **AUDITOR**
3. For any default on the part of the company to deposit to the unpaid dividend account within the stipulated time, the company needs to pay interest @ **12%** p.a.
4. The first auditor of a Govt. Company is appointed by the **CAG** of the company at the general meeting.
5. Secretarial audit is conducted by **COMPANY SECRETARY**
6. Cost Records are to be maintained as per Form **CRA -1**.
7. Reappointment of company auditor is guided by **139(9)** of the Companies Act, 2013.

3.1

• AUDIT OF EDUCATIONAL INSTITUTIONS

Educational Institutions

Educational institutions of any state in India are generally established and run under the Societies Registration Act 1960 or Public Trust Act of the state concerned. Similarly, central educational institutions are guided by the respective regulations issued by the Ministry of Education from time to time. In some cases, large educational institutions like universities are established by Central or State governments by enacting special legislation. Accordingly, the audit of accounts of these institutions is carried out as per the provisions of the legislation or the Trust Deed concerned. In addition, various circulars issued by the Central or State Government for institutions are also considered relevant in this respect. The audit procedure for these institutions must consider the following aspects:

A. UNDERSTAND THE CONSTITUTION: Study the Trust deed, Regulation or Act under which the institution has been established and should take note of the provisions regarding the maintenance of accounts. In case of State or Central University, established under the Special Act, study the regulations framed under the Act.

B. ASSESS THE INTERNAL CONTROL SYSTEM: Normally, these institutions have a well-organized internal control system. So, evaluate the internal control system associated with acquisition and maintenance of assets, authorization of transactions, etc. before finalizing the audit program me.

C. CONSULT THE MINUTE BOOK: Carefully examine all notices and minutes of the meeting of Governing Body (in case of colleges), Senate, Syndicate, Court and Council (in case of universities) and other committees which affect the accounts and finance of the institute. Confirm that the decisions taken for operation of bank accounts, approval of expenditure etc. have been duly complied with.

D. CONSULT THE BUDGET: Check the budget allocation to different heads and confirm that all amount sanctioned beyond budget has been duly approved.

E. VERIFY THE RECEIPTS RELATED TRANSACTIONS:

1. **Tuition Fees:** Tally the counterfoils of fee receipt with fee register to see whether they have been duly recorded or not. Check the register to identify whether all the students have paid their fees in due time. If any student has deposited the fees beyond the due date, check whether late fine has been charged or not and whether the same has been properly recorded. See whether all collections are deposited in the bank account at the end of the day. Total up the various columns of the Fees Register for each month or term to ascertain that fee paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
2. **Admission Fees:** Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
3. **Other Fees:** Verify the collection of other fees such as library fees, session fees or development fees, fees for hostel etc. based on the counterfoils and fee registered and ensure that the fees have been accounted for in appropriate heads.
4. See that all arrears on account of fees, fines, etc. have been taken into consideration at the end of accounting period.
5. See that free studentship and concessions have been granted by a person authorized to do so, having regard to the prescribed Rules.
6. Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
7. Verify grants received from Government or other organizations based on the sanction letter and bank statement.
8. Ensure that donation received, if any, has been acknowledged and recorded properly in the books of accounts.
9. Check income from letting out institutional properties based on the counterfoil of receipts issued to parties.
10. Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.

F. VERIFY THE PAYMENTS RELATED TRANSACTIONS:

1. Verify the salary and wages paid to the employees. In case of Govt. or aided colleges, verify that the claims have been properly prepared and the amount sanctioned has been distributed to

the right person. Check the calculation and accounting of arrear salary and see whether the deductibles from salary, such as Provident Fund Contribution and Income Tax deducted at source, have been deposited with the authority concerned in due time and if not, whether the same have been accounted for appropriately.

2. Examine whether all the expenditure associated with special events like seminar or symposium etc. has been accounted for by matching the expenditure in this regard against the amount obtained from any organization or sanctioned by the institution itself.

3. Vouch all the regular expenses such as electricity, telephone or broadband bills, travelling expenses, etc. based on available vouchers and accounting records.

4. Vouch purchase of fixed assets, expenditure for construction of college buildings based on the available vouchers, resolution of the meetings of purchase/finance committee. Similarly, utilization of grants for purchase of fixed assets, library books and laboratory equipment must be separately vouched.

5. Vouch the refund of Caution Deposit from the students based on receipts and accounting records.

6. Examine the payments on account of hostel facilities including repairs and mainte-nance of hostel building, electricity charges, purchase of food items etc.

7. See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.

G. VERIFICATION OF ASSETS AND LIABILITIES:

1. Conduct physical verification of tangible fixed assets as shown in the Fixed Asset Register. Verify investments based on Investment Register.

2. Check whether depreciation and amortization has been provided as per the policy adopted.

3. Verify the refund of TDS in respect of interest on investment, if any.

4. Carefully examine all outstanding liabilities such as electricity and telephone bills outstanding, TDS and PF not yet deposited.

5. Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.

6. Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorized and passed before payment.

