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CA INTER

Auditing

The

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Audit GOAT Notes

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This book is the perfect blend of conceptual clarity, exam relevance, and concise presentation, covering the entire CA Inter Audit syllabus in just 260 pages without compromising on subject terminology. It is designed to help students ****grasp concepts effortlessly and confidently score 80+ marks in exams.**

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Your Key to Success in Audit

With this book, mastering Audit is no longer a challenge. It is designed to make learning seamless, improve retention, and build the confidence needed to excel in the CA Inter exams.

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

#0A6847 - Headings

#C84C32 - Key Words

#7030A0 - Key Words

#133E87 - Normal Text

Dear Students,

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

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

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


Warm regards,





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FUNDAMENTALS OF AUDITING



1. Meaning of Audit

	Content
1.	<p>Meaning of Audit Audit is an independent examination of financial information of any Entity, whether or not profit oriented and irrespective of its size or legal form, when such an examination is conducted with a view to express an opinion thereon.</p>
2.	<p>Objective of the Audit/Auditor To express an opinion on the financial statements:</p> <ul style="list-style-type: none"> ✓ Whether the financial statements are free from material misstatements. ✓ Whether they are prepared according to the applicable financial reporting framework.
3.	<p>Auditor</p> <ul style="list-style-type: none"> ✓ The term "Auditor" refers to the person or team conducting the audit. This typically includes Engagement team members. ✓ For legal and regulatory accountability, only the engagement partner is referred to as the auditor.
4.	<p>Engagement Team Includes the following members:</p> <ul style="list-style-type: none"> ✓ Engagement Partner ✓ Audit Manager ✓ Paid Assistant ✓ Senior Article Assistant ✓ Junior Article Assistant ✓ Any other relevant designation



2. Books and Financials

	Content
1.	<p>Books of Accounts As per the Companies Act, 2013, "books of account" (Sec. 2(13)) includes records related to:</p> <ol style="list-style-type: none"> a. All sums of money received and expended by the company and related matters. b. All sales and purchases of goods and services by the company. c. The assets and liabilities of the company. d. The items of cost prescribed under Section 148.
2.	<p>Financial Statements</p> <ul style="list-style-type: none"> ✓ Definition as per SA 200: <ol style="list-style-type: none"> 1. A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes over a period. 2. The related notes include a summary of significant accounting policies and explanatory information.

✓	Definition as per Companies Act: Financial statements include: <ol style="list-style-type: none"> 1. Balance Sheet 2. Profit and Loss Account or Income and Expenditure Account 3. Cash Flow Statement 4. Statement of Changes in Equity (if applicable) 5. Any explanatory notes annexed or forming part of the financial statements.
3.	Users of Financial Statements: Shareholders, Bankers, Government, Tax authorities, Employees, customer, suppliers, etc.,



3. Frameworks

	Content
1.	<p>Applicable Financial Reporting Framework (AFRFW) The framework adopted by management for preparing and presenting financial statements, based on the nature of the entity and the objective of the financial statements. Example: For a company, the AFRFW is Schedule III and Accounting Standards.</p>
2.	<p>General Purpose Financial Statements (GPFS) Financial statements prepared in accordance with the General-Purpose Framework (GPFW) are called GPFS.</p>
3.	<p>Special Purpose Financial Framework (SPFS) If the financial statements are prepared as per SPFW for a particular user, they are SPFS. SPFW is a Framework designed by a specific user as per their specific requirements.</p>
4.	<p>General Purpose Framework (GPFW) A financial reporting framework designed to meet the common financial information needs of a wide range of users. The Characteristics are as below:</p> <ol style="list-style-type: none"> a. Use of fundamental accounting assumptions. b. Compliance with GAAP. c. Accounting standards as per AFRFW. d. Annual preparation, periodically. <p>This framework can be a Compliance Framework (CFW) or a Fair Presentation Framework.</p> <p>Compliance Framework (CFW)</p> <ul style="list-style-type: none"> ✓ A framework where financial statements are prepared strictly according to the requirements of that framework, without deviation. ✓ The words "True and Fair View" do not appear in financial statements. <p>Fair Presentation Framework</p> <ul style="list-style-type: none"> ✓ A framework where financial statements are prepared according to the framework's requirements, but may: <ul style="list-style-type: none"> • Include disclosures beyond the framework's requirements (explicitly or implicitly), or • Deviate from the framework's requirements to achieve fair presentation (explicitly). ✓ The words "True and Fair View" appear only in this type of framework. ✓ Example: Most general-purpose financial statements are prepared under the fair presentation framework.



4. Misstatement

- ✓ A misstatement is a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation or disclosure that is required under the applicable financial reporting framework.
- ✓ Misstatements can arise due to error or fraud.



5. Other Terms

	Content
1.	<p>Legal Form Different legal forms in which businesses are conducted, similar to the "Person" definition under Income Tax:</p> <ul style="list-style-type: none"> ✓ Proprietorship firm ✓ Partnership firm ✓ Limited Liability Partnership (LLP) ✓ Society ✓ Company ✓ AOP or BOI (Association of Persons or Body of Individuals) ✓ Any other artificial judicial person.
2.	<p>Fraud Fraud is an intentional act by one or more individuals (management, governance, employees, or third parties) to deceive and gain an unjust or illegal advantage.</p> <ol style="list-style-type: none"> a. Fraudulent Financial Reporting: Involves intentional misstatements (or omissions) in financial statements to deceive users, leading to overstatement or understatement of performance/position. b. Misappropriation of Assets: The theft of assets by employees, usually in small or immaterial amounts, or misuse of resources.
3.	<p>Error Error refers to unintentional mistakes in financial statements:</p> <ol style="list-style-type: none"> a. Clerical errors: <ul style="list-style-type: none"> ✓ Errors of omission, commission, duplication, and compensating errors. b. Misapplication of accounting policies (also called errors of principle). c. Audit perspective: <ul style="list-style-type: none"> ✓ Self-revealing errors: Apparent and easily identifiable from the record. ✓ Non-self-revealing errors: Not apparent and require additional efforts to detect.

1. NATURE, SCOPE AND OBJECTIVE OF AUDIT



1. Origin and History of Auditing Profession

	Content
1.	<p>Origin of Auditing</p> <ul style="list-style-type: none"> ✓ Kautilya's Arthshastra (4th century BC) mentions auditing. It talks about a fixed accounting year, a process for closing accounts, and the need for audit. ✓ Concepts of periodical checking and verification existed even then, with references to misstatements due to abuse of power.
2.	<p>Etymology of 'Audit'</p> <ul style="list-style-type: none"> ✓ The word "audit" comes from the Latin word "audire", meaning "to hear". ✓ In medieval times, auditors would hear the accounts being read out to check if employees were not careless or negligent.
3.	<p>Institute of Chartered Accountants of India (ICAI)</p> <ul style="list-style-type: none"> ✓ The ICAI was established in 1949 as a statutory body under an Act of Parliament to regulate the profession of Chartered Accountancy in India.



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

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

	B. Nature of Auditing
1.	<p>Independence</p> <p>Audit must be independent. The auditor's judgment should not be influenced by the entity being audited. The auditor must be free from any external influence to form an unbiased opinion.</p>
2.	<p>Nature of Financial Information</p> <p>Auditing applies to both profit-oriented (businesses) and non-profit organizations (NGOs, charitable trusts). It can be done for entities of any size or legal form (e.g., sole proprietorship, partnerships, companies, trusts, etc.).</p>
3.	<p>To Express Opinion</p> <p>The purpose of audit is to express an opinion on the financial statements. Auditing provides assurance and builds confidence among users that the financial statements are reliable and credible.</p>
4.	<p>Purpose</p> <ul style="list-style-type: none"> ✓ The purpose of an audit is to enhance confidence in the users of financial statements. ✓ This confidence comes from the auditor's opinion on whether the financial statements comply with an applicable reporting framework.

C. Aspects to be covered in Audit:	
1.	Conformity with Books of Accounts The financial statements should agree the entries in the books of accounts.
2.	Supported by Proper Evidence Journal entries in the books must be supported by sufficient and appropriate (proper) evidence .
3.	No Omissions or Duplications Ensure there are no omissions, duplicated entries, or fictitious entries in the financial statements.
4.	Clarity and Unambiguity The information presented in the financial statements must be clear and unambiguous (without confusion).
5.	Compliance with Accounting Standards Amounts, classification, presentation, and disclosures must comply with relevant accounting standards .
6.	True and Fair View The financial statements should present a true and fair view of the operational results, and the assets and liabilities of the entity.



3. Relationship Between Audit and other disciplines

A. Need for Diverse Knowledge	
	Auditing is interdisciplinary and draws from various fields such as accountancy, law, behavioural science, statistics, economics, and financial management.
1.	Knowledge of Accounting & Business Laws A solid understanding of accounting principles is essential for an auditor to conduct the audit and form an opinion. Knowledge of business laws and taxation laws helps auditors interpret financial statements correctly.
2.	Understanding Human Behaviour Auditors interact with many people during the audit process. Knowledge of human behaviour is crucial for effective communication and information gathering.
3.	Use of Statistical Methods Auditors use statistical methods to draw samples because checking every transaction is impractical. This allows for a scientific approach to sampling.
4.	Knowledge of Economics Understanding economics helps auditors grasp the overall economic environment in which a business operates.
5.	Financial Management Knowledge Financial management knowledge, including funds flow, working capital management, and ratio analysis, is important for auditors to carry out audit procedures effectively.
6.	Knowledge of Financial Markets An auditor should have knowledge of financial markets , as it is essential for understanding the broader financial landscape and market dynamics.

B. Interrelationship	
1.	Auditing and Accounting Auditing reviews financial statements, which are the result of the overall accounting process.
2.	Auditing and Law An auditor should have a good understanding of business laws that affect the entity being audited.
3.	Auditing and Economics The auditor must be familiar with the overall economic environment in which the client operates.
4.	Auditing and Behavioural Science Knowledge of human behaviour is essential for auditors to effectively interact with people and discharge their duties.
5.	Auditing and Statistics & Mathematics An auditor should know statistical sampling to draw meaningful conclusions and mathematics to verify inventories.
6.	Auditing and Data Processing EDP auditing (Electronic Data Processing) is becoming a specialized field in auditing and requires specific knowledge.
7.	Auditing and Financial Management An auditor must understand financial techniques like working capital management, funds flow, ratio analysis, and capital budgeting.
8.	Auditing and Production A good auditor should understand the client's business functions such as production, cost systems, and marketing.



4. Objectives of an Auditor as Per SA 200

A. Objective of the Auditor	
1.	Reasonable Assurance The auditor must obtain reasonable assurance that the financial statements are free from material misstatement (due to fraud or error), enabling the auditor to form an opinion on whether the statements are prepared in accordance with applicable AFRFW .
2.	Reporting on Findings The auditor must report on the financial statements and communicate findings as required by Standards on Auditing (SAs) .

B. Detailed Explanation	
1.	Reasonable vs. Absolute Assurance Reasonable assurance offers a high level of assurance that financial statements are free from material misstatements , but it is not a complete guarantee like absolute assurance .
2.	Audit Process <ul style="list-style-type: none"> ✓ The audit of financial statements is conducted by the auditor using professional competence and skills, following Standards on Auditing (SAs). ✓ Audit evidence is gathered, evaluated, and conclusions are formed. This results in reasonable assurance, not absolute assurance.

3. **Causes of Misstatements**
Misstatements can arise due to **fraud**, **error**, or both. The auditor's goal is to ensure that financial statements as a whole are **free from material misstatements** and assess their **impact** on the overall statements.
4. **Reporting Opinion**
The **auditor's opinion** is communicated in a written report, as required by the **Standards on Auditing**, based on the **auditor's findings**.



5. Scope of Audit

Content	
1.	Scope of Audit Scope refers to the range or reach of something. The purpose of an audit is to increase the confidence of users in the financial statements .
2.	Enhancing Confidence The auditor expresses an opinion on whether the financial statements are prepared, in all material respects, according to an applicable financial reporting framework .
3.	Applicable Financial Reporting Framework The framework used for preparing the financial statements should be acceptable for the entity's nature and the objectives of the financial statements, or required by law .
4.	Example In India , companies follow the financial reporting framework under Schedule III of the Companies Act, 2013 .

A. Scope of Audit Includes:

1.	Coverage of All Aspects of Entity The Audit should cover all relevant aspects of the entity related to the financial statements being audited.
2.	Reliability and Sufficiency of Financial Information <ol style="list-style-type: none"> a. Reliability of Information: The auditor must ensure that the underlying accounting records and other source data (like bills, vouchers, documents) are reliable and sufficient for preparing the financial statements. b. Assessment of Information: The auditor evaluates the reliability and sufficiency of financial information by studying the accounting systems, internal controls, and performing appropriate tests and procedures.
3.	Proper Disclosure of Financial Information <ol style="list-style-type: none"> a. Disclosure of Information: The auditor ensures that relevant information is properly disclosed in the financial statements, considering applicable statutory requirements. b. Transaction Summaries: The auditor ensures financial statements properly summarize the recorded transactions and events, and evaluates management judgments made during preparation. c. Management Judgments: Management makes many judgments, such as choosing an appropriate accounting policies (e.g., methods of depreciation or inventory valuation). d. Evaluation of Accounting Policies: The auditor evaluates whether these selected accounting policies are appropriate and applied consistently over time.

- e. **Historical Financial Information:** The auditor understands that financial statements are based on **historical financial information**, which reflects **past economic events** or conditions.

B. Scope of Audit DO NOT Include

1. **Competence beyond Auditor's Capability**
The **auditor** is not expected to perform tasks outside their **competence**. For example, determining the **physical condition** of assets like **machinery** or assessing the **suitability and life of buildings**. These require expertise from **qualified engineers**.
2. **Authentication of Documents**
The **auditor** is not an **expert** in authenticating documents. He cannot verify the **genuineness** of documents, as it requires specific expertise in that field.
3. **Official Investigation**
An **audit** is not an **official investigation**. The auditor does not have legal powers like **searching** or **recording witness statements** to conduct an investigation.
4. **Audit vs. Investigation**
Audit and **investigation** are distinct. **Investigation** involves a detailed examination with a special purpose, such as checking for **fraud**. If fraud is suspected, it turns into an investigation.
5. **Objective of Audit**
The **objective** of an audit is to obtain **reasonable assurance** that the financial statements are free from **material misstatements** due to **fraud** or **error**, allowing the auditor to express an **opinion**.



6. Inherent Limitations of an Audit

Introduction

1. The **audit** process has **inbuilt limitations** and the auditor cannot obtain absolute assurance that the **financial statements** are absolutely free from **misstatements** due to **fraud** or **error**. There are various inherent limitations and are:

A. Nature of Financial Reporting:

1. **Management Judgments**
Preparing **financial statements** involves many **judgments** by **management**, which may be **subjective decisions** or degree of uncertainty
2. **Management Responsibility**
The **management** is responsible for preparing **financial statements** in accordance with the applicable **financial reporting framework** and ensuring effectiveness of **internal controls**. These internal controls may not always be reliable due to their **Inherent limitations of Internal controls**.
3. **Example of Internal Control Limitation**
For example, a company may require that **purchase bills** reflect the **stamp** and **signature** of an authorized person, indicating goods have been received. However, if the **accountant** and **authorized person** collude, they can override the internal control. This is a limitation of **internal controls**.

B. Nature of Audit Procedures:

1.	<p>Practical Limitations on Audit Evidence</p> <p>The auditor obtains audit evidence by performing audit procedures, but he cannot test all transactions or balances. Instead, he forms an opinion based on samples, which is a practical limitation.</p>
2.	<p>Legal Limitations on Audit Evidence</p> <p>Management may not provide complete information requested by the auditor. The auditor cannot force management to provide this information. If not provided, the auditor can only report the matter. This is a legal limitation.</p>
3.	<p>Dishonesty in Management</p> <ul style="list-style-type: none"> ✓ If management is dishonest or involved in fraud, they may design sophisticated schemes in order to conceal the fraud. ✓ They might present fabricated documents to mislead the auditor, causing the auditor to accept invalid audit evidence.
4.	<p>Related Party Transactions</p> <ul style="list-style-type: none"> ✓ The entity might engage in paper transactions with related parties, which may not have actually occurred. ✓ The auditor may not detect these, especially if he is unaware of such relationships or the audit procedures do not uncover the issue.

C. Audit is Not an Investigation

Audit is **not an official investigation**, so the auditor cannot guarantee that financial statements are free from material misstatements due to fraud or errors.

D. Timeliness and Relevance of Information

Over time, the **relevance of information decreases**, and auditors **cannot verify every matter in detail**. A balance must be struck between the reliability of information and the cost of obtaining it.

For example, information relied upon from a previous year may lose relevance and reliability if something new has happened.

E. Future Events

- ✓ Future events or changes **may adversely affect an entity's ability to continue** its business. Market changes, new business models, or unforeseen events could cause the business to cease operations.



7. Define an Engagement and Benefits of External Audit Engagement

A. Meaning of Engagement

Engagement refers to **a formal agreement between the auditor and client**. It contains the audit services to be provided and is documented in an engagement letter.

B. External Audit Engagements

The purpose of external audit engagements is **to increase confidence of users** in the financial statements. These are reasonable assurance engagements. For example, in India, companies are

required to have their annual accounts audited by an external auditor. Non-corporate entities may also choose an audit for its benefits.

C. Benefits of Audit

Audited accounts provide high-quality information, ensuring confidence that it is reliable and meets Auditing Standards.

1. **Shareholders**
Shareholders, who may not be involved in daily operations, rely on **independent audits** to ensure that **financial statements** are reliable and qualitative.
2. **Moral Check**
Audit acts as a **moral check** on employees, discouraging fraud due to the fear of being discovered.
3. **Government**
Audited financial statements help **government authorities** determine accurate **tax liabilities**.
4. **Bankers**
Bankers use audited financial statements to make **credit decisions**—whether to lend money to a particular entity.
5. **Detection of Misstatements (MMS)**
Audit helps detect **fraud** or **errors** (material misstatements).
6. **Internal Controls**
Audit reviews the **effectiveness** of **internal controls** in place and highlights any **deficiencies** in the systems.



8. Is Audit- Mandatory or Voluntary?

Content

1. **Legal Requirement for Audit**
Audit is not always legally mandatory. Certain entities, like **companies**, are legally required to get their accounts audited under law.
2. **Non-Corporate Entities**
Non-corporate entities may also be required to audit their accounts under **tax laws**. For example, in **India**, individuals must audit their accounts if their turnover exceeds a specified threshold under **income tax law**.
3. **Government Grants**
Some entities, like **schools**, may need to audit their accounts to obtain **government grants** or assistance.
4. **Voluntary Audit**
Audit is not always compulsory. Many entities choose to **voluntarily audit** their accounts for the **benefits** of the audit process, including internal rules that require audits.



9. Who Appoints the Auditor?

Content	
1.	<p>For Private Sector Companies For companies, the auditor is appointed by the members (shareholders) in the Annual General Meeting (AGM), as the shareholders are the owners of the company.</p>
2.	<p>For Government Companies In case of government companies in India, the Comptroller and Auditor General of India (CAG), an independent constitutional authority, appoints the auditor.</p>
3.	<p>For Partnership Firms / LLPs For a firm, the auditor is appointed by the partners of the firm who engage the auditor to audit the firm's accounts.</p>
4.	<p>For Government Authorities In specific situations, the auditor may be appointed by a government authority as per applicable laws or regulations (e.g., under tax laws).</p>
	<p style="text-align: center;">To Whom the Report is Submitted</p> <p>The audit report, containing the auditor's opinion, is submitted to the person or authority who made the appointment:</p> <ul style="list-style-type: none"> ✓ For companies, it is submitted to the shareholders. ✓ For firms, it is submitted to the partners.



10. Assurance Engagement and Elements thereof

A. Meaning	
1.	<p>Definition of Assurance Engagement An assurance engagement is where a practitioner provides a conclusion to enhance the confidence of intended users (other than the responsible party) about the evaluation of a subject matter against criteria.</p>
2.	<p>Purpose of Assurance Engagement The practitioner gives an opinion on specific information, allowing users to make confident decisions, knowing the chance of incorrect information is significantly reduced.</p>

B. Elements of an Assurance Engagement	
1.	<p>A 3-Party Relationship</p> <p>a. Assurance engagement involves three parties:</p> <ol style="list-style-type: none"> i. Practitioner: Provides assurance (broader term than auditor). ii. Responsible party: Prepares the subject matter. iii. Intended users: Use the assurance report to make decisions. <p>b. Audit relates to historical information, while practitioner may offer assurance on non-historical information.</p>
2.	<p>Appropriate Subject Matter Refers to the information examined by the practitioner. Example: Financial information in financial statements during an audit.</p>
3.	<p>Suitable Criteria Benchmarks (standards, guidance, laws, rules) used to evaluate the subject matter.</p>

4. **Sufficient Appropriate Evidence**
 - a. The practitioner obtains **sufficient** and **appropriate** evidence to form an opinion.
 - b. **Sufficient** refers to Quantity, **appropriate** to Quality.
 - c. Evidence providing more comfort is considered **qualitative** and **appropriate**.
5. **Written Assurance Report in Appropriate Form**
A written report is provided containing conclusion that **conveys the assurance about the subject matter**. A written assurance report is the outcome of an assurance engagement.



11. Meaning of Review and Difference between Audit and Review

Content	
1.	Difference Between Audit and Review Audit provides reasonable assurance , whereas review provides limited assurance , which is a lower level of assurance.
2.	Review Engagement Review involves fewer procedures and gathers sufficient and appropriate evidence to form limited conclusions.
3.	Relationship to Financial Statements Both audit and review are related to financial statements based on historical financial information .

Reasonable Assurance Engagement	Limited Assurance Engagement
Reasonable assurance engagement provides high level of assurance .	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence. [Inquiry, Inspection, A/P, RC, RP etc.]	It performs fewer procedures as compared to reasonable assurance engagement. [Only Inquiry and A/P]
It draws reasonable conclusions on the basis of sufficient appropriate evidence.	It involves obtaining sufficient appropriate evidence to draw limited conclusions .
Example of reasonable assurance engagement is an audit engagement.	Example of limited assurance engagement is Review engagement.



12. Assurance Engagements and Prospective Financial Statements

Content	
1.	Other Types of Assurance Engagements Apart from Reasonable and limited assurance engagements , there are engagements focused on matters beyond historical financial information . Examples include assurance on prospective financial information or internal controls of an entity.
2.	Definition of Prospective Financial Information Prospective financial information refers to financial data based on assumptions about future events and actions. It can be presented as a forecast , projection , or a combination of both.

3.	<p>Focus of Such Assurance Engagements</p> <p>These engagements do not examine historical financial information.</p> <p>a. Historical vs. Prospective Financial Information</p> <ul style="list-style-type: none"> ✓ Historical financial information reflects financial details of past events, conditions, or circumstances. ✓ Prospective financial information is based on assumptions about future events and actions of the entity. <p>b. Differences</p> <ul style="list-style-type: none"> ✓ Historical information is rooted in the past and represents actual events. ✓ Prospective information focuses on the future, based on assumptions about what might occur.
4.	<p>Moderate Assurance</p> <p>In engagements involving prospective financial information, the practitioner ensures that:</p> <ul style="list-style-type: none"> ✓ Management's assumptions are not unreasonable. ✓ Information is properly prepared and presented based on these assumptions. ✓ All material assumptions are adequately disclosed.
	<p>Assurance Level</p> <p>These engagements provide only a moderate level of assurance.</p>
	<p>Limitations Due to Future Orientation</p> <ul style="list-style-type: none"> ✓ Prospective financial information pertains to future events. ✓ While evidence may support the assumptions, such evidence is often future-oriented. ✓ The practitioner cannot confirm if the results in the information will actually be achieved.
5.	<p>Practitioner's Report</p> <p>The practitioner assures that nothing has come to their attention to suggest the assumptions do not provide a reasonable basis for the projection.</p>



13. Qualities of an Auditor

1.	<p>Personal Qualities</p> <p>An auditor should possess qualities that contribute to being a good businessman, such as:</p> <ul style="list-style-type: none"> ✓ Tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear-headedness, reliability etc., ✓ An auditor must have a high level of culture and the highest integrity, backed by adequate independence to attain excellence in the profession. ✓ Beyond technical expertise, an auditor must have basic human qualities like trustworthiness. Integrity and independence are key in their role.
2.	<p>Professional Qualities</p> <p>The auditor must have an expert knowledge of accounting principles and techniques, as they critically review financial statements. Knowledge of all accounting areas is essential.</p>



14. Engagement and Quality Control Standards

Content	
1.	Standards on Auditing (SAs) Apply to Audit of historical financial information .
2.	Standards on Review Engagements (SREs) Apply to Review of historical financial information .
3.	Standards on Assurance Engagements (SAEs) Apply to Assurance engagements other than audits and reviews of historical financial information.
4.	Standards on Related Services (SRSs) Apply to agreed-upon procedures, compilation engagements, and other related service engagements .
Purpose of EQC Standards The purpose is to establish high-quality standards and provide guidance in financial statement audits and other types of assurance services.	

A. Standards on Auditing	
1.	Standards on Auditing apply to the audit of financial statements by an independent auditor. They set high-quality benchmarks for conducting audits of historical financial information.
2.	Scope The Standards cover a wide range of audit-related issues, including: <ul style="list-style-type: none"> ✓ Audit Objectives, Audit documentation, Audit planning - Risk assessment, Audit sampling, Audit evidence, Forming opinions
3.	Examples of Standards on Auditing (SA) <ul style="list-style-type: none"> ✓ SA 200: Overall Objectives of the Independent Auditor ✓ SA 230: Audit Documentation ✓ SA 315: Identifying and Assessing Risks of Material Misstatement ✓ SA 500: Audit Evidence

B. Standards on Review Engagements	
1.	Standards on Review Engagements apply to the review of financial statements . A review provides limited assurance , which is lower than that of an audit, as it involves fewer procedures.
2.	Assurance and Evidence Although providing limited assurance, a review also requires obtaining sufficient appropriate evidence . For example, when reviewing interim financial information .
3.	Examples of Standards on Review Engagements (SRE) Some key SRE examples include: <ul style="list-style-type: none"> ✓ SRE 2400 (Revised): Engagements to Review Historical Financial Statements ✓ SRE 2410: Review of Interim Financial Information Performed by the Independent Auditor.
Note	

Both **Standards on Auditing** and **Standards on Review Engagements** apply to engagements involving **historical financial information**.

C. Standards on Assurance Engagements

1. **Standards on Assurance Engagements** apply to engagements dealing with subject matters other than **historical financial information**. These do not include the **audit** or **review** of historical financial information.
2. **Scope**
These engagements may involve examination of **prospective financial information** or providing assurance on **non-financial matters**, such as the **design and operation of internal controls**.
3. **Examples of Standards on Assurance Engagements (SAE)**
Some key SAE examples include:
 - ✓ **SAE 3400**: The Examination of Prospective Financial Information
 - ✓ **SAE 3420**: Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus.

D. Standards on Related Services

1. **Standards on Related Services** apply to engagements that involve performing **agreed-upon procedures** regarding financial information.
2. **Agreed-Upon Procedures**
An engagement may require performing specific procedures on items like **accounts payable**, **accounts receivable**, **purchases from related parties**, or financial statements such as a **balance sheet**.
3. **Compilation Engagements**
A **compilation engagement** involves assisting management with the **preparation and presentation** of historical financial information without providing assurance. The practitioner issues a report stating that no opinion is expressed.
4. **Examples of Standards on Related Services (SRS)**
Some key SRS examples include:
 - ✓ **SRS 4400**: Engagements to Perform Agreed-Upon Procedures Regarding Financial Information
 - ✓ **SRS 4410 (Revised)**: Compilation Engagements.

E. Standards on Quality Control:

1. **Purpose**
Standards on Quality Control (SQCs) establish standards and provide guidance on a firm's responsibilities for its **quality control system** in audits, reviews, other assurance and related service engagements.
2. **SQC 1** requires auditors to establish a **quality control system** to ensure compliance with **professional standards, regulatory & legal requirements**, and that reports are appropriate.
3. **Objective**
The **basic objective** is to ensure a **quality control system** within firms that guarantees compliance with professional standards and legal requirements, and that appropriate reports are issued.

4. **Application**
 SQCs apply to all services covered by Engagement Standards, ensuring proper quality control for those services.



15. Need for EQC Standards

1. **Need:**
 - ✓ Ensure audits are conducted against established benchmarks, aligned with global practices.
 - ✓ Improve the quality of financial reporting, aiding diligent decision-making.
 - ✓ Promote uniformity in audits of financial statements.
 - ✓ Equip professional accountants with necessary knowledge and skills.
 - ✓ Ensure audit quality.
2. **Duties in Relation to Engagement and Quality Control Standards:**
 1. Professional accountants must follow Standards in their engagements. If a specific procedure in the Standards is ineffective, they must document alternative procedures and their purpose.
 2. They must also document the reason for departure unless it's clear, and draw attention to these departures in their report.
 3. Disclosure alone does not absolve the accountant from complying with applicable Standards.

2. ETHICS AND TERMS OF AUDIT ENGAGEMENTS

Part 1 – Ethics

1. Meaning and Need for Professional Ethics

Meaning	
1.	<p>Definition of Ethics</p> <p>Ethics refers to moral principles that govern a person's behaviour or actions. It is the branch of knowledge that deals with moral principles.</p>
2.	<p>Nature of Ethics</p> <p>Ethics comes from within an individual and must be inculcated into their habit and temperament. It should be strong enough to resist selfish motives or temptations.</p>
3.	<p>State of Mind</p> <p>Ethics is a state of mind that aligns actions with moral principles. It imposes obligations on individuals and is considered the science of morals in human conduct.</p>

Need for Professional Ethics	
1.	<p>Purpose of Assurance Engagements</p> <p>The goal of assurance engagements is to enhance the confidence of intended users, which requires users to trust the professionals providing the service.</p>
2.	<p>Basis of Professional Ethics</p> <p>Professional ethics are rooted in morality. Ethical professionals place public good above personal gain, earning respect and honour. Professional bodies must interpret public interest broadly.</p>
3.	<p>Adherence to Ethics</p> <p>The respect and confidence in a profession depend on how strictly professionals follow ethical standards through self-discipline.</p>
4.	<p>Public Interest</p> <p>A key feature of the accountancy profession is its commitment to act in the public interest.</p>
5.	<p>Role of Chartered Accountants (CAs)</p> <p>Chartered Accountants, whether in practice or service, must adhere to ethical behaviours and follow the fundamental principles of ethics, ensuring service users feel secure about the framework governing these services.</p>
6.	<p>ICAI's Ethical Standards</p> <p>The Institute of Chartered Accountants of India (ICAI) requires members to comply with ethical principles. Ethical compliance is a core philosophy of the profession, and ethics are codified for clarity and enforcement.</p>
7.	<p>Code of Ethics for CAs</p> <p>Chartered Accountants are required to follow the Code of Ethics in both practice and service.</p>
8.	<p>Disciplinary Actions for Deviations</p> <p>Any deviation from ethical responsibilities activates the disciplinary mechanism, leading to fines, suspension, removal from membership, or other actions.</p>



2. Principles Based Approach Vs Rules Based Approach to Ethics

Content

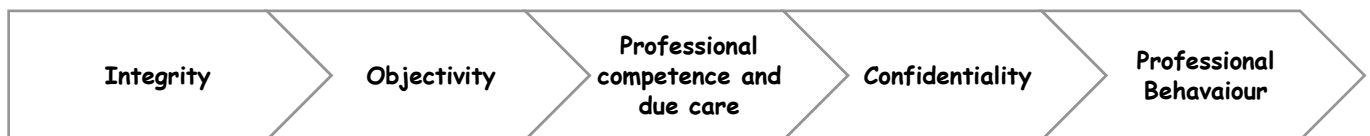
1. **Principles-Based Approach**
In a **principles-based approach**, accountants must comply with the **spirit of ethics**. It requires the use of **professional judgment** in every situation based on **knowledge, skill, and expertise** to evaluate and reach conclusions.
2. **Rules-Based Approach**
In a **rules-based approach**, accountants strictly follow **established rules**. This can be **narrow** in outlook and may overlook the **spirit of ethics**. It is also **rigid**, as not all practical situations can be handled by rules alone.
3. **Observe the Spirit of the code**
It is essential to follow the **spirit of the code** rather than just the letter of the rules to ensure ethical compliance in all situations.



3. Fundamental Principles of Professional Ethics

Fundamental Principles of Ethics

Fundamental principles of ethics set the expected **standard of behaviour** for a professional accountant. A professional accountant must comply with **each of these principles**.



1. **Integrity**
 - ✓ Accountants must be **straightforward** and **honest** in all professional and business relationships. **Integrity** means fair dealing and truthfulness.
 - ✓ Accountants **must not be associated** with reports or information that:
 - i. **False or misleading** statements.
 - ii. **Negligently** provided Information.
 - iii. Omitting or obscuring information that is **misleading**.
2. **Objectivity**
 - ✓ Accountants **must not compromise professional judgment** due to bias, conflict of interest, or undue influence.
 - ✓ Accountants **should not take on activities** where relationships or circumstances unduly **influence their professional judgment**.
3. **Professional Competence and Due Care**
 - ✓ Accountants must maintain the required **professional knowledge** and **skills** to provide competent service based on **current standards** and **legislation**.
 - ✓ They must act **diligently, thoroughly, and timely**, following technical and professional standards for each assignment.
4. **Confidentiality**

	<ul style="list-style-type: none"> ✓ The confidentiality principle requires accountants to respect the confidentiality of information obtained through professional or business relationships. ✓ Confidentiality supports the public interest by ensuring the free flow of information between the client or employer and the accountant, with the understanding it won't be shared without consent. ✓ Confidential information may be disclosed only when: <ul style="list-style-type: none"> i. Required by law. ii. Permitted by law and authorized by the client or employer. iii. There is a professional duty or right to disclose when not prohibited by law.
5.	<p>Professional Behaviour</p> <ul style="list-style-type: none"> ✓ Accountants must comply with relevant laws and regulations and avoid actions that could discredit the profession. ✓ Accountants should not engage in activities that might harm the integrity, objectivity, or reputation of the profession, as it would be incompatible with fundamental principles.



4. Independence of Auditors

Content	
1.	<p>Professional Integrity & Independence</p> <ul style="list-style-type: none"> ✓ Essential for all professions, especially accountancy. ✓ Independence means that judgment is not influenced by, wishes or direction of another person.
2.	<p>Rules of Professional Conduct</p> <ul style="list-style-type: none"> ✓ Aim to promote independence, but rules alone cannot ensure it. ✓ Independence is a state of mind and personal character. ✓ Should not be confused with legal standards of independence. ✓ These standards may change, but the quality of independence remains constant.
3.	<p>2 Perspectives of Independence</p> <p>Independence of Mind:</p> <ul style="list-style-type: none"> ✓ A state that allows unbiased judgment. ✓ Ensures integrity, objectivity, and professional skepticism. <p>Independence in Appearance:</p> <ul style="list-style-type: none"> ✓ Avoiding situations that are so significant that an informed third-party would conclude that integrity, objectivity or professional skepticism had been compromised.
4.	<p>Existence and Appearance of Independence</p> <ul style="list-style-type: none"> ✓ Independence must exist both in fact and in appearance. ✓ The relationship between the auditor and client should: <ol style="list-style-type: none"> 1. Satisfy the auditor about his own independence. 2. Any Unbiased person shall conclude that independence is not compromised. ✓ This ensures confidence to users of financial statements.
5.	<p>Importance for Listed Companies</p> <ul style="list-style-type: none"> ✓ As a statutory auditors of listed companies would cease to perform any useful function if persons do not have faith in the Independence and integrity. ✓ He is Expected to be, Objective, fearless, and capable of giving an honest opinion.
6.	<p>Subjectivity of Independence</p>

	<ul style="list-style-type: none"> ✓ Independence depends on the state of mind and character of the person. ✓ One person may feel independent in certain circumstances. ✓ Another person may not feel the same way in similar circumstances.
7.	<p>Duty of Chartered Accountants</p> <ul style="list-style-type: none"> ✓ Decide whether they can act independently in the given circumstances. ✓ Avoid any positions that might compromise their independence.



5. Threats to Independence

The International Federation of Accountants (IFAC) has identified 5 types of threats to independence.

Types of Threats and Examples

A. Self-Interest Threats

Occurs when the auditing firm or any partner benefits from a financial interest in the audit client.

Examples:

- ✓ Direct financial interest or materially significant indirect financial interest in the client.
- ✓ Loan or guarantee to/from the client.
- ✓ Dependence on client fees, risking loss of the engagement.
- ✓ Close business relationship with the client.
- ✓ Potential employment with the client.
- ✓ Contingent fees for audit engagement.

B. Self-Review Threats

Occurs when an auditor reviews their own judgement or conclusion from a previous audit or non-audit engagement.

Examples:

1. When an auditor or team member was recently a director or senior officer of the company.
2. When auditors perform services that are also subject to audit.

Note: Non-audit services include management services, internal audit, investment advisory, IT system design, etc.

C. Advocacy Threats

Occurs when the auditor promotes a client's opinion to the point where objectivity may be perceived as compromised.

Examples:

1. When an auditor deals with shares or securities of the audited company.
2. When the auditor acts as the client's advocate in litigation or third-party disputes. In these situations, the auditor may be perceived as championing the client's cause, undermining objectivity.

Familiarity Threat

Occurs when auditors become too close to the client, where they end up being too sympathetic to clients' interests.

Examples:

1. Close family member working in senior position of the client.
2. Former partner of the audit firm being a director or senior employee of the client.

3. Long-standing relationships between specific auditors and client counterparts.
4. Accepting significant gifts or hospitality from the client.

Intimidation Threat

Occurs when auditors are deterred from acting objectively and with professional skepticism.

Examples:

1. Threats of replacement due to disagreements on accounting principles.
2. Pressure to reduce audit work to lower fees.
3. Threats of litigation.



6. Safeguards to Independence

Content	
1.	<p>Appear Independent Auditors must always be independent and appear independent to the public for confidence in audit quality.</p>
2.	<p>Key Principles The key principles in auditing are integrity, objectivity, and professional scepticism, all of which require independence.</p>
3.	<p>Consideration of Independence Before accepting work, an auditor must assess whether it involves a threat to their independence.</p>
4.	<p>Threats exists If threats to independence exist, the auditor should either withdraw from the task or take precautions to eliminate the threats.</p>
5.	<p>Inability to Safeguard If the auditor cannot apply credible safeguards to address threats, they must decline the work.</p>



7. Professional Skepticism

Content	
1.	<p>Professional Skepticism It is an attitude of a questioning mind, being alert to unusual situations, and critical assessment of audit evidence.</p>
2.	<p>Professional skepticism involves being alert to:</p> <ol style="list-style-type: none"> a. Audit evidence that contradicts other evidence. b. Information questioning the reliability of documents or responses. c. Conditions indicating possible fraud. d. Need for additional audit procedures then required as per SAs.
3.	<p>Benefits Maintaining skepticism reduces risks of:</p> <ol style="list-style-type: none"> a. Overlooking unusual circumstances. b. Over-generalizing audit observations. c. Making inappropriate decisions regarding audit procedures (nature, timing, extent).

4. **Accepting Documents and records as genuine**
The auditor can accept documents as genuine **unless there is exists a doubt**. However, the auditor must evaluate the **reliability** of information. If in doubt or suspecting **fraud**, further investigation is needed.
5. **Past Experience**
Auditors **cannot ignore past experiences** with the **honesty and integrity of management** but must still maintain **professional skepticism**, regardless of past interactions.

Part 2 – SA 210 Agreeing the Terms of Audit Engagement



8. Scope and Objective of SA 210

Content	
1.	Scope SA 210 deals with the auditor's responsibilities in agreeing to the terms of the audit engagement with management and, when applicable, those charged with governance . This includes establishing preconditions for the audit.
2.	Objective The auditor's objective is to accept or continue an audit engagement only when: <ol style="list-style-type: none"> a. The preconditions for the audit are present. b. There is a clear and mutual understanding between the auditor and management (and, where appropriate, those charged with governance) about the terms of the audit engagement.



9. Preconditions For an Audit

Content	
1.	Preconditions for an Audit As per SA 210 , preconditions include: <ul style="list-style-type: none"> ✓ Management using an acceptable financial reporting framework for the financial statements. ✓ Agreement by management and, where applicable, governance, on the premise of the audit.
2.	Auditor's Responsibilities The auditor must: <ol style="list-style-type: none"> a. Determine if the financial reporting framework is acceptable. b. Obtain management's agreement on: <ol style="list-style-type: none"> i. Responsibility for preparing the financial statements in line with the framework, including fair representation. ii. Responsibility for necessary internal controls to prevent material misstatement (fraud or error). iii. Providing the auditor with: <ul style="list-style-type: none"> ✓ Access to all relevant information (records, documents). ✓ Additional information requested by the auditor. ✓ Unrestricted access to necessary persons within the entity.

3. **If Preconditions Are Not Present**
If preconditions are missing, the auditor must:
 - ✓ Discuss with **management**.
 - ✓ **Reject** the audit engagement **unless required by law or regulation**, if:
 - a. The financial reporting framework is **unacceptable**.
 - b. **Management does not agree** on their responsibilities regarding financial statement preparation, internal controls, or access to information and people.
4. **Limitation on Scope**
If **management** or those charged with governance **impose a limitation** that affects the auditor's ability to form an opinion (e.g., leading to a disclaimer of opinion), the **auditor should not accept such an engagement**, unless required by law or regulation.



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

Content	
1.	Audit Engagement Letter The engagement letter is sent by the auditor to the client to reduce misunderstandings.
2.	Agreement with TCWG The auditor must agree on the terms of the audit engagement with management or those charged with governance (TCWG) , as appropriate.
3.	Non-Statutory Audits A non-statutory audit is a matter of contract between the auditor and the client. It is most important to have an engagement letter to avoid conflicts.
4.	Must Be in Writing The terms of the engagement must be in writing to ensure both parties are clear on the nature and scope of the work .
5.	Contents of the Letter The engagement letter includes: <ol style="list-style-type: none"> a. The objective and scope of the audit. b. The auditor's responsibilities. c. The management's responsibilities. d. Identification of the applicable financial reporting framework. e. Reference to the expected form and content of the reports, with a statement about possible variations.
6.	Circumstance where engagement letter is Not required If the terms are prescribed in detail by law or regulation , the auditor doesn't need to include them in the letter , except for stating the law / regulation applies and management's acknowledgement of its responsibilities.



11. Change In Terms of Engagement as Per SA 210

Content	
1.	Reasons for Change in Terms The terms of the engagement may change due to:

	<ol style="list-style-type: none"> 1. Change in circumstances. 2. Misunderstanding of the terms originally agreed services. 3. A restriction on the scope of the engagement imposed by management or circumstances.
2.	<p>Acceptance of Change in Terms The auditor may accept a change if:</p> <ol style="list-style-type: none"> 1. If There is reasonable justification and the work complies with SAs. 2. The auditor and management must agree and record the new terms in a new engagement letter. <p>Note: To avoid confusion, The report shall not refer to the original engagement and Procedures from in the original engagement.</p>
3.	<p>Non-Acceptance of Change The auditor will not accept changes if there is no reasonable justification for the modification of terms.</p>
4.	<p>Withdrawal from Engagement If the auditor cannot agree to the change or management doesn't allow continuing the original engagement:</p> <ol style="list-style-type: none"> 1. The auditor must withdraw from the audit. 2. The auditor must assess if there is any obligation to report the circumstances to other parties (e.g., governance, owners, regulators).
	<p>Example of request from management to change terms If the auditor cannot obtain sufficient audit evidence on receivables, and management requests changing the audit to a review engagement to avoid a qualified or disclaimed opinion, the auditor must evaluate the situation carefully.</p>



12. Matters to be considered before agreeing to change terms

Content	
1.	<p>Change to Lower Assurance If the auditor is asked to change the audit engagement to one with lower assurance, they must determine if there is reasonable justification for the change.</p>
2.	<p>Legal or Contractual Implications Before agreeing to change the engagement to a review or related service, the auditor must assess any legal or contractual implications of the change.</p>
3.	<p>Relevance of Previous Work If the change is justified, the audit work done until the change may be relevant to the new engagement. However, the work and report will be those appropriate to the new engagement.</p>
4.	<p>Avoiding Confusion in Reporting To avoid confusion, the report on the new engagement will not mention:</p> <ol style="list-style-type: none"> a. The original audit engagement. b. Any procedures performed in the original audit.
5.	<p>Recording New Terms on a New letter If the terms of the engagement change, the auditor and management must agree on and record the new terms in an engagement letter or another suitable written agreement.</p>



13. Sending New Engagement Letter in Recurring Audits

Content	
1.	<p>Initial Audit Engagement The auditor must issue an engagement letter when newly appointed for an audit.</p>
2.	<p>Recurring Audit</p> <ol style="list-style-type: none"> 1. A recurring audit occurs when the previous year's auditor is reappointed for the current year. 2. In recurring audits, the auditor must decide if a new engagement letter is needed based on circumstances and professional judgment.
3.	<p>Circumstances for Re-issuing Engagement Letter The engagement letter should be issued in recurring audits if:</p> <ul style="list-style-type: none"> ✓ The entity misunderstands the objective or scope of the audit. ✓ There are revised terms of engagement. ✓ There is a change in legal or regulatory requirements. ✓ There is a change in the financial reporting framework. ✓ There is a change in audit reporting requirements. ✓ There is a recent change in top management. ✓ There is a significant change in the nature or size of the entity's business.

Part 3 - Quality Control

Content	
1.	<p>SQC 1 vs. SA 220 Both SQC 1 and SA 220 deal with quality control:</p> <ul style="list-style-type: none"> ✓ SQC 1 applies to all types of engagements (audits, reviews, other assurance services and related services). ✓ SA 220 applies only to audit engagements.
2.	<p>Scope of SQC 1 vs. SA 220</p> <ul style="list-style-type: none"> ✓ SQC 1 applies to the entire firm. ✓ SA 220 applies only to a specific audit engagement.


SQC 1 Quality Control for Firms that perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services engagements

Content	
1.	<p>Scope and Objective (SQC 1)</p> <ol style="list-style-type: none"> SQC 1 requires the firm to establish a Quality Control System that ensures: <ol style="list-style-type: none"> Compliance with Professional Standards, Regulatory and Legal requirements. Reports issued by the firm are appropriate. The QCS consists of policies and procedures to achieve these objectives.
2.	<p>Elements of the System of Quality Control</p> <p>The firm's quality control system should address the following elements:</p> <ol style="list-style-type: none"> Leadership responsibilities for quality. Ethical requirements. Acceptance and Continuance of client relationship. Human resources. Engagement performance. Monitoring. <p>Quality control policies must be documented and communicated to all personnel in the firm.</p>
3.	<p>Leadership Responsibilities for Quality</p> <ol style="list-style-type: none"> SQC 1 requires policies and procedures to promote a culture that values quality in performing engagements. The CEO or managing partners must assume ultimate responsibility for the QCS. Leadership should set an example that promotes high-quality audit work. The persons responsible for operational quality control must have the experience, ability, and authority to assume such responsibility.
4.	<p>Ethical Requirements</p> <p>The firm shall design P&P to provide it with reasonable assurance that the firm, its personnel and Experts contracted:</p> <ol style="list-style-type: none"> Ethical P&P: Complied with Code of Ethics. Code of Ethics: The Code includes integrity, objectivity, competence, confidentiality, professional behaviour, and independence. Independence: Maintain independence where required and the P&P shall: <ol style="list-style-type: none"> Communicate independence requirements to personnel. Identify and address threats to independence. Withdraw if threats cannot be eliminated. Reporting threats: Engagement partners should report any threats to independence promptly. Appropriate Action: Prompt notification of breaches for appropriate action. Annual Confirmation: Obtain written confirmation of compliance with independence policies from all relevant personnel on Annual Basis.
5.	<p>Acceptance and Continuance of Client Relationships</p> <ol style="list-style-type: none"> Client Information: Before accepting or continuing an engagement, the firm must gather vital information about the client to assess: <ol style="list-style-type: none"> Integrity of the client. Competence, capabilities, time and resources of the firm to perform the engagement.

	<p>c. Compliance with ethical requirements.</p> <p>2. The firm should document how issues are resolved when deciding to accept or continue a client relationship.</p>
	<p>Integrity of Client</p> <p>1. Matters to Consider:</p> <ol style="list-style-type: none"> Client's principal owners, key management, and governance. Client's business practices and operations. Attitudes towards accounting standards and internal controls. Pressure to reduce fees. Indications on inappropriate Scope limitation. Possible involvement in money laundering or criminal activities. Reasons for changing auditors. [Why Previous auditor Not reappointed?] <p>2. Conflict of Interest</p> <p>Any conflict between the firm and client must be resolved before accepting the engagement.</p> <p>If firm obtains any further information after accepting the engagement, that could have affected the decision regarding acceptance, the firm should assess:</p> <ol style="list-style-type: none"> Legal and professional responsibilities, including reporting to relevant parties. Possibility of withdrawal from the engagement or client relationship.
6.	<p>Human Resources</p> <ol style="list-style-type: none"> Policies and Procedures: P&P that provide reasonable assurance that the firm has sufficient personnel with capabilities, competence, and ethical principles to perform engagements in compliance with standards. HR Areas: Address issues such as recruitment, compensation, training, career development, and performance evaluation. Professional Development: Focus on the continuing development of personnel.
7.	<p>Engagement Performance</p> <ol style="list-style-type: none"> Consistency in Quality: Consistency in engagements can be achieved by briefing the teams on objectives, engagement standards, supervision, training, and performance review methods. Consultation: <ol style="list-style-type: none"> Consultation must take place for resolving difficult or contentious matters with individuals inside or outside the firm. External consultation may be sought from other firms, professional bodies, or regulatory bodies for advisory services.
8.	<p>Engagement Quality Control Review [EQCR]</p> <ol style="list-style-type: none"> Significant Judgments: Significant judgments must be reviewed by a quality control reviewer [EQCRr] before issuing the report. Extent of Review: The extent of review depends on complexity and risks involved in the engagement. EP only Responsible: The review doesn't reduce the engagement partner's responsibility. Mandatory For Listed Entities: <ul style="list-style-type: none"> ✓ EQCR is must for all audits of financial statements of listed entities. ✓ For other engagements, Firm shall develop the criteria for EQCR.

	<p>5. Differences between EP and EQCRr:</p> <ul style="list-style-type: none"> ✓ Any disagreements between the engagement team, reviewer, and partner should be resolved before issuing the report. ✓ If EQCRr recommendations are not accepted by EP, the matter shall be resolved by established P&P by consulting another practitioner, firm, or professional body.
9.	<p>Engagement Documentation</p> <ol style="list-style-type: none"> 1. Establish P&P: For timely assembly of Final Engagement files. 2. 60 Days for Audits: Assembly of Final Audit files should be completed within 60 days after the auditor's report. 3. Safe custody: Establish P&P for confidentiality, integrity, accessibility, and retrievability of documentation. 4. Ownership: Unless specified by Law or regulation, Engagement documentation is property of the firm. The Firm may at its discretion, disclose documentation to clients, provided such disclosure does not affect validity of work or independence in case. 5. Retention Period: <ul style="list-style-type: none"> ✓ Documentation should be retained long enough to perform monitoring procedures in order to evaluate compliance with QCS, or longer period if required by law. ✓ Typically, audit documentation should be retained for at least 7 years from date of auditor's report or if later, group auditors report.
10.	<p>Monitoring</p> <ol style="list-style-type: none"> 1. Establish P&P: Evaluate whether quality control policies and procedures are relevant, adequate, and operating effectively. 2. Periodic Inspections: Perform periodic inspections of completed engagements to assess compliance with the quality control system.



SA 220 Quality Control for an Audit of Financial Statements

Content	
1.	<p>Scope and Objective</p> <ol style="list-style-type: none"> 1. Engagement Partner Responsibility: EP is Responsible for quality control procedures at the audit engagement level as per SA 220 to comply with the firm's SQC. 2. Objective: To implement QC P&P at engagement level to ensure that the audit complies with professional standards, regulatory/legal requirements, and that the audit report is appropriate.
2.	<p>Responsibilities of Engagement Partner</p> <p>SA 220 outlines the responsibilities of the engagement partner, including:</p> <ol style="list-style-type: none"> 1. Leadership for quality on audits 2. Adherence to ethical requirements 3. Acceptance and continuance of client relationships 4. Assignment of engagement teams 5. Engagement performance 6. Monitoring
3.	<p>Leadership Responsibilities for Quality on Audits</p> <ol style="list-style-type: none"> 1. Overall Responsibility: The EP must take responsibility for overall audit quality. 2. The Actions of EP in taking responsibility for overall quality shall emphasise:

	<ol style="list-style-type: none"> a. Performing work that comply with professional standards and regulatory/legal requirements. b. Comply with the firm's quality control policies. c. Ensure the audit report is appropriate. d. Encourage the team to raise concerns without fear of reprisal.
4.	<p>Relevant Ethical Requirements</p> <ol style="list-style-type: none"> 1. Independence: Identify threats to independence that cannot be eliminated or reduced to acceptable level, with safeguards. 2. Reporting: Reporting by EP to appropriate firm personnel for appropriate actions (e.g., eliminating the threat or withdrawing from the engagement).
5.	<p>Acceptance and Continuance of Client Relationships and Audit Engagements</p> <p>Before accepting a client, ensure information on:</p> <ol style="list-style-type: none"> a. Integrity of principal owners b. Competence of the engagement team, including time/resources c. Compliance with ethical requirements d. Significant issues from previous audits.
6.	<p>Assignment of Engagement Teams</p> <p>Ensure the engagement team and any expert auditors possess the necessary competence and capabilities to perform the engagement in compliance with standards.</p>
7.	<p>Engagement Performance</p> <ol style="list-style-type: none"> 1. Responsibility for Direction: The engagement partner directs, supervises, and ensures the engagement complies with professional standards. 2. Review of Documentation: Ensure that sufficient and appropriate evidence has been obtained to supports conclusions and for issuance of audit report. 3. Consultation: Ensure appropriate consultation on difficult issues within/outside the firm. 4. Engagement Quality Control Review (EQCR): For audits of listed entities, ensure an EQCR is appointed, and the EP shall <ul style="list-style-type: none"> ✓ Discuss all significant matters. ✓ Not Date the audit report until QCR is completed ✓ If difference of Opinion arises among engagement team, between team and consulted parties or between EP and EQCRr, they shall be resolved as per firms P&P.
8.	<p>Monitoring</p> <ol style="list-style-type: none"> 1. Effective Quality Control System: Ensure that policies and procedures are relevant, adequate, and operating effectively. 2. Consider Monitoring Results: Evaluate deficiencies noted in the firm's monitoring process and their potential impact on the audit.
9.	<p>Documentation</p> <p>The engagement partner should document:</p> <ol style="list-style-type: none"> 1. Ethical issues identified and their resolution. 2. Independence related conclusions and relevant discussions. 3. Conclusions reached on Acceptance/continuance of client relationships. 4. Consultation details, including scope and conclusions.

3. AUDIT REPORT



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

A. Introduction

1.	<p>Scope of SA 700 SA 700 deals with the auditor's responsibility to form an opinion on the financial statements. Also deals with form and content of the auditor's report to be issued after the audit.</p>
2.	<p>Need of SA 700</p> <ol style="list-style-type: none"> 1. Global Consistency: Balances the need for consistency and comparability in audit reporting globally while making the information more relevant to users. 2. Credibility: Promotes credibility in the global marketplace by making audits conducted as per globally recognised SAs. 3. Helps promote user understanding and highlights unusual circumstances.
3.	<p>Objective of the Auditor The auditor's objectives according to SA 700 (Revised):</p> <ol style="list-style-type: none"> 1. Form an opinion on the financial statements based on the evaluation of audit evidence. 2. Clearly express that opinion in a written report.

B. Forming of an Opinion

1.	<p>Auditor's Opinion The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in line with the applicable financial reporting framework.</p>
2.	<p>Basis for Opinion To form this opinion, the auditor concludes whether reasonable assurance has been obtained that the financial statements are free from material misstatement due to fraud or error.</p>
3.	<p>Factors to be Considered</p> <ul style="list-style-type: none"> ✓ Whether sufficient appropriate audit evidence has been obtained. ✓ Whether uncorrected misstatements are material, individually or in aggregate. ✓ The evaluations performed.

C. Evaluations by the Auditor

1.	<p>Evaluation of Financial Statements The auditor evaluates whether the financial statements comply with the applicable financial reporting framework.</p>
2.	<p>Consideration of Qualitative Aspects of accounting practices Consideration of the entity's accounting practices, including indicators of possible bias in management's judgements.</p>
a.	<p>Qualitative Aspects as per SA 260 means</p> <ul style="list-style-type: none"> ✓ Management Judgements: Management makes number of judgments about amounts and disclosures in financial statements. ✓ Possible Bias: Auditor may detect bias in management's judgements. ✓ Misstatements: Lack of neutrality and uncorrected misstatements can lead to material misstatement.

	<p>b. Indicators of Lack of Neutrality</p> <ul style="list-style-type: none"> ✓ Selective Correction of misstatements identified by auditors, Example: Correcting misstatements that increase earnings, while ignoring those that decrease earnings. ✓ Possible management Bias in making accounting estimates. SA 540 address this issue. <p>c. Bias vs. Misstatements</p> <ul style="list-style-type: none"> ✓ Indicators of management bias does not constitute misstatements but may influence whether the financial statements as a whole are free from material misstatement.
<p>3.</p>	<p>Specific Evaluations by the Auditor</p> <p>The auditor evaluates Whether:</p> <ol style="list-style-type: none"> a. Significant accounting policies are disclosed. b. Those policies are consistent with the financial reporting framework. c. Management's accounting estimates are reasonable. d. Information presented in financial statements is relevant, reliable, comparable, and understandable. e. Adequate disclosures enable users to understand the impact of material transactions and events. f. Terminology used in financial statements is appropriate.
<p>4.</p>	<p>Evaluations under Fair Presentation Framework</p> <p>For fair presentation frameworks, the auditor also evaluates:</p> <ol style="list-style-type: none"> a. Overall Presentation, structure, and content of the financial statements. b. Whether financial statements and events represent the underlying transactions in a manner that achieve fair presentation.
<p>5.</p>	<p>Reference to Reporting Framework</p> <p>The auditor also evaluates whether the financial statements adequately refer to the applicable financial reporting framework.</p>

D. Key Definitions of SA 700

<p>1.</p>	<p>General Purpose Financial Statements</p> <p>Financial statements prepared in accordance with a general-purpose framework.</p>
<p>2.</p>	<p>General Purpose Framework</p> <p>A financial reporting framework designed to meet the common financial information needs of a wide range of users.</p>
<p>3.</p>	<p>Types of Financial Reporting Frameworks</p> <p>The financial reporting framework can be a fair presentation framework or a compliance framework.</p>
<p>4.</p>	<p>Fair Presentation Framework</p> <ul style="list-style-type: none"> ✓ Requires compliance with the framework's requirements AND ✓ Acknowledges, to achieve fair presentation, management may: <ol style="list-style-type: none"> i. Explicitly / Implicitly, to provide additional disclosures beyond those required by the framework. ii. Explicitly, to Depart from a framework requirement (in extremely rare cases) to achieve fair presentation.
<p>5.</p>	<p>Compliance Framework</p> <ul style="list-style-type: none"> ✓ Requires compliance with the framework's requirements and

- ✓ Does not acknowledge the need for additional disclosures or departure from requirements as described in the fair presentation framework.

E. Form of Opinions [Types]

1.	<p>Unmodified Opinion The auditor expresses an unmodified opinion when the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.</p>
2.	<p>Modified Opinion [SA 705] The auditor issues a modified opinion:</p> <ul style="list-style-type: none"> a. If the auditor concludes based on audit evidence obtained, the financial statements are not free from material MMS, or b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free from MMS.
3.	<p>Wording of Unmodified Opinion</p> <ul style="list-style-type: none"> ✓ The auditor's opinion uses one of these phrases: <ul style="list-style-type: none"> a. "Present fairly, in all material respects [...] in accordance with [the applicable financial reporting framework]." b. "Give a true and fair view [...] in accordance with [the applicable financial reporting framework]." ✓ These phrases are considered equivalent.
4.	<p>Prohibited Wordings When expressing an unmodified opinion, phrases like "with the foregoing explanation" or "subject to" must not be used as they suggest a conditional opinion or a weakening of the opinion.</p>

F. Contents / Elements of Auditor's Report for Audit Conducted as per SA's

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

G. Detailed Explanation for Above Elements

1.	<p>Title The auditor's report must have a title clearly indicating it is the report of an independent auditor, e.g., "Independent Auditor's Report."</p>
2.	<p>Addressee <ul style="list-style-type: none"> ✓ The report is addressed based on the engagement terms or law/regulation. ✓ Typically, auditors report is addressed to the shareholders or those charged with governance. </p>
3.	<p>Auditor's Opinion Includes the heading "Opinion" and also: <ul style="list-style-type: none"> a. Identifies the entity being audited. b. State that the financial statements have been audited. c. Identify the title of each financial statement. d. Refer to Notes, policies, and e. Specify the date and period covered by the financial statements. </p>
4.	<p>Basis for Opinion Includes the heading "Basis for Opinion" and also: <ul style="list-style-type: none"> a. State that Audit is conducted as per Standards on Auditing (SAs). b. Refers to the section that contains "Auditors responsibilities" c. Statement that Auditor is independent and complied with ethical requirements. d. State that the auditor believes he obtained sufficient and appropriate audit evidence as a basis for the opinion. </p>
5.	<p>Going Concern, as per SA 570, <ul style="list-style-type: none"> a. The auditor shall obtain S&A Audit evidence whether use of Going concern is appropriate in preparation of financial statements. b. Conclude whether any material uncertainty exist that may cast significant doubt on entities ability to continue as going concern c. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, appropriate disclosure is required in F/S to achieve fair presentation and not mislead. </p>
6.	<p>Key Audit Matters (KAM), As per SA 701, KAM is applicable for: <ul style="list-style-type: none"> ✓ Listed Entities: For Audit of Complete set of GPFS of listed entities, the auditor shall communicate KAMs ✓ Law / Regulation: Where required by law or regulation. ✓ Auditors Discretion: Where auditor decided to includes issues like significant public interest or audits of financial institutions or charitable entities. </p>
7.	<p>Other Information Addresses SA 720 requirements for inconsistencies or matters related to information beyond the audited financial statements.</p>
8.	<p>Responsibilities for Financial Statements States management's responsibility for: <ul style="list-style-type: none"> a. Preparing statements as per the applicable financial reporting framework [AFRFW]. b. Internal controls to ensure F/S are free from MMS. c. Appropriateness of use of going concern basis of accounting in preparation of F/S. </p>

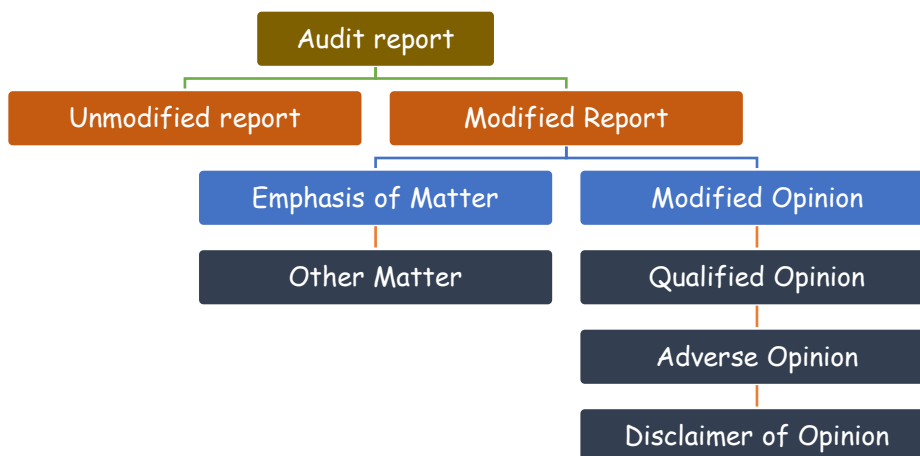
Note: This section shall also identify those responsible for oversight of financial reporting process if they are different from management. [Heading shall be modified accordingly to include TCWG]

9.	Auditor's Responsibilities	
	Section	Description
	I. Primary Responsibilities	
	Objectives of the Auditor	<ul style="list-style-type: none"> ✓ Obtain reasonable assurance that the financial statements are free from MMS due to fraud or error. ✓ Issue an auditor's report with an opinion.
	Reasonable Assurance	Reasonable assurance is a high level of assurance, but it's not a guarantee that all material misstatements will be detected.
	Misstatements	Misstatements may arise from fraud or error and are material if they could influence users' decisions.
	II. Additional Responsibilities under SAs	
	Judgment & Skepticism	The auditor must exercise professional judgment and maintain professional skepticism throughout the audit.
	Audit Process	<ul style="list-style-type: none"> ✓ Identify & assess risks of material misstatement due to fraud or error. ✓ Design & perform audit procedures to respond to those risks. ✓ Obtain sufficient & appropriate evidence. ✓ Understand internal control to design effective audit procedures. ✓ Evaluate accounting policies, estimates, and disclosures.
	Going Concern	Assess going concern assumptions and identify material uncertainties.
	Fair Presentation	In case of fair presentation framework, evaluate presentation, structure, and disclosures.
	Group Audits	When SA 600 applies, describe division of responsibility between auditors for group audits, including the work of other auditors.
	III. Communication Responsibilities	
	Governance Communication	<p>Communicate with those charged with governance regarding</p> <ul style="list-style-type: none"> ✓ The audit scope & timing and ✓ Significant findings, ✓ Deficiencies in internal control.
	Independence for Listed Entities	Statement that auditor complied with ethical requirements regarding independence and communicate the relationships and matters that affect independence including safeguards
	Key Audit Matters (KAM)	For listed entities and others, describe Key Audit Matters (KAM) unless restricted by law.
	Location of Responsibilities Section	
	3 options	<ul style="list-style-type: none"> ✓ Within the body of the auditor's report or ✓ As an appendix to the report or ✓ On an official website, if permitted by law or regulation.
10.	Other Reporting Responsibilities	

	<ol style="list-style-type: none"> Includes legal and regulatory reporting, such as the section "Report on Other Legal and Regulatory Requirements." The other reporting requirements shall be presented immediately after report on financial statements
11.	<p>Signature of the Auditor</p> <ul style="list-style-type: none"> ✓ Individual CAP: Signed by the engagement partner in personal name, ✓ Firm: 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. ✓ MRN FRN: Mention Membership Number (MRN) and the Firm Registration Number (FRN).
12.	<p>Place of Signature</p> <p>Specifies the city where the audit report is signed.</p>
13.	<p>Date of Auditor's Report</p> <p>The date is no earlier than:</p> <ol style="list-style-type: none"> The auditor obtaining sufficient appropriate audit evidence. The financial statements being approved by those with authority.
14.	<p>UDIN</p> <ul style="list-style-type: none"> ✓ Means Unique Document Identification Number (UDIN) ✓ All certificates and Reports issued on or after 1st February 2019 shall contain UDIN.
15.	<p>Prescribed Layout for Auditor's Report</p> <p>If a specific layout or wording is required by law, the auditor's report must refer to Standards on Auditing (SAs) only if such audit report includes minimum elements. [Refer ICAI SM for format under law /regulation]</p>



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



A. Scope of SA 705

- SA 705 deals with the auditor's responsibility to issue an appropriate report when, under SA 700 (Revised), a modification to the auditor's opinion is necessary.
- It also deals with the form and content of the report in case of modified opinion.

