

Chp ⑩ Audit principles & Techniques.

classmate

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* Meaning of Auditing:

↓	↓	↓	↓
Auditing checks a co.'s financial & internal processes.	It ensures the co. follows rules & reports finances correctly.	Internal auditors hired by co., conduct the audit.	Auditing helps identify & fix problems before outside auditors find them.

↓
It is imp. for investors, govt & other stakeholders to make informed decisions.

* fundamental principles governing an Audit →

① Integrity, independence & objectivity →

- Auditor must be honest, fair & unbiased
- must act independently without any interest in co. being audited.
- maintain public trust by following ethical guidelines & legal requirements.

② Confidentiality → Auditors must keep all sensitive info. private, sharing it only when required by law.

③ skill & competence → Auditors must be qualified & stay updated on latest auditing & accounting practices.

④ work performed by others → Auditors can delegate tasks but remain responsible for the work done by their team.

⑤ Documentation → Auditors must keep records of their work, which can be reviewed by clients / others.

⑥ Planning → Proper planning helps auditors work efficiently and tailor their approach based on co.'s nature & internal controls.

⑦ Auditor Evidence → Auditors must collect enough evidence (both from internal / external sources) to support their conclusions.

⑧ Accounting systems & Internal controls → Ensure the co.'s records are accurate & internal controls are effective.

⑨ Audit conclusions & Reporting → After gathering evidence, auditors & form an opinion based on whether:

Accounting Rules
were followed

financial reports
meet legal standards

All significant info.
is disclosed.

* AUDIT TECHNIQUES →

① Examination of Records - Inspecting Books & documents to verify data accurately.

② Inquiry - Asking people inside / outside the co. for info.

③ Sampling - Selecting a few items from larger set to draw conclusions about the whole.

④ Confirmation - Collecting data directly from 3rd party to verify accuracy.

⑤ Compliance check - Comparing A/c with vouchers to ensure arithmetical accuracy.

⑥ Compliance Test - checking if internal controls are working effectively.

⑦ use of computer techniques - using audit software & tools to test data accuracy.

(h) Substantive test - verifying if accounting data is accurate through:
 ↓ testing individual transactions ↓ ~~check~~ checking imp. (ratios trends)

(i) Dependence on experts - Relying on knowledge of internal auditors / ^{external} experts. (lawyers / engineers)

(j) Analytical review - studying trends & ratios, comparing past & present data to identify changes.

* preliminary preparation →

(i) understanding the entity - learn about co.'s business, operations, structure & risks.

(ii) Assessing Risk - Identify risk in business operations & financial reporting & evaluate internal controls.

(iii) Developing an audit plan - Create a plan detailing the audit scope, objectives, approach, timeline & budget.

(iv) Assigning Audit team - Assign team members based on their skills & knowledge of the company.

(v) Communicating with mgt - Discuss the audit plan with ^{co.'s} mgt & gather necessary information.

(vi) Developing audit programs - Plan specific audit procedures based on audit plan & identified risks.

(vii) Establishing an Audit file - Set up a file to document the audit plan, programs & collected evidence.

* Questionnaire →

set of questions used to evaluate a co.'s internal control system. It helps auditors assess how well co.'s controls are working & identify potential weaknesses.

Purpose : ① To gather info. about co.'s internal control, ensuring no imp. areas are missed.

② "Yes" means good controls, "No" means weaknesses and "Not Applicable" is used when question doesn't apply to business.

Process : ① Planning the audit - Auditors design the questionnaire based on identified risks & areas of concern.

② Administering the questionnaire - The questionnaire is sent to company to be completed by relevant personnel.

③ Analyzing the responses - The auditor reviews the answers to find potential risk / issues.

④ conducting Follow up interviews - If needed auditor may interview KMP to clarify / get more info.

⑤ Reporting the findings - The auditor summarizes findings, highlighting areas of concern & making recommendations for improvement.

Benefit :

→ provides a systematic way to approach internal controls.

→ helps auditors identify risks & areas needing requirement.