H. VERIFICATION OF FINANCIAL STATEMENTS: Verify that the financial statements (i.e., Income and Expenditure Account and Balance Sheet) have been prepared in the form and manner as specified by the regulatory authority complying with the account standards and applicable legal requirements.

3.2

• AUDIT OF HEALTHCARE ORGANIZATIONS

Healthcare Organizations

Healthcare Organizations primarily include hospitals and nursing homes. They are established to provide medical services to the public. There may be hospitals run and funded by the Government or local authorities or by any charitable trust. These are generally non-profit seeking organizations. However, hospitals may also be established by private sector organizations. These are profit seeking organizations (and are popularly known as private nursing homes). Since healthcare organisations largely differs from other commercial organisations on account of their business processes, an auditor needs to prepare a sound audit plan to cover typical aspects of these organisations. Accordingly, the audit procedure must highlight the following steps:

A. UNDERSTAND THE CONSTITUTION: Study all the relevant documents to determine its nature and ownership structure (i.e., trust, partnership or company). Study the trust deed (in case of trust), partnership agreement (in case of partnership business) and articles and memorandum of association (in case of a company) and accordingly identify the rules and regulation relating to its management and process of preparation of accounts.

B. ASSESS THE INTERNAL CONTROL SYSTEM: Evaluate the internal control system associated with acquisition and maintenance of assets, authorization of transactions, etc. and determine the scope of the audit work.

C. CONSULT THE MINUTE BOOK: Carefully examine the notices and minutes of the meeting of Board of Directors, Managing Committee and other committees (such as purchase committee) and identify the decisions which may affect the accounting. Confirm that the decisions undertaken with respect to operation of bank accounts, approval of expenditure, etc. have been duly complied with.

D. VERIFY THE RECEIPTS RELATED TRANSACTIONS:

1. In case of a hospital run by state government or any local authority, vouch the grants received from the state or the local authority based on Govt. Orders, sanction letters, counterfoil of receipts.

2. Vouch collection from patients admitted to the paying beds based on the Patient Admission Registrar and counterfoil of receipts/ copies of bills.
3. Vouch collection from various pathological tests based on the counterfoils of receipts/ copies of bills.
4. Vouch donations based on the counterfoils of receipts.
5. In case hospitals having guest houses, assess the collections based on the register, counterfoils of receipts and accounting entries.
6. Interest and/ or dividend income should be vouched with reference to the Investment Register and Interest and Dividend warrants.
7. In case of legacies and donations which are received for specific purposes, it should be ensured that any income therefrom is not utilized for any other purposes.

E. VERIFY THE PAYMENTS RELATED TRANSACTIONS:

1. Verify that all capital expenditure associated with machineries, furniture, vehicle, etc. is approved and supported by documentary evidences such as counterfoils cheque, invoices, tenders, etc.
2. Vouch the salary paid to staff based on attendance register, payroll, etc. Examine that the appointment of casual staff and payment of their salaries are duly authorized.
3. Verify doctor's remuneration should be verified based on the list of visits and operations performed.
4. Verify the purchases of pathological test kits, X-ray plate and other consumables based on tenders, orders placed and invoices received.
5. Vouch all other overhead expenses like telephone bills, electricity bills, fuel bills, etc. based on appropriate documentary evidences.

F. VERIFICATION OF ASSETS AND LIABILITIES:

1. Verify the stock registers of medicines, food items and other equipment and check their valuations.
2. Conduct physical verification of fixed assets and investments based on Fixed Asset Register and Investment Register respectively.
3. Check the adequacy of depreciated and its accounting.
4. Collect the list of all liabilities and verify them based on the contracts and arrear bills.

G. VERIFICATION OF FINANCIAL STATEMENTS:

Verify that the financial statements have been prepared in the manner and format appropriate to the nature (profit seeking or non-profit seeking) and ownership structure of the organization.

3.3

• AUDIT OF ORGANIZATIONS IN HOSPITALITY SECTOR

Hospitals

Hospitality sector covers a wide range of organizations which can broadly be divided into four categories, viz. (A) Food and Beverages i.e., Restaurants, (B) Travel and TOURISM, (C) Lodging i.e., Hotels and Guest Houses and (D) Recreation such as Cinema Halls, Theme Parks etc. Since, the organizations in the above categories largely differ in their business processes, auditing procedures will certainly be different for each of them, barring a few common areas. The steps to be followed are discussed below:

STEPS COMMON FOR ALL ORGANIZATIONS

a. Understand the ownership structure of the organization (such as sole proprietorship, partnership, private limited companies or public limited companies) and determine the regulatory requirements to be examined relating to management as well as accounting.

b. Evaluate the internal control system and determine the nature, timing and the extent of the audit procedures.

c. Check that the organization has a valid license from an appropriate authority to run the business.