B. Circumstances for Modification

The auditor issues a modified opinion in case:

- If the auditor concludes based on audit evidence obtained, the financial statements are not free from MMS, or

2. The auditor is unable to obtain **sufficient appropriate audit evidence** to conclude that the financial statements are free from MMS.

C. Objective of the Auditor

The objective is to express clearly an appropriately modified opinion when:

1. The auditor concludes that the financial statements are not free from material misstatement.
2. The auditor is unable to obtain sufficient appropriate audit evidence.

D. Types of Modified Opinions

1. **Qualified Opinion:** The auditor expresses a qualified opinion when:
 - a. The auditor, based on S&A Evidence conclude that Misstatements, individually or aggregate, are material but not pervasive.
 - b. The auditor unable to obtain S&A Evidence on which to base opinion, but concludes that possible effects on financial statements of undetected misstatements, if any, could be material but not pervasive.
2. **Adverse Opinion:** The auditor, based on S&A Evidence conclude that Misstatements, individually or aggregate, are material AND pervasive.
3. **Disclaimer of Opinion:** The auditor unable to obtain S&A Evidence on which to base opinion, but concludes that possible effects on financial statements of undetected misstatements, if any, could be material AND pervasive.
Auditor disclaims opinion in rare cases involving multiple uncertainties, interaction of uncertainties prevents forming an opinion.

E. Definition of Pervasive

Pervasive describes the impact of misstatements or undetected misstatements that:

- a. Are not confined to specific elements, accounts, or items or
- b. If so confined, Represent a substantial proportion of the financial statements or
- c. In relation to disclosures that are fundamental to users' understanding of the financial statements.

F. Determining the Type of Opinion

The type of modified opinion depends on:

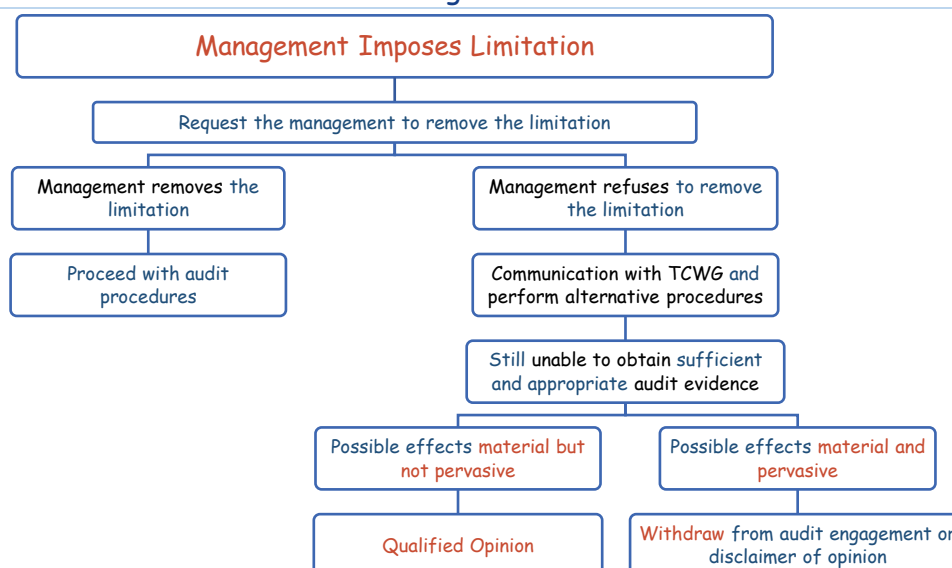
1. Nature of the matter giving rise to modification:
 - a. Whether the financial statements are materially misstated, or
 - b. Inability to obtain sufficient audit evidence leading to possible material misstatements.
2. Pervasiveness: Regarding the pervasiveness of the effects or possible effects on the financial statements.

Circumstances of Opinions

Situation	SL No.	MMS exist?	Pervasive?	Opinion
Sufficient and appropriate audit evidence Obtained	1.	No	NA	UQO
	2.	Yes	No	QO
	3.	Yes	Yes	AO
Sufficient and appropriate evidence NOT Obtained	SL No.	Material item?	Possible effect is Pervasive?	Opinion
	1.	Yes	No	QO
	2.	Yes	Yes	DOO

G. Consequence of Management-Imposed Limitation

1. **Request to Remove Limitation:**
If, after accepting the engagement, management imposes a limitation on the audit scope that may lead to a qualified opinion or disclaimer, the auditor shall request management to remove the limitation.
2. **Management refuses to remove:**
If management refuses, the auditor shall:
 - a. Communicate the matter to those charged with governance.
 - b. Determine if alternative procedures can be performed to obtain sufficient appropriate audit evidence.
3. **Unable to obtain evidence even through alternatives:**
If the auditor is unable to obtain S&A Evidence through alternative procedures and:
 - a. If the possible effects of undetected misstatements are material but not pervasive, the auditor shall qualify the opinion.
 - b. If the possible effects are both material and pervasive:
 - i. Withdraw from the audit, where possible under law.
 - ii. If withdrawal is not possible, disclaim an opinion.
4. **Communication MMS identified before withdrawal:**
Before withdrawing, the auditor shall communicate to those charged with governance any material misstatements identified during the audit that would have led to a modified opinion.



H. Reference in Audit Report for Modified Opinion

1. **Heading of Opinion and Basis for opinion** shall refer the type of modified opinion.
For Example: in case of Q.O - headings shall be changed to "Qualified Opinion" and "Basis for Qualified Opinion"
2. The **Basis for Opinion** section shall include a description of the matter giving rise to the modification.

I. Basis for Opinion in Modified Opinion

1. **MMS in F/s related to specific amounts:** If MMS in F/S relates to a specific amount including quantitative disclosures, the auditor shall include a description and quantification of the financial effects of the MMS unless impracticable.
Unable to Quantify: If quantification is not practicable, the auditor shall state so.
2. **MMS in Narrative Disclosures:** In basis of opinion, explain how the narrative disclosure is misstated.
3. **MMS by non-disclosure:**
 - a. Discuss with those charged with governance.
 - b. Describe the nature of omitted information.
 - c. Unless prohibited by L/R, Include the omitted disclosures if practicable based on S&A evidence is obtained.
4. **Inability to Obtain Evidence:** Describe the reasons for the inability.
5. **In Case of Disclaimer of Opinion:** The auditor shall not include:
 - a. A Reference to the section of auditor's responsibilities.
 - b. A Statement about whether S&A evidence obtained.

Note: Any other matter which could have resulted in modified opinion and effect there of shall also be included in BFO section.

J. Auditor's Responsibilities in Disclaimer Opinion

When disclaiming an opinion, the auditor shall amend auditors' responsibilities to include only:

- a. A Statement that auditor is responsible to conduct an audit as per Standards on Auditing to issue an auditor's report.
- b. A Statement that, because of matters described in the Basis for Disclaimer of Opinion, the auditors could not obtain S&A evidence.
- c. A Statement on independence and other ethical responsibilities.

Note: Unless required by L/R, Key Audit Matters section shall not be included in case of DOO.

K. Communication with TCWG

When a modified opinion is expected, the auditor shall communicate with those charged with governance about:

- ✓ The circumstances leading to the modification.
- ✓ The wording of the modification.



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

A. Scope

SA 701 outlines the auditor's responsibility to communicate Key Audit Matters (KAM) in the auditor's report and addresses:

- ✓ Auditors Judgments on what to communicate.
- ✓ Form and content of such communication.

B. Applicability

1. **Listed Entities:** For audits of complete set of **GPFS of listed entities**, KAM must be communicated in line with SA 701.
2. **Law or Regulation:** If **required by law or regulation**, or if the auditor chooses to communicate KAM, it must comply with SA 701.
3. **Public Interest:** The auditor **may communicate** KAM for other entities of significant **public interest**, e.g., large businesses with wide stakeholders.

Prohibition on KAM

Communicating KAM is prohibited If auditor **disclaims opinion** on the F/S.

C. Definition of Key Audit Matter

Key Audit Matters are those matters that, in the auditor's professional judgement

Were of most significance in the audit of the financial statements of the current period

Key audit matters are selected from matters communicated with those charged with governance

D. Purpose of Communicating Key Audit Matters (KAM)

1. **Enhances communicative value** of auditor's report and **provide greater transparency** in the auditor's report by providing insights about the audit.
2. Offer **additional information** to help users understand the entity and areas of **significant management judgment**.
3. **Communicating KAM is:**
 - a. **Not a substitute for disclosures** required by the financial reporting framework.
 - b. **Not a substitute for a modified opinion** under SA 705.
 - c. **Not a separate opinion** on individual matters.
 - d. **Not a substitute for reporting on material uncertainty** under SA 570 - Going concern.

E. Determining Key Audit Matters

1. KAM are **derived from matters communicated with those charged with governance** that required significant auditor attention during the audit.
2. The auditor considerations include:
 - a. **Areas of higher risk** or significant risks identified under SA 315.

- b. Areas involving significant management judgment, including accounting estimates with high estimation uncertainty.
- c. The impact of significant events or transactions during the period.

F. Manner of Communicating Key Audit Matters

- 1. KAMs are described under appropriate subheading in a separate section in the auditor's report.
- 2. The introductory section explains:
 - a. KAM are those matters that in the auditor's professional judgment were of most significant in the audit of F/S of current period and
 - b. These matters were addressed in the context of the audit as a whole, and the auditor does not provide a separate opinion on these matters.

G. Communication with those Charged with Governance

Auditor shall communicate with those charged with governance about:

- a. The matters determined to be KAM; or
- b. If No KAM are determined, the auditor's conclusion to that effect, depending on the facts and circumstances of the entity.



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

Content	
1.	<p>Scope and Objective</p> <p>SA 706 deals with additional communication in the auditor's report to:</p> <ul style="list-style-type: none"> b. EOMP: Draw attention to matters presented or disclosed in the financial statements that are fundamental to users' understanding of financial statements. c. OMP: Draw attention to matters other than those presented or disclosed in the financial statements but relevant to users' understanding of the audit, auditor's responsibilities, or report.
2.	<p>Definitions</p> <ul style="list-style-type: none"> a. Emphasis Of Matter Paragraph [EOMP] A paragraph in the auditor's report referring to a matter appropriately presented/disclosed in the financial statements, that in auditors' judgement is of such importance that it is fundamental to users' understanding of F/S. b. Other Matter Paragraph [OMP] A paragraph in the auditor's report referring to a matter not presented or disclosed in the financial statements, but relevant to users' understanding of the audit, auditor's responsibilities, or auditors report.
3.	<p>Usage of EOMP:</p> <p>EOMP can be included in audit report in respect of a matter provided:</p> <ul style="list-style-type: none"> 1. The auditor is not required to modify the opinion on such matter as per SA 705. 2. The matter is not determined as a Key Audit Matter under SA 701. <p>Examples of EOMP</p> <ul style="list-style-type: none"> 1. Uncertainty about the outcome of exceptional litigation or regulatory action. 2. A major catastrophe significantly affecting the entity's financial position.

	<ol style="list-style-type: none"> 3. Significant subsequent events between the financial statement date and the auditor's report date. 4. Early application of a new accounting standard with a material impact on the financial statements.
	<p>Manner of Presentation of EOMP</p> <ol style="list-style-type: none"> 1. Include the paragraph in a separate section of the auditor's report with a heading containing the term "Emphasis of Matter". 2. Clearly express the matter being emphasized and provide a reference to the relevant disclosure in the financial statements. 3. State that the auditor's opinion is not modified concerning the matter emphasized. 4. EOMP is not a substitute for: <ol style="list-style-type: none"> a. A Modified Opinion as per SA 705. b. Disclosures required in the financial statements as per AFRFW. c. Reporting under SA 570 when material uncertainty exists regarding an entity's ability to continue as a going concern.
4.	<p>Other Matter Paragraphs</p> <p>Include an OMP in the auditor's report if:</p> <ol style="list-style-type: none"> a. It is not prohibited by law or regulation. b. The matter is not determined as a Key Audit Matter under SA 701.
	<p>Separate Section for OMP</p> <p>Include the OMP in a separate section of the auditor's report with the heading "Other Matter" or another appropriate heading.</p>
5.	<p>Communication with Governance</p> <p>If an EOMP or OMP is expected to be included, the auditor shall communicate this with those charged with governance, including the wording of the paragraph.</p>



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

A. Scope

1. SA 710 addresses the auditor's **responsibilities regarding comparative information** in an audit of financial statements.
2. If **prior period** financial statements were audited by a **predecessor auditor** or were **not audited**, the requirements of SA 510 also apply.

B. Nature of Comparative Information

1. The nature of comparative information **depends on the AFRFW**.
2. There are **2 approaches** to auditor's reporting responsibilities on **comparative information**:
 - a. Corresponding figures and
 - b. Comparative financial statements
3. The **approach is often specified by law**, regulation, or terms of engagement.
4. Essential Audit reporting differences:
 - a. Corresponding figures: Auditor's opinion refers to the current period only.
 - b. Comparative financial statements: Auditor's opinion refers to each period presented in F/S.

C. Objectives

1. Obtain sufficient appropriate audit evidence that comparative information is presented in accordance with the applicable financial reporting framework.
2. Report in line with the auditor's reporting responsibilities.

D. Meaning of Comparative Information

Amounts and disclosures of one or more prior periods included in the financial statements as per the financial reporting framework.

E. Audit Procedures for Comparative Information

1. Auditor shall verify whether the financial statements include the required comparative information and whether it is appropriately classified and
 - a. Ensure comparative information agrees to prior period amounts and disclosures.
 - b. Verify consistency of accounting policies or ensure changes are properly accounted for and disclosed.
2. If a material misstatement in comparative information is identified, perform additional audit procedures to obtain sufficient evidence to determine MMS in current period F/s.
3. If prior period financial statements were audited by the same auditor, follow SA 560 for relevant requirements.
4. As per SA 580, obtain written representations for all periods referred to in the auditor's opinion.
5. Also obtain a specific representation regarding any prior period item disclosed in current year statement of P&L

F. Audit reporting regarding corresponding figures

1. Corresponding Figures
 - ✓ Comparative information where prior period amounts and disclosures are presented as part of the current period's financial statements.
 - ✓ These figures are intended to be read only in relation to the current period figures and
 - ✓ The level of detail is dictated by their relevance to the current period figures.
2. Auditor's Opinion

The auditor's opinion on corresponding figures shall not refer corresponding figures, except in the following cases:

 - a. Unresolved Prior Period Modifications: If the prior period report included a qualified, disclaimer, or adverse opinion, and the matter remains unresolved, modify the current period opinion. In BFMO para:
 - i. Material in Current Period [CP]: Refer to both the current period's figures and the corresponding figures in the Basis for Modification paragraph, if the unresolved matter materially affects current figures.
 - ii. Not Material in CP: Explain that the current period opinion is modified due to the unresolved matter's effects on the comparability of current and prior period figures (Even if no material impact on current figures).
 - b. Material Misstatement in Prior Period: If a material misstatement exists in prior period financial statements on which unmodified opinion is issued,

- ✓ Corrected in CP: Verify if the misstatement was corrected under the financial reporting framework.
- ✓ If not corrected, express a qualified or adverse opinion on the current period's financial statements.
- c. Prior Period Financial Statements Not Audited:
 - i. If prior period financial statements were not audited, state the same in Other Matter paragraph that the corresponding figures are unaudited.
 - ii. This statement doesn't reduce responsibility to obtain sufficient audit evidence to ensure opening balances as per SA 510.
- d. Prior Period Audited by Predecessor Auditor:
 - ✓ If prior period financial statements were audited by a predecessor auditor, and the auditor refers to the predecessor's report:
 - i. Include an Other Matter paragraph stating the financial statements were audited by a predecessor auditor.
 - ii. Mention the type of opinion expressed and the reasons for any modification.
 - iii. State the date of the predecessor auditor's report.

G. Audit reporting for Comparative Financial Statements

1.	<p>Definition of Comparative Financial Statements</p> <ul style="list-style-type: none"> ✓ Comparative information includes prior period amounts and disclosures for comparison with the current period. ✓ If audited, the prior period information is referred to in the auditor's opinion. ✓ The level of information is comparable to that of the current period financial statements.
2.	<p>Auditor's Opinion</p> <ul style="list-style-type: none"> ✓ Auditor's opinion must refer to each period for which financial statements are presented and on which an audit opinion is expressed.
3.	<p>Difference of Opinion with prior report issued by same auditor</p> <ul style="list-style-type: none"> ✓ If the auditor's opinion on prior period financial statements differs from the previously expressed opinion, disclose the substantive reasons in an Other Matter paragraph as per SA 706.
4.	<p>Prior Period Financial Statements Audited by a Predecessor Auditor</p> <ul style="list-style-type: none"> a. If prior period financial statements were audited by a predecessor auditor, include an Other Matter paragraph stating: <ul style="list-style-type: none"> i. That the prior period was audited by a predecessor auditor. ii. The type of opinion expressed, and reasons for any modification. iii. The date of the predecessor auditor's report (unless it is revised). b. If a material misstatement exists in prior period financial statements on which the predecessor auditor expressed unmodified opinion, communicate with management and those charged with governance, and notify the predecessor auditor. c. If prior period statements are amended, and the predecessor auditor issues a new report, the current auditor reports only on the current period.
5.	<p>Prior Period Financial Statements Not Audited</p>

- a. If the prior period was **not audited**, include an **Other Matter paragraph** stating that the comparative financial statements are **unaudited**.
- b. Such a **statement does not reduce auditor's responsibility** for obtaining **sufficient appropriate evidence** on opening balances as per SA 510.



6. SA 299 Joint Audit of Financial Statements

A. Meaning

- ✓ Joint Audit refers to **appointing two or more individuals/firms** for auditing financial statements (SA 299 - Joint Audit of Financial Statements).
- ✓ It involves pooling the resources and expertise of multiple firms to deliver quality results within a limited time.

B. Advantages of Joint Audit

- i. Sharing of expertise
- ii. Mutual consultation
- iii. Lower workload
- iv. Better quality of performance
- v. Improved client service
- vi. Healthy competition encouraging better performance
- vii. Expertise of local firms helps in dealing with local laws and regulations, especially for multinational companies.

C. Disadvantages of Joint Audit

- a. Fees must be shared
- b. Psychological issues when firms of different standings collaborate
- c. Superiority complexes among some auditors
- d. Challenges in coordinating work
- e. Risk of neglecting common areas of concern
- f. Uncertainty in liability for work performed

D. Responsibilities of Joint Auditors

1. **Individual or separate Responsibilities**
When **work is divided** among joint auditors, each auditor is **responsible only** for their **allocated works**, which may base on:
 - a. Items of **assets or liabilities**
 - b. **Income or expenditure**
 - c. **Geographical areas**
 - d. Identified units
 - e. **Period of financial statements**
2. **Joint Responsibilities**
Indivisible responsibilities in the following circumstances:
 - a. **Audit work not divided** among auditors and performed collectively.
 - b. **Decisions taken collectively** regarding **common areas**.

- c. Matters brought to all joint auditors' attention by one auditor and agreed upon by all.
- d. Ensuring of the financial statements that comply with statutory requirements.
- e. Verifying presentation and disclosure requirements as per the applicable financial reporting framework (AFRFW).
- f. Ensuring the audit report complies with relevant standards and statutes.

E. Audit Reporting in Case of Joint Audit

1. **Common Report**
Generally, joint auditors issue a single audit report with common conclusions and a common opinion.
2. **Disagreement among Joint Auditors**
 - ✓ A joint auditor is NOT bound by the majority's opinion.
 - ✓ If there is a difference of opinion, the disagreeing auditor can issue a separate report.

In such a case, each joint auditor's report should refer to the other joint auditor's report.

F. Coordination among Joint Auditors

Coordination

- ✓ Proper coordination is essential.
- ✓ If any matter is identified that affects the work of other joint auditors, it must be communicated to them before the audit report date.

Note: Each joint auditor can rely on the work of other joint auditors and is not required to review their work.

G. Special Considerations under SA 299

1. **Engagement Partner Role**
The Engagement Partner and Key Engagement Team from each joint auditor should be involved in audit planning.
2. **Overall Audit Strategy**
Joint auditors must jointly establish the overall audit strategy, as required under SA 300.
3. **Joint Audit Plan**
A Joint Audit Plan must be developed before starting the audit, addressing:
 - a. Division of areas and identification of common areas.
 - b. Reporting objectives of the engagement team.
 - c. Communication of significant factors among joint auditors to guide the engagement team.
 - d. Results of preliminary engagement activities.
 - e. Assessment of resources required for the engagement.
4. **Risk Assessment**
Each joint auditor must assess the risk of material misstatement and communicate it to others.
5. **Audit Procedures**
Joint auditors should discuss and document the nature, timing, and extent of procedures for common areas and specific areas.
6. **Engagement & Management Letters**

	Joint auditors must obtain a common engagement letter and a common management representation letter regarding management's responsibilities.
7.	Work Allocation Work allocation among joint auditors must be documented and signed by all and communicated to those charged with governance.



7. Audit of Branch Office Accounts

A. Books of Accounts (Section 128)

1.	Books of Accounts <ul style="list-style-type: none"> ✓ As per Section 128(1) of the Companies Act, 2013, every company must prepare and maintain books of account at its registered office that provide a true and fair view of its affairs. ✓ Books must be under the accrual basis and double-entry system of accounting. ✓ Books may also be kept at another place in India, as decided by the Board of Directors, and file a notice to the Registrar within 7 days. ✓ Books can also be maintained in electronic mode.
2.	Branch Books of Accounts BOA in respect of branch office can be maintained at the respective branch and summarized returns shall be sent to the registered office periodically .
3.	Audit of Branches <ul style="list-style-type: none"> ✓ As per Section 143(8), branch accounts can be audited by: <ul style="list-style-type: none"> a. The company's auditor (appointed under the Act). b. Another qualified auditor appointed under Section 139. c. For foreign branches, by: <ul style="list-style-type: none"> i. The company's auditor, ii. An accountant, or iii. A person qualified under the laws of that country.
4.	Reporting by Branch Auditor <ul style="list-style-type: none"> ✓ Branch auditor submits their report to the company's auditor, who includes it in their report as necessary. ✓ Reporting of fraud also apply to the branch auditor for matters relating to the branch.

B. SA 600 Using the Work of Another Auditor

1.	Definitions <ul style="list-style-type: none"> a. Principal Auditor: The Auditor responsible for reporting on the entity's financial information which includes components information which are audited by others. b. Other Auditor: The Auditor responsible for component financial information which is included in the financial information audited by principal auditors. c. Component: A division, branch, subsidiary, Joint venture or other entity whose financial information is included in the financial information audited by principal auditor.
2.	Using Another Auditor's Work <ul style="list-style-type: none"> a. If branch accounts are audited by another auditor, there should be clear understanding of their respective roles and effective coordination.

	b. As per SA 600, the principal auditor entitled to rely on the other auditor's work unless special circumstances require direct examination.
3.	<p>Principal Auditor's Procedures</p> <p>a. Inform the other auditor of how their work will be used and arrange for coordination at the planning stage.</p> <p>b. Inform areas requiring special considerations, inter-component transactions, reporting requirements, and time table for completion of audit.</p> <p>c. Review or discuss the procedures and findings of the other auditor through a checklists or summaries.</p> <p>d. Perform additional procedures based on engagement circumstances and knowledge of the other auditor's professional competence.</p> <p>e. If necessary, visit the other auditor to enhance coordination and understanding.</p>



8. Reporting Requirements Under The Companies Act, 2013

Reporting on Other Legal and Regulatory requirements [Other Reporting Requirements]	
1.	<p>Reporting Requirement on Matters (Section 143(1)) The auditor shall inquire into:</p> <p>a. Whether loans and advances are:</p> <ol style="list-style-type: none"> Properly secured, and Terms are not prejudicial to the company or its members. <p>b. Whether transactions represented by book entries are prejudicial to the company's interests.</p> <p>c. Whether shares or securities are sold at a price less than the purchase price (not applicable to banking and investment companies).</p> <p>d. Whether loans/advances are shown as deposits.</p> <p>e. Whether personal expenses are charged to the revenue account.</p> <p>f. For shares allotted for cash, verify:</p> <ol style="list-style-type: none"> Whether cash has actually been received. Whether the position in books and balance sheet is correct and not misleading. <p>Reporting Requirements Positive responses can be ignored. Adverse comments must be stated in the report with reasons.</p>
2.	<p>Reporting on Accounts Examined (Section 143(2))</p> <p>a. The auditor shall report to members on accounts examined and financial statements, considering the provisions of the Act, accounting and auditing standards, and other prescribed rules or orders.</p> <p>b. Auditor shall report whether financial statements provide a true and fair view of:</p> <ol style="list-style-type: none"> The state of affairs of the company at the end of the year and The profit/loss and Cash flows for the year. Other matters prescribed under Rule 11 of audit and auditors' rules.
3.	<p>Additional Reporting Requirements (Section 143(3)) The report shall include:</p>

- a. Whether the auditor sought and obtained information and explanations necessary for audit. If not, details and effect thereof on financial statements.
- b. Whether proper books of account were maintained, and adequate branch returns not visited by him are received from management.
- c. Consideration of branch audit report submitted under Section 143(8) and the manner in which it is dealt in his report.
- d. Whether the balance sheet and profit and loss account agree with the books and returns.
- e. Whether F/S comply with accounting standards.
- f. Observations or comments with adverse effects on the company's functioning.
- g. Whether any director is disqualified under Section 164(2).
- h. Qualifications, reservations, or adverse remarks on accounts or related matters.
- i. Whether the company has adequate internal financial controls (IFCs) and their operating effectiveness

Note: This do not apply to private companies which are

- ✓ OPCs,
 - ✓ Small companies, and
 - ✓ Other private companies
 - Whose turnover is less than 50 Crore as per latest audited F/S and
 - Borrowings are less than 25 Crore at any time during the year.
- j. Such other matters as per Rule 11:
 - a) Whether company disclosed impact of pending litigations on financial position.
 - b) Whether company made Provisions for material foreseeable losses on long-term contracts, including derivatives.
 - c) Whether there is a delay in transferring amounts to IEPF.
 - d) Obtain Management's representation that:
 - ✓ Client is Funding Party: The company [Funding Party] has NOT advanced or loaned or invested in any entity including foreign entity [i.e., Intermediary] that such intermediary shall
 - Lend or advance or invest directly / indirectly in another entity identified by the funding party [i.e., Ultimate beneficiary] or
 - Provide any guarantee or security or alike on behalf of ultimate beneficiary.
 - ✓ Client is Intermediary: The company [i.e., Intermediary] has NOT received any funds from any entity including foreign entity [i.e., Funding party] that the company shall
 - Lend or advance or invest directly / indirectly in another entity identified by the funding party or
 - Provide any guarantee or security or alike on behalf of ultimate beneficiary.
 - ✓ Obtain Limited Assurance on Representation: Conclude based on S&A evidence, whether nothing has come to the attention of the auditor that the above 2 representations contain any MMS.
 - e) Whether the company complied with Section 123 for dividends declared/paid.
 - f) Whether the company is using an accounting software that has
 - ✓ A feature of audit trail and
 - ✓ Such feature is not tampered and
 - ✓ Audit trail is preserved as per statutory requirements [8 years]

	<p>Reporting Requirements The auditor shall report whether positive or negative and for negative responses or qualifications, reasons must be stated in terms of Section 143(4).</p>
4.	<p>Reporting on Other Matters (Section 143(11)): The Central Government, in consultation with the National Financial Reporting Authority, may require additional statements in the auditor's report for specified classes of companies (e.g., CARO, 2020).</p>
5.	<p>Reporting on Frauds (Section 143(12)) If auditor has a reason to believe that an offence of fraud involving:</p> <p>A. Frauds ≥ Rs. 1 crore: Report to the Central Government under Rule 13 of the Companies (Audit and Auditors) Rules, 2014. [ADT 4]</p> <p>B. Frauds < Rs. 1 crore: Report to the Audit Committee or the Board, as case may be.</p> <p>Note: Include fraud-related matters in CARO 2020, paragraph 3, point (xi).</p>



9. The Companies (Auditor's Report) Order, 2020 [CARO, 2020]

Content	
1.	<p>Applicability of CARO 2020 CARO 2020 applies to all companies, including foreign companies, Except:</p> <ol style="list-style-type: none"> 1. Banking companies 2. Insurance companies 3. Companies licensed under Section 8 4. One Person Companies (OPC) 5. Small companies 6. Private limited companies that satisfied ALL the following 4 conditions: <ol style="list-style-type: none"> a. Is not a subsidiary or holding company of public companies. b. Aggregate paid-up capital and reserves & Surplus does not exceed Rs. 1 crore on balance sheet date. c. Aggregate borrowings from Banks and FIs does not exceed Rs. 1 crore at any time during the financial year. d. Whose turnover does not exceed Rs. 10 crores in the financial year.
2.	<p>Additional Points</p> <ul style="list-style-type: none"> ✓ For holding and subsidiary companies, CARO limits are computed separately for standalone financials and not based on consolidated. ✓ For companies with branches, CARO limits are based on the entire company. ✓ Branches are also covered under CARO, if the same applies to the company as a whole.
3.	<p>Non-Applicability on Consolidated Financial Statements: CARO 2020 does not apply to CFS. However, in the Audit report on CFS, the principal auditor shall report on Clause (xxi) of Para 3 of the order.</p>

Matters to be Included in under CARO 2020 of Auditor's Report

1. **Fixed Assets**
 - a. Fixed Asset Register: Whether the company is maintaining proper records including quantitative details and situation of PPE and intangible assets.
 - b. Physical Verification: Whether PPE have been physically verified at reasonable intervals and discrepancies, if any, were properly dealt in the books.
 - c. Title of Immovable Property: Whether title deeds of all immovable property are in the company's name. If not, disclose details in the following Format: [Horizontal / Vertical]

Details of the Property [Vertical Format]	Example
1. Description of the property	Factory Build.
2. Gross Carrying Value	Rs. 1.5 Crore
3. Held in Name of	Mr. Ram
4. Whether Promoter, Director or their relative or employee	Director
5. Period Held in others name	Since Incorp.
6. Reasons for Not held in Name of Company	Expl. in Class
 - d. Revaluation: Whether PPE or intangible assets were revalued and if so,
 - ✓ is it done by a Registered Valuer.
 - ✓ Specify amount of change if change is $\geq 10\%$ of aggregate of net carrying value of each class of PPE or Intangibles.
 - e. Benami Transactions: Whether any proceedings under the Benami Transactions Act are initiated/pending against the company. If so, whether company made appropriate disclosures in financial statements.
2. **Inventories**
 - a. Physical Verification:
 - ✓ Whether physical verification of inventory has been conducted at reasonable intervals and
 - ✓ 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. Working Capital Loans:
 - ✓ Whether the company been sanctioned working capital limits in excess of 5 crore rupees, in aggregate, from Banks or FIs on security of current assets and
 - ✓ Whether the quarterly returns or statements filed with such banks or FIs are in agreement with the books of accounts. If not, give details
3. **Loans, Advances, Investments, Guarantees**

Whether the company has invested in or provided loans or advances in the nature of loans [secured or unsecured], or stood guarantee, or provided security to any other entity. If so, Indicate:

 - a. Breakup between Related Parties and Others: The aggregate amounts during the year and balance outstanding on balance sheet date
 - ✓ To subsidiaries, Associates and Joint Ventures
 - ✓ To Others
 - b. Terms: Whether terms and conditions of the above transactions are not prejudicial to the company's interest.

	<p>c. Regular Repayments: In respect of loans and advances in nature of loans, whether the repayment receipts are regular</p> <p>d. Overdue > 90 Days: If the amount is overdue for >90 days, whether reasonable steps are taken to recover.</p> <p>e. Renewals / Extensions: Whether the loans or advances which fall due in this year has been rescheduled or extended or fresh loans granted to settle overdue loans and if so,</p> <ul style="list-style-type: none"> ✓ 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 <p>f. Demand Loans: Whether any loans or advances in the nature of loans granted which are repayable on demand or without specifying any terms or period of repayment, if so,</p> <ul style="list-style-type: none"> ✓ Specify the aggregate amount, percentage thereof to the total loans granted, ✓ Aggregate amount of loans granted to Promoters, related parties. <p>Note: point a and e doesn't apply to a company whose principal business is to give loans.</p>
4.	<p>Compliance with Sections 185 & 186</p> <p>Whether the company is in compliance with sec. 185 and 186 in respect of loans, investments, guarantees and security. If not, provide details thereof.</p>
5.	<p>Deposits</p> <p>1. In case the company has accepted deposits from the public, verify compliance with</p> <ul style="list-style-type: none"> ✓ Sections 73 to 76 of companies act. ✓ RBI directives, and ✓ orders from CLB/courts/tribunals <p>2. In any noncompliance, state the nature of contravention</p>
6.	<p>Cost Records</p> <p>Whether maintenance of cost records has been prescribed u/s 148(1). If so, whether such accounts and records have made and maintained.</p>
7.	<p>Statutory Dues</p> <p>a. Undisputed Dues:</p> <ul style="list-style-type: none"> ✓ Whether the company is regular in depositing undisputed statutory dues (PF, ESI, taxes, etc.) and ✓ If not, indicate the extent of arrears outstanding on balance sheet date for a period more than 6 months. <p>b. Disputed Dues: Dues not deposited on account of dispute. The auditor shall indicate:</p> <ul style="list-style-type: none"> ✓ Amount involved in the dispute and ✓ Forum where dispute is pending. <p>Note: Mere representation to department doesn't constitute dispute</p>
8.	<p>Undisclosed Income</p> <p>Whether any transactions not recorded in the books of account have been discovered during the year in the tax assessments under the Income Tax Act, 1961, if so, whether the same has been properly recorded in the books of account during the year. (Author Note: May Be treated as prior period items in the accounting records)</p>
9.	<p>Defaults in Repayment</p> <p>a. Lender-wise Defaults: Whether company has defaulted in repayment of loans or interest to any lender, if yes, indicate the following details:</p>

Lender wise defaults in case of Banks, FIs and Government	Example
1. Nature of Borrowing	WC Loan
2. Name of the Lender	ICICI Bank
3. Amount Not paid	Rs. 10,10,000/-
4. Whether principal or interest	Both
5. No. of Days Delay	>25 Days
6. Remarks, If any	To be paid soon

- b. Wilful defaulter: Whether the company is declared as a wilful defaulter by any lender.
- c. Diversion of Funds: Whether term loans are applied for the same purpose for which they were obtained. If not, indicate the amount of loan diverted and the purpose.
- d. Short-term funds diverted: Whether short term funds used for long term purposes, if so, indicate the nature and amount used.
- e. Loans taken for subsidiaries: Whether the company has taken any funds 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. Loans against pledge of shares:
 - ✓ Whether the company has raised any loans during the year on pledge of securities held in Subsidiaries/Associates/Joint ventures and if so, report details thereof
 - ✓ Also report whether the company has defaulted in repayment of these loans.

10. End Use of Funds
- a. IPO / FPO:
 - ✓ Whether the money raised by way of initial or further public offer (including debt instruments) were utilized for the purposes for which those are raised.
 - ✓ If not, the details along with the defaults, delays & subsequent rectifications, if any, to be reported.
 - b. Preferential Allotment:
 - ✓ Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review. If so, verify the following:
 - Compliance with section 42 of the act and
 - The amount raised have been used for the purpose for which they are raised.
 - ✓ If not, provide the details in respect of the amount involved & nature of non-compliance

11. Fraud Reporting
- a. Noticed or Reported: Whether any fraud by the company or on the company has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.
 - b. Reported to CG: Whether any report u/s 143(12) has been filed by the auditors in Form ADT-4 with the Central Government.
 - c. Whistle Blower Complaints: Whether the auditor has considered whistle-blower complaints, if any, received during the year by the company.

12. Nidhi Company Compliance

	<p>a. Whether Nidhi Company has complied with the net owned funds (i.e., net worth) to deposits in the ratio of 1:20 to meet out the liability. i.e., for every one rupee of net owned funds, Nidhi company cannot accept more than 20 rupees of deposits.</p> <p>b. Whether Nidhi Company is maintaining 10% Unencumbered term deposits as specified in Nidhi Rules, 2014 to meet out the liability.</p> <p>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.</p>
13.	<p>Related Party Transactions Whether all transaction with related parties is</p> <ul style="list-style-type: none"> ✓ Companies Act: In compliance with section 177 & 188 where applicable, & ✓ Disclosure as per AS: Details have been disclosed in the financial statements etc., as required by applicable accounting standards.
14.	<p>Internal Audit system</p> <p>a. Whether the company has an internal audit system commensurate with the size and nature of its business.</p> <p>b. Whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor.</p>
15.	<p>Non-Cash Transactions Whether Company has entered into any Non-Cash Transactions with directors & if so provisions of section 192 have been complied with.</p>
16.	<p>Non-Banking Financial Institutions</p> <p>a. 45IA OF RBI Act: Whether the company is required to be registered u/s 45-IA of RBI Act 1934, and if so, whether the registration has been obtained.</p> <p>b. NBFC Activities: 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.</p> <p>c. Core Investment Company:</p> <ul style="list-style-type: none"> ✓ 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. ✓ 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.	<p>Cash Losses Whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses.</p>
18.	<p>Resignation of Auditors Whether there has been any resignation of the statutory auditors during the year, if so, Whether the auditor has taken into consideration of the issues, objections or concerns raised by the outgoing auditors.</p>
19.	<p>Material Uncertainty</p>

	<p>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,</p> <ul style="list-style-type: none"> ✓ 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.	<p>CSR Compliance</p> <p>a. Other-than Project expense: Whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII within a period of six months of the expiry of the financial year proviso to sec. 135(5).</p> <p>b. Project expense: Whether any amount remaining unspent u/s 135(5) related to any ongoing project, has been transferred to special account u/s 135(6).</p>
21.	<p>This clause applies for A/R on CFS:</p> <p>a. Whether there have been any qualifications or adverse remarks by the respective auditors in the CARO 2020 reports of the companies included in the consolidated financial statements,</p> <p>b. If yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.</p>

Reporting Requirement under CARO 2020:

1. Where, in the auditor's report, the answer to any of the questions referred to in above is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.
2. 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.

4. COMPLETION AND REVIEW



1. Procedures to be performed Before Signing the Audit Report

Procedures before signing the auditor's report	
1.	SA 560: The auditor must address the impact of events occurring after the reporting period.
2.	SA 570: Obtain sufficient evidence about the management's use of the going concern assumption in preparing financial statements.
3.	SA 450: Review and communicate identified misstatements during the audit.
4.	SA 260: Share significant findings and other relevant matters with those charged with governance .
5.	SA 580: Obtain formal written statements from management.



2. SA 560 Subsequent Events

A. Definitions	
1.	Subsequent Events Events occurring after the date of the financial statements but before the date of auditor's report, and facts that become known to the auditor after the date of auditor's report .
2.	Date of the Financial Statements The end date of the latest period covered by the financial statements.
3.	Date of Approval of Financial Statements The date when all statements of the financial statements, including notes, are finalized and asserted by those with recognised authority that they have taken responsibility.
4.	Date of the Auditor's Report The date when the auditor dates the report , as per SA 700.
5.	Date the Financial Statements are Issued The date when the auditor's report and audited financial statements are made available to third parties . It depends on the entity's regulatory environment and often it is on or after the auditor's report date.

B. Types of Subsequent Events

<p>Subsequent events are broadly divided into 2 types:</p> <p>Adjusting Events: Events that provide evidence of conditions that existed at the date of the financial statements.</p> <p>Examples of Adjusting Events</p> <ol style="list-style-type: none"> Insolvency of a major debtor providing evidence on recoverability of debt. Settling a legal claim at a reduced amount after the financial statement date, adjusting the provision.
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Non-Adjusting Events:

Events that provide evidence of conditions that arose after the date of the financial statements.

Examples of Non-Adjusting Events

1. Issue of new share capital.
2. Planned merger of the company.
3. Destruction of inventories due to a fire.

C. Scope and Objective of SA 560

1. **Scope**
Deals with auditor's responsibilities related to subsequent events in an audit of financial statements.
2. **Objectives of Auditor (SA 560)**
 - a. Obtain S&A audit evidence to ensure events occurring between the financial statement date and the auditor's report date are appropriately adjusted or disclosed in the financial statements and
 - b. Respond appropriately to facts that become known after the auditor's report date, which might have required an amendment to the auditor's report had they been known earlier.

D. Audit Procedures for Subsequent Events

1. The auditor shall perform procedures to obtain S&A appropriate audit evidence that all events between the financial statement date and the auditor's report date requiring adjustment or disclosure are identified.
2. **No need Additional Procedures**
The auditor is not required to perform additional procedures on matters that were satisfactorily addressed in previous audit procedures.
3. **Audit Procedures**
 - a. Understanding management's procedures to identify subsequent events.
 - b. Inquiries with management and those charged with governance about subsequent events.
 - c. Reading minutes of meetings held after the financial statement date and inquiring about matters discussed but not recorded in minutes.
 - d. Read latest subsequent interim financial statements, if available.
 - e. Reviewing accounting records, budgets, and other relevant financial information after the financial statement date.
4. **Verification of Adjustments**
If auditor identifies any events, verify that events requiring adjustments or disclosures are appropriately reflected in the financial statements.
5. **Written Representations**
The auditor shall obtain written representations (as per SA 580) from management and those charged with governance, confirming that all subsequent events requiring adjustment or disclosure have been properly accounted for.

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

1.	<p>Discuss with Management</p> <p>If a fact becomes known to the auditor after the auditor's report date but before the financial statements are issued, the auditor shall:</p> <ol style="list-style-type: none"> Discuss the matter with management and those charged with governance. Determine if the financial statements need amendment. Inquire how management intends to address the matter.
2.	<p>Management Amends F/S</p> <p>If management amends the financial statements, the auditor shall:</p> <ol style="list-style-type: none"> Perform audit procedures specific to the amendment. Extend the audit procedures to the date of the new auditor's report. Provide a new auditor's report on the amended financial statements. Ensure the new auditor's report is not dated earlier than the approval of the amended financial statements.
	<p>Amendment Restricted to Subsequent Events [Not in India]</p> <p>If the law or framework does not prohibit management from restricting amendments to specific subsequent events and approval thereof, the auditor may:</p> <ol style="list-style-type: none"> Amend the report to include an additional date reflecting the restricted amendment. Provide a new report or amended report with an Emphasis of Matter or Other Matter(s) paragraph, stating the procedures are restricted to the described amendments.
3.	<p>Management doesn't amend the F/S</p> <p>If the law or framework does not require amendment to financial statements and management doesn't amend the F/S where auditor believes amendment is necessary then:</p> <ol style="list-style-type: none"> If the report has not been provided, the auditor shall modify the opinion as per SA 705 before issuing it. If the report has already been provided, the auditor shall notify management and governance about not to issue the financial statements and auditors report until amendments are made. If unamended financial statements are issued, the auditor shall take appropriate action to prevent reliance on the report.

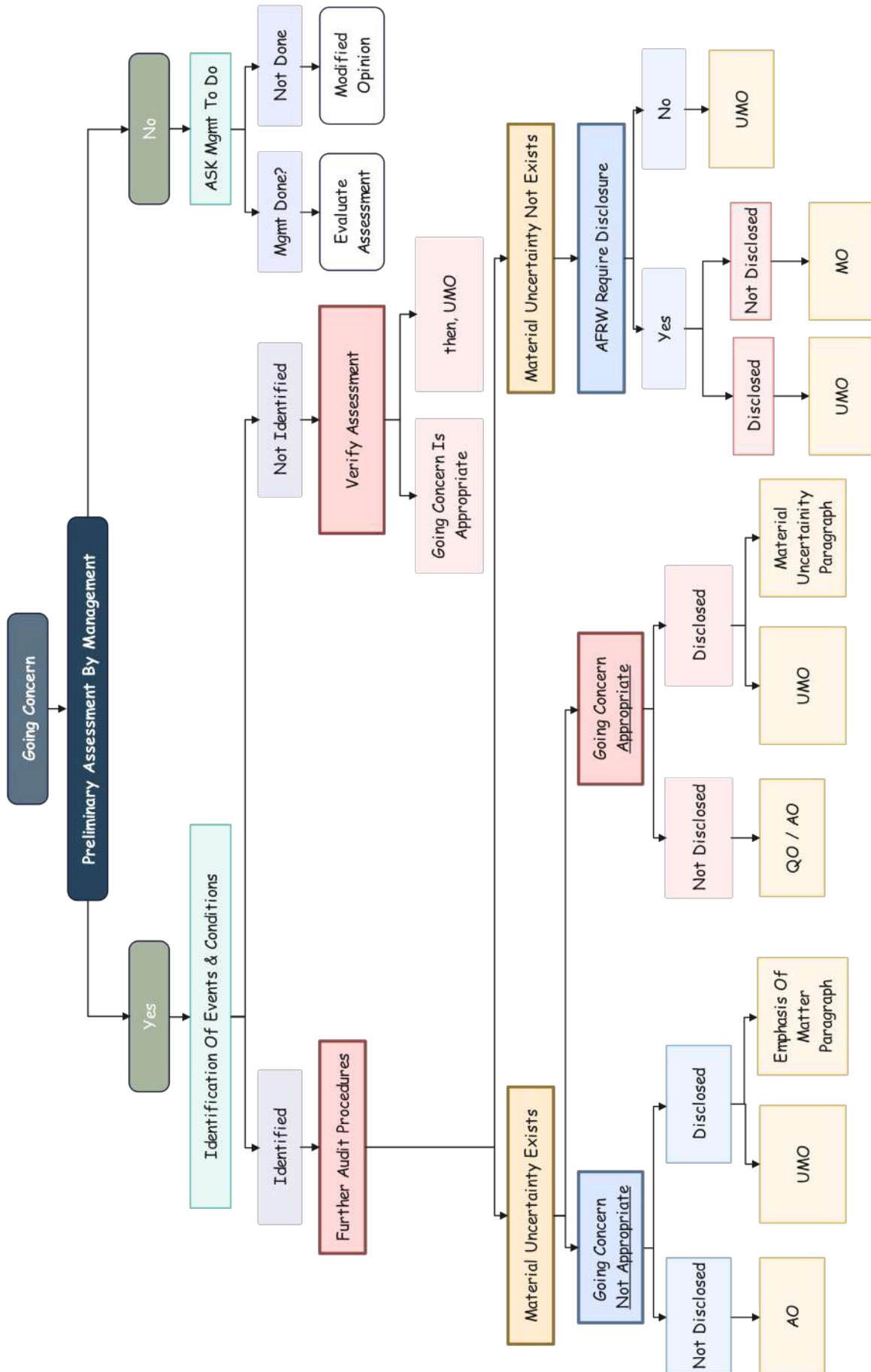
F. Facts identified After the date of F/S issued to public

1.	<p>Discuss with Management</p> <p>After the financial statements are issued, the auditor is under no obligation to perform further audit procedures. However, if a fact becomes known that might have required an amendment to the auditor's report, the auditor shall:</p> <ol style="list-style-type: none"> Discuss the matter with management and, if appropriate, those charged with governance. Determine if the financial statements need amendment. Inquire how management plans to address the matter.
2.	<p>Management Amends Financial Statements</p> <p>If management amends the financial statements, the auditor shall:</p> <ol style="list-style-type: none"> Perform necessary audit procedures on the amendment. Review management's steps to ensure recipients of the previously issued financial statements and report are informed of the situation.

	<p>c. Extend audit procedures to the date of the new auditor's report, ensuring the new report is not dated earlier than the approval of the amended financial statements.</p> <p>d. Provide a new auditor's report.</p>
	<p>Amendment Restricted to Subsequent Events [Not in India]</p> <p>If amendments are restricted to only specific subsequent events, include an Emphasis of Matter or Other Matter paragraph in the report, referencing the reason for the amendment and the earlier auditor's report.</p>
3.	<p>If Management Does Not Amend</p> <p>If management does not take necessary steps to inform recipients or refuses to amend the financial statements:</p> <p>a. The auditor shall notify management and governance (if separate) that the auditor will seek to prevent future reliance on the auditor's report.</p> <p>b. If management or governance still does not take necessary steps, the auditor shall take appropriate action to prevent reliance on the auditor's report.</p>



3. SA 570 Going Concern



A. Going Concern and its significance in F/R and Audit

1.	<p>Basis of Preparation</p> <ul style="list-style-type: none"> ✓ The ability or inability of an enterprise to operate as a going concern directly affects the preparation of financial statements. ✓ General purpose financial statements are prepared using the going concern basis, unless management plans to liquidate or cease operations, or has no realistic alternative.
2.	<p>When Going Concern Basis is Used</p> <p>If the going concern basis is appropriate, assets and liabilities are recorded assuming normal realization of assets and discharge of liabilities in the normal course of business.</p>
3.	<p>When the entity is Not a Going Concern</p> <ul style="list-style-type: none"> ✓ Financial statements are prepared on a liquidation basis. ✓ Inventories may need to be written down due to lower realizable prices. ✓ Assets may be recorded at their expected liquidation value.
4.	<p>SA 570 - Auditor's Responsibilities</p> <p>SA 570 Going Concern outlines the auditor's responsibilities in assessing the entity's going concern status and its implications for the auditor's report.</p>

B. Primary Responsibility for Assessment of Going Concern

1.	<p>Management's Responsibility - Primary</p> <p>Management must assess the entity's ability to continue as a going concern, even if the financial reporting framework does not explicitly require it.</p>
2.	<p>Making Judgements on uncertain future</p> <p>Management's assessment involves making judgments about inherently uncertain future outcomes of events or conditions.</p>
3.	<p>Factors Affecting Judgment</p> <ol style="list-style-type: none"> a. Degree of Uncertainty: The uncertainty increases regarding an event or outcome occurs at a future date. b. Entity-Specific Factors: The size, complexity, nature, and condition of the business, along with its sensitivity to external factors will influence the judgment. c. Timing of Information: Judgments are based on the information available at the time of assessment. Events occurred later may lead to outcomes inconsistent with the original judgment.

C. Objective of the Auditor under SA 570

1.	<p>S&A Evidence on Appropriateness</p> <p>Obtain S&A audit evidence to conclude on the appropriateness of management's use of the going concern basis in preparing the financial statements.</p>
2.	<p>Whether a Material Uncertainty Exists</p> <p>Conclude whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.</p>
3.	<p>Report as per SA 570</p> <p>Report findings in accordance with the requirements of SA 570 Going Concern.</p>

D. Responsibilities of the Auditor under SA 570

1.	<p>Auditor's Responsibilities</p> <p>a. Obtain S&A audit evidence and conclude on the appropriateness of management's use of the going concern basis in preparing the financial statements.</p> <p>b. Conclude whether a material uncertainty exists about the entity's ability to continue as a going concern.</p>
2.	<p>What if AFRFW silent on this?</p> <p>These responsibilities apply even if the financial reporting framework does not explicitly require management to assess the entity's ability to continue as a going concern.</p>
3.	<p>Silence in Audit Report is not a guarantee on Going Concern</p> <p>a. As per SA 200, the auditor's ability to detect material misstatements is limited for future events or conditions that may lead to the entity ceasing operations.</p> <p>b. The auditor cannot predict future events or conditions.</p> <p>c. The absence of reference to a material uncertainty in the auditor's report should not be viewed as a guarantee of the entity's ability to continue as a going concern.</p>

E. Risk assessment Procedure related to Going Concern

1.	As per SA 315 , the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern during risk assessment procedures.
2.	<p>Evaluate Management's Preliminary Assessment</p> <p>c. If performed:</p> <ul style="list-style-type: none"> ✓ Discuss the assessment with management. ✓ Whether management has identified events or conditions that may cast significant doubt on going concern. ✓ Evaluate management's plans to address these events or conditions. <p>d. If not performed:</p> <ul style="list-style-type: none"> ✓ Discuss with management the basis for using the going concern basis of accounting. ✓ Inquire whether events or conditions exist that may cast significant doubt on entities ability to continue as going concern.
3.	<p>Remain alert throughout the audit</p> <p>The auditor shall remain alert throughout the audit for evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.</p>

F. Examples of Events or Conditions Casting Significant Doubt

1.	<p>Financial Events or Conditions</p> <ol style="list-style-type: none"> 1. Net liability or net current liability position. 2. Fixed-term borrowings maturing without realistic prospects of renewal or repayment. 3. Reliance on short-term borrowings for long-term assets. 4. Indications of withdrawal of financial support from creditors. 5. Negative operating cash flows from historical or prospective financial statements. 6. Adverse financial ratios. 7. Operating losses or 8. Significant deterioration in asset values.
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	<p>9. Arrears or discontinuation of dividends.</p> <p>10. Inability to pay creditors on time.</p> <p>11. Non-compliance with loan terms.</p> <p>12. Change from credit to cash-on-delivery with suppliers.</p> <p>13. Failure to obtain financing for essential investments or new product development.</p>
2.	<p>Operating Events or Conditions</p> <p>1. Management's intent to liquidate or cease operations.</p> <p>2. Loss of key management without replacement.</p> <p>3. Loss of market, key customers, franchises, licenses, or suppliers.</p> <p>4. Labour difficulties.</p> <p>5. Shortages of Important supplies.</p> <p>6. Emergence of a highly successful competitor.</p>
3.	<p>Other Events or Conditions</p> <p>1. Non-compliances with capital or regulatory requirements (e.g., solvency or liquidity).</p> <p>2. Pending legal/regulatory proceedings that could lead to claims the entity cannot meet.</p> <p>3. Changes in laws or regulations or policies that adversely affect the entity.</p> <p>4. Uninsured or underinsured catastrophes.</p>

G. Evaluate management's assessment of going concern

1.	<p>Evaluation of Management's Assessment</p> <p>The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern.</p>
2.	<p>No need to rectify lack of analysis by Management</p> <ul style="list-style-type: none"> ✓ It is not the auditor's responsibility to rectify management's lack of analysis. ✓ However, in some cases, even without a detailed analysis, the auditor may conclude on the appropriateness of the going concern basis.
	<p>For Example</p> <ul style="list-style-type: none"> ✓ When there is a history of profitable operations and ready access to financial resources, management may make its assessment without detailed analysis. ✓ The auditor may conclude on the appropriateness of the going concern basis through other audit procedures.
3.	<p>Detailed Evaluation in other circumstances [e.g., No history of profits]</p> <p>In other cases, the auditor may need to evaluate:</p> <ul style="list-style-type: none"> ✓ the process management followed to make its assessment. ✓ The assumptions underlying the assessment. ✓ Management's plans for future actions and their feasibility.
4.	<p>Period of Assessment</p> <p>a. As per Framework/Law: The auditor shall cover the same period as management's assessment, as per the AFRFW or law/regulation.</p> <p>b. Minimum 12 Months: If management's assessment covers less than 12 months from the financial statement date, the auditor shall request an extension to at least 12 months.</p>

H. Additional Audit Procedures if events or conditions are identified

1. **Objective**
If any events or conditions identified that cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain S&A audit evidence to determine whether a material uncertainty exists by performing additional audit procedures including consideration of mitigating factors.
2. **Additional Audit Procedures to Obtain Evidence**
 1. Request Management's Assessment: If Management assessment is not performed, request management to assess the entity's ability to continue as a going concern.
 2. Management's Plans for future actions: Evaluate the likelihood of management's plans for future actions will improve the situation and feasibility of these plans.
 3. Analyse Cash Flow Forecasts: If entity prepared a cash flow forecasts, evaluate:
 - a. Reliability of underlying data used to prepare the forecasts.
 - b. Whether there is adequate support for assumptions underlying the forecasts.
 4. Consider Additional Information: Determine whether new facts or information have become available since management's assessment
 5. Written Representations: Request written representations from management and TCWG regarding their plans, future actions and their feasibility.

Examples of Additional Audit Procedures

1. **Financial Analysis**
 1. Analyse and discuss cash flow, profit, and other relevant forecasts with management.
 2. Analyse interim financial statements.
2. **Loan and Financing Terms**
 1. Read terms of debentures and loan agreements and check for breaches.
 2. Confirm existence, terms, and adequacy of borrowing facilities.
 3. Confirm financial support arrangements with related and third parties and assess their financial ability to provide funds.
3. **Legal and Regulatory**
 1. Inquire with legal counsel regarding litigation and claims, and assess management's evaluations.
 2. Obtain and review reports of regulatory actions.
4. **Governance and Commitments**
 1. Read minutes of meetings for references to financing difficulties.
 2. Evaluate management's plans for unfilled customer orders.
5. **Subsequent Events**
Perform audit procedures on subsequent events to identify those that mitigate or worsen the entity's ability to continue as a going concern.
6. **Asset Disposals**
Determine the adequacy of support for planned disposals of assets.

I. Auditors Conclusions on Existence of Material uncertainty

1. The auditor shall evaluate whether S&A audit evidence has been obtained and conclude on the appropriateness of management's use of the going concern basis in preparing the financial statements.

2.	<p>Conclusion on Material Uncertainty Based on the audit evidence, the auditor shall determine whether a material uncertainty exists regarding events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.</p>
3.	<p>Definition of Material Uncertainty A material uncertainty exists when:</p> <ol style="list-style-type: none"> The magnitude of its potential impact and The likelihood of occurrence <p>is such that, in the auditor's judgment, appropriate disclosure of nature and implications of uncertainty is necessary.</p>

J. Evaluate Adequacy of disclosures of Material Uncertainty

1.	<p>If Material Uncertainty Exists If management's use of the going concern basis is appropriate but a material uncertainty exists, the auditor shall determine whether the financial statements:</p> <ol style="list-style-type: none"> Adequately disclose the key events or conditions casting significant doubt and management's plans to address them and Clearly disclose the existence of a material uncertainty, its implications, that the entity's may be unable to realize its assets and discharge its liabilities in the normal course of business.
2.	<p>If No Material Uncertainty Exists If events or conditions were identified that may cast significant doubt but the auditor concludes no material uncertainty exists, the auditor shall evaluate whether the financial statements provide adequate disclosures about these events or conditions as per the AFRFW.</p>

K. Audit Reporting under SA 570

1.	<p>If Use of Going Concern Basis is Inappropriate If the financial statements are prepared using the going concern basis, but in the auditor's judgment this is inappropriate, the auditor shall express an adverse opinion.</p>
2.	<p>Use of Going Concern Basis is Appropriate but a Material Uncertainty Exists Adequately Disclosure in Financial Statements: If the financial statements adequately disclose the material uncertainty, the auditor shall:</p> <ol style="list-style-type: none"> Express an unmodified opinion. Include in a separate section in the auditor's report titled "Material Uncertainty Related to Going Concern" and: <ul style="list-style-type: none"> ✓ Draws attention to the relevant note in the financial statements. ✓ State that the material uncertainty exist that may cast significant doubt on the entity's ability to continue as a going concern and ✓ Also state that the auditor's opinion is not modified in respect of this matter. <p>Inadequate Disclosure in Financial Statements: If the financial statements do not adequately disclose the material uncertainty, the auditor shall:</p> <ol style="list-style-type: none"> Express a qualified opinion or an adverse opinion, as per SA 705.

	<p>b. In the Basis for Qualified (Adverse) Opinion section, state that a material uncertainty exists, its potential impact, and that the financial statements do not adequately disclose this matter.</p>
3.	<p>Management Unwilling to Make or Extend Assessment If management is unwilling to make or extend its assessment, the auditor shall:</p> <ul style="list-style-type: none"> ✓ Consider the implications for the auditor's report. ✓ Express a qualified opinion or a disclaimer of opinion if S&A audit evidence cannot be obtained regarding the use of the going concern basis.



4. SA 450 Evaluation of Misstatements Identified during the Audit

A. Objective of the Auditor under SA 450	
1.	<p>Uncorrected Misstatements ✓ Refer to misstatements that auditor has accumulated during the audit that have not been corrected.</p>
2.	<p>Auditor's Objective Before forming an opinion, the auditor has to evaluate:</p> <ol style="list-style-type: none"> a. Effects of identified misstatements on the audit. b. Effects of uncorrected misstatements, if any, on the financial statements.

B. Accumulation of Misstatements identified in Audit	
1.	<p>Accumulation of Misstatements ✓ The auditor shall accumulate misstatements identified during the audit, except those that are clearly trivial.</p>
2.	<p>Examples of Misstatements Misstatements may arise from:</p> <ol style="list-style-type: none"> a. Inaccuracies in gathering or processing financial data. b. Omissions of amounts or disclosures. c. Wrong capitalization of machinery repair expenses of Rs. 5 lacs lead to profit overstatement.
3.	<p>Revision of Overall Audit strategy and plan The auditor shall determine whether overall audit strategy and plan need any revision if:</p> <ol style="list-style-type: none"> a. The nature of identified misstatements and circumstance of their occurrence indicates other potential misstatements. b. The aggregate misstatements accumulated approach materiality as per SA 320.
4.	<p>Request to Management The auditor may request management to:</p> <ol style="list-style-type: none"> a. Review transactions, account balances, or disclosures to understand the cause of the misstatement, b. Perform procedures to identify the actual misstatement and make adjustments to the financial statements.
5.	<p>Additional Audit Procedures If management has identified and corrected misstatements after the auditor's request, the auditor shall perform additional audit procedures to ensure that no misstatements remain.</p>

C. Communication and Correction of Misstatements identified

1.	<p>Timely Communication</p> <ul style="list-style-type: none"> ✓ The auditor shall communicate all misstatements accumulated during the audit to the appropriate level of management, unless prohibited by law. ✓ This enables management to evaluate, disagree if necessary, and take corrective action.
2.	<p>Request Management to Correct Misstatements</p> <ul style="list-style-type: none"> ✓ The auditor shall request management to correct misstatements. ✓ Corrections help maintain accurate records and reduce risks of future material misstatements caused by cumulative uncorrected errors.
3.	<p>Management Refuses to Correct</p> <p>If management refuses to correct misstatements, the auditor shall:</p> <ul style="list-style-type: none"> ✓ Understand management's reasons for refusal. ✓ Take that understanding in evaluating whether the financial statements are free of material misstatement.
4.	<p>Evaluating effect of Uncorrected Misstatements</p> <ul style="list-style-type: none"> ✓ Re-evaluate Materiality levels: Confirm whether materiality is still appropriate based on actual financial results prior to evaluating uncorrected misstatements. ✓ Materiality of Uncorrected misstatements: Determine if uncorrected misstatements are material individually or in aggregate, considering: <ul style="list-style-type: none"> a. Their size and nature of the misstatement in relation to specific transactions, account balances, or disclosures and circumstances of their occurrence. b. The effect of prior period uncorrected misstatements on the relevant class of transactions, balances, disclosures and financial statements as a whole.
5.	<p>Communication with TCWG</p> <ul style="list-style-type: none"> ✓ The auditor shall communicate with TCWG about: <ul style="list-style-type: none"> a. Uncorrected misstatements, individually and in aggregate, and their impact on the auditor's report. b. Request corrections for uncorrected misstatements. c. Discuss the effect of prior period misstatements on the current financial statements.
6.	<p>Written Representation</p> <ul style="list-style-type: none"> ✓ The auditor shall request a written representation from management and TCWG that uncorrected misstatements are immaterial to the financial statements. ✓ A summary of these items shall be included or attached to the representation.

D. Documentation of Misstatements Identified shall include

1.	<p>Trivial level</p> <ul style="list-style-type: none"> ✓ The audit documentation must include the amount below which misstatements are considered clearly trivial.
2.	<p>Accumulated Misstatements</p> <ul style="list-style-type: none"> ✓ Document all misstatements accumulated during the audit and indicate whether they have been corrected.
3.	<p>Conclusion on Uncorrected Misstatements</p>

- ✓ The auditor's **conclusion** on whether **uncorrected misstatements** are **material**, individually or in aggregate and
- ✓ **Basis** for that conclusion.



5. SA 580 Written Representations

A. Meaning of Written Representation and Using as Audit Evidence

1. **Definition of Written Representations**
 - ✓ Written representations are **written statements provided by management** to the auditor to confirm specific matters or support other audit evidence.
 - ✓ **They do not include** financial statements, the assertions therein, or supporting records.
2. **Written Representations as Audit Evidence**
 - ✓ **Audit evidence** includes all information used by the auditor to form the **audit opinion**.
 - ✓ **Written representations** are considered **audit evidence**, similar to responses to inquiries.
 - ✓ Written representations are a **necessary source of audit evidence**.
 - ✓ If management **modifies** or refuses to provide them, it may indicate **significant issues**.
3. **Benefits of Written Representations**
 - ✓ Requesting written (rather than oral) representations **prompts management to consider matters more rigorously**, improving the quality of representations.
4. **Limitations of Written Representations**
 - ✓ Written representations alone **do not provide S&A audit evidence** on their own.
 - ✓ **Reliable written representations** provided by management **do not reduce the auditor's responsibility** to obtain other evidence for management's responsibilities or specific assertions.

B. Scope and Objective

1. **Scope of SA 580**
 - ✓ SA 580 deals with the **auditor's responsibility** to obtain **written representations from management** and, where appropriate, **those charged with governance**.
2. **Objectives of the Auditor**
 - a. For Management Responsibilities: **Obtain written representations** from management (and TCWG, if appropriate) confirming they have fulfilled their responsibilities for
 - ✓ Preparing the financial statements and
 - ✓ Providing complete information to the auditor.
 - b. Decided by auditor or SA: The auditor shall obtain written representation **to support other audit evidence** related to financial statements or specific assertions
 - ✓ If **determined necessary** by the auditor or
 - ✓ Required by **other SAs**.
 - c. **Respond appropriately**
 - ✓ To written representations provided or
 - ✓ To situations where management or governance does not provide the requested representations.
3. **From Whom to Obtain Written Representations**

- ✓ The auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned.
- ✓ Written representations relate to:
 - a. Fulfilment of management's responsibilities.
 - b. Supporting other audit evidence related to the financial statements or specific assertions.