* Case Study → XYZ Ltd is facing a decline in sales & profits & requests an audit →

Audit Steps :

- ① Design questionnaire — The auditor creates questions about sales, prodⁿ, supply chain and finance.
- ② Administer questionnaire — The questionnaire is sent to key staff with a deadline for completion.
- ③ Analyse responses — The auditor finds issues:
 - Quality control problems in prodⁿ
 - weak supply chain mgt.
- ④ Follow up interviews — Auditor interviews staff & requests more information.
- ⑤ Report findings — The auditor reports the issues & suggests improvement.

* As a PCS you have been appointed to conduct secretarial audit of XYZ Ltd. Prepare a questionnaire incl. a relating to RPT, Insider trading, non-apptⁿ of KMP, CSR Remunerations of Directors.

RPT

- are all RPT disclosed as per law?
- are transactions approved by Board / sth.?
- is related party register maintained?
- any transactions not at arm's length?
- any prior approval obtained for significant RPTs?

Insider trading

- does the co. have code for preventing insider trading?
- are trading windows & blackout periods properly communicated?
- are insider ~~trading~~ transactions disclosed?
- any unexplained insider trading.

are all required KMP (MD/CFO/CS) apptd)?

Non-apptn of KMP

→ Is co position filled?

→ are KMP apptd reported to Roc on time?

is there a CSR committee?

has the required CSR expn been made?

is CSR expn disclosed in Board's report?

are CSR activities in line with law?

CSR

Remuneration to Directors

is directors remuneration disclosed?

does co. comply with Co. Act 2013 limits?

Is there formal remuneration policy?

Has s/h approval been obtained for any excess remuneration?

* Interaction through interviews →

ORIENTATION: (planning phase)

- helps auditors to understand biz & processes
- open-ended & to gather broad info.

Purpose of interviews

EXAMINATION: (execution phase)

- focuses on specific issues to get new facts/evidence
- info often needs to be verified by other means.

CONFIRMATION: (Both phases)

- verifies facts/conditions already known/gathered
- Ensures accuracy & prevents misunderstanding.

Interview types

structured: used in execution phase to confirm specific facts/data.

unstructured: used in planning phase to explore & understand the business.

* Audit programme →

- An audit programme is a guide for audit team, outlining the tasks & procedures to be performed to ensure the audit is thorough & organized.

Key points: Purpose: Assign tasks to team members & ensure all audit areas are covered.

Structure: Contains detailed steps & checklists for team members to follow.

Flexibility: Can be updated based on audit's size & needs.

Documentation: Recorded in audit working papers for reference.

* Audit Plan

Audit Programme.

Purpose: Strategy for conducting audit

Detailed outline of audit tasks.

Four areas: ① Identify areas needing special attention.

① Specify tasks for each team member

② Gain knowledge of business & internal controls.

② outline procedures to be followed during audit.

Components: ① understand accounting system & controls.

① Evaluation process & accuracy checks.

② Assess reliance on internal control system.

② verification & security of docs.

③ Plan the audit procedure (nature, timing, extent (scope))

③ checking disclosure & presentation of items.

④ Co-ordinate team's work.

④ Prepare & submit audit report.

* Identification of Applicable laws →

- Businesses must follow laws based on their operations, sometimes across multiple countries.

Steps for compliance:

- ① keep a list of all relevant law / regulations
- ② Create a compliance policy with clear guidelines
- ③ Share compliance updates with legal teams / departments.
- ④ Ensure mgt is actively monitoring compliance.
- ⑤ Regularly review compliance through audits.

- Compliance varies for holding co., subsidiaries & JV, especially across locations.

- Stay updated on legal changes & their impact on business.
- Regulators issue guidelines to help businesses understand their compliance requirements.

* Creation of master checklist →

An audit is more than just data collection, it is an independent review of co.'s affairs to form an opinion on its operations.

In general, an audit checklist can be divided into following headings according to their significance in audit scope:

① Entity operations & organisation :

Review co.'s operations, ind. products / services, capital structure & promoters.

check co.'s legal status, subsidiaries, JV, RPT and geographical locations.

Examine changes, KPM, Audit committee and prior year's audit observations.

② financial & non-financial reporting requirements →

Ensure compliance with financial reporting requirements incl. formats, changes in law, accounting laws and judgement based items.

Review non-financial disclosures, legal & regulatory compliance & procedural requirements focusing on { criteria, limits }.

③ legal & regulatory requirements →

Review companies compliance with applicable laws / rules / regulations, considering businesses' nature / location & sector.