STEPS COMMON FOR THE CATEGORY

A. RESTAURANTS (FOOD AND BEVERAGES)

a. Verify the total revenue recognized based on the daily and monthly sales report.

b. Check that the revenue has been realized in cash based on bank statements. Check whether arrears written off, if any, has been duly approved by the person responsible.

c. Vouch all payments made to suppliers based on documentary evidences such as orders placed, invoices and bank records.

d. Carefully examine the petty cash book. Any irregularity should be examined further.

e. Vouch payments on account of rent, electricity and other overhead expenses.

f. Vouch the payment of salary based on payroll, attendance register and bank records.

g. Carefully examine the valuation of stock. Large writing off of any perishable item should be carefully examined.

h. Conduct physical verification of fixed assets and investments based on Fixed Asset Register and Investment Register respectively.

i. Check the adequacy of depreciated and its accounting.

j. Collect the list of all liabilities and verify them based on the contracts and arrear bills.

B. TRAVEL AND TOURISM

a. Vouch the collections from customers based on their booking details, counterfoil of receipts etc. Determine arrears, if any, at the end of the year.

b. Vouch revenue out of commissions from various companies and tour partners.

c. Vouch the payment made on account of tour bookings (divided into Air Travel, Rail, Road, Sea etc.), hotel accommodations.

d. Vouch transactions related with cancellation of bookings.

e. Check that discounts offered to individual customers are approved by the competent authority.

f. All overhead expenses including electricity bills, telephone and broadband bills, taxes to local authorities, etc. should be vouched based on the respective bills.

g. Verify the salary paid to permanent staff based on their payroll, attendance records and leave applications. Payment of incentives should be checked carefully.

h. Conduct physical verification of fixed assets and investments based on Fixed Asset Register and Investment Register respectively.

i. Collect the list of all liabilities and verify them based on the contracts and arrear bills.

C. HOTELS AND GUEST HOUSES (LODGING)

a. Vouch the collections from boarders based on their check-in and check-out information recorded in the register, counterfoils of bills and cash book.

b. Verify the room rent receipts and daily occupancy reports. Ask for proper clarification for differential rent charged from any boarder. Be careful while verifying the adjustment of unrealized room rent, cancellation charges of booking accommodation at the time of closing of accounts.

c. Vouch collections on account of special events such as conferences, wedding ceremony etc. separately based on counterfoil of receipts and cash book.

d. Income from bar, casino, health centre, etc. associated with the hotel should be vouched based on counterfoils of bills and cash book. Vouch the rent from shops situated in the premises of the hotel, if any.

e. Vouch transactions relating to purchase of food materials, drinks and other materials. Check whether the payments have been made based on purchase orders or contracts, invoice, etc.

f. Verify the salary paid to permanent staff based on their payroll. Salary paid to casual and contractual employees should be verified based on documentary evidences like authorization by management.

g. All overhead expenses including electricity bills, telephone and broadband bills, taxes to local authorities, etc. should be vouched based on the respective bills.

h. Carefully examine the valuation of stock. If possible, remain physically present at the time of stock taking.

i. Conduct physical verification of fixed assets and investments based on Fixed Asset Register and Investment Register respectively. Check the adequacy of depreciation and its proper accounting.

j. Collect the list of all liabilities and verify them based on the contracts and arrear bills.

RECREATIONS

1. CINEMA HALLS

a. Check whether appropriate control is in force over tickets of different denominations. Verify whether unsold tickets are kept under lock and key under the responsibility of any official.

b. Vouch the collections based on daily sales report of tickets and entries in the cash book.

c. Check whether collections from advance bookings have been duly adjusted.

d. Vouch collections on account of rental income due to hiring of the hall for special events based on the respective contract and counterfoil of receipt.

e. Vouch collection from sale of drinks, refreshments etc based on their daily sales report and entries in the cash book.

f. Check whether the entertainment tax collected as a part of the ticket value has been appropriately accounted and deposited within due dates. See that entertainment tax collected but not deposited has been considered as a liability in the financial statement.

g. Vouch payments relating to hiring of films based on relevant contract with the distributor and receipts.

h. Vouch payment on account of advertisement with the advertising agencies based on the agreements and receipts.

i. Payment to suppliers of refreshments should be vouched based on orders placed, invoices and entries in the cash book.

j. Vouch salary paid to staff based on payroll, attendance register and leave applications. Appointment of casual staff must be verified based on appointment letter issued by the responsible authority only.

k. Conduct physical verification of fixed assets and investments based on Fixed Asset Register and Investment Register respectively. Check the adequacy of depreciation and its proper accounting.

2. AMUSEMENT PARK

a. Check whether appropriate control is in force over tickets of different denominations. Verify whether unsold tickets are kept under lock and key under the responsibility of any official.

b. Vouch the collections based on daily sales report of tickets and entries in the cash book.

c. Check whether collections from advance bookings have been duly adjusted.

d. Vouch collection from sale of drinks, refreshments etc based on their daily sales report and entries in the cash book.

e. Vouch payment on account of advertisement with the advertising agencies based on the agreements and receipts.

f. Payment to suppliers of refreshments should be vouched based on orders placed, invoices and entries in the cash book.

g. Vouch salary paid to staff based on payroll, attendance register and leave applications. Appointment of casual staff must be verified based on appointment letter issued by the responsible authority only.

h. Conduct physical verification of fixed assets and investments based on Fixed Asset Register and Investment Register respectively. Check the adequacy of depreciation and its proper accounting.