C. Written representation about Management Responsibilities

1. **Confirm about Management's fulfilment of their responsibility**
Management must represent that it has fulfilled its responsibility for preparing financial statements in accordance with the AFRFW, including fair presentation, as mentioned in terms of engagement
2. **Management's Knowledge of Process for P&P of F/S**
Management is expected to have sufficient knowledge of the processes used in preparing and presenting the financial statements and related assertions.
3. **Informed Representations**
 - a. The auditor may request management to include in representations, confirmations it has made such as inquiries, to provide accurate written representations.
 - b. Management may seek input from specialists before making representations, such as:
 - ✓ Actuaries (for actuarially determined measurements).
 - ✓ Engineers (for environmental liabilities).
 - ✓ Internal counsel (for legal claims).
4. **Qualifying Language**
 - ✓ Management may use qualifying language such as "to the best of its knowledge and belief."
 - ✓ The auditor may accept this if satisfied that representations are made by responsible and knowledgeable individuals.

D. Written Representation about Completeness of Information

1. **Provision of Information**
Management must represent that it has provided the auditor with all relevant information and access as agreed in the audit engagement terms.
2. **Completeness of Transactions**
Management must represent that all transactions have been recorded and are reflected in the financial statements.

E. Why Written Representations about Management Responsibilities [Need]

1. **Audit evidence alone is not sufficient to confirm that management has fulfilled its responsibilities for:**
 - a. Preparation of financial statements.
 - b. Providing information and
 - c. Ensuring completeness of transactions.

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| 2. | <p>Limitations of Audit Evidence</p> <p>The auditor cannot judge solely on other audit evidence whether management has prepared financial statements and provided information based on their agreed responsibilities.</p> <p>Example</p> <p>The auditor cannot conclude that management has provided all relevant information as per the terms of the audit engagement without obtaining written confirmation.</p> |
| 3. | <p>Purpose of Written Representations</p> <p>Written representations confirm management's acknowledgement and understanding of its responsibilities as agreed in the audit engagement terms.</p> |

F. Reconfirmation of Responsibilities through written representations

- The auditor may ask management to **reconfirm responsibilities** through written representations, specifically in the following cases:
- a. Those **who signed the terms of audit engagement** NO longer hold the relevant responsibilities.
 - b. The terms of audit engagement are **prepared in previous year**.
 - c. There are indications that **management misunderstands its responsibilities**.
 - d. **Circumstances have changed**, making reconfirmation necessary.

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

Management's responsibilities in the written representations **shall be described in the same manner** as they are outlined **in the terms of the audit engagement**.

H. Written Representations related to Other than Management Responsibilities

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| 1. | <p>Requirements for Other Representations</p> <ul style="list-style-type: none"> ✓ Other SAs require the auditor to request written representations. ✓ If necessary, the auditor may also request additional written representations to support other audit evidence related to financial statements or specific assertions. |
| 2. | <p>Supplementary in nature</p> <p>These are supplementary representations and do not form part of the representations relating to management's responsibilities.</p> |
| 3. | <p>Examples of Supplementary Representations</p> <ol style="list-style-type: none"> a. Whether selection and application of accounting policies are appropriate. b. Recognition, Measurement, presentation or disclosure in compliance with the financial reporting framework of: <ol style="list-style-type: none"> i. Plans or intentions affecting asset or liability classification or valuation. ii. Liabilities (actual or contingent). iii. Title to assets, liens or encumbrances, and assets pledged as collateral. iv. Compliance with laws, regulations, and contractual agreements, including any non-compliance. |

I. Written Representations about Information Provided to The Auditor

1. **Additional Written Representation**
In addition to representation regarding **management's responsibility** for information provided to the auditor, the auditor **may request an additional representation**.
2. **Example: Communication of Deficiencies**
The auditor may ask management to **confirm in writing** that it has communicated all known **deficiencies in internal control** to the auditor.

J. Written Representations about Specific Assertions

If necessary, the auditor may request **management** to provide **written representations** about **specific assertions** in the financial statements.
 Purpose: To support the auditor's **understanding of management's judgment, intent, or the completeness** of an assertion obtained from other audit evidence.
 Example: If management's **intent** affects the **valuation basis** for investments, written representations may be necessary.

K. Date and Period Covered by Written Representation

1. **Date of Written Representations**
The written representations must be **dated as near as possible to**, but not after, the date of auditor's report. It shall be for **all financial statements and periods** mentioned in the report.
2. **Importance of Timing**
Since **written representations are necessary audit evidence**, the auditor **cannot express an opinion** or date the report **before receiving** them. Further the auditor has to consider events up to the date of audit report, that may affect the **financial statements**.
3. **For All Periods mentioned in Audit Report**
Written representations must cover **all periods** in the auditor's report. This ensures **management reaffirms** that previous representations remain **valid** for prior periods.
4. **What if Current Management is Not Present in All periods mentioned?**
If **current management was not present during earlier periods**, they might claim that they cannot provide representations for that time. This fact does not reduce their responsibility for the financial statements as a whole and **must provide representations for the entire period(s)**. Accordingly, the auditor can request representation from current management.

L. Conclusions and Reporting under SA 580

1. **Requested Representation is Not provided**
Management fails to provide requested written representations:
 - a. **Discuss** the matter with management.
 - b. **Re-evaluate** management's **integrity and impact on reliability** of audit evidence.
 - c. **Take appropriate actions**, including **disclaimer of opinion as per SA 705**.
2. **Written representation Not Reliable**
If the auditor has concerns about **competence, integrity, ethical values, or diligence** of management or **Written representations** are inconsistent with other **audit evidence** then:
 - a. Perform audit procedures to **resolve the matter**.

- b. If unresolved, reconsider management's **integrity and competence**.
- c. Determine the effect on the **reliability** of representations and evidence.
- d. Take **appropriate actions**, including **disclaimer of opinion as per SA 705**.

M. Obtaining evidence about Judgements and Intentions

The auditor may consider:

- a. **Entity's past history** in executing its **stated intentions**.
- b. **Reasons** for choosing a **particular course of action**.
- c. Entity's ability to pursue a specific course of action.
- d. Existence or absence of other information **obtained during the audit that may conflict with management's judgment or intent**.



6. SA 260 Communication with those Charged with Governance

A. An Effective two-way communication is Important during Audit

1. **For Benefit of Auditor and TCWG**
The auditor and those charged with governance together develop a **constructive working relationship** to support the **audit process**, while maintaining the auditor's independence and objectivity.
2. **For the Benefit of the Auditor**
The auditor **relies on those charged with governance** for **information** about the entity and its **environment**, including sources of **audit evidence** and insights into specific **transactions or events**.
3. **For the Benefit of TCWG**
Those charged with governance in fulfil their role of **overseeing** the financial reporting process, which helps **reduce risks of material misstatement** in the financial statements.

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

1. The **person(s) or organization(s)** responsible for **overseeing the strategic direction** and ensuring **accountability**, including the **financial reporting process**.
2. **Includes Management Personnel**
In some entities, **those charged with governance** may include **management personnel** (e.g., **executive members of a board or an owner-manager**).
3. **Depending on Governance Structures**
Governance structures differ based on factors like **culture, legal background, size, and ownership**. For example:
 - a. **Separate vs. Single Boards**: Some entities have a **supervisory board** separate from the **executive board**. In other entities both functions are performed by a **single board**.
 - b. **Legal Positions**: **Governance roles** can be part of the entity's **legal structure**, e.g., **company directors**.
 - c. **Overlap of Governance and Management**: In some cases, **those charged with governance** also **manage** the entity. In others, governance and management are **separate**.
 - d. **Collective Responsibility**: Governance is usually a **collective responsibility** of a governing body like a **board of directors, supervisory board, partners, trustees, or equivalent**.

	<p>e. Smaller Entities: In smaller entities, governance may rest with one person, e.g., an owner-manager or a sole trustee.</p> <p>f. Diversity and Auditor Communication: Due to diverse structures, the auditor may not always identify the correct persons for communication in all audits.</p> <p>g. Undefined Governance Structures: In some cases, such as family-owned entities or not-for-profits, the governance structure may not be formally defined.</p>
4.	<p>Engaging party has to determine TCWG</p> <p>a. Agree with engaging party: The auditor may need to discuss and agree with the engaging party on the relevant persons to communicate with.</p> <p>b. Understanding entity: The auditor's understanding of the entity's governance structure (as per SA 315) helps identify the appropriate persons for communication, depending on the matter.</p>

C. Scope and Objective of SA 260

Scope

SA 260 deals with the auditor's responsibility to communicate with those charged with governance during an audit of financial statements.

D. Objectives of the Auditor

a.	<p>Communication of Responsibilities of the Auditor</p> <ul style="list-style-type: none"> ✓ To clearly communicate the auditor's responsibilities relating to the audit and ✓ To provide an overview of the planned scope and timing of the audit.
b.	<p>Obtain Relevant Information</p> <ul style="list-style-type: none"> ✓ To obtain information from TCWG relevant to the audit.
c.	<p>Timely Observations</p> <ul style="list-style-type: none"> ✓ To provide with TCWG timely observations that are significant and relevant to their role in overseeing the financial reporting process.
d.	<p>Promote Two-Way Communication</p> <ul style="list-style-type: none"> ✓ To encourage effective two-way communication between the auditor and those charged with governance.

E. Matters to be communicated

1.	<p>Auditor's Responsibilities</p> <p>The auditor must communicate their responsibilities related to the audit, including:</p> <p>a. Forming and expressing an opinion on the financial statements prepared by management under the oversight of TCWG.</p> <p>b. The audit does not relieve management or TCWG of their responsibilities.</p>
2.	<p>Planned Scope and Timing</p> <p>The auditor provides an overview of the planned scope and timing of the audit, including significant risks identified.</p>
3.	<p>Significant Findings</p> <p>The auditor must communicate the following findings:</p> <p>a. Qualitative aspects of Entities Accounting Practices: Auditors Views on significant qualitative aspects of accounting practices, including Significant Accounting policies,</p>

	<p><i>estimates</i>, and <i>disclosures</i>. If applicable, explain why certain practices, though acceptable, may not be the <i>most appropriate</i>.</p> <p>b. Significant Difficulties: Any <i>significant difficulties</i> encountered during the audit.</p> <p>c. Significant Matters: If TCWG and management are <i>different</i>, communicate:</p> <ul style="list-style-type: none"> ✓ <i>Significant matters</i> discussed with management. ✓ <i>Written representations</i> requested by the auditor. <p>d. Modification of Auditor's Report: Circumstances <i>affecting the form and content</i> of the auditor's report.</p> <p>e. Other Significant Matters: Any other matters relevant to the <i>oversight of financial reporting</i> based on the auditor's <i>professional judgment</i>.</p>
4.	<p>Communication of Auditor's Independence in case of Listed Companies For Listed entities, the auditor shall communicate:</p> <p>a. Compliance with Independence: A statement <i>confirming compliance with ethical requirements on independence</i> by the Firm, Engagement team, and Network Firms.</p> <p>b. Relationships & Fees:</p> <ul style="list-style-type: none"> ✓ <i>Details of relationships and other matters</i> that may impact independence, including total fees for audit and non-audit services. ✓ Fees are allocated into categories to help governance assess the impact on <i>independence</i>. <p>c. Safeguards Applied: Explanation of <i>safeguards applied to eliminate or reduce threats</i> to independence to an acceptable level.</p>

F. Establish Communication Process

1.	<p>Form, Timing, and Content The auditor must communicate the <i>form, timing, and general content</i> of communications with <i>those charged with governance</i>.</p>
2.	<p>Written Communication The auditor shall communicate <i>significant findings in writing if</i>, in their professional judgment, oral communication is not sufficient.</p>
3.	<p>Scope of Written Communication Written communications <i>need not cover all matters from the audit</i>.</p>
4.	<p>Adequacy of Communication Process The auditor evaluates whether the <i>two-way communication</i> has been <i>adequate</i> for the audit. If not, the auditor must:</p> <ul style="list-style-type: none"> ✓ <i>Assess its effect on risks</i> of material misstatement. ✓ <i>Determine its impact</i> on obtaining sufficient appropriate audit evidence. ✓ Take <i>appropriate action</i>.
5.	<p>Documentation</p> <ul style="list-style-type: none"> ✓ If <i>matters are communicated orally</i>, the auditor must document what, when, and to whom the matters were communicated. ✓ If communicated <i>in writing</i>, the auditor must retain a copy of the communication as part of the <i>audit documentation</i>.



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

A. Scope and Objective

1.	<p>Scope SA 265 deals with the auditor's responsibility to communicate deficiencies in internal control to TCWG and management identified during an audit of financial statements.</p>
2.	<p>Understanding Internal Control The auditor must understand internal control relevant to the audit to identify and assess risks of material misstatement. This understanding helps in designing appropriate audit procedures but not for expressing an opinion on effectiveness of internal control.</p>
3.	<p>Identification of Deficiencies Deficiencies in internal control may be identified during the risk assessment process or at any other stage of the audit.</p>
4.	<p>Communication of Deficiencies SA 265 specifies which deficiencies the auditor must communicate to TCWG and management.</p>
5.	<p>Objective of the Auditor The auditor's objective is to appropriately communicate identified deficiencies in internal control that, in the auditor's professional judgment, are important enough to merit their respective attention.</p>

B. Deficiency and Significant Deficiency in Internal Control

1.	<p>Deficiency in Internal Control A deficiency exists when:</p> <ol style="list-style-type: none"> Ineffective Control: A control is designed, implemented, or operated in a way that it fails to prevent, detect, or correct misstatements in the financial statements on a timely basis. Missing Control: A control that is necessary to prevent, detect, or correct misstatements is missing.
2.	<p>Significant Deficiency A significant deficiency in internal control is:</p> <ol style="list-style-type: none"> Importance to Governance: A deficiency (or combination of deficiencies) that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance. Factors Determining Significance: The significance depends on: <ul style="list-style-type: none"> ✓ The likelihood of their occurrence of misstatements and ✓ The potential magnitude of the misstatement. Misstatements Not identified: Significant deficiencies can exist even if the auditor has not identified any misstatements during the audit.

C. Matters / Factors that decide Significant Deficiency

The matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency are:

1.	The likelihood of deficiencies leading to material misstatements in financial statements in the future.
2.	Susceptibility to Loss or Fraud of the related asset or liability .
3.	The subjectivity and complexity involved in determining estimates , such as fair value accounting .
4.	The financial statement amounts exposed to the deficiencies .
5.	The volume of activity in the account balance or transactions affected by the deficiency.
6.	Importance of Controls to Financial Reporting: The significance of controls to the financial reporting process, including: <ol style="list-style-type: none"> General monitoring controls, such as management oversight. Controls over fraud prevention and detection. Controls over the selection and application of significant accounting policies. Controls over significant transactions with related parties. Controls over transactions outside the normal course of business. Controls over the period-end financial reporting process, such as non-recurring journal entries.
7.	Cause and Frequency The cause and frequency of exceptions arising from the control deficiencies.
8.	Interaction with Other Deficiencies How the deficiency interacts with other deficiencies in internal control.

D. Indicators of Significant Deficiencies

1.	Ineffective Control Environment Evidence that aspects of the control environment are ineffective , such as: <ol style="list-style-type: none"> Management Interest: Significant transactions involving management interest are not properly scrutinized by governance. Management Frauds: Identification of management fraud, whether material or not, that internal control failed to prevent. No Remedial Action: Management fails to implement remedial action on previously reported significant deficiencies. Absence of Risk Assessment: Lack of a risk assessment process where it would typically be expected. Ineffective Risk Assessment: Evidence that the entity's risk assessment is ineffective, e.g., failure to identify a risk of material misstatement. Ineffective Risk Response: Ineffective response to significant risks, such as absence of controls over identified risks.
2.	Auditor-Detected Misstatements Misstatements found during the auditor's procedures that were not prevented, detected, or corrected by internal control.
3.	Prior Period Material Misstatements Material misstatements due to error or fraud are disclosed as prior period items in the current year's Statement of Profit and Loss .
4.	Management Inability to oversee Evidence of management's inability to oversee the preparation of the financial statements.

E. Communicating Significant deficiency to TCWG

1. **Determine Significant deficiency**
The auditor must determine, based on **audit work performed**, whether **deficiencies in internal control** exist. If so, the auditor must assess whether they are significant deficiencies, either individually or in combination.
2. **Communication to Governance and Management**
 - a. **To Those Charged with Governance:** **Communicate in writing any significant deficiencies in internal control identified during the audit on a timely basis.**
 - b. **To Management:** **Communicate to management (at the appropriate level) on a timely basis:**
 - ✓ **Significant Deficiencies:** In writing, **significant deficiencies communicated or to be communicated to TCWG.**
 - ✓ **Other Deficiencies:** **Other deficiencies** not communicated by other parties but are, in the auditor's **professional judgment**, important for management's **attention.**

F. Contents of Written Communication [Letter of Weakness]

- The written communication of significant deficiencies must include:
- a. **Description and Potential Effects:** **A description of the deficiencies** and an explanation of their **potential effects.**
 - b. **Context Information:** Sufficient details for governance and management to **understand the context** of the communication.
 - c. **Specific Explanations:** The auditor must mention in the letter of weakness:
 - ✓ **Audit Purpose:** The purpose of the audit is to express an **opinion** on the **financial statements.**
 - ✓ **Internal Control Consideration:** Internal control was considered to design **audit procedures** but not to express an opinion on the effectiveness of internal control.
 - ✓ **Scope of Matters Reported:** The **reported matters are limited to deficiencies identified** during the audit that are of sufficient importance to report to governance.

5. AUDIT DOCUMENTATION



1. Meaning and Objective of Documentation as Per SA 230

Content	
A.	<p>Meaning Audit Documentation refers to the record of:</p> <ul style="list-style-type: none"> ✓ Audit procedures performed. ✓ Relevant audit evidence obtained. ✓ Conclusions reached by the auditor. <p>Also known as "working papers" or "work papers".</p>
B.	<p>Objective of the Auditor The auditor's objective is to prepare documentation that provides:</p> <ol style="list-style-type: none"> 1. A sufficient and appropriate record supporting the basis for the auditor's report. 2. Evidence that the audit was planned and performed in accordance with: <ul style="list-style-type: none"> ✓ Standards on Auditing. ✓ Applicable legal and regulatory requirements.



2. Nature and Purpose of Documentation

Content	
A.	<p>Nature of Audit Documentation Audit documentation provides:</p> <ol style="list-style-type: none"> 1. Evidence for Conclusions: Evidence of the auditor's basis for conclusions about achieving the overall audit objectives. 2. Evidence for Compliance with SAs: Evidence that the audit was planned and performed as per SAs and applicable legal and regulatory requirements.
B.	<p>Purpose of Audit Documentation The purpose of audit documentation includes:</p> <ol style="list-style-type: none"> 1. Assists the engagement team to plan and perform the audit. 2. Helps team members to direct, supervise, and review the audit work effectively. 3. Ensures the engagement team is accountable for its work. 4. Retains a record of matters important for future audits. 5. Enables quality control reviews and inspections as per SQC 1. 6. Facilitates external inspections as per applicable legal or regulatory requirements.



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

Content	
A.	<p>Manner of Documentation The auditor must prepare audit documentation so that an experienced auditor with no prior connection with the audit, to understand:</p> <ol style="list-style-type: none"> a. The nature, timing, and extent of the audit procedures performed. b. The results of procedures and the audit evidence obtained.

	<p>c. Significant matters, conclusions reached, and professional judgments made.</p> <p>Meaning of Experienced Auditor An experienced auditor is a person with reasonable knowledge of:</p> <ol style="list-style-type: none"> 1. Financial reporting frameworks. 2. Accounting standards. 3. Auditing standards. 4. Knowledge of the client's business.
B.	<p>Documentation of NTE In documenting the Nature, Timing, and Extent (NTE) of audit procedures, the auditor must record:</p> <ol style="list-style-type: none"> 1. Tests Performed: The identifying characteristics of specific items tested. 2. Performed by Whom: Who performed the work and the date of completion. 3. Reviewed by Whom: Who reviewed the work, including the date and extent of the review. 4. Significant Matters: Document discussions of significant matters, including: <ul style="list-style-type: none"> ✓ The nature of the matters discussed. ✓ When and with whom the discussions occurred. 5. Inconsistencies: If information inconsistent with the final conclusion is identified, document how the inconsistency was addressed.
C.	<p>Factors Affecting Documentation The form, content, and extent of documentation depend on:</p> <ol style="list-style-type: none"> 1. The size and complexity of the entity. 2. The nature of the audit procedures performed. 3. The identified risks of material misstatement. 4. The significance of the audit evidence obtained. 5. The nature and extent of exceptions identified. 6. The need to document a conclusion or the basis for a conclusion if not readily determinable from documentation of work performed. 7. The audit methodology and tools used during the audit.



4. Examples of Audit Documentation

Content	
A.	<p>Examples Audit Documentation can be recorded on paper, electronic media, or other forms. Examples include:</p> <ol style="list-style-type: none"> 1. Audit programmes outlining planned procedures. 2. Analyses of financial information. 3. Memoranda regarding significant issues. 4. Summaries of key significant matters. 5. Confirmation letters and letters of representation. 6. Checklists used for audit procedures. 7. Correspondence (including emails) concerning significant matters.
B.	<p>Includes Copies of Entity Records The auditor may include copies of entity records as part of audit documentation. Examples:</p>

	<ol style="list-style-type: none"> 1. Significant contracts and agreements. 2. Audit documentation does not replace the entity's accounting records.
C.	<p>Does Not Include</p> <p>The auditor need not include:</p> <ol style="list-style-type: none"> 1. Superseded drafts of working papers or financial statements. 2. Notes showing incomplete or preliminary thinking. 3. Previous versions corrected for typographical errors or other minor corrections. 4. Duplicate copies of documents.



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

Content	
A.	<p>Audit File</p> <p>An audit file is one or more folders or storage media (physical or electronic) containing the audit documentation for a specific engagement.</p>
B.	<p>Timely Preparation of Documentation</p> <ol style="list-style-type: none"> 1. Timely Basis: The auditor must prepare audit documentation on a timely basis. 2. Enhancing Quality: Timely preparation enhances audit quality and supports effective review and evaluation before finalizing the auditor's report. 3. Accuracy: Documentation prepared after the work is done is likely to be less accurate than when prepared during the audit.
C.	<p>Assembly of Final Audit File</p> <ol style="list-style-type: none"> 1. Timely Basis: The final audit file must be assembled and completed timely after the auditor's report date. 2. SQC 1 Requirement: SQC 1 requires firms to establish policies and procedures for timely completion of the audit file assembly. 3. Audits - 60 Days Limit: The time limit to complete the final audit file is usually no more than 60 days after the auditor's report date. 4. Administrative Process: The final file assembly is an administrative process and does not involve new audit procedures or conclusions. Changes are only administrative, such as: <ol style="list-style-type: none"> a. Deleting or discarding superseded documentation. b. Sorting, collating, and cross-referencing working papers. c. Signing off on checklists related to file assembly process. d. Documenting audit evidence obtained, discussed, and agreed upon before the auditor's report date.
D.	<p>Retention of Documentation</p> <ol style="list-style-type: none"> 1. No Deletion: After the final audit file is assembled, the auditor shall not delete or discard documentation before the retention period ends. 2. SQC 1 Policies: SQC 1 requires firms to have policies for the retention of audit documentation. 3. Retention Period: The retention period for audit files is typically no shorter than 7 years from the auditor's report date or the group auditor's report date, whichever is later.
E.	<p>Ownership of Documentation</p>

1. Ownership: As per **SQC 1**, audit documentation is the **property of the auditor**, unless stated otherwise by law or regulation.
2. Discretion in Sharing: The auditor may at his discretion share **portions or extracts** of documentation with clients, **provided it does not**:
 - ✓ **Undermine** the **validity** of the work performed.
 - ✓ **Affect** the auditor's **independence** in assurance engagements.

6. Documentation of Significant Matters and Related Significant Professional Judgments

Content	
A.	<p>Documentation of Significant Matters</p> <p>Judging Significance of a matters require an objective analysis of facts and circumstances. Examples of significant matters include:</p> <ol style="list-style-type: none"> 1. Matters that give rise to significant risks. 2. Results that indicate: <ul style="list-style-type: none"> ✓ The financial statements could be materially misstated ✓ A need to revise the auditor's prior risk assessment and responses. 3. Circumstances causing significant difficulty in applying necessary audit procedures. 4. Findings that could result in: <ul style="list-style-type: none"> ✓ A modification to the audit opinion. ✓ Inclusion of an Emphasis of Matter Paragraph in the auditor's report.
B.	<p>Documentation Related to Professional Judgment</p> <ol style="list-style-type: none"> 1. Importance of Judgment The form, content, and extent of documentation depend on the level of professional judgment exercised. 2. Purpose of Judgment Documentation Documentation of significant professional judgments explains the auditors' conclusions and reinforces their quality. 3. Situations Requiring Documentation The auditor must document the use of professional judgment in the following cases: <ol style="list-style-type: none"> a. Rationale for Conclusions Document the rationale when a requirement asks the auditor to consider information that is significant. Example: Reliance Company changes useful life of 90% of fixed assets; the auditor documents reasons and details of the changes. b. Subjective Judgments Document the basis for conclusions on subjective judgments, such as the reasonableness of significant accounting estimates. c. Concerns on Authenticity of Documents Document the basis for conclusions on the authenticity of documents when further investigation is undertaken. Example: Use of an expert or confirmation procedures due to concerns about authenticity.



7. Audit Summary Memorandum

Content

1.	<p>Purpose of Summary (Completion Memorandum)</p> <p>The auditor may prepare a summary (also called a completion memorandum) as part of the audit documentation that describes:</p> <ol style="list-style-type: none">The significant matters identified during the audit.How those significant matters were addressed.
2.	<p>Benefits of Summary</p> <ul style="list-style-type: none">✓ A summary can help in the effective and efficient review and inspection of audit documentation, especially for large and complex audits.✓ It also helps the auditor in considering and addressing the significant matters.
3.	<p>Achievement of SA Objectives</p> <ul style="list-style-type: none">✓ The summary may help the auditor to evaluate whether any individual SA objective that has not been achieved.✓ This is important to ensure the auditor achieves the overall objectives of the audit.

6. AUDIT EVIDENCE



1. SA 500 - Audit Evidence

A. Audit evidence - a requirement for Objective evaluation

1. **Auditing as a Logical Process**
 Auditing is a **logical process** where the auditor assesses the **actual situation**, reviews the **accounts**, and provides an **expert opinion** on the **true and fair view** of the **financial statements**.
2. **Objective Examination**
 An **objective examination** means a **critical examination** and **scrutiny** of the **financial statements** to:
 - ✓ Assess if the statements **represent the actual state of affairs**.
 - ✓ Determine whether they give a **true and fair view** of the financial results and position.

Note: An opinion based on **reckless** or **negligent examination** can **expose the auditor to legal action**, causing **loss of professional standing** and **prestige**. Hence the auditor requires evidence.

B. Audit Evidence and Inclusions

- A. **Definition**
Audit Evidence refers to the **information** used by the auditor to arrive **conclusions** which is the base for **opinion**.
Audit evidence includes
 - a. **Accounting Records:** Information in the **accounting records** underlying the **F/S**.
 - b. **Other Information:** **Additional information** that supports the auditor's opinion.
- B. **Audit Evidence Includes**
 1. **Information in Accounting Records:** Accounting records includes:
 - a. **Initial Entries** and **Supporting Records** like **checks** and **electronic fund transfers**.
 - b. **Invoices** supporting financial transactions.
 - c. **Significant contracts** related to the entity.
 - d. **General and subsidiary ledgers**, **journal entries**, and **adjustments** to the financial statements.
 - e. **Work sheets** and **spreadsheets** used for **cost allocations**, **computations**, **reconciliations**, and **disclosures**.
 2. **Other Information:** Other information **authenticates the accounting records** and supports the **true and fair view** of the financial statements, such as:
 - a. Records of **minutes** from meetings.
 - b. **Confirmations** from trade **receivables** and **payables**.
 - c. **Manuals** detailing **internal control** systems.

Note: The auditor uses a **combination** of **accounting records** and **other information**.

C. Types of Audit Evidence

<p>A.</p>	<p>Depending Upon Nature</p> <ol style="list-style-type: none"> 1. Visual: Evidence obtained through observation. Example: Observing physical verification of inventory by client staff. 2. Oral: Evidence gathered through discussions. Example: Discussions with management and client officers. 3. Documentary: Evidence obtained through documents. Example: Fixed deposit certificates, loan agreements, sales bills, etc.
<p>B.</p>	<p>Depending Upon Source</p> <ol style="list-style-type: none"> 1. Internal Evidence Evidence that originates within the organization. Examples: <ul style="list-style-type: none"> ✓ Sales invoices ✓ Goods received notes ✓ Cash memos, debit and credit notes 2. External Evidence Evidence that originates outside the client's organization. Examples: <ul style="list-style-type: none"> ✓ Purchase invoices ✓ Supplier's challans and debit/credit notes ✓ Confirmations and quotations 3. Internal and External are Complementary in nature <ol style="list-style-type: none"> a. Most evidence is internal, but substantial external evidence is also available. b. Since internal evidence is under the control of the client and staff, the auditor must be careful in relying on it. c. Internal evidence may sometimes be false or misleading to suit the client's needs, so vigilance is required. d. External evidence is usually more reliable as it comes from third parties who are less likely to manipulate data. e. If there are doubts about a third party's independence (e.g., invoice from an associated concern), the auditor must exercise greater vigilance. f. As an ordinary rule, the auditor should match internal and external evidence. g. If external evidence is unavailable, internal evidences should be corroborated.
<p>C.</p>	<p>Previous Audits</p> <p>Audit evidence comes primarily from audit procedures performed during the year, but can also include information from other sources like previous audits. The quality of audit evidence depends on its relevance and reliability.</p>

D. Relevance of an Audit Evidence

<p>1.</p>	<p>Logical Connection</p> <p>Relevance deals with logical connection between the audit procedure and the assertion tested.</p>
<p>2.</p>	<p>Direction of Testing</p> <p>The relevance of evidence is influenced by the direction of testing.</p>

	<p>Example:</p> <ul style="list-style-type: none"> ✓ Testing recorded accounts payable is relevant for overstatement. ✓ Testing unpaid invoices and supplier statements is relevant for understatement.
3.	<p>Specific Assertion</p> <p>Audit procedures provide evidence for certain assertions but not others.</p> <p>Examples:</p> <ul style="list-style-type: none"> ✓ Inspection of receivable collection: Relevant for existence and valuation but not cut-off. ✓ Existence of inventory doesn't provide evidence for valuation of inventory. Each assertion needs its own evidence.
4.	<p>Test of Controls</p> <ol style="list-style-type: none"> a. Tests of controls evaluate the effectiveness of controls in preventing, detecting, and correcting misstatements at assertion level. b. Designing TOC includes Auditors identifying: <ul style="list-style-type: none"> ✓ Conditions that indicate performance of control. ✓ Deviations that show departure from prescribed control [i.e., Failure].
5.	<p>Substantive Procedures</p> <ol style="list-style-type: none"> a. Substantive procedures are designed to detect material misstatements at assertion level and include: <ul style="list-style-type: none"> ✓ Tests of details. ✓ Substantive analytical procedures. b. Designing S/P includes, Auditors identify conditions that indicate a misstatement in the relevant assertion.

E. Reliability

1.	<p>Factors Affecting Reliability</p> <p>Reliability of audit evidence depends on its source, nature, and circumstances of acquisition. Even external information may lack reliability if the source lacks knowledge or objectivity. Example: Management expert's lack of objectivity reduces reliability.</p>
2.	<p>Generalisations on Reliability of Audit evidence</p> <p>While recognising exceptions may exist, the following generalisations about reliability may be useful:</p> <ol style="list-style-type: none"> a. Independent Sources: Reliability is increased if the evidence is from independent sources outside the entity. b. Effectiveness of Controls: Internally generated evidence is more reliable if related controls (e.g., controls over preparation and maintenance) are effective. c. Obtained Directly: Evidence obtained directly by the auditor (e.g., observation) is more reliable than evidence obtained indirectly (e.g., inquiry). d. Documentary Form: Documentary evidence (paper, electronic, etc.) is more reliable than oral evidence. [Example: A written record is more reliable than oral discussions] e. Original Evidence: Original documents are more reliable than copies or transformed documents (e.g., photocopies, digital versions). Reliability depends on controls over their preparation and maintenance.

F. Need for Sufficient and Appropriate Audit Evidence [S&A Evidence]

1.	<p>Importance of Audit Evidence</p> <ul style="list-style-type: none"> ✓ Most of the auditor's work involves obtaining and evaluating audit evidence to support the auditor's opinion and report. Evidence is cumulative in nature and primarily obtained through audit procedures. ✓ Audit evidence may also include information from other sources, such as previous audits.
2.	<p>Entity's Records and Experts work</p> <ul style="list-style-type: none"> ✓ The entity's accounting records are a key source of audit evidence. ✓ Audit evidence may include information prepared using the work of a management's expert.
3.	<p>Both Supporting and Contradicting Evidence</p> <p>Audit evidence comprises:</p> <ul style="list-style-type: none"> ✓ Information that supports and corroborates management's assertions. ✓ Information that contradicts management's assertions.
4.	<p>Absence of Information</p> <p>In some cases, the absence of information (e.g., management's refusal to provide requested representations) also constitutes audit evidence.</p>
5.	<p>Audit Procedures</p> <p>Audit evidence is obtained by performing following audit procedures:</p> <ol style="list-style-type: none"> a. Inquiry b. Inspection c. Observation d. Confirmation e. Recalculation f. Re-performance g. Analytical Procedures <p>Note: While inquiry is important and may provide evidence of misstatements, Inquiry alone does not provide sufficient evidence of:</p> <ul style="list-style-type: none"> ✓ The absence of material misstatements at the assertion level. ✓ The operating effectiveness of controls.

G. Sufficiency and Appropriateness of Audit evidence

	<p>Interrelation</p> <p>Sufficiency and appropriateness of audit evidence are interrelated.</p>
1.	<p>Sufficiency of Audit Evidence</p> <p>Sufficiency measures the quantity of audit evidence. The quantity of evidence depends on:</p> <ol style="list-style-type: none"> 1. Risk of Misstatement <ul style="list-style-type: none"> ✓ Higher risk of misstatement, more evidence needed. ✓ Lower risk, less evidence required. 2. Quality of Evidence <ul style="list-style-type: none"> ✓ Higher quality of audit evidence, less quantity required; ✓ Lower quality, more evidence needed.

Factors Influencing Sufficiency

Additional factors affecting sufficiency of audit evidence:

a. **Materiality**

Materiality refers to the significance of transactions, account balances, and disclosures to **users** of financial statements. Example:

- ✓ Less evidence is required for **less material assertions**.
- ✓ More evidence is required for **more material assertions**.

b. **Risk of Material Misstatement**

The **risk** that financial statements are materially misstated **prior to audit**, includes:

i. **Inherent Risk**

The **susceptibility** of an assertion to misstatement **before considering controls**.

ii. **Control Risk**

The risk that **internal controls** fail to **prevent, detect, or correct** a misstatement.

Example:

- ✓ Lower **risk**, Less evidence;
- ✓ Higher **risk**, More evidence.

c. **Size of Population**

Refers to the **number of items** in the population. Example:

- ✓ Smaller, **homogeneous** populations, **less evidence** needed.
- ✓ Larger, **heterogeneous** populations, **more evidence** required.

2. **Appropriateness of Audit Evidence**

Appropriateness is a measure of **quality** of audit evidence based on:

- ✓ **Relevance**: Evidence must **logically relate to the assertion** being tested.
- ✓ **Reliability**: Influenced by the **source, nature, and circumstances** under which the evidence is obtained.

Note: Obtaining **more audit evidence** cannot compensate for its **poor quality**.

H. Source of Audit Evidence

1. **Testing Accounting Records**

a. Some **audit evidence** is **obtained** by performing audit procedures to **test accounting records**. Examples include:

- ✓ Performing **analysis and review** of accounting records.
- ✓ **Reperforming** procedures followed in the **financial reporting process**.
- ✓ **Reconciling** related types and applications of the **same information**.

b. These procedures help determine whether the **accounting records** are **internally consistent** and agree with the **financial statements**.

2. **Consistent Audit Evidence**

More assurance is obtained when audit evidence is:

- ✓ **Consistent** across different sources.
- ✓ From different **types or natures** of evidence.

Example

Information **corroborated** by **independent sources** increases assurance i.e., Evidence from **accounting records, minutes of meetings, or management representations** is more reliable when **supported by external sources**.

3. External Sources Includes
 Audit evidence from sources independent of the entity includes:
- ✓ Confirmations from third parties.
 - ✓ Analysts' reports.
 - ✓ Comparable data about competitors.

I. Audit Procedures to obtain Audit Evidence

1. Inspection
 - ✓ Involves Examining records, documents (paper / electronic), whether internal or external, or physical examination of an asset.
 - ✓ Provides evidence of varying degree of reliability based on the nature, source, and controls over production.

Example

 - ✓ Inspecting records for authorization (For test of controls).
 - ✓ Inspecting contracts for revenue recognition policies.
 - ✓ Inspecting tangible assets to confirm existence, not necessarily rights or valuation.
 - ✓ Inspection of individual inventory items may accompany the observation of inventory counting.
2. Observation
 - ✓ Consists of Looking at a process or procedure being performed by others.
 - ✓ The evidence provided by observation is limited to the point in time of observation and the fact that being observed affects the process performed.

Example: Observing inventory counting or control activities.
3. External Confirmation
 - ✓ Audit evidence obtained as a Direct written response to the auditor from a third party (paper, electronic, or other media).
 - ✓ Frequently Used for addressing assertions related to account balances, terms of agreements, or the absence of conditions.

Examples

 - ✓ Confirming terms of a contract.
 - ✓ Confirming the absence of a "side agreement" affecting revenue recognition.
4. Recalculation

Checking the mathematical accuracy of records or documents, performed manually or electronically.

Example: Recalculating depreciation schedules or totals in financial statements.
5. Re-performance

Auditors' Independent execution of procedures or controls originally performed as part of internal control.

Example: Re-performing bank reconciliation or aging of accounts receivable.
6. Analytical Procedures
 - ✓ Evaluations of financial information based on plausible relationships among financial and non-financial data.
 - ✓ Includes Investigating identified fluctuations or relationships inconsistent with other information or deviated from predicted amounts.

7. Inquiry
- ✓ Consists of Seeking information from knowledgeable persons within or outside the entity.
 - ✓ Inquiries can be formal written or informal oral.
 - ✓ Response to inquiry may provide the auditor with:
 - New information or Corroborative evidence, or
 - Provide information that is significantly different from other information
 - Provide a basis for the auditor to modify or perform additional audit procedures.
 - ✓ When necessary, auditors obtain written confirmations from management or those charged with governance.

Inquiries about Management Intent

Inquiries about management intent, the information available may be limited. In these cases, the auditor evaluates:

- a. Managements Past history of carrying out stated intentions.
- b. Management's reasons for choosing a particular course of action.
- c. Management's ability to pursue specific course of action.

Used in Combination

- a. Audit procedures (e.g., inspection, observation, confirmation) in combination with inquiry are used as risk assessment, test of controls, or substantive procedures.
- b. Audit evidence obtained in previous audits may remain relevant if procedures confirm its continuing relevance.

J. Timing of Audit procedures when accounting records in Electronic Form

1. **Impact on Nature and Timing**
 Nature and timing of audit procedures may be affected if accounting data is:
 - ✓ Available only in electronic form.
 - ✓ Available only at specific points or periods in time.
 Example
 - ✓ Source documents (e.g., purchase orders, invoices) may exist only electronically when entities use e-commerce.
 - ✓ Documents may be discarded after scanning in image processing systems.
2. **Non-Retrievable Information**
 Some electronic information may not be retrievable after a certain period, such as:
 - ✓ Files that are changed.
 - ✓ Absence of backup files.
3. **Auditor's Actions**
 In the above cases, Due to the entity's data retention policies, the auditor may need to:
 - ✓ Request retention of certain information for audit review.
 - ✓ Perform audit procedures at the time when information is available.

K. Risk Assessment and Further Audit Procedures

Audit Evidence: The auditor obtains required audit evidence by performing the following audit procedures.

1. **Risk Assessment Procedures**
 Risk assessment procedures are performed to:
 - ✓ Obtain an **understanding** of the **entity** and its **environment**.
 - ✓ Understand the entity's **internal control**.
 - ✓ Identify and assess **risks of material misstatement** (due to **fraud or error**) at the **financial statement and assertion levels**.
2. **Further Audit Procedures**
 Further Audit Procedures consist of:
 - a. **Tests of Controls:**
 - ✓ Tests of controls are procedures designed to **evaluate the operating effectiveness of controls** to prevent, detect, and correct **material misstatements** at the **assertion level**.
 - ✓ Tests of controls are performed:
 - When **required** by the **SAs**.
 - When the auditor **chooses** to perform them.
 - b. **Substantive Procedures**
 - ✓ **Substantive procedures** are designed to **detect material misstatements** at the **assertion level**.
 - ✓ Substantive procedures include:
 - **Tests of details** (specific account balances, transactions, and disclosures).
 - **Substantive analytical procedures** (evaluation of relationships between financial/non-financial data).

L. Concept of Assertions

1. **Meaning**
Assertions are **representations** by **management**, explicit or implicit, that are embodied in the financial statements, which are used by auditors to identify potential **misstatements**.
2. **Usage of Assertions**
 - a. **By Management:** Management makes implicit or explicit assertions about **Recognition, measurement, presentation, and disclosure** of financial statement elements.
 - b. **By Auditor:** Auditors use assertions to identify different types of potential **misstatements** and are divided into 3 categories:
 - i. **Assertions Related to Class of Transactions and Events [T&E]:**

Assertion	Meaning
Occurrence	T&E and events occurred and relate to the entity.
Completeness	All T&E that should have been recorded are recorded .
Accuracy	T&E are recorded appropriately with correct amounts .
Cut-off	T&E are recorded in the correct accounting period .
Classification	T&E are recorded in the proper accounts .

ii. Assertions Related to Account Balances:

Assertion	Meaning
Existence	Assets, liabilities, and equity interests exist.
Rights and Obligations	The entity holds rights to assets, and liabilities are its obligations.
Completeness	All assets, liabilities, and equity balances are recorded.
Valuation and Allocation	Balances are recorded at appropriate amounts with correct valuations and adjustments.

iii. Assertions Related to Presentation and Disclosures:

Assertion	Meaning
Occurrence and Rights	Disclosed T&E and other matters have occurred and relate to the entity.
Completeness	All required disclosures are included.
Classification & Understandability	Financial Information is appropriately presented and described and disclosures are clearly expressed
Accuracy and Valuation	Disclosed items are fair and at appropriate amounts.

3. Combination of Assertions

Auditors may combine assertions across transactions and balances, provided all aspects are covered.

4. Consideration of Law and Regulation

For certain entities (e.g., Government stakeholders), management may assert that T&E have been complied with laws and regulations. Such assertions also fall within the scope of audit.

Each financial statement item asserts something (e.g., ownership, existence, or quantity), and the auditor tests the authenticity of these assertions.

Example 1: When we find in the balance sheet, an item under current assets reading as "cash in hand - Rs. 8,000"

The obvious assertions that would strike the mind are the following:

- The firm concerned had Rs. 8,000 in hand in valid notes and coins on the balance sheet day.
- That the cash was free and available for expenditure to the firm and
- That the books of account show a cash balance of identical amount at the end of the day on which the balance sheet is drawn up.

Example 2:

Particulars	Rs.	Rs.
Plant and Machinery (at cost)		2,00,000
Less: Depreciation till the end of previous year	70,000	
Less: Depreciation for the current year	13,000	(83,000)
Net WDV		1,17,000

The assertions are as follows:

- The firm owns the plant and machinery.
- The historical cost of plant and machinery is Rs. 2 lacs.
- The plant and machinery physically exist.

- d. The asset is being utilised in the business of the company productively.
- e. Total charge of depreciation on this asset is Rs. 83,000 to date on which Rs. 13,000 relates to the year in respect of which the accounts are drawn up. and
- f. The amount of depreciation has been calculated on recognised basis and the calculation is correct.

5. Nature of Assertions

Assertions in financial statements can be **explicit** or **implied**:

- a. **Implied Assertions**: Generally, assertions are **not specifically stated** but are **implied** in the financial statements.
- b. **Explicit Assertions**: Explicit assertions are made when **specific details** are needed to give a **complete picture**. Without them, information may be **misleading**.
Example: Secured Loans Rs. 4,00,000. This is not giving a complete picture and we do not know:
 - ✓ The **name of the lender**.
 - ✓ The **nature of security** provided.
 - ✓ The **interest rate** payable.

6. Negative Assertions

Negative assertions can be **expressed** or **implied** in the financial statements:

- a. **Explicit Negative Assertion**: Directly stated, negative assertions.
Example: Stating there is **no contingent liability**.
- b. **Implied Negative Assertion**: Indirect assertions when an **item is absent in the financial statements**.
Example: If there is **no "building"** item in the balance sheet, it implies the entity **does not own** any building.

7. Audit opinion shall be based on Overall Representation

Financial statements contain an **overall representation** in addition to specific assertions:

- a. **Purpose of Overall Representation**
Each statement presents a **whole picture**:
 - ✓ The **income statement** shows "**results of operations**."
 - ✓ The **balance sheet** shows the "**financial position**."
- b. **Auditor's Role**
The auditor's opinion is based on the **overall representation**. To form this opinion, the auditor examines:
 - ✓ **Specific assertions** (expressed and implied).
 - ✓ Both **positive** and **negative** assertions.
 - ✓ **Individual judgments lead to** a conclusion on the financial statements as a whole.

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

When **information to be used as audit evidence** has been prepared using the work of a **management's expert**, the nature, timing and extent of audit procedures may be affected by such matters:

1. Nature and **complexity** of the matter.
2. **Risks of MMS** in the matter.
3. **Nature, Scope, and Objectives** of the management's expert's work.
4. Whether the expert is **employed** by the entity or **engaged as an outsider**.

5. Extent of management's control or influence over the expert's work.
6. Whether the expert follows technical standards or industry requirements.
7. Auditor's knowledge and experience of the expert's field.
8. Auditor's previous experience with the expert's work.

N. Information Prepared by Management - Used as Audit Evidence

When using information produced by the entity, Auditor evaluates whether the information is sufficiently reliable. This Includes

1. Obtaining evidence about accuracy and completeness of the data.
2. Evaluating whether the information is sufficiently precise and detailed.

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

1. Inconsistent Evidence	When audit evidence from one source is inconsistent with evidence from another source. Example: Responses to inquiries from management, internal audit, or others conflicting each other.
2. Doubts on Reliability	When the auditor has doubts about the reliability of information used as audit evidence. Then, <ul style="list-style-type: none"> ✓ The auditor must determine what modifications or additions to audit procedures are needed to resolve the matter. ✓ The auditor must consider the effect on other aspects of the audit.
3. Documentation	<ul style="list-style-type: none"> ✓ If the auditor identifies information inconsistent with the final conclusion on a significant matter, it must be documented. ✓ SA 230 requires specific documentation of such inconsistencies.

P. Factors to be considered while placing reliance on Management expert

1.	Management's Expert Means An individual or organization with expertise in a field other than accounting or auditing, whose work in that field is used by the entity in preparation of financial statements.
2.	Auditor Relying on Work of Management's Expert <ol style="list-style-type: none"> a. If the entity employs experts, the auditor can rely on their work if he is satisfied that sufficient and appropriate audit evidence is obtained to form an opinion on the financial statements. b. When using the work of a management's expert as audit evidence, the auditor must: <ul style="list-style-type: none"> ✓ Evaluate the expert's competence, capabilities, and objectivity. ✓ Obtain an understanding of the work performed by the expert. ✓ Evaluate if the expert's work is appropriate as audit evidence for the relevant assertion being tested.

Q. Evaluation of Audit Evidence

1.	<p>Applicability of SA 500 SA 500 (Audit Evidence) applies to all audit evidence obtained during the audit. It ensures the auditor obtains sufficient appropriate audit evidence to form reasonable conclusions for the auditor's opinion.</p>
2.	<p>Role of Audit Evidence Most of the auditor's work involves obtaining and evaluating audit evidence to form their opinion.</p>
3.	<p>Auditor's Professional Judgment The auditor must conclude whether sufficient appropriate audit evidence has been obtained. This reduces audit risk to an acceptably low level and enables the auditor to draw reasonable conclusions.</p>

R. Means of selecting items for TOC and TOD

<p>Selecting All Items (100%)</p>	<ol style="list-style-type: none"> Examining the entire population of items within a class of transactions, account balance, or a stratum. More common for Tests of Details and Unlikely for Tests of Controls. This testing approach is Appropriate when: <ol style="list-style-type: none"> Small number of large value items. Significant risk exists and other procedures are insufficient. Repetitive calculations by automated systems make it cost-effective.
<p>Selecting Specific Items</p>	<ol style="list-style-type: none"> Choosing specific items from the population using judgmental selection. Factors for selection: <ol style="list-style-type: none"> Understanding of the entity. Assessed Risks of MMS. Characteristics of the Population. Judgemental selection is subject to non-sampling risk and Specific Items selected may include: <ol style="list-style-type: none"> High-value or key items: Items with high value, risk-prone, unusual, or error-prone history. Items over a certain amount: To verify a significant portion of the class. Items to obtain information: Understand entity or transaction nature.
<p>Audit Sampling</p>	<p>Drawing conclusions about entire population by testing a sample drawn from it.</p>



2. Concept Of Audit Trail

Meaning and Benefits of Audit Trail

1.	<p>Meaning of Audit Trail An audit trail is a documented flow of a transaction that helps trace how a source document leads to an account entry and ultimately into the financial statements.</p> <ol style="list-style-type: none"> Purpose: It is used as audit evidence to establish authentication and integrity of a transaction. Example: Banks maintain audit trails to record log-on activity, including log-on attempts and devices used.
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- b. Traceability: It is a **step-by-step record** that traces **accounting**, trade, or financial data back to its **source**.
- c. Fraud Prevention: **Audit trails** document evidence of events to reduce **fraud**, **material errors**, and **unauthorized use**.
- d. Costs Involved: Maintaining audit trails **involves costs such as**,
 - ✓ System expenditure.
 - ✓ Time required to **analyse data**.
 - ✓ **Automated tools** can analyse large volumes of data efficiently.

2. Benefits of Audit Trail

- a. Enhancing Internal Controls: Audit trails **strengthen internal controls** and **improve data security** by:
 - ✓ **Fixing responsibility** for user activities.
 - ✓ **Rebuilding events** when problems occur, helping in their **analysis**.Example: Tracking user activities to identify responsibility for specific actions.
- b. Problem Analysis: Audit trail analysis **helps**:
 - ✓ Identify the **reason for problems**.
 - ✓ Ensure that the **system operates as intended** during regular operations.
- c. Auditor Confidence: Systems with audit trail features **build confidence in auditors** by verifying whether **management controls** were operating **effectively**.
- d. Transaction Verification:
 - ✓ Audit trail helps to **verify if a transaction was performed by an authorized person**.
 - ✓ They **enhance data security** and increase the **reliability of audit evidence** obtained during audits.



3. SA 610 Using the Work of Internal Auditor

A. Internal Audit Function and Objectives

Meaning

A function of the entity that performs assurance and consulting activities to evaluate and improve:

- Entity's Governance processes
- Risk management
- Internal control processes

Activities Related to Governance

Evaluates the governance process in achieving objectives on:

- Ethics and Values
- Performance Management and accountability.
- Ensure risk and control information is communicated effectively within the organization.
- Effectiveness of communication among TCWG, management, and auditors.

Activities Related to Risk Management

- Risk Exposure: Identify and evaluate significant risks.
- Contribute to improving internal controls.
- Fraud Detection: Perform procedures to assist in detecting fraud.

Activities Related to Internal Controls

- Evaluation of Controls: Specific responsibility to review and recommend improvements in controls. For example:
 - ✓ Test controls for design, implementation, and operational effectiveness.
 - ✓ Provide assurance on internal controls relevant to the audit.
- Examination of Financial and Operating Information: Review methods for identifying, measuring, classifying, and reporting financial information including detailed testing of transactions and balances.
- Review of Operating Activities: Assess the economy, efficiency, and effectiveness of operations, including non-financial activities.
- Review of Compliance with L&R: Review compliance with laws, regulations, management policies, and internal directives.

B. 2 Types of usage of work of Internal Auditor

Using Work Performed by Internal Audit Function (Type 1)

- ✓ To Obtain information relevant to the external auditor's assessment of risks of material misstatement (error or fraud).
- ✓ If not prohibited by law or regulation, the external auditor may, after evaluation, use work performed by the internal audit function.
- ✓ This work may partially substitute for audit evidence to be obtained directly by the external auditor.

Direct Assistance (Type 2)

- ✓ If not prohibited by law or regulation, internal auditors may perform audit procedures under the direction, supervision, and review of the external auditor.

C. External Auditor's responsibility under SA 610

External Auditor's responsibility	<p>Sole Responsibility</p> <ul style="list-style-type: none"> ✓ External auditor has sole responsibility for the audit opinion expressed. ✓ This responsibility is not reduced by using the internal audit function or direct assistance. ✓ The external auditor is not required [No compulsion] to use internal audit work to modify or reduce procedures. It remains the absolute discretion of the external auditors.
Purpose of SA 610	<ul style="list-style-type: none"> ✓ Defines conditions that are necessary for external auditors to be able to use the work of internal auditors. ✓ Provides a framework for external auditor's judgment to avoid over or undue reliance while using the work of internal auditor.

D. Objective of External Auditor

Objective	<ul style="list-style-type: none"> ✓ Determine if the work of the internal audit function or direct assistance from internal auditors can be used. ✓ Identify which areas and to what extent internal audit work or assistance will be used.
Type 1	<ul style="list-style-type: none"> ✓ Determine whether the internal audit work is adequate for the purposes of the audit.
Type 2	<ul style="list-style-type: none"> ✓ Appropriately direct, supervise, and review the work performed by internal auditors.

E. Evaluating Internal Audit Function before using Type 1 Work

1. Objectivity and its Evaluation

The extent to which the **IAFs organizational status** and **relevant policies** support their **objectivity**. The following are the factors:

- a. **Organisational Status**: **Whether Authority and accountability** of IAF supports the ability to function free from bias or conflicts or undue influence.
E.g., **Whether they Report to TCWG** or **having direct access** to them.
- b. **Governance Oversight**: **Employment decisions** overseen by **TCWG**
E.g., **Remuneration policy**.
- c. **Restrictions**: **Any Constraints or Restrictions** on IAF such as **whether management restricts communication** of internal audit findings to the external auditor.
- d. **Conflicting Responsibilities**: Ensure internal auditors do not have **managerial or operational duties** outside their role.

2. Competence

The level of competence of the internal audit function. Refers to knowledge and skills required to perform tasks **diligently** and as per standards.

- a. Resourcing: Adequate resources **relative to entity size and operations**.
- b. Hiring and Training Policies: Established **policies** for **hiring, training, and assigning** auditors to tasks.
- c. Technical Proficiency: Internal auditors have **adequate technical training** in auditing.
- d. FRFW Knowledge: Whether IAF possess required **knowledge of the entity's FRFWs**.

Objectivity and Competence

Interrelationship

Both **objectivity** and **competence** are critical to determine if and how much internal audit work can be used.

Viewed as Continuum

- a. Stronger the organisations **support to objectivity** and **higher the competence** of IAF, more likely external auditors use **their work**.
- b. **Objectivity** cannot compensate for lack of competence.
- c. **Competence** cannot compensate for lack of objectivity.

3. Systematic and Disciplined Approach

Whether the internal audit function **applies a systematic and disciplined approach**, including quality control such as Internal audit activities are planned, performed, supervised, reviewed, and documented systematically. The IAF activities **are different from entity's monitoring control activities**. The following are the factors

- a. Documented Procedures: Existence and adequacy of **internal audit procedures** (e.g., risk assessment, work programs, reporting).
- b. Quality Control Policies: Existence of **quality control policies** and procedures.

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

- 1. If the IAFs **objectivity is not adequately supported** by Organizational Status & Policies.
- 2. If the IAF lacks **sufficient competence**.
- 3. If the IAF does not apply a **systematic and disciplined approach, including quality control**.

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

Basis for Determining Use

Nature and Scope: External auditor considers the **nature** and **scope** of work performed or planned by the **internal audit function**.

Relevance: Assess the **relevance** of this work to the external auditor's **overall audit strategy and audit plan**.

Examples of work that can be used by the external auditor include

- a. TOC: Testing the **operating effectiveness** of controls.
- b. Substantive Procedures: Performing **substantive procedures** involving Limited Judgment.
- c. Inventory Observations: Observing **inventory counts**.
- d. Tracing Transactions: Tracing transactions through the **information systems**.
- e. Regulatory Compliance: Testing **compliance with regulatory requirements**.

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

More Judgment Involved

- ✓ The more judgment required in planning and performing audit procedures.
- ✓ The more judgment involved in evaluating audit evidence gathered.

High Risk of MMS at Assertion level

- ✓ If the assessed risk of material misstatement at the assertion level is higher, with focus on significant risks.

Lack of Objectivity

- ✓ The IAFs objectivity is Not adequately supported by its status and policies.

Lack of Competence

- ✓ The lower the level of competence of the internal audit function.

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

1. Discuss Planned Usage

The external auditor shall discuss the planned use of the IAF work to coordinate respective activities. It is useful to address the following:

- a. The timing of the work.
- b. The nature of the work performed.
- c. The extent of audit coverage.
- d. Materiality levels for the financial statements as a whole, and for specific classes or balances.
- e. Proposed methods for item selection and sample sizes.
- f. Documentation of the work performed.
- g. Review and reporting procedures.

2. Review Internal Audit Reports

The external auditor shall read reports of the internal audit function to understand the nature, extent of procedures performed, and related findings.

3. Perform Audit Procedures

The external auditor shall perform sufficient audit procedures on the internal audit work planned for use to assess its adequacy for audit purposes.

J. Effective Coordination between External Auditor and IAF

Coordination is effective when:

1. Discussions takes place at appropriate intervals throughout the period.
2. The external auditor informs internal audit of significant matters that may affect their work.
3. The external auditor has access to relevant reports and is informed of significant findings.

K. EA usage of IAFs staff for Direct Assistance [Type 2]

1. Direct Assistance

Refers to the use of internal auditors to perform audit procedures under the direction, supervision, and review of the external auditor.

2. Evaluation by EA Prior to usage under Direct Assistance

If not prohibited by law or regulation, the external auditor shall:

- a. Assess the competence of internal auditors providing direct assistance.

- b. The existence and significance of threats to objectivity
- c. Make **inquiries** with internal auditors regarding relationships or interests that may affect objectivity.

3. Prohibition on Type 2

External auditor **shall not** use internal auditors if:

- a. There are **significant threats** to objectivity.
- b. Internal auditors lack **sufficient competence**.

4. Restrictions on scope of work from Direct Assistance

External auditor **shall not** use internal auditors for direct assistance for procedures that:

- a. Involve making **significant judgments**.
- b. Relate to **higher assessed risks of material misstatement** requiring significant judgment.
- c. Relate to **work already performed** or planned to be performed to **management** or **TCWG**.
- d. **Relate to decisions** the external auditor makes under this SA 610.

5. Written Agreements

Before using internal auditors for **direct assistance**, the external auditor **shall obtain**:

- a. From Management: Written agreement the management will allow the internal auditors to perform **under the external auditor's instructions without intervention**.
- b. From Internal Auditors: Written agreement to:
 - ✓ **Maintain confidentiality** as instructed by EA.
 - ✓ **Inform** the external auditor of any **threats to objectivity**.



4. SA 530 Audit Sampling

A. Introduction to Sampling

1. Traditional Audit Approach

- a. Economically Wasteful: Traditional audit is economically wasteful which focuses on checking **all transactions**, leading to unnecessary **routine checking**.
- b. Routine Checking: Routine checking involves extensive **vouching** of all entries, ignoring the concept of **materiality**.

2. Changing Audit Approach - Focus on Principles and Controls

- a. Audit is **shifting from irrelevant routine checking** to focus on principles and controls.
- b. With shift in favour of effective **internal controls** the routine **errors** and **frauds** have greatly diminished.

3. Auditor's Judgment in Extent of Checking

- a. The **extent of checking** is determined by the **auditor's judgment**. There is no statutory requirement for:
 - ✓ **What** work to do,
 - ✓ **How** to perform it, and
 - ✓ To **what extent** it should be done.
- b. The auditor's primary role is to provide an **opinion** on the **financial statements**.

4. Standards and Techniques

- a. Auditors are **not legally bound to use sampling techniques**.
- b. If **sampling** is used, the auditor should **rely on techniques with a recognized basis**.
- c. Statistical Sampling:
 - ✓ The **statistical theory of sampling** is **scientific, reliable, and widely accepted**.
 - ✓ Sampling allows auditors to make **conclusions** and express a fair opinion without checking all items.

B. Audit Sampling and Objective of Auditor under SA 530

Audit Sampling

Refers to **applying audit procedures** to less than 100% of items in a population to draw conclusions about the **population**.

Objective of Auditor

To provide a **reasonable basis** for drawing **conclusions about the population**.

Applicability

1. SA 530 Applies when the **auditor decides to use audit sampling** to perform audit procedures.
2. This SA deals with:
 - ✓ **Designing and Selecting** the Audit sample and
 - ✓ Performing **TOC and TOD** and
 - ✓ **Evaluating** the **results** from sample
3. There are 2 approaches for Sampling
 - ✓ Statistical Sampling
 - ✓ Non-Statistical Sampling

C. Definition of Population and Characteristics of Population

Population

Refers to the **entire set of data** from which a **sample is selected**, and conclusions are drawn.

Characteristics of Population

The sample items must be **representative** of the **population**. The following important characteristics:

1. Appropriateness

- a. **Meaning:** The population used for sampling must be **relevant to the specific audit objective** as projections are made on the **population**.
- b. **Purpose:** **Audit procedures** are applied on the **sample**, and conclusions are drawn on the **population**.
- c. **Example:**
 - ✓ Testing **overstatement of accounts receivable** → Use the **accounts receivable listing**.
 - ✓ Testing **understatement of accounts payable** → Use **Subsequent disbursements, unpaid invoices, suppliers' statements, etc.**

2. Completeness

- a. **Meaning:** Population must include **all relevant items** throughout the **entire audit period**.
- b. **Purpose:** A complete population ensures that **conclusions drawn are reasonable**.
- c. **Example:** If testing a **control activity**, the population must cover all activities related to the control throughout the period.

3. Reliability

- a. **Meaning:** The population must be **sufficiently complete and accurate** for audit sampling. Auditor performs **procedures** to ensure the population is **reliable**.
- b. **Reliable evidence:**
 - ✓ Auditor shall obtain **evidence about the accuracy and source** of the population.
 - ✓ If the **population is not reliable**, the **sample will not be relevant** for the audit objective.

D. Sampling Unit

Sampling Unit: Individual items that make up the **population** are called **sampling units**.

Note: The **population can be divided** into sampling units in various ways.

Extrapolation:

- a. **Audit procedures** are applied on these units which are selected from population, and **conclusions** are projected to the **population**.
- b. **Conclusions drawn on sample** becomes conclusion on population

Example:

For **Trade Receivables**, Sampling units can be **customer balances** or **individual invoices**

E. Approach to Sampling

Types of Sampling

1. There are 2 approaches to Audit Sampling
 - a. Statistical Sampling
 - b. Non-Statistical Sampling
2. **Auditor's Judgment:** The decision to use **statistical** or **non-statistical sampling** depends on the auditor's **judgment**.

Note: **Sample size** is not a valid criterion to distinguish between statistical and non-statistical approaches.

Statistical Sampling

- a. **Random selection** of sample units.
- b. Use of **probability theory** to evaluate results.
- c. Measurement of **sampling risk** characteristics
- d. Sample is chosen using **mathematical** and **statistical methods**.

Non-Statistical Sampling

Sampling approach that **does not** use the features of **statistical sampling**.

F. Representative Sample

1. **Representative**: The sample must be **representative**. Sample must be **closely similar** to the **population**, though not identical.
2. **Sample Size**: Must be **large enough** to provide **statistically meaningful** results.
3. **Sampling Process**: Sampling is performed on:
 - a. **TOC**: To **identify deviations** from expected internal controls.
 - b. **TOD**: To **identify misstatements** in account balances or class of transactions.

G. Difference Between Statistical Sampling and Non-Statistical Sampling

Statistical Sampling

1. Audit testing is **scientific** as it uses **laws of probability** to determine appropriate sample size.
2. Suitable for populations with **large numbers** of similar items. Common form, **Compliance testing**, **receivables' confirmation**, **payroll checking**, **vouching**.
3. **Reduces personal bias** as sample selection is objective.
4. Results can be **evaluated scientifically and reliably** projected to the whole population.
5. For **large organisations** with huge transactions, statistical sampling is **recommended**.

Example

Verifying purchases with **45,000 transactions** - use **random sampling** under statistical methods.

Non-Statistical Sampling

1. Sample size and selection depend on the auditor's **personal experience and judgment**.
2. **Objectivity cannot be assured** and Risk of personal bias cannot be eliminated.
3. **Year-End Checking**: Focus on checking **year-end transactions** to assess **cut-off procedures** and identify **risks**.
4. **Not Scientific**: Lacks **scientific objectivity** and is criticized for being subjective.
5. **Measurement Risk**: Closeness of **sample results** to the population **cannot be measured** due to absence of statistical techniques.
6. **Not Representative**: The sample may **not represent** the population due to **personal bias** and **unscientific selection**.

Example

Selecting specific months like **March, June, September** or **highest-value items**.

H. How Sampling is different from Traditional methods

Good Satisfaction: Audit evidence is rarely **conclusive**. Even with **100% checking**, auditors cannot derive **absolute satisfaction**. Auditors achieve good satisfaction by checking less using the **sampling technique**.