Track amendments to regulations during the audit period.

④ matters of s/h & Public interest →

Assess factors indicating s/h & public interest such as public deposits, loans, dividends, CSR & media attention.

⑤ Review of control environment →

Evaluate co.'s control environment, assessing whether it's suitable for co.'s size & operations

investigate mgf committee, org. structure, monitoring methods & control effectiveness.

Report any concerns regarding the reliability of control environment.

↓ master checklist for Secretarial Audit of a listed automobile manuf co. (PSC - 5000 CR) →

Corporate Governance compliance } → verify Board composition (independence/no. of BOD)
 → check compliance with AC / NRC / other committees
 → review BM (quorum / attendance / resolution)
 → Examine annual report
 → ensure compliance with code of conduct.

Compliance with Co. Act 2013 } → confirm filing of forms with Roc.
 → review MoA / AOA
 → ensure director appointments / ~~resignations~~ resignations are in compliance with the Act.
 → verify compliance with FS & statutory registers.
 → check adherence to RPT provisions.

Compliance with SEBI Regulations } → ensure adherence to SEBI [LODR] regulations, 2015
 → review quarterly financial disclosures, rth patterns, & corporate governance reports.
 → verify compliance with insider trading regulations and rth approval for RPT.

Legal & regulatory compliance } → ensure compliance with ^{labour laws.} environmental laws.
 — IP rights (IPR)
 → review certificates, licenses & approvals required by government & regulatory authorities.

Annual filings & returns } → ensure timely filing of returns (AOC 4, MGT & A / F, DIR - 12, MGT - 14.)
 → verify compliance with IEPF.
 → check compliance with RBI / FEMA.

* Working papers → ↓

Audit Working papers are docs created during the audit to record procedures, evidence & conclusions. They support the audit opinion & ensure compliance with audit standards.

Purpose: Document the { audit process
conclusions
actions taken.

Content: Includes evidence, audit findings & reasoning for conclusions.

Importance: Ensures the audit is planned, executed & reviewed properly.

Types of documents: ① Planning audit programmes
② Internal controls through { questionnaire
checklists.

③ notes / minutes resulting from interview.

④ key docs such as contracts / financial policies

⑤ Test results like control evaluations, transaction tests.

⑥ Audit reports ~~like~~ and final conclusions & responses.

Best practices: { Be clear & concise
only include essential info.
remove unnecessary papers after audit.

* Scanned docs on working papers → scanned docs should include a reference to the source & purpose, if not already provided in working papers.

* Tick marks → Tick marks should be consistent with each working paper with explanations included either in same paper or a separate legend.

* Cross - referencing →

- Cross-referencing links audit procedures to primary working papers, which then refer to supporting documents. It ensures accuracy & reduces redundancy by keeping only one copy of each document.

Whether working papers are the property of client / auditor? Whether client can demand custody of such working papers?

Audit working papers are the property of auditor, not client. Those papers record the audit procedures, evidence and work allocation. While the auditor may choose to provide portions / extracts of the working papers to client - client CANNOT demand custody of them.

* Case law →

- Auditor found a ₹ 10 lakh payment in bank statement that wasn't recorded in Accounting system. By cross-referencing, auditor discovered the payment was made to a different vendor. After reviewing invoices, auditor confirmed the payment was for services rendered and should be recorded. The auditor made the necessary adjustments to financial statements.

- In short: Cross-referencing helped identify & correct the discrepancy ensuring accurate financial records.