3.4

• AUDIT OF BANKS

Importance of Banking Institutions in Economy

The banking industry is the pivot of any economy and its financial system. Banks are one of the foremost agents of financial intermediation in an economy like India and, therefore, development of a strong banking system is of utmost importance. Under the able leadership of RBI, the banking institutions in the country are working in a competitive environment and their regulatory framework is aligned with the international best practices. As a result, financial deepening has taken place in India and continues to be in progress with a focus on orderly conditions in financial markets while sustaining the growth momentum.

Different types of Banks

In India, banks are generally classified into the following broad categories:

a. Commercial Banks

b. Regional Rural Banks

c. Co-operative Banks

d. Development Banks

e. Payment Banks

f. Small Finance Banks

Though all of them are guided by RBI, they are fundamentally different with respect to their nature, mode of operation and power and target customer group.

Regulatory Framework of Banks in India

In India, banks are guided by a whole host of Acts and associated Rules. However, not all are applicable to each and every banking institutions. These are as follows:

a. Banking Regulation Act, 1949

b. Companies Act, 2013

c. State Bank of India Act, 1955

d. State Bank of India Act (Subsidiary Banks) Act, 1959

e. Regional Rural Banks Act, 1976

f. Information Technology Act, 2000

g. Prevention of Money Laundering Act, 2002

h. Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980

i. Credit Information Companies Regulation Act, 2005

j. payment and Settlement Act, 2007

In addition, Reserve Bank of India Act, 1934 also affect the functioning of banks in India.

Form and Content of Financial Statements of a Bank

Section 29(1) and (2) of Banking Regulations Act, 1949 deal with the form and content of financial statements of a banking company. The provisions are applicable to nationalized banks, State Bank of India and Regional Rural Banks.

Accordingly, every banking company is required to prepare a Balance Sheet and a Profit and Loss Account in the forms set out in the Third Schedule to the Act or as near thereto as the circumstances admit. Form A of the Third Schedule to the Banking Regulation Act, 1949, contains the form of Balance Sheet and Form B contains the form of Profit and Loss Account.

Statutory Audit in Banks

As per section 30(1) of Banking Regulations Act, 1949, the balance sheet and profit and loss account of a banking company should be audited by a person duly qualified under any law for the time being in force to be an auditor of companies.

Accordingly, the auditor of a banking company is to be appointed at AGM of the shareholders. The auditor of a nationalized bank is to be appointed by the bank concerned acting through its Board of Directors. The auditor of State Bank of India (SBI) is appointed by the CAG of India while the auditors of Regional Rural Banks are appointed by the bank concerned with the approval of the Central government.

The remuneration of the auditor, so appointed, is fixed as per Section 142 of Companies Act, 2013 in case of banking companies while in case of nationalized banks, the remuneration is fixed by RBI in consultation with the Central government.

The power of an auditor in a bank is almost similar to that of a company auditor.

Auditor's Report - Content

The auditor of a nationalized bank is primarily required to comment on the following aspects in its report to the Central Government:

a. whether the financial statements present a true and fair view of the affairs of the bank and whether all necessary explanation and information has been made available to him;

b. whether or not the transactions of the bank, which have come to his notice, have been within the powers of that bank;

c. whether or not the returns received from the offices and branches of the bank have been found adequate for the purpose of his audit; and

d. any other matter which he considers should be brought to the notice of the Central Government.

Audit of other banks require more or less the same assessment. In addition, the auditor of a banking company requires to report the matters covered by Section 143 of the Companies Act, 2013. However, Companies (Auditor's Report) Order, 2020 is not applicable to a banking company.

Auditors of Public Sector Banks, Private Sector Banks & Foreign Banks (as well as their Branches), are required to submit Long Form Audit Report (LFAR) on various matters specified by RBI. In addition to Reports, the Auditors of Bank Branches as well as Central Statutory Auditors of Banks, have to furnish / issue various 'Certificates' as required by RBI and other Regulations.

Auditing Aspects of Banks' Financial Statements

A part from the general considerations such as confirming the validity of his appointment, communicating with the previous auditor, agreeing on the terms of audit engagements etc. the auditor should consider the following aspects in conducting the audit of a bank.

1. GENERAL ISSUES:

a. Understand the Bank and its Environment: Obtain an understanding of the bank and the control environment to identify and assess risk and develop an audit plan to determine the effectiveness of controls and address specific risk issues.

b. Understand the Accounting Process: Obtain an understanding of the accounting process – computerized or manual – of the bank.

c. Understand the Risk Management Process: Obtain a clear understanding of the process adopted by the bank for managing financial as well as operational risks.

d. Develop a detail audit plan.

e. Determine audit materiality

f. Obtain a detail understanding of the relevant BASEL framework applicable for the bank.

g. Determine the extent of reliance on reports of previous auditor, RBI reports, internal audit report etc.