Representative Sample: If a sample is chosen **randomly**, it reflects the **features** and **characteristics** of the **population**.

Sample Reliability: **Reliability** of sample checking depends on the effectiveness of **internal controls** within the organization.

Test of Controls:

- ✓ Sampling is part of the **Test of Controls** to check internal controls' **operating effectiveness**.
 - **Satisfactory Controls** leads to smaller sample will be sufficient
 - **Weak Controls** leads to larger sample for satisfactory results.

Professional Judgment

Estimation Process: Sampling is a process of **estimation** and may have **errors**. The acceptable **tolerable error** depends on the auditor's **judgment**.

Example

Example: Mr. X tolerates a **2% error** in stores valuation and expects **98% reliability**.

I. Factors for Extent of Checking on a Sampling Plan

1. **Size** of the Organisation
2. State of the **internal control**.
3. Adequacy and **reliability** of books and records.
4. **Tolerable error** range.
5. Degree of the **desired confidence**.

Tolerable error means is the **maximum error in the population** that auditor is ready to accept in a given sample size. Smaller the tolerable error, larger will be the sample size.

J. Advantages of Statistical Sampling

Reduced testing

Testing does not increase proportionately with the size of the universe.

Objective selection

Sample selection is **more objective** and **defensible**.

Minimum Sample Size

Provides a way to estimate **minimum sample size** with specified **risk** and **precision**.

Calculated Risk

Enables estimation of **calculated risk** and **sampling error** - the probable difference compared to examining the entire group (universe).

Low non-sampling errors

Provides **better description** of large mass of data and reduces **non-sampling errors** like clerical and processing mistakes.

Scientific and Reliable

It is scientific, **free of personal bias**, and **results can be evaluated** and **projected reliably**.

K. When Not to Use Statistical Sampling

Sometimes, statistical sampling methods may not be appropriate. For example:

1. Exact accuracy is needed (e.g., legal requirements).
2. Audit staff lacks knowledge of sampling techniques, making it complex and inappropriate.
3. Usage of another approach provides satisfactory information in less time or with less effort.

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

Sample Design: The auditor considers the purpose of the audit procedure and the characteristics of the population from which the sample is drawn.

Sample Size The auditor determines a sample size that is sufficient to reduce sampling risk to an acceptable low level.

Sample Selection: Selection must be in a way each item in the population has a chance of selection.

M. Factors while choosing Sample Design

1. Purpose of Audit Procedure

The auditor considers the specific purpose and identifies the combination of audit procedures to achieve that purpose.

2. Nature of Audit Evidence sought

Understanding the nature of audit evidence and possible deviation or misstatement assists in defining the population for sampling.

3. Identify what constitutes deviation or Misstatement

Auditor must clearly identify what constitutes a deviation or misstatement to ensure only relevant conditions are considered in the audit.

Example: Testing existence of accounts receivable:

- a. Payments made before confirmation date and received shortly after that date are not considered as misstatement.
- b. Wrong postings between customer accounts do not impact the total balance but may affect fraud assessment or adequacy of provision for doubtful debts.

4. Tests of Controls

Auditor assesses the expected rate of deviation to design the audit sample and determine sample size.

Example: If the rate of deviation is unacceptably high, the auditor may choose not to test controls.

5. Tests of Details

Auditor assesses the expected misstatement in the population to determine sampling design.

Example: If misstatement is high, the auditor may conduct 100% examination or use a large sample size.

N. Stratification

1. **Meaning:** Dividing a population into discrete sub-populations (Strata) based on identifying characteristics.

Note: Each subpopulation is called as stratum and units under those are called as strata.

2. **Audit Efficiency:** Stratifying the population improves audit efficiency.

3. **Objective:** To select sample from all parts of the population with different characteristics.

4. **Monetary Value:** For tests of details, stratification is often based on monetary value.
 5. **Stratum-Specific Projection:** Results from a sample within a stratum can only be projected to that specific stratum.
 6. **Combine all stratum projections:** Combine projected misstatements of each stratum to assess the total impact on account balances or class of transactions.
- Example: 20% of items may form 90% of the value. The auditor examines a sample from these items, evaluates results, and separately tests the remaining 10%.

O. Value-Weighted Selection

- Monetary Amounts:** Under this, Sample size, selection, and evaluation focus on monetary amounts.
- In case of TOD:** Sampling unit may be defined as individual monetary units.
- Focus Larger Values:** Greater focus is placed on larger value items, which have a higher chance of selection. Results in a smaller sample size
- Best used with Random Selection:** This approach can be used
- ✓ In combination with systematic selection and
 - ✓ It is most efficient to use with random selection.

P. Sample Size and Factors affecting them

General Requirements

- ✓ The auditor determines a sample size sufficient to reduce sampling risk to an acceptable low level.
- ✓ Lower sampling risk → Larger sample size.
- ✓ Sample size can be determined using statistical formulas or professional judgment.

Factors for Tests of Controls

If Auditors risk assessment includes consideration of operating effectiveness of controls, then he is required to perform test of controls. The following factors impact sample size for tests of controls:

- a. The more Assurance on operating effectiveness of controls → Larger sample size.
- b. Higher the tolerable rate of deviation [T ROD] → Smaller sample size and Vice versa
- c. Higher the expected rate of deviation [E ROD] → Larger sample size and vice versa. Factors for expected rate of deviation includes:
 - ✓ Auditors Understanding of business and controls.
 - ✓ Changes in Personnel or controls.
 - ✓ Results of Audit procedures in Prior period or other audit procedures.
- d. Higher the desired assurance that T ROD not exceeded by Actual ROD → Larger sample size.
- e. **Population Size**
 - ✓ Large populations: Minimal impact on sample size.
 - ✓ Small populations: Sampling may not be efficient.

Factors for Tests of Details

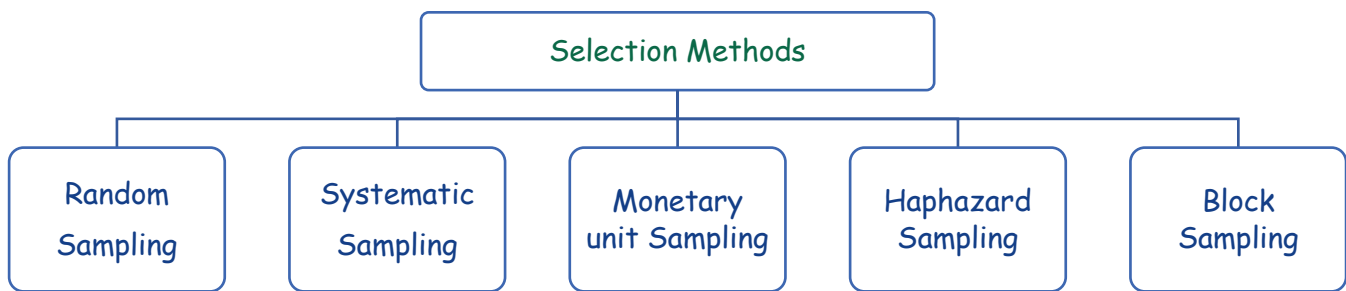
The following factors impact sample size for tests of details:

- a. Higher risk of misstatement → Larger sample size.
- b. Greater reliance on other substantive procedures on same assertion → Smaller sample size.
- c. Higher tolerable misstatement → Smaller sample size and vice versa.

- d. Higher **expected misstatement** → Larger sample size and vice versa. Factors relevant for consideration of expected misstatements:
 - a. **Extent of Subjectivity** involved in values.
 - b. Results of **risk assessment**.
 - c. Results of **tests of control** and
 - d. **Results of prior audit results** and other substantive procedures.
- e. Higher **desired assurance** that tolerable misstatement is not exceeded by Actual Misstatement → Larger sample size.
- f. Stratifying populations with a **wide range of values** → Smaller sample size.
- g. **Population Size**
 - ✓ Large populations: Minimal impact on sample size.
 - ✓ Small populations: Alternative evidence may be more efficient.

Definitions

- a. **Tolerable Misstatement**: The **monetary amount** set by the auditor for assuring that the **tolerable misstatement is not exceeded by Actual misstatement** in the population.
- b. **Tolerable Rate of Deviation**: The **rate of deviation** set by the auditor for assuring that the **tolerable ROD is not exceeded by Actual ROD** in the population.



Q. Methods of Sampling

1. **Simple Random Sampling**
 - a. **Equal Chance** Each unit in the **population** has an **equal chance** of being selected.
 - b. Uses **random number tables** to avoid bias in selection.
 - c. **Appropriate** for Populations with **similar units** and a **reasonable range**. [Homogeneous]
2. **Stratified Sampling**
 - a. Stratification means Dividing a **heterogeneous population** into **homogeneous strata** (sub-populations) and samples drawn from each sub population.
 Note: The **subpopulations** are called as **strata**.
 - b. Selection by Stratum: Items are selected from each **stratum**, treated as a separate population.
 - c. Auditor Judgment: The auditor decides the **number of strata**.

Example

 - ✓ Balances above Rs. 10 Lakhs - **100% of items** will be selected.
 - ✓ Balances between 5.5 Lakh to 10 Lakh - **25% of items** be selected
 - ✓ Balances between 2.25 Lakh to 5.5 Lakh - **10% of items** be selected
 - ✓ Balances Below 2.25 Lakh - **2% of items** be selected

3. Systematic Sampling

- a. The population is divided by the sample size to determine a **sampling interval**.
- b. Random Starting Point:
 - ✓ Starting Point Can be determined **haphazardly**.
 - ✓ For True random sample, **use random number tables** or random number generators.
- c. Avoid Patterns: Ensure that the **sampling interval** does not match a particular pattern in the population.
- d. Risk Mitigation: Use **multiple starting points** to minimize the risk of missing key transactions.

Example

- ✓ Branch Sales Example: If **branch sales only occur every 100th** item, and the auditor picks **every 100th item for review**, they would either end up selecting all sales from that branch or none at all. This would lead to an **incomplete or unbalanced sample**
- ✓ Accountant Example: If one accountant (Accountant A) **records transactions for one month** and another accountant (Accountant B) for the next month, and the **auditor checks transactions from alternate months**, they might end up **reviewing only one accountant's work**. The other accountant's work would not be checked.

4. Monetary Unit Sampling

A Value weighted selection where Sample size, selection, and evaluation are done based on **monetary amounts**.

5. Haphazard Sampling

- a. No Structured Approach: The sample is selected **without structure**, but **bias and predictability are avoided**.
- b. Limitations: **Not superior** to statistical methods.
- c. Chance of Selection: **All the sampling units** in the population **have a chance of selection**.

6. Block Sampling

- a. Meaning: Selection of **blocks** of contiguous **adjacent items** within the population.
- b. Limitations:
 - ✓ **Items in a sequence** may have similar characteristics, limiting coverage of diverse transactions.
 - ✓ Unusual transactions may not be covered in the group taken all at once.
- c. Bias Risk: If **management identifies** the block selection **pattern**, **misstatements** may be **overlooked** by management practices.
- d. It has Similarities to **non-statistical**.
- e. It is Simple, economical but **prone to bias** and pattern of selection may be noted by auditees.

Example

Take the first **200 sales invoices** in September or 4 blocks of **50 invoices**. Once the first item is selected, the block continues.

R. Sampling Risk

1. Meaning

- a. Risk that the auditor's conclusion based on a **sample** may differ from the conclusion if the **entire population** was tested.

b. Also known as the risk of selecting an **inappropriate sample**.

2. Sampling Risk in case of Test of Controls

a. Risk of Over-Reliance:

- ✓ Treating controls as **more effective** than they actually are.
- ✓ Affects **audit effectiveness** and may lead to an **inappropriate audit opinion**.

b. Risk of Under-Reliance:

- ✓ Treating controls as **less effective** than they actually are.
- ✓ Affects **audit efficiency** and results in **additional work** to verify conclusions.

3. Sampling Risk in case of Test of Details

a. Risk of Incorrect Acceptance:

- ✓ Concluding that **no material misstatement** exists when in fact it does.
- ✓ Leads to **audit risk**.

b. Risk of Incorrect Rejection:

- ✓ Concluding that a **material misstatement** exists when it does not.
- ✓ Does **not** typically affect **audit risk**.

S. Non-Sampling Risk

1. Meaning: Risk that the auditor reaches an **erroneous conclusion** for any reasons **other than sampling risk**.

2. Non-sampling risk **cannot be mathematically measured**.

Examples

- ✓ Use of **inappropriate audit procedures**.
- ✓ **Misinterpretation** of audit evidence.

3. Sources: Causes of Non-Sampling Risk

- ✓ Human Mistakes.
- ✓ Misinterpreting sample results.
- ✓ Relying on erroneous information (e.g., incorrect confirmations).

T. Performing Audit procedures on selected sample

1. Perform Procedures: The **auditor performs** audit procedures **appropriate to the purpose** on each selected item.

2. Replacement Item: If a **procedure is not applicable** to the selected item, the auditor shall **perform it on a replacement item**.

3. Alternative Procedure: If **replacement is not possible or reasonable**, the auditor applies an **alternative audit procedure**.

4. Inability to Apply Procedures: If the auditor **cannot apply the procedure or an alternative**, the item is treated as:

- ✓ A **deviation** from the prescribed **control** (for tests of controls).
- ✓ A **misstatement** (for tests of details).

Examples

Replacement Item

- ✓ **Cancelled Check**: While testing **payment authorization**, a **cancelled check** can be replaced with a **valid check**.

Unable to Apply Audit procedure

- ✓ **Lost Documentation:** If sales documentation is lost, confirmation can be sought from the debtor (SA 505).

Suitable Alternative Procedure Example

- ✓ **Subsequent Cash Receipts:** Examining cash receipts and supporting evidence when no reply is received to a confirmation request.

Replacement for Different Transaction

- ✓ **Manual Bill in Computerized Sales:** If a manual bill is selected in a computerized sales test, it can be replaced after verifying its correctness with supporting documents.

U. Nature and Cause of Deviations and Misstatements

Common Features

Auditor may observe that all deviations or misstatements share a common feature (e.g., transaction type, location, period, or product line).

Identifying Related Items

- ✓ Auditor may identify all items in the population with the same common feature and extend audit procedures to those items.
- ✓ Such deviations or misstatements may be intentional and indicate a possibility of fraud.

Investigation and Evaluation

The auditor investigates the nature and causes of deviations or misstatements. Also, Evaluates their effect on the purpose of the audit procedure and other areas of the audit.

Anomaly Identification

- ✓ High degree of certainty: If the auditor considers a misstatement or deviation to be an anomaly, they must obtain a high degree of certainty that it is not representative of the population.
- ✓ Additional Procedures: Auditor performs additional procedures to ensure the anomaly does not affect the remainder of the population.

Anomaly: A misstatement or deviation that is demonstrably not representative of the population.

V. Projection of Misstatements

Misstatement Projection

Broad View: The auditor projects misstatements to the population to get a broad view of the scale of misstatement.

Limitation: This projection may not be sufficient to determine the exact amount to be recorded.

Exclusion from Projection

Anomaly: If a misstatement is established as an anomaly, it may be excluded from the projection.

Considered in Total MS: The effect of any uncorrected anomaly must be considered in addition to non-anomalous misstatements while determining Total Misstatement.

Tests of Details (TOD) - Extrapolation

For tests of details, the auditor projects misstatements found in the sample to the population.

Tests of Controls (TOC) - No Extrapolation

For tests of controls, no explicit projection is required as the sample deviation rate represents the population deviation rate.

W. Evaluation of Sampling Results

Evaluation:

The auditor evaluates whether **audit sampling provides a reasonable basis** for conclusions about the population tested.

- ✓ **Test of Controls:** An unexpectedly **high sample deviation rate** may increase the assessed risk of material misstatement.
- ✓ **Test of Details:** An unexpectedly **high misstatement in a sample** may indicate the class of transactions or account balance is materially misstated.
- ✓ The best way to evaluate for the auditor is to consider **projected misstatements and anomalous misstatements**.
- ✓ **Anomalous Misstatements** are non-repetitive misstatements and are considered for calculating **aggregate misstatement** on whole population.

Circumstances when Sampling doesn't provide reasonable basis

- ✓ **Exceeding Tolerable Misstatement:** If **projected misstatement plus anomalous misstatement exceeds tolerable misstatement**, the sample does not provide a reasonable basis.
- ✓ **PMS exceeds EMS:** If **projected misstatement** exceeds the auditor's **expectations**, there is an **unacceptable sampling risk** that actual misstatement exceeds tolerable misstatement.

Conclusion on Total Misstatement

The closer **projected + anomalous misstatements** are to **tolerable misstatement**, the more likely actual misstatements exceed tolerable misstatement.

X. Auditor's response if Sampling has not provided reasonable basis

If audit sampling does **not provide a reasonable basis** for conclusions about the population:

- ✓ **Investigation by Management:** The auditor may **request Management to investigate** the identified **misstatements**.
- ✓ **Additional Procedures:** Auditor may conduct **additional audit procedures**.
For Example,
 - Extend the **sample size**.
 - Test an **alternative control**.
 - Modify **substantive procedures**.

Y. Precautions while applying test checking

1. **Accounting System:** Perform a **thorough study of the accounting system** before **sampling**.
2. **Internal Controls:** Conduct a proper study of the **internal control system**.
3. **Unsuitable Areas:** Identify areas **not suitable** for sampling
4. (e.g., **Checking statutory compliance, unusual transactions**).
5. **Sampling Methods:** Plan the **sampling methods** to be used and explain them to the **staff**.
6. **Classification:** Properly **classify or stratify** transactions and balances.
7. **Sample Size:** Determine the **sample size** appropriately to achieve audit objectives.
8. **Unbiased Selection:** Ensure the sample is **chosen in an unbiased manner**.
9. **Error Analysis:** Properly **analyse errors** located in the sample.



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

A. Scope and Objective

The auditor's objective is to obtain S&A audit evidence regarding:

- ✓ Existence and condition of Inventory.
- ✓ Completeness of Litigations and Claims involving entity.
- ✓ Presentation and disclosure of Segment information as per AFRFW

B. Considerations Related to Attendance at Physical Inventory Counting

1. Objective

When inventory is material to the financial statements, the auditor must obtain S&A audit evidence regarding its existence and condition.

2. Audit Procedure

a. Physical Inventory Counting: Auditor's attendance at the physical count to:

- ✓ Evaluate management's instructions and procedures for recording and controlling physical inventory counting.
- ✓ Observe the performance of management's count procedures.
- ✓ Inspect the inventory.
- ✓ Perform test counts.

b. Reconcile with Records: Verify whether the entity's final inventory records accurately reflect the results of the physical count.

3. Attendance at Physical Inventory Counting Involves

- a. Inspecting inventory for existence and condition, and performing test counts.
- b. Observing compliance with management's instructions and count procedures for recording and controlling results.
- c. Obtaining audit evidence about the reliability of management's procedures.

4. Nature of Audit Procedure

Procedures may serve as tests of controls or substantive procedures depending on the auditor's risk assessment, planned approach, and specific procedures performed.

5. Matters relevant for attendance at physical inventory counting

- a. Nature of inventory.
- b. Stages of completion of work-in-progress.
- c. Risks of material misstatement related to inventory.
- d. Internal control systems related to inventory.
- e. Whether adequate procedures and proper instructions for inventory counting are expected.
- f. Timing of the inventory count.
- g. Whether the entity using a perpetual inventory system.
- h. Locations of inventory, materiality, and risks of misstatement at different locations to determine where attendance is necessary.
- i. Need for an auditor's expert to obtain sufficient appropriate audit evidence.

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

1. **Purpose:** If **physical inventory counting** occurs on a date other than the financial statement date, the auditor must perform **additional audit procedures** to ensure changes in inventory between the count date and the financial statement date **are properly recorded**.
2. **Additional Audit Procedures**
Relevant matters the auditor should consider to **verify changes in inventory**:
 - a. Whether **perpetual inventory records** are properly adjusted.
 - b. **Reliability** of the entity's perpetual inventory records.
 - c. Reasons for **significant differences** between the physical count results and the perpetual inventory records.

D. Auditor unable to attend Inventory counting

1. **Alternative Date for Inventory Count**
 - ✓ If the auditor is **unable to attend** the physical inventory counting due to unforeseen circumstances, they should:
 - ✓ Conduct or observe a **physical count on an alternative date**.
 - ✓ Perform **audit procedures on intervening transactions** to ensure inventory accuracy.
2. **When Physical Counting is Impracticable**
 - ✓ If attendance at **physical inventory counting** is **impractical**, the auditor should:
 - a. Perform **alternative audit procedures** to obtain **sufficient appropriate audit evidence** about the **existence** and **condition** of inventory.
 - b. **Modify the opinion** in the auditor's report as per **SA 705**, if alternative procedures are not possible.
 - c. Impracticality may arise due to **nature and location** of inventory, such as safety concerns at the site.
3. **What Does Not Constitute Impracticality**
 - ✓ **General inconvenience** (e.g., scheduling issues) is **not a valid reason** for considering attendance impractical.
 - ✓ As per **SA 200**, challenges related to **difficulty, time, or cost** are **not valid bases** to omit an audit procedure without an alternative.
4. **Examples of Alternative Audit Procedures**
 - ✓ Inspect **documentation** of subsequent sales of inventory items acquired before the physical count.
 - ✓ Perform other **valid alternative procedures**, if practical, to verify the **existence** and **condition** of inventory.
5. **When Evidence Cannot be obtained?**
 - ✓ In cases where alternative procedures cannot provide **sufficient appropriate audit evidence**, the auditor must:
 - ✓ **Modify the audit opinion** due to **scope limitation** as per **SA 705**.

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

1. If inventory under the **custody and control** of a **third party** is **material** to the financial statements, the auditor must obtain **sufficient appropriate audit evidence** regarding its **existence** and **condition**.

2.	<p>Key Audit Procedures</p> <p>To verify inventory held by a third party, the auditor may perform one or both of the following:</p> <ol style="list-style-type: none"> Request confirmation from the third party about the quantities and condition of inventory held. Perform inspection or other audit procedures appropriate to the circumstances.
3.	<p>Examples of Other Audit Procedures</p> <ul style="list-style-type: none"> ✓ Inspect documentation such as warehouse receipts regarding inventory held by third parties. ✓ Request confirmation from other parties if inventory is pledged as collateral. ✓ Attend or arrange for another auditor to attend the third party's physical inventory count, if practicable. ✓ Obtain a report from another auditor or a service auditor's report on the adequacy of the third party's internal controls for inventory management.

F. Audit Procedures regarding Litigation and Claims

1.	<p>Litigation and claims may materially affect financial statements and require disclosure or accounting.</p>
2.	<p>Audit Procedures</p> <p>Procedures to Identify Litigation and Claims:</p> <ol style="list-style-type: none"> Inquiry of management and in-house legal counsel. Review of minutes of TCWG Meetings and correspondence with external legal counsel. Review legal expenses accounts. Use risk assessment insights. <p>Note: The above Audit procedures may also provide evidence regarding valuation or measurement of litigations. SA 540 deals with Evaluate accounting estimates and disclosures.</p>
3.	<p>Direct Communication with External Legal Counsel [ELC]</p> <ol style="list-style-type: none"> When to Seek Direct Communication: <ul style="list-style-type: none"> ✓ Risk of material misstatement identified. ✓ Audit procedures suggest other material litigation may exist. Process of Direct Communication: <ul style="list-style-type: none"> ✓ General Letter of Inquiry: <ul style="list-style-type: none"> • Through Letter of Inquiry, request ELC to directly communicate with the auditor. • If direct communication with auditor is prohibited for legal counsel, perform alternative audit procedures. ✓ Letter of Specific Inquiry: <p>In case of general inquiry, it is unlikely that ELC responds, the auditor shall use a letter of specific inquiry and include in the letter:</p> <ul style="list-style-type: none"> • List of litigations and claims. • Management's assessment of outcomes and financial implications. • Request that ELC confirm management's assessments and provide further information to the auditor if the list is incomplete or incorrect.
4.	<p>Meeting External Legal Counsel</p> <p>In certain circumstances the auditor may judge it to meet ELC, for example, where:</p>

	<p>a. The matter is a significant risk.</p> <p>b. Complex matter exists.</p> <p>c. Disagreement between management and legal counsel.</p> <p>Note: For these meetings, management permission and representative attendance is must.</p>
5.	<p>Management Refusal</p> <p>If management refuses permission for direct communication or meeting or ELC does not respond, and auditor unable to obtain evidence through alternative procedures, the auditor shall modify audit opinion as per SA 705.</p>

G. Segment Information

1.	<p>Definition of Segment Information</p> <p>Segment Information refers to details about different products and services of an enterprise and its operations in different geographical areas.</p>
2.	<p>Audit Evidence for Segment Information</p> <p>The auditor must obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in line with the financial reporting framework by:</p> <p>a. Understanding management's methods for determining segment information.</p> <p>b. Testing those methods where appropriate.</p> <p>c. Performing analytical or other audit procedures as necessary.</p> <p>Note: The auditor is not required to give a separate opinion on segment information.</p>
3.	<p>Understanding Management's Methods</p> <p>Examples of matters relevant to understanding methods used by management include:</p> <p>a. Sales, transfers, and intersegment eliminations.</p> <p>b. Comparisons with budgets and expected results (e.g., operating profits as a % of sales).</p> <p>c. Allocation of assets and costs among segments.</p> <p>d. Consistency with prior periods and adequacy of disclosures regarding inconsistencies.</p>



6. SA 505 External Confirmations

A. Scope and Objective of SA 505

1.	<p>Scope of SA 505: External Confirmations" addresses the auditor's use of external confirmation procedures to obtain audit evidence as per SA 500.</p>
2.	<p>Objective of SA 505: Assists auditors in designing and performing external confirmation procedures to obtain relevant and reliable audit evidence.</p>

B. Key Definitions under SA 505

1.	<p>External Confirmation</p> <p>Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party) to the auditor, in paper, electronic, or other medium.</p>
2.	<p>Positive Confirmation Request</p> <p>A request that the confirming party respond directly to the auditor, indicating whether they agree or disagree with the information, or providing the requested information.</p>
3.	<p>Negative Confirmation Request</p>

	A request for the confirming party to respond directly to the auditor only if they disagree with the information in the request.
4.	Non-Response ✓ A failure of the confirming party to respond or ✓ Failure to fully respond to a positive confirmation request, or ✓ A request returned undelivered.
5.	Exception A response indicating a difference between the information requested by the auditor or contained in the entity's records and information provided by the confirming party . Note: This exception must be analysed and assessed for its impact on the entire population.

C. External Confirmation Procedure

1.	Determining Information to Confirm ✓ External confirmation procedures are used to confirm or request information about account balances and their elements . ✓ They are also used to confirm terms of agreements , contracts, transactions, or the absence of conditions (e.g., side agreements).
2.	Selecting the Appropriate Confirming Party Responses are more reliable when sent to a party the auditor believes is knowledgeable about the information. Example: A financial institution official knowledgeable about the transactions or arrangements may be the most appropriate party.
3.	Designing the Confirmation Requests a. Requests must be properly addressed and include return information for direct responses to the auditor. b. The design of confirmation request affects the response rate and reliability of evidence . c. Factors when designing confirmation request: i. Assertions being addressed. ii. Identified risks of material misstatement (including fraud). iii. Layout and presentation of the request. iv. Past experience on similar audits. v. Method of communication (e.g., paper, electronic). vi. Management's authorization for confirming parties to respond. vii. Ability of the confirming party to provide specific or aggregated information.
4.	Sending the Requests a. Send requests including follow-ups requests as needed. b. Ensure requests are properly addressed and validate addresses before sending. c. Use additional or follow-up requests if replies are not received in a reasonable time. d. To enhance reliability, use positive confirmation requests that do not state amounts but require the confirming party to fill in details. However, this may reduce response rates due to the extra effort involved.

Determining the information to be confirmed

Selecting the appropriate confirming party

Designing the confirmation requests and

Sending the requests, including follow - up requests

D. Management Refusal to allow External Confirmation Procedure

1.	<p>Inquire the Reasons</p> <ul style="list-style-type: none"> ✓ The auditor shall inquire about management's reasons for refusal and assess their validity and reasonableness. ✓ Reasons for refusal may include legal disputes or ongoing negotiations that could be affected by confirmation. ✓ The auditor must seek evidence to validate the reasons, as management may attempt to conceal fraud or error.
2.	<p>Evaluate Implications</p> <ul style="list-style-type: none"> ✓ Assess how the refusal impacts the risk of MMS, including the risk of fraud. ✓ Modify the nature, timing, and extent of other audit procedures if necessary.
3.	<p>Perform Alternative Procedures</p> <ul style="list-style-type: none"> ✓ Perform alternative audit procedures to obtain reliable evidence. ✓ Examples: <ol style="list-style-type: none"> a. For Accounts Receivable: Examine subsequent cash receipts, shipping documents, and sales near period-end. b. For Accounts Payable: Examine subsequent cash disbursements, correspondence from third parties, and records like goods received notes.
4.	<p>Communicate with TCWG</p> <ul style="list-style-type: none"> ✓ If management's refusal is unreasonable or reliable audit evidence cannot be obtained, the auditor must communicate with TCWG as per SA 260. ✓ Further such a refusal may indicate a fraud risk factor and evaluate as per SA 240.
5.	<p>Determine Implications for Audit Opinion</p> <ul style="list-style-type: none"> ✓ Assess the implications for the audit opinion in accordance with SA 705.

E. Negative Confirmations Request as an Audit Procedure

1.	<p>Audit Evidence from Negative Confirmations Request [NCR]</p> <ul style="list-style-type: none"> ✓ Negative confirmations provide less persuasive audit evidence compared to positive confirmations. ✓ Auditor shall not use NCR as the sole substantive audit procedure unless all the Conditions are satisfied as below: <ol style="list-style-type: none"> a. Assessed Low risk of material misstatement and obtained sufficient evidence of control effectiveness. b. Population includes many small, homogeneous balances or transactions. c. Very low exception rate is expected. d. No conditions exist that indicate that the recipients will disregard requests.
2.	<p>Non-Response to the NCR</p> <ul style="list-style-type: none"> ✓ Non-response to a negative confirmation request does not explicitly confirm receipt or accuracy of information by the intended party. ✓ Non-responses to negative confirmation requests provide significantly less persuasive evidence than positive confirmation responses. ✓ Recipients are more likely to respond if the information in the request is not in their Favor and less likely to respond otherwise.

Example: Bank account holders may respond if the balance is **understated**, but not if it is **overstated**. Hence NCR is **less effective** for detecting **overstatements**.

F. Evaluating the Evidence Obtained Through External Confirmations

1. **Evaluation of Confirmation Results**
 - ✓ The auditor **shall evaluate whether the results** of external confirmation procedures provide relevant and reliable audit evidence.
 - ✓ Determine if further audit procedures are necessary.
2. **Categories of Results**

When evaluating individual confirmation requests, **results may be categorized as:**

 - a. **Agreement:** Response by the confirming party **indicating agreement** or providing requested information **without exception**.
 - b. **Unreliable Response:** A response deemed **unreliable**.
 - c. **Non-Response:** No response received.
 - d. **Exception:** A response indicating a **discrepancy** or difference in the information.
3. **Conclusion Based on Evaluation**
 - ✓ The auditor's evaluation, combined with results from **other audit procedures**, helps in determining whether **sufficient appropriate audit evidence** has been obtained or
 - ✓ Whether Additional procedures may be required as per **SA 330**.



7. SA 510 Initial Audit Engagements - Opening Balances

A. Scope and Objective of SA 510

1. **Scope**
 - ✓ **SA 510** addresses auditor responsibilities regarding **opening balances** in an **initial audit engagement**.
 - ✓ When F/S includes comparative information, then **SA 710** also shall apply.
2. **Objective of the Auditor**

In an initial audit engagement, the auditor's objectives regarding opening balances are to obtain S&A evidence about whether:

 - a. Opening Balances contain **misstatements** that materially affect the current period's financial statements.
 - b. **Accounting policies** are consistently applied or changes are properly accounted for and disclosed.
3. **Definitions**
 - a. **Initial Audit Engagement:**
 - ✓ An Engagement where **Prior Period F/S:**
 - i. Are **not audited** or
 - ii. Audited by a **predecessor auditor**.
 - b. **Opening Balances** means:
 - ✓ **Account balances** that exist at the beginning of the accounting period and are based on prior period **closing balances**.
 - ✓ Reflect **prior period transactions, events, and accounting policies**.
 - ✓ **Includes** matters that require **disclosure** (e.g., **contingencies, commitments**).

c. Predecessor Auditor:

- ✓ Auditor from another firm who audited the prior period's financial statements and is now replaced.

B. Audit Procedures for Opening Balances

1. Audit Procedures

The auditor shall obtain S&A audit evidence to determine whether opening balances contain misstatements that could materially affect the current period's F/S by:

- a. Verifying that prior period's closing balances are correctly brought forward or disclosed as prior period items.
- b. Ensuring opening balances reflect the application of appropriate accounting policies.
- c. Performing one or more of the following:
 - i. Reviewing audited financial statements and relevant documents of the prior period.
 - ii. Evaluating whether current audit procedures provide evidence relevant to the opening balances.
 - iii. Conducting specific audit procedures for opening balances.

2. Misstatements Identified (MMS)

- a. If auditor obtains evidence for misstatements in opening balances that could materially affect the current period's financial statements, the auditor shall perform additional procedures to assess their impact.
- b. If auditor concluded that misstatements exist, the auditor shall communicate them to management and those charged with governance.

C. Nature and Extent of Audit Procedures for Opening Balances

1. Factors Affecting the Audit Procedures

The nature and extent of audit procedures for opening balances depend on:

- a. The accounting policies followed by the entity.
- b. The nature of account balances, transactions, and disclosures, and the risk of material misstatement.
- c. The significance of opening balances to the current period.
- d. Whether the predecessor auditor's opinion was modified.

2. Reliance on Predecessor Auditor

If prior period financials were audited by predecessor auditor, the auditor can obtain S&A evidence by:

- ✓ Reviewing Audited financial statements.
- ✓ Reviewing Supporting schedules and relevant documents from the prior period.

3. Reliance on Prior Closing Balances

Ordinarily, the auditor may rely on prior closing balances unless current period audit procedures indicate potential misstatements in opening balances.

4. For Current Assets and Liabilities

Evidence for current assets and liabilities may be obtained during the current audit, such as:

- a. Accounts receivable/payable: Collection/payment provides evidence of existence, rights and obligations, and valuation.

	<p>b. Inventories: Current audit procedures may not provide sufficient evidence for opening balances. Therefore, Additional procedures are necessary and includes:</p> <ol style="list-style-type: none"> i. Observing a physical inventory count and reconciling with opening balances. ii. Performing audit procedures on valuation of opening inventory items. iii. Testing gross profit and cut-off.
5.	<p>For Non-Current Assets and Liabilities Evidence for non-current assets and liabilities, such as property, plant, equipment, investments, and long-term debt, may be obtained by:</p> <ol style="list-style-type: none"> a. Examining accounting records and other underlying information. b. Using confirmation with third parties for items like long-term debt or investments. c. Performing additional audit procedures if necessary.

D. Auditors Conclusion and Reporting under SA 510

1.	<p>Reporting on Accounting Policies: If the auditor concludes that:</p> <ol style="list-style-type: none"> a. Current period's accounting policies are not consistently applied to opening balances as per the framework, or b. Changes in accounting policies are not properly accounted for or adequately disclosed. <p>The auditor must express a qualified opinion or adverse opinion as per SA 705.</p>
2.	<p>Reporting on Opening Balances</p> <ol style="list-style-type: none"> a. Insufficient Evidence: If the auditor cannot obtain sufficient appropriate audit evidence for opening balances, they shall express a qualified opinion or a <u>disclaimer of opinion</u> as per SA 705. b. Material Misstatement: If opening balances have a material misstatement affecting the current period's financial statements and are not properly accounted for or adequately disclosed, the auditor must express a qualified opinion or an <u>adverse opinion</u> as per SA 705.



8. SA 550 Related Parties

A. Scope and Meaning of Related Party

1.	<p>Scope SA 550 "Related Parties" deals with the auditor's responsibilities regarding related party relationships and transactions, specially it applies in relation to risks of MMS.</p>
2.	<p>Definition of Related Party A related party is:</p> <ol style="list-style-type: none"> 1. AFRFW: Related party defined in the applicable financial reporting framework. 2. If Framework is Silent: Related Party Includes: <ol style="list-style-type: none"> a. A person/entity that has control or significant influence over the reporting entity through one or more intermediary. b. Another entity over which reporting entity has control or significant influence. c. Another entity under common control through: <ol style="list-style-type: none"> i. Common ownership. ii. Close family owners. iii. Common key management.

	Exception: Entities under common control of a state are not treated as related parties unless involved in significant transactions or share resources.
3.	<p>Control and Significant Influence</p> <p>Control: The power to govern an entity's financial and operating policies to benefit from its activities.</p> <p>Significant Influence: The power to participate in financial and operating decisions (without control).</p> <p>Indicators of control/influence include:</p> <ol style="list-style-type: none"> Equity holdings or financial interests in the entity. Holdings other financial interest in other entities. Being part of governance/key management. Being a close family member of key management. Significant business relationships with key management.
4.	<p>Related Parties with Dominant Influence</p> <p>Related parties can exert dominant influence over the entity/management. This is relevant in assessing risks of material misstatement due to fraud.</p>
5.	<p>Special-Purpose Entities (SPEs)</p> <p>SPEs may be related parties if the entity controls them in substance, even with little or no equity ownership.</p>

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

1.	<p>Normal Course of Business</p> <p>Many related party transactions occur in the normal course of business and may not pose a higher risk of material misstatement compared to transactions with unrelated parties.</p>
2.	<p>Higher Risk Situations</p> <p>The nature of related party relationships and transactions can sometimes result in higher risks of material misstatement in financial statements.</p>
3.	<p>Examples of Higher Risks</p> <ol style="list-style-type: none"> Complex Relationships: Related parties may have extensive and complex structures, increasing the complexity of transactions. Ineffective IS Systems: Information systems may fail to identify or summarize transactions and outstanding balances between the entity and its related parties. Non-Market Terms: Related party transactions may not follow normal market terms and conditions. For example, some transactions may involve no exchange of consideration.

C. Understanding of Entities RPRTs

1.	<p>The auditor shall inquire about</p> <ol style="list-style-type: none"> Identity of RPs: The entity's related parties, including any changes from the prior period. Type of Relationships: The relationships between the entity and its related parties. Transactions: Whether the entity entered into transactions with related parties, including their type and purpose.
2.	<p>Risk Assessment Procedures</p> <p>The auditor shall:</p>

- a. Internal Controls for RPs: Obtain an understanding of controls established to identify, account for, and disclose related party transactions.
- b. Authorisation: Assess controls for authorising and approving significant transactions and arrangements with related parties.
- c. Outside Normal Course: Evaluate controls for authorising and approving significant transactions outside the normal course of business.

D. Considerations Specific to Smaller Entities for RPRTs

1. **Control Environment in Smaller Entities**
Smaller entities often have a different control environment compared to larger entities.
For example:
 - ✓ Governance roles may not include outside members.
 - ✓ In some cases, governance is handled directly by the owner-manager, especially if no other owners exist.
2. **Informal Control Activities**
Control activities in smaller entities are typically less formal, and there may be no documented processes for managing related party relationships and transactions.
3. **Role of the Owner-Manager**
The owner-manager may either:
 - ✓ Mitigate risks by actively overseeing transactions or
 - ✓ Potentially Increase risks through involvement in related party transactions.
4. **Auditor's Approach**
For These entities, the auditor may obtain understanding of RPRTs and Internal Controls through:
 - a. Inquiring of management.
 - b. Observing management's oversight and review activities.
 - c. Inspecting relevant documentation.

E. Verification of Existence of RPRTs

1. **Alertness for Related Party Information:** The auditor should stay alert for related party information while reviewing records and documents.
2. **Records/Documents to Inspect, For Example, Includes:**
 - a. Entity's income tax returns.
 - b. Information supplied to regulatory authorities.
 - c. Share holder registers to identify the entity's principal shareholders.
 - d. Statement of Conflicts from management and those charged with governance.
 - e. Entity's investment records and those of its pension plans.
 - f. Agreements with key management or those charged with governance.
 - g. Significant contracts and agreements not in the entity's ordinary course of business.
 - h. Specific invoices and correspondence from the entity's professional advisors.
 - i. Life Insurance Policies acquired by the entity.
 - j. Significant contracts renegotiated during the period.
 - k. Reports from the internal auditors.
 - l. Documents related to filings with securities regulators, such as prospectuses.



9. SA 520 Analytical Procedures

A. Meaning and Objective of Analytical Procedures

	<p>Overall Tests and Analytical Procedures Routine checks alone may not detect all mistakes or manipulations. Additional procedures like comparisons, trend analysis, and ratio analysis are used, collectively known as overall tests.</p>
1.	<p>Meaning of Analytical Procedures</p> <ol style="list-style-type: none"> 1. Definition (SA 520): Evaluations of financial information through analysis of plausible relationships among financial and non-financial data. 2. Investigation: Includes investigating fluctuations or relationships that differ significantly from expected values or are inconsistent with other relevant information.
2.	<p>Objectives of Analytical Procedures</p> <ol style="list-style-type: none"> 1. Audit Evidence: Obtain relevant and reliable audit evidence using substantive analytical procedures. 2. Overall Conclusion: Design and perform analytical procedures near the end of the audit to confirm whether the financial statements are consistent with the auditor's understanding of the entity. <p>Example 1: Verifying Rent Payments Scenario: CA Amar verifies XYZ Ltd. rent payments of Rs. 50,000/- per month, consistent with the rent agreement. Other companies in the same industry pay only Rs. 10,000/- per month for similar locations. Applying Analytical Procedures: By comparing XYZ Ltd.'s payments with other companies, CA Amar identifies inconsistencies, which might indicate a misstatement. Without such a comparison, these issues may remain undetected.</p> <p>Example 2: Wages Verification Scenario: The statutory auditor of ABC Ltd. verifies total wages paid during FY 2020-21 across multiple factories. Approach: Analyse the relationship: Total wages = Wages per worker (financial data) × No. of workers (non-financial data). This relationship combines financial data (e.g., wages per worker in Rs.) with non-financial data (e.g., number of workers) to ensure accuracy.</p>

A. Analytical Procedures - Comparisons of Entity Financial Information

1.	<p>Compare with Prior Periods Compare financial information with prior periods. Example: CA Brijesh verifies travelling expenses of PRT Ltd., comparing Rs. 2.50 lakhs (current year) with Rs. 2 lakhs (previous year), identifying a 25% increase. CA Brijesh can compare this trend over several years.</p>
2.	<p>Comparing with Anticipated Results Compare actual results with budgets, forecasts, or auditor's expectations (e.g., depreciation estimates).</p>
3.	<p>Compare with Industry Information Compare entity's ratios (e.g., sales-to-accounts-receivable ratio) with industry averages or other entities of similar size.</p>

B. Analytical Procedures - Consideration of Relationships

1.	<p>Predictable Patterns Compare relationships within financial elements expected to follow predictable patterns (e.g., gross margin %).</p>
2.	<p>Financial and Non-Financial Data Compare relationships between financial data (e.g., payroll costs) and non-financial data (e.g., number of employees).</p>

<p>Summary</p> <ul style="list-style-type: none"> ✓ Methods range from simple comparisons to complex analyses using advanced statistical techniques. ✓ Analytical procedures can be applied to consolidated financial statements, components, or individual elements of information. <p>Typical comparisons</p> <ol style="list-style-type: none"> Comparison of client and industry data. Comparison of client data with prior period data. Comparison of client data with client-determined expected results. Comparison of client data with auditor-determined expected results. Comparison of client data with expected results using non-financial data. 	
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C. Purpose of Analytical procedures

1.	<p>Purpose of Analytical Procedures</p> <ul style="list-style-type: none"> ✓ Analytical procedures use comparisons and relationships to assess if account balances or other data appear reasonable. ✓ These helps detect unusual transactions, mistakes, or manipulations.
2.	<p>Thus, Analytical procedures benefits</p> <ul style="list-style-type: none"> ✓ Unusual Transactions: Help identify unusual events, amounts, ratios, or trends that may indicate audit risks, including fraud risks. ✓ Risk of Misstatement: Assist in identifying risks of material misstatement.

D. Examples of Analytical Procedures

1.	<p>Relationships between BS and PL Compare balances in the Balance Sheet and Statement of Profit and Loss across periods.</p>
2.	<p>Physical Reconciliation Reconcile physical balances of assets with relevant financial records.</p>
3.	<p>Account Confirmations Obtain statements from bankers, account receivables, or payables and reconcile with balances in the books of accounts.</p>
4.	<p>Reconciliation Statements Confirm amounts of outstanding income or expenses by preparing reconciliation statements.</p>
5.	<p>Gross Profit Ratio Compare gross profit ratio with the previous year to detect issues like inventory pilferage, misappropriation, or cost/sales price variations.</p>

6.	<p>Sundry Account Receivables Discrepancies in receivables may indicate failure to debit goods supplied or adjust a remittance received.</p>
7.	<p>Sundry Account Payables Discrepancies in payables may result from failure to credit consignments or debit a remittance amount.</p>
8.	<p>Inventory Variations Investigate excesses or shortages in raw materials and stores to detect misappropriation or recording errors.</p>
9.	<p>Interest and Dividends Reconcile collected amounts with accrued or outstanding amounts to detect errors in income adjustments.</p>
10.	<p>Inter-firm Comparisons Compare trading results between the entity and another firm in the same industry to identify reasons for profitability variations.</p>
11.	<p>Intra-firm Comparisons Compare Profit and Loss balances across periods to understand reasons for profitability changes.</p>
12.	<p>Expense Ratios Set up expense ratios (e.g., expenses/sales) and compare with the previous year to assess variations in expenditures or profit manipulations.</p>
13.	<p>Abnormal Cost Reductions Investigate falls in costs (e.g., manufacturing, administrative) to ensure proper provisioning for expenses.</p>
14.	<p>Independent Expense Verification Verify costs using external data. For instance:</p> <ul style="list-style-type: none"> ✓ Import costs using duty amounts. ✓ Sales (e.g., sugar) using GST paid.

E. Timing of Analytical Procedures

Used in 3 Stages: Planning, Testing and Completion phase

1.	<p>During the planning phase: Analytical procedures help the auditor:</p> <ol style="list-style-type: none"> 1. Understand the client's business. 2. Identify areas of potential risk, highlighting aspects or developments previously unaware to the auditor.
2.	<p>Benefits: The information obtained helps determine the nature, timing, and extent of other audit procedures.</p>
3.	<p>Data Used: Analytical procedures in planning phase use both financial data and non-financial information.</p>

F. Substantive Analytical Procedures [SAP]	
1.	Meaning: Substantive procedures at assertion level include Test of Details and Substantive Analytical Procedures .
2.	When to Use SAP: When to use SAP is based on the auditor's judgment to reduce audit risk to an acceptably low level.
3.	Inquiries of Management The auditor may: <ul style="list-style-type: none"> ✓ Inquire about the availability and reliability of information. ✓ Inquire about results of analytical procedures performed by the entity.
4.	Use of Management Data The auditor may use analytical data prepared by management , provided they are satisfied the data is reliable and properly prepared.

G. Factors for Substantive Analytical Procedures [ISM uses the word "Audit"]	
1.	Availability of Data Reliable and relevant data facilitates effective analytical procedures.
2.	Disaggregation The degree of disaggregation affects its usefulness in detecting misstatements.
3.	Account Type Analytical procedures are more effective for income statement accounts (predictable over time) than for balance sheet accounts (subject to management judgment). Example Compare sales and cash receipts through trade receivables or analyse ratios over time for balance sheet accounts.
4.	Source of Data <ul style="list-style-type: none"> ✓ Routine transactions (e.g., sales, purchases) are predictable and suitable for analytical procedures. ✓ Significant Classes of Transactions (SCOTs) (e.g., R&D expenditure) that are subject to management judgment and are less predictable.
5.	Predictability Analytical procedures are effective for predictable relationships (e.g., between sales and cost of sales or receivables and cash receipts).
6.	Nature of Assertion Suitable for certain assertions like completeness or valuation but less effective for others like rights and obligations .
7.	Inherent Risk When addressing inherent risk or "what can go wrong," the auditor considers: <ul style="list-style-type: none"> ✓ Nature of risk of MMS. ✓ Use of tests of details for higher risk areas. ✓ Significant risks require audit evidence beyond analytical procedures. Example If side agreements on revenue recognition are identified as significant risks, analysing sales vs. cash receipts is unlikely to address the risk.

H. Techniques of Substantive Analytical Procedure

1. **Overview**
The design of **substantive analytical procedures** is limited by the **availability of reliable data** and the **experience and creativity** of the audit team.

1. **Trend Analysis**

1. **Definition:** A commonly used technique **involving comparison of current data with prior period balances or trends over multiple periods.**

2. **Purpose:** Evaluate if the **current balance moves in line with established trends** or factors influencing account changes.

3. **Example:** Compare **salary expenses** over several years. An **unusual increase** may indicate **fraudulent payments** to fake employees.

2. **Ratio Analysis**

1. **Definition:** Analyses the relationship between assets and liability **accounts** as well **revenues and expense accounts** (e.g., **trade receivables and sales**).

2. **Purpose:** Ratios can be compared over **time**, within a group, or with other **industry standards**.

3. **Examples of Financial Ratios**
 ✓ **Trade receivables turnover**
 ✓ **Freight expense** as a percentage of **sales revenue**.
Example
 Review the **Gross Profit (GP) ratio** for the audit year and compare it with prior years or with **industry averages**.

3. **Reasonableness Tests**

1. **Definition:** Relies on **non-financial data** to assess the reasonableness of account **balances**, rather than using prior period events.

2. **Purpose:** Applies mainly to **income statement accounts** and **accrual/prepayment accounts**.

3. **Example**
 ✓ **Interest expense** against interest-bearing obligations
 ✓ **Raw material consumption** to production (quantity)
 ✓ **Sales discounts/commissions** to sales volume.
 ✓ Estimate **rental revenues** based on **occupancy rates**.

4. **Structural Modelling**

1. **Definition:** Uses **statistical models** (e.g., **linear regression**) built from prior **financial and non-financial data** to predict current account balances.

I. Analytical Procedures - As Sole Substantive Audit Procedures

Substantive Analytical Procedures

When designing and performing **substantive analytical procedures** (alone or with **tests of details**) as per **SA 330**, the auditor shall:

1. **Suitability of Procedures**
Determine the **suitability** of specific **substantive analytical procedures** for the given **assertions**, considering:
 - ✓ **Assessed risks** of material misstatement
 - ✓ **Results of tests of details**, if performed.
2. **Reliability of Data**

	Evaluate the reliability of data used to develop expectations by considering: <ul style="list-style-type: none"> ✓ Source ✓ Comparability ✓ Nature and relevance of information ✓ Controls over data preparation.
3.	Development of Expectation Develop an expectation for recorded amounts or ratios and ensure it is sufficiently precise to identify misstatements that could result in material misstatement of financial statements.
4.	Acceptable Difference Determine the acceptable difference between recorded amounts and expected values without requiring further investigation.

J. Suitability of a Particular Analytical procedure for given assertion

1.	Applicability of Substantive Analytical Procedures Substantive analytical procedures are generally suited for large volumes of transactions that are predictable over time.
2.	Assumption before applying The application of planned analytical procedures is based on the expectation that relationships among data exist in the absence of contrary situations.
3.	Suitability of Procedures The suitability of a specific analytical procedure depends on its effectiveness in detecting misstatements that could result in a material misstatement .
4.	Use of Predictive Models In some cases, even unsophisticated predictive models may be effective. Example <ul style="list-style-type: none"> ✓ If employee numbers and pay rates are fixed, auditors can estimate total payroll costs with high accuracy, reducing the need for tests of details. ✓ Trade ratios (e.g., profit margins for retail entities) can support the reasonableness of recorded amounts.
5.	Levels of Assurance from Procedures Different analytical procedures provide varying levels of assurance . Examples <ul style="list-style-type: none"> ✓ High Assurance: Predicting total rental income using rental rates, number of apartments, and vacancy rates may eliminate the need for further verification. ✓ Lower Assurance: Calculating and comparing gross margin percentages provides less persuasive evidence but may corroborate other procedures.
6.	Factors Influencing Suitability Suitability depends on: <ul style="list-style-type: none"> ✓ Nature of the assertion. ✓ Auditor's assessment of risk of material misstatement. Example If controls over sales order processing are weak, the auditor may prioritize tests of details over analytical procedures for receivables assertions .

7.	<p>Combination with Tests of Details</p> <p>Substantive analytical procedures are more suitable when tests of details are also performed on the same assertion.</p> <p>Example</p> <p>For valuation of accounts receivable, the auditor may:</p> <ul style="list-style-type: none"> ✓ Use aging analysis of customer accounts. ✓ Perform tests of details on subsequent cash receipts to assess collectability.
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K. Factors for Determining Reliability of Data

Reliability of Data
 The **reliability of data** is influenced by its **source**, **nature**, and the circumstances under which it is obtained.

Factors Affecting Reliability

1.	<p>Source of Information</p> <p>Data is generally more reliable when obtained from independent sources outside the entity.</p>
2.	<p>Comparability</p> <ul style="list-style-type: none"> ✓ Data must be comparable to the entity's context. ✓ For instance, broad industry data may need adjustments for an entity producing specialized products.
3.	<p>Nature and Relevance</p> <ul style="list-style-type: none"> ✓ The data's nature and relevance matter. ✓ For example, budgets are more reliable when established as expected results rather than aspirational goals.
4.	<p>Controls over Preparation</p> <ul style="list-style-type: none"> ✓ Controls should ensure data completeness, accuracy, and validity. ✓ For example, controls on the preparation, review, and maintenance of budgets.

Testing Controls over preparation of Information

1.	<p>Testing Operating Effectiveness</p> <p>The auditor may test the operating effectiveness of controls over the preparation of information used in substantive analytical procedures.</p> <p>Benefits of Effective Controls</p> <p>Effective controls provide greater confidence in the reliability of data and the results of analytical procedures.</p>
2.	<p>Testing Non-Financial Information Controls</p> <p>Controls over non-financial information can be tested alongside other controls.</p> <p>Example</p> <p>Controls over the recording of unit sales may be tested with controls over the processing of sales invoices to ensure operating effectiveness.</p>

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

1.	<p>Predictability of Expected Results</p> <p>The accuracy of expected results depends on how predictable the results are.</p> <p>Example</p>
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	<p>Gross profit margins are more consistent and predictable across periods compared to discretionary expenses like research or advertising.</p>
2.	<p>Degree of Disaggregation Analytical procedures are more effective when applied to disaggregated information, such as data for individual sections or components, rather than the entire entity. Example Apply analytical procedures to specific operations or components of a diversified entity, rather than the entity as a whole.</p>
3.	<p>Availability and Reliability of Information The availability of financial and non-financial information impacts the design of substantive analytical procedures. Example Consider the availability and reliability of: ✓ Financial data: Budgets or forecasts. ✓ Non-financial data: Units produced or sold.</p>

M. Amount of Difference that is Acceptable

1.	<p>Acceptable Difference The amount of difference between recorded amounts and expected values that can be accepted without further investigation.</p>
2.	<p>Factors Influenced by materiality and the desired level of assurance. Also considers the risk that a misstatement (individually or in aggregate) could result in a material error.</p>
3.	<p>SA 330 Requirement ✓ Requires auditors to obtain more persuasive evidence as risk increases. ✓ Higher risk means a lower acceptable difference without investigation to achieve the desired level of evidence.</p>
4.	<p>Relationship As assessed risk increases, the acceptable difference without further investigation decreases to ensure sufficient audit evidence.</p>

N. Investigating results of Analytical Procedures

If analytical procedures performed **identify fluctuations or relationships** that are inconsistent with other relevant information or that **differ from expected values by a significant amount**, the auditor **shall investigate such differences** by:

1.	<p>Inquiring of Management The auditor should: ✓ Request management to explain the significant fluctuations or inconsistencies. ✓ Evaluate management's response against other audit evidence.</p>
2.	<p>Performing Additional Audit Procedures If management fails to provide an adequate explanation, the auditor should, Perform additional procedures to identify any material misstatements.</p>

O. Overall Conclusions

1.	Purpose of Analytical Procedures The conclusions from analytical procedures are intended to corroborate conclusions formed during the audit of individual components or financial elements.
2.	Auditor's Opinion These procedures help the auditor draw reasonable conclusions to support their opinion on the financial statements.
3.	Identifying New Risks Analytical procedures may reveal a previously unrecognized risk of material misstatement.
4.	Action Required In such cases, as per SA 315, the auditor must: <ul style="list-style-type: none">✓ Revise their assessment of risks.✓ Modify further planned audit procedures accordingly.

7. AUDIT OF DIFFERENT TYPES OF ENTITIES

1. Government Audit

A. Background for Government Audit

1.	<p>Historical Background</p> <ul style="list-style-type: none"> ✓ Government Audit dates back to the emergence of organized governments. ✓ Its concept, content, and scope have evolved alongside political, social, and economic progress.
2.	<p>Purpose</p> <ul style="list-style-type: none"> ✓ Ensures accountability of the executive for public revenue and expenditure. ✓ Parliament/State Legislatures control government spending through demand for grants. ✓ No expenditure can occur without approval by Parliament/State Legislatures. ✓ Funds for such expenditures come from the Consolidated Fund of India/States.
3.	<p>Article 266: Consolidated Fund</p> <ul style="list-style-type: none"> ✓ Includes revenue from direct and indirect taxes, loans taken by the Government of India, and repayment of loans received by the Government.
4.	<p>Post-Expenditure Scrutiny</p> <ul style="list-style-type: none"> ✓ After expenditures, Appropriation Accounts are prepared. ✓ These accounts are reviewed by the Public Accounts Committee (PAC), which audits government revenue and expenditure.
5.	<p>Professional Adaptations</p> <ul style="list-style-type: none"> ✓ Government audit incorporates standard auditing practices. ✓ Introduces new concepts, techniques, and procedures tailored for government transactions.

B. Meaning and Objectives of Government Audit

1.	<p>Definition</p> <p>Government Auditing as per the U.N. Handbook on Government Auditing and Developing Countries:</p> <ul style="list-style-type: none"> ✓ An objective, systematic, professional, and independent examination of financial, administrative, and other operations of a public entity, ✓ Conducted after execution for evaluation and verification, ✓ presenting a report with comments on audit findings, conclusions, and recommendations for future actions and ✓ Includes expressing a professional opinion on financial statements regarding fairness of presentation.
2.	<p>Objectives</p> <ul style="list-style-type: none"> ✓ Ensures public accounting of government funds. ✓ Appraisal of Government Policies: Accounts for operational, management, programme, and policy aspects of public administration, ensuring accountability of officials. ✓ Base for Corrective Actions: Highlights lapses in lower levels of hierarchy and aids supervisory officers in taking corrective measures.
3.	<p>Administrative Accountability</p>

- ✓ Not an Investigating Agency: The audit ensures **accountability** but does not pursue all **irregularities**.
- ✓ Combines accountability to the **legislature** with aiding the **administration**.
- ✓ In **India**, government audit is conducted by the Comptroller and Auditor General (**C&AG**) through the **Indian Audit and Accounts Department**.
- ✓ **CAG** verifies **compliance with the Constitution**, Parliament laws, and related rules/orders.

C. Legal Framework around CAG

1. **Appointment & Removal**
 - ✓ **Independence**: **C&AG** is appointed by the **President of India** and can only be removed on grounds of **proven misbehaviour or incapacity**.
 - ✓ **Removal Process** is Similar to a **Supreme Court Judge**, removal requires a **2/3rd majority** in both Houses of Parliament.
 - ✓ **Salary & Service Conditions** are Determined by **Parliament**; cannot be **varied to his disadvantage** after appointment.
 - ✓ **Administrative Powers**: **Service conditions and administrative powers are determined by the President** in consultation with the **C&AG**.
2. **Tenure**
 - ✓ **Governed by the C&AG (Duties, Powers and Conditions of Service) Act, 1971**.
 - ✓ **Fixed tenure** with salary equivalent to that of a **Supreme Court Judge**, ensuring **independence**.
3. **Constitutional Provisions**
 - ✓ **Article 149**: **C&AG performs duties** and exercises powers related to accounts of the **Union, States**, and other authorities as defined by **Parliament-made laws** (e.g., the 1971 Act).
 - ✓ **Article 150**: **Accounts** of the Union and States are maintained in a **form prescribed by the President** based on **C&AG's advice**.
 - ✓ **Article 151**: **C&AG's Reports** on Union/State accounts are submitted to the **President/Governor**, who presents them to the **Parliament/State Legislature**.

D. Duties of CAG

1. **Compile and Submit Accounts**
 - ✓ Responsible for compiling accounts of the **Union, States, and Union Territories** from treasuries and departments.
 - ✓ **Prepares annual accounts** (e.g., **appropriation accounts**) showing receipts and disbursements for:
 - i. **Union**: Submitted to the **President**.
 - ii. **State**: Submitted to the **Governor**.
 - iii. **Union Territory**: Submitted to the **Chief Administrator**.
2. **Provides Information and Assistance**
 - ✓ Provides information and **assistance** to Union, State, and Union Territory **Governments** for preparing **annual financial statements**.
3. **General Provisions Relating to Audit**
 - ✓ Audits and reports on:

	<ul style="list-style-type: none"> a. Expenditure from the Consolidated Fund of India [CFI], States, and UTs. b. Transactions from Contingency Funds and Public Accounts. c. Profit/loss accounts, balance sheets, and subsidiary accounts of Union/State departments.
4.	<p>Audit of Receipts and Expenditure</p> <ul style="list-style-type: none"> ✓ Audits all receipts and expenditure of bodies or authorities substantially financed by grants/loans from the Consolidated Fund. ✓ Substantially financed: Grant/loan \geq ₹25 lakhs from CFI and such grant is \geq 75% of the total expenditure of such body.
5.	<p>Audit of Grants or Loans</p> <ul style="list-style-type: none"> ✓ Verifies procedures and conditions for grants/loans given from the Consolidated Fund for specific purposes, excluding foreign States or international organizations.
6.	<p>Audit of Receipts</p> <ul style="list-style-type: none"> ✓ Audits all receipts payable into the Consolidated Fund of India, States, and Union Territories. ✓ Ensures effective checks on assessment, collection, and allocation of revenue.
7.	<p>Audit of Stores and Inventory</p> <ul style="list-style-type: none"> ✓ Audits and reports on accounts of stores and inventory kept in Union/State offices or departments.
8.	<p>Audit of Government Companies</p> <ul style="list-style-type: none"> ✓ Duties in relation to Government Companies under the Companies Act, 2013: <ul style="list-style-type: none"> a. Appoints auditors (e.g., first/subsequent auditors under Sections 139(5) and 139(7)). b. Directs auditors on manner of audit. c. The auditor shall submit audit reports including on report on directions issued and their impact on accounts and financial statements.

E. Powers of CAG

1.	<p>Inspection of Accounts</p> <ul style="list-style-type: none"> ✓ Inspects any office of accounts under the control of the Union or State Government, including offices responsible for initial or subsidiary accounts.
2.	<p>Access to Documents</p> <ul style="list-style-type: none"> ✓ Requires accounts, books, papers, and documents relevant to audited transactions to be sent to specified locations.
3.	<p>Questions and Observations</p> <ul style="list-style-type: none"> ✓ Questions or makes observations to the person in charge of the office. ✓ Calls for information needed for preparing any account or report that is his duty to prepare.
4.	<p>Audit Scope and Checks</p> <ul style="list-style-type: none"> ✓ Has the power to dispense with detailed audits of specific accounts or transactions. ✓ Can apply limited checks as he determines necessary.

F. Audit of Government Expenditure

1.	<p>Audit Against Rules & Orders</p> <ul style="list-style-type: none"> ✓ Auditor Ensures expenditure confirms with statutes, rules, and regulations.
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	<ul style="list-style-type: none"> ✓ Involves interpretation of the Constitution, statutes, and regulations, though final interpretation does not rest with the C&AG. ✓ The Rules fall under following categories: <ol style="list-style-type: none"> a. Rules on powers to incur and sanction expenditure from Consolidated Funds or Contingency Funds. b. Rules on presentation of claims, withdrawing funds, and following financial procedures. c. Rules on service conditions, pay, allowances, and pensions of government servants. ✓ Audit ensures that these rules are: <ol style="list-style-type: none"> a. Not inconsistent with the Constitution and laws. b. Consistent with audit and accounts requirements. c. Not in conflict with higher authority orders/rules. d. Properly authorized by competent authorities.
2.	<p>Audit of Sanctions</p> <ul style="list-style-type: none"> ✓ Ensures expenditure is covered by a valid sanction authorized by a competent authority. ✓ Confirms the sanctioning authority has the power under the Constitution, laws, or delegated financial rules. ✓ Typically involves expenditure from the Consolidated Fund of India or States.
3.	<p>Audit Against Provision of Funds</p> <ul style="list-style-type: none"> ✓ Ensures there is a provision of funds for the expenditure and it does not exceed appropriations made.
4.	<p>Propriety Audit</p> <ul style="list-style-type: none"> ✓ Identifies improper or avoidable expenditure even if it complies with rules and regulations.
5.	<p>Performance Audit</p> <ul style="list-style-type: none"> ✓ Evaluates whether programmes, schemes, and projects are: <ol style="list-style-type: none"> a. Being Run economically. b. Achieving expected results.

G. Propriety Audit

1.	<p>Objective of the Audit</p> <ul style="list-style-type: none"> ✓ To identify improper, avoidable, or wasteful expenditure. ✓ Regularity audit alone is insufficient as expenditure may still be wasteful. ✓ Auditor should evaluate transactions for reasonableness, faithfulness, and economy.
2.	<p>General Principles / Guidelines</p> <p>No precise rules exist; audit against propriety depends on common sense and logic applied by the auditor.</p> <ol style="list-style-type: none"> a. Principles for Judging Propriety <ul style="list-style-type: none"> ✓ Reasonable Expenditure: Expenditure should not be more than what the occasion demands. Public officers should act with the prudence of an ordinary person managing their own money. ✓ No Self-Benefit: Authorities should not sanction expenditure that benefits themselves, directly or indirectly.