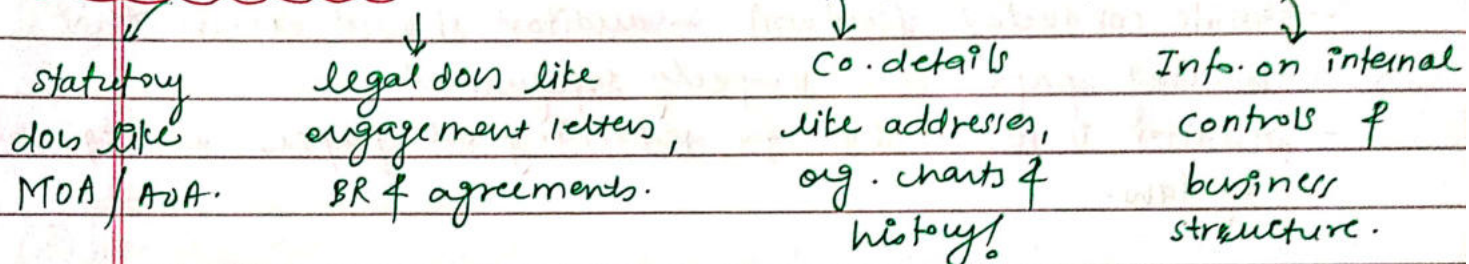
* Standard working papers →

- ① General file: Contain audit objectives, planning details, reports & audit responses.
- ② work paper file: Includes detailed audit procedures & working papers.
- ③ Future audit considerations: Notes for future audits.

- Working papers are auditor's property, provide a permanent record and help in future audits.
- They must remain confidential & disclosing them could be professional misconduct.

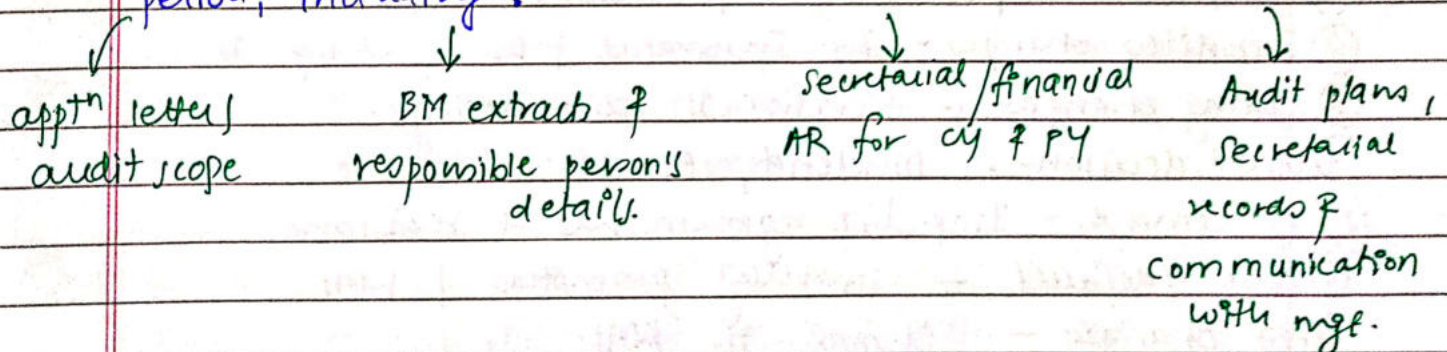
* Types of working papers →

① Permanent file : contains docs imp. for multiple audits, incl. :



↓
list of co. advisors, records and significant financial ratios.

② Current Audit file : contains info. specific to current audit period, including :



* Working paper Review →

Auditor should review working papers to ensure they are relevant, support findings & meet standards. The review includes :

- checking compliance with guidelines
- ensuring audit objectives are met.
- verifying procedures are completed & documented.
- confirming conclusions are reasonable & well documented.

- Ensuring findings are discussed with mgt.
- Resolving + documenting review notes.



- working papers are auditor's property & must be kept confidential & under control to prevent unauthorized access / alteration.
- while conducting fieldwork - auditors should ensure that working papers are properly safeguarded.
- Auditor is responsible for retaining all papers as required by law.

* Identification of event & corporate actions →

During audit planning, auditor should focus on key events requiring legal compliance, including:

- ① Corporate changes - mergers / acquisitions / sales
- ② Securities changes - Iss Insurance, BB, change in terms
- ③ Rating changes - Revision in co.'s ratings.
- ④ Board decisions - Dividend, BB etc.
- ⑤ Agreements - Imp. biz agreements + revisions
- ⑥ fraud / defaults - involving promoters / KMP
- ⑦ Mgt changes - changes in KMP.
- ⑧ Share trf. agents - apptⁿ / removal
- ⑨ Debt restructuring - changes in co. debt.
- ⑩ legal proceedings - Insolvency, litigation + winding up.
- ⑪ notices & commⁿ - slh of public notices
- ⑫ prodⁿ changes - Starting & delaying operations.
- ⑬ Contracts - changes to key contracts.
- ⑭ litigation - legal disputes / regulatory issues.
- ⑮ EC fraud - fraud by directors / EC.
- ⑯ Guarantees - giving financial guarantees.