2. SPECIFIC ISSUES:

A. ADVANCES: In relation to advances made by bank an auditor needs to review the followings:

1. Ensure that the internal control is in place in relation to advances made.
2. Scrutinize the subsidiary, ledger, & control accounts
3. Ensure the proper documentation of account.
4. Scrutinize the overdue account and scheme for recovery of such amount.

B. CASH IN HAND: The auditor should

1. Ensure that the internal control is in place.
2. Visit the bank branch and inspect physical cash and ensure that it tallies with the bank's cash book balance.
3. Verify the amount of foreign currency held by bank and its translation at market rate on the date at which financial statement is prepared.

C. BALANCE WITH RBI: The auditor should Inspect the ledger balance in each account with

(a) bank confirmation certificates from Reserve Bank of India and

(b) Reconciliation Statement.

D. BALANCE WITH OTHER BANK: The auditor should

1. Inspect the reconciliation statement to ensure that no debit or credit for interest have been taken to Revenue account to the year.
2. Examine the large transition and balances with banks outside India.
3. Ensure that they are converted at market rate as on financial statement preparation date.

E. MONEY AT CALL & SHORT NOTICE: He should

1. Examine the system of authorization for money at call and short notice.
2. Ensure that call loan made by bank are not netted off against call loan received by it.

3. Ensure that money market lending for more than 6th days are not classified under this head but as a deposit or advance based on their nature of lending.

F. FIXED AND OTHER ASSETS: He should

The auditor has to ensure the following while auditing the fixed assets held by banks:

1. Ensure that accounting method of bank is appropriate and ownership document is adequate.
2. Examine with reference to schedule of fixed assets to find new assets acquired.
3. Examine sale deed in relation to sale of assets by bank.
4. Ensure appropriateness of basis of revaluation of fixed assets.
5. Ensure compliance of Section 9 of Banking Regulation Act, 1949.

G. BARROWINGS: He should

1. Ensure that the amount has been properly disclosed for borrowing in India from RBI and barrowing from outside India.
2. Ensure that the rate of interest is commensurate with the duration of borrowing.
3. Verify whether the barrowings of money at call and short notice are property authorized.

H. DEPOSITS: He should

1. Ensure that the interest accrued but not due on deposits has not been taken under other liabilities and provision
2. See whether there is any instance of window dressing.

I. CAPITAL: He should

1. Examine the opening balance of capital.
2. Examine the special resolution of shareholders' meeting or MOA about increase in authorized capital during the year.
3. Examine the prospectus regarding increase in subscribed/ paid up capital.
4. Examine the Government notification for any fresh contribution from them.

J. RESERVE AND SURPLUS: He should

1. Examine the opening balance of different type of reserve, addition/ deduction from reserves, reason for appropriation from such account and dividend paid by bank.
2. In respect of foreign branch ensure compliance with foreign laws.

K. BILLS PAYABLE:

1. He should Evaluate the existence, effectiveness and continuity of internal controls over bills payable. Such controls should usually include the following:

a. Drafts, mail transfers, traveler's cheques, etc., should be made out in standard printed forms.

b. Unused forms relating to drafts, traveler's cheques, etc., should be kept under the custody of a responsible officer.

2. The bank should have a reliable private code known only to the responsible officers of its branches. Coding and decoding of the telegrams should be done only by such officers.

3. The signatures on a demand draft should be checked by an officer with the specimen signature book.

4. The telegraphic transfers and demand drafts issued by a branch should be immediately confirmed by advices to the branches concerned. On payment of these instruments, the paying branch should send a debit advice to the originating branch.

5. If the paying branch does not receive proper confirmation of any telegraphic transfers or demand draft from the issuing branch, it should take immediate steps to ascertain the reasons. In case an instrument prepared on a security paper, e.g., draft, has to be cancelled (say, due to error in preparation), it should be examined whether the manner of cancellation is such that the instrument cannot be misused. Cases of frequent cancellation and reissuance of drafts, pay orders, etc., should be carefully looked into by a responsible official.

L. CONTINGENT LIABILITIES:

1. In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. To this end, the auditor should generally follow the audit procedures given below:

2. The auditor should verify whether there exists a system whereby the non-fund-based facilities to parties are extended only to their regular constituents, etc.

3. Ascertain whether there are adequate internal controls to ensure that transactions giving rise to contingent liabilities are executed only by persons authorized to do so and in accordance with the laid down procedures.

4. The auditor should also examine whether in case of LCs (Letter of Credits) for import of goods, the payment to the overseas suppliers is made on the basis of shipping documents and after ensuring that the said documents are in strict

conformity with the terms of LCs.

5. He should also ascertain whether the accounting system of the bank provides for maintenance of adequate records in respect of such obligations and whether the internal controls ensure that contingent liabilities are properly identified and recorded.

6. He must perform substantive audit tests to establish the completeness of the recorded obligations. Such tests include confirmation procedures as well as examination of relevant records in appropriate cases.

7. He should review the reasonableness of the year-end amount of contingent liabilities in the light of previous experience and knowledge of the current year's activities.