- ✓ No Partiality: Public money should not be used to benefit specific individuals or groups unless legally or policy-based exceptions apply.
- b. Exceptions
 - ✓ Expenditure is justified if:
 - a. The amount is insignificant.
 - b. A claim for the amount could be enforced in a court of law.
 - c. The expenditure aligns with a recognized policy or custom.
 - d. Allowances granted are regulated to avoid becoming a source of profit for recipients.
- c. The expenditure shall
 - ✓ Transparency: Pass down to beneficiaries without corruption.
 - ✓ Long-term Impact: Bring optimum, enduring benefits instead of merely covering daily needs.
 - ✓ Cost-Benefit: The cost of expenditure should not exceed the benefits derived.
 - ✓ Compensatory Nature: Expenditure meant as compensation should not turn into profits for recipients.

H. Performance Audit

1. Objective of the Audit
 - ✓ Ensures that programmes, schemes, and projects with large financial expenditure are:
 - a. Run economically.
 - b. Yielding the expected results.
 - ✓ Involves an objective examination of financial and operational performance.
 - ✓ Aims to identify opportunities for greater economy and effectiveness.
2. Components of Performance Audit
 - a. Efficiency Audit:
 - ✓ Examines whether schemes/projects are conducted economically and producing the expected results.
 - ✓ Focuses on the relationship between goods/services produced and resources used.
 - ✓ Aims to determine the extent of efficient operations.
 - b. Economy Audit:
 - ✓ Checks whether financial, human, and physical resources are acquired in an economical manner.
 - ✓ Evaluates if sanctioning and spending authorities observe economy.
 - c. Effectiveness Audit:
 - ✓ Appraises performance against the targeted objectives of programmes, schemes, and projects.
 - ✓ Evaluates the efficiency of the means adopted to achieve objectives.
3. Procedure for Conducting Performance Audit
 - a. Identification of Topic
 - b. Preliminary Study
 - c. Planning and Execution
 - d. Reporting

I. Audit of Government Receipts

1.	<p>Objective of the Audit</p> <ul style="list-style-type: none"> ✓ Ensures no leakage of revenue that should legally come to the Government. ✓ Focuses on the general aspects of revenue collection rather than specific cases, though individual assessments, collections, and refunds are important in test checks.
2.	<p>Aspects Covered in Audit of Receipts</p> <ol style="list-style-type: none"> a. Proper Assessment and Realization: Ensures all revenues and debts due to the Government are correctly assessed, realized, and credited. b. Adequate Rules and Procedures: Verifies that departments have effective rules and procedures for assessment, collection, and allocation. c. Adequate Controls: Ensures controls exist for prompt detection of irregularities, such as double refunds, fraudulent vouchers, or revenue loss. d. Actual Implementation: Confirms that procedures are being properly implemented. e. Review of Assessment Orders: <ul style="list-style-type: none"> ✓ Reviews systems to ensure correct and regular accounting of demands, collections, and refunds. b. Focuses on the general effectiveness of assessment procedures. c. Reviews judicial decisions by tax authorities to evaluate assessment procedure effectiveness.
3.	<p>Extent of Checking</p> <ol style="list-style-type: none"> a. Audit Scope: Determined by the C&AG and based on test checks, random sampling, in-depth studies, and general reviews. b. Institutional Mechanism: Includes primary checks by auditors, test checks by supervisors, and control and direction by group leaders. c. Planning and Monitoring: <ul style="list-style-type: none"> ✓ Work planning, execution, and reporting are directed at middle and top levels of the audit hierarchy. ✓ Ensures assigned work is carried out as prescribed within the C&AG framework. d. Central and Local Audit: Audit conducted: <ul style="list-style-type: none"> ✓ Centrally: Where accounts and vouchers are maintained. ✓ Locally: Where drawing and disbursing functions are performed.

J. Audit of Stores and Inventories

1.	<p>Objective of Audit</p> <ul style="list-style-type: none"> ✓ Ensures that purchases of stores and inventories are: <ol style="list-style-type: none"> a. Properly sanctioned. b. Made economically. c. In accordance with the rules laid down by the competent authority. ✓ Forms part of the expenditure audit.
2.	<p>Aspects Covered in Audit of Stores and Inventories</p> <ol style="list-style-type: none"> a. Regulations: Verifies whether regulations for purchase, receipt, issue, custody, sale, and inventory management are properly devised and followed. b. Reasonable Pricing: Ensures prices paid are: <ul style="list-style-type: none"> ✓ Reasonable.

- ✓ Match the **contract terms** for supply.
- ✓ Supported by **quality and quantity certificates** from inspecting and receiving units.
- c. **Economical Purchases:** Identifies cases of **uneconomical purchases** or **losses** due to defective/inferior-quality stores.
- d. **Accuracy of Accounts:** Checks **receipts, issues, and balances** for accuracy, correctness, and compliance with **inventory holding norms**.
- e. **Idle or Excess Inventory:** Highlights cases of **idle or excess inventory** and ensures **periodic verification** of inventory for physical existence.
- f. **Valuation:**
 - a. Confirms that **physical accounts** tally with **value accounts**.
 - b. Ensures **adjustments** for profits or losses due to revaluation, inventory checks, or other causes are properly accounted for.

K. Concept of Audit of Commercial Accounts

1. **Types of Government Entities**
 - ✓ **Departmental Enterprises:** Engaged in **commercial and trading operations**, governed by **Government departmental regulations** (e.g., **defense factories, mints**).
 - ✓ **Statutory Corporations:** Created by **specific statutes** (e.g., **LIC, Air India**).
 - ✓ **Government Companies:** Incorporated under the **Companies Act, 2013**.
2. **Maintenance of Accounts on Commercial basis**
 - a. **Departmental Entities**
 - ✓ Audited as **Government departments** where **commercial accounts** are maintained.
 - b. **Statutory Corporations**
 - ✓ **Audit Nature:** Depends on the governing **statute**.
 - ✓ **C&AG's Role:** Conducts **financial/accounts audit** and may compile accounts following professional auditor standards.
 - c. **Government Companies**
 - ✓ Governed by the **Companies Act, 2013**.
 - ✓ **C&AG Role:**
 - a. Conducts **supplementary, test audits** and periodic financial audits.
 - b. Conducts **performance appraisals**.
 - c. Issues **directions to company auditors** for specific aspects of audit work.
 - d. Reviews and condenses audit findings into **reports for government/legislatures**.
 - ✓ **Audit Board Mechanism:** Includes representatives from **audit, government nominees**, and **functional specialists** for **performance reviews and appraisals**.

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

- A. **Appointment of Auditors (Sec. 139)**
 1. **CAG's Role in Government companies:**
 - ✓ Appoints **First Auditor** under **Sec. 139(5)** or **Subsequent Auditor** under **Sec. 139(7)**.
 - ✓ **Directs auditors on how to audit** the accounts of **Government Companies**.
 - ✓ **Audit Report:** Auditor submits a copy of the **report to the CAG** as per **Sec. 143(5)**.
- B. **Supplementary Audit (Sec. 143(6))**

	<p>1. CAG's Right:</p> <ul style="list-style-type: none"> ✓ Conducts a Supplementary Audit of the financial statements within 60 days of receiving the audit report. ✓ Requests additional information for the supplementary audit. <p>2. CAG's Comments:</p> <ul style="list-style-type: none"> ✓ Comments on the supplementary audit report are: <ol style="list-style-type: none"> a. Sent to persons entitled to audited financial statements (as per Sec. 136(1)), including: <ol style="list-style-type: none"> i. Members of the company, ii. Trustees for debenture-holders, and iii. Other entitled persons. b. Presented at the AGM alongside the statutory audit report. <p>Note: Supplementary audit is an extension of the original audit under Sec. 139.</p>
C.	<p>Test Audit (Sec. 143(7))</p> <p>1. CAG's Order:</p> <ul style="list-style-type: none"> ✓ CAG may order a Test Audit of a Government Company's accounts if deemed necessary. ✓ Governed by Sec. 19A of the CAG (Duties, Powers, and Conditions of Service) Act, 1971. <p>2. Conducted by CAG directly.</p>
D.	<p>Two-Layer Audit System</p> <ul style="list-style-type: none"> ✓ Statutory Auditors: Conduct audit by a qualified Chartered Accountants. ✓ CAG's Audit: Adds an additional layer of audit (e.g., supplementary and test audits).
E.	<p>Audit Standards</p> <ul style="list-style-type: none"> ✓ CAG's Standards: Combines principles of government audit and commercial audit as practiced by professional auditors. ✓ Focuses on autonomy, accountability, and the three Es: Economy, Efficiency, Effectiveness.

M. Reporting Procedures under Government Audit

1.	<p>Importance of Reporting</p> <ul style="list-style-type: none"> ✓ Effectiveness of audit relies on reporting findings to the proper authority. ✓ Enables action to rectify irregularities or prevent their reoccurrence.
2.	<p>Right and Obligation to Report</p> <ul style="list-style-type: none"> ✓ C&AG's right to report audit findings is inherent to the institution. ✓ Safeguarded by the Constitution and related enactments.
3.	<p>Reporting as per Article 151</p> <ul style="list-style-type: none"> ✓ C&AG's Reports on Union and State accounts are submitted to the President or respective Governor. ✓ These reports are then laid before the legislatures.
4.	<p>Publicity of Reports</p> <ul style="list-style-type: none"> ✓ Reports should be publicised to create awareness and encourage remedial action where necessary. ✓ Publicity ensures a proper climate of public opinion for future safeguards.

5.	<p>Objectivity in Reporting</p> <ul style="list-style-type: none"> ✓ In India, reporting is factual, and conclusions are left to the reader. ✓ Ensures total objectivity in findings.
6.	<p>Recommendations</p> <ul style="list-style-type: none"> ✓ C&AG is not barred from making recommendations in the audit report. ✓ Traditionally, recommendations are made by the Public Accounts Committee.

2. Audit of Local Bodies

A. Background of Local Bodies

1.	<p>Definition of a Municipality</p> <p>A municipality is a unit of local self-government in an urban area.</p> <p>Local Self-Government</p> <p>Refers to the administration of a locality (village, town, or city) by a body:</p> <ol style="list-style-type: none"> a. Representing local inhabitants. b. Possessing fairly large autonomy. c. Raising part of revenue through local taxation and spending on local services.
2.	<p>Types of Local Bodies</p> <ul style="list-style-type: none"> ✓ Municipal Government in India includes: <ol style="list-style-type: none"> a. Municipal Corporations. b. Municipal Councils. c. Notified Area Committees. d. Town Area Committees. e. Cantonment Committees.
3.	<p>Functions</p> <ul style="list-style-type: none"> ✓ Municipal authorities perform local functions, covering: <ol style="list-style-type: none"> a. Regulatory activities. b. Maintenance activities. c. Development activities.
4.	<p>Expenditure</p> <ul style="list-style-type: none"> ✓ Broad categories of municipal expenditure include: <ol style="list-style-type: none"> a. General administration and revenue collection. b. Public health. c. Public safety. d. Education. e. Public works. f. Others, such as interest payments.
5.	<p>Revenues</p> <ol style="list-style-type: none"> a. Property taxes and octroi. b. Other taxes: Profession tax, non-mechanized vehicle tax, taxes on advertisements, animals, boats, tolls, show-tax, etc. c. Taxation powers: <ol style="list-style-type: none"> i. Corporations: Limited to a few compulsive items.

	<p>ii. Other urban local authorities: Cover a wider range, optional in nature, subject to state government approval.</p>
6.	<p>Grants Local bodies receive certain state grants, classified as:</p> <ol style="list-style-type: none"> General Purpose: Bridge the gap between needs and resources. Specific Purpose: Tied to providing specific services or performing certain tasks. Statutory and Compensatory: Compensation for loss of revenue when state governments take over local taxes.

B. Financial Administration of Local Bodies

A.	<p>Budgetary Procedure</p> <ul style="list-style-type: none"> ✓ Ensures financial accountability and control of expenditure. ✓ Funds must be raised and spent in accordance with rules, regulations, and legislative authorization. ✓ Budget Preparation: Determines taxation levels, expenditure ceilings, and includes variations between corporations and municipalities. ✓ Key Features: <ol style="list-style-type: none"> No strict separation between revenue and capital items. Capital transactions are grouped under "extraordinary items." Presence of special funds (e.g., roads) or separate budgets for specific functions (e.g., education, water supply, transport, etc.).
B.	<p>Expenditure Control</p> <ul style="list-style-type: none"> ✓ Financial control in municipalities differs from state/central government due to integrated legislative and executive functions in the municipal council. ✓ Lack of an independent finance officer accountable to the municipal council makes external audit by the state government the main instrument for controlling municipal expenditure.
C.	<p>Accounting System</p> <ul style="list-style-type: none"> ✓ Municipal accounting formats are often: <ol style="list-style-type: none"> Complicated and not simple or comprehensible. Either provide inadequate or excessive information, neither of which supports effective management information systems.

C. Objectives of Audit of Local Bodies

1.	<p>External Control of Expenditure</p> <ul style="list-style-type: none"> ✓ State governments exercise control over municipal expenditure by appointing auditors to examine municipal accounts. ✓ Municipal Corporations like Delhi and Mumbai have the authority to appoint their own external auditors for regular audits.
2.	<p>Objectives of Audit</p> <ol style="list-style-type: none"> Fairness: Evaluate the fairness of content and presentation of financial statements. Financial Control: Assess the strengths and weaknesses of financial control systems. Compliance: Ensure adherence to legal and/or administrative requirements. Value for Money: Verify whether value is fully received for the money spent.

- e. Error and Fraud Detection: Detect and prevent errors, fraud, and misuse of resources.

D. Audit Programme for Audit of Local Bodies

1. **Audit as Financial Control**
 - ✓ Audit acts as a method of financial control for local governments, coupled with the provision of ultra vires.
 - ✓ Surcharge: Actions beyond legal authority can result in a surcharge by audit, a legacy from colonial practices. [Penalties as punishments]
2. **Internal Audit**
 - ✓ Internal audit should be conducted by the institution's own staff.
 - ✓ Performed continuously based on a well-defined programme.
 - ✓ External auditors rely on internal audits as part of a complete financial control system.
 - ✓ Where internal audits are absent, external auditors conduct detailed checking.
3. **Value for Money Audit**
 - ✓ Focuses on whether urban institutions operate with efficiency, economy, and effectiveness (the three Es).
4. **Audit Programme**
 - a. Appointment:
 - ✓ The Local Fund Audit Wing of the State Government usually conducts municipal audits.
 - ✓ Larger corporations (e.g., Delhi, Mumbai) appoint their own external auditors.
 - b. Auditor's Concerns:
 - i. Fairness of financial statements.
 - ii. Strengths and weaknesses of financial control systems.
 - iii. Compliance with legal and administrative requirements.
 - iv. Ensuring value for money spent.
 - v. Detecting errors, fraud, and misuse of resources.
 - c. Rules and Regulations: Ensure expenditure conforms to laws and financial rules set by competent authorities.
 - d. Authorizations: Verify that all types of sanctions (special or general) are approved by competent authorities.
 - e. Provisioning: Confirm there is a provisioning of funds, and expenditure is incurred from this provision with proper authorization.
 - f. Performance: Assess whether schemes, programmes, and projects with large expenditure are running economically and yielding expected results.

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

A. Background of NGO's

1. **Definition of NGOs**
 - ✓ Non-profit organisations that raise funds from members, donors, contributors, and receive time, energy, and skills donations.
 - ✓ Aim to achieve social objectives, such as education, medical aid, economic assistance, and disaster management.

2.	<p>Examples of NGOs</p> <ul style="list-style-type: none"> ✓ Include religious organisations, health agencies, charitable organisations, old age homes, and research foundations. ✓ Notable examples in India: CRY, NORAD, UNICEF, Vidya, Concern India Foundation, etc.
3.	<p>Legal Incorporation</p> <ul style="list-style-type: none"> ✓ NGOs can be registered as: <ul style="list-style-type: none"> a. Societies under the Societies Registration Act, 1860. b. Trusts under the Indian Trust Act, 1882. c. Section 8 Companies under the Companies Act, 2013.
4.	<p>Mandatory Registration</p> <ul style="list-style-type: none"> ✓ Not required under most acts, except: <ul style="list-style-type: none"> a. Trusts involving immovable property worth over ₹100 must comply with Section 17(1) of the Registration Act, 1908 and Section 123 of the Transfer of Property Act, 1882. b. In states like Maharashtra and Gujarat, charitable trusts must register under the Bombay Public Trusts Act, 1950.
5.	<p>Additional Registrations</p> <ul style="list-style-type: none"> ✓ NGOs may need to register under: <ul style="list-style-type: none"> a. Income Tax Act, 1961. b. Foreign Contribution (Regulation) Act, 2010 (FCRA) for foreign donations.
6.	<p>Maintenance of Accounts</p> <ul style="list-style-type: none"> ✓ NGOs under Companies Act, 2013: <ul style="list-style-type: none"> a. Must maintain accounts on an accrual basis as per Section 128. b. Non-compliance with accrual basis constitutes a violation of the Act. ✓ Other NGOs: Can maintain accounts on either an accrual or cash basis.

B. Sources and Applications of Funds of NGO's

1.	<p>Main Sources of Funds</p> <ul style="list-style-type: none"> ✓ Grants and donations. ✓ Fundraising programmes. ✓ Advertisements and member fees. ✓ Technical assistance fees and fees for services rendered. ✓ Subscriptions, gifts, sale of produce or publications. <p>a. Promoters' Contributions</p> <p>Treated as capital receipts and shown as liabilities in the Balance Sheet.</p> <ul style="list-style-type: none"> ✓ Types: <ul style="list-style-type: none"> i. Corpus Contribution: <ul style="list-style-type: none"> ▪ Contribution toward the capital or corpus of an NGO. ▪ Specified by donors to form part of the corpus. ▪ Section 11(1)(d) of the Income Tax Act, 1961: Voluntary contributions with specific directions for the corpus are excluded from total income. ii. Revolving Fund: <ul style="list-style-type: none"> ▪ Fund used to give temporary loans to other NGOs or beneficiaries, with recovery for re-lending.
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	<ul style="list-style-type: none"> ▪ Interest Earned: Credited back to the fund or the Income and Expenditure Account, depending on donor restrictions or NGO rules. <p>b. Donations and Grants Grants received to acquire specific fixed assets (e.g., land, buildings, or equipment).</p> <p>c. Non-Monetary Donations Includes contributions in kind such as:</p> <ul style="list-style-type: none"> ✓ Assets: Land, buildings, vehicles, office equipment. ✓ Programme-related items: Food, books, building materials, clothes, beds, and raw materials for training (e.g., wool, reeds).
2.	<p>Application of Funds</p> <ul style="list-style-type: none"> ✓ Establishment costs. ✓ Office and administrative expenses. ✓ Maintenance expenses. ✓ Programme/Project expenses. ✓ Charity, donations, and contributions given.

C. Audit of NGOs

1.	<p>Appointment of Auditors</p> <ul style="list-style-type: none"> ✓ Societies and Trusts: Auditors are appointed by the Management. ✓ Section 8 Companies: Auditors are appointed by the members at AGM.
2.	<p>Statutory Audit Requirements</p> <ul style="list-style-type: none"> ✓ Statutes like the Companies Act, 2013, Foreign Contribution (Regulation) Act, 2010, and Income Tax Act, 1961 require NGOs to have their accounts audited and submitted to prescribed authorities. ✓ Non-compliance can lead to the forfeiture of exemptions and benefits.
3.	<p>Audit Reports for Specific Statutes</p> <ul style="list-style-type: none"> ✓ For NGOs receiving foreign contributions, the Foreign Contribution (Regulation) Act, 2010 mandates a specific audit report format. ✓ This report must be submitted to the Ministry of Home Affairs within 60 days of the financial year's close (i.e., by May 30).
4.	<p>Audit Planning Considerations</p> <ol style="list-style-type: none"> a. Knowledge: Understand the NGO's mission, vision, operations, and environment. b. Statutory Updates: Stay updated on statutes like the FCRA, 2010, Societies Registration Act, 1860, and Income Tax Act, 1961, including amendments, circulars, and judicial decisions. c. Legal Review: Examine the Memorandum of Association, Articles of Association, and Rules and Regulations of the NGO. d. Policies and Guidelines: Review the NGO's organisation chart, financial and administrative manuals, project guidelines, funding agency requirements, and budgetary policies. e. Minutes Review: Study minutes of the Board, Managing Committee, or Governing Body meetings to identify financial implications. f. Accounting Systems: Assess the NGO's accounting system, internal controls, and internal checks. g. Materiality Levels: Determine materiality thresholds for the audit.

- h. Reporting: Plan the **nature and timing** of reports or communications.
- i. Experts: Involve relevant **experts** and review their reports if required.
- j. Previous Year Audit: Review the prior year's **audit report** for reference.

D. Audit Programme of NGO

1. **Audit Programme**
Ensures all assets, liabilities, income, and expenditure are audited in a sequential order, covering:
 1. **Corpus Fund**
 - ✓ Verify contributions/grants with **donor letters**.
 - ✓ Check **interest income** on investments with the **Investment Register** and physical investments.
 2. **Reserves**
 - ✓ Cross-check transfers with **donor letters** and **board resolutions**.
 - ✓ Verify all transfers and adjustments made during the year.
 3. **Earmarked Funds**
 - ✓ Check donor requirements, **board resolutions**, and scheme rules.
 4. **Loans**
 - ✓ Verify loans with **loan agreements** and **receipt counterfoils**.
 5. **Fixed Assets**
 - ✓ Check acquisitions, sales, disposals, and **depreciation**.
 - ✓ Verify immovable property for **title documents** and authorizations.
 6. **Investments**
 - ✓ Ensure investments match the **Investment Register** and are in the **NGO's name**.
 - ✓ Verify **approvals**, dis-investments, and amounts in bank accounts for principal and interest.
 7. **Cash in Hand**
 - ✓ Physically verify **cash in hand** and imprest balances at year-end and reconcile with books.
 8. **Bank Balance**
 - ✓ Check **bank reconciliation statements** and investigate old outstanding and unadjusted amounts.
 9. **Inventory in Hand**
 - ✓ Verify inventory and obtain **management certificates** for quantities and valuation.
 10. **Programme and Project Expenses**
 - ✓ Cross-check agreements with **donors/contributors** to verify programme/project compliance with conditions.
 11. **Establishment Expenses**
 - ✓ Verify **PF, life insurance**, and administrative charges for timely deduction and deposit.
 - ✓ Check office and administrative expenses like **postage, stationery, and travelling**.

2. **Audit of Receipts of NGO**
 Covers all receipts, ensuring compliance with statutory and internal control standards:
1. Contributions and Grants
 - a. Verify grants/donations with agreements, grant letters, and bank statements.
 - b. Foreign contributions:
 - i. Ensure compliance with RBI guidelines.
 - ii. Verify deposits in FCRA bank accounts.
 2. Internal Controls
 - a. Identify responsible persons for fund collection.
 - b. Verify mode of receipt.
 - c. Ensure proper accounting and daily deposit of collections in the bank.
 3. Membership Fees
 - a. Match fees with the membership register.
 - b. Differentiate entrance fees, annual fees, and life membership fees.
 - c. Reconcile fees received with expected collections.
 4. Subscription
 - a. Verify receipts with the subscription register and rate schedule.
 - b. Reconcile subscriptions received with dispatch records of magazines or periodicals.
 5. Interest and Dividends
 - ✓ Check interest and dividends received or receivable against investments held.

4. Audit of Sole Trader

Content	
A.	<p>No Legal Obligation</p> <ul style="list-style-type: none"> ✓ Sole traders are not legally required to have their accounts audited. ✓ However, audits are often done due to: <ol style="list-style-type: none"> a. Regulatory requirements (e.g., inventory brokers). b. Bank requirements for loan approvals.
B.	<p>Appointment of Auditor</p> <ol style="list-style-type: none"> a. Auditor Appointment: Made by the sole proprietor. b. Change of Auditor: Incoming auditor must communicate with the previous auditor. c. Scope and Conditions: Determined by the sole proprietor, including: <ol style="list-style-type: none"> i. Whether to conduct a partial or full audit. ii. Specific areas to be excluded from audit. iii. Auditor's responsibility to prepare final statements of accounts. iv. Whether the audit is conducted continuously or at the end of the year.
C.	<p>Contract of Appointment</p> <ul style="list-style-type: none"> ✓ The contract of appointment should be in writing to clearly define the scope of work and prevent misunderstandings. ✓ If not in writing, the auditor should write to the client explaining: <ol style="list-style-type: none"> a. The scope of duties. b. Any limitations placed on the audit work. c. Obtain the client's confirmation on the scope.

- D. Similarities with Partnerships
- ✓ The **advantages** and audit procedures for a **partnership firm** are similar to those for a **proprietorship**.

5. Audit of Partnership Firm's

A. Special Points in Audit of a Partnership Firm

1. Letter of Appointment
 - ✓ Confirm it is signed by an **authorized partner** and clearly states the **scope of the audit** and any **limitations**.
2. Partnership Deed
 - ✓ Verify it is:
 - a. **Signed** by all partners.
 - b. **Registered** with the Registrar of Firms.
 - ✓ Review details such as **capital contribution**, **profit-sharing ratios**, interest on capital, and responsibilities.
3. Reading the Minutes
 - ✓ **Review policy decisions** related to:
 - a. Extraordinary and capital expenditure.
 - b. Loans, asset purchases, and contracts.
4. Business Authorization
 - ✓ Ensure the business activities align with the **partnership agreement** or its modifications.
5. Adequacy of Books of Account
 - ✓ Assess if books of account are **reasonable and adequate** for the business nature.
6. Partner Interests
 - ✓ Verify **no partner's interests are prejudiced** by unauthorized activities or violations of the partnership agreement.
7. Compliance with Tax Laws
 - ✓ Ensure provision for the firm's **tax payable** is made before calculating profits.
 - ✓ Verify compliance with provisions like **Section 44AB** of the Income Tax Act, 1961.
8. Profit and Loss Sharing
 - ✓ Confirm **profits and losses** are divided according to the agreed **ratios**.

B. Matters to Consider Before Audit

1. Partnership Agreement

Review details on:

 - a. **Name and style** of business.
 - b. **Duration** of the partnership.
 - c. **Capital contributions** and whether they are fixed or variable.
 - d. **Profit/loss sharing ratios**.
 - e. Responsibility for **loss bearing**.
 - f. Rules for **books of account**, **reserves**, and **depreciation**.
 - g. **Borrowing capacity** and limits.
 - h. Rates of **interest on capital**, **loans**, and **drawings**.

- i. Rules for **salaries** or withdrawals for partners.
- j. **Duties** and management roles of partners.
- k. **Bank operations** and surplus fund investments.
- l. **Restrictions** and limitations on partner powers.

C. Advantages of Audit of a Partnership Firm

1.	Disputes ✓ Audited accounts help settle accounts and reduce the risk of disputes .
2.	Dissolution ✓ Provide reliable evidence for computing dues during retirement or death of a partner.
3.	Reliability ✓ Audited accounts are trusted by banks for loans and by buyers for assessing profitability and financial position .
4.	Admission ✓ Useful for negotiations during the admission of a new partner , especially with past audited accounts.
5.	Control ✓ Safeguard against undue advantage taken by working partners , especially for inactive partners.

6. Audit of LLP's

Content	
A.	Overview of LLP Act <ol style="list-style-type: none"> 1. Governed by the Limited Liability Partnership Act, 2008. 2. Combines features of Company and Partnership. 3. Minimum of 2 Partners, including 2 Designated Partners with DPIN (Designated Partner Identification Number). 4. Small LLP: <ol style="list-style-type: none"> a. Contribution \leq ₹25,00,000 (or prescribed limit up to ₹5 crore). b. Turnover \leq ₹40,00,000 (or prescribed limit up to ₹50 crore).
B.	Books of Accounts LLPs must maintain: <ol style="list-style-type: none"> 1. Records of money received and expended. 2. Details of assets and liabilities. 3. Statements of inventory, costs of goods, and finished goods. 4. Any other particulars as decided by the partners.
C.	Requirement of Audit <ol style="list-style-type: none"> 1. Audit required as per Rule 24 of LLP Rules, 2009. 2. Exceptions: An LLP whose <ol style="list-style-type: none"> a. Turnover \leq ₹40,00,000 or b. contribution \leq ₹25,00,000. 3. Partners may voluntarily decide to audit accounts even if not required.
D.	Appointment of Auditor Including filling of Casual Vacancy

1. Authority:
 - a. Designated partners appoint the auditor.
 - b. Other partners may appoint if designated partners fail to do so.
2. Time Limits:
 - a. First auditor: Appointed anytime during the first financial year.
 - b. Subsequent auditor: Appointed 30 days prior to year-end (except in the first financial year).

E. Returns to be maintained and Regulatory Compliance

Form	Timeline
Annual Return	Every LLP must file Form 11 with ROC within 60 days of the end of the financial year. The return is available for public inspection upon payment of prescribed fees to the Registrar.
Statement of Account and Solvency	LLPs must submit Form 8 within 30 days from the end of the 6 months period of the financial year to which it relates.

F. Advantages of Audit
Refer advantages for Partnership Firms.

G. Auditor's Duty

1. Engagement Letter: Obtain written instructions regarding the scope of work.
2. Minutes Books: If partners maintain minute books, he shall refer it for any resolution passed regarding the accounts.
3. Review the LLP Agreement for:
 - a. Nature of business and
 - b. Capital contributions.
 - c. Interest,
 - d. Drawings,
 - e. Salaries, and profit-sharing ratios.
 - f. Borrowing powers,
 - g. Partner rights/duties.
 - h. Settlement methods for admissions, retirements, or dissolutions.

H. Reporting

Auditor must report:

1. Whether records are correct and reliable.
2. Whether all information and explanations were obtained.
3. Whether any restrictions were imposed during the audit.

7. Audit of Charitable Institution

Content

A. Background

1. Study the constitution of the charitable institution (e.g., society, trust, or company limited by guarantee).
2. Verify compliance with the law under which the institution was set up.

B.	<p>Subscriptions and Donations</p> <ol style="list-style-type: none"> 1. Check receipt books for the review period and ensure control over unused books. 2. Agree total collections shown in accounts with: <ol style="list-style-type: none"> a. Acknowledgment receipts. b. Cash book entries. c. Printed subscription/donation lists or published figures. 3. Examine internal controls over collections and ensure proper accounting and bank deposits. 4. Ascertain changes in annual or life membership subscription amounts during the year.
C.	<p>Legacies and Grants</p> <ol style="list-style-type: none"> 1. Verify grants with relevant papers and if any expense is disallowed, ascertain reasons. 2. Vouch amounts received with correspondence, receipts, and minute books.
D.	<p>Investment Income</p> <ol style="list-style-type: none"> 1. Vouch amounts with dividend/interest counterfoils and investment schedules. 2. Inspect securities physically and investigate non-income-generating investments. 3. Check proper receipt of dividends for ex-dividend sales or cum-dividend purchases.
E.	<p>Rents</p> <ol style="list-style-type: none"> 1. Verify rent amounts and due dates using the Rent Register and tenancy agreements. 2. Vouch rents received with the Rent Register, receipt book counterfoils, and cash book entries.
F.	<p>Special Functions</p> <ol style="list-style-type: none"> 1. Vouch gross receipts and expenses for events like concerts or performances. 2. Verify proceeds of tickets issued after accounting for returns.
G.	<p>Income Tax Refunds</p> <ul style="list-style-type: none"> ✓ Confirm refund of taxes deducted from investment income (e.g., interest on securities) has been claimed and recovered.
H.	<p>Expenditure</p> <ol style="list-style-type: none"> 1. Grants Payment: <ol style="list-style-type: none"> a. Ensure grants are for charitable purposes within the institution's objectives. b. Verify no trustee, director, or committee member has benefited directly or indirectly. 2. Verify schedules of securities and inventories of properties (movable and immovable) through inspection and physical verification. 3. Check cash and bank balances. 4. Confirm that funds for special purposes are utilized appropriately.

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

Content	
A.	<p>General</p> <ol style="list-style-type: none"> 1. Examine the Trust Deed, Regulations, or Act of Legislature under which the institution is set up. 2. Review minutes of Managing Committee or Governing Body meetings to ensure: <ol style="list-style-type: none"> a. Compliance with resolutions.

	b. Decisions regarding bank operations and expenditure sanctioning.
B.	<p>Audit of Fee Received from Students</p> <ol style="list-style-type: none"> 1. Verify Students' Fee Register with class registers for names and fees charged. 2. Match fee receipts with cash book entries and confirm all revenue is duly accounted for. 3. Total columns of the Fees Register to ensure fees paid in advance are carried forward and arrears are written off with proper sanction. 4. Check admission fees with admission slips; confirm credit to Capital Fund, unless decided otherwise. 5. Confirm that free studentships and concessions are authorized as per prescribed rules. 6. Ensure internal checks exist for raising proper demands against students. 7. Verify fines and confirm proper authority for collection or remission. 8. Check that hostel dues are recovered before refunding caution money. 9. Report old heavy arrears of fees or dormitory rents to the Managing Committee. 10. Ensure caution money and deposits are shown as liabilities in the balance sheet.
C.	<p>Legacies, Grants, and Donations</p> <ol style="list-style-type: none"> 1. Verify grants with relevant papers and ensure compliance with disallowed expenses. 2. Vouch amounts with correspondence, receipts, and minute books. 3. Check that specific-purpose donations are utilized accordingly.
D.	<p>Investment Income</p> <ol style="list-style-type: none"> 1. Vouch amounts with dividend/interest counterfoils and inspect securities physically. 2. Verify appropriate dividend receipt for ex-dividend sales or cum-dividend purchases. 3. Ensure endowment fund investments are kept separate and excess income is reinvested with the corpus.
E.	<p>Assets and Liabilities</p> <ol style="list-style-type: none"> 1. Report old heavy arrears of fees or rents to the Managing Committee. 2. Ensure caution money and deposits are shown as liabilities unless deemed non-refundable. 3. Verify inventories (e.g., furniture, stationery, provisions) with the Inventory Register and previous year records. 4. Check inspection system for receipts and issues of provisions, clothing, and equipment.
F.	<p>Compliances</p> <ol style="list-style-type: none"> 1. Income Tax/TDS: Confirm refund of taxes deducted from investment income (e.g., interest on securities). 2. Verify annual statements of accounts, ensuring separate statements for specific funds (e.g., Poor Boys Fund, Games Fund, Hostel, and Provident Fund).
G.	<p>Expenditure</p> <ol style="list-style-type: none"> 1. Vouch all capital expenditure and verify sanction by the Committee. 2. Check establishment expenses and investigate unusually high expenditures. 3. Verify salary increases are sanctioned and minuted by the Committee. 4. Ensure proper authorization for bills and receipts related to provisions, foodstuffs, and equipment.

9. Audit of Hospital

Content	
1.	<p>Register of Patients</p> <ul style="list-style-type: none"> a. Verify patient registers with bills issued. b. Verify bills for a selected period with attendance records to ensure accuracy. c. Confirm bills are issued to all patients as per hospital rules.
2.	<p>Collection of Cash</p> <ul style="list-style-type: none"> ✓ Check cash collections in the Cash Book against receipts, counterfoils, patient bills, and other evidence.
3.	<p>Income from Investments and Rent</p> <ul style="list-style-type: none"> ✓ Use the Property and Investment Register to confirm all income from rent, dividends, and interest has been collected.
4.	<p>Legacies and Donations</p> <ul style="list-style-type: none"> ✓ Verify that legacies and donations for specific purposes are applied as agreed.
5.	<p>Reconciliation of Subscriptions</p> <ul style="list-style-type: none"> ✓ Trace collections from the Cash Book to respective registers. ✓ Reconcile subscriptions due with the amount collected and amounts still outstanding.
6.	<p>Authorization and Sanctions</p> <ul style="list-style-type: none"> ✓ Vouch all purchases and expenses. ✓ Confirm capital expenditure is sanctioned by Trustees or the Managing Committee. ✓ Ensure staff appointments and increments are properly authorized.
7.	<p>Grants and TDS</p> <ul style="list-style-type: none"> ✓ Verify accounting of grants from Government or local authorities. ✓ Ensure refunds for taxes deducted at source (TDS) have been claimed.
8.	<p>Budgets</p> <ul style="list-style-type: none"> ✓ Compare actual income and expenses with budgeted amounts. ✓ Report significant variations to Trustees or the Managing Committee.
9.	<p>Internal Check</p> <ul style="list-style-type: none"> ✓ Review internal checks for receipt and issue of stores (e.g., medicines, linen, instruments). ✓ Ensure purchases are recorded in the Inventory Register and issues are properly authorized.
10.	<p>Depreciation</p> <ul style="list-style-type: none"> ✓ Verify depreciation is written off for all assets at appropriate rates.
11.	<p>Registers</p> <ul style="list-style-type: none"> ✓ Inspect bonds, share scrips, title deeds, and compare details with the Property and Investment Registers.
12.	<p>Inventories</p> <ul style="list-style-type: none"> ✓ Obtain year-end inventories of stocks and stores. ✓ Physically verify a percentage of items and compare totals with ledger balances.
13.	<p>Management Representation and Certificate</p> <ul style="list-style-type: none"> ✓ Obtain Management Representation and a certificate for various audit aspects.

10. Audit of Club

Content	
1.	<p>Entrance Fee</p> <ul style="list-style-type: none"> ✓ Vouch receipts with members' applications, counterfoils, and the minutes of the Managing Committee.
2.	<p>Subscriptions</p> <ul style="list-style-type: none"> ✓ Vouch members' subscriptions with receipt counterfoils and trace to the Register of Members. ✓ Reconcile total subscriptions due, collected, and outstanding.
3.	<p>Arrears of Subscriptions</p> <ul style="list-style-type: none"> ✓ Confirm arrears from the previous year are correctly brought forward. ✓ Verify current-year arrears and subscriptions received in advance are properly adjusted.
4.	<p>Arithmetical Accuracy</p> <ul style="list-style-type: none"> ✓ Check totals of columns in the Register of Members and ensure they tally.
5.	<p>Irrecoverable Member Dues</p> <ul style="list-style-type: none"> ✓ Identify arrears in the Register of Members and confirm recovery efforts. ✓ Report amounts deemed irrecoverable in the Audit Report.
6.	<p>Pricing</p> <ul style="list-style-type: none"> ✓ Verify charges for foodstuffs, drinks, and special services (e.g., billiards, tennis) for members and their guests.
7.	<p>Member Accounts</p> <ul style="list-style-type: none"> ✓ Trace debits for a selected period from subsidiary registers to confirm all amounts recoverable from members are debited.
8.	<p>Purchases</p> <ul style="list-style-type: none"> ✓ Vouch purchases of sports items, furniture, crockery, etc., and trace entries into respective inventory registers.
9.	<p>Margins Earned</p> <ul style="list-style-type: none"> ✓ Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale prices to confirm normal gross profit margins. ✓ Physically verify and value unsold provisions and stores at year-end.
10.	<p>Inventories</p> <ul style="list-style-type: none"> ✓ Physically verify furniture, sports materials, and other assets against inventory registers or end-of-year inventories.
11.	<p>Investments</p> <ul style="list-style-type: none"> ✓ Inspect share scrips and bonds, verify their current values for disclosure, and ensure safe custody arrangements.
12.	<p>Management Powers</p> <ul style="list-style-type: none"> ✓ Examine the financial powers of the secretary and report cases where they were exceeded for confirmation by the Managing Committee.

11. Audit of Cinema

Content	
A.	<p>Audit of Receipts from Daily Show Collections</p> <ol style="list-style-type: none"> Verify: <ol style="list-style-type: none"> Entrance is only through printed tickets. Tickets are serially numbered and bound into books. Different ticket series for each show and class. Separate ticket series for advance bookings. Inventory of tickets is properly maintained. For computerized ticketing, audit the system for reliability and data authenticity. Ensure proper statements are prepared after each show and cash collected is tallied. Vouch entries in the Cash Book with Daily Statements and tickets issued for shows. Verify cash deposits in the bank (partly same day, partly next day). Ensure free passes are properly recorded and issued with authorization. Reconcile Entertainment Tax collected with total tickets issued for each class.
B.	<p>Income from Advertisement</p> <ul style="list-style-type: none"> ✓ Verify charges collected for advertisement slides and shorts with the Register of Slides and Shorts and advertiser agreements.
C.	<p>Restaurant Income</p> <ol style="list-style-type: none"> Enquire into the arrangement for the share of restaurant income. If the cinema runs the restaurant, check its accounts, including sales of foodstuffs and purchases. Audit is similar to a club for food and beverage accounts. Verify other incomes like car/scooter parking and display windows.
D.	<p>Expenditure</p> <ol style="list-style-type: none"> Vouch expenditure on advertisements, repairs, and maintenance (not capitalized). Verify expenses for publicity, electricity, etc. Confirm depreciation on machinery and furniture at appropriate rates, which are generally higher than those for other businesses. Vouch payment of film hire with distributor/producer agreements. Examine unadjusted advances paid to distributors to ensure they are recoverable. Investigate advances for films already run and request management to provision for irrecoverable advances.

12. Audit of Hire Purchase Companies

Content	
A.	<p>Hire Purchase</p> <p>Definition: An agreement where goods are let on hire with an option for the hirer to purchase them under agreed terms.</p> <p>Key Elements:</p> <ol style="list-style-type: none"> Possession of goods is delivered by the owner to the hirer, who pays in instalments. Ownership passes to the hirer upon payment of the final instalment.

	iii. Hirer can terminate the agreement any time before ownership transfer.
	<p>Key Terms</p> <ul style="list-style-type: none"> ✓ Hirer: The person who obtains possession of goods under a hire-purchase agreement. ✓ Owner: The person who delivers possession of goods under a hire-purchase agreement to facilitate the purchase. ✓ Deposit: Includes any initial payment by the hirer under the agreement.
B.	<p>Audit Procedure</p> <p>Steps to verify hire-purchase transactions:</p> <ol style="list-style-type: none"> 1. Hire Purchase Agreement <ul style="list-style-type: none"> ✓ Ensure the agreement is in writing and signed by all parties. ✓ Verify the agreement includes: <ol style="list-style-type: none"> a. Hire-purchase price of the goods. b. Cash price (price for outright purchase). c. Starting date of the agreement. d. Details of instalments: <ul style="list-style-type: none"> ▪ Number of instalments. ▪ Amount and due dates. ▪ Payee and payment location. e. Description of goods for identification. 2. Instalment Payments <ul style="list-style-type: none"> ✓ Ensure instalments are being received regularly as per the agreement.

13. Audit of Leasing Entities

Content	
1.	<p>Lease Agreement</p> <p>A lessee acquires the right to use an asset for a specific time by paying rent to the lessor</p> <p>Types of Leases</p> <ol style="list-style-type: none"> a. Finance Lease: Qualifies if: <ol style="list-style-type: none"> i. Ownership transfers to the lessee at lease end. ii. Lessee has a purchase option at a price lower than fair value. iii. Lease term covers the major part of asset life. iv. Present value of lease payments equals or exceeds fair value of the asset. v. Asset is specialized for the lessee. b. Operating Lease: Does not transfer substantial risks and rewards of ownership.
2.	<p>Finance Lease Process</p> <ol style="list-style-type: none"> a. Lessee selects the equipment and verifies its suitability. b. Lessee approaches a lessor directly or through a broker. c. Lease agreement is negotiated, and the lessor orders the equipment from the manufacturer. d. Manufacturer delivers the equipment to the lessee, who accepts it. e. Lease agreement is signed, specifying terms and duration. f. During the lease period, the lessee: <ul style="list-style-type: none"> ✓ Pays regular rentals as agreed.

	<ul style="list-style-type: none"> ✓ Maintains the equipment in good condition. ✓ Benefits from manufacturer warranties and services. <p>g. At end of the lease period, the equipment returns to the lessor, or the lessee may have renewal rights or purchase options (not specified in the agreement).</p>
3.	<p>Auditor's Procedures</p> <p>a. Verify the leasing company's object clause to ensure authority for leasing or financing activities.</p> <p>b. Assess lessee's creditworthiness (past credit, capital strength, collateral security).</p> <p>c. Examine the lease agreement for:</p> <ol style="list-style-type: none"> i. Details of lessor, lessee, equipment, and location. ii. Tenure, payments, late charges, and other terms. iii. Clause for equipment return at lease end, with costs borne by the lessee. iv. Prohibition on subletting and rights for lessor to assign or sublet. <p>d. Review the lease proposal form submitted by the lessee.</p> <p>e. Ensure the invoice for equipment is retained safely.</p> <p>f. Verify the lessee's acceptance letter for delivered equipment.</p> <p>g. Check Board resolution authorizing the lease agreement.</p> <p>h. Confirm copies of insurance policies are obtained for lessor's records.</p>

	Operating Lease	Financial Lease
Common examples	Lease of Projector, Computers, Laptops, Coffee Dispensers etc.	Lease of Plant and Machinery, Land, Office Building etc.
Ownership	Ownership of the asset remains with the lessor for the entire period of lease.	Ownership transfer option at the end of the lease period is with the lessee. Title may or may not be eventually transferred.
Accounting treatment	Operating lease is generally treated like a renting arrangement . That means, the lease payments are treated as operating expenses and the asset does not appear as an asset on lessee's balance sheet .	Financial lease is treated like loan arrangement . Hence, the asset ownership is considered as of the lessee and thus appears on the balance sheet of the lessee .
Purchase Option	Under operating lease, the lessee does not have any option to buy the asset during the lease period.	Financial lease allows the lessee to have a purchase option at less than the fair market value of the asset.
Lease Term	Lease term generally extends to less than 75% of the projected useful life of the leased asset.	Lease term is generally more than or equal to estimated economic life of the asset under the lease arrangement.
Operating/running expenses	Lessee pays only the monthly lease payments . No running or administration costs are to be borne.	Lessee generally bears insurance, maintenance and taxes .
Tax benefit	Since operating lease is as good as renting , lease payment is considered as expense. No depreciation can be claimed by the lessee.	Lessee can claim both interest and depreciation expense as financial lease is treated like a loan.

14. Audit of Hotels

Content	
A.	<p>Internal Control</p> <ul style="list-style-type: none"> ✓ Ensure proper control over: <ol style="list-style-type: none"> 1. Receipts and disbursements of cash. 2. Purchasing and stocking of commodities and provisions. 3. Customer billing for room service, telephone, laundry, etc. 4. Recording and custody of edibles, wines, cigarettes, and assets like crockery, cutlery, linen, furniture, carpets.
B.	<p>Room Sales and Cash Collections</p> <ol style="list-style-type: none"> 1. Verify room charges from the guest register and ensure accuracy for period of stay. 2. Reconcile total sales with total bills issued at sales points. 3. Verify bills for credit customers and ensure payments are made within specified terms. 4. Ensure billing is room-wise and customers pay bills upon departure or within agreed dates. 5. Verify restaurant bills with Kitchen Order Tickets (KOT). 6. Compare occupancy rates with similar hotels and previous years. Investigate deviations. 7. Check compliance with statutory provisions and Foreign Exchange Regulations, especially currency conversion facilities.
C.	<p>Receipts from Function Halls</p> <ul style="list-style-type: none"> ✓ Verify special receipts from auditorium, banquet hall, shop spaces, and shows against arrangements made.
D.	<p>Sharing Income from Travel Agents</p> <ol style="list-style-type: none"> 1. Ensure recovery of amounts from travel agents as per credit terms. 2. Verify commission payments to travel agents with agreements.
E.	<p>Inventory</p> <ol style="list-style-type: none"> 1. Ensure proper documentation of inventory movement and transfers. 2. Inventory areas should remain locked with keys retained by trusted personnel. 3. Auditor should verify physical inventory at year-end, considering materiality and location. 4. Control over edibles, linen, crockery, cutlery, glassware, silver, and toilet items must be verified.
F.	<p>Fixed Assets</p> <ul style="list-style-type: none"> ✓ Ensure depreciation is applied appropriately, and the Fixed Assets Register is updated.
G.	<p>Casual Labour</p> <ol style="list-style-type: none"> 1. Confirm adequate records for casual labour are maintained. 2. Check wages payments to casual labour for accuracy and prevent manipulation.
H.	<p>Expenditure</p> <ol style="list-style-type: none"> 1. Trace inventory consumption to customers' bills to confirm all issues are billed. 2. Verify payments to foreign collaborators, if applicable. 3. Compare expenses and receipts with the previous year. 4. Check painting, decoration, and renovation expenses. 5. Verify salaries and wages against the number of employees.

15. Audit of Trusts & Societies

Content	
A.	<p>Legal Framework Charitable entities can be trusts, societies, or section 8 companies.</p> <ol style="list-style-type: none"> Public Trusts: Governed by the Public Trust Act (state-specific) or Indian Trusts Act, 1882 (if no state law exists). Societies: Governed by the Societies Registration Act, 1860. Section 8 Companies: Governed by the Companies Act, 2013. Additional applicable laws: Income Tax Act, 1961 and Foreign Contribution (Regulation) Act, 2010 (for foreign contributions).
B.	<p>Books of Account Charitable entities must maintain:</p> <ol style="list-style-type: none"> Cash book, Ledger, Journal. Copies of bills and receipts, machine/serially numbered. Original bills and receipts for payments. Any additional books required for a true and fair view of accounts.
C.	<p>Financial Statements</p> <ul style="list-style-type: none"> ✓ Prepare Balance Sheet and Income & Expenditure Statements annually, as per respective state laws. ✓ Different laws/forms may necessitate unique accounting requirements.
D.	<p>Auditor's Responsibility</p> <ol style="list-style-type: none"> Obtain list of maintained books and records and verify compliance. Follow Accounting Standards (AS) and Standards on Auditing (SA). Use audit tests, considering internal controls, materiality, and professional expertise. Maintain detailed working papers, including: <ol style="list-style-type: none"> Work done and explanations provided. Judicial pronouncements relied upon. Certificates and management representations. Ensure audit opinion is based on complete and accurate information and explanations.
E.	<p>Trusts Auditor must ascertain:</p> <ol style="list-style-type: none"> Regular maintenance of accounts as per the applicable Act. Proper application of donations as per trust objectives or donor directions. Agreement of cash balances and vouchers with accounts. Maintenance of property registers and communication of changes. Compliance with prior audit recommendations and rectifications. Any irregularities, breaches, or misuse of trust funds. Proper recording of anonymous donations and cash donation limits.
F.	<p>Societies Auditor's focus includes:</p> <ol style="list-style-type: none"> Governing legislation and objectives (e.g., charitable, social, cultural). Registration under FCRA, 2010 (if receiving foreign contributions) and Income Tax Act for exemptions. Adequacy of internal controls for donations and expenditures.

4. Appropriateness of **accounting policies** for donations and grants.
5. Recognition of **donor-reimbursed expenses** in financial statements.
6. Inquiry reports from **Registrar** under applicable laws and implications for auditor's opinion.
7. Any cases of **irregular, illegal, or improper expenditure** or waste of society funds.

16. Audit of Co-Operative Societies

A. Background of Cooperative Societies Audit

1. **Background**
 1. A **Cooperative** [AKA co-op] is an **autonomous association** of persons united to meet their economic, social, and cultural needs through a jointly-owned enterprise.
 2. The **Co-operative Societies Act, 1912** provides fundamental laws for the formation and working of co-operative societies in India.
 3. **Many states have specific Acts** (e.g., Maharashtra, West Bengal, Orissa) governing co-operative societies.
 4. Co-operative societies eliminate **middlemen** and **external exploitation** by pooling resources and doing business co-operatively.
 5. The auditor **must be familiar with the Act** applicable to the society under audit.
2. **Role of Auditor**
 - ✓ A **Chartered Accountant** plays a key role in the **development** of co-operative organisations through:
 - a. Guidance in Accounts Writing.
 - b. Installation of Accounting Systems.
 - c. Internal Audit.
 - d. Management Accounting Services.
 - e. Taxation services.

B. Audit of Cooperative Societies u/s 17

1. **Audit Authority**
 - ✓ The **Registrar** or a person authorised by them (via **general** or **special order**) must ensure that the accounts of every registered society are **audited at least once every year**.
2. **Scope of Audit**
 - ✓ The audit must include:
 - a. Examination of **overdue debts** (if any).
 - b. **Valuation of assets and liabilities** of the society.
3. **Access and Information**
 - ✓ The Registrar, Collector, or authorised person has:
 - a. **Access to all books, accounts, papers, and securities** of the society at all times.
 - b. The right to require **information** on the society's transactions and working from any officer of the society.
4. **Registrar**
 - ✓ The **Registrar** refers to the person appointed to perform the duties of **Registrar of Co-operative Societies** under the applicable Act.

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

1.	<p>Overview of MSCS</p> <ol style="list-style-type: none"> The Multi-State Co-operative Societies Act, 2002 applies to co-operative societies whose objects extend beyond a single State. The Act provides detailed provisions for registration, membership, and management of these societies. Funds of a multi-state co-operative society cannot be used for political purposes. Includes provisions for investment of funds, and restrictions on loans and borrowings.
2.	<p>Books of Accounts</p> <p>Every MSCS must maintain books for:</p> <ol style="list-style-type: none"> All money received and expended and details of related transactions. All sales and purchases of goods. Assets and liabilities of the society. For societies engaged in production, processing, or manufacturing: Details of material utilization, labour, and other cost items as specified in the society's bye-laws.

D. Qualifications and Disqualifications of Auditors of MSCS

A.	<p>Qualification of Auditors</p> <p>As per Section 72 of the Multi-State Co-operative Societies Act, 2002, only a Chartered Accountant (as defined in the Chartered Accountants Act, 1949) can be appointed as an auditor.</p>
B.	<p>Disqualification of Auditors</p> <p>The following persons are not eligible for appointment:</p> <ol style="list-style-type: none"> A body corporate. An officer or employee of the multi-State co-operative society. A person who is a member or in the employment of an officer or employee of the society. A person who: <ol style="list-style-type: none"> Is indebted to the society. Has given a guarantee to the society. Has provided any security for a third person's indebtedness Exceeding Rs. 1000.
C.	<p>Vacation of Office</p> <p>If an auditor becomes disqualified after appointment, they are deemed to have vacated their office.</p>
D.	<p>Appointment of First Auditors</p> <ul style="list-style-type: none"> ✓ Authority to appoint: <ol style="list-style-type: none"> Board of the society, within 1 month of registration. If the board fails, the general meeting may appoint the first auditor. ✓ Tenure: Till the conclusion of the first annual general meeting.
E.	<p>Appointment of Subsequent Auditors</p> <ul style="list-style-type: none"> ✓ Authority to appoint: By members at each annual general meeting. ✓ Tenure: From the conclusion of that meeting until the conclusion of the next annual general meeting.

E. Powers of Auditors of MSCS

1. **Right of Access:** The auditor has the right to access the **books, accounts, and vouchers** of the multi-State co-operative society at all times, whether kept at the **head office** or elsewhere.
2. **Inquiry and Information:** The auditor can Inquire the **officers** or **employees** of the society and request any **information or explanation** they deem necessary.

F. Duties of Auditor of MSCS

1. **Duty of Auditors to Make Inquiry (Sec. 73(2))**
The auditor must inquire into the following:
 1. **Loans and Advances:**
 - a. Whether they are **properly secured**.
 - b. Whether their **terms** are **not prejudicial** to the interests of the society or its members.
 2. **Book Entries:** Whether transactions represented merely by **book entries** are **not prejudicial** to the interests of the society.
 3. **Personal Expenses:** Whether **personal expenses** have been charged to the revenue account.
 4. **Shares Allotted for Cash:**
 - a. Whether **cash** has **actually been received** for such allotments.
 - b. Whether the position stated in the **balance sheet** is correct and not misleading.
2. **Duty to Report (Sec. 73(3))**
The auditor must report to the members of the society on:
 1. The **accounts examined** and the **balance sheet** and **profit and loss account**, including notes.
 2. Whether the accounts provide:
 - a. A **true and fair view** of the **state of affairs** (balance sheet).
 - b. A **true and fair view** of the **profit or loss** (profit and loss account).
3. **Duty to State Matters (Sec. 73(4))**
The auditor's report must also state:
 1. Whether the auditor has obtained **all necessary information** and explanations.
 2. Whether, in their opinion, **proper books of account** have been kept and **adequate returns** received from branches.
 3. Whether reports from **branch office auditors** were received and how they were dealt with.
 4. Whether the **balance sheet** and **profit and loss account** agree with the books and returns.
 5. If any matter is answered **negatively** or with a **qualification**, the reasons must be stated in the report.

G. Special Audit of MSCS under CG order

1. **Passing an Order by CG**
Circumstances Necessitating Special Audit:
 - a. **Affairs of the society** are **not managed** as per co-operative principles or prudent commercial practices.

	<p>b. Management is likely to cause serious injury or damage to the interests of the relevant trade, industry, or business.</p> <p>c. Financial position endangers the society's solvency.</p> <p>Condition for Passing Order: The Central Government or State Government must hold 51% or more of the paid-up share capital of the society.</p>
2.	<p>Procedure for Conducting Special Audit</p> <ol style="list-style-type: none"> 1. Appointing Special Auditor: The CG may appoint either: <ol style="list-style-type: none"> a. Another chartered accountant or b. The society's existing auditor. 2. Powers of Special Auditor: The special auditor has the same powers and duties as under Section 73. 3. Reporting by Special Auditor: <ol style="list-style-type: none"> a. Reports to Central Government. b. Includes all matters as per Section 73 and any other as directed by the CG. 4. Action Taken by CG: <ol style="list-style-type: none"> a. CG may take action on the report as per the Act or other laws. b. If no action is taken within 4 months, CG shall: <ol style="list-style-type: none"> i. Send the report and comments to the Multi-State Co-operative Society. ii. Require the society to circulate the report or have it read at the general meeting.
3.	<p>Expenses of Special Audit</p> <ul style="list-style-type: none"> ✓ Expenses and remuneration of the special audit are determined by the CG. ✓ These are paid by the society. ✓ If unpaid, they are recoverable as arrears of land revenue.

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

A.	<p>Eligibility to Apply for Inquiry/Inspection</p> <ol style="list-style-type: none"> 1. Creditor of the multi-State co-operative society. 2. Not less than 1/3rd of the members of the board. 3. Not less than 1/5th of the total members of the society.
B.	<p>Authority to Apply</p> <ul style="list-style-type: none"> ✓ The application must be made to the Central Registrar.
C.	<p>Inquiry By Whom</p> <ol style="list-style-type: none"> 1. Registrar himself. 2. A person authorized by the Registrar.
D.	<p>Notice to Society</p> <ul style="list-style-type: none"> ✓ A 15-day notice must be given to the society before initiating the inquiry.
E.	<p>Powers of the Person Conducting Inquiry / Inspection</p> <ol style="list-style-type: none"> 1. Access to Books: Right to access books, accounts, documents, and other properties of the society. 2. Call General Meeting: <ol style="list-style-type: none"> a. May require society officers to call a general meeting with at least 7 days' notice. b. If officers fail or refuse, the person can call the meeting themselves. 3. Issue Summons: <ol style="list-style-type: none"> a. Can summon any person believed to have knowledge of the society's affairs.

	b. Can examine such a person under oath .
F.	<p>Report by Central Registrar</p> <ul style="list-style-type: none"> ✓ The Central Registrar must communicate the inquiry/inspection report within 3 months of receipt to: <ul style="list-style-type: none"> 1. The multi-State co-operative society. 2. The person or authority at whose request the inquiry was initiated.

I. Special Features of Audit of Cooperative Societies

A.	<p>Examination of Overdue Debts</p> <ol style="list-style-type: none"> 1. Classification: Overdue debts classified as: <ol style="list-style-type: none"> a. 6 months to 5 years. b. More than 5 years. 2. Comparison with Previous Year: Compare overdue debts and their ratio to total working capital with the previous year. 3. Assessing Recovery: Analyse overdue debts as good or bad. 4. Provisions for Doubtful Debts: Ensure adequate provisions are made.
B.	<p>Overdue Interest</p> <ol style="list-style-type: none"> 1. Meaning: Interest accrued on accounts where the principal is overdue. 2. Accounting Treatment: <ol style="list-style-type: none"> a. Exclude overdue interest from interest income when calculating profit. b. Credit to Overdue Interest Reserve and transfer to profit and loss account only after realization.
C.	<p>Certification of Bad Debts</p> <ol style="list-style-type: none"> 1. Auditor Authorization: Required auditors authorisation for write-off in some state acts (e.g., Maharashtra State Co-operative Rules, 1961). 2. Managing Committee Authorization: If no such legal requirement exists.
D.	<p>Valuation of Assets and Liabilities</p> <ol style="list-style-type: none"> 1. Assets: <ol style="list-style-type: none"> a. Verify existence, ownership, and valuation. b. Fixed assets at cost less depreciation; current assets at cost or market price (whichever is lower). 2. Liabilities: Ensure all known liabilities are accounted for and contingent liabilities disclosed via notes.
E.	<p>Adherence to Co-operative Principles</p> <ol style="list-style-type: none"> 1. Society Objectives: Check if society's functioning aligns with its objectives and benefits members. 2. Propriety Principles: <ol style="list-style-type: none"> a. Ensure expenses are economical and funds are not wasted. b. Avoid middlemen commissions and ensure direct purchases.
F.	<p>Compliance with Act and Rules</p> <p>Auditor must identify non-compliance with Co-operative Societies Act, Rules, and bye-laws.</p>
G.	<p>Verification of Members' Register</p> <ul style="list-style-type: none"> ✓ Verify entries in members' passbooks regarding loans and repayments. ✓ Confirm loan balances in person, especially in rural/agricultural credit societies.
H.	<p>Special Report to Registrar</p>

	<p>Report irregularities such as:</p> <ol style="list-style-type: none"> 1. Personal profiteering by management detrimental to society's interest. 2. Fraud detection (expenses, purchases, property, stores). 3. Issues of Mismanagement, e.g., reckless advances without adequate security.
I.	<p>Audit Classification of Society</p> <ol style="list-style-type: none"> 1. Auditor assigns a class to society based on Registrar's criteria. 2. Management can appeal to Registrar if dissatisfied with classification.
J.	<p>Discussion of Draft Audit Report</p> <ol style="list-style-type: none"> 1. Auditor discusses draft report with managing committee before finalization. 2. Secretary must convene a meeting for this discussion.

J. Special issues in Cooperative societies Act 1912

A.	<p>Qualifications of Auditors</p> <ol style="list-style-type: none"> 1. Chartered accountants as per the Chartered Accountants Act, 1949 or 2. Diploma holders in co-operative accounts or those with experience in the Co-operative Department may also act as auditors (per some State Co-operative Acts).
B.	<p>Appointment of Auditor</p> <ol style="list-style-type: none"> 1. Appointed by the Registrar of Co-operative Societies. 2. Auditor conducts audit on behalf of the Registrar and submits the report to both the Registrar and the society. 3. Audit fees are paid based on a statutory scale of fees prescribed by the Registrar.
C.	<p>Books, Accounts, and Records</p> <ol style="list-style-type: none"> 1. Under Section 43(h) of the Central Act, State Governments prescribe books of account to be maintained, including: <ol style="list-style-type: none"> a. Receipts and expenditure details. b. Sales and purchases of goods. c. Assets and liabilities. 2. Large-scale societies may also maintain additional subsidiary books such as: <ol style="list-style-type: none"> a. Daily cash sales summary register. b. Loan disbursement register (for credit societies). c. Any other records depending on the society's nature and functions.
D.	<p>Restrictions on Shareholding (Sec. 5)</p> <p>Members cannot hold more than:</p> <ol style="list-style-type: none"> a. 20% of the total shares or b. Face value exceeding ₹ 1,000.
E.	<p>Restrictions on Loans (Sec. 29)</p> <p>✓ Loans can be made only to members, unless approved by the Registrar.</p>
F.	<p>Restrictions on Borrowings (Sec. 30)</p> <p>✓ Societies cannot accept loans or deposits from non-members, unless permitted by the bye-laws.</p>
G.	<p>Investment of Funds (Sec. 32)</p> <p>Funds can be invested in:</p> <ol style="list-style-type: none"> a. Central or State Co-operative Bank. b. Other banks approved by the Registrar.

	<p>c. Securities under Section 20 of the Indian Trusts Act, 1882.</p> <p>d. Shares or securities of other limited liability societies.</p> <p>e. In any other moneys permitted by CG/SG.</p>
H.	<p>Appropriation of Profits (Sec. 33) Societies must transfer a prescribed percentage of profits to a Reserve Fund before distributing dividends or bonuses.</p>
I.	<p>Contributions to Charitable Purposes (Sec. 34) Societies may contribute up to 10% of net profits (after Reserve Fund transfer) for charitable purposes with the Registrar's sanction.</p>
J.	<p>Use of Reserve Fund Reserve funds can be used for:</p> <ol style="list-style-type: none"> Working capital. Investments as per the Act. Public purposes promoting society's objectives.
K.	<p>Contribution to Education Fund Societies must contribute to the Education Fund of the State Federal Society at prescribed rates (treated as a charge on profits).</p>
L.	<p>Other Appropriations</p> <ol style="list-style-type: none"> Transfers to other reserves and dividends must be approved by the General Body. Accounting entries for appropriations are made after General Body approval (different from corporate practices). Transfers to Dividend Equalization Reserve and Share Capital Redemption Fund are treated as charges in some states, though they are appropriations per accounting principles. Auditors must spot contradictions between statutory provisions and accounting principles.

8. AUDIT STRATEGY, PLANNING AND PROGRAMME



1. Audit Strategy and Plan

A. Benefits of Planning Activities

1.	<p>Importance of Audit Planning Planning an audit is essential for effective and timely execution. It ensures compliance with professional standards and enhances the audit engagement.</p>
2.	<p>Benefits of Planning to the Auditor</p> <ol style="list-style-type: none"> Helps to focus and attentive on important audit areas. Helps to Identify and Resolves potential problems in a timely manner. Helps to organize and manage the audit for efficiency and effectiveness. Assists in selecting engagement team members with appropriate competence. Facilitates direction, supervision, and review of team members' work. Coordinates work among auditors of components and experts.
3.	<p>Impact on Audit Risk Adequate planning reduces audit risk to an acceptable low level and minimizes the risk of issuing an inappropriate opinion.</p>
4.	<p>Relevant Standard SA 300: Planning an Audit of Financial Statements. Objective: To plan the audit so that it is performed in an effective manner.</p>

B. Planning is a Continuous Process

A.	<p>Nature of Planning</p> <ol style="list-style-type: none"> Planning is not a discrete phase [specific] but a continual and iterative process. It begins after the completion of the previous audit and continues until the completion of the current audit engagement. The audit plan should be reviewed periodically to ensure it covers newly identified areas.
B.	<p>Considerations in Planning</p> <ol style="list-style-type: none"> Understanding the legal and regulatory framework applicable to the entity and its compliance. <ul style="list-style-type: none"> ✓ Example: Telecom companies and banks follow frameworks regulated by TRAI (Telecom Regulatory Authority of India) and RBI (Reserve Bank of India). Application of analytical procedures. Determination of materiality as per SA 320. Assessment of the need for expert's assistance. Performance of risk assessment procedures to identify and assess Risks of MMS.