- * Types of audit tests for internal control → classmate
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- * Testing methods used during audit procedure

Auditors use several testing methods to gather evidence during audits:

- ① **Inquiry**: Auditors ask questions to key staff to understand business processes. This method relies on accuracy of answers but is not the sole evidence, often used with other methods.
- ② **Observations**: Auditors watch tasks / processes in action to verify claims such as checking if records are stored securely or observing equipment functioning.
- ③ **Examination / Inspection**: Auditors check docs & records to ensure controls are being followed, such as verifying if backups are regularly performed or reviewing written records.
- ④ **Re-performance**: Auditors manually repeat a task (eg. recalculating an amt.) to verify controls, especially if other methods are insufficient. This method provides strong evidence of control effectiveness.
- ⑤ **CAATC (Computer assisted audit techniques)**: Auditors use software to analyze large sets of data and identify trends / irregularities, helping spot issues like fraud.

* Audit Sampling :

↓
method where auditors check a small no. of items from a larger group to draw conclusions about entire group.

Purpose:

- collect evidence for an audit opinion
- save time / resources
- find errors / frauds.
- following audit standards.

Types of Audit Sampling

→ STATISTICAL SAMPLING:

- items are selected randomly
- Every item has an equal chance of being chosen.
- Best for large no. of transactions.

→ NON-STATISTICAL SAMPLING:

- Items are selected based on auditor's judgement.
- Result may not be used to infer conclusions for entire group.
- Selections may be based on item value / specific criteria.

Audit Sampling allows auditors to make accurate conclusions without checking everything!

* Case Study →

- An external auditor used statistical sampling to review a manufⁿ co. sales & purchases transactions.
- Auditor found some errors in some transactions such as missing docs / incorrect amt.
- Based on these findings, auditor concluded that there were significant issues with B.
- Co. made necessary corrections & auditor issued an unqualified opinion : confirming B were correct.

* Tests of internal control →

procedures used by a company to ensure continuity, prevent fraud and maintain accurate financial reporting.

- Testing internal control evaluates whether these procedures are effective in preventing errors / fraud in financial reports.

- 2 main purposes for testing internal controls:

shortening audit process

if controls are effective, auditors can skip addⁿ testing.

providing extra audit evidence.

If substantive procedures aren't enough: internal control testing can provide further evidence of compliance.

* Substantive testing →

auditing method used to check for errors / misstatements in co.'s financial records. It provides evidence that co.'s financial claims are accurate & valid. This testing helps the auditors form an opinion on FS.

Who performs it?

↳ Internal auditors → Regularly conduct substantive testing to ensure internal record systems are working correctly & improve them if needed.

↳ External Auditors → Typically perform substantive testing once a year, usually year-end.

* How substantive testing works? →

① Company makes assertions: Co. claims the following about financial situation:

- Existence: Assets & liab are real
- Presentation: All inf. is deal.
- ownership: co. owns its assets & owes its liabilities
- Accuracy: FJ are correct & valued properly.
- Completeness: All relevant items are included.

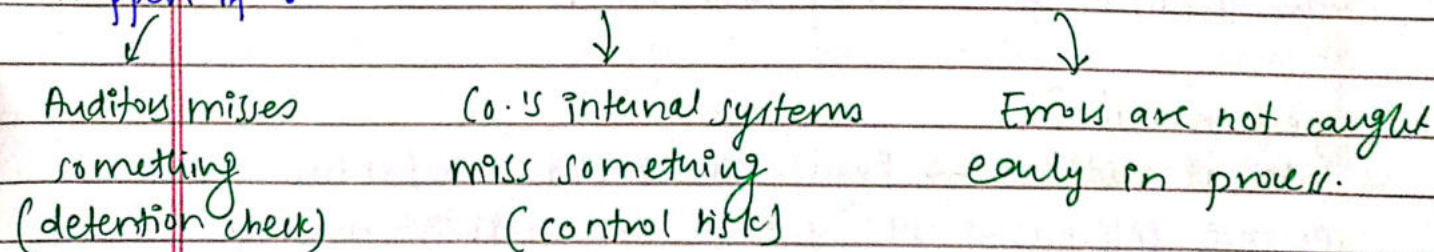
② Auditor creates a plan: Auditor develops a plan to test these claims by:

- checking adjustments & journal entries
- Comparing records to FJ
- Testing A/c balances & transactions.