8. He should also review whether comfort letters issued by the bank has been considered for disclosure of contingent liabilities.

M. BILLS FOR COLLECTION

1. The auditor should examine whether the bills drawn on other branches of the bank are not included in bills for collection.

2. Inward bills are generally available with the bank on the closing day and the auditor may inspect them at that time. The bank dispatches outward bills for collection soon after they are received. They are, therefore, not likely to be in hand at the date of the balance sheet. The auditor may verify them with reference to the register maintained for outward bills for collection.

3. The auditor should also examine collections made subsequent to the date of the balance sheet to obtain further evidence about the existence and completeness of bills for collection.

4. In regard to bills for collection, the auditor should also examine the procedure for crediting the party on whose behalf the bill has been collected. The procedure is usually such that the customer's account is credited only after the bill has actually been collected from the drawee either by the bank itself or through its agents, etc. This procedure is in consonance with the nature of obligations of the bank in respect of bills for collection.

N. TREASURY OPERATION-FOREIGN EXCHANGE AND DERIVATIVES:

While innovative products and ways of trading create new possibilities for earnings for the bank, they also introduce novel and sometimes unfamiliar risks that must be identified and managed. Failure to do so can result losses entailing financial and reputational consequences that linger long after the loss has been recognized in financial statements. Hence, auditor should assess controls as part of audit work.

It is imperative that an auditor obtains a complete overview of the treasury operations of a bank before the commencement of the statutory audit. After conducting appropriate risk assessment of the treasury processes, the audit program needs to be designed in a manner that it dovetails into not just the control assessments of the treasury process but there is an assurance that the figures appearing in the financial statements as well as the disclosures are true and reflect fairly the affairs of the bank treasury.

3.5

• AUDIT OF CO-OPERATIVE SOCIETIES

Unique Features of Co-Operative Societies

Co-operative society may broadly be defined as an association of persons who have voluntarily joined together to achieve a common economic objective through the formation of a democratically-controlled business organization, making equitable contributions to the capital as required, and accepting a fair share of risks and benefits of the undertaking. Elimination of middlemen and sharing of gains of economic activities seems to be the hallmark of a co-operative society.

A co-operative society may be formed for different purposes. Accordingly, there may be consumers' co-operative societies, housing co-operative societies, industrial co-operative societies, urban and rural co-operative banks, etc.

Statutory Audit Requirement in Co-Operative Societies

As per Section 17 of the Co-Operative Societies Act, 1912 –

1. The Registrar shall audit or cause to be audited by some person authorized by him by general or special order in writing in this behalf, the accounts of every registered society once at least in every year.
2. The audit under sub-section (1) shall include an examination of overdue debts, if any, and a valuation of the assets and liabilities of the society.
3. The Registrar, the Collector or any person authorized by general or special order in writing in this behalf by the Registrar, shall at all times have access to all the books, accounts, papers and securities of a society, and every officer of the society shall furnish such information in regard to the transactions and working of the society as the person making such inspection may require.
4. Here, 'Registrar' means a person appointed to perform the duties of a Registrar of co-operative societies under this Act.

The following additional points should be kept in mind while auditing a co-operative society:

1. **QUALIFICATIONS OF AUDITOR:** Generally, only a chartered accountant within the meaning of the Chartered Accountants Act 1949, can be appointed as the auditor of a co-operative society. However, in certain State Co-operative Societies Act, a person holding a government diploma in co-operative accounts, or in co-operation and accounts, or a person who has served as an auditor in the Co-operative Department of Government, may also be appointed as the auditor.

2. **APPOINTMENT OF THE AUDITOR:** An auditor of a co-operative society is appointed by the Registrar of Co-operative Societies-and the auditor so appointed conducts the audit on behalf of the Registrar and submits his report to him as also to the society. The audit fees are paid by the society on the basis of statutory scale of fees prescribed by the Registrar, according to the category of the society audited. For example, the audit fees of co-operative credit society and Urban Co-operative Banks are to be calculated with reference to working capital at the prescribed rates. 'Working Capital' here means funds at the disposal of the society inclusive of paid-up share capital, funds built up out of profits and monies raised by borrowing and by other means.

3. **BOOKS OF ACCOUNTING RECORDS:** Under section 43(h) of the Co-operative Societies Act, a state government can frame rules prescribing the books and accounts to be kept by a co-operative society. For example, In Maharashtra the co-operative societies are required to maintain cash book, general ledger, personal ledger, stock register, property register, etc.