C. Involvement of Various Members in Planning Process

1.	<p>Responsibility for Planning</p> <ol style="list-style-type: none"> The auditor is responsible for establishing the overall audit strategy and developing the audit plan. The auditor may discuss elements of planning with the entity's management, ensuring the effectiveness of the audit is not compromised.
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2.	<p>Involvement of Engagement Team</p> <p>a. The engagement partner and key engagement team members must be involved in planning the audit and discussions among team members.</p> <p>b. Their involvement enhances the effectiveness and efficiency of the planning process through their experience and insight.</p>
3.	<p>Discussion with Entity's Management</p> <p>a. The auditor may discuss planning elements with the entity's management to facilitate audit engagement.</p> <p>b. Ensure that the discussions do not compromise the effectiveness of the audit.</p> <p>c. Matters related to surprise checks should not be included in discussions with the client.</p>

D. Elements of Planning

1.	<p>Preliminary Engagement Activities</p> <p>a. Performing procedures related to acceptance and continuation of client relationship.</p> <p>b. Compliance with ethical requirements.</p> <p>c. Establishing understanding of terms of engagement.</p>
2.	<p>Planning Activities Includes</p> <p>a. Establishing the overall audit strategy.</p> <p>b. Developing an audit plan.</p>

E. Preliminary Engagement Activities

1.	<p>Acceptance and Continuation of Client Relationship</p> <p>The firm shall obtain the following information before accepting or continuing the audit:</p> <p>a. Integrity of principal owners and key management.</p> <p>b. Competence of the engagement team to perform the audit engagement.</p> <p>c. Implications of matters arising during current and previous engagements.</p> <p>d. For initial engagements, communicate with the predecessor auditor in case of a change.</p>
2.	<p>Relevant Ethical Requirements</p> <p>a. Continuously evaluate compliance with ethical requirements, including independence.</p> <p>b. The engagement partner shall remain alert for evidence of non-compliance with ethical requirements.</p> <p>c. In case of Non compliances with ethical requirements, The engagement partner takes appropriate actions.</p> <p>d. EP shall form conclusion on compliance with independence by:</p> <ul style="list-style-type: none"> ✓ Obtaining information to identify threats to independence. ✓ Evaluate identified breaches of firm independence policies ✓ Take appropriate action to eliminate the threat or reduce them to acceptable level by applying safeguards to address threats. [Withdraw if cannot be eliminated] ✓ Promptly report to the firm in case of unresolved matters to the firm.
3.	<p>Establish Terms of Engagement</p> <p>a. Send an engagement letter before starting the audit to avoid misunderstandings.</p> <p>b. Ensure there is no confusion with the client regarding the terms of engagement.</p>

F. How Overall Audit Strategy assists the Auditor

	<p>Purpose of Overall Audit Strategy Sets the scope, timing, and direction of the audit and guides the development of the detailed audit plan. Overall Audit Strategy assists the auditor in different ways:</p>
1.	<p>Resources to Deploy</p> <ol style="list-style-type: none"> Use of experienced team members for high-risk areas. Involvement of experts for complex matters.
2.	<p>Allocation of Resources</p> <ol style="list-style-type: none"> Assigning resources to specific audit areas (e.g., Team members for inventory counts). Extent of review of other auditors' work (e.g., In group audits). Allocating audit budget (e.g., hours for high-risk areas).
3.	<p>Timing of Resource Deployment Deciding when resources are deployed:</p> <ul style="list-style-type: none"> ✓ Interim audit stage. ✓ Key cut-off dates.
4.	<p>Management of Resources</p> <ol style="list-style-type: none"> Scheduling team briefing and debriefing meetings. Determining how reviews by engagement partners and managers will occur [On-site or off-site reviews]. Whether to complete engagement quality control reviews.

G. Factors to consider while establishing Overall Audit strategy

1.	<p>Characteristics of the Engagement that define its Scope The auditor identifies the scope of the engagement to establish a sound strategy. Such as:</p> <ul style="list-style-type: none"> ✓ Applicable financial reporting framework. ✓ Nature of business segments requiring specialized knowledge. ✓ Industry-specific reporting requirements (e.g., by regulators). ✓ Use of audit evidence from previous audits.
2.	<p>Reporting Objectives of Engagement Helps plan timing of audit procedures and communications. For example:</p> <ul style="list-style-type: none"> ✓ Entity's reporting timetable. ✓ Organising Meetings for discussing NTE of audit work with management. ✓ Discussing with management on type and timing of reports including audit reports. ✓ Communications with management about status of audit work during the engagement. ✓ Nature and timing of communication among engagement team including meetings and reviews.
3.	<p>Significant Factors in directing engagement Team Efforts Identification of MCOTs, ABs, Disclosures and Direct team efforts to significant matters to achieve desired outcomes.</p> <ul style="list-style-type: none"> ✓ Transaction volume affecting reliance on internal control. ✓ Significant industry developments (e.g., regulatory or reporting changes). ✓ Changes in financial reporting framework (e.g., accounting standards). ✓ Changes in the legal environment affecting the entity.

4.	<p>Consider Results of Preliminary Activities</p> <p>Uses knowledge from previous audits to enhance strategy. Example:</p> <ul style="list-style-type: none"> ✓ Results of past audits evaluating internal control effectiveness. ✓ Emphasis to engagement team on professional skepticism during evidence gathering.
5.	<p>NTE of Resources Required</p> <p>Determines the nature, timing, and extent of resources necessary.</p> <ul style="list-style-type: none"> ✓ Assign experienced team members for high-risk areas. ✓ Budget resources and devote more time to areas with higher risk of MMS.

H. Development of an Audit Plan

1.	<p>Audit Plan Development</p> <p>The audit plan addresses matters identified in the overall audit strategy while ensuring efficient use of resources to meet audit objectives.</p>
2.	<p>Importance of Understanding Client's Business</p> <p>Adequate knowledge of the client's business is essential for developing a proper audit plan and conducting a proper audit.</p>
3.	<p>SA-300 Requirements for Audit Plan</p> <p>The audit plan should include descriptions of:</p> <ol style="list-style-type: none"> 1. Nature, timing, and extent of planned Risk Assessment Procedures. 2. Nature, timing, and extent of planned Further Audit procedures at the assertion level. 3. Other planned audit procedures to ensure compliance with Standards on Auditing (SAs). 4. Plans for the type, timing, and scope of audit procedures, including sampling and workload allocation.
4.	<p>Detail Level of Audit Plan vs. Strategy</p> <p>The audit plan is more detailed than the overall strategy, focusing on specific procedures to be performed by engagement team members.</p>
5.	<p>Planning of Audit Procedure</p> <p>Planning occurs over the course of the audit, with specific stages:</p> <ul style="list-style-type: none"> ✓ Risk assessment procedures are planned and executed early in the process. ✓ Planning further audit procedures depends on the outcomes of risk assessment. ✓ Execution of further procedures may begin for some transactions or balances while planning continues for others.

I. Relationship Between Overall Audit Strategy and Audit Plan

1.	<p>Audit Strategy vs. Audit Plan</p> <p>Audit Strategy sets the broad overall approach to the audit, whereas the Audit Plan addresses specific matters identified in the strategy.</p>
2.	<p>Scope, Timing, and Direction</p> <p>Audit Strategy determines the scope, timing, and direction of the audit. Audit Plan describes how the strategy will be implemented.</p>
3.	<p>Detail Level</p> <p>The Audit Plan is more detailed than the overall strategy, including the nature, timing, and extent of procedures to be performed.</p>
4.	<p>Development of Audit Plan</p>

	<p>Planning for audit procedures occurs throughout the audit as the plan develops and adapts to engagement needs.</p>
5.	<p>Connection Between Strategy and Plan Once the Audit Strategy is established, the Audit Plan is developed to address the strategy's objectives using the auditor's resources.</p>
6.	<p>Inter-relationship of Processes Establishing the Audit Strategy and developing the Audit Plan are not discrete or sequential but are inter-related, with changes in one affecting the other.</p>

J. Changes to Audit Plan [Planning Decisions]

1.	<p>Flexibility of Audit Plans The auditor shall update and change the overall audit strategy and audit plan as and when necessary.</p>
2.	<p>Reasons for Change</p> <ol style="list-style-type: none"> Unexpected events. Changes in conditions. New information discovered during the audit process.
3.	<p>Need for Modifications Changes in the audit strategy and plan ensure that the audit remains effective under revised circumstances.</p>
4.	<p>Dynamic Nature The audit plan should be dynamic and flexible, allowing for modifications based on changing circumstances.</p>
5.	<p>Example Audit evidence from detailed checking may contradict evidence obtained from testing internal controls, prompting a change in the plan.</p>

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

A.	<p>Inclusion in Planning The auditor shall plan NTE of direction, supervision and review of Engagement Team work.</p>
B.	<p>Factors Influencing Direction, Supervision, and Review</p> <ol style="list-style-type: none"> Size and complexity of the entity. Specific audit areas. Assessed risks of material misstatement. Capabilities and competence of individual team members performing audit tasks.

L. Documentation of Overall Audit Strategy and Audit Plan

A.	<p>Purpose of Documentation</p> <ol style="list-style-type: none"> Acts as a record of key decisions regarding audit planning. Facilitates communication with the engagement team on significant matters. Records the planned nature, timing, and extent of risk assessment and audit procedures. Helps in review and approval of audit procedures before performance.
B.	<p>Documentation Includes</p> <ol style="list-style-type: none"> Overall Audit Strategy.

	<ol style="list-style-type: none"> 2. Audit Plans. 3. Significant Changes to the overall strategy or audit plan with reasons for changes.
C.	<p>Record of Significant Changes</p> <ol style="list-style-type: none"> 1. Explains why the significant changes were made. 2. Reflects the final strategy and audit plan adopted. 3. Shows appropriate response to changes during the audit.



2. Audit Programme

M. Audit Programme

1.	<p>Definition</p> <p>An audit programme is a detailed plan comprising a series of verification procedures applied to financial statements and accounts to gather sufficient evidence for the auditor to express an informed opinion on such statements.</p>
2.	<p>Purpose</p> <p>Provides instructions on the appropriate techniques to achieve audit objectives under specific circumstances.</p>
3.	<p>Evolving One Audit Programme is Not practicable for All Businesses</p> <ol style="list-style-type: none"> a. Nature, size, and composition of businesses vary. b. Internal controls differ in efficiency and operation. c. Nature of services rendered by the auditor varies from one assignment to another. <p>Necessity of Tailored Programmes</p> <ol style="list-style-type: none"> a. Prevents time waste on irrelevant matters. b. Addresses special situations or specific matters. c. Ensures the audit programme is aligned to the specific circumstances of the engagement.

N. Assistants Keep an Open Mind for Changes

A.	<p>Standard Programme</p> <p>The auditor frames a standard programme considering the nature, size, composition of business, the dependability of internal controls, and the scope of work.</p>
B.	<p>Minimum essential work</p> <p>This programme provides a minimum essential work.</p>
C.	<p>Alterations Based on Experience</p> <ol style="list-style-type: none"> 1. Additions: As experience is gained, the programme may be altered to include relevant situations initially left out. 2. Deletions: Work deemed unnecessary or irrelevant may be dropped.
D.	<p>Encouraging Open-Mindedness</p> <p>Assistants engaged in the audit are encouraged to:</p> <ol style="list-style-type: none"> 1. Maintain an open mind beyond the given programme. 2. Note and report significant matters to seniors or partners of the audit firm.

O. Periodic Review of Audit Programme

A.	Periodic Review
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	Audit programmes should undergo regular review to ensure continued adequacy for obtaining requisite knowledge and evidence about transactions.
B.	Risk of Obsolete Programme ✓ Changes in the client's business policy may render an audit programme outdated. ✓ An obsolete programme may lead to negligent audit work and lead to legal consequences . Example: Audit of a financing branch - a shift from vehicle financing to real estate financing.
C.	Utility Enhancement The programme and the client's operations should be kept under periodic review to identify and correct inadequacies or redundancies .
D.	Content of Audit Programme Besides listing tasks to be performed, the programme includes relevant instructions like: <ol style="list-style-type: none"> 1. Extent of checking. 2. Sampling plan. 3. Other guidelines necessary for execution.
E.	Adherence by Assistants Until officially updated by the principal, assistants must strictly adhere to the programme and its instructions.
F.	Addressing Rigidity Concerns ✓ Concerns about rigidity are not true if periodic reviews are conducted. ✓ Keeping the programme up-to-date ensures its flexibility and relevance.

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

A.	Commencement of Planning ✓ Audit Planning Starts after previous year's audit . ✓ Audit Plan will be Reviewed and modified during the audit based on: <ol style="list-style-type: none"> 1. Internal control review. 2. Preliminary evaluation. 3. Compliance and substantive procedures.
B.	Reliance on Internal Controls ✓ Auditor may Rely on internal controls if effective and efficient . ✓ May choose not to rely on internal controls if other efficient evidence-gathering methods are available.
C.	Timing and Coordination ✓ Consider: <ol style="list-style-type: none"> 1. Timing of procedures. 2. Coordination of client assistance. 3. Availability of assistants. 4. Involvement of other auditors or experts. ✓ On Certain procedures Auditors do not have discretion on timing .
D.	Key Points for Programme Construction <ol style="list-style-type: none"> 1. Stay within scope of assignment. 2. Prepare a written audit programme to implement the audit plan. 3. Identify best evidence reasonably available. 4. Include only relevant steps for specific verification purposes.

5. Specify **audit objectives** and **detailed instructions** for assistants.
6. Anticipate errors.
7. **Coordinate procedures** for related items.

Q. Audit Programme is Designed to provide Audit Evidence

1.	Determination of Best Evidence ✓ Determining the best evidence is a matter of expert knowledge and experience . ✓ This is the Auditor's primary task during audit programme development.
2.	Nature and Impact of Transactions ✓ Transactions vary in nature and impact . ✓ Procedures depend on prior knowledge of the evidence reasonably available for each transaction.
3.	Broad Types of Audit Evidence a. Documentary examination. b. Physical examination. c. Statements and explanations from management, officials, employees. d. Statements from third parties . e. Arithmetical calculations by the auditor. f. Internal controls and checks. g. Inter-relationship of accounting data. h. Subsidiary and memorandum records. i. Minutes . j. Subsequent actions by client or others.
4.	Specific Examples a. Cash in hand: Best evidence is physical count . b. Investment pledged with a bank: Best evidence is the banker's certificate . c. Book debts: Evidence includes client's ledger, invoices, debit/credit notes, monthly statements to customers, and balance confirmation .
5.	Weight and Priority of Evidence ✓ Auditor must assign appropriate weight to each piece of evidence. ✓ Use multiple procedures to ensure reliability of the assertion.
6.	Broader Definition of Available Evidence ✓ Evidence should not be limited to what is available with the client. ✓ Auditor must identify evidence that normally exists for the transaction in context of circumstances and usage.

R. Advantages of Audit Programme

1.	Provides assistants with a clear set of instructions for the work to be done.
2.	Offers a total perspective of the audit, especially for major audits .
3.	Enables selection of assistants based on capabilities when work is well-planned and segregated.
4.	Reduces the risk of ignoring records , ensuring that work proceeds in a systematic manner .
5.	Assistants accept responsibility by signing the programme , enabling traceability of work performed.

6.	Assists the principal in monitoring progress of audits by examining completed sections of the programme.
7.	Serves as a guide for subsequent year audits.
8.	Acts as evidence of due diligence in the event of charge against auditor, aiding in defence against charges of negligence .

S. Disadvantages

1.	Work may become mechanical , with assistants lacking an understanding of the audit's objectives .
2.	Programmes may become rigid and inflexible , failing to adapt to changes in business operations.
3.	Continued use of outdated programmes may overlook changes in business conduct .
4.	Changes in staff or internal controls may necessitate alterations to the programme.
5.	Inefficient assistants might defend their work's deficiencies by blaming the absence of specific instructions.
6.	Rigid programmes may kill the initiative among efficient and enterprising assistants.

T. Precautions [Purported disadvantages can be over come]

1.	Imaginative Supervision Supervise assistants' work to ensure they understand the programme's objectives and avoid blind adherence.
2.	Receptive Attitude Foster a receptive environment for assistants to raise concerns and share observations .
3.	Encourage Objectivity Encourage assistants to observe objectively and report significant matters to supervisors.

U. Extract of Sample audit programme pertaining to sales of an entity

Name of concern	Fine Industries
Financial year	2021-22
Prepared by	P (with date)
Reviewed by	Q (with date)
Approved by	R (with date)

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

9. RISK ASSESSMENT AND INTERNAL CONTROL



1. Risk Assessment [SA 315]

A. Meaning of Audit Risk

1.	<p>Meaning The risk of expressing an inappropriate opinion when the financial statements are materially misstated. Example: Expressing an unmodified opinion when a modified opinion is required.</p>
2.	<p>Consequences</p> <ol style="list-style-type: none"> Damage to the auditor's reputation. Potential regulatory action from professional bodies. Risk of legal action by intended users. <p>Example: Artificially increased profits through fake revenues can result in Audit risk.</p>
3.	<p>Exclusions Audit risk does not include:</p> <ol style="list-style-type: none"> Expressing a modified opinion when financial statements are not materially misstated. Business risks such as litigation, adverse publicity, or loss of reputation.

B. Components of Audit Risk

$$\text{Audit Risk} = \text{Risk of Material Misstatement} \times \text{Detection Risk}$$

1.	<p>Risk of Material Misstatement (RMM) The risk that financial statements are materially misstated prior to audit.</p>
2.	<p>Examples of Misstatements</p> <ol style="list-style-type: none"> Charging capital expenditure to revenue or vice-versa. Incorrect disclosure of financial statement items. Applying inappropriate accounting policies. Errors in accounting estimates. Recording fake expenses intentionally. Overstating receivables by not writing off irrecoverable debts. Misstating inventories (overstating or understating).
3.	<p>Levels of RMM</p> <ol style="list-style-type: none"> Financial Statement Level: Pervasive risks affecting the financial statements as a whole. Assertion Level: Risks for specific classes of transactions, account balances, or disclosures, affecting the nature, timing, and extent of audit.

C. Components of Risk of MMS

1.	<ol style="list-style-type: none"> RMM consists of Inherent Risk (IR) and Control Risk (CR). These risks are entity's risks and exist independently of the auditor.
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D. Inherent Risk (IR)

1.	<p>Definition: The susceptibility of an assertion about a class of transaction, account balance, or disclosure to a material misstatement before considering related controls (SA-200).</p>
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2.	<p>Characteristics</p> <ul style="list-style-type: none"> ✓ Exists before considering internal controls. ✓ Higher for complex calculations or when influenced by external circumstances (e.g., technological obsolescence).
3.	<p>Influencing Factors</p> <ul style="list-style-type: none"> ✓ External factors: e.g., business risks like technological advancements causing product obsolescence. ✓ Entity-specific factors: e.g., complex accounting standards misunderstood by management.
4.	<p>Assessment</p> <ul style="list-style-type: none"> ✓ IR varies across assertions, transactions, and disclosures. ✓ Auditor designs tests of controls and substantive procedures considering inherent risks.
5.	<p>Examples</p> <ol style="list-style-type: none"> a. Complex accounting standard misunderstood, leading to potential misstatement. b. Industry with high business failure rate, increasing risk of misstatement.

E. Control Risk (CR)

1.	<p>Definition: The risk that a material misstatement in an assertion will not be prevented, detected, or corrected on a timely basis by the entity's internal controls (SA-200).</p>
2.	<p>Characteristics</p> <ul style="list-style-type: none"> ✓ Reflects inefficiency of internal control systems. ✓ Higher control risk indicates weaker internal controls. <p>Examples</p> <ol style="list-style-type: none"> a. Cash and cheque books control not followed, increasing risk of theft or misuse. b. Fire safety controls (e.g., expired fire extinguishers or non-working smoke detectors) not adhered to, risking inventory damage. c. Petty cash control breached (e.g., expenses above threshold routed through petty cash).

F. Detection Risk

1.	<p>Definition: SA 200 defines detection risk as the risk that audit procedures performed by the auditor will not detect a material misstatement that exists, individually or when aggregated with other misstatements.</p> <p>Example: Even after using specific audit procedures, there is a risk of undetected MMS.</p>
2.	<p>Components of Detection Risk</p> <p>Sampling Risk</p> <ul style="list-style-type: none"> ✓ The risk that the auditor's conclusion based on a sample may differ from the conclusion if the entire population were tested. ✓ Occurs when the sample is not representative of the population. <p>Example: Auditor tests revenue using a sample that is not representative of population.</p>

	<p>Non-Sampling Risk</p> <ul style="list-style-type: none"> ✓ The risk that the auditor reaches an erroneous conclusion for reasons unrelated to sampling. ✓ May arise due to inappropriate audit procedures or errors in application of procedures. <p>Example: Auditor does not attend inventory count of work-in-progress but relies on alternative procedures.</p>
3.	<p>Control by Auditor</p> <ul style="list-style-type: none"> ✓ Detection risk is the only component of audit risk that the auditor can control. ✓ Reducing detection risk helps in keeping overall audit risk at an acceptably low level.
4.	<p>How to Reduce Detection Risk</p> <ul style="list-style-type: none"> ✓ Perform checks over a broader scope of transactions or balances. ✓ Use larger sample sizes to reduce sampling risk. ✓ Include experienced and competent personnel in the audit engagement team.

G. Assessment of Risk is a Matter of Professional Judgment

a.	<p>Definition</p> <ul style="list-style-type: none"> ✓ Audit Risk is a function of risks of material misstatement (RMM) and detection risk (DR).
b.	<p>Nature</p> <ul style="list-style-type: none"> ✓ Assessment of risks is based on audit procedures to obtain information and evidence throughout the audit.
c.	<p>Judgment</p> <ul style="list-style-type: none"> ✓ The assessment of risks involves professional judgment rather a matter not capable of precise measurement.
d.	<p>Distinguishing Feature</p> <ul style="list-style-type: none"> ✓ Professional judgment is exercised by auditors with training, knowledge, and experience to develop competencies for making reasonable judgments.

H. Combined Assessment of RMM

a.	<p>Approach</p> <ul style="list-style-type: none"> ✓ The auditor may assess inherent risk and control risk separately or combine them, based on preferred audit techniques, methodologies, or practical considerations. ✓ Generally the SAs do not refer them separately.
b.	<p>Expression of Risk</p> <ul style="list-style-type: none"> ✓ Risk may be expressed in: <ul style="list-style-type: none"> • Quantitative terms: e.g., percentages • Non-quantitative terms: e.g., high, medium, low
c.	<p>Importance</p> <ul style="list-style-type: none"> ✓ Regardless of the approach, making appropriate risk assessments is crucial.

I. Interrelationship Between Components

a.	<p>Inverse Relationship</p> <ul style="list-style-type: none"> ✓ RMM and Detection Risk (DR) have an inverse relationship: ✓ Higher RMM requires the auditor to conduct a more in-depth audit, reducing detection risk.
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- ✓ Conversely, lower RMM allows for less extensive audit procedures, leading to higher detection risk.

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

- | | |
|----|--|
| a. | Objective - Identify Risk of MMS
✓ At 2 levels: <ol style="list-style-type: none"> 1. Financial Statement Level 2. Assertion Level |
| b. | Assess Risk
✓ Analyze the risk of MMS to determine its significance. |
| c. | Minimize Audit Risk
✓ Reduce audit risk to an acceptably low level by planning and performing audit procedures based on the risk assessment process. |

K. Concept of Risk Assessment Procedure

- | | |
|----|---|
| a. | Definition
Risk assessment procedures are audit procedures performed to understand the entity and its environment, including internal control, to identify and assess risks of material misstatement (due to fraud or error) at financial statement and assertion levels. |
| b. | Purpose
✓ Provides a basis for identifying and assessing risks of material misstatement.
✓ Risk assessment alone does not provide S&A audit evidence for the audit opinion. |
| c. | Evaluate Impact
✓ Assess whether risks identified are pervasive, impacting financial statements at a broad level and affecting many assertions. |
| d. | Relate Risks to WCGR (What Can Go Wrong)
✓ Relate the risks to What Can Go Wrong at assertion level, considering relevant controls that the auditor intends to test. |
| e. | Consider Likelihood and Magnitude
✓ Evaluate: <ul style="list-style-type: none"> ▪ Likelihood of misstatements, including potential for multiple misstatements ▪ Magnitude of misstatements that could result in material misstatements |
| f. | Use of Information as Audit Evidence
Information from risk assessment can serve as evidence for: <ul style="list-style-type: none"> ✓ Assessing risks of material misstatement. ✓ Gaining audit evidence for transactions, balances, or disclosures. ✓ Understanding the effectiveness of controls. Sometimes, substantive procedures or tests of controls are performed concurrently. |

L. Risk Assessment Procedures Includes

- | | |
|----|---|
| 1. | Inquiries of Management and Others
Inquiries with management, governance, and other employees to identify risks of material misstatement. Such as |
|----|---|

	<p>a. Governance: Understands the environment of financial statement preparation.</p> <p>b. Internal Audit: Information on internal control procedures and management response to findings.</p> <p>c. Employees: Evaluate the appropriateness of accounting policies for complex transactions.</p> <p>d. Legal Counsel: Information on litigation, compliance, suspected fraud, warranties, and business arrangements.</p> <p>e. Marketing/Sales: Insights into marketing strategies, sales trends, or customer contracts.</p> <p>f. Risk Management Function: Information on operational and regulatory risks affecting financial reporting.</p> <p>g. IT Personnel: Details about system changes, failures, or related risks.</p>
2.	<p>Analytical Procedures Analysis of financial and non-financial information to identify unusual transactions, trends, or ratios. Examples:</p> <p>a. Relationship between profit and employees or sales and square footage.</p> <p>b. Unusual relationships may indicate risks, especially due to fraud.</p> <p>c. Analytical procedures include:</p> <ul style="list-style-type: none"> ✓ Ratio Analysis ✓ Trend Analysis ✓ Reasonableness Test ✓ Structural Modelling (e.g., Regression).
3.	<p>Observation and Inspection Observation or inspection to understand the entity and its environment. Examples:</p> <p>a. Observing operations (e.g., production, accounting).</p> <p>b. Inspecting documents, records, or SOPs.</p> <p>c. Reviewing management reports or minutes.</p> <p>d. Observing client premises (e.g., factory, offices).</p>

M. Concept of Significant Risks

1.	<p>Definition of Significant Risks Significant risks are inherent risks with both a higher likelihood of occurrence and a higher magnitude of potential misstatement. Assertions affected by these risks are assessed as having higher inherent risk.</p>
2.	<p>Examples of Significant Risks</p> <p>a. Fraud risks leading to material misstatement.</p> <p>b. Related party transactions outside the normal course of business.</p>
3.	<p>Factors to Determine Significant Risks The auditor considers the following when assessing significant risks:</p> <p>a. Whether the risk is a fraud risk.</p> <p>b. If the risk is due to recent significant changes, such as in the economic or regulatory environment.</p> <p>c. The complexity of the transactions involved.</p>

	<p>d. If the risk involves significant related party transactions.</p> <p>e. The degree of subjectivity in measuring financial information.</p> <p>f. Whether the risk involves non-routine transactions or unusual transactions outside the normal course of business.</p>
4.	<p>Clarifications</p> <ul style="list-style-type: none"> ✓ Non-routine transactions: Unusual due to size or nature and occur infrequently. ✓ Judgmental matters: Include developing accounting estimates with significant measurement uncertainty.

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

1.	<p>Management Intervention</p> <p>Greater management involvement is required to specify the accounting treatment for non-routine transactions.</p>
2.	<p>Manual Data Processing</p> <p>Manual intervention in data collection and processing increases the risk of errors.</p>
3.	<p>Complex Calculations or Principles</p> <p>Non-routine transactions involve complex calculations or accounting principles, increasing the risk of misstatement.</p>
4.	<p>Difficulty in Implementing Controls</p> <p>The nature of non-routine transactions may make it challenging for the entity to implement effective controls to address the risks.</p>

O. Risk of MMS is Greater for Judgemental Matters

1.	<p>Differing Interpretation of Accounting Principles</p> <p>Accounting principles related to estimates or revenue recognition may have differing interpretations, increasing the risk.</p>
2.	<p>Subjective or Complex Judgment</p> <p>Required judgment may be subjective, complex, or involve assumptions about future events, such as determining fair value.</p>

P. Documenting Risks

1.	<p>Engagement Team Discussion</p> <ul style="list-style-type: none"> ✓ Document the discussion among the engagement team and the significant decisions reached.
2.	<p>Understanding of Entity and Environment</p> <ul style="list-style-type: none"> ✓ Record key elements of understanding regarding: <ul style="list-style-type: none"> a. Each aspect of the entity and its environment. b. Each component of internal controls. ✓ Include the sources of information and risk assessment procedures performed.
3.	<p>Document identified and assessed risks at</p> <ol style="list-style-type: none"> 1. Financial statement level. 2. Assertion level.
4.	<p>Risks and Controls Matrix</p>

- ✓ Record the risks identified and the related controls about which the auditor has obtained an understanding.



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

A. Concept of Materiality

1.	<p>Definition of Material Items</p> <ul style="list-style-type: none"> ✓ Financial statements must disclose all material items that could influence decisions of users. ✓ Materiality is not always about size; small items can highlight serious issues (e.g., fraud revealing flaws in internal controls).
2.	<p>Quantitative Limits on Materiality</p> <p>Examples:</p> <ol style="list-style-type: none"> a. Schedule III to the Companies Act, 2013: Additional notes must disclose any income/expenditure item exceeding 1% of revenue or ₹1,00,000, whichever is higher. b. Notes must disclose shareholders holding >5% shares, specifying the number of shares held.
3.	<p>Relevant Standards on Auditing (SA)</p> <ul style="list-style-type: none"> ✓ SA 320: Addresses auditor's responsibility to apply materiality during audit planning and execution. ✓ SA 450: Explains the application of materiality in evaluating the effect of misstatements (identified and uncorrected) on financial statements.
4.	<p>Materiality in Financial Reporting Framework (FRFW)</p> <ul style="list-style-type: none"> ✓ FRFW often discusses materiality in the context of financial statement preparation. ✓ Characteristics of Material Misstatements: <ol style="list-style-type: none"> a. Material misstatements are those likely to influence user decisions. b. Judgments depend on the size, nature, or both of the misstatements. c. Materiality judgments are based on common user needs, not specific individual users. ✓ If FRFW does not define materiality, the above characteristics provide a frame of reference for auditors.

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

1.	<p>Reasonable Knowledge</p> <ul style="list-style-type: none"> ✓ Users have a reasonable knowledge of business, economics, and accounting and be willing to study financial statements with reasonable diligence.
2.	<p>Materiality Awareness</p> <ul style="list-style-type: none"> ✓ Users are aware that financial statements are prepared, presented, and audited with materiality levels in mind.
3.	<p>Recognition of Uncertainty</p> <ul style="list-style-type: none"> ✓ Users understand the inherent uncertainties in measurements that involve estimates, judgments, and future considerations.
4.	<p>Economic Decision-Making</p> <ul style="list-style-type: none"> ✓ Users use the information in financial statements to make reasonable economic decisions.

C. Performance Materiality

1.	<p>Need Auditors find it difficult to test for individual misstatements; hence, misstatements are typically considered material in aggregate. This leads to the concept of performance materiality.</p>
2.	<p>Performance Materiality Definition: Performance materiality is the lower threshold set by the auditor, below the overall materiality, to reduce the chance of undetected or uncorrected misstatements that exceed overall materiality. SPM: Performance materiality may also apply to specific classes of transactions, account balances, or disclosures at levels lower than their respective materiality thresholds. Purpose: Setting performance materiality lower than overall materiality reduces the risk that aggregated misstatements will remain undetected and material to the financial statements.</p>

D. Use of Benchmarks in Determining materiality

1.	<p>Professional Judgment Determining materiality involves the auditor's professional judgment. A percentage is applied to a chosen benchmark to determine materiality for the financial statements.</p>
Factors Influencing Benchmark	
1.	<p>Elements of Financial Statements The elements such as assets, liabilities, equity, revenue, and expenses.</p>
2.	<p>Focus Areas Users may focus on specific items like profit, revenue, or net assets when evaluating financial performance.</p>
3.	<p>Entity Nature and Context The entity's nature, life cycle stage, industry, and economic environment impact the benchmark selection.</p>
4.	<p>Ownership and Financing The ownership structure and financing method. For example, debt-financed entities may emphasize assets and claims over earnings.</p>
5.	<p>Volatility of Benchmark If a benchmark like profit before tax is volatile, alternate benchmarks like gross profit or total revenues may be more suitable.</p>

E. Examples and Selection of Benchmarks

1.	<p>Examples of Benchmarks Benchmarks used to determine materiality may include:</p> <ol style="list-style-type: none"> Profit before tax [PBT] Total revenue Gross profit and total expenses Total equity or net asset value
2.	<p>Selection of Benchmark Relevant financial data for choosing a benchmark includes:</p>

- a. **Prior periods'** financial results and positions
- b. **Current period's** results and position
- c. **Budgets or forecasts** for the current period, adjusted for:
 - a. Significant changes in the **entity's circumstances** (e.g., acquisitions).
 - b. Changes in the **industry or economic environment**.

Example

If materiality is determined on **profit before tax** but this figure shows **exceptional fluctuations**, the auditor may use a **normalized profit before tax** based on past results.

3. **Applying a Percentage**
 - a. **Professional judgment** determines the **percentage** applied to a chosen benchmark.
 - b. The **percentage** for benchmarks like **PBT** is typically **higher** than that for **total revenue**.

F. Materiality levels for Particular COTs, ABs and Disclosures

For Certain COTs, ABs and Disclosures, that are **particularly sensitive or significant** to users, **misstatements below materiality could influence users'** economic decisions. [Even if the misstatements are not material to the financial statements as a whole]. The Factors are:

1. **Legal or Regulatory Impact**
 - ✓ **Laws, regulations, or the financial reporting framework** may affect users' expectations about certain items.
 - ✓ **Example: Related party transactions and management remuneration.**
2. **Industry-Specific Key Disclosures**
 - ✓ **Key disclosures** that are critical for industries based on their nature.
 - ✓ **Example: Research and development costs** for a pharmaceutical company.
3. **Focus on Specific Business Aspects**
 - ✓ **Users may pay particular attention** to aspects of the entity's business that are **separately disclosed** in the financial statements.
 - ✓ **Example: A newly acquired business.**

G. Revision and Documentation of Materiality

1. **Revision in Materiality**

Materiality levels may change during the audit due to the following:

 - a. Occurrence of **new circumstances** during the audit.
 - b. Availability of **new information** not known at the start of the audit.
 - c. Significant difference between **actual financial results** and **anticipated results**.
 - d. **Higher risk estimates** than initially predicted.
 - e. **Enhanced understanding** of the client's business during the audit.

Example

If **actual financial results** differ significantly from **anticipated results**, the auditor revises materiality and evaluates if **performance materiality** and audit procedures need adjustment.
2. **Documentation of Materiality**

The auditor must document the following:

 - a. **Overall Materiality: Materiality for the financial statements as a whole.**
 - b. **Specific Materiality: Materiality for specific classes of transactions, account balances, or disclosures, if applicable.**

- c. Performance Materiality: General performance materiality used in the audit.
- d. Revisions: Any revision made to the above during the audit.

H. Materiality and Audit Risks are throughout the Audit

1. **Materiality**
Materiality is applied in:
 - a. Planning and performing the audit.
 - b. Evaluating misstatements (identified or uncorrected).
 - c. Forming the auditor's opinion in the audit report.
2. **Audit Risk**
Audit risk is the risk of giving an inappropriate opinion when financial statements are materially misstated.
$$\text{Audit risk} = \text{Risk of material misstatement} \times \text{Detection risk.}$$
3. **Materiality and Audit Risk Usage**
Materiality and audit risk are considered throughout the audit, especially during:
 - a. Risk Assessment: Identifying and assessing risks of material misstatement.
 - b. Audit Procedures: Determining the NTE of further audit procedures.
 - c. Evaluating Misstatements: Evaluating the effect of uncorrected misstatements on financial statements and forming an opinion in the audit report.



3. Understanding of Entity

A. Understanding the Entity and Its Environment

1. **Relevant Industry, Regulatory, and External Factors**
The auditor must understand the industry, regulatory, and external factors affecting the entity:
 - a. Industry Factors
 - a. Industry conditions: Competition, supplier-customer relationships, technological developments.
 - b. These factors give rise to specific risks from nature of business or regulations.
 - c. Examples: Market competition, seasonal activities, product technology, and specific risks due to the nature of the business or regulation.
 - b. Regulatory Factors
 - d. Includes the regulatory environment (e.g., legal, political, and financial reporting frameworks).
 - e. Examples: Accounting principles, specific industry regulations, tax laws, and government policies.
 - c. External Factors
 - f. Includes economic conditions, interest rates, financing availability, and inflation.
2. **Nature of the Entity**
Understanding the entity's nature helps identify risks of material misstatement and determine related-party transactions. This includes:
 - a. Operations: Nature of revenue sources, product/services, and production locations.
 - b. Ownership and Governance: Structure, ownership relationships, and financing methods.
 - c. Investments: Current or planned investments.

	<p>Examples</p> <p>d. Business operations: Key customers/suppliers, and revenue sources.</p> <p>e. Financing activities: Debt structure and major subsidiaries.</p> <p>f. Financial reporting: Accounting principles and revenue recognition practices.</p>
3.	<p>Selection and Application of Accounting Policies</p> <p>The auditor evaluates whether the entity's accounting policies are appropriate for the business and comply with the financial reporting framework and industry standards.</p>
4.	<p>Objectives, Strategies, and Business Risks</p> <p>a. Objectives and Strategies: The auditor understands objectives, strategies, and related business risks to identify risks of material misstatement.</p> <ul style="list-style-type: none"> ✓ Objectives: Entity's plans in response to internal and external factors. ✓ Strategies: Methods to achieve objectives, which may evolve over time. <p>b. Business Risks</p> <ul style="list-style-type: none"> ✓ Broader than risks of material misstatement but may have financial consequences impacting the statements. ✓ Understanding of Business risks lets the auditor identify likelihood of risk of MMS. ✓ Auditor doesn't have responsibility to identify all business risks. <p>Examples</p> <ul style="list-style-type: none"> ✓ Industry developments: Lack of expertise to handle changes. ✓ New products/services: Increased liability risks. ✓ Business expansion: Demand misestimations.
5.	<p>Measurement and Review of Financial Performance</p> <p>Understanding performance measures helps the auditor identify potential pressures. These pressures may motivate management to misstate the financial statements.</p> <p>Examples</p> <ul style="list-style-type: none"> ✓ Key performance indicators: Financial and non-financial metrics. ✓ Financial performance analyses: Period comparisons, budgets, forecasts, variance report. ✓ External reports: Credit rating agency assessments.

B. Understanding is a Continuous Process

1.	<p>Need for Understanding the Entity</p> <p>Understanding the entity and its environment is critical for:</p> <ul style="list-style-type: none"> ✓ Planning the audit. ✓ Identifying areas requiring special attention. ✓ Gaining knowledge about the client's business, which is essential for a proper audit.
2.	<p>Continuous Process</p> <p>Understanding the entity is a continuous, dynamic process of gathering, updating, and analysing information throughout the audit.</p>
3.	<p>Importance of Understanding</p> <p>Provides a frame of reference for the auditor to:</p> <ol style="list-style-type: none"> a. Identify and assess risks of material misstatement in financial statements. b. Set materiality levels as per SA 320. c. Assess the appropriateness of the selection and application of accounting policies. d. Identify areas needing special audit consideration, such as:

- ✓ Related party transactions.
 - ✓ Appropriateness of the going concern assumption.
 - ✓ Business purpose of transactions.
- e. Establish expectations for use in analytical procedures.
- f. Assess the sufficiency and appropriateness of audit evidence, including:
- ✓ Assumptions used by management.
 - ✓ Management's oral and written representations.



4. Internal Controls

A. Meaning and Benefits of Internal Controls

- A. **Meaning of Internal Control**
 As per SA-315, internal control is a process designed, implemented, and maintained by governance, management, and personnel to provide reasonable assurance about:
- a. Reliability of financial reporting.
 - b. Effectiveness and efficiency of operations.
 - c. Safeguarding of assets.
 - d. Compliance with applicable laws and regulations.
- Controls Definition: Refers to aspects of one or more components of internal control.
 Note: The design, implementation, and maintenance of internal controls depend on the size and complexity of the entity.
- B. **Benefits of Understanding Internal Controls**
 Understanding internal controls helps the auditor to:
- a. Identify types of potential misstatements.
 - b. Identify factors affecting risks of material misstatement.
 - c. Design the NTE of further audit procedures.

B. Inherent Limitations of Internal Controls

Internal Controls can only provide reasonable assurance about achievements of entities objectives.

1. **Human Judgment in Decision-Making**
 - ✓ Errors in judgment can lead to control failures due to human error.
 - ✓ Design errors in controls may also occur.
2. **Lack of Understanding the Purpose**
 - ✓ Responsible individuals may not fully understand the purpose of controls.
 - ✓ This can result in ineffective use of reports and incorrect actions.
3. **Collusion Among People**
 - ✓ Controls can be overridden by collusion of individuals or management override.
 - ✓ Example: Side agreements with customers results in improper revenue recognition.
4. **Judgments by Management**
 - ✓ Management may choose controls based on judgments about the nature and extent of risks they are willing to assume.
5. **Limitations in Small Entities**
 - ✓ Fewer employees in small entities make segregation of duties impractical.

- ✓ **Owner-managed entities** may have more effective oversight but may also **override controls** due to less structured systems.
- ✓ **Auditor's Role:** The auditor must consider these factors when **assessing risks** in small entities.

C. Components of Internal Controls

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

D. Control Environment and Its elements

Control Environment

- a. Includes **governance, management functions,** and the **attitudes and actions** of those charged with governance and management.
- b. Sets the **tone** for organizational controls.

Elements of Control Environment

1.	<p>Communication and enforcement of Integrity and Ethical Values</p> <ul style="list-style-type: none"> ✓ The effectiveness of controls cannot rise above integrity and ethical values of TCWG. ✓ Integrity and ethical behaviour influence the effectiveness of controls. ✓ Communicated through policy statements, codes of conduct, and management actions to eliminate unethical incentives.
2.	<p>Commitment to Competence</p> <ul style="list-style-type: none"> ✓ Management considers the competence levels for jobs and ensures requisite skills and knowledge for tasks.
3.	<p>Participation by TCWG</p> <p>Involvement of those charged with governance includes:</p> <ul style="list-style-type: none"> ✓ Independence from management. ✓ Experience, Stature and scrutiny by them. ✓ Appropriateness of their actions and ✓ Interaction with Internal and External auditors.
4.	<p>Management's Philosophy</p> <p>Encompasses management's:</p> <ul style="list-style-type: none"> ✓ Approach to Business Risk-taking ✓ Approach and attitude towards financial reporting. ✓ Approach to information processing and personnel.
5.	<p>Organizational Structure</p> <ul style="list-style-type: none"> ✓ It depends on size and nature of its activities. ✓ Refers to the Framework for planning, executing, controlling, and reviewing activities. ✓ Includes key authority, responsibility, and reporting lines.
6.	<p>Assignment of Authority</p> <ul style="list-style-type: none"> ✓ Covers how authority and responsibility are assigned and how reporting hierarchies are established.

7.	<p>Human Resource Policies</p> <ul style="list-style-type: none"> ✓ Relate to recruitment, training, evaluation, promotion, and compensation. ✓ Example: Recruitment focuses on qualifications, integrity, and experience. ✓ Training includes roles and responsibilities through seminars and schools. ✓ Promotions are based on performance appraisals, ensuring advancement of qualified personnel.
<p>Satisfactory Control Environment Not an Absolute Deterrent to Fraud</p>	
1.	<p>Positive Impact of a Control Environment</p> <p>A satisfactory control environment can reduce the risk of material misstatement and may help lower the risk of fraud. However, it is not an absolute deterrent to fraud.</p>
2.	<p>Deficiencies in Control Environment</p> <p>Weaknesses in the control environment can reduce the effectiveness of controls, especially in relation to fraud risks.</p>
3.	<p>Example</p> <p>Management's failure to address IT security risks may allow:</p> <ul style="list-style-type: none"> ✓ Improper changes to programs or data. ✓ Unauthorized transactions to be processed.
4.	<p>Control Environment's Role</p> <ul style="list-style-type: none"> ✓ The control environment does not directly prevent, detect, or correct MMS. ✓ It influences the auditor's evaluation of other controls, such as: <ul style="list-style-type: none"> • Monitoring of controls. • The operation of specific control activities.
5.	<p>Auditor's Assessment</p> <p>The control environment affects the auditor's evaluation of the risks of material misstatement.</p>

E. Risk Assessment Process

Understanding the Entity's Process

- a. The entity's **risk assessment process** includes identify risks that need to be managed.
- b. It Assists the auditor in identifying **risks of material misstatement**.
- c. Auditor evaluates whether the entity's risk assessment process is **appropriate to its circumstances**, which is a matter of **professional judgment**.

The auditor assesses whether the entity has a process for:

- a. Identifying **business risks** relevant to **financial reporting objectives**.
Example: Doctor's prescription vs bill.
- b. Evaluating the **Significance** of the identified risks.
- c. Determining the **likelihood** of risks occurring.
- d. Deciding on **actions** to manage or mitigate the risks.

F. Information Systems and Related Business Process

1. **Classes of Transactions**
Identify **transactions** in the entity's operations that are **significant** to the financial statements.
2. **Transaction Procedures**

	Understand how transactions are initiated, recorded, processed, corrected , transferred to the general ledger , and reported in the financial statements.
3.	Accounting Records Assess the related accounting records , supporting information, and specific accounts used to initiate, record, process, and report transactions .
4.	Capturing Significant Events Evaluate how the information system captures events and conditions that are significant to the financial statements. Example: Bill to accounts recordings.
5.	Financial Reporting Process Understand the process used to prepare the entity's financial statements .
6.	Controls Over Journal Entries Assess controls surrounding journal entries . Example: Voucher controls.

G. Control Activities

1.	Meaning of Control Activities Policies and procedures that ensure management directives are carried out. Examples: Authorizations, segregation of duties (SOD) , physical controls, and performance reviews.
2.	Application of Control Activities Control activities, whether in IT systems or manual systems , serve various objectives and are applied at different organizational and functional levels .
3.	Auditor's Focus on Control Activities The auditor focuses only on control activities related to significant classes of transactions, account balances, or disclosures relevant to the risk assessment process .
4.	Determining Relevant Control Activities Control activities are relevant when: <ul style="list-style-type: none"> a. Significant Risks Exist They relate to financial statement items where there are significant risks and substantive procedures alone are insufficient to obtain appropriate audit evidence. b. Auditor's Professional Judgment They are considered relevant based on the auditor's professional judgment. Examples Internal checks employed by management, such as day-end counting or product counts for material items.

H. Monitoring of Controls

1.	Definition of Monitoring of Controls A process to assess the effectiveness of internal controls over time. Examples: Internal Audit, Walkthrough Test.
2.	Timely Assessment and Remediation Involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions .
3.	Types of Monitoring Activities Management monitors controls through:

	<ul style="list-style-type: none"> ✓ Ongoing activities: Built into regular activities like management and supervisory reviews. ✓ Separate evaluations: Conducted periodically to assess control effectiveness.
4.	<p>External Information Use Monitoring may involve information from external parties. Example: Customer complaints or regulatory comments indicating problems or areas needing improvement.</p>

I. Controls Relevant to Audit

1.	<p>Controls Relevant to Audit The auditor obtains an understanding of internal controls relevant to the audit. Most controls relate to financial reporting, but not all are relevant.</p>
2.	<p>Professional Judgment Determining whether a control is relevant to the audit is a matter of the auditor's professional judgment.</p>
3.	<p>Factors Influencing Relevance Factors affecting the auditor's judgment about the relevance of controls include:</p> <ol style="list-style-type: none"> a. Materiality. b. The Significance of risk associated with the control. c. The size of the entity and its operations. d. The nature, organisation, and ownership characteristics of the entity's business. e. The diversity and complexity of the entity's operations. f. Applicable legal and regulatory requirements. g. Circumstances and the applicable component of internal control. h. The nature and complexity of internal control systems, including those using service organisations. i. Whether a control prevents, detects, or corrects material misstatements, individually or in combination.
4.	<p>Controls Not Relevant to Audit Certain controls, though important for operations, may not be relevant to the audit. Example</p> <ul style="list-style-type: none"> ✓ An airline's automated system for maintaining flight schedules may not be relevant to the audit. ✓ Understanding all internal controls in every operating unit or process may not be necessary for the audit.

J. Controls Over the Completeness and Accuracy of Information

1.	<p>Relevance of Controls to Audit Controls over the completeness and accuracy of information are relevant if the auditor uses the information for designing and performing further procedures.</p>
2.	<p>Example: Revenue Audit When auditing revenue, the auditor evaluates:</p> <ul style="list-style-type: none"> ✓ Accuracy of price information (e.g., standard prices). ✓ Completeness and accuracy of sales volume data.
	<p>Example: Purchase Order Register Control</p>

	A purchase order register control ensures that all purchases are correctly recorded.
3.	<p>Operational and Compliance Controls Controls related to operations and compliance objectives may be relevant if they involve data the auditor evaluates or uses for audit procedures.</p> <p>Examples</p> <ul style="list-style-type: none"> ✓ Purchases: Use purchase orders (P.O.s) to verify accuracy and completeness. ✓ Bank statements: Verify the completeness of recorded payments.

K. Internal controls over safeguarding of assets	
1.	<p>Safeguarding Assets Internal controls for safeguarding assets may relate to both financial reporting and operations objectives.</p>
2.	<p>Financial Reporting Objective The auditor focuses on controls relevant to the reliability of financial reporting. Example: Use of access controls (e.g., passwords) that limits access to data and program dealing with cash disbursement. Example: Assets valued above ₹5,000/- are considered for financial statement audits.</p>
3.	<p>Operational Objective Controls for safeguarding related to operations objectives are usually not relevant to a financial statement audit. Example: Preventing excessive material use in production or meeting input-output ratio targets is not typically related to the auditor's focus.</p>
4.	<p>Examples of Safeguarding Controls</p> <ul style="list-style-type: none"> ✓ Asset tagging. ✓ Physical verification of assets at reasonable intervals.

L. Nature and Extent of The Understanding of Relevant Control	
1.	<p>Evaluating Control Design Consider if the control, individually or with other controls, can effectively prevent, detect, and correct material misstatements.</p>
2.	<p>Implementation of Controls</p> <ul style="list-style-type: none"> ✓ A control is considered implemented if it exists and the entity is using it. ✓ The design of the control is evaluated first. ✓ Improperly designed controls may indicate a significant deficiency.
3.	<p>Risk Assessment Procedures Procedures to obtain evidence about design and implementation include:</p> <ol style="list-style-type: none"> a. Inquiring entity personnel about controls. b. Observing the application of specific controls. c. Inspecting documents and reports. d. Tracing transactions through the information system relevant to financial reporting.
4.	<p>Understanding vs. Testing Effectiveness Understanding controls is not enough to test their operating effectiveness, unless automation ensures consistent operation of controls.</p>
	Example

- ✓ Testing a **manual control** does not provide evidence of its consistent operation.
- ✓ For **IT controls**, inherent consistency may allow testing **implementation** as a test of **operating effectiveness**, depending on assessments like **program change controls**.

M. Benefits of Internal Control Evaluation

1.	Purpose of Evaluating Internal Control The auditor examines and evaluates the internal control system to ensure the accounting system is adequate and all relevant information is recorded .
2.	Auditor's Understanding The auditor gains an understanding of the accounting system and internal controls to determine the nature, timing, and extent of other audit procedures.
3.	Benefits of Evaluation <ol style="list-style-type: none"> a. Adequacy of System: Determines if the internal control system is adequate and operating as intended by management. b. Internal Audit Department: Verifies whether an effective internal auditing department is in place. c. Safeguarding Assets: Ensures that controls adequately safeguard assets. d. Transaction Recording: Assesses how well management ensures accurate transaction recording. e. Reliability of Reports: Evaluates the reliability of reports, records, and certificates provided to management. f. Audit Examination Scope: Identifies the extent and depth of audit examination required in different areas. g. Appropriate Audit Techniques: Determines the most suitable audit techniques and procedures for the circumstances. h. Weak Control Areas: Highlights areas where controls are weak. i. Suggestions for Improvement: Identifies potential recommendations to improve the control system for management.

N. Development of Audit Programme After Understanding of Internal Controls

1.	Audit Programme and Internal Controls The auditor formulates the audit programme only after understanding the internal control systems and their actual operation.
2.	System in Operation The auditor must confirm whether the internal control system is actually in operation , as management often fails to ensure compliance after installation.
3.	Review of Internal Controls Reviewing internal controls allows the auditor to assimilate controls and implications , enabling an objective audit programme .
4.	Appropriate Audit Procedures Proper understanding of internal controls helps the auditor apply appropriate audit procedures in different areas.
5.	Significance for Test Checking

	The existence and operation of the internal control system influences the plan for test checking .
6.	<p>Weak Internal Controls</p> <p>When internal controls are weak, the auditor might:</p> <ul style="list-style-type: none"> ✓ Choose additional or alternative auditing procedures. ✓ Extend tests to cover more transactions. ✓ Perform extra tests to ensure satisfaction.
	<p>Examples</p> <ul style="list-style-type: none"> ✓ Wages Distribution: If internal control over wages is weak (e.g., risk of dummy workers), the auditor may include observation of wages distribution. ✓ Trade Receivables: <ul style="list-style-type: none"> ✓ If control over sales and trade receivables is weak, the auditor may: <ul style="list-style-type: none"> • Get confirmations on the exact balance sheet date. • Cover a larger sample of trade receivables. ✓ If controls are satisfactory, confirmations can be obtained at any reasonable time near the balance sheet date.

O. Methods of Evaluation of Internal Controls

1.	<p>Determination of Controls</p> <p>Auditor determines controls and procedures by reviewing manuals, organization charts, flowcharts, and through enquiries with officers and employees.</p>
2.	<p>Understanding Accounting Information</p> <p>Auditor must understand how accounting information is collected, processed, and controlled to ensure reliability and asset protection.</p>
3.	<p>Limited Written Information</p> <p>In many cases, little written information is available, so the auditor must ask the right questions to obtain necessary details.</p>
4.	<p>Documentation of Information</p> <p>Auditor should make written notes of relevant information from manuals or obtained through enquiry.</p>
5.	<p>Methods for Evaluating Internal Controls</p> <p>Tools to facilitate internal control evaluation include:</p> <ol style="list-style-type: none"> a. Narrative Record <ul style="list-style-type: none"> ✓ A detailed description of the system in operation. ✓ Suitable for cases with no formal control system (e.g., small businesses). ✓ Disadvantages: Difficult to comprehend, identify weaknesses, and update for changes. b. Checklist <ul style="list-style-type: none"> ✓ A series of instructions or questions about internal control. ✓ Responses are usually Yes, No, or Not Applicable. ✓ Example: Checklist for purchases (e.g., Are tenders called before placing orders? Is the purchase order standardized and pre-numbered?). c. Internal Control Questionnaire (ICQ)

- ✓ A comprehensive set of questions about **existence, operation, and efficiency** of internal controls.
- ✓ Main advantage is it **oversight or omission of significant controls is less likely**.
- ✓ IC evaluation can be reviewed in **sections or interim basis**.
- ✓ General Practice to **review the control system annually** and record the details.
- ✓ Answer **'Yes'** denotes satisfactory controls; **'No'** indicates weaknesses, with explanations provided for **No** answers.
- ✓ Usually issued to the **client** for completion by executives and employees, followed by **auditor's review and recommendations for improvement**.

d. Flowcharts

- ✓ A **graphic representation** of internal control systems showing **activities, goods/materials flow, and cash inflows/outflows**.
- ✓ Provides a **concise view**,
- ✓ Reduces **narrative explanation**,
- ✓ Shows **transaction flow stages** [Bird eye view], and
- ✓ Easy Identification of areas for **improvement**.

Examples of ICQs

A. Purchases

1. Are **purchases centralized** in the Purchase Department?
2. Are purchases made only from **approved suppliers**?
3. Is a **list of approved suppliers** maintained?
4. Does the master list have multiple sources for key materials?
5. Are **purchase orders** based on valid **purchase requisitions** signed by authorized persons?
6. Are purchases based on **competitive quotations** from two or more suppliers?
7. Are **purchase orders pre-numbered** and signed by authorized employees?
8. Are all materials received only in the **Receiving Department**?
9. Are receiving staff restricted from issuing **purchase orders** or approving **invoices**?
10. Are materials **inspected and measured** in the Receiving Department?
11. Are receipts evidenced by **pre-numbered Goods Received Notes**?

B. Creditors

1. **Invoice Processing**
 - ✓ Are suppliers' **invoices sent directly** to the Accounts Department?
 - ✓ Are they entered in a **Bill Register** before checking?
 - ✓ Are advance payments noted on invoices?
2. **Invoice System**
 - ✓ Does the system ensure all **invoices are processed**?
 - ✓ Are quantities reconciled with **purchase invoices** and stock records?
3. **Matching and Checking**
 - ✓ Does the Accounts Department match **invoices, Goods Received Notes, and purchase orders**?
 - ✓ Are **prices and terms** checked?
 - ✓ Are **duplicate invoices** marked?
4. **Reconciliation**
 - ✓ Are **supplier statements** compared with ledger accounts?
 - ✓ Are **unpaid creditors lists** prepared and reconciled periodically?

C.	<p>Inventories</p> <ol style="list-style-type: none"> Storage and Insurance <ul style="list-style-type: none"> ✓ Are stocks stored in assigned areas? ✓ Are stocks comprehensively insured? ✓ Is the adequacy of insurance cover reviewed periodically? Stock Records <ul style="list-style-type: none"> ✓ Are perpetual stock records kept? ✓ Are they reconciled with accounting records? ✓ Are shortages/excesses investigated and adjusted with written approval? Norms <ul style="list-style-type: none"> ✓ Are there norms for stock levels to be maintained?
D.	<p>Fixed Assets</p> <ol style="list-style-type: none"> Capital Expenditure <ul style="list-style-type: none"> ✓ Are budgets for capital expenditure approved? ✓ Is authority for expenditure restricted to specified officials? ✓ Are capital purchases subject to purchase controls? Verification <ul style="list-style-type: none"> ✓ Are fixed assets verified periodically? ✓ Is there a written procedure for verification? ✓ Are reports prepared, including details on damaged or obsolete items? Corrections <ul style="list-style-type: none"> ✓ Are discrepancies in verification investigated and corrected in records with appropriate authority?

P. Why Test of Controls and what it Includes

1.	<p>Understanding and Testing Internal Control After understanding the internal control system, the auditor conducts testing on a selective basis to ensure the system is actually in operation.</p>
2.	<p>Testing Period Testing can be planned to cover all important areas over a period (e.g., say 3 years).</p>
3.	<p>Purpose of Tests of Control Tests of control provide evidence about the effectiveness of:</p> <ol style="list-style-type: none"> Design of accounting and internal control systems. Operation of internal controls throughout the period.
4.	<p>Tests of Control Components Include control environment tests where strengths reduce control risk.</p>
5.	<p>Dual Purpose Procedures Procedures for understanding controls may also provide evidence of their effectiveness, acting as tests of control.</p>
6.	<p>Example: Sales Control Procedures</p> <ul style="list-style-type: none"> ✓ Check inventory position before accepting orders. ✓ Authorised advice sent by sales manager with order acceptance details. ✓ Standardised forms used and forwarded to inventory section. ✓ Normal credit periods allowed, with special credit requiring sales manager approval.

	<ul style="list-style-type: none"> ✓ Clear terms for rates, transport, and insurance specified. ✓ Creditworthiness reviewed via credit section before granting credit.
7.	<p>Tests of Control Includes</p> <ol style="list-style-type: none"> a. Inspection of Documents Verify transaction authorisation and document compliance. b. Inquiries and Observation Check who performs functions versus who is supposed to. c. Re-performance Re-perform controls (e.g., bank reconciliation) to ensure correctness. d. Testing IT Controls Assess specific computer applications or overall IT functions (e.g., access controls or program changes).
8.	<p>Procedural Tests and In-depth Examination</p> <p>Test compliance with procedures for initiation, authorisation, recording, and documentation at each transaction stage.</p>
9.	<p>Deviations from Prescribed Controls</p> <ol style="list-style-type: none"> a. Inquiries on Deviations Auditor makes specific inquiries on deviations to assess implications. b. Amending Control Risk Assessment If deviations are significant, the auditor revises the preliminary control risk assessment unless supported by other control tests. c. Adjusting Substantive Procedures When control risk is revised, the auditor modifies the nature, timing, and extent of planned substantive procedures.



5. Automated Environment

A. Meaning and Features of Automated Environment

1.	<p>Definition</p> <p>A business setting where processes, operations, accounting, and decisions are executed using computer systems (Information Systems/Information Technology).</p>
2.	<p>Key Features</p> <p>An Automated Environment is characterized by reduced manual intervention and system-driven processes. Greater automation often means greater complexity. Key features include:</p> <ol style="list-style-type: none"> a. Faster business operations b. Accurate data processing and computation c. Capability to handle large transaction volumes d. Integration of business operations e. Enhanced security and controls f. Reduced human errors g. Access to latest information h. Strong connectivity and networking capabilities
3.	<p>System Complexity</p> <ul style="list-style-type: none"> ✓ Using ERP systems (e.g., SAP, Oracle) increases complexity, making audits more challenging.

- ✓ Using **off-the-shelf accounting software** indicates less automation and thus a simpler environment.

B. Understanding and Documenting Automated Environment

1. **Auditor's Role in IT Understanding**
 During a **financial statement audit**, an auditor must understand the **entity and its business**, including its **IT environment**. This includes analysing the IT department, IT activities, dependencies, risks, and controls.
2. **Key Points to Understand the IT Environment**
 An auditor should consider the following:
 - a. Info Systems used: Identify the **application systems** in use (single or multiple).
 - b. Purpose: Determine if the systems handle **financial or non-financial** operations.
 - c. Location of IT: Assess if the IT systems are **local** or part of a **global setup**.
 - d. Architecture (e.g., **desktop-based, client-server, web-based, or cloud-based**).
 - e. Version: **Functions and risks** may differ across versions.
 - f. System Interfaces: Check the **interfaces** between multiple systems, if applicable.
 - g. In-House vs. Packaged: IT systems are **custom-developed** or **off-the-shelf**.
 - h. Outsourced Activities: Identify **outsourced IT tasks** (e.g., **maintenance and support**).
 - i. Key IT Personnel: Know key roles such as **CIO, CISO, and System Administrators**.
3. **Documentation Requirement**
 The **IT environment understanding** must be **documented** by the auditor.

Information Systems being used	Version	Purpose	Location- Local vs. global	Architecture	Interfaces within systems	In-House vs. Packaged	Outsourced Activities	Key Persons	In-Scope
SAP	ECC 6.0, EHPS	Accounting, Supply chain, Production	Texas, USA	Client/Server, Unix, AIX 5.3, MS-SQL Server 2008	Paymaster	Packaged		CIO, Administrators	Yes
Budget King	1	Management MIS Budgeting	Hyderabad, India	Web-based, Windows, Apache, Oracle 11g	None	In-house	-	-	No

C. Risks arising from use of IT Systems

1. **Understanding IT Risks**
 After assessing the IT systems and automated environment, auditors must evaluate IT-related risks such as:
 - a. Inaccurate Processing: **Inaccurate data processing** or processing of **incorrect data**.
 - b. Unauthorized Access: Risks of **unauthorized access** to sensitive data.
 - c. Backend Changes: Risks of **direct data changes** bypassing front-end controls.
 - d. Excessive Access: **Privileged access** (e.g., super users) enabling excessive control.
 - e. Segregation of Duties: **Inadequate segregation of duties** leading to process risks.
 - f. Unauthorized Changes: Risks of **unauthorized modifications** to systems or programs.
 - g. Change Management: **Failure to update systems** or programs with necessary changes.
 - h. Data Loss: Risks of **data loss**, impacting data integrity and availability.

2. **Impact of IT Risks**
 If not mitigated, these risks can affect audits in the following ways:
- Impact on Substantive Checking**
 Non-mitigation may result in **non-reliance** on system-generated data, necessitating **detailed checks** for **accuracy** and **completeness**. This increases **substantive checking**.
 - Impact on Controls**
 Leads to **non-reliance** on **automated controls**, **system calculations**, and **built-in procedures**, requiring additional audit work.
 - Impact on Reporting**
 Regulatory requirements for **internal financial controls** may necessitate a **modified auditor's report** in certain cases.

D. Types of Controls in Automated Environment

- General IT Controls (GITC)**
 - ✓ **Definition:** Policies and procedures supporting the effective functioning of **application controls**. Apply to mainframe, mini-frame, and end-user environments.
 - ✓ **Purpose:** Ensure **integrity** of information and **security** of data.

Components of GITC

 - Data Centre and Network Operations Controls:**
 - ✓ Ensure **production systems** meet financial reporting objectives.
 - ✓ Activities include **computer operations**, **batch job execution**, **backup storage**, and **performance monitoring**.
 - ✓ Cover plans like **BCP** and **DRP** for recovery from failures.
 - Program Change Controls:** Ensure modified systems meet **financial reporting objectives** through **change management** processes, including tracking and testing.
 - Access Security Controls:** Ensure **authenticated** and **authorized access** to programs and data, covering areas like **security policies**, **data security**, and **physical security**.
 - System Development and Maintenance Controls:** Ensure systems are developed and implemented to meet financial reporting objectives. Activities include **project management**, **testing**, and **quality assurance**.