③ Audit Results shared: Auditor writes a report about any mistakes found & gives an opinion on whether FJ are accurate.

* What happens when substantive testing finds an error?

If the auditor finds an error during testing, they may ask the co. to do more checks. Auditor writes a report on the errors & shares it with the co. & Audit committee. Errors can happen if:



* Examples of Substantive testing →

- check if dividends are approved by ~~the~~ reviewing minutes.
- verify amt. owed (A/c payable) with suppliers.
- confirm amts. owed to co. (A/c receivable) with customers.
- Check value of assets with experts.
- observe physical inventory counts.
- confirm cash / loan balances with Banks & lenders.
- match asset records with physical assets.

* Audit trials →

- from April 1 '2023, all co. except }

 - sole proprietorship
 - partnership
 - LLP.

using Accounting software must ensure their software has an audit trial feature.

Key points:

- | | | |
|--|---|---|
| <p>↓</p> <p>software must record all transactions & any changes (edits, deletions etc)</p> | <p>↓</p> <p>Every change must be logged with the date & time it was made.</p> | <p>↓</p> <p>The audit trial cannot be turned off.</p> |
|--|---|---|

- This Rule ensures accuracy & transparency in financial records.

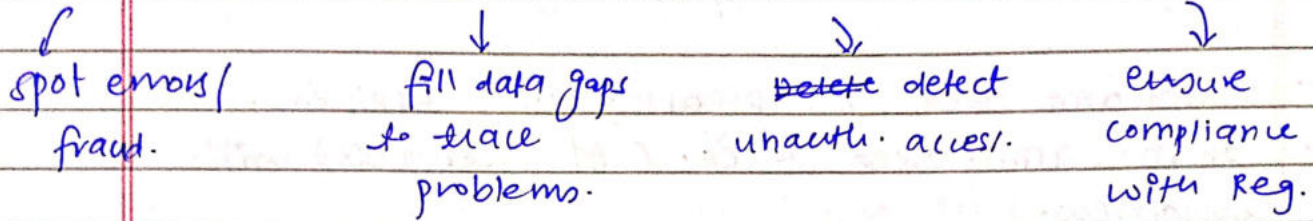
* How Audit trial works?

An audit trial tracks imp. details about transactions, ind.:

- | | | |
|--|--|--|
| <p>✓</p> <p>Access logs</p> <p>↓</p> <p>who accessed co.'s records & when.</p> | <p>↓</p> <p>Edits</p> <p>↓</p> <p>who made changes & when.</p> | <p>↓</p> <p>deletes.</p> <p>↓</p> <p>any deleted info. is also logged.</p> |
|--|--|--|

* purpose of Audit trial →

An audit trial records all actions to:



* Benefits of an Audit trial →

MCA Audit trial system offers several key benefits:

- ① **Increased transparency**: Provides a clear record of all transactions, making it easier to detect irregularities.
- ② **Improved accuracy**: helps prevent errors / omissions in financial records.
- ③ **Greater accountability**: Holds co. & ee responsible for change in records.
- ④ **Enhanced compliance**: ensures co. follow laws & regulations related to financial reporting.
- ⑤ **Fool proof records**: strengthen's co.'s reputation & helps with raising funds / securing loans.

* Audit finding →

It is a report of issues found during the audit. The lead auditor reviews it with the department head & once accepted, head signs the report, taking the responsibility for addressing the issues.

* Plan of Action →

- Audit aims to ensure compliance & improve systems.
- issues found must be fixed quickly.
- After corrective actions, auditors check if root cause was addressed.

if fixed: issue is resolved.

if not: a new plan is made & reviewed.

* Case Study →

Auditor found out few discrepancies in audit



Auditor recommended changes & co. adjusted its FS.



Auditor issued modified opinion due to mistakes



Co. improved its processes, documented contracts better & trained staff.



Auditor confirmed the ~~opinion~~ improvements & then gave an unqualified opinion of FS next FY!