Generally, the following records are maintained by co-operative societies –

i. **Cash book:** It may be maintained to record particulars regarding cash receipts and expenses under suitable heads, with clear distinction between capital and revenue items of receipts and expenses.

ii. **Stock register:** It may contain detailed information as regards receipts, issues and balances of stock-in- trade, date-wise. In a producers' co-operative society, perpetual inventory records may be maintained based on an appropriate costing method.

iii. **Register of assets and investments:** It will contain detailed particulars regarding the various immovable and movable assets belonging to the society, such as, types of assets, location, date of acquisition, cost, depreciation provided, and so on.

iv. **Register of fixed deposits:** In the case of a co-operative credit society, or a co-operative bank, or any other society which is authorized by its bye-laws to accept deposits from members/non-members, a register of fixed deposits may be maintained giving details as regards the dates of acceptance, maturity, interest accrual, repayment, etc.

v. **Register of sureties:** In the case of a co-operative credit society, loans are given against personal security of members as also surety (guarantee) provided by two other members. The Register of Sureties will give particulars about the number of borrowers in respect of which a member has stood surety, and show whether it is within the overall limit of surety-ship that may.

4. RESTRICTION ON SHAREHOLDING: Shareholding in a co-operative society is subject to the limit prescribed in Sec. 5 of the Co-operative Societies Act 1912. Accordingly, no member of the society, other than a registered society, can hold more than twenty per cent of the total number of shares of the society, or such number of shares which in value exceeds `1,000. A co-operative society cannot prescribe any other limit in its bye-laws which is violative of this provision. In addition to this, the Acts passed by the states may also prescribe other restrictions as regards shareholding. The auditor should see that the provision regarding shareholding is duly followed.

5. RESTRICTION ON LOAN: As per Section 29 of Co-operative Societies Act, 1912, a registered co-operative society can only grant loans to its members, though, with prior approval of the Registrar, it may grant loans to other registered co-operative societies. The auditor should see that the loans granted by the society are in conformity with this provision.

6. RESTRICTION ON BORROWING: Subject to the restrictions imposed by its bye-laws, a co-operative society may accept loans and deposits from its members as well as non-members. It is the auditor's duty to ascertain that the restrictions, if any, laid down by the bye-laws are carefully observed.

7. INVESTMENT OF FUNDS: There are restrictions on investment of funds belonging to a co-operative society. Accordingly, a society may invest its funds in any of the following (Sec.32 of the Central Co-operative Societies Act):

i. Central or State Co-operative Bank,

ii. Any securities specified in Section 20 of the Indian Trusts Act, 1882.

iii. Any shares, securities, bonds or debentures of any other Co-operative society with limited liability.

iv. Any bank, or person carrying on banking business or a Co- operative bank, other than a

Central or State co-operative bank, as duly approved by the Registrar;

v. In any other manners as duly permitted by the requisite authority.

It shall be the duty of the auditor to ascertain whether the requirement as to investment of the society funds are being observed.

8. APPROPRIATION OF PROFITS: According to the Central Co-operatives Societies Act, 25% of the profits of a co-operative society should be transferred to a Reserve Fund before distribution of dividend or payment of bonus to its members. However, the Registrar may, having regard to the financial position of the society, reduce the percentage of profits to be transferred to the Reserve Fund. But in any case, he cannot reduce it to less than 10% of the profits of the society. Apart from the above mandatory provision, a co-operative society may, subject to the provisions of its bye-laws, appropriate its profits by way of transfer to other reserves, distribution of dividends to members, etc. However, appropriation of profits must be duly approved by the members of the society in the general meeting called for the purpose.

9. CONTRIBUTIONS TO CHARITABLE PURPOSES: According to Section 34 of Co-operative Societies Act, 1912, a registered society may, with the sanction of the Registrar, contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund for any charitable purpose as defined in Section 2 of the Charitable Endowments Act, 1890.

As per Section 17 of the Co-Operative Societies Act, 1912 –

1. The Registrar shall audit or cause to be audited by some person authorized by him by general or special order in writing in this behalf, the accounts of every registered society once at least in every year.
2. The audit under sub-section (1) shall include an examination of overdue debts, if any, and a valuation of the assets and liabilities of the society.
3. The Registrar, the Collector or any person authorized by general or special order in writing in this behalf by the Registrar, shall at all times have access to all the books, accounts, papers and securities of a society, and every officer of the society shall furnish such information in regard to

Steps to be Taken by an Auditor of a Co-Operative Society

A. GENERAL POINTS: In general, while conducting audit of Co-operative society, the auditor needs to look into the following: -

1. The auditor should carefully go through the bye-laws of the society and see that they are being observed both in letter and spirit.
2. He should examine the Register of Members of the society and individual shareholdings.
3. He should test-check the internal check and control system operated by the society and model his audit examination based on its strengths and weaknesses.

B. AUDIT OF INCOME: He should carefully vouch the receipt of cash. Cash receipts on account of share capital should be vouched with the Register of Members. Cash received against sales should be vouched with the cash memos and invoices issued to customers as also Sales Account. Receipt of cash in respect of payment of interest and repayment of loans advanced by the society should be vouched with the loan agreements. Cash received from members towards construction of houses or their maintenance, should be vouched with the Register of Members, demands made by the society from time to time, and money receipts.

C. AUDIT OF EXPENDITURE:

1. He should vouch all expenditure with reference to authorization from the Managing Committee, particularly in the case of large capital expenditure, as also the bills received from individual parties, the money receipts obtained from them, and entries in the Bank Pass Book along with counter-foils of cheques.
2. He should vouch the payment of loans from the loan agreements entered into with borrower members.
3. He should vouch establishment expenses with reference to the resolutions of the Managing Committee, agreements with the persons concerned, and money receipts obtained from them.