Characteristics of GITC

 - ✓ Mitigate **IT-specific risks** across multiple systems.
 - ✓ Known as "**pervasive**" or "**indirect**" controls.
- Application Controls**
 Automated or manual **controls** at the **business process level** to ensure **data completeness**, **accuracy**, and **integrity**. These are Embedded in IT systems such as ERPs.
- IT-Dependent Controls**
Manual controls relying on **data or reports** produced by IT systems.
 - ✓ Design and effectiveness depend on the **reliability** of source data.
 - ✓ Require **General IT Controls** to ensure **effectiveness and reliability**.
- Interrelation Between Controls**
 - ✓ **General IT Controls** and **Application Controls** are interrelated.
 - ✓ **General IT Controls** support the functioning of **Application Controls** to ensure **complete and accurate** information processing.

E. Testing Methods used in Automated Environment

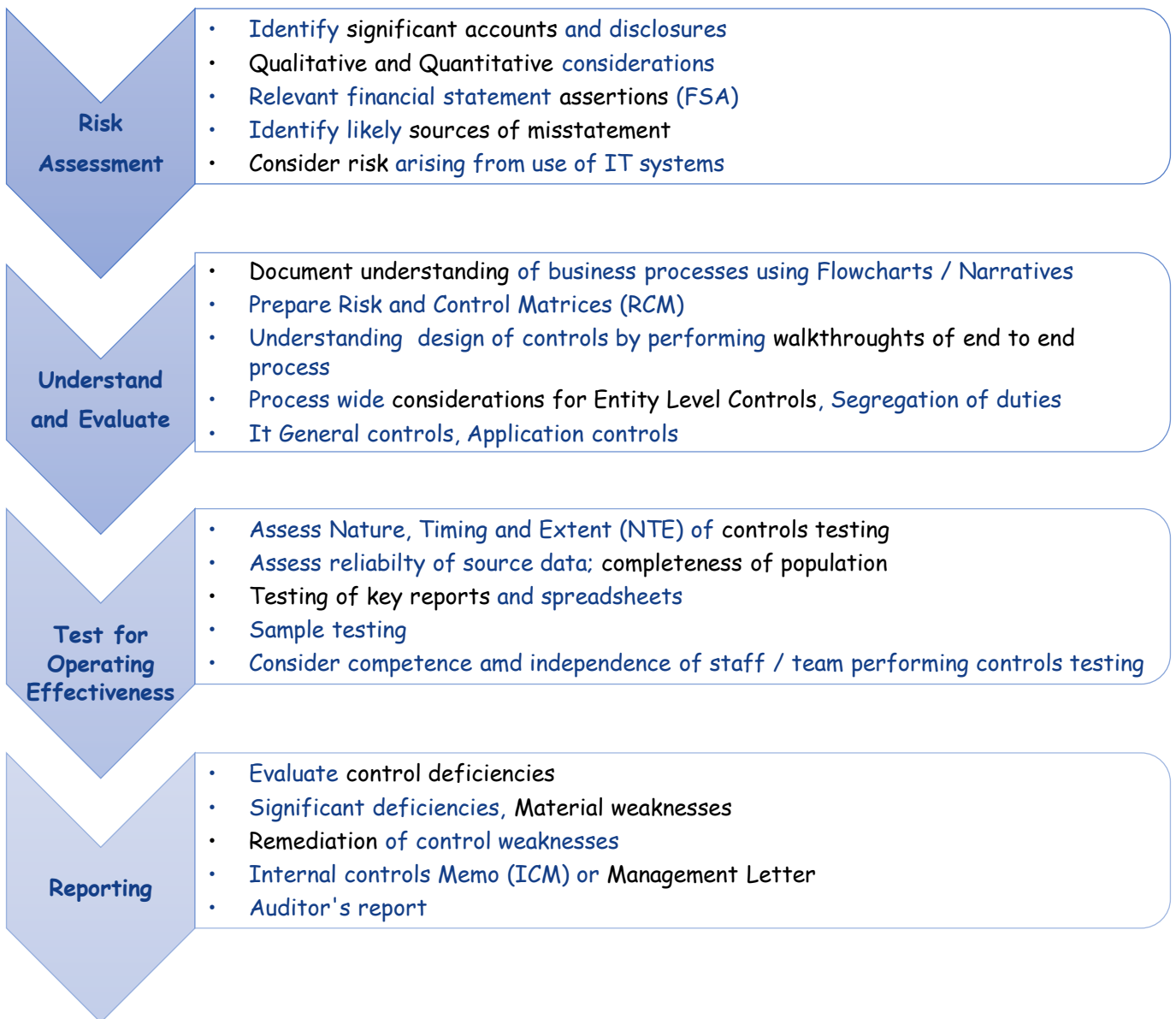
A.	<p>Methods</p> <p>Various audit testing methods used in automated environments include:</p> <ol style="list-style-type: none"> 1. Inquiry <ul style="list-style-type: none"> ✓ Most efficient audit test but must be combined with other methods for reliability. ✓ Combination with inspection provides the most effective and efficient audit evidence. 2. Observation <ul style="list-style-type: none"> ✓ Involves observing users as they process transactions under different scenarios. 3. Inspection <ul style="list-style-type: none"> ✓ Involves examining application configurations, system logs, and user manuals. ✓ Determines any changes made since the last audit testing. 4. Reperformance <ul style="list-style-type: none"> ✓ Provides best audit evidence, but it is time-consuming. ✓ Conduct test checks (negative testing) and observe error messages.
B.	<p>Professional Judgement</p> <p>Application of audit tests depends on factors such as risk assessment, control environment, desired evidence level, and complexity of business.</p> <p>Key points to consider in automated environments:</p> <ol style="list-style-type: none"> a. Walkthroughs <ul style="list-style-type: none"> ✓ Understand how a transaction is processed end-to-end. b. Configuration Inspection <ul style="list-style-type: none"> ✓ Review application configurations to ensure compliance. c. System Logs <ul style="list-style-type: none"> ✓ Examine logs to identify changes since the last audit. d. Manuals <ul style="list-style-type: none"> ✓ Review technical and user manuals for applications. e. Negative Testing <ul style="list-style-type: none"> ✓ Perform test checks and observe error messages.

F. Characteristics of Manual and Automated Elements of Internal Control

1.	<p>Internal Control Elements</p> <p>Internal control systems contain manual and automated elements affecting transactions initiation, recording, processing and reporting.</p>
2.	<p>Manual Controls</p> <ul style="list-style-type: none"> ✓ Include approvals, reviews, reconciliations, and follow-ups. ✓ Operate independently of IT, use IT-generated information, or monitor IT and automated controls.
3.	<p>Automated Controls</p> <ul style="list-style-type: none"> ✓ Use electronic records to initiate, record, process, and report transactions, replacing paper documents.

4. **Impact of Manual Elements in Automated Environments**
Manual controls are suitable for scenarios requiring judgment or discretion:
- a. **When Manual Controls Are Useful**
 - i. **Unusual or non-recurring transactions.**
 - ii. **Situations where errors are hard to define or predict.**
 - iii. **Changing circumstances** needing controls beyond existing automated controls.
 - iv. **Monitoring effectiveness** of automated controls.
 - b. **Limitations of Manual Controls**
 Manual controls are **less reliable** than automated controls due to their **susceptibility to bypass, errors, and inconsistency**. Unsuitable for:
 - i. **High-volume or recurring transactions**, where automated controls can prevent or correct errors.
 - ii. **Activities where specific processes can be adequately automated.**

Q NO 1. WRITE ABOUT AUDIT APPROACH IN AN AUTOMATED ENVIRONMENT?



G. Data Analytics for Audit

Companies benefit from data analytics through increased profitability, better customer service, competitive advantage, and efficient operations.

- ✓ Data Analytics: Combination of processes, tools, and techniques to extract meaningful information from vast amounts of electronic data.
- ✓ CAATs (Computer Assisted Auditing Techniques): Tools and techniques used by auditors to analyse electronic data for obtaining audit evidence.

Significance of Data Analytics for Auditors

Auditors can use data analytics in audits for testing electronic records and IT systems to achieve the following:

1. **Completeness Check**
Verify the completeness of data and population for control tests or substantive audit tests.
2. **Audit Sampling**
Use random or systematic sampling to select audit samples.
3. **Re-computation of Balances**
Reconstruct trial balances from transaction data.
4. **Mathematical Reperformance**
Perform calculations such as depreciation or bank interest verification.
5. **Journal Entry Analysis**
Analyse journal entries as required under SA 240 (related to fraud risks).
6. **Fraud Investigation**
Use tools for fraud detection and investigation.

H. Digital Audit

1. **Digitization in Business**
 - ✓ Entities are adopting digitization to stay aligned with evolving business environments.
 - ✓ New technologies are transforming operations and traditional business models.
 - ✓ Automation plays a central role in driving digitization.
2. **Auditors' Use of Technology**
 - ✓ Auditors integrate digital technology throughout the audit process, from planning to expressing the final opinion.
3. **Key Technologies Used by Auditors**
 - ✓ Artificial Intelligence (AI), data analytics, and other latest technologies help auditors understand business processes.
 - ✓ These tools enhance audit quality and allow auditors to focus on high-risk areas.
4. **Benefits of Digital Audit**
 - ✓ Digital audits enable better risk identification using technology.

I. Assess and Report Audit Findings in IT environment

1. **Findings in IT Environment**
 - ✓ At the conclusion of an audit, findings or exceptions in IT environment and controls must be assessed.
 - ✓ Findings should be reported to relevant stakeholders, including management and those charged with governance (e.g., Board of Directors, Audit Committee).

2.	<p>Evaluation of Findings</p> <ul style="list-style-type: none"> ✓ Use professional judgment to assess findings based on quantitative and qualitative measures. ✓ Evaluate findings individually and in aggregate by combining with other deficiencies.
3.	<p>Key Considerations</p> <ol style="list-style-type: none"> a. Are there weaknesses in IT controls? b. What is the impact of these weaknesses on the overall audit? c. Report deficiencies to management via an Internal Controls Memo or Management Letter. d. Communicate significant deficiencies in writing to those charged with governance.
4.	<p>Assessing Impact</p> <ul style="list-style-type: none"> ✓ The auditor must assess each finding or exception to evaluate its impact on the audit.
5.	<p>Deficiency in Internal Control</p> <p>A deficiency exists if:</p> <ol style="list-style-type: none"> 1. A control is not designed, implemented, or operated to prevent, detect, or correct misstatements on a timely basis. 2. A control is missing altogether.



6. Internal Financial Controls with Reference to F/S

A. IFCOFR and Reporting Requirements	
	<p>Objective and Purpose of Internal Financial Controls (IFC)</p> <p>Internal financial controls are policies and procedures adopted by a company to ensure:</p>
1.	Safeguarding of Assets: Protect the company's assets from misuse or loss.
2.	Fraud Prevention: Ensure prevention and detection of frauds and errors .
3.	Accurate Records: Maintain accuracy and completeness of accounting records .
4.	Reliable Financial Information: Enable timely preparation of reliable financial reports .
5.	Legal Compliance: Ensure compliance with applicable laws and regulations .
	<p>Responsibility</p> <ul style="list-style-type: none"> ✓ Directors and management are primarily responsible for implementing and maintaining the IFC framework. ✓ Auditors evaluate, validate, and report on the design and operating effectiveness of IFC.

The **Companies Act, 2013** emphasizes effective implementation and reporting of internal controls. The term "internal financial controls" is used at some places in **Companies Act, 2013** casting responsibilities as under:

Companies Act	Nature of Responsibility
Section 134(5)(e)	<p>In listed companies, the Directors' Responsibility Statement must state that:</p> <ol style="list-style-type: none"> 1. Internal financial controls (IFC) were laid down to be followed by the company. 2. Such controls are adequate and operating effectively.

Section 143(3)(i)	<p>The auditor's report must state whether:</p> <ol style="list-style-type: none"> 1. The company has an adequate IFC system in place. 2. The IFC is operating effectively. <p>Exemption: Does not apply to private companies that:</p> <ol style="list-style-type: none"> 1. Are One Person Companies or small companies. 2. Have a turnover < ₹50 crore as per latest audited financial statements. 3. Have borrowings < ₹25 crore during the financial year.
Section 177(4)(vii)	<p>The Audit Committee must evaluate:</p> <ol style="list-style-type: none"> 1. Internal financial controls. 2. Risk management systems.
Section 149(8) & Schedule IV	<ul style="list-style-type: none"> ✓ Independent Directors must abide by the Code for Independent Directors. ✓ Their role includes ensuring the integrity of financial information. ✓ They must ensure financial controls and risk management systems are robust and defensible.

B. Distinction Between IFC and Internal Control Over F/R

1.	<p>Internal Financial Controls (IFC) Refers to policies and procedures ensuring:</p> <ol style="list-style-type: none"> a. Reliability of financial reporting. b. Effectiveness and efficiency of operations. c. Compliance with applicable laws and regulations. d. Safeguarding of assets. e. Prevention and detection of frauds.
2.	<p>Internal Controls Over Financial Reporting (ICFR)</p> <ul style="list-style-type: none"> ✓ Focused on internal controls over financial reporting. ✓ Auditors must express an opinion on the effectiveness of internal controls over financial reporting. ✓ This opinion is distinct from the opinion on financial statements.
3.	<p>Comparison</p> <ul style="list-style-type: none"> ✓ IFC: A broader term encompassing all aspects of internal controls. ✓ ICFR: A narrower term limited to the entity's internal controls over financial reporting.



7. SA 330 - The Auditor's Responses to Assessed Risks

Content

A.	<p>Scope and Objective (SA 330)</p> <ul style="list-style-type: none"> ✓ Deals with auditor's responsibility to respond to risks of material misstatement identified as per SA 315. ✓ Objective: Obtain sufficient appropriate audit evidence by designing and implementing responses to assessed risks. ✓ Key Requirements: <ol style="list-style-type: none"> a. Design overall responses to risks at the financial statement level. b. Perform further audit procedures responsive to risks at the assertion level.
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B.	<p>Designing Further Audit Procedures</p> <p>Consider:</p> <ol style="list-style-type: none"> Reasons for risk assessment at the assertion level for transactions, balances, and disclosures. <ol style="list-style-type: none"> Likelihood of material misstatement (inherent risk). Assessment of controls (control risk) and reliance on their operating effectiveness. Obtain more persuasive evidence for higher risks.
C.	<p>Tests of Controls</p> <ul style="list-style-type: none"> ✓ Perform tests to evaluate operating effectiveness of controls when: <ol style="list-style-type: none"> The auditor relies on controls for substantive procedures. Substantive procedures alone are insufficient. ✓ Obtain more persuasive evidence for higher reliance on controls.
D.	<p>Nature and Extent of Tests of Controls</p> <ul style="list-style-type: none"> ✓ Combine inquiry with other procedures (e.g., inspection, reperformance) to assess controls. ✓ Consider: <ol style="list-style-type: none"> How and when controls were applied. Consistency of application. Who applied the controls. ✓ Determine reliance on indirect controls, if applicable. ✓ Combine inquiry with inspection or reperformance for greater assurance. ✓ Adjust testing based on the nature of the control (e.g., inspect documentation for evidence of effectiveness).
E.	<p>Factors Influencing Extent of Testing</p> <p>Consider:</p> <ol style="list-style-type: none"> Frequency of control performance during the period. Length of reliance on controls. Expected rate of deviation. Relevance and reliability of audit evidence. Evidence from other related controls.
F.	<p>Timing of Test of Controls</p> <ul style="list-style-type: none"> ✓ Test controls for the specific time period or throughout the period for which reliance is intended. ✓ Point-in-time evidence may suffice (e.g., testing physical inventory counting at period-end). ✓ For reliance over a period, perform tests to verify controls operated effectively during relevant times (e.g., monitoring of controls).
G.	<p>Using Audit Evidence from Previous Audits</p> <p>Considerations for using prior audit evidence:</p> <ol style="list-style-type: none"> Effectiveness of other internal control elements, such as the control environment and monitoring. Characteristics of the control (e.g., manual or automated). General IT-controls effectiveness. Control's effectiveness and deviations noted in previous audits. Risks due to lack of change in the control amidst changing circumstances.

	<p>f. Material misstatement risks and level of reliance.</p> <p>g. Ensure continuing relevance of prior evidence by confirming if significant changes occurred.</p>
H.	<p>Evaluating Operating Effectiveness of Controls</p> <ul style="list-style-type: none"> ✓ Determine if detected misstatements indicate ineffective controls. ✓ Absence of misstatements does not confirm control effectiveness. ✓ A material misstatement is a strong indicator of a significant deficiency in internal control.
I.	<p>Specific Inquiries When Deviations Are Detected</p> <p>When deviations in controls are identified, auditors should:</p> <ol style="list-style-type: none"> a. Assess if the test of controls provides sufficient basis for reliance. b. Determine if additional control tests are required. c. Address potential risks of misstatement using substantive procedures.
J.	<p>Substantive Procedures</p> <ul style="list-style-type: none"> ✓ Performed for each material class of transactions, account balance, and disclosure, regardless of assessed risks. ✓ Reflects the judgmental nature of risk assessment and limitations of internal control (e.g., management override). <ol style="list-style-type: none"> 1. Purpose <ul style="list-style-type: none"> ✓ Designed to detect material misstatements at the assertion level. 2. Types of Substantive Procedures <ol style="list-style-type: none"> a. Tests of Details: <ul style="list-style-type: none"> ✓ Verify transactions (e.g., vouching) and balances (e.g., verification). ✓ Example: Verify purchase transactions using invoices, goods received notes, and registers. ✓ Example: Verify fixed assets through physical verification to confirm existence on the balance sheet date. b. Substantive Analytical Procedures: <ul style="list-style-type: none"> ✓ Evaluate financial data using plausible relationships among financial and non-financial data. ✓ Investigate fluctuations or inconsistencies in data. ✓ Use recognized ratios (e.g., profit margins) to support reasonableness of recorded amounts. ✓ Example: Predict total rental income based on rental rates, number of apartments, and vacancy rates. 3. Nature and Extent of Substantive Procedures <p>The auditor may:</p> <ol style="list-style-type: none"> a. Perform only substantive analytical procedures if sufficient to reduce audit risk. b. Use tests of details if supported by control testing. c. Combine analytical procedures and tests of details for most responsive risk assessment. d. Increase extent of procedures when control test results are unsatisfactory. e. Consider sample size and alternative testing methods when designing tests of details.

10. AUDIT OF BANKS



1. Brief Overview of Banking

A. Peculiarities in Banks

1.	Huge Volumes & Complexity Banks handle large volumes of transactions with complex processes .
2.	Wide Geographical Spread The network of banks is vast , covering diverse locations .
3.	Range of Products & Services Banks offer a variety of financial products and services .
4.	Extensive Use of Technology Technology is heavily integrated into banking operations .
5.	Strict Regulatory Vigilance Banks are closely monitored by the banking regulator for compliance .

B. Types of Banking Entities

1. Commercial Banks	Widest spread banking institutions in India offering a range of products and services to the public and economy .
2. Regional Rural Banks (RRBs)	Banks in rural areas catering to the banking needs of rural communities . E.g., Punjab Gramin Bank, AP Grameen Vikas Bank.
3. Co-operative Banks	Similar to Commercial Banks but operate under Cooperative Principles . Registered under Cooperative Societies Acts and focus on agriculture and rural sectors . E.g., The Gujarat State Co-operative Bank Ltd., Chhattisgarh Rajya Sahakari Bank Maryadit
4. Payments Banks	✓ A new type of bank introduced by RBI. Allowed to accept restricted deposits but cannot issue loans or credit cards. ✓ Offers Current & Savings accounts, ATM/Debit cards, Internet-banking, and Mobile banking. E.g., Airtel Payments Bank, India Post Payments Bank, etc.
5. Development Banks	Focus on providing funds for infrastructure to promote economic growth . E.g., IFCI, IDBI, SIDBI, etc.
6. Small Finance Banks	Established by RBI to provide banking facilities to unserved sectors like small farmers and micro business units . E.g., Equitas Small Finance Bank, AU Small Finance Bank, etc.

C. Functions of RBI in Banking

1.	Regulation by RBI The Reserve Bank of India (RBI) acts as the Central Bank of India, regulating the banking industry .
2.	RBI Responsibilities

	<p>a. Development and supervision of the Indian financial system (banks and non-banking financial institutions).</p> <p>b. Formulating monetary and credit policies in collaboration with the Central Government.</p>
3.	<p>Important RBI Functions</p> <p>a. Issuance and regulation of currency.</p> <p>b. Acting as banker to central/state governments and other banks.</p> <p>c. Regulating commercial and other banks' activities.</p>
4.	<p>Bank Licensing</p> <p>Banks cannot start operations or open new branches without an RBI license. RBI has the authority to inspect any bank.</p>
5.	<p>Banking Operations</p> <p>a. Conducted at branches, while administrative offices oversee policies, systems, and internal controls for regulatory compliance.</p> <p>b. Administrative offices also ensure delegation of powers, fix responsibilities, monitor operations, and address policy deviations.</p>

D. Regulatory Framework for Banking Companies

1.	RBI Act, 1934
2.	Banking Regulation Act, 1949
3.	State Bank of India Act, 1955
4.	Companies Act, 2013
5.	State Bank of India (Subsidiary Banks) Act, 1959
6.	Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970
7.	Regional Rural Banks Act, 1976
8.	Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980
9.	Information Technology Act, 2000
10.	Prevention of Money Laundering Act, 2002
11.	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
12.	Credit Information Companies Regulation Act, 2005
13.	Payment and Settlement Systems Act, 2007

E. Additional Reports by Statutory Central Auditors

1.	<p>Internal Controls over Financial Reporting</p> <p>Report on adequacy and operating effectiveness of internal controls as per Section 143(3)(i) of the Companies Act, 2013. Annexed to the main audit report.</p>
2.	Long Form Audit Report (LFAR)
3.	SLR Compliance Report
4.	Report on Treasury Operations conducted as per RBI instructions
5.	Report on Income Recognition & Asset Classification as per Guidelines of RBI
6.	Report on Serious irregularity on working of bank
7.	Reports on the bank's compliance with the Ghosh Committee (frauds/malpractices) and Jilani Committee (internal controls/inspection systems).
8.	Report on Adverse Credit-Deposit Ratio

F. Understanding of Bank Accounting System

1.	<p>Transaction Volume Bank transactions are voluminous, requiring robust systems to maintain data integrity, free from errors, omissions, irregularities, and frauds.</p>
2.	<p>Internal Controls Banks continuously strive to make their internal control systems safe, secure, convenient, and efficient for customers in a technology-driven environment.</p>
3.	<p>Bank Categorisation (Based on Computerisation Level) Banks are divided into 3 categories:</p>
a.	<p>Non-Computerised Banks Transactions are conducted at branches using paper and pen during working hours.</p>
b.	<p>Partially Computerised Banks Some transactions are computerised, but most remain non-computerised.</p>
c.	<p>Fully Computerised Banks</p> <ul style="list-style-type: none"> i. Core Banking System (CBS) enables branch interconnectivity and allows customers to access accounts/services from any branch over the network. ii. Auditors must ensure all RBI norms/parameters are incorporated in the computerised system for accurate classification, provisions, and income recognition. iii. Auditors should exercise Professional Scepticism and Prudence to validate system-generated data with manual checks and document findings.

4. Difference between Computerised and Non computerised Banks:

Aspect	Computerised Banks	Non-Computerised Banks
1. Banking Activities	All activities are done through computers .	Banking is done manually .
2. Transaction Availability	Can transact anywhere, anytime .	Can transact only during working hours .
3. Processing Time	Shortest processing time for transactions.	Takes a long time to process transactions.
4. Productivity & Efficiency	Higher productivity and efficiency .	Lower productivity and efficiency .

G. Audit Plan and Points to be considered

1.	Nature and Level of Operations
2.	Nature of Adverse Features
3.	Level of Compliance based on previous reports and
4.	Evaluates risks due to inadequate internal controls or breaches and insights from the familiarization exercise .

H. Control Environment in a Bank

1.	<p>Segregation of Duties Effective separation of roles, especially between front and back offices.</p>
2.	Accurate measurement and reporting of positions.
3.	Proper verification and approval of transactions.
4.	Regular reconciliation of positions and results.

5. Setting appropriate **limits** for activities.
6. Timely **reporting** and **approval** of exceptions.
7. Ensuring **physical security** and **contingency planning**.

The following are **certain common questions /steps**, which have to be kept in mind while undertaking/ performing control activities:

Nature of Questions	Questions to be considered / answered
Who	1. Who performs the control?
	2. Does the above person have requisite knowledge and authority to perform the control?
What	What evidence is generated to demonstrate /prove that the control is performed?
When	1. When and with what frequency is the control performed?
	2. Is the frequency enough to prevent, detect and correct Risk of Material Misstatements?
Where	1. Where is the evidence of performance of the control retained?
	2. For how long is the evidence retained?
	3. Is the evidence accessible for / available for audit?
Why	Why is the control being performed?
	What type of errors are prevented or detected through the performance of the control?
How	1. How is the control performed?
	2. Can these activities be bypassed?
	3. Can the bypass, if any, be detected?
	4. How are exceptions / deviations resolved on identification?
	5. What is the time frame for resolving the exceptions / deviations?



2. Procedure for Conducting Audit of a Bank

1. Engagement Team Discussion

1.	Engagement Team Discussions The team holds discussions to understand the bank and its environment , including internal controls .
2.	Purpose of Discussions <ol style="list-style-type: none"> a. Assess potential for material misstatements in financial statements. b. Conduct discussions during the planning stage of the audit. 3. Document discussions for future reference.
4.	Matters to Discuss <ol style="list-style-type: none"> a. Likely errors to occur. b. Errors identified in prior years. c. Possible fraud methods by personnel or others. d. Need for professional skepticism. e. Responses to Engagement Risk, Pervasive Risks, and Specific Risks. f. Alertness to material misstatements.
5.	Advantages of Discussions

- a. Helps assess **fraud risk** in financial statements and plan responses to **engagement, pervasive, and specific risks**.
- b. Enables the **partner** to delegate work to experienced team members and determine **procedures for fraud detection**.
- c. Facilitates the decision to involve **specialists** for addressing fraud-related issues.

2. Initial Considerations by Statutory Auditor

1.	<p>Communication with Previous Auditor As per Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant must communicate in writing with the previous auditor before accepting the position.</p>
2.	<p>Acceptance & Continuance Perform procedures as per SA 220 regarding acceptance of client relationship and engagement risk.</p>
3.	<p>Declaration of Indebtedness Auditor must declare no credit facilities have been taken or such facilities have not become NPA.</p>
4.	<p>Terms of Audit Engagements As per SA 210, terms must be agreed upon and documented to avoid confusion.</p>
5.	<p>Internal Assignments Audit firms cannot undertake statutory audits if associated with internal assignments in the same year.</p>
6.	<p>Establish the Engagement Team Assign qualified professionals based on the size, nature, and complexity of the bank's operations.</p>

3. Understanding the Bank and Its Environment

1.	<p>Accounting Process As per SA 315, obtain an understanding of the entity, its internal control, and accounting process to identify and assess risks.</p>
Risk Management Process	
1.	<p>Involvement in the Control Process Governance bodies (Board of Directors/CEO) should approve written risk management policies aligned with business objectives and regulatory requirements.</p>
2.	<p>Risk Identification, Measurement & Monitoring Identify, measure, and monitor risks that impact the bank's goals against pre-approved limits and criteria.</p>
3.	<p>Control Activities Implement controls such as segregation of duties, transaction verification/approval, physical security, and contingency planning.</p>
4.	<p>Monitoring Activities Regularly assess and update risk management models and methodologies.</p>
5.	<p>Reliable Information Systems</p>

Maintain reliable systems that provide financial, operational, and compliance information in a timely and consistent manner.

4. Other Steps

1.	Engagement Team Discussions Team discussions assess internal control and potential material misstatements.
2.	Develop the Audit Plan As per SA 300, involve all key team members to effectively plan the audit.
3.	Determine Audit Materiality Consider the relationship between audit materiality and audit risk using professional judgment.
4.	Consider Going Concern Assess events or conditions casting doubt on the bank's ability to continue as a going concern.
5.	Maintain Professional Scepticism As per SA 240, maintain a sceptical attitude to detect possible fraud or misstatements.
6.	Stress Testing RBI mandates banks to adopt a Board-approved Stress Testing framework as part of their risk management systems.
7.	Basel III Framework As per the BCBS Basel III document (2010), banks must follow criteria for regulatory capital inclusion.
8.	Reliance on/Review of Other Reports Auditor reviews the following reports for adverse comments: <ul style="list-style-type: none"> ✓ Previous audit reports ✓ Internal inspection reports ✓ RBI inspection report ✓ Concurrent/Internal audit reports ✓ Security verification reports ✓ Manager's charge ✓ handing-over report.



3. Appointment and Reporting by Auditors of Bank

A. Provisions of Appointment

1.	Eligibility, Qualifications, & Disqualifications Same as auditor of a company under Section 141 of the Companies Act, 2013.
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B. Authority to Appoint Auditor

1.	Banking Company Appointed by shareholders at the AGM with RBI approval.
2.	Nationalised Bank Appointed by the Board of Directors (BOD) with RBI approval.
3.	State Bank of India (SBI) Appointed by CAG of India in consultation with Central Government (CG). Subsidiary auditors are appointed by SBI.

4. **Regional Rural Banks (RRBs)**
Appointed by **BOD** with approval from the **Central Government**.

C. Remuneration of Auditor

1. **Banking Company**
Fixed as per **Section 142** of the **Companies Act, 2013** by the company in a **general meeting**.
2. **Nationalised Banks, SBI, & RRBs**
Fixed by the **RBI** in consultation with the **Central Government**.
3. **Powers of Auditor**
Same as the **company auditor** under the **Companies Act, 2013**, including access to **books, accounts, documents, and vouchers**.

D. Reporting by Auditor

- A. **Reporting to CG**
For Nationalised Bank, The Auditor's **Report to the Central Government** shall include:
 1. **True and Fair View**: Verify if the **balance sheet and profit and loss account** present a true and fair view.
 2. **Information Provided**: Confirm if requested **explanations/information** were satisfactory.
 3. **Powers of the Bank**: Ensure transactions are **within the bank's powers**.
 4. **Branch Returns**: Verify if branch returns are **adequate** for audit purposes.
- B. **Format of Report**
Key Elements of the Audit Report:
 1. **Compliance with SA's**: Ensure report follows **Standards on Auditing (SA)**.
 2. **Unaudited Branches Disclosure**: Include **quantification** of advances, deposits, interest income, and expenses for unaudited branches. [Under OMP - SA 600]
 3. **Section 143**: Report must comply with **Section 143** of the **Companies Act, 2013**.
 4. **CARO Applicability**: **CARO, 2020** is **not applicable** to banking companies.
- C. **Long Form Audit Report (LFAR)**
LFAR Submission and Guidelines:
 1. Auditors of public, private, and foreign banks must submit **LFAR**.
 2. **Matters for LFAR** are outlined by the RBI.
 3. LFAR must be submitted **by 30th June annually**.
 4. Proper planning ensures **timely submission**.
 5. **Executive Summary** is optional, but recommended for **key observations**.
- D. **Reporting to RBI (or Fraud Reporting)**
Fraud Reporting Responsibilities:
 1. **RBI Circular**: Auditors must report **fraudulent activities** or suspicious transactions to the **RBI**.
 2. **SA 240**: Auditors must report fraud to **RBI** and the **Chairman/Managing Director/Chief Executive** of the bank.
 3. **System Evaluation**: Focus is on evaluating the **system** rather than every individual transaction.
- E. **Duty to Report on Frauds u/s 143(12)**
✓ Applies to company auditors under **Section 139** and is **in addition** to RBI reporting.



4. Advances of a Bank

A. Meaning and Types of Advances

1. **Definition of Advances**
 - ✓ Advances are a major **asset** and income source for banks, shown on the **assets side** of the balance sheet.
 - ✓ **Advances** are loans or credits given by a **bank** to a party with repayment period.
 - ✓ All loans will have **interest** as compensation for borrowing.
 - ✓ Auditors need in-depth **banking knowledge**, including regulations, processes, and internal controls in order to audit the advances
2. **Examination of Advances**
 - ✓ Large Advances: 100% examination.
Criteria: **Year-end balance > ₹10 crore or 10% of branch's aggregate year-end advances, whichever is less.**
 - ✓ Other Advances: Examined on a **sampling basis**.
3. **Types of Advances**
 - ✓ **Funded Advances:** Involves actual transfer of funds.
Examples: Term loans, Cash credits, Overdrafts, Demand Loans, Bills Discounted and Purchased, Risk-sharing participation, Interest-bearing Staff Loans.
 - ✓ **Non-Funded Advances:** No actual funds transfer.
Examples: Letters of credit, Bank guarantees.
4. **Advances Comprises**
 - ✓ Term loans
 - ✓ Cash credits, Overdrafts, Demand Loans
 - ✓ Bills Discounted and Purchased
 - ✓ Risk-sharing participation
 - ✓ Interest-bearing Staff Loans
5. **Disclosures in Balance Sheet**
Types of Advances to be disclosed:
 - a. **Bills purchased and discounted**
 - b. **Cash credits, Overdrafts, and loans repayable on demand**
 - c. **Term loans**
 Further categorized as:
 - a. **Secured by tangible assets,**
 - b. **Covered by guarantees,**
 - c. **Unsecured.**

Advances in India	Advances Outside India:
<ol style="list-style-type: none"> a. Priority sectors b. Public sector c. Banks d. Others 	<ol style="list-style-type: none"> a. Due from banks b. Due from others: <ol style="list-style-type: none"> i. Bills purchased and discounted ii. Syndicated loans iii. Others

B. Classification of Advances - Based on Sector

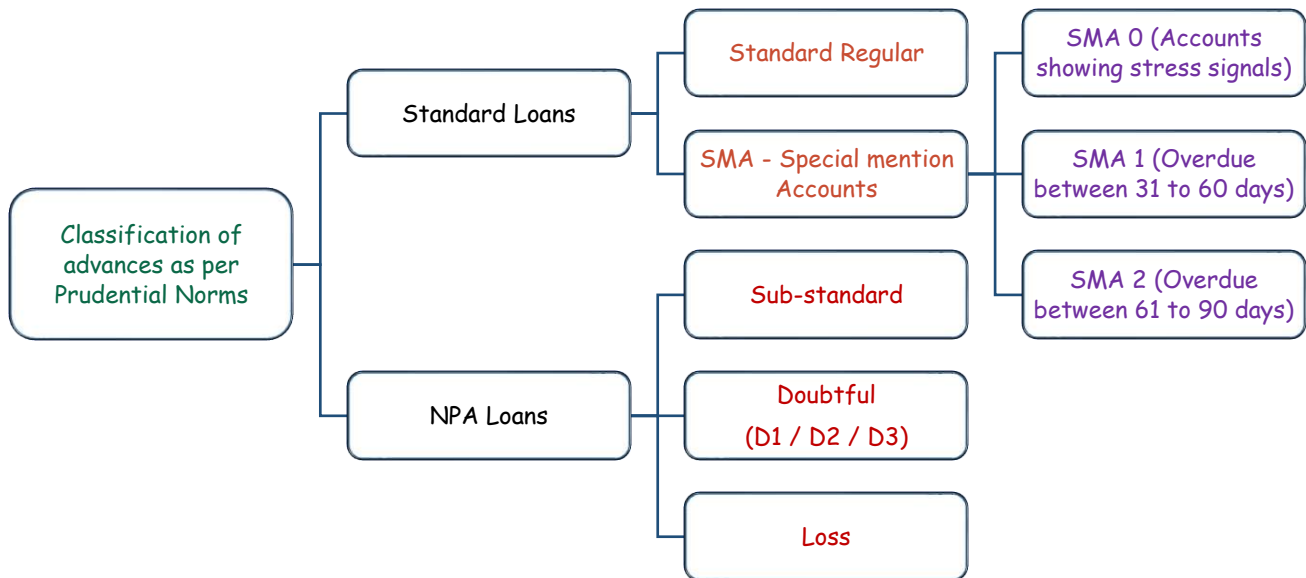
- ✓ Banks must follow **common guidelines** for lending to **Priority Sectors**.
- ✓ Guidelines include: **Interest rates, service charges**, loan application process (**receipt, sanction, rejection, disbursement register**), and **acknowledgment issuance**.
- ✓ Priority Sector Examples: **Agriculture, MSME, Education, Housing, etc.**
- ✓ RBI also sets **lending targets** for these sectors.

C. Classification of Advances - Based on Security

1. **Based on Security**
 - ✓ **Primary Security**: The **principal security** offered by the borrower for the advance.
 - ✓ **Collateral Security**: Additional security provided by the borrower.
 - ✓ **Common Securities Accepted**:
 - a. Goods/Stocks/Debtors/Trade Receivables
 - b. Gold Ornaments and Bullion
 - c. Immovable Property
 - d. Plantations (for agricultural advances)
 - e. Life Insurance Policies
 - f. Stock Exchange Securities and Other Instruments
2. **Mode of Creation of Security**
 - a. **Mortgage**
 - ✓ **Registered Mortgage**: Created using a registered instrument (**Mortgage Deed**) signed by the mortgagor.
 - ✓ **Equitable Mortgage**: Created by delivering **title deeds** to the bank with intent to create security.
 - b. **Pledge**
 - ✓ Involves **bailment or delivery of goods** to the bank as security.
 - ✓ **Ownership remains with the pledger**, while the bank gets defined interests in the goods.
 - c. **Hypothecation**
 - ✓ **Ownership and possession** remain with the borrower, who acts as the bank's **agent/trustee**.
 - ✓ Borrower submits **statements of assets (stocks, debtors, etc.)** to determine drawing power.
 - d. **Assignment**
 - ✓ Transfer of **existing or future debt** or rights (e.g., book debts, life insurance policies).
 - ✓ Only **actionable claims** (excluding secured debt) are accepted by banks.
 - e. **Set-Off**
 - ✓ Enables bank to **combine two accounts** (e.g., deposit and loan) of the same person.
 - ✓ Accounts must be in the **same name and capacity**.
 - ✓ Right of **set-off** applies to **time-barred debts**.
 - ✓ **All branches** of the banks are **treated as one** for the purpose of setoff.
 - f. **Lien**: A legal charge where the lender has the **right to seize and liquidate assets**.



5. Audit of Advances and Prudential Norms



A. Definition of NPA

Non-Performing Assets (NPA)

1. Definition: An asset becomes an NPA when it stops generating income for the bank.
2. Criteria for NPA:
 - a. Term Loan: Interest and/or principal overdue for more than 90 days.
 - b. Overdraft/Cash Credit (OD/CC): Account remains 'out of order'.
 - c. Bills Purchased/Discounted: Bill remains overdue for more than 90 days.

Notes:

1. Classification of advance as NPA depends on record of recovery, not based on security or borrower/guarantor's net worth.
2. Borrower-wise Classification: NPA Classification is made borrower wise and NOT based on facility wise. [Including Investments in securities]
 Example: Mr. Raman has a Car Loan (NPA) and a Housing Loan (regular). Both loans are classified as NPA because classification is borrower-wise, not facility-wise.

Out of Order

Definition: An OD / CC account is treated as 'out of order' if:

1. Outstanding balance exceeds the sanctioned limit/drawing power continuously.
2. Balance is less than the sanctioned limit/drawing power, but there are no credits for 90 days as of the balance sheet date.
3. Credits are insufficient to cover interest debited during the same period.

Example: A Ltd. has a Cash Credit Facility of INR 50 lakhs, but drawing power is INR 42 lakhs. The account is 'out of order' if:

1. Outstanding exceeds INR 50 lakhs/42 lakhs.
2. Outstanding is below INR 42 lakhs, but there are no credits for 90 days.
3. Credits are insufficient (e.g., INR 2 lakhs vs. interest debited of INR 5 lakhs).

Meaning of Overdue

Any amount due to the bank under a credit facility is 'overdue', if not paid on the due date.

Category of NPA	Meaning	Provision % of O/S Amt	
1. Substandard Assets	Assets that have been classified as NPA for ≤ 12 months.	15%	
2. Doubtful Assets	Assets that have been in the Substandard category for > 12 months.	Secured Portion	Unsecured Portion
	Subcategories:		
	1. Doubtful up to 1 Year (D1)	25%	100%
	2. Doubtful 1 to 3 Years (D2)	40%	100%
	3. Doubtful > 3 Years (D3)	100%	100%
3. Loss Assets	Assets where loss has been identified by the bank, auditors, or RBI inspection but not fully written off.	100%	100%

B. Special NPA Norms

1.	<p>Accounts Regularized Near Balance Sheet Date Accounts with credits just before the balance sheet date. Asset Classification:</p> <ul style="list-style-type: none"> ✓ Handled with care. ✓ If data indicates inherent weakness, the account should be treated as an NPA. ✓ The auditor shall check sample transactions before and after closing of the year to get knowledge of credits. ✓ If the credits are reversed during first few days after closure of FY, it shows inherent weakness.
2.	<p>Government Guaranteed Advances Central Govt. Guaranteed Advances:</p> <ol style="list-style-type: none"> a. Advances are treated as Standard Assets if guarantee is not invoked/repudiated. b. For Income Recognition, regarded as NPA. <p>State Govt. Guaranteed Advances:</p> <ol style="list-style-type: none"> a. Classified as NPA if overdue for >90 days, for both purposes. b. Relaxation for provisioning does not apply. Income Recognition norm is similar to CGGA.
3.	<p>Advances Under Consortium Meaning:</p> <ul style="list-style-type: none"> ✓ Loans advanced by 2 or more banks jointly by forming a Consortium. Bank with the higher share leads the consortium and is called as Lead Bank. <p>Asset Classification:</p> <ul style="list-style-type: none"> ✓ Based on record of recovery of each member bank. ✓ If borrower remits funds to the lead bank but share is not transferred to other banks, account is classified as NPA. <p>Recovery Share Management:</p> <ul style="list-style-type: none"> ✓ Member banks must ensure recovery share is transferred by the lead bank. ✓ Alternatively, get express consent for the transfer to maintain proper classification. <p>Drawing Power (DP) Allocation:</p> <ul style="list-style-type: none"> ✓ Lead Bank computes and allocates DP to member banks. ✓ Borrower may request adjustments in DP allocation among member banks.

Illustrative Drawing Power for December 2022 as per Stock Statement November, 2022

(Rs. in Crores)			
Description of Stocks	Market Value	Margin	Advance Value
Raw Materials	636.27	25	477.20
Finished Goods	372.75	25	279.56
Stock in process	659.35	25	494.51
Stores and Spares	124.51	25	93.38
Book Debts (Upto 120/180 days)	37379.90	35	24296.94
Stock in Transit	52.31	25	39.23
<u>Total</u>	<u>39225.09</u>		<u>25680.82</u>
Less: Unpaid Stocks under LC	0.00	100	0.00
<u>Total</u>	<u>39225.09</u>		<u>25680.82</u>

(Rs. in Crores)		
BANKS	Share %	LIMIT/D.P.
State Bank of India	32.25	500.00
Bank of Baroda	2.58	40.00
Bank of India	6.45	100.00
Canara Bank	5.16	80.00
Standard Chartered Bank	9.03	140.00
Union Bank of India	6.45	100.00
HSBC	13.87	215.00
Citi Bank	6.45	100.00
Bank of America	1.29	20.00
BNP Paribas	1.94	30.00
Punjab National Bank	6.45	100.00
ICICI Bank	4.84	75.00
IDBI Bank	3.23	50.00
Unallocated		
TOTAL	100.00	1550.00

4. Accounts with Erosion in Security Value/Fraud
- a. Erosion refers to gradual destruction / diminution in security value.
 - b. Classification:
 - i. Doubtful Asset:
 - ✓ If the realisable value of security is < 50% of assessed value by bank or RBI at the time of last inspection, such advances will be classified as Doubtful assets.
 - ✓ Provisioning as per doubtful asset norms.
 - ii. Loss Asset:

	<ul style="list-style-type: none"> ✓ If realisable value of security is < 10% of outstanding amount, classify as Loss Asset and write off fully.
5.	<p>Advances Against Term Deposits, NSCs, and KVPs Advances secured against Term Deposits, NSCs, KVP / IVP are Not NPAs provided adequate margin is available.</p>
6.	<p>Agricultural Advances Affected by Natural Calamities</p> <ol style="list-style-type: none"> a. Governed by RBI Master Circular on income recognition and classification for calamity-affected advances. b. Relief Measures by Banks: <ul style="list-style-type: none"> ✓ Convert short-term production loans into term loans. ✓ Reschedule repayment periods. ✓ Sanction fresh short-term loans. c. NPA Classification: Will be based on the rescheduled terms.
7.	<p>Advances to Staff</p> <ol style="list-style-type: none"> a. Interest-bearing staff advances forms part of the bank's advances portfolio. b. NPA Classification: <ul style="list-style-type: none"> ✓ If interest is payable after principal recovery, Interest is not considered as overdue. ✓ Classified as NPA only if instalments remain overdue for >90 days. c. Salary Advances: Shown under 'Others' in the schedule of Other Assets if treated as employer loans.
8.	<p>Agricultural Advances</p> <ol style="list-style-type: none"> a. These are 2 types: <ol style="list-style-type: none"> 1. Long Duration Crops (LDC) 2. Short Duration Crops (SDC) b. NPA Norms: <ol style="list-style-type: none"> a. SDC: Treated as NPA if instalment [P/I/Both] remains overdue for 2 crop seasons. b. LDC: NPA if instalment remains overdue for 1 crop season. c. Definition of LDC: Crops with a season >1 year are long duration crops. d. Crop season: Means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each State.

C. Computation of Drawing Power

1.	<p>Drawing Power (DP) DP is the limit up to which a firm can withdraw from its working capital limit sanctioned.</p>
2.	<p>Sanctioned Limit (SL)</p> <ol style="list-style-type: none"> a. Meaning: The total exposure a bank can take on a client for facilities like cash credit, overdrafts, etc. b. Difference: DP is calculated based on primary security minus margin, whereas SL is the maximum exposure limit.
3.	<p>Rules for DP/SL</p> <ol style="list-style-type: none"> a. Accounts must stay within both DP and SL at all times. b. Accounts exceeding DP or SL, or using unapproved securities, or irregular should be reported to Management/Head Office. c. Drawings in the working capital account must be covered by current assets adequacy.

- d. DP must be calculated based on the **current stock statement**.
- e. These stock statements **shall not be older than 3 months**.
- f. If there is an outstanding advance **with stock statements older than 3 months** render the account irregular.
- g. **DP Computation** must follow guidelines from the **Bank's Board of Directors** and agreed upon by statutory auditors.
- h. Special focus should be on **sundry creditors** during DP calculation.

4. Auditor's concerns

a. Scrutiny of Borrower Documents:

- ✓ Scrutinize **stock statements, quarterly returns**, and other borrower-submitted statements.
- ✓ Compare **monthly stock statements** with the audited accounts and investigate **deviations**.

b. Stock Audit:

- ✓ Required for accounts with funded exposure **> ₹5 crores**.
- ✓ Auditors can **recommend stock audits for other cases if needed**.
- ✓ For consortium lending, **obtain stock audit reports** from the lead bank.
- ✓ **Review Stock Audit Reports** during the audit, focusing on Valuation of security and Calculation of DP.

D. Audit of Advances

1. Objectives of Audit

The auditor aims to ensure:

- a. **Outstanding advances** in the balance sheet are accurate.
- b. Advances represent **amounts due to the bank**.
- c. **Loan and supporting documents** are complete and appropriate.
- d. There are no **unrecorded advances**.
- e. **Valuation of advances** is appropriate and recoverability is recognised in their valuation.
- f. Advances are **disclosed, classified, and described** per accounting policies and regulations.
- g. **Provisions** are made as per **RBI norms, Accounting Standards**, and accepted practices.

2. Evaluation of Internal Controls Over Advances [Compliance Procedures]

The auditor reviews the bank's internal controls, which should include:

- a. **Credit Worthiness**: Advances are made only **after verifying** the borrower's credit worthiness and obtaining proper sanction.
- b. **Documentation**: Necessary documents like **agreements, promissory notes**, etc., must be executed before disbursement.
- c. **End Use of Funds**: Compliance with terms of sanction and **proper use of funds** must be ensured.
- d. **Margin of Safety**: Maintain sufficient **margin** against securities and ensure regular checks.
- e. **Creation of Security**:
 - ✓ Transfer ownership of **shares, debentures, etc.** to the bank.
 - ✓ Register securities in the bank's name where applicable.
 - ✓ Inspect and verify **goods in go-downs** frequently.
- f. **Drawing Power (DP)**:

	<ul style="list-style-type: none"> ✓ Update DP Register monthly and ensure entries are verified by an officer. ✓ Accounts should stay within DP and sanctioned limits. ✓ Irregular accounts should be reported to the controlling authority. <p>g. Review: Review each advance account once a year, or more frequently for large advances.</p>
3.	<p>Substantive Audit Procedures</p> <p>The auditor can obtain S&A audit evidence about advances by:</p> <ul style="list-style-type: none"> ✓ Verifying recorded amounts. ✓ Checking loan documentation. ✓ Reviewing account operations. <p>b. Ensuring security valuation and enforceability.</p> <p>c. Checking compliance with RBI norms for classification and provisioning.</p> <p>d. f. Performing analytical procedures.</p>
	<p>Extent of Substantive Procedures</p> <p>a. Large Advances: Examine all large advances; others may be reviewed on a sampling basis.</p> <p>b. Problem Accounts: Examine in detail unless amounts are insignificant.</p> <p>c. Special Focus: Include advances sanctioned during the year or commented on by RBI, internal audit, or inspection teams.</p>



6. Audit of Incomes

Interest Earned	Other Income
<ul style="list-style-type: none"> ✓ Interest/ Discount on Advances/ Bills ✓ Interest Income on Investments ✓ Interest on Balances with RBI and Other Inter-bank Funds ✓ Others: This includes any other interest/discount income not included in the above heads 	<p>Commission, Exchange and Brokerage:</p> <p>This item comprises of the following:</p> <ul style="list-style-type: none"> a. Commission on bills for collection. b. Commission/exchange on remittances and transfers, e.g., demand drafts, NEFT, RTGS, etc. c. Commission on letters of credit and guarantees, letter of comforts. d. Loan processing, arranger and syndication fees. e. Mobile banking fees. f. Credit/Debit card fee income including annual fee income, merchant acquiring income, interchange fees, etc. g. Rent from letting out of lockers h. Commission on Government business. i. Commission on other permitted agency business including consultancy and other services. j. Brokerage on securities. k. Fee on insurance referral. l. Commission on referral of mutual fund clients.

	<p>m. Service/transaction banking charges including charges levied for transaction at other branches.</p> <p>n. Income from rendering other services like custodian, demat, investment advisory, cash management and other fee based services.</p> <p>o. Profit on Sale of Investments</p> <p>p. Profit/Loss on Revaluation of Investments Profit on sale of Land, Buildings and Other Assets:</p> <p>q. Income earned by way of dividends, etc., from subsidiaries and joint ventures abroad/in India.</p> <p>r. Miscellaneous income.</p>
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A. Audit of Income

1.	<p>Audit Objective The auditor primarily concerned with:</p> <ol style="list-style-type: none"> a. Recorded income arose from valid transactions. b. Income pertains to the relevant period and bank. c. No unrecorded income exists. d. Income is recorded at the appropriate amount.
2.	<p>Accrual Basis</p> <ol style="list-style-type: none"> a. Materiality Threshold: Income exceeding 1% of total income (Gross basis) or 1% of net profit before taxes (Net basis) is recorded on an accrual basis. b. Income below this threshold may be recognised on a cash basis.
3.	<p>Revenue Certainty</p> <ol style="list-style-type: none"> a. Banks recognise income (interest, fees, commissions) on an accrual basis unless collection is uncertain. b. Interest on NPAs: <ul style="list-style-type: none"> ✓ No income is recognised on NPAs until realised. ✓ For newly classified NPAs, previously accrued interest is reversed or provided for, including Government-guaranteed accounts. c. Memorandum Account: On turning NPA, unrealised interest is reversed and recorded in a memorandum account for control purposes. d. Advances Against Specific Securities: Interest on Term Deposits, NSCs, KVPs, IVPs, Life Policies can be recorded on due date if adequate margin exists.
4.	<p>Bills Purchased</p> <ol style="list-style-type: none"> a. For outstanding bills as on year end, the discount received thereon should be properly apportioned between the 2 years. b. The unexpired discount/rebate related to period after year end, should be recorded under "Other Liabilities". c. Interest on rediscounted bills should not be netted off from discount earned.

5.	<p>Bills for Collection</p> <p>Auditor shall verify procedure for crediting the party:</p> <ol style="list-style-type: none"> Generally, Customer account is credited only after actual collection. Ensure, Branch commission is due and recognised only after the bill is collected.
6.	<p>Renegotiations</p> <ol style="list-style-type: none"> Fees/commissions from renegotiations/rescheduling of debts should be recognised on an accrual basis over the extended credit period. Test Check Interest, fees, and commissions (e.g., commission on bills, letters of credit, guarantees).
7.	<p>Partial Recoveries in NPAs</p> <ol style="list-style-type: none"> In absence of clarity, banks must adopt a consistent accounting policy for appropriating recoveries. This must be applied on a uniform and consistent manner. Recognise income as per AS 9 only when certainty of realisation exists. Interest realised on NPA can be taken to income account. Ensure interest credits are not from fresh/additional credit facilities to the borrower.
8.	<p>Other Incomes</p> <ol style="list-style-type: none"> Interest Income on Investments: <ul style="list-style-type: none"> ✓ Income includes Government securities, bonds, debentures, and other investments (excluding subsidiary dividends). ✓ Broken period interest and premium amortisation are netted off. Profit on Sale of Investments: Recorded in the Profit and Loss Account. Revaluation of Investments: Periodic revaluation gains/losses are recognised in the Profit and Loss Account.

B. Reversal of Income

1.	<p>Reversal of Interest on NPAs</p> <ol style="list-style-type: none"> If an advance, including bills purchased and discounted, becomes NPA, the entire accrued interest must be reversed or provided for if not realised. Applies to Government guaranteed accounts as well.
2.	<p>Fees and Commission on NPAs</p> <p>For NPAs, fees, commissions, and similar income:</p> <ol style="list-style-type: none"> Cease to accrue for the current period. Must be reversed or provided for past periods if uncollected.
3.	<p>Wrongly Recognised Income</p> <p>For wrongly recognised income:</p> <ol style="list-style-type: none"> Reverse the amount if recognised during the current year. Provide for an equivalent amount if recognised in previous years.
4.	<p>Auditor's Enquiries</p> <p>Auditor should:</p> <ol style="list-style-type: none"> Enquire about unexplained large debits in the Interest Income account. Check for borrower communications about interest charge discrepancies and confirm appropriate action.
5.	<p>Income on Leased Assets: As per AS 19 - Leases, unrealised finance income on leased assets accrued before becoming NPA must be reversed or provided for in the current period.</p>

6. **Takeout Finance**
- a. A **takeout loan** replaces an initial loan with long-term financing.
 - b. Used in **property development** and based on meeting specific project completion criteria.
 - c. **Income Recognition:**
 - ✓ If classified as NPA, income should be recognised **only when realised** from the borrower or taking-over institution (as per arrangement).
 - d. **Objectives of Takeout Finance:**
 - ✓ **Expand financing sources** for infrastructure projects.
 - ✓ Address **sectoral/group/entity exposure** and credit mismatch issues.
 - ✓ Boost availability of **long-term debt facilities** for projects.



7. Audit of Expenses

Interest Expense	Operating Expenses	Provisions and Contingencies
<ul style="list-style-type: none"> ✓ Interest on Deposits ✓ Interest on Reserve Bank of India/Inter-Bank Borrowings ✓ Others 	<ul style="list-style-type: none"> ✓ Payments to and Provisions for Employees ✓ Rent, Taxes and Lighting ✓ Printing and Stationery ✓ Depreciation ✓ Directors' Fees, Allowances and Expenses ✓ Auditors' Fees and Expenses ✓ Legal expenses ✓ Postage, Telegrams, Telephones, etc. ✓ Insurance ✓ Advertisements and Repairs ✓ Other Expenses 	<ul style="list-style-type: none"> ✓ Provisions made in respect of the non-performing assets. ✓ Provisions for Taxation ✓ Provisions for Diminution in the value of investments ✓ Provisions for contingencies

Audit Procedures

- A. **Audit of Interest Expenditure**
- The auditor ensures **interest expense is reasonable by analyzing ratios** and comparing them with averages for liabilities. The following procedures:
1. Obtain **quarterly analysis** of deposits and compute **weighted average interest rate**. Compare with the actual rate and investigate material differences.
 2. Compare the **average interest rate** with previous years and analyses significant variances.
 3. Obtain **general ledger break-up** of interest expenses (deposits and borrowings).
 4. Perform **monthly/quarterly cost analysis** and document reasons for variances.
 5. Test check interest calculations to ensure:
 - a. Interest is provided on all deposits up to the **balance sheet date**.
 - b. Rates comply with **bank regulations, RBI directives**, and deposit agreements.
 - c. Interest on savings accounts follows **bank/RBI rules**.
 - d. Interest on inter-branch balances is provided at **prescribed rates**.

	<ol style="list-style-type: none"> 6. Verify interest rate changes during the period using the interest rate card. 7. Ensure interest is accrued on the entire borrowing portfolio and matches the general ledger. 8. Re-compute interest accrual by considering parameters like payment frequency, rate, elapsed period, term sheet, and agreements.
B.	<p>Audit of Operating Expenses</p> <ul style="list-style-type: none"> ✓ Evaluate internal control systems for expense authorization. ✓ Check for divergent trends in major expense items. ✓ Perform analytical procedures (e.g., ratio of expenses to total operating expenses compared with prior years). ✓ Verify expenses against supporting documents and check calculations.
C.	<p>Audit of Provisions and Contingencies</p> <ol style="list-style-type: none"> 1. Ensure compliance with regulatory requirements for provisioning as per RBI circulars. 2. Understand the bank's provisioning process for standard and non-performing assets (NPAs). 3. Verify loan classification (standard, sub-standard, doubtful, loss, NPAs) on a sample basis. 4. Reconcile loan classifications with the general ledger. 5. Audit tax provisions by verifying tax computation and ensuring all items in the profit and loss account are appropriately considered. 6. Review provisions for expenses and assess adequacy with management explanations.
D.	<p>Disclosure of Prior Period Items</p> <p>As the format under 3rd Schedule of Banking Regulation Act, 1949 does not mandate disclosure of prior period items, any significant impacts should still be disclosed as warranted.</p>



8. Form and Content of Financial Statements

Content	
1.	<p>Applicability of Section 29</p> <ul style="list-style-type: none"> ✓ Sub-sections (1) and (2) of Section 29 of the Banking Regulation Act, 1949: ✓ Govern the form and content of financial statements of a banking company. ✓ Applicable to nationalised banks, State Bank of India, and Regional Rural Banks.
2.	<p>Preparation of Financial Statements</p> <ol style="list-style-type: none"> a. Balance Sheet and Profit and Loss Account as per the forms in the Third Schedule to the Act. b. Form A: Specifies the Balance Sheet format. c. Form B: Specifies the Profit and Loss Account format.
3.	<p>Compliance with Accounting Standards</p> <ol style="list-style-type: none"> a. Accounting Standards under Section 133 of the Companies Act, 2013. b. Rule 7 of the Companies (Accounts) Rules, 2014, as applicable to banking companies. c. Accounting Standards issued by ICAI.

11. AUDIT OF ITEMS OF FINANCIAL STATEMENTS



1. Introduction

Introduction

1.	<p>Financial Statement Audit Examination of an entity's financial statements and disclosures by an independent auditor and provides a report attesting to the truth and fairness of financial statements and disclosures.</p>
2.	<p>Management Responsibility Management is responsible for the preparation and presentation of financial statements. Financial statements include overall representations and specific assertions.</p>
3.	<p>Definition of Assertion</p> <ul style="list-style-type: none"> ✓ Representations by management, explicit or implicit, embodied in financial statements. ✓ Assertions address potential misstatements and are used by the auditor to guide their examination. ✓ Key Assertions: <ul style="list-style-type: none"> a. Completeness: All transactions and balances are recorded. b. Cut-off: Transactions are recorded in the correct accounting period. c. Existence/Occurrence: Recorded assets, liabilities, and transactions exist and occurred. d. Valuation/M Measurement: Assets, liabilities, and transactions are properly valued and measured. e. Rights and Obligations: Entity owns or controls assets and has obligations for liabilities. f. Presentation and Disclosure: Financial statements are appropriately presented with adequate disclosures. ✓ Assertions apply to Assets, Liabilities, Equity, Income, Expenses, and Disclosures as per applicable accounting standards.
4.	<p>Example Company X's balance sheet shows a building with a carrying amount of Rs. 50 lakh. Assertions Implied by Management:</p> <ul style="list-style-type: none"> a. Existence: The building exists at period-end. b. Rights and Obligations: Company X owns and controls the building. c. Valuation: The building is valued accurately as per measurement principles. d. Completeness: All buildings owned/controlled by Company X are included in the Rs. 50 lakh amount.
5.	<p>Auditor's Role</p> <ul style="list-style-type: none"> ✓ Auditor creates an audit programme to verify management assertions. ✓ Auditor obtains sufficient and appropriate audit evidence for each assertion related to: <ul style="list-style-type: none"> a. Account Balances. b. Class of Transactions. c. Related Disclosures.



2. Income Statement Captions Comprising Revenue and Expense Balances

Assertion	Explanation	Example - Employee Benefits and Sales
Occurrence	Transactions recognized in the financial statements have occurred and relate to the entity.	<ul style="list-style-type: none"> ✓ Employee benefit expense is incurred during the period for personnel employed by the entity; excludes unauthorized personnel. ✓ Sales represent goods ordered, dispatched, and invoiced in the period.
Completeness	All transactions that should be recorded have been recognized in the financial statements. No transactions are omitted.	<ul style="list-style-type: none"> ✓ Employee benefit expenses for all personnel have been fully accounted for. ✓ All genuine sales are recorded.
Cut-off	Ensures income and expenses are reported in the correct accounting period.	<ul style="list-style-type: none"> ✓ Employee benefit expenses relate only to the current accounting period. ✓ Sales include dispatches made at year-end belonging to the relevant period.
Measurement	Transactions are recorded accurately in the financial statements, with no errors in documentation or posting.	<ul style="list-style-type: none"> ✓ Employee benefit expense is measured/calculated correctly; tax deductions are reconciled and accounted for. ✓ Sales reflect correct invoice amounts, including discounts.
Presentation and Disclosure	Transactions are classified and presented fairly in the financial statements with complete and accurate disclosures.	<ul style="list-style-type: none"> ✓ Disclosures ensure material information is not omitted, distorted, or misleading. ✓ Additional notes include: <ol style="list-style-type: none"> 1. Employee Benefits Expense (salaries, funds, ESOP/ESPP, welfare). 2. For non-finance companies, revenue disclosures include: <ol style="list-style-type: none"> a. Sale of products/services, b. Grants/donations (for Section 8 companies), c. Other operating revenues. <p>Less: Excise duty/GST.</p>



3. Balance Sheet Captions Comprising Assets, Liabilities and Equity Balances

Assertion	Explanation	Example of Inventory
Existence	Ensures assets, liabilities, and equity balances exist as of the period-end .	Inventory recognized in the balance sheet actually exists at the period-end.
Completeness	All assets, liabilities, and equity balances that should be recorded have been recognized in the financial statements.	<ul style="list-style-type: none"> ✓ All inventory units held by the entity are recognized, including inventory held by a third party on behalf of the entity. ✓ Inventory held by the entity as a Consignee (on behalf of another party) is excluded.
Cut-off	Ensures all assets and liabilities are reported in the appropriate period .	<ul style="list-style-type: none"> ✓ Inventory balance at year-end excludes elements of the next financial year. ✓ All items of inventory for the relevant year are included, regardless of their location.
Valuation	Assets, liabilities, and equity balances are valued appropriately , avoiding overstatement or understatement.	<ul style="list-style-type: none"> ✓ Inventory is valued at the lower of cost or net realizable value, as per AS 2 - Inventories. ✓ Costs unrelated to production (e.g., general/admin costs) or abnormal wastage are excluded. ✓ An acceptable valuation basis (e.g., FIFO, Weighted Average) is used.
Rights & Obligations	Entity has the right to assets (e.g., legal title/ownership) and recognizes all obligations to repayment for liabilities.	<ul style="list-style-type: none"> ✓ The entity owns or controls inventory recorded in the financial statements (e.g., purchase invoices are in the name of the entity). ✓ Inventory held on behalf of others (e.g., Consignment agreements) is not included as part of the entity's inventory.
Presentation and Disclosure	Ensures items are properly classified , described, and disclosed, and that disclosures are complete and accurate without omission or distortion.	Inventories: <ul style="list-style-type: none"> ✓ Classified as Raw materials, Work-in-progress, finished goods, Stock-in-trade, Stores and spares, Loose tools, Others (specify nature). ✓ Goods-in-transit are disclosed under the relevant subhead. ✓ Mode of valuation is stated.

Balance Sheet Items



1. Audit of Share Capital

Content	
1.	<p>Existence of Share Capital</p> <ol style="list-style-type: none"> Tally authorized, issued, and paid-up share capital with the previous year's audited financial statements. If no changes occurred, obtain a written representation from the Company Secretary. Verify if paid-up capital is within authorized capital by reviewing the MOA for any changes.
2.	<p>Completeness of Equity Balances</p> <ol style="list-style-type: none"> Obtain certified resolutions for changes in authorized or paid-up capital. For fresh issues, ensure compliance with the Companies Act 2013 (Return of Allotment, Minimum Subscription, Bank account maintenance, Sec 40). Ensure no shares are issued at a discount (Sec 53). Check if shares are issued for cash or consideration other than cash (e.g., services to promoters). Verify compliance with SEBI regulations. Check filings with MCA (Forms SH-7, PAS 3) and RBI (Form FCGPR for FDI). Confirm fee and stamp duty calculations for share capital increases.
3.	<p>Valuation of Equity Balances</p> <p>Shares Issued at Premium:</p> <ol style="list-style-type: none"> Verify premiums are transferred to the securities premium account (Sec 52). Confirm premium usage for purposes like bonus shares, writing off preliminary expenses, redemption premiums, writing off discounts on issue, or buybacks (Sec 68). <p>Shares Issued at Discount:</p> <ol style="list-style-type: none"> Ensure no shares were issued at a discount, except sweat equity shares (Sec 53). Ensure compliance for discounted shares issued for debt restructuring.
4.	<p>Sweat Equity Shares</p> <ol style="list-style-type: none"> Issued to employees/directors under Section 54 as compensation. Verify compliance with: <ul style="list-style-type: none"> ✓ Special resolution, specifying terms (number, price, recipients). ✓ SEBI regulations (for listed companies) or prescribed rules (for unlisted companies). Ensure sweat equity holders rank pari passu with other shareholders.
5.	<p>Reduction of Capital</p> <ol style="list-style-type: none"> Verify compliance with Section 66: <ul style="list-style-type: none"> ✓ Special resolution, ✓ Authorization in AOA, ✓ No defaults in deposit repayments. Check Tribunal orders and filings with the Registrar of Companies. Review accounting entries for capital reduction/write-offs. Confirm Schedule III presentation and disclosure of asset revaluation. Ensure compliance with Tribunal-imposed conditions and MOA alterations.