D. OTHER POINTS:

1. He should appropriately classify overdue debts for a period from six months to five years and more, and report them to the members, with a note regarding the effects these might have on the financial position of the society. He should also put a note regarding the probability of recovery of such debts.
2. Similarly, he should make a special reference to the overdue amount of interest from members. Generally, interest on overdue debts should not be credited to Interest Account but to the Overdue Interest Reserve Account.
3. Writing off of bad debts should be after prior authorization from the Managing Committee of the society. According to the Maharashtra Co-operative Societies Rules, a bad debt can be written off only when it is certified to be irrecoverable by the auditor.

3.6

• AUDIT OF LOCAL SELF-GOVERNMENT

Local Self - Government

In India, local self-government refers to governmental jurisdictions below the level of the state. With the introduction of 73rd and 74th amendments to the Indian Constitution, the local self-governance system has been recognised as the formal system of governance at the local level in both rural and urban areas throughout the country. In addition, state legislations also have given power to these organisations.

The urban local self-governance bodies are further divided into Municipal Corporation or Nagar Nigam, Municipality or Nagar Palika and Notified Area Council or Town Panchayat or Nagar Panchayat. Similarly, the rural self-governance in India is structured in three layers, viz. Gram Panchayat (at village level), Panchayat Samiti (at block level) and Zilla Parishad (at district level). All these local bodies are operated by representatives elected through a democratic process by participation of every Indian citizen.

Both urban and rural local bodies are vested with a long list of functions delegated to them by the state governments. Grants are issued by the States and these are to be utilized by the local bodies within the set parameters to execute the sanctioned projects. In addition, several local taxes are also the sources of revenue for them and they employ such funds for development and maintenance of public assets and similar other works. For example, urban local bodies are required to perform functions including general administration and revenue collection, public health, public safety, education, public works, and others such as interest payments. Similarly, rural local bodies are primarily required to help plan, coordinate, monitor and wherever required regulate the implementation of various national programmers. The responsibility of maintaining the assets created through various programmers also lies on them.

Since these organizations deal with public money, audit or the accounts of these bodies are of immense importance to ensure transparency and accountability.

The major objective of audit of Municipalities and Panchayats are enumerated below:

a. To ensure on the fairness and correctness of contents in the Financial Statement

b. To report on adequacy of Internal control

c. To ensure value of money is fully received on amount spent.

d. To detect the frauds and errors.

Accordingly, the auditor is supposed to consider the following general points in conducting the audit of local bodies:

a. Ensure that his appointment is in line with the respective regulation of the local body and approved by the appropriate authority.

b. Obtain a detail understanding of the rules and regulations that governs the operations, especially the financial control and accounting of the organization.

c. Consult the relevant documents, minutes and resolutions of various meetings of different committees.

d. With regards to various government schemes which are implemented through local bodies, check the utilization of grant, appropriate authorization being maintained throughout and adequacy of accounting.

e. Apply in depth investigation in areas with potential fraud such as revenue collection, various waiver schemes, use of casual labor etc.

f. Whenever there is a pro vision of funds, ensure that the expenditure is incurred from the provision and

g. Ensure that where huge financial expenditure is involved, the schemes are running economically and is expected to generate the targeted outcome.

OBJECTIVES

A. Multiple Choice Questions

1. Which of the following is not a part of urban self-governance system in India?
A. Municipal Corporation
B. Town Panchayat
C. Municipality
D. Municipal Society

2. Which of the following is not a part of rural self-governance system in India?
A. Gram Panchayat
B. Gram Parishad
C. Panchayat Samiti
D. Zilla Parishad

3. The amendments that gave the local self-governance in India the constitutional protection are _______ and ________.
A. 53 and 54
B. 63 and 64
C. 73 and 74
D. 83 and 84

4. According to the Central Co-operatives Societies Act, ______ of the profits of a co-operative society should be transferred to a Reserve Fund before distribution of dividend or payment of bonus to its members.
A. 20%
B. 25%
C. 30%
D. 35%

B. State True or False

1. The Banking Regulations Act, 1949 is an important source of regulation in case of banks- **TRUE**

2. The educational institutions in India are mostly structured as Public Trusts- **TRUE**

3. The rural self-governance in India is structured in four layers- **FALSE**

4. Statutory audit requirements have been covered in Co-Operative Societies Act, 1912- **TRUE**

5. Companies (Auditor's Report) Order, 2020 is not applicable to a banking company- **TRUE**

C. Fill in the Blanks

1. Auditor in a co-operative society is appointed by the **REGISTER** of Co-operative Societies.

2. Section **29** of Banking Regulations Act, 1949 deal with the form and content of Financial statements of a banking company.

3. In case of nationalised banks, the remuneration of an auditor is fixed by **RBI**

4. The auditor of a banking company is to be appointed by the **Shareholders**