Section 66(6) exempts buybacks from capital reduction requirements. Verify compliance with Section 68 for buybacks.

6. Disclosures for Share Capital

For each class of share capital:

- a. Number and amount of authorized shares.
- b. Number of shares issued, subscribed, fully paid, and partially paid.
- c. Par value per share.
- d. Reconciliation of shares outstanding at the beginning and end of the period.
- e. Rights, preferences, and restrictions for each class of shares.
- f. Shares held by the holding/ultimate holding company and subsidiaries/associates.
- g. Shares held by shareholders holding >5%.
- h. Shares reserved for options/contracts/disinvestments with terms and amounts.
- i. For the last five years, disclose:
 - ✓ Fully paid shares issued without payment in cash.
 - ✓ Shares issued as bonus shares.
 - ✓ Shares bought back.
- j. Terms of convertible securities with conversion dates.
- k. Unpaid calls (aggregate value for directors/officers).
- l. Forfeited shares (amount paid-up).

A company shall disclose Shareholding of Promoters as below:

Shares held by promoters at the end of the year % Change during the year***

S. No.	PromoterName	No. of shares	% Of total shares**
Total			

** Details shall be given separately for each class of shares

*** percentage change shall be computed with respect to the number at the beginning of the year or if issued during the year for the first time then with respect to the date of issue.]

Unused Issue Proceeds

If funds from an issue of securities remain unused, disclose how such unutilized amounts have been used or invested.

7. Additional Regulatory Information

- 1. For funds advanced/loaned/invested to intermediaries:
 - ✓ Date and amounts loaned or invested in intermediaries.
 - ✓ Details of further investments/loans/guarantees by intermediaries to ultimate beneficiaries.
 - ✓ Date and amount of guarantee by intermediary to ultimate beneficiary.
 - ✓ Compliance declarations for FEMA, Companies Act, and Prevention of Money-Laundering Act.
- 2. For funds received from Funding Parties:
 - ✓ Date and amount received from funding parties with details of funding parties.
 - ✓ Details of further investments/loans/guarantees by the company on behalf of ultimate beneficiaries.
 - ✓ Date and amount of guarantee by company to ultimate beneficiary.

- ✓ **Compliance declarations** for FEMA, Companies Act, and Prevention of Money-Laundering Act



2. Audit of Reserves and Surplus

Content	
1.	<p>Definition of Reserves Reserves are amounts appropriated out of profits, not intended to meet:</p> <ol style="list-style-type: none"> a. Liabilities, b. Contingencies, c. Commitments, or d. Diminution in asset value as at the balance sheet date.
2.	<p>Purpose of Reserves Reserves are an internal financing source and are utilized based on their type:</p> <ul style="list-style-type: none"> ✓ Revenue Reserves: Available for distribution or purposes like: <ol style="list-style-type: none"> a. Supplementing profits in lean years. b. Financing business expansion. c. Augmenting working capital. d. Strengthening the financial position. ✓ Capital Reserves: Not available for distribution; used for specific limited purposes (e.g., securities premium, capital redemption reserve).
3.	<p>Revenue Reserve treated as Capital Reserve If revenue profits are appropriated for asset replacement reserves for capital purposes, then such reserve is treated as a capital reserve.</p>
4.	<p>Source of Capital Reserves Created from capital profits, such as:</p> <ul style="list-style-type: none"> ✓ Sale of fixed assets, ✓ Profit on share sales.
5.	<p>Utilization of Capital Reserves Capital reserves can be used for:</p> <ul style="list-style-type: none"> ✓ Writing down fictitious assets or losses. ✓ Issuing bonus shares, if realized and permitted by Articles.
6.	<p>Specific Restrictions ✓ Securities premium (Sec 52) and Capital redemption reserve (Sec 55) can only be utilized for purposes specified under the Companies Act, 2013.</p>

Audit Procedure for Reserves & Surplus

1.	<p>Existence of Reserves and Surplus</p> <ol style="list-style-type: none"> 1. Trace and tally opening balances of reserves and surplus with the previous year audited financial statements. 2. For additions/utilization, verify transactions during the current year.
2.	<p>Completeness of Reserves and Surplus Profit and Loss Balance:</p>

	<ol style="list-style-type: none"> Trace movements in surplus/deficit as per the Statement of Profit and Loss for the audited year. Verify movements in the Statement of Changes in Equity. Check board and shareholder resolutions for dividends.
3.	Valuation of Reserves and Surplus <ol style="list-style-type: none"> As per AS-4 (Revised) or IND AS 10, dividends proposed or declared after the balance sheet date are not recognized as liabilities but must be disclosed. For Securities Premium, verify issuance of shares above nominal value and ensure proper board resolutions are in place. Confirm utilization of securities premium complies with Sec 52.
4.	Disclosures for Reserves and Surplus Ensure compliance with Schedule III (Part I) : <ol style="list-style-type: none"> Reserves and Surplus must be classified as: <ul style="list-style-type: none"> ✓ Capital Reserves ✓ Capital Redemption Reserve ✓ Securities Premium ✓ Debenture Redemption Reserve ✓ Revaluation Reserve ✓ Share Options Outstanding Account ✓ Other Reserves (specify nature and purpose). Surplus: Balance in the Statement of Profit and Loss should disclose allocations (e.g., dividends, bonus shares, transfers to/from reserves). Additions/deductions since the last balance sheet must be shown under each head. Reserves backed by earmarked investments should be termed as a "fund". Debit balance of Profit and Loss Statement must be shown as a negative figure under "Surplus". Any resulting negative balance after adjustments should be shown under "Reserves and Surplus".



3. Audit of Borrowings

Audit Procedures

1.	Existence of Borrowings All borrowings on the balance sheet represent valid claims by banks or other third parties. <ol style="list-style-type: none"> Review board minutes to confirm approval of new lending agreements and significant debt commitments. Agree loan details (interest rate, nature, repayment terms) with loan agreements and ensure borrowing limits are not exceeded. Obtain independent balance confirmations (SA 505) for borrowings. Verify lease/hire purchase creditors with contracts. Examine debenture trust deeds for terms, restrictions, and compliance. Confirm discharge of assets for retired debt. Obtain written representations from management confirming liabilities represent valid claims.
2.	Completeness of Borrowings

That **all borrowings have been accounted** for in the books of the company on a timely basis.

1. Obtain a schedule of **short-term and long-term borrowings**, showing:
 - ✓ Opening and closing balances.
 - ✓ Borrowings taken and repaid during the year.
2. Trace balances to the **general ledger**.
3. Review subsequent transactions after the reporting period for **unrecorded liabilities**.
4. Roll out and Obtain **independent confirmations** for borrowings and ensure:
 - ✓ Interest rates, due dates, collateral, and balances match records.
 - ✓ Send reminders for non-replies and
 - ✓ Compare balances with confirmation and reconcile discrepancies.

3. Valuation of Borrowings

1. Ensure **accounting policies** for borrowings are consistently applied.
2. **Recompute interest** and verify amortization of premiums/discounts.
3. For **foreign currency loans**, verify closing exchange rates and restatements as per **AS 11**.
4. Verify **due dates** for accurate classification between short-term and long-term loans.
5. Check compliance with **Sections 180, 185, 186** of Companies Act, 2013.
6. Confirm borrowings are within the company's **Articles of Association (AOA)** and **Memorandum of Association (MOA)** limits.
7. Read provisions in the loan and debt agreements and perform:
 - ✓ Ensure **entity is in compliance with loan covenants** and other significant provisions
 - ✓ If there are **any provisions with which the entity is not in compliance**, determine whether the debt should be classified as current.
 - ✓ If **enforcement of the provisions has been waived** by the lender in case of breach of any covenant by the entity, **obtain confirmation of the waiver** from the lender.

4. Disclosure of Borrowings

Ensure compliance with **Schedule III (Part I)** of the Companies Act, 2013:

Long-Term Borrowings:

- ✓ Classified as bonds/debentures, term loans (banks/other parties), deferred payment liabilities, deposits, loans from related parties, etc.
- ✓ Specify **secured/unsecured** status and nature of security.
- ✓ Include terms of repayment, period of default, and particulars of redeemed bonds.

Short-Term Borrowings:

- ✓ Classified as loans repayable on demand, loans from related parties, deposits, etc.
- ✓ Specify **secured/unsecured** status, terms of repayment, and period of default.

Disclose current maturities of long-term borrowings separately.

Note: If borrowings are **not used for the specific purpose** taken, disclose alternative uses.

5. Other Long-Term Liabilities

Classified as:

- a. **Trade Payables**
- b. **Others**

To be disclosed as Additional Regulatory Information

1.	<p>Disclosure for Borrowings Secured by Current Assets</p> <ol style="list-style-type: none"> 1. Disclose whether quarterly returns/statements filed with banks or financial institutions are in agreement with the books of accounts. 2. If not, provide a summary of reconciliation and disclose reasons for material discrepancies.
2.	<p>Wilful Defaulter</p> <ul style="list-style-type: none"> ✓ If the company is declared a wilful defaulter by any bank, financial institution, or lender: <ol style="list-style-type: none"> a. Date of declaration as wilful defaulter. b. Details of defaults (amount and nature). ✓ Definition: A wilful defaulter is a person/entity categorized as such by a bank/financial institution under RBI guidelines.
3.	<p>Registration of Charges or Satisfaction</p> <p>If any charges or satisfaction are not registered with the Registrar of Companies within the statutory period, disclose details and reasons for the delay.</p>
4.	<p>Utilization of Borrowed Funds and Share Premium</p> <p>A. Funds Advanced or Loaned to Intermediaries:</p> <ol style="list-style-type: none"> 1. Disclose date and amount of funds loaned or invested in intermediaries with details of each intermediary. 2. Disclose date and amount further loaned/invested by intermediaries to ultimate beneficiaries with complete details. 3. Disclose date and amount of guarantees or securities provided to/for ultimate beneficiaries. 4. Include a declaration of compliance with FEMA, Companies Act, and Prevention of Money-Laundering Act. <p>B. Funds Received from Funding Parties:</p> <ol style="list-style-type: none"> 1. Disclose date and amount of funds received with details of each Funding Party. 2. Disclose date and amount further advanced or invested to intermediaries/ultimate beneficiaries with details. 3. Disclose date and amount of guarantees/securities provided to/for ultimate beneficiaries. 4. Include a declaration of compliance with FEMA, Companies Act, and Prevention of Money-Laundering Act.



4. Audit of Trade Receivables

Content	
1.	<p>Test of Controls for Trade Receivables</p> <p>Points to ensure effectiveness of internal controls over sales as a part of Receivables audit:</p> <ol style="list-style-type: none"> a. Only bona fide sales create trade receivables. b. Sales are made to approved customers. c. All sales are properly recorded in the books. d. Debtors can only be settled by cash receipt or with the approval of a responsible official. e. Duties related to sales transactions are segregated (e.g., accounting, collection, reminders).

- f. Debtors are **collected on time**.
- g. For overdue debtors, **reminders** are sent, and legal action is taken if needed.
- h. Debtors' **balances are regularly reviewed**.
- i. **Follow-up system** exists, and adequate **provision for bad debts** is made using an **ageing schedule** of debtors.

2. Post-Control Audit Procedures

After performing the **Test of Controls** on sales, the auditor decides on the appropriate **audit procedures** to verify debtors' balances.

Audit Procedures for Trade Receivables

1. Existence of Trade Receivables

1. Ensure controls **prevent duplicate invoice recording**, and receivables are auto-recorded in the **general ledger**.
2. Verify accounts receivable **ageing report** against the general ledger.
3. Check **realizations** are recorded **invoice-wise** or adjusted **chronologically (FIFO)**.
4. Investigate **long overdue balances**.

Direct Confirmation Procedure

1. Use **direct confirmation procedures** to confirm balances from customers.
2. **Cover all significant account balances** at year end and for small amounts, random balances are verified.
3. **Date of Balance**: The trade receivables may be requested to confirm the balances on
 - ✓ The date of the balance sheet, or
 - ✓ Any other selected date which is **reasonably close to the date of the balance sheet**. The **date should be decided by the auditor** in consultation with the Company.
4. **Form of Request** can be
 - ✓ The **form with balance outstanding** and the customer responds his agreement with balance shown or
 - ✓ The **form without any balance mentioned**, where the customer shall respond with balance outstanding as per his records.
5. Maintain **strict control over confirmation requests** and handle replies independently.
6. Perform **alternate procedures** if confirmations are not received. This includes
 - ✓ Agreeing balances with **subsequent cash receipts**
 - ✓ Confirming that these transactions actually occurred by preparing **detailed analysis of balance with transaction breakup**.

Analytical Procedures:

1. Review a **trend line of sales and accounts receivable**, to check if there are any unusual trends i.e., perform analytical procedures.
2. Measure the **average collection period**.
3. Make **inquiries** about reasons for **changes in trends** with the management and
4. **Document** the same in audit work papers.

2. Completeness of Trade Receivables

1. Verify **cut-off procedures**:
 - ✓ For invoices issues during last few days, **check that goods are dispatched**.

- ✓ Also Ensure goods dispatched before the year-end are invoiced and included in debtors.
- ✓ Verify no goods dispatched after the year-end are included in debtors.
- 2. Match invoices to shipping logs and ensure sales are recorded in the correct period.
- 3. Test invoices from the ageing report for accuracy in amounts, dates, and customers.
- 4. Review credit memos and ensure proper authorization and period inclusion.
- 5. Examine bill-and-hold transactions for legitimacy.
- 6. Check for unusual trends using analytical procedures (e.g., average collection periods).

3. Valuation of Trade Receivables

- 1. Review process for allowance for doubtful accounts and ensure consistency with prior years.
- 2. Obtain the ageing report and compare with prior year lists.
- 3. Identify debtors under litigation and evaluate provisions for doubtful debts.
- 4. Check provisions are made at appropriate rates.
- 5. Verify bad debts write-offs are approved by authorized personnel (e.g., Board of Directors).
- 6. Prepare schedules for movements of bad debts, provisions, and written-off amounts, and compare with prior years.
- 7. Check write off of debtors are by proper authority.

4. Disclosure of Trade Receivables

- 1. Restate foreign currency receivables as per AS 11.
- 2. Disclose Related Party Transactions per AS 18/IND AS 24.
- 3. Report transactions under Section 189 of the Companies Act in CARO, 2020.
- 4. Ensure compliance with Schedule III (Part I) of the Companies Act, 2013:

i. Trade Receivables ageing schedule

Particulars	(Amount in Rs.)					Total
	Outstanding for following periods from due date of payment#					
	Less than 6 months	6 months-1 year	1-2 years	2-3 years	More than 3 years	
i. <u>Undisputed</u> Trade receivables- considered good						
ii. <u>Undisputed</u> Trade Receivable- considered doubtful						
iii. <u>Disputed</u> Trade Receivables considered good						
iv. <u>Disputed</u> Trade Receivables considered doubtful						

- ii. Sub-classify trade receivables as:
 - ✓ Secured, considered good.

- ✓ Unsecured, considered good.
- ✓ Doubtful.
- iii. Disclose allowances for bad debts under relevant heads.
- iv. Separately disclose debts due by directors, officers, or related parties.



5. Cash and Cash Equivalents

Audit Procedure for Cash

1. **Existence of Cash and Cash Equivalents**
 1. Perform **surprise checks** of cash balances, both at year-end and at a later date, without prior notice.
 2. If more than one cash balance, **simultaneously verify all cash balances**, including **cashier, petty cashier, branch cashier, and imprest balances**.
 3. Ensure the **cashier signs** the cash count statement with denomination details. If he is absent during cash count, he may hold auditor responsible for shortages.
 4. Verify slips or LOUs for **temporary advances are authorized and recorded**.
 5. Analyse monthly **cash receipts and payments trends** and investigate unusual variations.
2. **Completeness of Cash and Cash Equivalents**
 1. Obtain **Bank Reconciliation Statements (BRS)** for all bank accounts, verify periodic preparation, and ensure **authorized signatures**.
 2. **Verify BRS details**:
 - ✓ **Bank book balances** match bank confirmations/statements.
 - ✓ Check **cheques issued but not presented**, ensuring subsequent clearance or reclassification if stale (over 3 months).
 - ✓ Verify **cheques deposited but not credited**, using bank deposit slips and subsequent bank statements.
 - ✓ Review **unrecorded bank charges/credits** and ensure management adjusts material amounts.
 3. Use **direct confirmation procedures** to confirm balances from banks/financial institutions. Auditor shall obtain confirmation for 100% of bank balances.
 4. Testing includes, **agreeing book balances to balance confirmation** or bank statements.
 - ✓ For unresolved discrepancies, obtain **written explanations** from banks.
 - ✓ For **non-replies**, perform **alternate testing like checking bank statements** in the auditor's presence or direct branch visits.
3. **Valuation of Cash and Cash Equivalents**
Ensure **foreign currency bank accounts** are restated at **closing exchange rates** as per applicable financial reporting standards.
4. **Disclosure of Cash and Cash Equivalents**
Comply with **Schedule III (Part I)** of the Companies Act, 2013:
 - i. Classify cash and cash equivalents as:
 - ✓ **Balances with banks**.
 - ✓ **Cheques/drafts on hand**.
 - ✓ **Cash on hand**.
 - ✓ **Others (specify nature)**.
 - ii. Separately disclose **earmarked balances** (e.g., unpaid dividends).
 - iii. State balances held as **margin money or security** separately.
 - iv. Mention any **repatriation restrictions** on cash/bank balances.
 - v. Disclose **bank deposits** with maturity over 12 months separately.



6. Audit of Inventories

Meaning and Principle

1. **Definition of Inventories**
Inventories are assets:
 - a. **Held for sale** in the ordinary course of business.
 - b. **In production** for such sale.
 - c. **Materials or supplies** for production or rendering services.
2. **Valuation of Inventories**
As per **AS 2 - Valuation of Inventories**:
 - ✓ Inventories are valued at the **lower of cost** and **net realisable value**.
 - ✓ The valuation basis should be applied **consistently** year-on-year.
 - ✓ Changes in **accounting policy** must be adequately **disclosed** in financial statements.

Audit Procedures for Inventory

1. **Existence of Inventories**
 1. Review entity's **inventory count plan** and participate in the count.
 2. Verify that **consigned goods** are segregated.
 3. Participate in inventory counting and Perform test counts:
 - ✓ Observe **adherence** to count plan.
 - ✓ Ensure **supervision** of count.
 - ✓ **Check items** are tagged and properly recorded.
 - ✓ **Reconcile test counts**, tags, and summary sheets.
 - ✓ Stay alert for empty boxes or **obsolete items**.
 - ✓ Conduct **cut-off testing** (last 5-10 receiving/shipping reports).
 4. Ensure **exclusion of third-party stock** and accounting of all stock sheets.
 5. **Investigate differences** between physical and recorded stock.
 6. Perpetual Inventory system - Counting can be at any **interim dates**.
 7. Periodical Inventory system - Counting shall be **undertaken at year end**.
2. **Completeness of Inventories**
 1. Perform analytical procedures:
 - ✓ Compare with industry averages, budgets, and trends.
 - ✓ Compute **inventory turnover ratio** (COGS/average inventory).
 - ✓ Conduct **vertical analysis** (inventory/total assets).
 - ✓ Compare budgets with actuals.
 - ✓ Verify **non-financial information** related to inventory such as weights.
 2. Conduct cut-off tests:
 - ✓ Match shipping and receiving documents to accounting records.
 - ✓ Test for omitted or invalid transactions.
 3. Verify **arithmetical accuracy** of inventory listings.
 4. Reconcile physical counts with **perpetual records**.
 5. Reconcile inventory **held with third-party** like transporter, ports.
 6. Ensure **consigned goods** are segregated.
3. **Ownership of Inventories**
 1. **Vouch purchases** to supporting documents (purchase orders, invoices, payment records).

	<ol style="list-style-type: none"> 2. Review consignment agreements, collateral agreements, and material purchase commitments. 3. Check invoices for evidence of ownership. 4. Obtain confirmations for third-party inventory. Require declarations on letterheads signed by authorized personnel.
4.	<p>Valuation of Inventories</p> <ol style="list-style-type: none"> 1. Verify valuation methods (FIFO or weighted average) are reasonable. 2. For raw materials: <ul style="list-style-type: none"> ✓ Ensure costs include carriage inward, non-refundable duties, etc. ✓ If standard costs are used, enquire into basis of standards and compare with actual costs. Check treatment in books for differences in cost. 3. For work-in-progress: <ul style="list-style-type: none"> ✓ Ascertain valuation of production stages and basis for such estimate ✓ Overhead allocation and compare with costing and financial date maintained. ✓ Ensure cost of abnormal waste is excluded 4. For finished goods: <ul style="list-style-type: none"> ✓ Verify inclusion of reasonable costs and ✓ Ensure that inventories are valued at net realizable value if they are likely to fetch a value lower than their cost. 5. For obsolete, damaged, slow moving: <ul style="list-style-type: none"> ✓ Examine damaged, slow-moving, or obsolete inventory for proper valuation and realizable value. ✓ Request client for inventory aging split. ✓ Compare recorded cost with actual costs. ✓ Calculate inventory turnover ratio and identify obsolete inventory if ratio is significantly lower. ✓ Verify correct application of cost or NRV principle ✓ Test overhead allocation rates in manufacturing environments.
5.	<p>Disclosures for Inventories</p> <p>Ensure compliance with Schedule III (Part I) of the Companies Act, 2013:</p> <ol style="list-style-type: none"> 1. Classify inventory as: <ul style="list-style-type: none"> ✓ Raw materials ✓ Work-in-progress ✓ Finished goods ✓ Stock-in-trade ✓ Stores and spares ✓ Loose tools ✓ Others (specify nature). 2. Disclose goods-in-transit separately under each sub-head. 3. State mode of valuation.



7. Audit of property, Plant and Equipment (PPE)

Intro and Clarifications

1.	<p>Definition of PPE Property, Plant, and Equipment (PPE) includes Land, Building, Plant & Equipment, Furniture & Fixtures, Vehicles, Office Equipment, Computers, etc.</p>
2.	<p>Valuation of PPE The valuation of PPE is critical during audits. The auditor must assess if expenditures are Revenue or Capital in nature.</p>
3.	<p>Recognition Criteria for PPE Recognition Conditions:</p> <ol style="list-style-type: none"> Probable future economic benefits will flow to the enterprise. The cost of the item can be measured reliably. <p>Costs include:</p> <ul style="list-style-type: none"> ✓ Cost incurred initially to Acquire or construct. ✓ Costs for addition, replacement, or servicing.
4.	<p>Measurement at Recognition PPE that qualifies for recognition as an asset is measured at its cost.</p>
5.	<p>Elements of Cost The cost of PPE includes:</p> <ol style="list-style-type: none"> Purchase price (import duties, non-refundable taxes, less discounts/rebates). Directly attributable costs to bring the asset to location/condition for intended use. Costs of dismantling, removal, restoration, or decommissioning.
6.	<p>Examples of Directly Attributable Costs</p> <ol style="list-style-type: none"> Employee benefits (AS 15). Site preparation. Initial Delivery and handling. Installation and assembly. Testing costs, net of proceeds from selling samples. Professional fees.
7.	<p>Costs Excluded from PPE Examples of costs NOT part of PPE:</p> <ol style="list-style-type: none"> Costs for opening a new facility (e.g., inauguration). Costs for introducing new product or services (e.g., advertising). Costs for business in new locations (e.g., staff training). Administrative costs.
8.	<p>Expense Classification Revenue expenses like repairs must be charged to the Statement of Profit and Loss.</p>

Audit Procedures

1.	<p>Existence of PPE</p> <ul style="list-style-type: none"> ✓ Review the entity's plan for physical verification of PPE (e.g., performed by staff or third party; periodicity such as annual or every 2 / 3 years). ✓ Examine supervision evidence during verification.
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- ✓ Obtain PPE physical verification report and perform:
 - Assess if all PPE are tagged with identification numbers and if these are captured in working papers.
 - Reconcile physically verified PPE with the fixed asset register.
 - Verify discrepancies (e.g., shortages, non-working assets) and ensure appropriate accounting treatment and approval by management.
 - Confirm additions include only entity-owned PPE and exclude third-party assets.

For example, Assets not in working condition and/or active use should be accounted for as deletions in the books of account post approvals by the entity's management and depreciation should have ceased to be charged after the date of deletion.

2. Completeness

- ✓ Verify PPE schedule movement: Opening balance + Additions - Deletions = Closing balance.
- ✓ Check arithmetical accuracy and reconcile balances with prior year audited financials.
- ✓ For additions:
 - Verify costs meet PPE criteria as per AS 10 (Revised).
 - Ensure purchase costs, spares, and servicing comply with AS 10 (Revised).
 - Test supporting documents like purchase invoices, installation certificates, etc.
 - Verify approvals for additions and adherence to procurement processes.
- ✓ For deletions:
 - Understand rationale for deletion and verify management approval.
 - Check disposal process (e.g., competitive quotes/tenders) and
 - Ensure accurate accounting of deletion and gain/loss on disposal.

3. Valuation

- ✓ Verify depreciation charged on all PPE (except non-depreciable assets like freehold land).
- ✓ Assess whether the depreciation method reflects the pattern of economic benefit (e.g., straight-line, diminishing value).
- ✓ Ensure impairment assessment is done as per AS 28

4. Rights and Obligations

- ✓ For additions, verify purchase invoices are in the entity's name.
- ✓ For land and buildings, check the conveyance/sale deed for legal ownership.
- ✓ Insist on verifying original title deeds for immovable properties.
- ✓ If properties are pledged as security, request a confirmation from lenders holding the deeds.
- ✓ Review the register of charges for any charges created on PPE.

5. DISCLOSURES

Ensure compliance with Schedule III (Part I) of the Companies Act, 2013:

- ✓ Classification by categories like Land, Buildings, P&M, F&F, Vehicles etc.
- ✓ Separate disclosure for leased assets.
- ✓ Provide reconciliation of gross and net carrying amounts with details on additions, disposals, revaluations, and adjustments.
- ✓ For revaluations, disclose the reduced/increased figures and date of changes (first 5 years).

Notes: To be disclosed as Additional Regulatory Information

i. Title deeds of Immovable Property not held in name of the Company

The company shall provide the details of all the immovable property (other than properties where the Company is the lessee and the lease agreements are duly executed in favour of the lessee) whose title deeds are not held in the name of the company in format given below and where such immovable property is jointly held with others, details are required to be given to the extent of the company's share.

Relevant line item in the Balance sheet	Description of item of property	Gross carrying value	Title deeds held in the name of	Whether title deed holder is a promoter, director or relative# of promoter*/director or employee of promoter/director	Property held since which date	Reason for not being held in the name of the company**
PPE	Land Building	-	-	-	-	**also indicate if in dispute
Investment property	Land Building					
PPE retired from active use and held for disposal-	Land Building					
Others						

#Relative here means relative as defined in the Companies Act, 2013.

*Promoter here means promoter as defined in the Companies Act, 2013.

ii. Revaluation:

Where the Company has revalued its Property, Plant and Equipment, the company shall disclose as to whether the revaluation is based on the valuation by a registered valuer as defined under rule 2 of the Companies (Registered Valuers and Valuation) Rules, 2017.

iii. Capital-Work-in Progress (CWIP)

a. For Capital-work-in progress, following ageing schedule shall be given: CWIP ageing schedule

(Amount in Rs.)					
CWIP	Amount in CWIP for a period of				Total*
	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Projects in Progress					
Projects temporarily suspended					

*Total shall tally with CWIP amount in the balance sheet.

b. For capital-work-in progress, whose completion is overdue or has exceeded its cost compared to its original plan, following CWIP completion schedule shall be given**:

(Amount in Rs.)				
CWIP	To be completed in			
	Less than 1 year	1-2 years	2-3 years	More than 3 years

Project 1				
Project 2				

**Details of projects where activity has been suspended shall be given separately.



8. Audit of Intangible Assets

Intro and clarifications	
1.	<p>Definition of Intangible Asset</p> <ul style="list-style-type: none"> ✓ An identifiable non-monetary asset without physical substance. ✓ Used for production, supply of goods/services, rental, or administrative purposes.
2.	<p>Examples of Intangible Assets</p> <ul style="list-style-type: none"> ✓ Enterprises invest in: <ul style="list-style-type: none"> ▪ Scientific or technical knowledge. ▪ Design and implementation of processes/systems. ▪ Licenses, intellectual property, market knowledge, and trademarks. ✓ Common examples include: <ul style="list-style-type: none"> ▪ Computer software, patents, copyrights, customer lists. ▪ Franchises, market share, marketing rights. ▪ Goodwill (arises on acquisition or is internally generated).
3.	<p>Recognition of Intangible Assets</p> <ul style="list-style-type: none"> ✓ Not all items meet the definition of an intangible asset (criteria: identifiability, control, and economic benefits). ✓ Items not meeting the criteria are the expense will be charged to P&L. ✓ Internally generated goodwill should not be recognized as per AS 26
4.	<p>Physical Substances Containing Intangibles</p> <ul style="list-style-type: none"> ✓ Some intangible assets exist on physical media (e.g., compact disks, legal documents, or films). ✓ Cost of the physical substance is usually insignificant. ✓ Such physical items are treated as part of the intangible asset.
5.	<p>Intangible vs Tangible Elements</p> <ul style="list-style-type: none"> ✓ Some assets have inseparable intangible and tangible elements. ✓ Judgement is required to determine the predominant element. ✓ Examples: <ul style="list-style-type: none"> ▪ Software integral to hardware (e.g., a machine tool's software or a computer's operating system) is treated as a fixed asset. ▪ Software not integral to hardware is treated as an intangible asset.

Audit Procedure for Intangibles	
1.	<p>Existence</p> <ul style="list-style-type: none"> ✓ Verify whether the intangible asset is in active use for production, services, rental, or administrative purposes. Example: For software, check its use in generating sales of goods/services. Example: For designs/drawings, verify production data to confirm their use. ✓ If not in active use, ensure deletion is recorded and amortization ceased post-approval.

2.	<p>Completeness</p> <ul style="list-style-type: none"> ✓ Verify movement in intangibles: Opening + Additions - Deletions = Closing balance. ✓ Check arithmetical accuracy of movements. ✓ For additions: <ul style="list-style-type: none"> ▪ Confirm expenditure meets AS 26 criteria. ▪ Ensure research phase expenses are not recognized as intangible assets. ▪ Verify approval and adherence to procurement processes. ✓ For deletions: <ul style="list-style-type: none"> ▪ Check rationale, approvals, and disposal process. ▪ Ensure accurate recording of cost, accumulated amortization, and gain/loss.
3.	<p>Valuation</p> <ul style="list-style-type: none"> ✓ Verify amortization is charged on all intangible assets. ✓ Confirm the amortization method reflects the pattern of economic benefit. ✓ Check if impairment assessment is done as per AS 28 ✓ Impairment of Assets, including: <ul style="list-style-type: none"> ▪ Reviewing carrying amount. ▪ Determining recoverable amount. ▪ Recording impairment loss, if any.
4.	<p>Rights and Obligations</p> <ul style="list-style-type: none"> ✓ Verify purchase invoices/contracts are in the entity's name, confirming legal ownership of intangible assets. ✓ Perform testing on completeness and ownership during addition verification.
5.	<p>Disclosures</p> <p>Ensure compliance with Schedule III (Part I) of the Companies Act, 2013:</p> <ul style="list-style-type: none"> ✓ Classification by categories such as Goodwill, Trademarks, Software, Patents, Licenses, etc. ✓ Provide reconciliation of gross/net carrying amounts (additions, disposals, revaluation, and adjustments). ✓ For revaluations/write-offs, disclose reduced/increased figures for the first 5 years.

Notes: To be disclosed as Additional Regulatory Information.

Intangible assets under development:

a. For Intangible assets under development, **following ageing schedule shall be given**:

Intangible assets under development ageing schedule

					(Amount in Rs.)
Intangible asset under development	Amount in CWIP for a period of				Total*
	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Projects in Progress					
Projects temporarily suspended					

* Total shall tally with the amount of Intangible assets under development in the balance sheet.

b. For Intangible assets under development, **whose completion is overdue or has exceeded** its cost compared to its original plan, following Intangible assets under development completion

schedule shall be given**:

(Amount in Rs.)				
Intangible asset under development	To be completed in			
	Less than 1 year	1-2 years	2-3 years	More than 3years
Project 1				
Project 2				

**Details of projects where activity has been suspended shall be given separately.



9. Audit of Trade Payables and Other Current Liabilities

Audit Procedure	
1.	<p>Existence</p> <ul style="list-style-type: none"> ✓ Verify controls to prevent duplicate recording of invoices. ✓ Obtain and reconcile accounts payable ageing report with the general ledger. ✓ Investigate reconciling items and review large journal entries. ✓ Use direct confirmation procedures: <ul style="list-style-type: none"> ▪ Send confirmation requests to vendors for significant payables and material purchases. ▪ Confirm the balances either <ul style="list-style-type: none"> ▪ as at the date of the balance sheet, or ▪ as at any other selected date which is reasonably close to the date of the balance sheet. ▪ The date should be decided by the auditor in consultation with the Company. ▪ The form of requesting may be either <ul style="list-style-type: none"> ▪ the form with balance as at year end wherein the creditor has to respond whether or not he is in agreement with the balance shown, or ▪ the form with no balance wherein the creditor has to respond the balance as per his records. ▪ The method of selection of the trade creditors should not be revealed to the Company until the trial balance of the trade payables' ledger is handed overed. ▪ Ensure proper dispatch and receipt of confirmation letters. ▪ Investigate and reconcile discrepancies from confirmations or additional tests. ▪ For non-replies, perform additional testing like reviewing subsequent payments or vendor invoices. ✓ Analyse balances to ensure they consist of identifiable transactions. ✓ Examine related party payables for authorization and arm's length valuation.
2.	<p>Analytical Procedures</p> <ul style="list-style-type: none"> ✓ Review trends in purchases/expenses and accounts payable over time and see is there any unusual trends. ✓ Inquire about reasons for changes in trend.
3.	<p>Completeness</p> <ul style="list-style-type: none"> ✓ Perform cut-off procedures for the last invoices recorded at year-end to confirm proper inclusion

- ✓ Ensure all goods received before year-end are booked as purchases and included in payables.
- ✓ Match invoice dates to gate entry (inward) records for correct period inclusion.
- ✓ Review subsequent expense vouchers for relevance to the audit period.
- ✓ Verify statutory dues liabilities (e.g., GST, TDS, PF) for reasonableness and ensure deposits are made timely with supporting challans.
- ✓ For advances, the auditor should verify the underlying documentation based on which the entity had received the advance.
- ✓ Perform aging analysis on advances.

4. Valuation

- ✓ Review processes for identifying and writing back old creditor balances.
- ✓ Check aging of payables and review vendor disputes or claims.
- ✓ Ensure write-backs are approved by authorized personnel.
- ✓ Verify restatement of foreign currency payables as per AS 11.
- ✓ Assess management's process for identifying unpaid amounts to MSME suppliers. Test check the management process.

5. Disclosures

Ensure compliance with Schedule III (Part I) of the Companies Act, 2013:

- ✓ Disclose details for MSME payables:
 - Unpaid principal and interest amounts [to be shown separately].
 - Interest paid under MSMED Act and payment made beyond appointed day.
 - Accrued/unpaid interest at the end of each accounting period.
 - Amount of further interest remaining due and payable even in succeeding years.
- ✓ Provide trade payables ageing schedule:

(Amount in Rs.)					
Particulars	Outstanding for following periods from due date of payment#				
	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
i. MSME					
ii. Others					
iii. Disputed Dues-MSME					
iv. Disputed Dues Others					

similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction.

Unbilled Dues: Shall be disclosed separately.

Other Current Liabilities

1.
 - a. Current Maturities of Finance Lease Obligations
 - b. Interest Accrued but Not Due on Borrowings
 - c. Interest Accrued and Due on Borrowings
 - d. Income Received in Advance
 - e. Unpaid Dividends
 - f. Application Money for Allotment of Securities

	<ul style="list-style-type: none"> ✓ Money received for securities allocation, pending refund or allotment. ✓ Disclose terms, including: number of shares, premium, and allotment period. ✓ Specify if the company has sufficient authorised capital for these allotments. ✓ Reasons for delay in allotment. ✓ Non-refundable application money to be shown under Equity. ✓ Refundable amounts must be under Other Current Liabilities.
2.	Unpaid Matured Deposits/Debentures
3.	Unpaid Matured Debentures
4.	Others (Specify Nature)



10. Audit of Loans and Advances and Other Current Assets

Audit Procedures	
1.	<p>Existence of Loans and Advances Perform direct confirmations for loans and advances, including interest receivable as per agreed terms.</p>
2.	<p>Statutory Balances</p> <ul style="list-style-type: none"> ✓ Verify balances (e.g., GST input credit) by reconciling with purchases/expenses using applicable rates. ✓ Obtain and review statutory returns (e.g., GST returns) to ensure alignment with books of account.
3.	<p>Completeness</p> <ul style="list-style-type: none"> ✓ Obtain a list of advances and assets and compare with ledger balances. ✓ Verify loan agreements and approvals by relevant authorities (directors, partners, trustees). ✓ Confirm loans are authorized as per the Memorandum and Articles of Association. ✓ Inspect board minutes for loan approvals. ✓ Verify security deposits against loans and ensure regular repayment. ✓ Review related party loans for authorization, arm's length terms, and reasonableness.
4.	<p>Valuation</p> <ul style="list-style-type: none"> ✓ Assess allowance for doubtful accounts and ensure consistency with previous years. ✓ Review the ageing report and loans under litigation. ✓ Identify doubtful loans and discuss with management. ✓ Review write-offs and movements in provision accounts. ✓ Verify approvals for write-offs by senior authority ✓ Confirm proper restatement of foreign currency balances per AS 11.
5.	<p>Disclosure</p> <p>Long-Term Loans & Advances:</p> <ol style="list-style-type: none"> i. Classified as Capital Advances, Related Party Loans, or Other Loans (specify nature). ii. Sub-classify as: Secured (Good), Unsecured (Good), or Doubtful. iii. Disclose allowance for doubtful loans under relevant heads. iv. Separate disclosure for loans due by: <ul style="list-style-type: none"> ✓ Directors/officers (jointly or severally). ✓ Firms or companies where directors are partners, directors, or members.

Short-Term Loans & Advances:

- i. Classified as **Related Party Loans** or **Others** (specify nature).
- ii. Sub-classify as: **Secured (Good)**, **Unsecured (Good)**, or **Doubtful**.
- iii. Disclose **allowance for doubtful loans** under relevant heads.
- iv. Separate disclosure for loans due by:
 - ✓ **Directors/officers** (jointly or severally).
 - ✓ **Firms or companies** where directors are **partners, directors, or members**.

Notes: To be disclosed as Additional Regulatory Information

- i. Following disclosures shall be made where Loans or Advances in the nature of loans are granted to **promoters, Directors, KMPs and the related parties** (as defined under Companies Act, 2013,) either severally or jointly with any other person, that are:
 - a. **repayable on demand** or
 - b. **without specifying any terms or period of repayment**

Type of Borrower	Amount of loan or advance in the nature of loan outstanding	Percentage to the total Loans and Advances in the nature of loans
Promoters		
Directors		
KMPs		
Related Parties		



11. Audit of Provisions and Contingent Liabilities

Intro and Clarifications

1.	<p>Provision A liability that can be measured only using a substantial degree of estimation.</p>
2.	<p>Recognition of Provision A provision is recognized when:</p> <ul style="list-style-type: none"> a. There is a present obligation (legal or constructive) from a past event. b. It is probable that an outflow of resources with economic benefits will be required to settle the obligation. c. The amount can be reliably estimated. <p>If these conditions are not met, no provision is recognized. Examples Provision for litigation, provision for warranties, etc.</p>
3.	<p>Contingent Liability Either:</p> <ul style="list-style-type: none"> a. A possible obligation from past events, confirmed only by the occurrence or non-occurrence of future uncertain events not wholly within the entity's control. <p>or</p> <ul style="list-style-type: none"> b. A present obligation from past events, but not recognized because: <ul style="list-style-type: none"> i. It is not probable that an outflow of resources will be required.

- ii. The amount **cannot be measured** with sufficient **reliability**.

Audit Procedures

1.	<p>Existence of Provisions</p> <ul style="list-style-type: none"> ✓ Obtain a list of all provisions and compare with ledger balances. ✓ Inspect agreements (e.g., customer warranties, legal claims).
2.	<p>Completeness of Provisions</p> <ul style="list-style-type: none"> ✓ Confirm all provisions are recognized in the financial statements as required.
3.	<p>Valuation of Provisions</p> <ul style="list-style-type: none"> ✓ Obtain and verify management's working and basis for each provision. ✓ If necessary, review reports from experts (e.g., actuarial reports, legal assessments). ✓ Verify assumptions used with supporting data. <p>Note: Management expert discussion is covered here and is already discussed in Chapter 6 under SA 500 topic.</p>
4.	<p>Disclosure Requirements</p> <p>Ensure compliance with Schedule III (Part I) of the Companies Act, 2013:</p> <p>a) Long-term Provisions</p> <ol style="list-style-type: none"> a. Employee benefits b. Others (specify nature). <p>b) Short-term Provisions</p> <ol style="list-style-type: none"> a. Employee benefits b. Others (specify nature). <p>c) Contingent Liabilities</p> <ol style="list-style-type: none"> a. Claims not acknowledged as debt b. Guarantees c. Other contingent liabilities. <p>d) Commitments</p> <ol style="list-style-type: none"> a. Capital contracts not provided for b. Uncalled liability on partly paid shares/investments c. Other commitments (specify nature).
5.	<p>AS 29 Disclosures</p> <p>For each class of provision, disclose:</p> <ul style="list-style-type: none"> ✓ Carrying amount at the beginning and end of the period. ✓ Additional provisions, amounts used, and unused amounts reversed during the period. ✓ Nature and timing of expected outflows. ✓ Disclose major assumptions about future events. ✓ State the amount of any expected reimbursement and recognized asset. <p>For contingent liabilities, unless remote:</p> <p>Provide a brief description and, if practicable:</p> <ul style="list-style-type: none"> ▪ An estimate of financial effect. ▪ Indicate uncertainties. ▪ State any possibility of reimbursement. <p>If certain information is not practicable to disclose, that fact should be stated.</p>

Additional Regulatory Information

1. **Benami Property Held**
 If proceedings are initiated under the Benami Transactions (Prohibition) Act, 1988, disclose:
- Details of property, including year of acquisition.
 - Amount of property.
 - Details of beneficiaries.
 - If property is in the books, reference to the Balance Sheet.
 - If not in the books, state reasons.
 - Details of proceedings against the company as a beneficiary or transferor.
 - Nature of proceedings, their status, and the company's view.

2. **Relationship with Struck-Off Companies**
 For transactions with companies struck off under Section 248 of the Companies Act, 2013 or Section 560 of the Companies Act, 1956, disclose:

Name of struck off Company	Nature of transactions with struck off Company	Balance outstanding	Relationship with the Struck off company, if any, to be disclosed
	Investments in securities		
	Receivables		
	Payables		
	Shares held by struck off company		
	Other outstanding balances (to be specified)		

3. **Ratios to be Disclosed**
 The following ratios must be disclosed:
- Current Ratio
 - Debt-Equity Ratio
 - Debt Service Coverage Ratio
 - Return on Equity Ratio
 - Inventory Turnover Ratio
 - Trade Receivables Turnover Ratio
 - Trade Payables Turnover Ratio
 - Net Capital Turnover Ratio
 - Net Profit Ratio
 - Return on Capital Employed
 - Return on Investment

- ✓ Explain the items in the numerator and denominator for each ratio.
- ✓ Provide explanation for any ratio change exceeding 25% compared to the prior year.

Profit and Loss Items



1. Audit of Sale of Products and Services

Introduction and Clarifications

1.	<p>Sales and Collections Cycle</p> <ul style="list-style-type: none"> ✓ Refers to processes starting with customer purchase of goods/services and ending with complete payment. ✓ Sales is a key item in the financial statements, significantly affecting profit and closing stock. ✓ As per SA 315, Sales will have high risk of misstatement.
2.	<p>Understanding the Organization</p> <p>Auditor obtains knowledge about the business and revenue centres, including:</p> <ul style="list-style-type: none"> ✓ Types of products/services offered. ✓ Demand for products/services. ✓ Major products/services and customers. ✓ Discontinuance of products and services ✓ Sales terms (credit/cash).
3.	<p>Understand Management Controls on Sales</p> <p>Auditor examines management controls over the sales process, such as:</p> <ul style="list-style-type: none"> ✓ Segregation of duties. ✓ Who checks Credit limit ✓ Authorization of sales orders. ✓ Issuing invoices. ✓ Delivery of goods/services. ✓ Recognition of sales.
4.	<p>Common Controls on Sales</p> <ul style="list-style-type: none"> ✓ Auditor tests controls to assess their strength and reliability. ✓ If controls are strong, substantive testing can be reduced. Deficiencies in controls must be reported as per SA 265. <p>Common internal controls over sales cycle include:</p> <ul style="list-style-type: none"> ✓ Pre-numbered invoices. ✓ Approval of sales orders. ✓ Customer purchase order authorization. ✓ Authorization of write-offs.
5.	<p>Substantive Procedures</p> <ul style="list-style-type: none"> ✓ Auditor selects a random sample of transactions and checks related purchase orders, invoices, and customer statements to verify controls, such as the presence of numbered invoices. ✓ Auditor ensures all numbers are accounted for with none missing.
6.	<p>Substantive Analytical Procedures</p> <ul style="list-style-type: none"> ✓ Auditor performs sales trend analysis, comparison with prior periods, category-wise analysis, and builds a sales expectation to compare with the client's records. ✓ Examines sales prices, average monthly prices, and discount policies. <p>Example:</p>

For product X, if **average sales price** is Rs. 10 and 1,500 units sold, expected sales = Rs. 15,000. Auditor compares this to client's records and discusses **variances** (e.g., discounts or wrong bookings). Auditors also analyse **sales discounts/returns**.

Audit Procedure for Sales

1.	<p>Occurrence</p> <p>Recorded sales represent goods shipped or services performed during the period: Ensure revenue is not overstated by:</p> <ul style="list-style-type: none"> ✓ Checking if sales invoices are duplicated or cancelled invoices are recorded. ✓ Testing invoices with sales journal entries. ✓ Obtaining customer confirmations. ✓ Ensure No fictitious customers or sales are recorded. ✓ Whether Shipments were authorized by customers, especially near year-end. ✓ Whether unearned revenue is recognized. ✓ Whether significant uncertainty about collectability. ✓ Review invoice sequence, and sales returns ratio (compare to prior year). ✓ Review Journal entries for unusual transactions. ✓ Match sales returns with supporting documents (e.g., invoices, challans, credit notes).
2.	<p>Completeness</p> <p>All sales made during the period are recorded without understatement or overstatement:</p> <ul style="list-style-type: none"> ✓ Perform cut-off procedures to ensure revenue is recognized in the correct period. Cut-off errors will usually arise when companies recognise revenue based on the date on of sales invoices rather delivery of goods. ✓ Verify credit notes issued after year end for potential fictitious sales. ✓ Trace shipping documents to the sales journal. ✓ Check if quantities appear in the sales register. ✓ Reconcile stock records, financial records, and statutory records (e.g., GST). ✓ Review GST tax and returns, ensuring consistency with reported revenue.
3.	<p>Measurement</p> <p>Sales are accurately measured, journalized, summarized, and posted as per standards:</p> <ul style="list-style-type: none"> ✓ Trace transactions from inception to completion (e.g., sales orders to payments), ensuring accuracy and inclusion of discounts/incentives. ✓ Verify compliance with AS 11 for export sales. ✓ Understand GAAP issues (e.g., point-of-sale recognition vs. percentage of completion). ✓ Review related-party transactions for collectability, authorization, and arm's length terms.
4.	<p>Disclosure Requirements</p> <p>Ensure disclosures as per Schedule III (Part II) of the Companies Act, 2013:</p> <p>a. For Non-Finance Companies</p> <ul style="list-style-type: none"> ✓ Sale of products ✓ Sale of services ✓ Grants or donations (for Section 8 companies) ✓ Other operating revenues <p>Less:</p> <ul style="list-style-type: none"> ✓ Excise duty

- b. For Finance Companies
- a. Interest
 - b. Other financial services

Additional Notes

- ✓ Revenue under each head should be disclosed separately in notes to accounts.
- ✓ Disclose brokerage and discounts on sales (other than usual trade discounts).
- ✓ Appropriately disclose related-party transactions in notes to accounts.



2. Audit of Other Incomes

Introduction

1. **Definition of Other Income**
Income not linked to the entity's core business operations.
Examples:
 - ✓ Interest on fixed deposits (non-bank entities).
 - ✓ Interest on loans to third parties or group entities.
 - ✓ Returns on mutual fund investments.
2. **Recognition of Interest Income**
Interest on fixed deposits is recognized on a time proportion basis, considering the amount outstanding and the applicable interest rate.
3. **Recognition of Dividends**
Dividends are recognized in the statement of profit and loss only when:
 - a. The entity's right to receive payment is established.
 - b. It is probable that economic benefits will flow to the entity.
 - c. The amount is reliably measurable.
4. **Gain/(Loss) on Mutual Fund Sales**
 - ✓ Recorded as other income upon transfer of title.
 - ✓ Determined as the difference between redemption price and carrying value of the investment.

Audit Procedures

1. **Occurrence: Recorded other income was earned during the period**
For interest income on fixed deposits:
 - ✓ Obtain a listing of fixed deposits with applicable interest rates and outstanding days during the period.
 - ✓ Verify calculations by recomputing.
 - ✓ Trace outstanding deposits at period-end to direct confirmations from banks/financial institutions.
 - ✓ Reconcile interest income with bank confirmations and Form 26AS (TDS withholding).
 For dividends
 - ✓ Verify recognition in the statement of profit and loss only when the entity's right to receive payment is established.
 For gain/loss on mutual fund investments:
 - ✓ Recorded only upon transfer of title.

	<ul style="list-style-type: none"> ✓ As the difference between redemption price and carrying value. Verify with mutual fund statements. ✓ Obtain Mutual Fund statement to verify gain or loss.
2.	Completeness Ensure all other income earned is recorded with no understatement or overstatement.
3.	Measurement Verify that other income is measured appropriately as per applicable accounting standards:
4.	Disclosure Requirements Ensure disclosures as per Schedule III (Part II) of the Companies Act, 2013: <ol style="list-style-type: none"> a. Interest Income (for non-finance companies). b. Dividend Income. c. Net gain/loss on sale of investments. d. Other non-operating income (net of direct expenses).
5.	Additional Regulatory Information <ul style="list-style-type: none"> ✓ The company shall give details of transactions not recorded in books but disclosed as income during tax assessments under the Income Tax Act, 1961 (e.g., search or survey cases). ✓ State whether such previously unrecorded income and related assets are properly recorded in the books during the year.



3. Audit of Purchases

Introduction and Clarifications

1.	Understanding the Organization and production centres Auditor obtains knowledge about the production centres and purchases, including: <ol style="list-style-type: none"> a. Types of products/services procured. b. Domestic/overseas procurement. c. Terms and conditions of purchase. d. Major vendors. e. Credit period. f. Quality checks. g. Purchase terms (credit/cash).
2.	Control points over purchases Auditor identifies control points over purchases, such as: <ol style="list-style-type: none"> a. Segregation of duties. b. Competitive quotes invited. c. Existence of purchase committee. d. Authorization of purchase price and orders. e. Goods receipt and acknowledgment. f. Quality and quantity checks and preparation of Goods Receipt Note (GRN). g. Vendor invoice approval. h. Existence of 2-way/3-way match (purchase order, GRN, vendor invoice).
3.	Testing Controls Auditor tests purchase cycle controls for effectiveness. If effective, reduces substantive testing.

4.	<p>Common Internal Controls over purchases cycle</p> <ul style="list-style-type: none"> a. Competitive quotations. b. Numbered purchase orders. c. Purchase order authorization over limits. d. Generation of GRN. e. Quality inspection of goods. f. 2-way/3-way match. g. Invoice authorization.
5.	<p>Sample Testing</p> <p>Auditor examines random samples of:</p> <ul style="list-style-type: none"> ✓ Purchase orders ✓ GRNs ✓ Purchase invoices ✓ Inward gate entry register ✓ Vendor reconciliations/statements.
6.	<p>Substantive Analytical Procedures</p> <p>Auditor performs:</p> <ul style="list-style-type: none"> ✓ Purchase trend analysis ✓ Comparisons with Prior periods ✓ Category-wise purchases ✓ Sets a purchase expectation based on sales and compares with purchase records. <p>Example</p> <ul style="list-style-type: none"> ✓ If purchase price is 100 and 15,000 units were received, expected purchases = 15,00,000. ✓ Auditor investigates variances, considering discounts or price changes due to demand.

Audit Procedures

1.	<p>Occurrence</p> <p>Recorded purchases represent goods received or services availed during the period:</p> <ul style="list-style-type: none"> ✓ Verify for fictitious vendors by reviewing the vendor selection process and ensuring existence of vendors. ✓ Confirm goods receipt at factory gate using the inward register. ✓ Check if quality inspection was performed and a Goods Receipt Note (GRN) was prepared and signed by appropriate personnel. ✓ Ensure purchase invoices were approved as per authority. ✓ Confirm if 2-way/3-way match was performed and stock records were updated. <p>Special Considerations</p> <ul style="list-style-type: none"> ✓ Ensure purchase invoices are original copies, not photocopies. ✓ Purchases are recorded only when risks and rewards are transferred (e.g., F.O.B., C.I.F.). ✓ Invoices should be in the name of the entity/branch. ✓ Verify input tax booking in the tax ledger and reconcile with tax returns filed. ✓ Confirm related-party purchases are at arm's length with proper approvals. ✓ Assess whether purchases are capitalized or expensed based on professional judgment. ✓ Review journal entries for unusual transactions.
2.	<p>Completeness</p>

	Ensure all purchases during the period are recorded with no understatement or overstatement.
3.	Measurement Verify purchases are measured appropriately.
4.	Cut-off Testing <ul style="list-style-type: none"> ✓ Perform cut-off tests to ensure purchases are recorded in the correct accounting period. ✓ Examine material inward records for last 5 transactions at period-end and match to purchase book. ✓ Verify goods-in-transit are accounted correctly per terms with vendor. ✓ Obtain management representation confirming all purchases are properly recorded.
5.	Analytical Procedures Perform analytical procedures for reasonableness of purchase quantity and price: <ul style="list-style-type: none"> ✓ Consumption Analysis: Compare raw material consumption with previous years and ask management for variations. ✓ Stock Composition Analysis: Compare stock composition with prior year. ✓ Compare creditor turnover ratios and stock turnover ratios with prior years. ✓ Reconcile closing stock with opening stock, purchases, and consumption.
6.	Disclosure Requirements Ensure disclosures as per Schedule III (Part II) of the Companies Act, 2013: <ul style="list-style-type: none"> ✓ Disclose purchases of stock-in-trade. ✓ Disclose changes in inventories of finished goods, stock-in-trade, and work-in-progress. ✓ Appropriately disclose related-party transactions.



4. Audit of Employee Benefits Expenses

Introduction and Clarifications

1.	Definition of Employee Benefits Expenses Payroll expenses include all payments to employees for their labour/efforts, such as: <ul style="list-style-type: none"> ✓ Perquisites/benefits ✓ Post-employment benefits (e.g., gratuity, superannuation, leave encashment, provident fund contributions) ✓ Welfare and training expenses
2.	Understanding of the entity's hiring, appraisal and retirement process <ol style="list-style-type: none"> a. Test controls over employee benefit payments to determine effectiveness. b. If controls are effective, reduce substantive testing. Common Internal Controls over Employees payment cycle <ul style="list-style-type: none"> ✓ Maintaining attendance records. ✓ Keeping an updated employee master. ✓ Authorization and approval of payroll processing and disbursement. ✓ Accurate computation of payroll deductions (e.g., taxes). ✓ Accrual of other benefits like gratuity, leave encashment, and bonuses.
3.	Sample Testing Auditor selects random samples and examines related documents: <ul style="list-style-type: none"> ✓ Appointment letters

	<ul style="list-style-type: none"> ✓ Appraisal letters ✓ Attendance records ✓ HR policies ✓ Employee master.
4.	<p>Substantive Audit Procedures</p> <p>Perform substantive analytical procedures, including:</p> <ul style="list-style-type: none"> ✓ Monthly expense reasonability. ✓ Compare with previous periods. ✓ Set an expectation of expense based on the entity's operations and industry trends, and compare with records.

Audit Procedures

1.	<p>Occurrence</p> <p>Recorded employee benefit expenses were actually incurred during the period:</p> <ul style="list-style-type: none"> ✓ Understand the entity's process for capturing employee attendance. ✓ Verify the risk of fictitious employees by: <ul style="list-style-type: none"> ✓ Meeting employees in person (sample basis). ✓ Reviewing employee bank details/identity proofs.
2.	<p>Completeness</p> <p>Employee benefit expenses pertaining to the period are recorded:</p> <ul style="list-style-type: none"> ✓ Obtain a list of employees at period-end, split by new hires, leavers, and continuing employees. ✓ For new hires, verify appointment letters and salary processing as per agreed terms. ✓ For resigned employees, verify full and final settlements, including dues for gratuity, leave encashment, and ensure employee's acknowledgment. ✓ Check if all provisions (e.g., bonus, gratuity, leave encashment) have been made accurately.
3.	<p>Measurement</p> <p>Employee benefit expenses are appropriately measured with no understatement or overstatement:</p> <ul style="list-style-type: none"> ✓ Review monthly salary registers for all 12 months. ✓ Compile monthly payroll reasonability by calculating average salary per employee and compare with prior periods. ✓ For PF/ESI, verify accuracy by applying the rate to basic wages, compare recorded amounts, and review monthly deposit challans to ensure timely deposits.
4.	<p>Analytical Procedures</p> <p>Perform substantive analytical procedures:</p> <ul style="list-style-type: none"> ✓ Analyse units produced per employee, compare with prior periods and industry trends, and ask management for reasons for significant variations.
5.	<p>Disclosure Requirements</p> <p>Ensure disclosures as per Schedule III (Part II) to Companies Act, 2013:</p> <p>Employee Benefits Expense</p> <ol style="list-style-type: none"> a. Salaries and wages. b. Contribution to provident and other funds. c. Expenses for ESOP/ESPP.

d. Staff welfare expenses.



5. Audit of Depreciation and Amortisation

Introduction and Clarifications

1.	<p>Significance of Depreciation & Amortisation Depreciation and amortisation are significant expenses that directly impact an entity's profit/loss. Auditors must ensure these expenses are appropriate, accurately calculated, and comply with relevant laws and standards.</p>
2.	<p>Key Audit Attributes Auditors should consider the following while verifying depreciation and amortisation:</p> <p>Accounting Policy</p> <ul style="list-style-type: none"> ✓ Understand the entity's accounting policy for depreciation and amortisation. ✓ Ensure the policy aligns with Companies Act or other applicable standards. <p>Consistency</p> <ul style="list-style-type: none"> ✓ Verify that the policy is applied consistently year-on-year. ✓ Check if changes in the policy are adequately disclosed. <p>Residual Value</p> <ul style="list-style-type: none"> ✓ Confirm depreciation is calculated after adjusting the residual value from the asset cost. <p>Validity and Accuracy</p> <ul style="list-style-type: none"> ✓ Ensure all depreciation and amortisation charges are valid, accurate, and recorded in the appropriate period. <p>Component Depreciation</p> <ul style="list-style-type: none"> ✓ Verify that each significant component of PPE is depreciated separately. <p>Example:</p> <ul style="list-style-type: none"> ✓ Depreciate airframe and engines of an aircraft separately.
3.	<p>Depreciation Method</p> <ul style="list-style-type: none"> ✓ Ensure the most appropriate depreciation method is used for each separately depreciable component.

Audit Procedure

1.	<p>Occurrence Recorded depreciation and amortisation expenses were actually incurred during the period:</p> <ul style="list-style-type: none"> ✓ Understand the entity's process for charging depreciation and amortization. ✓ Obtain and review the fixed asset register for risk of: <ul style="list-style-type: none"> ▪ Capitalizing revenue expenses to inflate profits. ▪ Charging capital expenditure directly to expenses to reduce profits. ▪ Fake assets being capitalized (perform physical verification for material assets).
2.	<p>Completeness Depreciation and amortization expenses are appropriately recorded with no understatement or overstatement:</p> <ul style="list-style-type: none"> ✓ Obtain a list of additions/deletions with approvals from authorized personnel. ✓ Ensure intangible assets (e.g., patents, goodwill) are properly amortized. ✓ Verify that depreciation starts from the date the asset is ready to use, not from actual usage.

	<ul style="list-style-type: none"> ✓ Check depreciation on revalued amounts is properly accounted from revaluation reserve. ✓ Ensure depreciation under the Income Tax Act, 1961 aligns with Companies Act additions and opening WDV matches the Tax Audit Schedule.
3.	<p>Measurement</p> <p>Depreciation and amortization expenses are measured appropriately:</p> <ul style="list-style-type: none"> ✓ Verify depreciation rates and calculations for sample assets. ✓ Perform analytical procedures to test reasonableness of expenses (e.g., re-compute depreciation). ✓ Ensure depreciation is based on useful lives of PPE and intangible assets. ✓ Confirm residual values are accurately assessed. ✓ Check depreciation is computed prospectively after any change in useful lives.
4.	<p>Disclosures</p> <p>Ensure required disclosures are made, including:</p> <ul style="list-style-type: none"> ✓ Accounting policy for depreciation and amortization. ✓ Useful lives of assets as per Schedule II to the Companies Act, 2013. ✓ Residual values of assets. ✓ Depreciation method.



6. Audit of Other Expenses

Content	
1.	<p>Other Expenses Includes</p> <ul style="list-style-type: none"> ✓ Power and Fuel ✓ Rent ✓ Repairs to Building, Plant, and Machinery ✓ Insurance ✓ Travelling ✓ Legal and Professional ✓ Miscellaneous Expenses.
2.	<p>Audit Focus Areas</p> <p>The auditor analyses monthly trends for some expenses (e.g., rent, power, fuel) and vouches for other expenses to verify the following attributes:</p> <ol style="list-style-type: none"> a. Expense pertains to the current period under audit. b. Expense qualifies as revenue, not capital expenditure. c. Valid supporting documents exist (e.g., travel tickets, insurance policy). d. Expense is classified under the correct expense head. e. Expense is authorized per delegation of authority. f. Expense relates to the entity's business, not personal use.

Audit Procedures	
1.	<p>Occurrence</p> <p>Ensure recorded other expenses were actually incurred during the period.</p>
2.	<p>Completeness</p> <p>Ensure other expenses for the period are recorded with no understatement or overstatement.</p>

3.	<p>Measurement Verify other expenses are measured accurately.</p>
4.	<p>Rent Expense</p> <ul style="list-style-type: none"> ✓ Obtain month-wise expense schedule and rent agreements. ✓ Verify expense is recorded for all 12 months and aligns with the agreement. ✓ Consider escalation clauses for straight-line recording. ✓ Verify agreement is in the name of the entity and pertains to premises used for business operations.
5.	<p>Power and Fuel Expense</p> <ul style="list-style-type: none"> ✓ Obtain month-wise expense schedule and power bills. ✓ Ensure expenses are recorded for all 12 months. ✓ Compile units consumed, applicable rate, and verify accuracy. ✓ Analyse monthly trends by linking power units consumed to finished goods produced and investigate variances.
6.	<p>Insurance Expense</p> <ul style="list-style-type: none"> ✓ Obtain insurance policy summary with validity periods. ✓ Verify correct classification between prepaid and expense for the period based on days.
7.	<p>Legal and Professional Expenses Obtain month-wise and consultant-wise summary.</p> <ul style="list-style-type: none"> ✓ For retainership agreements, verify 12 months of expenses. ✓ For non-recurring expenses, vouch selected samples for discussed attributes. ✓ Be cautious of legal expenses indicating disputes, ensuring provisions are made and matters are disclosed to the auditor.
8.	<p>Travel, Repairs, Printing, Miscellaneous</p> <ul style="list-style-type: none"> ✓ Select samples and vouch for attributes discussed above. ✓ Prepare a monthly summary for analytical trend comparison. ✓ Perform analytical procedures to assess reasonableness (e.g., expense per unit of production).
9.	<p>Analytical Procedures</p> <ul style="list-style-type: none"> ✓ Compare expense per unit produced with prior years and industry trends. ✓ Ask management for reasons behind significant variations.
10.	<p>Required Disclosures Ensure other expenses are classified as:</p> <ul style="list-style-type: none"> ✓ Rent ✓ Insurance ✓ Power and Fuel ✓ Repairs and Maintenance (Building, Plant and Machinery, Others) ✓ Legal and Professional ✓ Printing and Stationery ✓ Travel Expenses ✓ Miscellaneous Expenses

Notes: To be disclosed as Additional Information

Content	
1.	<p>Corporate Social Responsibility (CSR) Companies covered under Section 135 of the Companies Act must disclose:</p> <ol style="list-style-type: none"> Amount required to be spent during the year. Expenditure incurred. Shortfall at year-end. Total of previous years' shortfall. Reason for shortfall. Nature of CSR activities. Details of related party transactions (e.g., contributions to a trust controlled by the company as per relevant standards). Where a provision is made for liability under a contractual obligation, disclose movements in the provision during the year separately.
2.	<p>Crypto Currency or Virtual Currency If the company has traded or invested in Crypto Currency or Virtual Currency during the year, disclose:</p> <ol style="list-style-type: none"> Profit or loss on transactions involving Crypto Currency or Virtual Currency. Amount held as at the reporting date. Deposits/advances received for trading or investment purposes.



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